

Joint Stock Commercial Bank “RABITABANK”

**Financial Statements
And Independent Auditors' Report**

For the year ended 31 December 2004

JOINT STOCK COMMERCIAL BANK “RABITABANK”

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1
FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2004:	
Profit and Loss Account	2
Balance Sheet	3
Statement of Changes in Shareholders' Equity	4
Statement of Cash Flows	5-6
Notes to Financial Statements	7-39

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 2004 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.

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 2004, 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 Notes 12 and 19 to the accompanying financial statements. As discussed in these Notes, the Bank had certain loans and advances due to and due from the same banks for the same amounts.



5 August 2005

JOINT STOCK COMMERCIAL BANK "RABITABANK"

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2004 (in Azerbaijan Manats and in thousands)

	Notes	2004	2003
Interest income	4, 26	9,660,947	5,895,157
Interest expense	4, 26	<u>(4,135,375)</u>	<u>(2,059,800)</u>
NET INTEREST INCOME BEFORE (PROVISION)/RECOVERY OF PROVISION FOR LOAN LOSSES		5,525,572	3,835,357
(Provision)/recovery of provision for loan losses	5	<u>(2,007,965)</u>	<u>539,264</u>
NET INTEREST INCOME		<u>3,517,607</u>	<u>4,374,621</u>
Net gain/(loss) on foreign exchange operations	6	73,491	(48,139)
Fees and commission income	7, 26	5,344,915	4,081,365
Fees and commission expense	7	(910,059)	(933,957)
Net gain on investment securities		-	5,000
Dividend income		85,448	-
Other income		<u>555</u>	<u>539</u>
NET NON-INTEREST INCOME		<u>4,594,350</u>	<u>3,104,808</u>
OPERATING INCOME		8,111,957	7,479,429
OPERATING EXPENSES	8, 26	<u>(5,748,429)</u>	<u>(3,851,893)</u>
PROFIT BEFORE OTHER PROVISIONS AND INCOME TAX		2,363,528	3,627,536
Provision for claims, guarantees and other commitments	5	(843,162)	(198,787)
Recovery of provision/(provision) for losses on other transactions	5	<u>15,325</u>	<u>(110,250)</u>
PROFIT BEFORE INCOME TAX		1,535,691	3,318,499
Income tax expense	9	<u>(391,803)</u>	<u>(660,238)</u>
NET PROFIT		<u>1,143,888</u>	<u>2,658,261</u>
Earnings per share (basic and diluted)	10	<u>8</u>	<u>27</u>

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 2004 (in Azerbaijan Manats and in thousands)

	Notes	2004	2003
ASSETS			
Cash and balances with the National Bank of Azerbaijan	11	32,163,207	10,023,683
Loans and advances to banks, less allowance for loan losses	12	6,947,742	4,098,862
Securities purchased under agreement to resell	13	-	9,002,412
Loans and advances to customers, less allowance for loan losses	14, 26	95,212,569	50,745,144
Investment securities:			
- securities available for sale, less allowance for impairment	15	1,152,600	1,152,600
Fixed assets, less accumulated depreciation	16	10,973,977	3,198,945
Intangible assets, less accumulated amortization	17	-	15,144
Other assets, less allowance for losses	18	325,750	387,997
TOTAL ASSETS		<u>146,775,845</u>	<u>78,624,787</u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES:			
Deposits and loans from banks and other credit institutions	19	31,893,784	9,171,076
Customer accounts	20, 26	84,731,671	53,752,156
Debt securities issued	21, 26	5,000,000	-
Finance lease liability	22	-	45,621
Income tax liabilities	9	376,142	580,975
Other liabilities	23, 26	1,240,430	255,143
Total liabilities		<u>123,242,027</u>	<u>63,804,971</u>
SHAREHOLDERS' EQUITY:			
Ordinary share capital	24	15,177,811	14,177,811
Preference share capital	24	2,000,000	2,000,000
Fixed assets revaluation reserve	16	6,570,114	-
Accumulated deficit		(214,107)	(1,357,995)
Total shareholders' equity		<u>23,533,818</u>	<u>14,819,816</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		<u>146,775,845</u>	<u>78,624,787</u>
FINANCIAL COMMITMENTS AND CONTINGENCIES	25	<u>26,939,717</u>	<u>8,597,730</u>

