Joint Stock Commercial Bank “RABITABANK”

Independent Auditors’ Report

Financial Statements
Year Ended 31 December 2003

JOINT STOCK COMMERCIAL BANK "RABITABANK"

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Deloitte.

Deloitte & Touche LLC
4th Floor
Landmark Building
96 Nizami Street
Baku, Azerbaijan
AZ1010

Tel: + 994 (0) 12 982 970
Fax: + 994 (0) 12 989 805
www.deloitte.az

INDEPENDENT AUDITORS' REPORT

To the Shareholders and the Board of Directors of the Joint Stock Commercial Bank "Rabitabank":

We have audited the accompanying balance sheet of the Joint Stock Commercial Bank "Rabitabank" ("the Bank") as at 31 December 2003 and the related profit and loss account and statements of cash flows and changes in shareholders' equity for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements as of 31 December 2002 and for the year then ended were audited by another auditor, whose report dated 26 August 2003 was modified to include limitation on scope paragraph regarding the allowance for losses on loans and advances to customers and expressed a qualified opinion.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2003, and the results of its operations and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

Without qualifying our opinion we draw attention to Note 23 and 26 to the accompanying financial statements. As discussed in Note 23, the Bank has a substantial concentration of certain operations with related parties. In addition, as disclosed in Note 26 the Bank ratio for capital adequacy purposes at 31 December 2003 was 5.10% comparing to the minimum required ratio of 8% set by the Basle Committee.

Deloitte & Touche.

30 June 2004

PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2003
(in Azerbaijan Manats and in thousands)

	Notes	2003	2002
Interest income	4, 23	5,895,157	2,772,551
Interest expense	4, 23	(2,059,800)	(1,295,322)
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES		3,835,357	1,477,229
Recovery of provision/(provision) for loan losses	5	539,264	(1,058,161)
NET INTEREST INCOME		4,374,621	419,068
Net gain on foreign exchange operations	6	1,149,497	991,417
Fees and commission income	7, 23	2,820,723	1,521,512
Fees and commission expense	7	(870,951)	(572,771)
Other income		539	-
NET NON-INTEREST INCOME		3,099,808	1,940,158
OPERATING INCOME		7,474,429	2,359,226
OPERATING EXPENSES	8,23	(3,976,893)	(2,038,295)
PROFIT BEFORE OTHER PROVISIONS AND INCOME TAX		3,497,536	320,931
Recovery of provision for impairment of securities available for sale	5	5,000	-
Recovery of provision for losses on other transactions	5	14,750	12,075
Provision for impairment of guarantees	5	(198,787)	-
PROFIT BEFORE INCOME TAX		3,318,499	333,006
Income tax expense	9	(660,238)	(15,281)
NET PROFIT		2,658,261	317,725

On behalf of the Management Board

Chairman **Chief Accountant**

The notes on pages 7 to 39 form an integral part of these financial statements. The Independent Auditors' Report is presented on page 1.

JOINT STOCK COMMERCIAL BANK “RABITABANK”

BALANCE SHEET
AS OF 31 DECEMBER 2003
(in Azerbaijan Manats and in thousands)

	Notes	2003	2002
ASSETS			
Cash and balances with the National Bank of Azerbaijan	10	10,023,683	8,453,282
Loans and advances to banks, less allowance for loan losses	11	4,098,862	3,711,237
Securities purchased under agreement to resell	12	9,002,412	-
Loans and advances to customers, less allowance for loan losses	13, 23	50,745,144	24,999,169
Investment securities:			
- securities available for sale, less allowance for impairment	14	150,000	964,224
Fixed and intangible assets, less accumulated depreciation	15	3,490,764	2,780,166
Income tax asset	9	-	79,263
Other assets, less allowance for losses	16	111,322	44,970
TOTAL ASSETS		77,622,187	41,032,311
LIABILITIES AND SHAREHOLDERS’ EQUITY			
LIABILITIES:			
Deposits from banks and other credit institutions	17	9,171,076	1,417,732
Customer accounts	18, 23	53,752,156	29,029,508
Finance lease liability	19	45,621	142,465
Income tax liabilities	9	580,975	-
Other liabilities	20, 23	255,143	283,651
Total liabilities		63,804,971	30,873,356
SHAREHOLDERS’ EQUITY:			
Share capital	21	15,175,211	14,175,211
Accumulated deficit		(1,357,995)	(4,016,256)
Total shareholders’ equity		13,817,216	10,158,955
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY		77,622,187	41,032,311
FINANCIAL COMMITMENTS AND CONTINGENCIES	22	8,597,730	3,823,963

On behalf of the Management Board

Chairman **Chief Accountant**

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STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2003
(in Azerbaijan Manats and in thousands)

	Share capital	Accumulated deficit	Total shareholders' equity
31 December 2001	9,174,863	(4,333,981)	4,840,882
Share capital increase	5,000,348	-	5,000,348
Net profit	-	317,725	317,725
31 December 2002	14,175,211	(4,016,256)	10,158,955
Share capital increase	1,000,000	-	1,000,000
Net profit	-	2,658,261	2,658,261
31 December 2003	15,175,211	(1,357,995)	13,817,216

On behalf of the Management Board

Chairman **Chief Accountant**

The notes on pages 7 to 39 form an integral part of these financial statements. The Independent Auditors' Report is presented on page 1.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2003
(in Azerbaijan Manats and in thousands)

	Notes	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income taxes		3,318,499	333,006
Adjustments for:			
(Recovery of provision)/provision for loan losses, net of write-offs		(539,264)	310,588
Recovery of loans and advances to customers previously written-off		155,432	-
Recovery of provision for impairment of securities available for sale		(5,000)	-
Recovery of provision for losses on other transactions, net of write-offs		(30,420)	(12,075)
Provision for guarantees		198,787	-
Depreciation charge and impairment of fixed and intangible assets		733,394	185,845
Loss on disposal of fixed assets		3,787	106,095
Commissions settled against other liabilities		(66,155)	(19,234)
Net change in interest accruals		(618,060)	71,107
Cash flow from operating activities before changes in operating assets and liabilities		3,151,000	975,332
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the National Bank of Azerbaijan		(650,472)	(1,813,532)
Loans and advances to banks		(82,903)	1,708,185
Loans and advances to customers		(24,584,075)	(12,724,019)
Securities purchased under agreement to resell		(9,000,000)	-
Other assets		(35,932)	83,630
Increase/(decrease) in operating liabilities:			
Deposits from banks and other credit institutions		7,753,344	(2,979,048)
Customer accounts		24,587,995	16,629,602
Finance lease liability		(96,844)	(88,906)
Other liabilities		(161,140)	(198,105)
Cash inflow from operating activities before income taxes		880,973	1,593,139
Income tax paid		-	(20,961)
Net cash inflow from operating activities		880,973	1,572,178
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of fixed and intangible assets		(1,447,779)	(734,400)
Proceeds from sale of fixed assets		-	137,626
Purchase of available for sale debt securities		-	(407,739)
Sales of available for sale debt securities		787,184	-
Sale of investment in associate		5,000	-
Net cash outflows from investing activities		(655,595)	(1,004,513)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Share capital increase		1,000,000	5,000,348
Net cash inflow from financing activities		1,000,000	5,000,348

STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2003
(in Azerbaijan Manats and in thousands)

	Notes	2003	2002
NET INCREASE IN CASH AND CASH EQUIVALENTS		1,225,378	5,568,013
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD	10	9,593,074	4,025,061
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	10	10,818,452	9,593,074

Interest paid and received by the Bank in cash during the year ended 31 December 2003 amounted to AZM 1,927,507 thousand and AZM 5,124,444 thousand, respectively.

Interest paid and received by the Bank in cash during the year ended 31 December 2002 amounted to AZM 1,073,770 thousand and AZM 2,663,765 thousand, respectively.

