

AZERISTAR MICROFINANCE LLC

Financial Statements and Auditors' Report
For the Year Ended 31 December 2008

AZERISTAR MICROFINANCE LLC

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and the Board of Directors of AzeriStar Microfinance LLC:

Report on the Financial Statements

We have audited the accompanying financial statements of AzeriStar Microfinance LLC (the "Company"), which comprise the Statement of Financial Position as at 31 December 2008, and the Statement of Income, Statement of Changes in Equity and Cash Flow statements for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing ("ISA"). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects the financial position of AzeriStar Microfinance LLC as at 31 December 2008, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw your attention to Note 1 in the financial statements which describes that the ongoing global liquidity crisis has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking and microfinance sector, and, at times, higher interbank lending rates and very high volatility in stock and currency markets. In the credit crunch environment, banks and microfinance organizations face rising loan defaults and are becoming more risk averse when considering whether to provide or renew finance facilities. The uncertainties in the global financial markets create significant difficulties in assessing the impairment of loans to customers and the ability of the Company to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions. These conditions, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty which may cast significant doubt about the Company's ability to continue as a going concern.

Baku, Azerbaijan

13 April, 2009

AZERISTAR MICROFINANCE LLC**STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2008***(in Azerbaijan manat)*

	Notes	31 December 2008	31 December 2007
ASSETS:			
Cash and cash equivalents	4	36,193	4,055
Loans to customers	5	1,905,566	1,084,475
Property and equipment	6	34,383	22,968
Deferred income tax assets	16	871	-
TOTAL ASSETS		<u>1,977,013</u>	<u>1,111,498</u>
LIABILITIES AND EQUITY			
LIABILITIES:			
Long term borrowings	7	870,946	245,328
Other liabilities	8	35,673	33,336
Total liabilities		<u>906,619</u>	<u>278,664</u>
EQUITY:			
Share capital	9	32,229	32,229
Accumulated grants		588,964	588,964
Retained earnings		449,201	211,641
Total equity		<u>1,070,394</u>	<u>832,834</u>
TOTAL LIABILITIES AND EQUITY		<u>1,977,013</u>	<u>1,111,498</u>

On behalf of the Management Board:

Rufat Abas
Chief executive officer

13 April, 2009

Baku, Azerbaijan

Rovshan Mammadov
Chief accountant

13 April, 2009

Baku, Azerbaijan

The notes on pages 7-34 form an integral part of these financial statements. The Independent Auditors' Report is on pages 1-2.

AZERISTAR MICROFINANCE LLC**STATEMENT OF INCOME
FOR THE YEAR ENDED 31 DECEMBER 2008***(in Azerbaijan manat)*

	Notes	Year ended 31 December 2008	Year ended 31 December 2007
Interest income	10	808,514	517,970
Interest expense	10	<u>(104,881)</u>	<u>(9,092)</u>
Net interest income before provision for impairment losses on interest bearing assets		<u>703,633</u>	<u>508,878</u>
(Provision)/recovery of provision for impairment losses on interest bearing assets	11	<u>(17,751)</u>	<u>(7,972)</u>
Net interest income		<u>685,882</u>	<u>500,906</u>
Net gain/(loss) on foreign exchange operations	12	7,169	(125)
Fee and commission expense	13	(17,604)	(9,961)
Other income	14	<u>14,751</u>	<u>7,114</u>
Net non-interest income		<u>4,316</u>	<u>(2,972)</u>
Operating Income		690,198	497,934
Operating Expenses	15	<u>(387,041)</u>	<u>(326,113)</u>
PROFIT/(LOSS) BEFORE INCOME TAX		303,157	171,821
Income tax expense (benefit)	16	(65,597)	(35,580)
NET PROFIT		<u><u>237,560</u></u>	<u><u>136,241</u></u>

On behalf of the Management Board:

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Chief executive officer

13 April, 2009

Baku, Azerbaijan

Rovshan Mammadov
Chief accountant

13 April, 2009

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AZERISTAR MICROFINANCE LLC

**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2008**

(in Azerbaijan manat)

	Note	Share Capital	Accumulated grants	Retained Earnings	Total Equity
31 December 2006		32,229	551,000	75,399	658,628
Additional grant received		-	37,964	-	37,964
Net profit		-	-	136,241	136,241
31 December 2007		32,229	588,964	211,640	832,833
Net profit		-	-	237,560	237,560
31 December 2008		32,229	588,964	449,200	1,070,393

On behalf of the Management Board:

Rufat Abas
Chief executive officer

13 April, 2009

Baku, Azerbaijan

Rovshan Mammadov
Chief accountant

13 April, 2009

Baku, Azerbaijan

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AZERISTAR MICROFINANCE LLC**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2008***(in Azerbaijan manat)*

	Notes	Year ended 31 December 2008	Year ended 31 December 2007
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income tax		303,157	171,821
Adjustments for:			
Provision/ (recovery of provision) for impairment losses on interest bearing assets	11	16,873	5,476
Other granted income	14	(14,355)	-
Depreciation and amortization expense	15	7,894	8,147
Translation (gain)/loss on foreign exchange operations	12	7,169	(125)
Change in interest accruals, net	5	<u>(15,649)</u>	<u>-</u>
Cash flows from operating activities before changes in operating assets and liabilities		305,089	185,319
Changes in operating assets and liabilities (Increase)/decrease in operating assets:			
Loans to customers	5	(822,315)	(352,489)
Increase/(decrease) in operating liabilities			
Long term borrowings	7	<u>618,337</u>	<u>175,326</u>
Cash inflow/(outflow) from operating activities before taxation		101,111	8,156
Tax paid		<u>(49,777)</u>	<u>(41,998)</u>
Net cash inflow/(outflow) from operating activities		<u>51,334</u>	<u>(33,842)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of fixed assets	6	<u>(19,309)</u>	<u>(4,099)</u>
Net cash outflow from investing activities		<u>(19,309)</u>	<u>(4,099)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Grants received		<u>-</u>	<u>37,964</u>
Net cash inflow from financing activities		<u>-</u>	<u>37,964</u>
Effect of changes in foreign exchange rate on cash and cash equivalents		<u>112</u>	<u>415</u>
NET INCREASE IN CASH AND CASH EQV.		32,137	438
CASH AND CASH EQUIVALENTS, beginning of year	4	<u>4,055</u>	<u>3,618</u>
CASH AND CASH EQUIVALENTS, end of year	4	<u><u>36,192</u></u>	<u><u>4,055</u></u>

On behalf of the Management Board:

Rufat Abas
Chief executive officer

13 April, 2009

Baku, Azerbaijan

Rovshan Mammadov
Chief accountant

13 April, 2009

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AZERISTAR MICROFINANCE LLC

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

(in Azerbaijan manat)

1. INTRODUCTION

Organization and its principal activity

“AzeriStar Microfinance” LLC is Non-banking Credit Organization was established by “Save the Children Federation, Inc” in 18.07.2002 and entered the state registration 30.05.2003 but began operating in 01.03.2006. The Company’s operations are based on the license provided by the National Bank of Azerbaijan Republic. The company has two representative offices with Head Office in the city of Barda. The Company is involved in one main type of activity (i.e. lending) and operates in one geographical area (i.e. Azerbaijan).