On behalf of the Management Board

Chairman

Chief Accountant

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JOINT STOCK COMMERCIAL BANK "RABITABANK"

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEAR ENDED 31 DECEMBER 2004 (in Azerbaijan Manats and in thousands)

	Ordinary share capital	Preference share capital	Fixed assets revaluation reserve	Accumulated deficit	Total shareholders' equity
31 December 2002	13,177,811	2,000,000	-	(4,016,256)	11,161,555
Share capital increase	1,000,000	-	-	-	1,000,000
Net profit	-	-	-	2,658,261	2,658,261
31 December 2003	14,177,811	2,000,000	-	(1,357,995)	14,819,816
Share capital increase	1,000,000	-	-	-	1,000,000
Revaluation of fixed assets	-	-	6,570,114	-	6,570,114
Net profit	-	-	-	1,143,888	1,143,888
31 December 2004	<u>15,177,811</u>	<u>2,000,000</u>	<u>6,570,114</u>	<u>(214,107)</u>	<u>23,533,818</u>

On behalf of the Management Board

Chairman

Chief Accountant

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JOINT STOCK COMMERCIAL BANK “RABITABANK”

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2004 (in Azerbaijan Manats and in thousands)

	Notes	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income taxes		1,535,691	3,318,499
Adjustments for:			
Provision/(recovery of provision) for loan losses		2,007,965	(539,264)
Recovery of loans and advances to customers previously written-off		36,740	155,432
Provision for claims, guarantees and other commitments		843,162	198,787
(Recovery of provision)/provision for losses on other transactions		(15,325)	110,250
Net gain on investment securities		-	(5,000)
Dividend income		(85,448)	-
Depreciation and amortization expense		342,062	608,394
Loss on disposal of fixed assets		102	3,787
Fixed assets given as a gift		4,659	-
Commissions settled against other liabilities		(22,356)	(66,155)
Net change in interest accruals		484,047	(618,060)
		<u>5,131,299</u>	<u>3,166,670</u>
Cash flow from operating activities before changes in operating assets and liabilities			
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the National Bank of Azerbaijan		(1,848,103)	(650,472)
Loans and advances to banks		(4,006,548)	(82,903)
Loans and advances to customers		(46,542,033)	(24,584,075)
Securities purchased under agreement to resell		9,000,000	(9,000,000)
Other assets		(109,598)	(51,602)
Increase/(decrease) in operating liabilities:			
Deposits from banks and other credit institutions		22,626,158	7,753,344
Customer accounts		30,673,363	24,587,995
Other liabilities		164,481	(161,140)
		<u>15,089,019</u>	<u>977,817</u>
Cash inflows from operating activities before income taxes			
Income tax paid		(596,636)	-
		<u>14,492,383</u>	<u>977,817</u>
Net cash inflows from operating activities			
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of fixed and intangible assets		(1,286,597)	(1,447,779)
Dividends received		22,618	-
Sales of available for sale debt securities		-	787,184
Sale of investment in associate		-	5,000
		<u>(1,263,979)</u>	<u>(655,595)</u>
Net cash outflows from investing activities			
CASH FLOWS FROM FINANCING ACTIVITIES:			
Share capital increase		1,000,000	1,000,000
Debt securities issued		5,000,000	-
Finance lease liability		(45,621)	(96,844)
		<u>5,954,379</u>	<u>903,156</u>
Net cash inflows from financing activities			

JOINT STOCK COMMERCIAL BANK "RABITABANK"

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2004 (CONTINUED) (in Azerbaijan Manats and in thousands)

	Notes	2004	2003
NET INCREASE IN CASH AND CASH EQUIVALENTS		19,182,783	1,225,378
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD	11	<u>10,818,452</u>	<u>9,593,074</u>
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	11	<u><u>30,001,235</u></u>	<u><u>10,818,452</u></u>

Interest paid and received by the Bank in cash during the year ended 31 December 2004 amounted to AZM 3,732,673 thousand and AZM 9,742,292 thousand, respectively.