On behalf of the Management Board

Chairman	**Chief Accountant**

The notes on pages 7 to 37 form an integral part of these financial statements. The Independent Auditors’ Report is presented on page 1.

1. ORGANISATION

Joint Stock Commercial Bank "Rabitabank" (the "Bank") is a joint stock company, which was established on 17 May 1993. The address of its registered office is B. Sardarov Street 1, Baku, AZ1001, Azerbaijan. The Bank is regulated by the National Bank of Azerbaijan (the "NBA") and conducts its business under the general banking license # 136. The Bank's principal business activities are commercial and retail banking operations.

The Bank has 8 branches in Azerbaijan.

The number of employees of the Bank at 31 December 2003 and 2002 was 93 and 69, respectively.

As of 31 December 2003 and 2002 the share capital was owned as follows:

	2003 Ownership interest, %	2002 Ownership interest, %
Individuals	77.9	73.8
Legal entities	22.1	26.2
	100	**100**

These financial statements were authorized for issue by the Management Board on 25 May 2004.

Operating Environment - The Bank's principal business activities are within the Azerbaijan Republic. Laws and regulations affecting the business environment in the Azerbaijan Republic are subject to rapid changes and the Bank's assets and operations could be at risk due to negative changes in the political and business environment.

2. BASIS OF PRESENTATION

Accounting basis - These financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These financial statements are presented in thousands of Azerbaijan Manats ("AZM"), unless otherwise indicated. These financial statements are prepared on the accrual basis under the historical cost convention modified for the measurement at fair value of available-for-sale investment securities.

The Bank maintains its accounting records in accordance with Azerbaijan law which in majority complies with IFRS. These financial statements have been prepared from the Azerbaijan statutory accounting records and have been adjusted to conform with IFRS.

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates that are particularly susceptible to change relate to the provisions for losses on loans and impairment and the fair value of financial instruments.

Measurement currency - The measurement currency of these financial statements is the Azerbaijan Manat ("AZM").

3. SIGNIFICANT ACCOUNTING POLICIES

Investments in non-consolidated subsidiaries and associated companies - Investments in corporate shares where the Bank owns more than 20% of share capital, but does not have ability or intent to control or exercise significant influence over operating and financial policies, or non-consolidation of such companies does not have a significant effect on the financial statements taken as a whole, or the Bank intends to resell such investments in the nearest future are accounted for at cost or approximated cost, or at cost of acquisition, if the fair value of investments cannot be determined. Management periodically assesses the carrying values of such investments and provides allowances for impairment, if necessary.

Recognition and measurement of financial instruments - The Bank recognizes financial assets and liabilities on its balance sheet when, and only when, it becomes a party to the contractual provisions of the instrument. Regular way purchase and sale of the financial assets and liabilities are recognized using trade date accounting.

Financial assets and liabilities are initially recognized at cost, which is the fair value of consideration given or received, respectively, including or net of any transaction costs incurred, respectively. 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, unrestricted balances on correspondent and time deposit accounts with the National Bank of Azerbaijan with original maturity within 90 days, advances to banks in countries included in the Organization for Economic Co-operation and Development ("OECD"), except for margin deposits for operations with plastic cards. For the purposes of determining cash flows, the minimum reserve deposit required by the National Bank of Azerbaijan is not included as a cash equivalent due to restrictions on its availability (Note 10).

Loans and advances to banks - In the normal course of business, the Bank maintains advances or deposits for various periods of time with other banks. Loans and advances to banks with a fixed maturity term are subsequently measured at amortized cost using the effective interest method. Those that do not have fixed maturities are carried at cost. Amounts due from credit institutions are carried net of any allowance for losses.

Reverse repurchase agreements - The Bank enters purchase and sale back agreements ("reverse repos") in the normal course of its business. Reverse repurchase agreements are utilized by the Bank as an element of its treasury management and trading business.

Assets purchased under reverse repos are recoded in the financial statements as cash placed on deposit which is collateralized by securities and other assets.

Originated loans - Loans originated by the Bank are financial assets that are created by the Bank by providing money directly to a borrower.
Loans granted by the Bank are initially recognized in accordance with the policy stated above. The difference between the nominal amount of consideration given and the amortized cost of loans issued at other than market terms is recognized in the period the loan is issued as an initial recognition adjustment discounted using market rates at inception and included in the profit and loss account. Loans to customers with fixed maturities are subsequently measured at amortized cost using the effective interest method. Those that do not have fixed maturities are carried at cost. Loans and advances to customers are carried net of any allowance for loan losses.

Write off of loans - Loans are written off against the allowance for loan losses in the case of the uncollectibility of loans and advances, including through repossession of collateral. In accordance with the statutory legislation, loans may only be written off with the approval of the Shareholders' Meeting.

Non-accrual loans - Loans are placed on a non-accrual status when interest or principal is delinquent for a period in excess of 90 days. Interest income is not recognized if recovery is doubtful. Subsequent payments by borrowers are applied to delinquent interest first and then to principal. A non-accrual loan is restored to accrual status when all principal and interest amounts contractually due are reasonably assured of repayment within a reasonable period.

Allowance for losses - The Bank establishes an allowance for losses on financial assets when it is probable that the Bank will not be able to collect the principal and interest according to the contractual terms of financial assets, which are carried at cost or amortized cost. The allowance for losses is defined as the difference between carrying amounts and the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted at the original effective interest rate of the financial asset.

The determination of the allowance for loan losses is based on an analysis of the loan portfolio and reflects the amount which, in the judgment of management, is adequate to provide for losses inherent in the loan portfolio. Specific provisions are made as a result of a detailed appraisal of risk assets. In addition, provisions are carried to cover potential risks, which although not specifically identified, are present in the loan portfolio judging by previous experience.

The change in the allowance for loan losses is charged to the profit and loss account and the total of the allowance for loan losses is deducted in arriving at loans and advances to customers and banks. The amount of foreign exchange differences arising on loan losses for loans given in foreign currencies is included in the net gain on foreign exchange operations included in the profit and loss account. Management's evaluation of the allowance is based on the Bank's past loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral and current economic conditions.

It should be understood that estimates of loan losses involve an exercise of judgment. While it is possible that in particular periods the Bank may sustain losses, which are substantial relative to the allowance for loan losses, it is the judgment of management that the allowance for loan losses is adequate to absorb losses inherent in the loan portfolio.

Securities available-for-sale - Securities available-for-sale represent debt and equity investments that are intended to be held for an indefinite period of time. Such securities are initially recorded at cost which approximates the fair value of the consideration given. Subsequently the securities are measured at fair value, with such re-measurement included in the profit and loss account, plus accrued coupon income. The Bank uses quoted market prices to determine fair value for the Bank's securities available-for-sale. If such quotes do not exist, management's estimation is used.

Fixed and intangible assets - Fixed and intangible assets are carried at historical cost less accumulated depreciation and any accumulated impairment loss. Depreciation of fixed and intangible assets is designed to write off assets over their useful economic lives and is calculated on a straight line basis at the following annual prescribed rates:

Buildings	5%
Computers	20-25%
Furniture and equipment	20-25%
Vehicles	20%
Intangible assets	20%

The carrying amounts of fixed and intangible assets are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts, and where the carrying values exceed this estimated recoverable amount, assets are written down to their recoverable amount. An impairment is recognized in the respective period and is included in other administrative and operating expenses. After the recognition of an impairment loss the depreciation charge for fixed assets is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

Impairment loss - If the recoverable amount of an asset is less that its carrying amount, the carrying amount of the asset is reduced to its recoverable value. The difference being an impairment loss is recognized as an expense in the profit and loss account for the year in which it arises.

Finance leases - Leases that transfer substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. The lease is classified as a finance lease if:

- the lease transfers ownership of the asset to the lessee by the end of the lease term;
- the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;
- the lease term is for the major part of the economic life of the asset even if title is not transferred;
- at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
- the leased assets are of a specialized nature such that only the lessee can use them without major modifications being made.