The main objective of the company is:

- Support the development of micro, small and medium sized enterprises, included those engaged in production and agricultural activities;
- The creation of new employment opportunities in family, and other types of enterprises;
- Provide equal access to financial resources for both men and women.

Registered address and place of business

The Head Office of the Company’s registered address is Garabagh Street 22, Barda city, Azerbaijan Republic.

Founder and shareholder of the Company

As at 31 December 2008 and 2007, the following shareholder owned the issued ordinary shares of the Company:

Shareholder	31 December 2008, %	31 December 2007, %
Save the Children Federation, Inc.	<u>100%</u>	<u>100%</u>
Total	<u><u>100%</u></u>	<u><u>100%</u></u>

Operating Environment of the Company

Despite strong economic growth in recent years, the financial situation in the global financial and commodity market significantly deteriorated during 2008, particularly in the fourth quarter. Volatility in financial and commodity market, have been characterized by significant trading difficulties compounded by a reduction in liquidity. Although the primary market shock arose due to defaults on sub-prime mortgages in the United States, the effect has been felt globally due to widespread use of structured securities and leveraged funding. Entities with exposure to the financial market through debt, equity, derivative and leveraged finance activities may experience significant difficulty in financing their operations as a result of restricted credit facilities.

As the downturn in global economy, liquidity crunch and declining inflation started to evolve; the National Bank of Azerbaijan Republic has undertaken a number of measures in its monetary policy starting from October, 2008 to maintain the sources of liquidity at the relevant levels.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(in Azerbaijan manat)

1. INTRODUCTION (Continued)

On October 14, 2008

- The refinancing rate of the National Bank has been reduced from 15 percent to 12 percent.
- A 5-percent reserve requirement on banks' foreign liabilities has been lifted to improve their respective liquidity indicators,
- Reserve requirements on domestic liabilities have been lowered from 12 percent to 9 percent. The averaging period of reserve requirement ratios have been extended up to one month.

On October 31, 2008

- The refinancing rate of the National Bank has been reduced from 12 percent to 10 percent.

On November 26, 2008

- Reserve requirements on domestic liabilities have been lowered from 9 percent to 6 percent.
- The refinancing rate of the National Bank has been reduced from 10 percent to 8 percent.

On February 27, 2009

- Reserve requirements on domestic liabilities have been lowered from 6 percent to 3 percent.
- The refinancing rate of the National Bank has been reduced from 8 percent to 5 percent.

On March 02, 2009

- Reserve requirements on domestic liabilities have been lowered from 3 percent to 0.5 percent.
- The refinancing rate of the National Bank has been reduced from 5 percent to 3 percent.

The reduction of reserve requirement ratios resulted in liquidity support of AZN 350 million to the banking system.

The tax, currency and customs legislation within the Azerbaijan Republic is subject to varying interpretations and frequent changes. Furthermore, the need for further developments in the bankruptcy laws, the absence of formalized procedures for the registration and enforcement of collateral, and other legal and fiscal impediments contribute to the challenges faced by banks currently operating in the Azerbaijan Republic. The future economic direction of the Azerbaijan Republic is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

Management is unable to predict all developments which could have an impact on the banking and microfinance sector and the wider economy and consequently what effect, if any, they could have on the future financial position of the Company.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(in Azerbaijan manat)

1. INTRODUCTION (Continued)

Borrowers

Borrowers of the Company may be affected by the lower liquidity situation which could in turn impact their ability to repay the amounts owed. Deteriorating operating conditions for borrowers may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, management has properly reflected revised estimates of expected future cash flows in its impairment assessments.

Liquidity

The volume of wholesale financing has significantly reduced since August 2007. Such circumstances may affect the ability of the Company to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions.

Management is unable to reliably determine the effects on the Company's future financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and growth of the Company's business in the current circumstances.

2. BASIS OF PRESENTATION

Accounting basis

These financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

These financial statements are presented in Azerbaijani manats ("AZN"), unless otherwise indicated. These financial statements have been prepared under the historical cost convention, except for the measurement at fair value of certain financial instruments. The functional currency of the Company is also the Azerbaijani manat as the business activities are mainly conducted in the Republic of Azerbaijan. The Company maintains its accounting records in accordance with laws of the Republic of Azerbaijan. These financial statements have been prepared from the statutory accounting records and have been adjusted to conform with IFRS. These adjustments include certain reclassifications to reflect the economic substance of underlying transactions including reclassifications of certain assets and liabilities, income and expenses to appropriate financial statement captions.

Key assumptions

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts. Such estimates and assumptions are based on the information available to the Company's management as of the date of the financial statements. Therefore, actual results could differ from those estimates and assumptions. Estimates that are particularly susceptible to change relate to the provisions for impairment losses and the fair value of financial instruments.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(in Azerbaijan manat)

2. BASIS OF PRESENTATION (Continued)

Loans to customers are measured at amortized cost less allowance for impairment losses. The estimation of allowances for impairments involves the exercise of significant judgment. The Company estimates allowances for impairment with the objective of maintaining balance sheet provisions at a level believed by management to be sufficient to absorb losses incurred in the Company's loan portfolio. The calculation of provisions on impaired loans is based on the likelihood of the asset being written off and the estimated loss on such a write-off. These assessments are made using statistical techniques based on historic experience. These determinations are supplemented by the application of management judgment.

The Company considers accounting estimates related to provisions for loans key sources of estimation uncertainty because: (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of losses relating to impaired loans and advances are based on recent performance experience, and (ii) any significant difference between the Company's estimated losses (as reflected in the provisions) and actual losses will require the Company to take provisions which, if significantly different, could have a material impact on its future statement of income and statement of financial position. The Company's assumptions about estimated losses are based on past performance, past customer behavior, the credit quality of recent underwritten business and general economic conditions, which are not necessarily an indication of future losses.

A deferred tax liability is recognized for all taxable temporary differences to the extent that it is probable that taxable profit will be available against which the taxable temporary difference can be utilized. Estimation of probabilities are based on management estimation of future taxable profit and involves the exercise of significant management judgment from the Company. Taxation is discussed in Notes 16 and 18.

SIGNIFICANT ACCOUNTING POLICIES

Key recognition and measurement terms

The Company recognizes financial assets and liabilities on its statement of financial position when it becomes a party to the contractual obligation of the instrument. Regular way purchase and sale of the financial assets and liabilities are recognized using settlement date accounting. Regular way purchases of financial instruments that will be subsequently measured at fair value between trade date and settlement date are accounted for in the same way as for acquired instruments.