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.

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”

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2004 (in Azerbaijan Manats and in thousands)

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 12 branches in Azerbaijan.

The number of employees of the Bank at 31 December 2004 and 2003 was 139 and 93, respectively.

As of 31 December 2004 and 2003, the following shareholders owned more than 5% of the issued shares of the Bank:

	2004	2003
	Ownership interest,	Ownership interest,
	%	%
Mr. Nuriyev	47	42
Ms. Mammadova	7	8
Ms. Nuriyeva	5	6
Other individuals	21	22
Other legal entities	20	22
	<hr/>	<hr/>
Total	100	100
	<hr/> <hr/>	<hr/> <hr/>

These financial statements were authorized for issue by the Management Board on 5 August 2005.

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 have been prepared on the historical cost basis, except for the revaluation of certain financial instruments.

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 to 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 the 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.

Functional currency - The functional currency of these financial statements is the Azerbaijan Manat (“AZM”).

3. SIGNIFICANT ACCOUNTING POLICIES

Recognition and measurement of financial instruments - The Bank recognizes financial assets and liabilities on its balance sheet when it becomes a party to the contractual obligation of the instrument. Regular way purchases and sales of the financial assets and liabilities are recognized using settlement date accounting.

Financial assets and liabilities are initially recognized at cost, which is the fair value of the consideration given or received, respectively, net of any transaction costs incurred. 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, unrestricted balances on correspondent accounts with the National Bank of Azerbaijan and central banks of other countries and advances to banks in countries included in the Organization for Economic Co-operation and Development (“OECD”). 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 11).

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 into 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 recorded 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 with fixed maturities are initially recognized in accordance with the policy stated below. The difference between the nominal amount of consideration given and the amortized cost of loans issued at lower than market rates 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 as losses on origination of assets. Subsequently, the carrying amount of such loans is adjusted for amortization of the losses on origination and the related income is recorded as interest income within the profit and loss account using the effective interest method. Loans to customers 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 and advances - Loans are written off against allowance for loan losses in the case of the uncollectibility of loans and advances, including through repossession of collateral. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Bank and after the Bank has received all available collateral. In accordance with the statutory legislation, loans may only be written off with the approval of the Shareholders’ Council and, in certain cases, with the respective decision of the Court.

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, except when all amounts due are fully secured by cash or marketable securities and collection proceedings are in process. Interest income is not recognized if recovery is doubtful. Subsequent payments by borrowers are applied to either principal or delinquent interest based on individual arrangements with the borrower. 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 of 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 the financial assets, which are carried at cost or amortized cost. The allowance for losses is defined as the difference between the carrying amounts and the present value of expected future cash flows, including amounts recoverable from guarantees and collateral.

The determination of the allowance for 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 inherent in the risk assets. Provisions are made as a result of a detailed appraisal of risk assets.

The change in the allowance for loan losses is charged to the profit and loss account and the total of the allowance for losses is deducted in arriving at assets as shown in the balance sheet. Management's evaluation of the allowance is based on the Bank's past loss experience, known and inherent risks in the risk assets, 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 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 losses, it is the judgment of management that the allowance for losses is adequate to absorb losses inherent in the risk assets.

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 estimation is used. Realised and unrealised gains and losses arising from changes in the fair value of securities available-for-sale are included in the profit and loss account in the period in which they arise. Interest earned on securities available-for-sale is reflected in the profit and loss account as interest income on investment securities. Dividends received are included in dividend income in the profit and loss account.