Bank as lessee - The Bank recognizes finance leases as assets and liabilities in the balance sheet at the inception of the lease at amounts equal to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. In calculating the present value of the minimum lease payments the discount factor used is the interest rate implicit in the lease, when it is practicable to determine; otherwise, the Bank's incremental borrowing rate is used. Initial direct costs incurred are included as part of the asset. Lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Capital costs incurred to maintain or improve assets received under finance lease are capitalized and reported as leasehold improvements and are amortized over the term of the related lease.

Taxation - Taxes on income are computed in accordance with the laws of the Azerbaijan Republic. Deferred taxes, if any, are provided on items recognized in different periods for financial reporting purposes and income tax purposes, using the balance sheet liability method at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled. Deferred tax liabilities, if any, which result from temporary differences, are provided for in full. Deferred tax assets are recorded to the extent that there is a reasonable expectation that these assets will be realized.

Deferred income tax assets and liabilities are offset when:

- the Bank has a legally enforceable right to set off the recognized amounts of current tax assets and current tax liabilities;
- the Bank has an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously;
- the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority in the each future period in which significant amounts of deferred tax liabilities and assets are expected to be settled or recovered.

Azerbaijan also has various other taxes, which are assessed on the Bank's activities. These taxes are included as a component of operating expenses in the profit and loss account.

Deposits from banks and customers - Customers' and bank deposits are initially recognized at cost, which amounts to the issue proceeds less transaction costs incurred. Subsequently amounts due are stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the profit and loss account over the period of the borrowings using the effective interest method.

Provisions - Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the obligation can be made.

Share capital - Share capital is recognized at cost. Share capital contributions made in the form of assets other than cash are stated at their fair value at the date of contribution.

Retirement and other benefit obligations - The Bank does not have any pension arrangements separate from the State pension system of the Azerbaijan Republic, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such expense is charged in the period the related salaries are earned.

Contingencies - Contingent liabilities are not recognized in the financial statements unless it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made. A contingent asset is not recognized in the financial statements but disclosed when an inflow of economic benefits is probable.

Recognition of income and expense - Interest income and expense are recognized on an accrual basis calculated using the effective yield method. The recognition of interest income is suspended when loans become overdue by more then 90 days. Interest income also includes interest income earned on investment and trading securities. Commissions and other income are credited to income when the related transactions are completed.

Foreign currency translation - Monetary assets and liabilities denominated in foreign currencies are translated into Azerbaijan Manats 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 transactions.

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

	31 December 2003	**31 December 2002**
AZM/USD	4,923	4,893
AZM/EUR	6,195	5,080
AZM/RUR	167	154

Offset of financial assets and liabilities - Financial assets and liabilities are offset and reported net on the balance sheet when the Bank has a legally enforceable right to set off the recognized amounts and the Bank intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Reclassifications - Certain reclassifications have been made to the financial statement as of 31 December 2002 to conform to the presentation as of 31 December 2003.

4. NET INTEREST INCOME

Net interest income comprises:

	2003	2002
Interest income		
Interest on loans and advances to customers	5,840,986	2,695,636
Interest on debt securities	33,133	67,052
Interest on loans and advances to banks	18,626	9,863
Interest on reverse repurchase transactions	2,412	-
Total interest income	**5,895,157**	**2,772,551**
Interest expense		
Interest on customer accounts	1,872,082	1,119,708
Interest on deposits from banks and other credit institutions	170,353	153,605
Interest on finance lease liability	17,365	22,009
Total interest expense	**2,059,800**	**1,295,322**
Net interest income before recovery of provision/(provision) for loan losses	**3,835,357**	**1,477,229**

5. ALLOWANCE FOR LOAN LOSSES

The movements in allowance for loan losses were as follows:

	Loans and advances to banks	Loans and advances to customers	Total
31 December 2001	22,795	2,369,120	2,391,915
(Recovery)/provision	(22,795)	1,080,956	1,058,161
Write-offs of assets	-	(747,573)	(747,573)
31 December 2002	-	2,702,503	2,702,503
Recovery of provision	-	(539,264)	(539,264)
Recovery of assets previously written off	-	155,432	155,432
31 December 2003	-	2,318,671	2,318,671

The movements in allowances for other losses were as follows:

	Securities available for sale	Other assets	Guarantees	Total
31 December 2001	5,000	42,495	-	47,495
Recovery of provision	-	(12,075)	-	(12,075)
31 December 2002	5,000	30,420	-	35,420
Provision/(recovery)	(5,000)	(14,750)	198,787	179,037
Write-offs	-	(15,670)	-	(15,670)
31 December 2003	-	-	198,787	198,787

Allowances for losses on assets are deducted from the related assets. Provisions for guarantees and commitments are recorded in liabilities.

6. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprise:

	2003	2002
Dealing, net	1,211,328	957,703
Translation differences, net	(61,831)	33,714
Total net gain on foreign exchange operations	**1,149,497**	**991,417**

7. FEES AND COMMISSION INCOME AND EXPENSE

Fees and commission income and expense comprise:

	2003	2002
Fees and commission income:		
Cash operations	1,342,388	665,446
Settlements	1,038,440	694,865
Documentary operations	264,225	79,755
Plastic cards operations	175,670	81,446
Total fees and commission income	**2,820,723**	**1,521,512**

	2003	2002
Fees and commission expense:		
Plastic cards operations	323,227	231,687
Documentary operations	238,215	72,703
Settlements	158,058	193,561
Cash operations	90,252	67,465
Other operations	61,199	7,355
Total fees and commission expense	**870,951**	**572,771**

8. OPERATING EXPENSES

Operating expenses comprise:

	2003	2002
Staff costs	1,491,103	671,024
Depreciation of fixed and intangible assets	608,394	143,845
Advertising and marketing expenses	322,321	158,781
Communications	309,732	236,912
Office supplies	259,483	113,585
Occupancy costs	242,695	120,201
Insurance of premises	177,396	-
Professional services fees	137,020	173,825
Impairment of fixed assets	125,000	42,000
Business travel expenses	87,788	34,436
Taxes other than income tax	76,781	26,814
Repairs and maintenance expenses	61,492	161,267
Loss on disposal of fixed assets	3,787	106,095
Other	73,901	49,510
Total operating expenses	**3,976,893**	**2,038,295**

9. INCOME TAXES

The Bank provides for taxes based on the statutory tax accounts maintained and prepared in accordance with the Azerbaijan statutory tax regulations which may differ from International Financial Reporting Standards. During the years ended 31 December 2003 and 2002, Azerbaijan's tax rate for corporations' profits was 25% and 27%, respectively. Effective from 1 January 2004 the tax rate for corporations' profits is 24%.

Income tax assets and liabilities consist of the following:

	2003	2002
Current income tax asset	-	79,263
Income tax asset	**-**	**79,263**

	2003	2002
Deferred income tax liability	274,010	-
Current income tax liability	306,965	-
Income tax liabilities	**580,975**	**-**

The Bank is subject to certain permanent tax differences due to non-deductibility of certain expenses under local tax regulations.