Financial assets and liabilities are initially recognized at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss transaction costs that are directly attributable to acquisition or issue of the financial asset or financial liability. The accounting policies for subsequent re-measurement of these items are disclosed in the respective accounting policies set out below.

Cash and cash equivalents

Cash and cash equivalents include cash on hand and unrestricted balances with the commercial banks. The Company realizes the credit operations only in national currency of Azerbaijan Republic, (i.e. Azerbaijani manat - AZN).

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(in Azerbaijan manat)

2. BASIS OF PRESENTATION (Continued)

Loans to customers

Loans to customers are non-derivative assets with fixed or determinable payments that are not quoted in an active market other than those classified in other categories of financial assets.

Loans granted by the Company are initially recognized at fair value plus related transaction costs. Where the fair value of consideration given does not equal the fair value of the loan, for example where the loan is issued at lower than market rates, the difference between the fair value of consideration given and the fair value of the loan is recognized as a loss on initial recognition of the loan and included in the statement of income according to nature of these losses. Subsequently, loans are carried at amortized cost using the effective interest method. Loans to customers are carried net of any allowance for impairment losses.

Allowance for impairment losses

The Company accounts for impairment losses of financial assets when there is objective evidence that a financial asset or group of financial assets is impaired. Impairment losses are measured as the difference between carrying amounts and the present value of expected future cash flows, discounted at the financial asset's original effective interest rate, for financial assets which are carried at amortized cost. If in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. For financial assets carried at cost, the impairment losses are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows, discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

The determination of impairment losses is based on an analysis of the risk assets and reflects the amount which, in the judgment of management, is adequate to provide for losses incurred. Provisions are made as a result of an individual appraisal of risk assets for financial assets that are individually significant, and an individual or collective assessment for financial assets that are not individually significant.

The change in impairment losses is charged to profit, and the total of impairment losses is deducted in arriving at assets as shown in the statement of financial position. Factors that the Company considers in determining whether it has objective evidence that an impairment loss has been incurred include information about the debtors' or issuers' liquidity, solvency and business and financial risk exposures, levels of and trends in delinquencies for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees. These and other factors may, either individually or taken together, provide sufficient objective evidence that an impairment loss has been incurred in a financial asset or group of financial assets.

The Company accounts for impairment losses on financial assets at amortized cost using allowance account, for financial assets measured at cost through direct write off.

It should be understood that estimates of losses involve an exercise of judgment. While it is possible that in particular periods the Company may sustain losses that are substantial relative to the allowance for impairment losses, it is the judgment of management that the allowance for impairment losses is adequate to absorb losses incurred on the risk assets.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(in Azerbaijan manat)

2. BASIS OF PRESENTATION (Continued)

Property and equipment

Property and equipment are carried at historical cost less accumulated depreciation and any recognized impairment loss, if any. Depreciation is charged on the carrying value of property and equipment and is designed to write off assets over their useful economic lives. It is calculated on a straight line basis at the following annual prescribed rates:

Vehicles and computer equipment	25%
Furniture and other	20%

The carrying amounts of property and equipment are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts, and where carrying values exceed this estimated recoverable amount, assets are written down to their recoverable amount.

Long term borrowings

Long term borrowings, are initially recognized at fair value. Subsequently, amounts due are stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest method.

Share capital

Contributions to share capital are recognized at cost.

Grant

The company received Grants for the loan portfolio, and operating and administrative expenses. The purchase of property and equipment grant are recorded in income statement after the net income from operations. Grant for periods beyond the current operating period are recorded under liabilities as deferred grant revenue. During the useful work period these fixed assets will be decreased as depreciation amount and will be accounted as "other income" in profit/loss statement.

Recognition of income and expense

Interest income and expense are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

Once a financial asset has been written down as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Interests earned on assets at fair value are classified within interest income.

AZERISTAR MICROFINANCE LLC

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

(in Azerbaijan manat)

2. BASIS OF PRESENTATION (Continued)

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into AZN at the appropriate spot rates of exchange ruling at the balance sheet date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Profits and losses arising from these translations are included in net gain on foreign exchange operations.

Rates of exchange

The exchange rates at the year-end used by the Company in the preparation of the financial statements are as follows:

	31 December 2008	31 December 2007
AZN/1 US Dollar	0.8010	0.8453

Offset of financial assets and liabilities

Financial assets and liabilities are offset and reported net on the statement of financial position when the Company has a legally enforceable right to set off the recognized amounts and the Company intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. In accounting for a transfer of a financial asset that does not qualify for de-recognition, the Company does not offset the transferred asset and the associated liability.

Taxation

Income tax expense represents the sum of the current and deferred tax expense.

The current tax expense is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's current tax expense is calculated using tax rates that have been enacted during the reporting period.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(in Azerbaijan manat)

2. BASIS OF PRESENTATION (Continued)

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the statement of income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the statement of financial position if deferred income tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

Segment reporting

A segment is a distinguishable component of the Company that is engaged in providing services (business segment) or in providing services within a particular economic environment (geographical segment), and which is subject to risks and rewards that are different from those of other segments. Segments with a majority of revenue earned from providing services to external customers and whose revenue, result or assets are ten percent or more of all the segments are reported separately. Geographical segments of the Company have been reported separately within these financial statements based on the ultimate domicile of the counterparty, e.g. based on economic risk rather than legal risk of the counterparty.

Adoption of new standards

For the preparation of these financial statements the following new standards and interpretations became mandatorily applicable and were not early adopted last year:

- IAS 39: Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures “Reclassification of Financial Assets (as revised in 2008) (This amendment is effective 1 July 2008. It permits an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances. Moreover, this amendment also permits an entity to transfer from the available-for-sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial asset had not been designated as available for sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future. An entity shall apply those amendments from 1 July 2008)
- IFRIC 11: IFRS 2 - Group and Treasury Share Transactions (issued in 2006) (This interpretation is mandatory for annual periods beginning on or after 1 March 2007. The Group accounts for share-based payment transactions. The first-time application of this interpretation did not modify significantly how share-based payment transactions are reported)
- IFRIC 12: Service Concession Arrangements (issued in 2006) (This interpretation is mandatory for annual periods beginning on or after 1 January 2008. Topics covered by this interpretation are not relevant for the preparation of this set of IFRS financial statements)

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(in Azerbaijan manat)

2. BASIS OF PRESENTATION (Continued)

- IFRIC 14: IAS 19: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (issued in 2007) (This interpretation is mandatory for annual periods beginning on or after 1 January 2008. This interpretation addresses (a) when refunds or reductions in future contributions should be regarded as available, (b) how a minimum funding requirement might affect the availability of reductions in future contributions and (c) when a minimum funding requirement might give rise to a liability. This interpretation does not affect the measurement of the pension schemes of the Company)