Fixed and intangible assets - Fixed and intangible assets (except for buildings) are stated at cost less accumulated depreciation and any recognized impairment loss. Buildings are stated at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Depreciation and amortization of fixed and intangible assets begins when they are available for use, i.e. when they are in the location and condition necessary for them to be capable of operating in the manner intended by management. Depreciation and amortization on fixed and intangible assets is charged to write off the cost of assets over their estimated useful lives, using the straight-line method at the following annual rates:

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

When buildings are revalued, any accumulated depreciation at the date of the revaluation is eliminated against the gross carrying amount of the building and the net amount restated to the revalued amount of the building.

When carrying amount of a building is increased as a result of a revaluation, the increase is credited directly to equity under the heading of fixed assets revaluation reserve. However, a revaluation increase is recognized as income to the extent that it reverses a revaluation decrease of the same building previously recognized as an expense.

When carrying amount of a building is decreased as a result of a revaluation, the decrease is recognized as an expense. However, a revaluation decrease is charged directly against related fixed assets revaluation reserve to the extent that the decrease does not exceed the amount held in the fixed assets revaluation reserve in respect of that same building.

Properties received in satisfaction of non-performing loans - these are carried at the lower of cost and net realizable value.

Impairment loss - If the recoverable amount of an asset is less than 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 - 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 profit and loss account 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 Bank's current tax expense is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

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 recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or 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.

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 realised. Deferred tax is charged or credited in the profit and loss account, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

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 - Customer 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.

Debt securities issued - Debt securities issued represent bonds issued by the Bank. They are accounted for according to the same principles used for customer and bank deposits.

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 incur any expenses in relation to the provision of pensions to its employees. In accordance with the legal requirements of Azerbaijan, the Bank withholds pension contributions from employee salaries and transfers them to the state pension fund. Current contributions by the Bank are calculated as a percentage of current gross salary payments with the expense charged in the period in which the related salaries are earned. Upon retirement of employees, all pension payments are administered by the above pension fund.

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. The recognition of interest income is suspended when loans become overdue by more than 90 days. Interest income also includes income earned on investment securities. Loan origination fees, if significant, are deferred (together with related direct costs) and recognized as an adjustment to the loan's effective yield. Commission income/expenses are recognized on an accrual basis. Other income is credited to the profit and loss account 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/(loss) on foreign exchange operations.

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

	31 December 2004	31 December 2003
AZM/USD	4,903	4,923
AZM/EUR	6,682	6,195
AZM/RUR	177	167

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.

Financial reporting in hyperinflationary economies - Economy of Azerbaijan was deemed hyperinflationary until towards the end of 1997. International Accounting Standard No. 29 "Financial Reporting in Hyperinflationary Economies" requires that financial statements of all entities that report in the currency of hyperinflationary economy be expressed in terms of the measuring unit current at the balance sheet date to reflect the loss in purchasing power of the entity resulting from hyperinflation.

When an economy ceases to be hyperinflationary, amounts expressed in the measuring unit current at the end of the hyperinflationary period become the new historical basis for subsequent periods.

Reclassifications - Certain reclassifications have been made to the financial statements as of 31 December 2003 and for the year then ended to conform to the presentation as of 31 December 2004 and for the year then ended.

4. NET INTEREST INCOME

Net interest income comprises:

	2004	2003
Interest income		
Interest on loans and advances to customers	9,632,701	5,840,986
Interest on loans and advances to banks	28,246	18,626
Interest on debt securities	-	33,133
Interest on reverse repurchase transactions	-	2,412
	<u>-</u>	<u>2,412</u>
Total interest income	<u>9,660,947</u>	<u>5,895,157</u>
Interest expense		
Interest on customer accounts	3,006,213	1,872,082
Interest on deposits and loans from banks and other institutions	772,433	170,353
Interest on debt securities issued	354,423	-
Interest on finance lease liability	2,306	17,365
	<u>2,306</u>	<u>17,365</u>
Total interest expense	<u>4,135,375</u>	<u>2,059,800</u>
Net interest income before (provision)/recovery of provision for loan losses	<u>5,525,572</u>	<u>3,835,357</u>