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 of 31 December 2003 and 2002 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets. Temporary differences as of 31 December 2003 and 2002 comprise:

	2003	**2002**
Deferred assets:		
Fixed and intangible assets	228,993	-
Loans and advances to customers	107,452	227,726
Investment securities	19,844	6,428
Other liabilities	-	37,503
Other assets	-	8,017
Loans and advances to banks	-	1,009
Total deferred assets	**356,289**	**280,683**

	2003	**2002**
Deferred liabilities:		
Loans and advances to customers	1,247,664	-
Securities purchased under agreement to resell	180,000	-
Investment securities	70,334	-
Fixed and intangible assets	-	8,271
Total deferred liabilities	**1,497,998**	**8,271**
Net deferred (liabilities)/assets	**(1,141,710)**	**272,412**
Deferred income tax (liability)/asset at the statutory rate of 24 %: 2003 (25 %: 2002)	(274,010)	68,103
Less valuation allowance	-	(68,103)
Net deferred income tax liability	**(274,010)**	**-**

Relationships between tax expenses and accounting profit for the years ended 31 December 2003 and 2002 are explained as follows:

	2003	2002
Profit before income taxes	**3,318,499**	**333,006**
Statutory tax rate	25%	27%
Theoretical tax at the statutory tax rate	829,625	89,912
Tax effect of permanent differences	(180,804)	88,158
Effect of changes in income tax rate	11,417	-
Change in valuation allowance	-	(162,789)
Income tax expense	**660,238**	**15,281**
Current income tax expense	386,228	15,281
Deferred income tax expense	274,010	-
Income tax expense	**660,238**	**15,281**

	2003
Deferred income tax liability	
At beginning of the period	-
Increase in the deferred income tax for the period	(274,010)
At end of the period	**(274,010)**

10. CASH AND BALANCES WITH THE NATIONAL BANK OF AZERBAIJAN

Cash and balances with the National Bank of Azerbaijan comprise:

	2003	2002
Cash on hand	6,431,150	2,967,570
Balances with the National Bank of Azerbaijan	3,592,533	5,485,712
Total cash and balances with the National Bank of Azerbaijan	**10,023,683**	**8,453,282**

The balances with the NBA as of 31 December 2003 and 2002 include AZM 3,087,589 thousand and AZM 2,437,117 thousand, respectively, which represent the minimum reserve deposits required by the NBA. The Bank is required to maintain the reserve balance at the NBA at all times.

Cash and cash equivalents for the purposes of the statement of cash flows comprise:

	2003	2002
Cash and balances with the National Bank of Azerbaijan	10,023,683	8,453,282
Loans and advances to banks in OECD countries	3,882,358	3,576,909
	13,906,041	**12,030,191**
Less minimum reserve deposit with the National Bank of Azerbaijan	(3,087,589)	(2,437,117)
Total cash and cash equivalents	**10,818,452**	**9,593,074**

11. LOANS AND ADVANCES TO BANKS, LESS ALLOWANCE FOR LOAN LOSSES

Loans and advances to banks comprise:

	2003	2002
Advances to banks	4,098,862	3,710,510
Accrued interest income on loans and advances to banks	-	727
Total loans and advances to banks, net	**4,098,862**	**3,711,237**

Movements in allowance for loan losses for the year ended 31 December 2002 are disclosed in Note 5.

As of 31 December 2003 and 2002 the Bank had advances of AZM 2,677,462 thousand with Raiffeisen Centrobank, Austria and AZM 3,416,510 thousand with ABN AMRO Bank, USA, respectively. These exposures exceeded 25% and 20% of the Bank's equity as of 31 December 2003 and 2002, respectively.

12. SECURITIES PURCHASED UNDER AGREEMENT TO RESELL

Securities purchased under agreement to resell comprise long-term bonds of the Ministry of Finance of Azerbaijan amounting to AZM 9,002,412 thousand as of 31 December 2003.

Long-term bonds of the Ministry of Finance are AZM denominated government securities issued at an annual interest of 0.15% payable on nominal value and guaranteed by the Ministry of Finance of Azerbaijan with maturity on 22 May 2023.

On 31 December 2003 the Bank purchased from the National Bank of Azerbaijan 90 bonds of the Ministry of Finance of Azerbaijan with a total nominal value of AZM 9,000,000 thousand under agreement to resell them on 2 January 2004. An annual interest rate of 5% of the nominal value is payable to the Bank on these bonds. As of 31 December 2003 included in securities purchased under agreement to resell is accrued interest income on the bonds of the Ministry of Finance of Azerbaijan of AZM 2,412 thousand.

13. LOANS AND ADVANCES TO CUSTOMERS, LESS ALLOWANCE FOR LOAN LOSSES

Loans and advances to customers comprise:

	2003	2002
Originated loans	51,816,151	27,232,076
Accrued interest income on loans and advances to customers	1,247,664	469,596
	53,063,815	**27,701,672**
Less allowance for loan losses	(2,318,671)	(2,702,503)
Total loans and advances to customers, net	**50,745,144**	**24,999,169**

Movements in allowances for loan losses for the years ended 31 December 2003 and 2002 are disclosed in Note 5.

As of 31 December 2003 and 2002 the Bank had credit exposures to 6 and 3 borrowers totaling AZM 17,471,948 thousand and AZM 12,228,795 thousand, respectively, which individually exceeded 10% of the Bank's equity.

As of 31 December 2003 and 2002 included in loans and advances to customers are non-accrual loans amounting to AZM 686,566 thousand and AZM 653,176 thousand respectively, on which interest was not accrued.

Analysis by industry	**2003**	**2002**
Trading	22,614,023	7,880,625
Individuals	16,698,032	8,192,277
Communication	8,105,020	8,559,028
Manufacturing	2,516,931	2,559,970
Agriculture and food processing	848,017	30,176
Construction	5,035	10,000
Other	1,029,093	-
Accrued interest income on loans and advances to customers	1,247,664	469,596
	53,063,815	**27,701,672**
Less allowance for loan losses	(2,318,671)	(2,702,503)
Total loans and advances to customers, net	**50,745,144**	**24,999,169**

14. INVESTMENT SECURITIES

Investment securities comprise:

	2003	**2002**
Equity securities available-for-sale	150,000	150,000
Debt securities available-for-sale	-	814,224
Total investment securities	**150,000**	**964,224**

Equity securities available-for-sale comprise:

Name	**Country of incorporation**	**Ownership interest**	**2003**	**2002**
Baku Stock Exchange	Azerbaijan	2.78 %	150,000	150,000
Total equity securities available for sale			**150,000**	**150,000**

Debt securities available for sale comprised of the short-term bonds of the Ministry of Finance of Azerbaijan totaling AZM 814,224 thousand as of 31 December 2002. These bonds are AZM denominated securities purchased by the Bank at discount to nominal value with maturity periods of up to 1 month. The average effective interest rate is 14 %.

As of 31 December 2002 included in debt securities available-for-sale was accrued discount income amounting to AZM 27,040 thousand.

Investment in associated company comprises:

Name	Country of incorporation	Ownership interest	2003	2002
Rabita Insurance	Azerbaijan	50 %	-	5,000
Less allowance for impairment			-	(5,000)
Total investment in associated company			**-**	**-**

Movements in allowances for impairment for the years ended 31 December 2003 and 2002 are disclosed in Note 5.

The associated company was not consolidated and accounted for under the equity method since its financial position as of 31 December 2002 and the results of its operations for the year then ended were not material to the Bank's financial statements.

15. FIXED AND INTANGIBLE ASSETS, LESS ACCUMULATED DEPRECIATION

	Buildings	Computers	Furniture and equipment	Vehicles	Intangible assets	Total
At cost						
31 December 2002	2,342,066	838,967	1,020,384	188,261	29,000	4,418,678
Additions	727,549	447,262	242,058	30,910	-	1,447,779
Disposals	-	(33,996)	(9,169)	-	-	(43,165)
Impairment loss	(125,000)	-	-	-	-	(125,000)
Transfers	-	(489,072)	489,072	-	-	-
31 December 2003	2,944,615	763,161	1,742,345	219,171	29,000	5,698,292
Accumulated depreciation						
31 December 2002	235,208	366,972	983,615	44,661	8,056	1,638,512
Charge for the period	135,470	188,339	231,659	47,126	5,800	608,394
Disposals	-	(32,355)	(7,023)	-	-	(39,378)
Transfers	-	(293,518)	293,518	-	-	-
31 December 2003	370,678	229,438	1,501,769	91,787	13,856	2,207,528
Net book value						
31 December 2003	**2,573,937**	**533,723**	**240,576**	**127,384**	**15,144**	**3,490,764**
Net book value						
31 December 2002	**2,106,858**	**471,995**	**36,769**	**143,600**	**20,944**	**2,780,166**

As of 31 December 2003 and 2002, fixed assets include two ATM machines held under a finance lease agreement (Note 19). The carrying amount of the ATM machines equals AZM 135,189 thousand and AZM 200,907 thousand as of 31 December 2003 and 2002, respectively. Upon the expiration of the lease term the Bank will take ownership over the equipment.