For the avoidance of doubt, the following standards and interpretations, which were issued by IASB and IFRIC before 31 December 2008 and are not yet in effect, have not been adopted early:

- IFRS 8: Operating Segments (issued in 2007) (This standard is mandatory for annual periods beginning on or after 1 January 2009. This standard replaces IAS 14 - Segment Reporting and will affect how segment information will be presented and disclosed in annual and interim financial statements. According to IFRS 8, segmental information presented in the financial statements that will be issued during 2009 is consistent with information that is provided and utilised by the management of the Company. It will not affect the measurement attributes of assets and liabilities)
- IAS 1: Presentation of Financial Statements (as revised in 2007) (This standard is mandatory for annual periods beginning on or after 1 January 2009. In substance these amendments to IAS 1 will modify how reporting income and changes in shareholder's equity will be presented. These amendments to IAS 1 will not affect the measurement attributes of assets and liabilities)
- IAS 23: Borrowing Costs (as revised in 2007) (This standard is mandatory for annual periods beginning on or after 1 January 2009. In substance these amendments to IAS 23 remove the option of immediate recognition of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as an expense. The current version of IAS allows IFRS preparers to either expense or capitalise such borrowing costs. Currently, the accounting policy selected by the Company is to capitalise such borrowing costs. As a result, the Company does not foresee that the application of these amendments will result in a significant impact on figures and disclosures on the reporting period they will be adopted)
- IAS 27: Consolidated and separate financial statements, (as revised in 2008) (This amendment is mandatory for annual periods beginning on or after 1 July 2009 and is part of the so called Business Combinations Phase II. The modifications introduced relate primarily to the accounting for minority interests, which have been renamed "non-controlling interests")
- IAS 32: Financial instruments: Presentation and IAS 1: Presentation of financial statements (as revised in 2008) (These amendments are mandatory for annual periods beginning on or after 1 January 2009 and they deal with puttable financial instruments and obligations arising on liquidation. The amendment addresses the classification of some puttable financial instruments, and other instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation)
- IAS 39 Financial Instruments: Recognition and Measurement (as revised in 2008) (This amendment is mandatory for annual periods beginning on or after 1 July 2009. It relates to Eligible Hedged Items, and clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations)

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2. BASIS OF PRESENTATION (Continued)

- IFRS 1: First time adoption of IFRS and IAS 27: Consolidated and separate financial statements (as revised in 2008) (This amendment is mandatory for annual periods beginning on or after 1 January 2009. This amendment permits first-time adopters of IFRS to resolve some practical difficulties on transition to IFRS and relates to the accounting for investments in subsidiaries, jointly controlled entities and associates either at cost or in accordance with IAS 39 in their separate financial statements)
- IFRS 2: Share-based payment (as revised in 2008) (This standard is mandatory for annual periods beginning on or after 1 January 2009 and provides some clarifications with regard to vesting conditions and cancellations)
- IFRS 3: Business combinations (as revised in 2008) (This amendment is mandatory for annual periods beginning on or after 1 July 2009 and is part of the so-called Business Combinations Phase II. This project has introduced significant modifications on how business combinations will be accounted for. Amongst others, a major change relates to the introduction of the “Full-Goodwill approach” which will allow entities to recognise the entire value of the goodwill regardless of the percentage of ownership)
- IASB’s annual improvements project (revisions to various standards issued in 2008) (The effective date varies depending on the amendment, but in any case is not before 1 January 2009. The annual improvements project provides a vehicle for making non-urgent but necessary amendments to IFRS and involves various IFRS. These amendments are divided in two macro categories: 1) amendments that result in accounting changes for presentation, recognition or measurement purposes and 2) amendments to terminology or editorial changes only, which should have no or minimal effect on accounting. Standards affected included in category 1 are the following: IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, IAS 1 Presentation of Financial Statements, IAS 16 Property, Plant and Equipment, IAS 19 Employee Benefits, IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, IAS 23 Borrowing Costs, IAS 27 Consolidated and Separate Financial Statements, IAS 28 Investments in Associates and IAS 31 Interests in Joint Ventures, IAS 29 Financial Reporting in Hyperinflationary Economies, IAS 36 Impairment of Assets, IAS 38 Intangible Assets, IAS 39 Financial Instruments: Recognition and Measurement, IAS 40 Investment Property, IAS 41 Agriculture. Standards affected included in category 2 are the following IFRS 7 Financial Instruments: Disclosures, IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, IAS 10 Events after the Reporting Period, IAS 18 Revenue, IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, IAS 29 Financial Reporting in Hyperinflationary Economies, IAS 34 Interim Financial Reporting, IAS 40 Investment Property, IAS 41 Agriculture)
- IFRIC 13: Customer Loyalty Programmes (issued in 2007) (This interpretation is mandatory for annual periods beginning on or after 1 July 2008. Topics covered by this interpretation are not relevant for the preparation of this set of IFRS financial statements)
- IFRIC 15: Agreements for construction of real estates (issued in 2008) (This interpretation is mandatory for annual periods beginning on or after 1 January 2009 and applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors.)

AZERISTAR MICROFINANCE LLC

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2. BASIS OF PRESENTATION (Continued)

- IFRIC 16 Hedges of a Net Investment in a Foreign Operation (issued in 2008) (This interpretation is mandatory for annual periods beginning on or after 1 October 2008 and applies to entities that hedge the foreign currency risk arising from its net investments in foreign operations and wish to qualify for hedge accounting in accordance with IAS 39. In particular, this Interpretation refers to such an entity as a parent entity and to the financial statements in which the net assets of foreign operations are included as consolidated financial statements)

Regardless of when the application of the standards and interpretations above will be mandatory, the Company is planning to adopt all of them in the financial statements for the year ended 31 December 2009, if they are then relevant to the Company.

The Company has assessed the potential impact of all new standards, amendments and interpretations that will be effective in the next periods and expects that they will not have a significant impact on transactions that are in place at 31 December 2008.

3. PRIOR PERIOD RECLASSIFICATION

In 2008, the management of the Company discovered reclassification error that should be adjusted in financial statements for the year ended December 31, 2007.

The grant related to fixed assets in the amount of AZN 14,355 that had been classified and shown under capital reserves in the financial statements for the year ended December 31, 2007 was reclassified to the deferred income under the other liabilities, whereas grants related to fixed assets should be recognized as income on a systematic and rational basis over the useful life of the related assets.