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 2002	-	2,702,503	2,702,503
Recovery of provision	-	(539,264)	(539,264)
Recovery of assets previously written off	-	155,432	155,432
	<u>-</u>	<u>155,432</u>	<u>155,432</u>
31 December 2003	-	2,318,671	2,318,671
Provision	49,030	1,958,935	2,007,965
Recovery of assets previously written off	-	36,740	36,740
	<u>-</u>	<u>36,740</u>	<u>36,740</u>
31 December 2004	<u>49,030</u>	<u>4,314,346</u>	<u>4,363,376</u>

The movements in allowances for other losses were as follows:

	Other assets	Guarantees and other commitments	Total
31 December 2002	72,420	-	72,420
Provision	110,250	198,787	309,037
Write-offs	(15,670)	-	(15,670)
	<hr/>	<hr/>	<hr/>
31 December 2003	167,000	198,787	365,787
(Recovery of provision)/provision	(15,325)	843,162	827,837
	<hr/>	<hr/>	<hr/>
31 December 2004	<u>151,675</u>	<u>1,041,949</u>	<u>1,193,624</u>

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

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

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

	2004	2003
Dealing, net	136,466	13,692
Translation differences, net	(62,975)	(61,831)
	<hr/>	<hr/>
Total net gain/(loss) on foreign exchange operations	<u>73,491</u>	<u>(48,139)</u>

7. FEES AND COMMISSION INCOME AND EXPENSE

Fees and commission income and expense comprise:

	2004	2003
Fees and commission income:		
Cash operations	1,637,109	1,247,296
Foreign exchange operations	1,529,505	1,260,642
Settlements	1,402,433	1,038,440
Plastic cards operations	421,627	175,670
Documentary operations	178,213	264,225
Other	176,028	95,092
	<hr/>	<hr/>
Total fees and commission income	<u>5,344,915</u>	<u>4,081,365</u>
Fees and commission expense:		
Plastic cards operations	549,354	323,227
Documentary operations	38,154	238,215
Foreign exchange operations	86,343	63,006
Settlements	171,347	158,058
Cash operations	53,682	90,252
Other operations	11,179	61,199
	<hr/>	<hr/>
Total fees and commission expense	<u>910,059</u>	<u>933,957</u>

8. OPERATING EXPENSES

Operating expenses comprise:

	2004	2003
Salaries and bonuses	1,485,274	1,018,202
Communications	617,597	309,732
Payroll taxes and social security costs	433,506	284,624
Professional services fees	442,079	137,020
Occupancy costs	434,001	242,695
Insurance expense	415,410	177,396
Advertising and marketing expenses	393,878	322,321
Depreciation and amortization expense	342,062	608,394
Office supplies	245,238	259,483
Business travel expenses	202,337	87,788
Other employees' benefits	195,569	29,476
Charity	136,844	158,801
Repairs and maintenance expenses	121,427	61,492
Taxes other than income tax	86,346	76,781
Gift of fixed assets	4,659	-
Loss on disposal of fixed assets	102	3,787
Other	192,100	73,901
	<u>5,748,429</u>	<u>3,851,893</u>
Total operating expenses	<u>5,748,429</u>	<u>3,851,893</u>

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 that may differ from International Financial Reporting Standards. The Bank is subject to certain permanent tax differences due to non-tax deductibility of certain expenses.