As of 31 December 2003 and 2002, fixed assets include an ATM machine held under a servicing agreement (Note 20). The carrying amount of the ATM machine equals AZM 75,779 thousand and AZM 102,729 thousand as of 31 December 2003 and 2002, respectively. Upon the full settlement of the liability under the servicing agreement the Bank will take ownership of the equipment.

16. OTHER ASSETS, LESS ALLOWANCE FOR LOSSES

Other assets comprise:

	2003	**2002**
Unsettled payments on money transfer operations	110,853	-
Prepaid taxes other than income tax	469	18,606
Receivable for collateral sold	-	30,420
Unsettled payments on plastic cards operations	-	22,381
Other	-	3,983
	111,322	**75,390**
Less allowance for losses on other assets	-	(30,420)
Total other assets	**111,322**	**44,970**

Movements in allowances for losses for the years ended 31 December 2003 and 2002 are disclosed in Note 5.

17. DEPOSITS FROM BANKS AND OTHER CREDIT INSTITUTIONS

Deposits from banks and other credit institutions comprise:

	2003	**2002**
Time deposits	8,122,361	500,000
Demand deposits	1,048,715	917,732
Total deposits from banks and other credit institutions	**9,171,076**	**1,417,732**

As of 31 December 2003 included in deposits from banks and other credit institutions is AZM 1,178,742 thousand with one Azerbaijan bank.

As of 31 December 2003 included in deposits from banks and other credit institutions is a credit line provided by the International Finance Corporation amounting to AZM 1,166,751 thousand. This non-revolving credit facility was provided to the Bank solely for the small and medium-sized enterprises financing under the agreement concluded with the International Finance Corporation on 8 May 2003. The credit facility bears a floating interest rate based on six months LIBOR plus 4.25% premium. In accordance with the agreement the credit facility is limited to the amount of 1,200,000 US dollars and is to be repaid within 3 years starting from 15 March 2005.

The Bank receives loans from the State Fund for Support of Entrepreneurs as a means of support of small and medium-sized entrepreneurs in Azerbaijan. Under the agreement with the Fund as of 31 December 2003 the Bank obtained loans amounting to AZM 4,611,000 thousand with maturity periods from 3 to 5 years, bearing annual interest rates ranging from 2% to 4%. Subsequently, these funds were used by the Bank to issue loans to the individual entrepreneurs in Azerbaijan at an annual interest rate of 7%.

As of 31 December 2003 and 2002 included in time deposits from banks and other credit institutions are loans from the National Bank of Azerbaijan amounting to AZM 2,000,000 thousand and AZM 500,000 thousand, respectively. The loans have a 1 year maturity and bear an annual interest rate of 7%. Subsequently, these credits were released to corporate borrowers at an annual interest rate of 10%.

18. CUSTOMER ACCOUNTS

Customer accounts comprise:

	2003	2002
Repayable on demand	30,996,774	19,615,446
Time deposits	22,363,860	9,157,193
Accrued interest expense on customer accounts	391,522	256,869
Total customer accounts	**53,752,156**	**29,029,508**

As of 31 December 2003 customer accounts amounting to AZM 30,715,595 thousand were due to 8 customers representing significant concentration forming 57.1 % of customer accounts.

As of 31 December 2003 customer accounts of AZM 152,377 thousand were held as security against a letter of credit issued by the Bank.

Analysis of customer accounts by industry:

	2003	2002
Communication	21,434,354	7,503,484
Individuals	16,902,464	9,739,026
Trading	7,398,496	3,563,038
Construction	4,905,865	752,152
Manufacturing	1,727,725	200,879
Agriculture	347,941	5,879,849
Other	643,789	1,134,211
Accrued interest expense on customer accounts	391,522	256,869
Total customer accounts	**53,752,156**	**29,029,508**

19. FINANCE LEASE LIABILITY

In 2002 the Bank entered into a finance lease agreement under which it obtained two ATM machines included in fixed assets. The liability bears interest at 20% per annum.

As of 31 December 2003 and 2002 the obligations of the Bank on future minimum lease payments and their present value under the finance lease of two ATM machines were as follows:

	2003	**2002**
Not later than 1 year	47,912	114,209
From 1 to 5 years	-	47,912
Total minimum lease payments	**47,912**	**162,121**
Less interest charges related to future periods	(2,291)	(19,656)
Present value of minimum lease payments	**45,621**	**142,465**

20. OTHER LIABILITIES

Other liabilities comprise:

	2003	**2002**
Provision for guarantees	198,787	-
Taxes payable, other than income tax	34,000	1,307
Payable for an ATM machine	22,356	88,511
Accrued expenses	-	173,241
Unsettled payments on plastic cards operations	-	20,592
Total other liabilities	**255,143**	**283,651**

Movements in provision for guarantees for the year ended 31 December 2003 are disclosed in Note 5.

In 2002 the Bank entered into a servicing agreement with Azeurotel JV, a related party, under which it received an ATM machine at a cost of AZM 107,745 thousand. In accordance with the agreement the Bank's liability for the equipment received is settled against the commissions on plastic cards operations receivable from Azeurotel JV.

21. SHARE CAPITAL

As of 31 December 2002 the authorized, issued and fully paid share capital amounted to AZM 11,443,231 thousand and comprised 30,195 ordinary shares with par values of AZM 100,000, AZM 500,000, AZM 1,000,000, AZM 5,000,000, AZM 10,000,000, AZM 20,000,000, AZM 25,000,000, AZM 40,000,000, AZM 50,000,000 and AZM 100,000,000 and 20 thousand preference shares with a par value of AZM 100,000 each.

During the year ended 31 December 2003 10 thousand ordinary shares with a par value of AZM 100,000 each were paid in and registered with the State Security Committee resulting in AZM 12,443,231 thousand authorized, issued and fully paid share capital as of 31 December 2003.

The ordinary shares are ranked differently and the voting power of each share is determined based on the proportion between the par value of a share and the paid-in share capital.

The holders of preference shares are entitled to receive dividends at a fixed rate of 10% of statutory profit according to Azeri accounting standards but are not entitled to vote at annual and general meetings of the Bank.

In 2000 the Bank purchased the shares of two Azerbaijan banks amounting to AZM 1,002,627 thousand. Simultaneously, these banks purchased the shares of the Bank amounting to AZM 1,002,627 thousand. In the management's estimation, these transactions by nature do not represent investments in the share capital of the two above mentioned banks and in the share capital of the Bank, respectively. For the purpose of these financial statements the above mentioned transactions were eliminated.

As of 31 December 2003 and 2002 included in share capital is an adjustment of AZM 3,734,607 thousand resulting from the restatement of share capital due to hyperinflationary period of Azerbaijan economy between 1990 and end of 1995.

22. FINANCIAL COMMITMENTS AND CONTINGENCIES

In the normal course of business the Bank 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 balance sheet.

The Bank'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.

The Bank uses the same credit control and management policies in undertaking off-balance sheet commitments as it does for on-balance sheet operations.

The risk-weighted amount is obtained by applying credit conversion factors and counterparty risk weightings according to the principles employed by the Basle Committee on Banking Supervision.