The adjustment has been made to the financial statements as at 31 December 2007 and for the year then ended to conform to the presentation as at 31 December 2008 and for the year then ended as following:

Grant related fixed assets	Re-classing amount (AZN)	Amount as per the previous report (AZN)	Amount as per the current report (AZN)
Capital reserves	(14,355)	14,355	-
Other liabilities	14,355	18,982	33,336

4. CASH AND CASH EQUIVALENTS

	31 December 2008	31 December 2007
Cash in hand	1,917	864
Balances with the banks	34,276	3,191
Total cash and cash equivalents	36,193	4,055

The AZN settlement accounts of the Company are kept with International Bank of Azerbaijan

AZERISTAR MICROFINANCE LLC

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5. LOANS TO CUSTOMERS

Loans to customers comprise:

	31 December 2008	31 December 2007
Loans to customers	1,929,615	1,107,300
Accrued interest income on loans to customers	<u>15,649</u>	<u>-</u>
Less allowance for impairment losses	<u>(39,698)</u>	<u>(22,825)</u>
Total loans to customers	<u>1,905,566</u>	<u>1,084,475</u>

	31 December 2008	31 December 2007
Analysis by sector:		
Livestock	600,425	435,474
Retail	586,545	454,329
Consumer	553,266	84,332
Services	112,433	58,122
Production	41,976	32,860
Agriculture	24,841	22,761
Other	<u>25,778</u>	<u>19,422</u>
Less allowance for impairment losses	<u>(39,698)</u>	<u>(22,825)</u>
Total loans to customers	<u>1,905,566</u>	<u>1,084,475</u>

	31 December 2008	31 December 2007
Analysis by region:		
Barda	1,001,062	608,133
Ganja	<u>944,202</u>	<u>499,167</u>
Less allowance for impairment losses	<u>(39,698)</u>	<u>(22,825)</u>
Total loans to customers	<u>1,905,566</u>	<u>1,084,475</u>

	31 December 2008	31 December 2007
Analysis by loan models:		
Zirve	820,790	536,735
Individual	516,905	48,289
Business	505,257	302,542
Livestock	65,951	183,691
Employees	<u>36,361</u>	<u>36,043</u>
Less allowance for impairment losses	<u>(39,698)</u>	<u>(22,825)</u>
Total loans to customers	<u>1,905,566</u>	<u>1,084,475</u>

Movements in allowances for impairment losses for the years ended 31 December 2008 and 2007 are disclosed in Note 11.

As at 31 December 2008 and 2007 a maximum credit risk exposure on loans to customers amounted to AZN 1,905,566 and AZN 1,084,475 respectively.

As at 31 December 2008 loans to customers included loans in amount of AZN 4,887 that were individually determined to be impaired. As at 31 December 2008 such loans were not collateralized by tangible items.

AZERISTAR MICROFINANCE LLC

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6. PROPERTY AND EQUIPMENT

Property and equipment comprise:

	Equipments	Computer equipment	Vehicles	Total
At initial cost				
31 December 2006	8,749	21,416	12,463	42,628
Additions	166	854	3,079	4,099
Transfers to other assets	<u>279</u>	<u>(279)</u>	<u>-</u>	<u>-</u>
31 December 2007	9,194	21,991	15,542	46,727
Additions	12,212	3,345	3,752	19,309
Transfer out	(6,421)	(2,824)	(5,109)	(14,354)
31 December 2008	<u>14,985</u>	<u>22,512</u>	<u>14,185</u>	<u>51,682</u>
Accumulated depreciation				
31 December 2006	(4,897)	(7,599)	(3,116)	(15,612)
Charge for the year	(803)	(4,237)	(3,107)	(8,147)
Transfers to other assets	<u>(279)</u>	<u>279</u>	<u>-</u>	<u>-</u>
31 December 2007	(5,979)	(11,557)	(6,223)	(23,759)
Charge for the year	(605)	(3,914)	(3,375)	(7,894)
Disposal	<u>6,421</u>	<u>2,824</u>	<u>5,109</u>	<u>14,354</u>
31 December 2008	<u>(163)</u>	<u>(12,647)</u>	<u>(4,489)</u>	<u>(17,299)</u>
Net book value				
31 December 2008	<u>14,822</u>	<u>9,865</u>	<u>9,696</u>	<u>34,383</u>
31 December 2007	<u>3,215</u>	<u>10,434</u>	<u>9,319</u>	<u>22,968</u>

In 2005, the Company received fixed assets in the amount of AZN 14,354 as grant. As of 31.12.2008, the management estimated the future useful life of these fixed assets as zero.

7. LONG TERM BORROWINGS

	31 December 2008	31 December 2007
Triple Jump	378,981	175,020
Oiko credit	242,675	-
Blue Orchard	162,871	-
Qafqaz kredit	<u>86,419</u>	<u>70,308</u>
Total long term borrowings	<u>870,946</u>	<u>245,328</u>

Long term borrowings from foreign non-banking credit organizations as at 31 December 2008 represent the accounts of Triple Jump (AZN 362,042 with average 14% p.a.), Oiko credit (USD 300,000 with average 11% p.a.), Blue Orchard (USD 200,000 with average 11% p.a.), Qafqaz kredit (USD 86,000 with average 15% p.a.) and accrued interest payable as at the end of the period.

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8. OTHER LIABILITIES

Other liabilities comprise:

	31 December 2008	31 December 2007
Profit tax payable	34,968	18,982
Rent tax payable	670	-
Property tax payable	35	-
Differed income	<u>-</u>	<u>14,354</u>
Total other liabilities	<u>35,673</u>	<u>33,336</u>

9. SHARE CAPITAL

According to confirmed instructions, the share capital of the company was determined as 33,000 USD (32,229 AZN) in two contribution forms. USD 8,414 was made in the form of cash, but USD 24,586 as fixed assets.

Share capital contribution made in the form of cash is registered at fair value at the date of contribution.

10. NET INTEREST INCOME

	Year ended 31 December 2008	Year ended 31 December 2007
Interest income comprises:		
Interest income on assets recorded at amortized cost:		
- interest income on unimpaired assets	<u>808,514</u>	<u>517,970</u>
Total interest income	<u>808,514</u>	<u>517,970</u>
Interest income on assets recorded at amortized cost comprises:		
Interest on loans to customers	<u>808,514</u>	<u>517,970</u>
Total interest income on financial assets recorded at amortized cost	<u>808,514</u>	<u>517,970</u>
Interest expense comprises:		
Interest on liabilities recorded at amortized cost	<u>(104,881)</u>	<u>(9,092)</u>
Total interest expense	<u>(104,881)</u>	<u>(9,092)</u>
Interest expense on liabilities recorded at amortized cost comprise:		
Triple Jump	(61,438)	
Oikocredit	(22,498)	
Blue Orchard	(11,753)	
Qafqaz Kredit	(9,192)	(9,092)
Total interest expense on financial assets recorded at amortized cost	<u>(104,881)</u>	<u>(9,092)</u>
Net interest income before (provision)/recovery of provision for impairment losses on interest bearing assets	<u>703,633</u>	<u>508,878</u>

AZERISTAR MICROFINANCE LLC**NOTES TO THE FINANCIAL STATEMENTS
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*(in Azerbaijan manat)***11. ALLOWANCE FOR IMPAIRMENT LOSSES**

The movements in allowance for impairment losses on interest earning assets were as follows:

	Loans to customers
31 December 2006	17,348
Provision for loan impairment	7,972
Write-off	<u>(2,496)</u>
31 December 2007	22,824
Provision for loan impairment	17,751
Write-off	<u>(877)</u>
31 December 2008	<u>39,698</u>

12. NET GAIN/(LOSS) ON FOREIGN EXCHANGE OPERATIONS

Net gain/(loss) on foreign exchange operations comprises:

	Year ended 31 December 2008	Year ended 31 December 2007
Long term borrowing operations	7,281	290
Other operations	(112)	(415)
Total net gain/(loss) on foreign exchange operations	<u>7,169</u>	<u>(125)</u>

13. FEE AND COMMISSION EXPENSE

Fee and commission expense comprise:

	Year ended 31 December 2008	Year ended 31 December 2007
Fee and commission expense:		
Bank commission expenses	<u>(17,604)</u>	<u>(9,961)</u>
Total fee and commission expense	<u>(17,604)</u>	<u>(9,961)</u>

AZERISTAR MICROFINANCE LLC

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

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14. OTHER INCOME

Other income comprises:

	Year ended 31 December 2008	Year ended 31 December 2007
Other income:		
Penalty income from loans	396	226
CGAP grants	-	6,888
Asset related grant income	<u>14,355</u>	<u>-</u>
Total other income	<u>14,751</u>	<u>7,114</u>

Asset related grant income as at 31 December 2008 is income recognition of fully depreciated granted assets.

15. OPERATING EXPENSES

Operating expenses comprise of the following items:

	Year ended 31 December 2008	Year ended 31 December 2007
Salary and bonuses	(254,110)	(221,825)
Hired drivers payments	(40,624)	(30,603)
Rent expense	(25,713)	(19,824)
Travel expenses	(13,947)	(5,864)
Office supplies	(10,179)	(8,653)
Utilities	(8,901)	(8,590)
Depreciation and amortization	(7,894)	(8,147)
Rating expenses	(5,473)	(9,514)
Professional services fees	(4,430)	(6,828)
Membership fees	(3,029)	(1,000)
Printed products	(1,994)	(224)
Training expenses	(1,500)	(1,420)
Vehicle maintenance and insurance	(1,272)	(982)
Business lunch	(375)	(79)
Other expenses	(7,600)	(2,560)
Total operating expenses	<u>(387,041)</u>	<u>(326,113)</u>

16. INCOME TAXES

The Company provides for taxes based on the tax accounts maintained and prepared in accordance with the tax regulations of Republic of Azerbaijan which may differ from International Financial Reporting Standards.

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16. INCOME TAXES (Continued)

The Company is subject to certain permanent tax differences due to non-tax deductibility of certain expenses and a tax free regime for certain income.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at 31 December 2008 and 2007 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Temporary differences as at 31 December 2008 and 2007 comprise:

	31 December 2008	31 December 2007
Deductible temporary differences:		
Long-term borrowings	22,406	-
Total deductible temporary differences	22,406	-
Taxable temporary differences:		
Property and equipment	2,767	-
Loans to customers	15,649	-
Other liabilities	32	-
Total taxable temporary differences	18,448	-
Net deferred deductible temporary differences	3,958	-
Net deferred tax asset at the statutory tax rate (22%)	871	-

Relationships between tax expenses and accounting profit for the years ended 31 December 2008 and 2007 are explained as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
Profit before income tax	303,157	171,821
Tax at the statutory tax rate	66,694	37,801
Tax effect of permanent differences	(1,097)	2,221
Income tax expense	65,597	35,580
Current income tax expense	66,468	35,580
Change in the deferred tax asset	(871)	-
Income tax expense	65,597	35,580
	31 December 2008	31 December 2007
Deferred income tax asset		
Beginning of the period	-	-
Change in the income tax asset for the period charged to profit	(871)	-
End of the period	(871)	-

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17. BUSINESS SEGMENTS

The Company is organized on the basis of two main business segments:

- Grant base operations - representing operations are financed by grants.
- Non-grant base operations - representing operations are financed by borrowings from other credit organizations

Segment information about this business is presented below.

As of 31 December 2008

	Note	Grant base operations	Non-grant base operations	Shared services	Total
External Revenue					
Net Interest Income		463,551	222,331	-	685,882
Net Fee and Commission Exp.		(11,898)	(5,706)	-	(17,604)
Other Operating Income		-	21,920	-	21,920
Total Segment Revenue		451,653	238,545	-	690,198
Segment Results		(253,274)	(133,769)	-	(387,042)
Income Tax Expense					(65,597)
Profit for the Period					(237,559)
Segment Assets					
Segment Assets		839,134	1,066,433	71,446	1,977,013
Unallocated Assets		-	-	-	-
Total Assets		839,134	1,066,433	71,446	1,977,013
Segment Liabilities					
Segment Liabilities		-	870,946	35,672	906,618
Unallocated Liabilities		-	-	-	-
Total Liabilities		-	870,946	35,672	906,618
Impairment losses on financial assets					
Impairment losses on financial assets		-	-	(17,751)	(17,751)
Depreciation and amortization		-	-	(7,894)	(7,894)

AZERISTAR MICROFINANCE LLC

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17. BUSINESS SEGMENTS (Continued)

As of 31 December 2007

	Note	Grant base operations	Non-grant base operations	Shared services	Total
External Revenue					
Net Interest Income		452,419	48,487	-	500,906
Net Fee and Commission Exp.		(8,997)	(964)	-	(9,961)
Other Operating Income		6,888	101	-	6,989
Total Segment Revenue		450,310	47,624	-	497,934
Segment Results		(294,923)	(31,190)	-	(326,113)
Income Tax Expense					(35,580)
Profit for the Period					(136,241)
Segment Assets		198,488	885,987	27,023	1,111,498
Unallocated Assets		-	-	-	-
Total Assets		198,488	885,987	27,023	1,111,498
Segment Liabilities		-	245,328	33,336	278,664
Unallocated Liabilities		-	-	-	-
Total Liabilities		-	245,328	33,336	278,664
Impairment losses on financial assets		-	-	(7,972)	(7,972)
Depreciation and amortization		-	-	(8,147)	(8,147)

18. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk in order to meet the needs of its customers. These instruments, involving varying degrees of credit risk, are not reflected in the statement of financial position. The Company's maximum exposure to credit loss under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

Operating lease commitments – Where the Company is the lessee, the future minimum lease payments under non cancelable operating leases are as follows:

	31 December 2008	31 December 2007
Not later than 1 year	25,720	20,213
Later than 1 year and not later than 5 years	-	-
Total operating lease commitments	25,720	20,213

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18. COMMITMENTS AND CONTINGENCIES (Continued)

Taxation

Provisions of the Azerbaijani tax legislation are sometimes inconsistent and may have more than one interpretation, which allows the Azerbaijani tax authorities to take decisions based on their own arbitrary interpretation of these provisions. In practice, the Azerbaijani tax authorities often interpret the tax legislation not in favor of the taxpayers, who have to resort to court proceeding to defend their position against the tax authorities. It should be noted that the Azerbaijani tax authorities can use the clarifications issued by the judicial bodies that have introduced the concept of “unjustified tax benefit”, “primary commercial goal of transaction” and the criteria of “commercial purpose (substance) of transaction”.