As of 31 December 2003 and 2002, the nominal or contract amounts and the risk weighted credit equivalents of instruments with off-balance sheet risks were:

	2003		2002	
	Nominal Amount	**Risk Weighted Amount**	**Nominal Amount**	**Risk Weighted Amount**
Guarantees issued and similar commitments	6,356,666	6,356,666	2,905,691	2,905,691
Commitments on credits and unused credit lines	2,088,687	-	918,272	-
Letters of credit secured by customer funds	152,377	-	-	-
Total contingent liabilities and credit commitments	**8,597,730**	**6,356,666**	**3,823,963**	**2,905,691**

The Bank has made a provision of AZM 198,787 thousand against guarantees issued as of 31 December 2003.

Capital commitments - The Bank had no material commitments for capital expenditures outstanding as of 31 December 2003.

Insurance - As of 31 December 2003 the Bank's premises were insured for 545,696 US dollars, commercial liabilities were insured for 600,000 US dollars and losses related to damage from theft, employee dishonesty and electronic and computer crime were insured for 600,000 US dollars.

Legal proceedings - From time to time and in the normal course of business, claims against the Bank can be received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these financial statements.

Taxes - Due to the presence in Azerbaijan commercial legislation, and tax legislation in particular, of provisions allowing more than one interpretation, and also due to the practice developed in a generally unstable environment by the tax authorities of making arbitrary judgment of business activities, if a particular treatment based on Management's judgment of the Bank's business activities was to be challenged by the tax authorities, the Bank may be assessed additional taxes, penalties and interest. The Bank believes that it has already made all tax payments, and therefore no allowance was made in the financial statements. Tax years remain open to review by the tax authorities for three years.

Pensions and retirement plans - Employees receive pension benefits from the Republic of Azerbaijan in accordance with the laws and regulations of the country. As of 31 December 2003 and 2002, the Bank was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

23. TRANSACTIONS WITH RELATED PARTIES

Related parties, as defined by IAS 24, are those counter parties that represent:

(a) enterprises which directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with the Bank. (This includes holding companies, subsidiaries and fellow subsidiaries);

(b) associates – enterprises in which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;

(c) individuals owning directly or indirectly, an interest in the voting power of the Bank that gives them significant influence over the Bank;

(d) key management personnel, that is, those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, including directors and officers of the Bank and close members of the families of such individuals; and

(e) enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the Bank and enterprises that have a member of key management in common with the Bank.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Bank had the following transactions outstanding with related parties:

	2003		2002	
	Related party transactions	**Total category as per financial statements caption**	**Related party transactions**	**Total category as per financial statements caption**
Loans to customers, gross	11,806,725	53,063,815	7,899,923	27,701,672
Allowance for loans to customers	(366,356)	(2,318,671)	(1,227,003)	(2,702,503)
Customer accounts	15,378,095	53,752,156	578,101	29,029,508
Other liabilities	22,355	255,143	88,511	283,651

During the year ended 31 December 2003 Bank originated loans to customers - related parties amounting to AZM 18,989,920 thousand and received loans repaid amounting to AZM 15,083,118 thousand. The Bank has interest income accrued in respect of loans and advances granted to related parties totaling AZM 372,332 thousand as of 31 December 2003.

During the year ended 31 December 2003 and 2002 the Bank received deposits from customers - related parties of AZM 174,055,975 thousand and repaid deposits of AZM 159,255,981 thousand. The Bank has interest expense accrued in respect of deposits received from related parties totaling AZM 4,000 thousand and AZM 404 thousand as of 31 December 2003 and 2002, respectively.

Included in the profit and loss account for the years ended 31 December 2003 and 2002 are the following amounts which arose due to transactions with related parties:

	2003		2002	
	Related party transactions	**Total category as per financial statements caption**	**Related party transactions**	**Total category as per financial statements caption**
Interest income		5,895,157		2,772,551
- related companies	2,152,478		820,000	
Interest expense		(2,059,800)		(1,295,322)
- related companies	(40,250)		(3,334)	
- directors	(31,725)		(11,550)	
Commission income		2,820,723		1,521,512
- related companies	718,985		307,936	
Operating expenses		(3,976,893)		(2,038,295)
- related companies	(271,566)		(60,301)	
- directors	(91,520)		(58,588)	

Transactions with related parties entered into by the Bank during the years ended 31 December 2003 and 2002 and outstanding as of 31 December 2003 and 2002 were made in the normal course of business and mostly under arm-length conditions.

24. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments is 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 a forced or liquidation sale. As no readily available market exists for a large part of the Bank’s financial instruments, judgment is necessary in arriving at fair value, based on current economic conditions and specific risks attributable to the instrument. The estimates presented herein are not necessarily indicative of the amounts the Bank could realize in a market exchange from the sale of its full holdings of a particular instrument.

As of 31 December 2003 and 2002 the following methods and assumptions were used by the Bank to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

Cash and balances with the NBA - For these short-term instruments the carrying amount is a reasonable estimate of fair value.

Loans and advances to banks - As of 31 December 2003 and 2002, the carrying amount of short-term deposits and advances given is a reasonable estimate of their fair value.

Securities purchased under agreement to resell - As of 31 December 2003 securities purchased under agreement to resell are stated at a fair value amounting to AZM 9,002,412 thousand. As of 31 December 2003, the fair value of securities purchased under agreement to resell is determined based on their market prices.

Loans and advances to customers **-** The fair value of the loan portfolio is based on the credit and interest rate characteristics of the individual loans within each sector of the portfolio. The estimation of the provision for loan losses includes consideration of risk premiums applicable to various types of loans based on factors such as the current situation of the economic sector in which each borrower operates, the economic situation of each borrower and guarantees obtained. Accordingly, the provision for loan losses is considered a reasonable estimate of the discount required to reflect the impact of credit risk.

Securities available-for-sale **-** As of 31 December 2003 and 2002 equity securities available for sale are stated at estimated fair value amounting to AZM 150,000 thousand. Since there is no active market for these securities and no market prices of securities with similar credit risk and/or maturity exist, management estimation was used. As of 31 December 2002 debt securities available-for-sale are stated at fair value amounting to AZM 787,184 thousand plus accrued discount totaling AZM 27,040 thousand. Fair value of securities available-for-sale was determined with reference to an active market for those securities.

Deposits from banks and other credit institutions **-** As of 31 December 2003 and 2002 the carrying amount of short-term deposits and deposits repayable on demand of AZM 3,393,325 thousand and AZM 1,417,732 thousand, respectively, is a reasonable estimate of their fair value. As of 31 December 2003 long-term deposits from banks other credit institutions are stated at cost of AZM 5,777,751 thousand which approximates fair value.

Customer accounts **-** As of 31 December 2003 and 2002 the carrying amount of short-term deposits and current accounts of the Bank's customers of AZM 43,441,403 thousand and AZM 23,637,303 thousand, respectively, is a reasonable estimate of their fair value. As of 31 December 2003 and 2002 long-term customer accounts are stated at cost of AZM 10,310,753 thousand and AZM 5,371,654 thousand, respectively, which approximates fair value.

25. SUBSEQUENT EVENTS

On 5 March 2004 the shareholders approved an additional issue of 20 thousand ordinary shares with a par value of AZM 100,000 each. These shares had not been paid in up to the date of issue of these financial statements.

In April 2004 the shares of the Bank were converted from documentary to non-documentary form and their par values were equalized. These changes were registered with the State Security Committee on 27 April 2004. At that date the share capital comprised 104 thousand ordinary shares with par value of AZM 100,000 each and 20 thousand preference shares with par value of AZM 100,000 each.

In April 2004 the Bank issued AZM 5,000,000 thousand of bonds which were sold on the Baku Stock Exchange. These debt securities have a 1 year maturity and bear an annual interest rate of 10 %.

On 8 May 2004 the Bank entered into the Line of Financing Agreement with the Islamic Corporation for the Development of the Private Sector. Under this agreement the Bank will be provided a credit line limited to 800,000 US dollars to finance the projects sponsored by small and medium-sized enterprises with substantial business development impact. The credit line has a 6 year maturity and bears a floating interest rate determined based on US dollars bid rate of the SWAP agreements on 6 month LIBOR plus 5.5 % premium. Under the terms of the agreement the Bank is allowed to provide credits to small and medium enterprises at any market competitive margin.

26. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (as set forth in the table below) of total and tier 1 capital to risk weighted assets.

The capital is calculated as the amount of restricted and free components of the shareholders' capital plus the Bank's provisions for the principal risks on the condition that the general provision for losses does not exceed 1.25% of the risk weighted assets.

The ratio was calculated according to the principles employed by the Basle Committee by applying the following risk estimates:

Estimate	Description of position
0%	Cash and balances with the National Bank of Azerbaijan
0%	State debt securities in Azerbaijan Manats
20%	Loans and advances to banks for up to 1 year
100%	Loans and advances to customers
100%	Other assets
0%	Standby letters of credit secured by customer funds
50%	Other standby letters of credit and other transaction related contingent obligations and commitments on unused loans with the initial maturity of over 1 year
100%	Guarantees issued and similar commitments

The Bank's actual capital amounts and ratios are presented in the following table:

Capital amounts and ratios	Actual Amount in AZM thousand	For Capital Adequacy purposes Amount in AZM thousand	Ratio For Capital Adequacy purposes	Minimum Required Ratio
As of 31 December 2003				
Total capital	13,817,216	3,147,768	5.10%	8%
Tier 1 capital	10,082,626	10,082,626	16.35%	4%
As of 31 December 2002				
Total capital	10,158,955	3,882,304	12.25%	8%
Tier 1 capital	6,424,365	6,424,356	20.27%	4%

27. RISK MANAGEMENT POLICIES

Management of risk is fundamental to the banking business and is an essential element of the Bank's operations. The main risks inherent to the Bank's operations are those related to credit exposures, liquidity and market movements in interest rates and foreign exchange rates. A description of the Bank's risk management policies in relation to those risks follows.

The Bank manages the following risks:

Liquidity risk

Liquidity risk refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due.

In order to manage liquidity risk, the Bank performs daily monitoring of expected future cash flows on clients' and banking operations, which is a part of the assets/ liabilities management process. The Management Board sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

The following tables present an analysis of the interest rate risk and the liquidity risk on the balance sheet. Interest bearing assets and liabilities are generally shown at the earliest contractual maturities and interest rates are generally re-priced only at maturity.

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Overdue	Maturity undefined (incl. allowance for losses)	2003 AZM thousand Total
ASSETS								
Loans and advances to banks, less allowance for loan losses	1,147,669	-	-	-	-	-	-	1,147,669
Securities purchased under agreement to resell	9,000,000	-	-	-	-	-	-	9,000,000
Loans and advances to customers, less allowance for	9,477,588	9,911,793	20,743,063	10,997,141	-	-	(1,659,560)	49,470,025
Total fixed interest rate bearing assets	19,625,257	9,911,793	20,743,063	10,997,141	-	-	(1,659,560)	59,617,694
Cash and balances with the NBA	6,936,094	-	-	-	-	-	3,087,589	10,023,683
Loans and advances to banks, less allowance for loan losses	2,951,193	-	-	-	-	-	-	2,951,193
Loans and advances to customers, less allowance for loan losses	-	-	-	-	-	686,566	(659,111)	27,455
Investment securities	-	-	-	-	150,000	-	-	150,000
Interest accrued on interest bearing assets	1,250,076	-	-	-	-	-	-	1,250,076
Fixed and intangible assets, less accumulated depreciation	-	-	-	865,347	2,625,417	-	-	3,490,764
Other assets	111,322	-	-	-	-	-	-	111,322
Total non-interest bearing assets	11,248,685	-	-	865,347	2,775,417	686,566	2,428,478	18,004,493
TOTAL ASSETS	**30,873,942**	**9,911,793**	**20,743,063**	**11,862,488**	**2,775,417**	**686,566**	**768,918**	**77,622,187**
LIABILITIES								
Fixed interest rate bearing								
Deposit from banks and other credit institutions	-	-	2,344,610	4,611,000	-	-	-	6,955,610
Customer accounts	7,049,692	413,207	4,590,208	10,280,875	29,878	-	-	22,363,860
Finance lease liability	-	45,621	-	-	-	-	-	45,621
Total fixed interest rate bearing liabilities	7,049,692	458,828	6,934,818	14,891,875	29,878	-	-	29,365,091
Floating interest rate bearing								
Deposit from banks and other credit institutions	-	-	-	1,166,751	-	-	-	1,166,751
Total interest bearing	7,049,692	458,828	6,934,818	16,058,626	29,878	-	-	30,531,842
Deposits from banks and other credit institutions	1,048,715	-	-	-	-	-	-	1,048,715
Customer accounts	30,996,774	-	-	-	-	-	-	30,996,774
Interest accrued on interest bearing liabilities	391,522	-	-	-	-	-	-	391,522
Income tax liabilities	-	306,965	274,010	-	-	-	-	580,975
Other liabilities	56,356	-	-	-	-	-	198,787	255,143
Total non-interest bearing liabilities	32,493,367	306,965	274,010	-	-	-	198,787	33,273,129
TOTAL LIABILITIES	**39,543,059**	**765,793**	**7,208,828**	**16,058,626**	**29,878**	**-**	**198,787**	**63,804,971**

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years
Liquidity gap	(8,669,117)	9,146,000	13,534,235	(4,196,138)	2,745,539
Interest sensitivity gap	12,575,565	9,452,965	13,808,245	(5,061,485)	(29,878)
Cumulative interest sensitivity gap	12,575,565	22,028,530	35,836,775	30,775,290	30,745,412
Cumulative interest sensitivity gap as a percentage of total	16.20%	28.38%	46.17%	39.65%	39.61%

	Up to 1 month	1 month to 3 months	3 months to 1 year	More than 1 year	No maturity	2002 AZM thousand Total
ASSETS						
Cash and balances with the NBA	6,016,165	-	-	-	2,437,117	8,453,282
Loans and advances to bank, less allowance for loan losses	3,711,237	-	-	-	-	3,711,237
Loans and advances to customers, less allowance for loan losses	1,831,606	4,514,997	13,793,386	4,859,180	-	24,999,169
Investment securities	814,224	-	-	-	150,000	964,224
Fixed and intangible assets, less accumulated depreciation	-	-	-	-	2,780,166	2,780,166
Current income tax asset	-	-	79,263	-	-	79,263
Other assets, less allowance for losses	44,970	-	-	-	-	44,970
TOTAL ASSETS	**12,418,202**	**4,514,997**	**13,872,649**	**4,859,180**	**5,367,283**	**41,032,311**
LIABILITIES						
Deposits from banks	917,732	-	500,000	-	-	1,417,732
Customer accounts	20,481,710	676,646	2,478,947	5,371,654	20,551	29,029,508
Finance lease liability	9,547	14,743	72,720	45,455	-	142,465
Other liabilities	80,150	10,317	132,521	60,663	-	283,651
TOTAL LIABILITIES	**21,489,139**	**701,706**	**3,184,188**	**5,477,772**	**20,551**	**30,873,356**
Liquidity gap	(9,070,937)	3,813,291	10,688,461	(618,592)		
Cumulative liquidity gap	(9,070,937)	(5,257,646)	(5,430,815)	(6,049,407)		

Most of the Bank’s interest earning assets and interest bearing liabilities are at fixed rates of interest.

Asset and liability maturity periods and the ability to replace interest liabilities at an acceptable cost when they mature are crucial in determining the Bank’s liquidity and its susceptibility to fluctuation of interest rates and exchange rate.

Currently, a considerable part of customer deposits are repayable on demand. However, the fact that these deposits are diversified by the number and type of customers and the Bank’s previous experience indicate that these deposits are a stable and long-term source of finance for the Bank.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect the value of the financial instruments. The following table presents an analysis of interest rate risk and thus the potential of the Bank for gain or loss. Effective interest rates are presented by categories of financial assets and liabilities to determine interest rate exposure and effectiveness of the interest rate policy used by the Bank.