Such uncertainty could, in particular, be attributed to tax treatment of financial instruments/derivatives and determination of market price of transactions for transfer pricing purposes. It could also lead to temporary taxable differences occurred due to loan impairment provisions and income tax liabilities being treated by the tax authorities as understatement of the tax base. The management of the Company is confident that applicable taxes have all been accrued and, consequently, creation of respective provisions is not required.

Generally, taxpayers are subject to tax audits with respect to three calendar years preceding the year of the audit. However, completed audits do not exclude the possibility of subsequent additional tax audits performed by upper-level tax inspectorates reviewing the results of tax audits of their subordinate tax inspectorates. Also according to the clarification of the Azerbaijan Constitutional Court the statute of limitation for tax liabilities may be extended beyond the three year term set forth in the tax legislation, if a court determines that the taxpayers has obstructed or hindered a tax inspection.

19. TRANSACTIONS WITH RELATED PARTIES

Related parties or transactions with related parties, as defined by IAS 24 “Related party disclosures”, represent:

- (a) Parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Company (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Company that gives them significant influence over the Company; and that have joint control over the Company;
- (b) Associates – enterprises on which the Company has significant influence and which is neither a subsidiary nor a joint venture of the investor;
- (c) Joint ventures in which the Company is a venturer;
- (d) Members of key management personnel of the Company or its parent;
- (e) Close members of the family of any individuals referred to in (a) or (d);
- (f) Parties that are entities controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
- (g) Post-employment benefit plans for the benefit of employees of the Company, or of any entity that is a related party of the Company.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Company had the following transactions outstanding as at 31 December 2008 and 2007 with related parties:

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19. TRANSACTIONS WITH RELATED PARTIES (Continued)

	Year ended 31 December 2008		Year ended 31 December 2007	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Loans to customers		1,929,615		1,107,300
- <i>key management personnel of the entity or its parent</i>	36,404		36,042	
Allowance for impairment losses		(39,698)		(22,825)
- <i>key management personnel of the entity or its parent</i>	(728)		(721)	

	Year ended 31 December 2008		Year ended 31 December 2007	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Key management personnel compensation:		(254,110)		(221,825)
- <i>short-term employee benefits</i>	89,173		82,620	
Total key management personnel compensation	89,173		82,620	

Included in the income statement for the years ended 31 December 2008 and 2007 are the following amounts which arose due to transactions with related parties:

	Year ended 31 December 2008		Year ended 31 December 2007	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Interest income		808,514		517,970
- <i>key management personnel of the entity or its parent</i>	6,553		1,712	
Provision for impairment losses		(17,751)		(7,972)
- <i>key management personnel of the entity or its parent</i>	(7)		(721)	

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20. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments are made in accordance with the requirements of IAS 32 “Financial Instruments: Disclosure and Presentation” and IAS 39 “Financial Instruments: Recognition and Measurement”. Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm’s length transaction, other than in forced or liquidation sale. The estimates presented herein are not necessarily indicative of the amounts the Company could realize in a market exchange from the sale of its full holdings of a particular instrument.

The fair value of financial assets and liabilities compared with the corresponding carrying amount in the balance sheet of the Company is presented below:

	31 December 2008		31 December 2007	
	Carrying value	Fair value	Carrying value	Fair value
Cash and cash equivalents	36,193	36,193	4,055	4,055
Loans to customers	1,905,566	1,905,566	1,084,475	1,084,475
Long term borrowings	870,946	870,946	245,328	245,328

21. RISK MANAGEMENT POLICIES

Management of risk is fundamental to the Company’s banking business and is an essential element of the Company’s operations. The main risks inherent to the Company’s operations are those related to:

- Credit risk
- Liquidity risk
- Market risk.

The Company recognizes that it is essential to have efficient and effective risk management processes in place. To enable this, the Company has established a risk management framework, whose main purpose is to protect the Company from risk and allow it to achieve its performance objectives. Through the risk management framework, the Company manages the risks the following risks:

Credit risk

The Company is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

Maximum Exposure

The Company maximum exposure to credit risk varies significantly and is dependant on both individual risks and general market economy risks.

The following table presents the maximum exposure to credit risk of financial assets. For financial assets the maximum exposure equals to a carrying value of those assets prior to any offset or collateral.

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21. RISK MANAGEMENT POLICIES (Continued)

					31 December 2008
	Maximum exposure	Offset	Net exposure after offset	Collateral Pledged	Net exposure after offset and collateral
Loans to customers	1,905,566	-	1,905,566	-	1,905,566
					31 December 2007
	Maximum exposure	Offset	Net exposure after offset	Collateral Pledged	Net exposure after offset and collateral
Loans to customers	1,084,475	-	1,084,475	-	1,084,475

The banking industry and non banking credit organizations are generally exposed to credit risk through its financial assets and contingent liabilities. Credit risk exposure of the company is concentrated within the Azerbaijan Republic. The exposure is monitored on a regular basis to ensure that the credit limits and credit worthiness guidelines established by the Company's risk management policy are not breached.

The following table details the carrying value of assets that are impaired and the ageing of those that are past due but not impaired:

	Financial assets past due but not impaired					31 December 2008	
	Neither past due nor impaired	0-3 months	3-6 Months	6 months to 1 year	Greater than one year	Financial assets that have been impaired	Total
Loans to customers	1,888,881	15,649	-	-	-	1,036	1,905,566
							31 December 2007
	Neither past due nor impaired	0-3 months	3-6 Months	6 months to 1 year	Greater than one year	Financial assets that have been Impaired	Total
Loans to customers	1,083,409	-	-	-	-	1,065	1,084,475

Geographical concentration

The Management exercises control over the risk in the legislation and regulatory arena and assesses its influence on the Company's activity. This approach allows the Company to minimize potential losses from the investment climate fluctuations in the Azerbaijan Republic.

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21. RISK MANAGEMENT POLICIES (Continued)

The geographical concentration of assets and liabilities is set out below:

	Azerbaijan Republic	OECD countries	31 December 2008 Total
ASSETS			
Cash and cash equivalents	36,193	-	36,193
Loans to customers	1,905,566	-	1,905,566
Property and equipment	34,383	-	34,383
Deferred income tax assets	871	-	871
TOTAL ASSETS	<u>1,977,013</u>	<u>-</u>	<u>1,977,013</u>
LIABILITIES			
Long term borrowings	86,419	784,527	870,946
Other liabilities	35,673	-	35,673
TOTAL LIABILITIES	<u>122,092</u>	<u>784,527</u>	<u>906,619</u>
NET POSITION	<u>1,854,921</u>	<u>(784,527)</u>	<u>1,070,394</u>

	Azerbaijan Republic	OECD countries	31 December 2007 Total
ASSETS			
Cash and cash equivalents	4,055	-	4,055
Loans to customers	1,084,475	-	1,084,475
Property and equipment	22,968	-	22,968
TOTAL ASSETS	<u>1,111,498</u>	<u>-</u>	<u>1,111,498</u>
LIABILITIES			
Long term borrowings	70,308	175,020	245,328
Other liabilities	33,336	-	33,336
TOTAL LIABILITIES	<u>103,644</u>	<u>175,020</u>	<u>278,664</u>
NET POSITION	<u>1,007,854</u>	<u>(175,020)</u>	<u>832,834</u>

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21. RISK MANAGEMENT POLICIES (Continued)

Liquidity risk

An analysis of the liquidity and interest rate risks is presented in the following table. The tables have been drawn up to detail:

(i) The remaining contractual maturity of non-derivative financial liabilities based on the undiscounted cash flows of financial liabilities (both interest and principal cash flows) based on the earliest date on which the Company can be required to pay, and

(ii) The expected maturity for non-derivative financial assets based on the undiscounted contractual maturities of the financial assets including interest that will be earned on those assets except where the Company anticipates that the cash flow will occur in a different period.

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Maturity undefined	31 December 2008 Total
ASSETS							
Loans to customers	46%	344,353	622,333	1,340,514	60,357	16,403	2,383,960
Total interest bearing assets		344,353	622,333	1,340,514	60,357	16,403	2,383,960
Cash and cash equivalents		36,193	-	-	-	-	36,193
TOTAL ASSETS		380,546	622,333	1,340,514	60,357	16,403	2,420,153
LIABILITIES							
Long term borrowings	13%	2,150	33,875	135,493	900,672	-	1,072,190
Other liabilities		35,672	-	-	-	-	35,672
TOTAL LIABILITIES		37,822	33,875	135,493	900,672	-	1,107,862
Liquidity gap		342,724	588,458	1,205,021	(840,315)	16,403	
Interest sensitivity gap		78,709	106,320	185,050	(115,399)	67	
Cumulative interest sensitivity gap		78,709	185,029	370,079	254,680	254,747	

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21. RISK MANAGEMENT POLICIES (Continued)

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Maturity undefined	31 December 2007 Total
ASSETS							
Loans to customers	45%	252,304	459,698	585,198	23,599	671	1,321,470
Total interest bearing assets		252,304	459,698	585,198	23,599	671	1,321,470
Cash and cash equivalents		4,055	-	-	-	-	4,055
TOTAL ASSETS		256,359	459,698	585,198	23,599	671	1,325,525
LIABILITIES							
Long term borrowings	14%	8,632	16,991	61,138	224,025	-	310,787
Other liabilities		18,982	-	-	-	14,355	33,336
TOTAL LIABILITIES		27,614	16,991	61,138	224,025	14,355	344,123
Liquidity gap		228,745	442,707	524,060	(200,426)	(13,684)	
Interest sensitivity gap		61,744	80,319	90,843	(47,015)	(14,354)	
Cumulative interest sensitivity gap		61,744	142,063	232,906	185,891	171,537	

Market risk

Market risk covers interest rate risk, currency risk and other pricing risks to which the Company is exposed. There have been no changes as to the way the Company measures risk or to the risk it is exposed in 2007.

Interest rate risk

The following table presents a sensitivity analysis of interest rate risk, which has been determined based on “reasonably possible changes in the risk variable”. The level of these changes is determined by management and is contained within the risk reports provided to key management personnel.

Impact on profit before tax:

	As at 31 December 2008		As at 31 December 2007	
	Interest rate +1%	Interest rate -1%	Interest rate +1%	Interest rate -1%
Assets:				
Loans to customers	13,621	(13,621)	16,034	(16,034)
Liabilities:				
Long term borrowings	(17,443)	17,443	(4,676)	4,676
Net impact on profit before tax	(3,822)	3,822	11,358	(11,358)

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21. RISK MANAGEMENT POLICIES (Continued)

Impact on shareholders equity:

	As at 31 December 2008		As at 31 December 2007	
	Interest rate +1%	Interest rate -1%	Interest rate +1%	Interest rate -1%
Assets:				
Loans to customers	13,621	(13,621)	16,034	(16,034)
Liabilities:				
Long term borrowings	<u>(17,443)</u>	<u>17,443</u>	<u>(4,676)</u>	<u>4,676</u>
Net impact on shareholders equity	<u><u>(3,822)</u></u>	<u><u>3,822</u></u>	<u><u>11,358</u></u>	<u><u>(11,358)</u></u>

Currency risk

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Company is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The Company's exposure to foreign currency exchange rate risk is presented in the table below:

	AZN	USD	31 December 2008 Total
ASSETS			
Cash and cash equivalents	36,193	-	36,193
Loans to customers	1,905,566	-	1,905,566
Property and equipment	34,383	-	34,383
Deferred income tax assets	<u>871</u>	<u>-</u>	<u>871</u>
TOTAL ASSETS	<u>1,977,013</u>	<u>-</u>	<u>1,977,013</u>
LIABILITIES			
Long term borrowings	465,400	405,546	870,946
Other liabilities	<u>35,673</u>	<u>-</u>	<u>35,673</u>
TOTAL LIABILITIES	<u>501,073</u>	<u>405,546</u>	<u>906,619</u>
OPEN BALANCE SHEET POSITION	<u>1,475,940</u>	<u>(405,546)</u>	<u>(1,070,394)</u>

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21. RISK MANAGEMENT POLICIES (Continued)

	AZN	USD	31 December 2007 Total
ASSETS			
Cash and cash equivalents	4,055	-	4,055
Loans to customers	1,084,475	-	1,084,475
Property and equipment	22,968	-	22,968
TOTAL ASSETS	1,111,498	-	1,111,498
LIABILITIES			
Long term borrowings	245,328	-	245,328
Other liabilities	33,336	-	33,336
TOTAL LIABILITIES	278,664	-	278,664
OPEN BALANCE SHEET POSITION	832,834	-	832,834

Currency risk sensitivity

The following table details the Company's Sensitivity to a 10% increase and decrease in the USD against the AZN. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Company where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

	As at 31 December 2008		As at 31 December 2007	
	AZN/USD +10%	AZN/USD -10%	AZN/USD +10%	AZN/USD -10%
Impact on profit or loss	(40,555)	40,555	-	-
Impact on equity	(40,555)	40,555	-	-

22. SUBSEQUENT EVENTS

The Company is planning to open a new branch in the city of Goychay. Infrastructural and organizational activities have been finished and the opening is expected to be during the next month.