		2003		2002
	AZM	**USD**	**AZM**	**Other currencies**
ASSETS				
Loans and advances to banks	0.7%	-	-	0.7%
Securities purchased under agreement	5%	-	-	-
Loans and advances to customers	21.1%	19.5%	11.2%	22.9%
Debt securities available-for- sale	-	-	14%	-
LIABILITIES				
Deposits from banks and other credit institutions:				
- due to the NBA	7%	-	7%	-
- due to the State Fund for Support of Entrepreneurs	2%	-	-	-
- due to the International Finance Corporation	-	5.42%	-	-
- time deposits from banks	-	10%	-	-
Customer accounts	11.7%	14.7%	21.1%	14.6%
Finance lease liability	-	20%	-	20%

As disclosed in the maturity analysis above, the maturity dates applicable to the majority of the Bank’s assets and liabilities are relatively short-term. The Bank monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

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 Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Management Board sets limits on the level of exposure by currencies and in total. These limits also comply with the minimum requirements of the NBA. The Bank’s exposure to foreign currency exchange rate risk is presented in the table below:

	AZM	USD 1 USD= AZM 4,923	EUR 1 EUR= AZM 6,195	Other currencies	Currency undefined (incl. allowance for losses)	2003 AZM thousand Total
ASSETS						
Cash and balances with the NBA	5,273,234	4,747,772	1,090	1,587	-	10,023,683
Loans and advances to banks, less allowance for loan losses	-	3,964,106	1	134,755	-	4,098,862
Securities purchased under agreement to resell	9,002,412	-	-	-	-	9,002,412
Loans and advances to customers, less allowance for loan losses	29,899,745	23,164,070	-	-	(2,318,671)	50,745,144
Investment securities	150,000	-	-	-	-	150,000
Fixed and intangible assets, less accumulated depreciation	3,490,764	-	-	-	-	3,490,764
Other assets	469	110,853	-	-	-	111,322
TOTAL ASSETS	**47,816,624**	**31,986,801**	**1,091**	**136,342**	**(2,318,671)**	**77,622,187**
LIABILITIES						
Deposits from banks and other credit institutions	6,611,000	2,560,076	-	-	-	9,171,076
Customer accounts	24,094,530	28,469,268	1,046,815	141,543	-	53,752,156
Finance lease liability	-	45,621	-	-	-	45,621
Income tax liabilities	580,975	-	-	-	-	580,975
Other liabilities	56,356	-	-	-	198,787	255,143
TOTAL LIABILITIES	**31,342,861**	**31,074,965**	**1,046,815**	**141,543**	**198,787**	**63,804,971**
OPEN POSITION	**16,473,763**	**911,836**	**(1,045,724)**	**(5,201)**		

	AZM	Other currencies	2002 AZM thousand Total
ASSETS			
Cash and balances with the NBA	6,327,707	2,125,575	8,453,282
Loans and advances to banks, less allowance for loan losses	-	3,711,237	3,711,237
Loans and advances to customers, less allowance for loan losses	11,109,482	13,889,687	24,999,169
Investment securities	964,224	-	964,224
Fixed and intangible assets, less accumulated depreciation	2,780,166	-	2,780,166
Current income tax asset	79,263	-	79,263
Other assets, less allowance for losses	26,693	18,277	44,970
TOTAL ASSETS	**21,287,535**	**19,744,776**	**41,032,311**
LIABILITIES			
Deposits from banks	500,000	917,732	1,417,732
Customer accounts	10,255,297	18,774,211	29,029,508
Finance lease liability	-	142,465	142,465
Other liabilities	214,581	69,070	283,651
TOTAL LIABILITIES	**10,969,878**	**19,903,478**	**30,873,356**
OPEN POSITION	**10,317,657**	**(158,702)**	

Market Risk

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market. The Bank is exposed to market risks of its products which are subject to general and specific market fluctuations. The Bank manages market risk through periodic estimation of potential losses that could arise from adverse changes in market conditions and establishing margin and collateral requirements. With respect to undrawn loan commitments the Bank is potentially exposed to loss in an amount equal to the total amount of such commitments. However, the likely amount of loss is less than that, since most commitments are contingent upon certain conditions set out in the loan agreements.

Credit risk

The Bank 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.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers. Limits on the level of credit risk by borrower are reviewed and approved by the Management Board. Actual exposure per borrower against limits is monitored on new loans granted.

Where appropriate, and in the case of most loans, the Bank obtains collateral and corporate guarantees. The credit risks are monitored on a continuous basis and are subject to annual or more frequent reviews especially where no such security can be obtained.

Commitments to extend credit represent unused portions of credit in the form of loans, guarantees or letters of credit. The credit risk on off-balance sheet financial instruments is defined as a probability of losses due to the inability of the counterparty to comply with the contractual terms and conditions. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank applies the same credit policy to the contingent liabilities as it does to the balance sheet financial instruments, i.e. the one based on the procedures for approving the grant of loans, using limits to mitigate the risk, and current monitoring. The Bank monitors the term to maturity of credit commitments because longer term commitments generally have a greater degree of credit risk than shorter-term commitments.

Geographical concentration

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

	Azerbaijan	Other CIS countries	OECD countries	Undefined (incl. allowance for losses)	2003 AZM thousand Total
ASSETS					
Cash and balances with the NBA	10,023,683	-	-	-	10,023,683
Loans and advances to banks, less allowance for loan losses	81,866	134,638	3,882,358	-	4,098,862
Securities purchased under agreement to resell	9,002,412	-	-	-	9,002,412
Loans and advances to customers, less allowance for loan losses	53,063,815	-	-	(2,318,671)	50,745,144
Investment securities	150,000	-	-	-	150,000
Fixed and intangible assets, less accumulated depreciation	3,490,764	-	-	-	3,490,764
Other assets	469	110,853	-	-	111,322
TOTAL ASSETS	**75,813,009**	**245,491**	**3,882,358**	**(2,318,671)**	**77,622,187**
LIABILITIES					
Deposits from banks and other credit institutions	7,999,497	4,828	1,166,751	-	9,171,076
Customer accounts	53,752,156	-	-	-	53,752,156
Finance lease liability	45,621	-	-	-	45,621
Income tax liabilities	580,975	-	-	-	580,975
Other liabilities	56,356	-	-	198,787	255,143
TOTAL LIABILITIES	**62,434,605**	**4,828**	**1,166,751**	**198,787**	**63,804,971**
NET BALANCE SHEET POSITION	**13,378,404**	**240,663**	**2,715,607**		

	Azerbaijan	OECD countries	Non-OECD countries	2002 AZM thousand Total
ASSETS				
Cash and balances with the NBA	8,453,282	-	-	8,453,282
Loans and advances to banks, less allowance for loan losses	121,385	3,577,636	12,216	3,711,237
Loans and advances to customers, less allowance for loan losses	24,999,169	-	-	24,999,169
Investment securities	964,224	-	-	964,224
Fixed and intangible assets, less accumulated depreciation	2,780,166	-	-	2,780,166
Current income tax asset	79,263	-	-	79,263
Other assets, less allowance for losses	44,970	-	-	44,970
TOTAL ASSETS	**37,442,459**	**3,577,636**	**12,216**	**41,032,311**
LIABILITIES				
Deposits from banks	722,459	-	695,273	1,417,732
Customer accounts	29,029,508	-	-	29,029,508
Finance lease liability	142,465	-	-	142,465
Other liabilities	271,276	12,375	-	283,651
TOTAL LIABILITIES	**30,165,708**	**12,375**	**695,273**	**30,873,356**
NET BALANCE SHEET POSITION	**7,276,751**	**3,656,261**	**(683,057)**	