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 2004 and 2003 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Tax liabilities consist of the following:

	2004	2003
Current income tax liability	376,142	306,965
Deferred income tax liability	-	274,010
	<u>376,142</u>	<u>580,975</u>
Income tax liabilities	<u>376,142</u>	<u>580,975</u>

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

Temporary differences as of 31 December 2004 and 2003 comprise:

	2004	2003
Deferred assets:		
Fixed and intangible assets	341,291	228,993
Other liabilities	53,693	-
Loans and advances to customers	-	107,452
Investment securities	19,223	19,844
	<u>414,207</u>	<u>356,289</u>
Deferred liabilities:		
Loans and advances to customers	(252,376)	(1,247,664)
Securities purchased under agreement to resell	-	(180,000)
Other assets	(62,830)	-
Investment securities	(60,156)	(70,334)
	<u>(375,362)</u>	<u>(1,497,998)</u>
Net deferred assets/(liabilities)	<u>38,845</u>	<u>(1,141,709)</u>
Deferred income tax asset/(liability) at the statutory rate of 24 %:		
2003 (25 %: 2002)	9,323	(274,010)
Less valuation allowance	(9,323)	-
	<u>-</u>	<u>(274,010)</u>
Net deferred income tax liability	<u>-</u>	<u>(274,010)</u>

Relationships between tax expenses and accounting profit for the year ended 31 December 2004 and 2003 are explained as follows:

	2004	2003
Profit before income taxes	<u>1,535,691</u>	<u>3,318,499</u>
Statutory tax rate	24%	25%
Theoretical tax at the statutory tax rate	368,566	829,625
Tax effect of permanent differences	13,914	(180,804)
Change in valuation allowance	9,323	-
Effect of changes in income tax rate	<u>-</u>	<u>11,417</u>
Income tax expense	<u>391,803</u>	<u>660,238</u>
Current income tax expense	391,803	386,228
Deferred income tax expense	<u>-</u>	<u>274,010</u>
Income tax expense	<u>391,803</u>	<u>660,238</u>
Deferred income tax liability		
At beginning of the period	(274,010)	-
Decrease/(increase) in deferred income tax liability	<u>274,000</u>	<u>(274,010)</u>
At end of the period	<u>-</u>	<u>(274,010)</u>

10. EARNINGS PER SHARE

Earnings per share are calculated as follows:

	2004	2003
Net income for the year	1,143,888	2,658,261
Less dividends declared on preference shares	<u>(250,000)</u>	<u>-</u>
Net income for the year attributable to ordinary shareholders	<u>893,888</u>	<u>2,658,261</u>
Weighted average number of ordinary shares for basic and diluted earnings per share	<u>110,691</u>	<u>97,309</u>
Earnings per share (basic and diluted)	<u>8</u>	<u>27</u>

11. CASH AND BALANCES WITH THE NATIONAL BANK OF AZERBAIJAN

Cash and balances with the National Bank of Azerbaijan comprise:

	2004	2003
Cash on hand	9,936,535	6,431,150
Balances with the National Bank of Azerbaijan	<u>22,226,672</u>	<u>3,592,533</u>
Total cash and balances with the National Bank of Azerbaijan	<u>32,163,207</u>	<u>10,023,683</u>

The balances with the NBA as of 31 December 2004 and 2003 include AZM 4,935,692 thousand and AZM 3,087,589 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:

	2004	2003
Cash and balances with the National Bank of Azerbaijan	32,163,207	10,023,683
Loans and advances to banks in OECD countries	<u>3,116,930</u>	<u>3,882,358</u>
	35,280,137	13,906,041
Less minimum reserve deposit with the National Bank of Azerbaijan	(4,935,692)	(3,087,589)
Less restricted deposits with banks in OECD countries (Note 12)	<u>(343,210)</u>	<u>-</u>
Total cash and cash equivalents	<u>30,001,235</u>	<u>10,818,452</u>

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

Loans and advances to banks comprise:

	2004	2003
Advances to banks	4,202,062	4,098,862
Loans to banks	2,451,500	-
Restricted deposits	<u>343,210</u>	<u>-</u>
	6,996,772	4,098,862
Less allowance for loan losses	<u>(49,030)</u>	<u>-</u>
Total loans and advances to banks, net	<u>6,947,742</u>	<u>4,098,862</u>

Movements in allowance for loan losses for the years ended 31 December 2004 and 2003 are disclosed in Note 5.

As of 31 December 2004 the Bank had a restricted deposit of AZM 343,210 thousand placed with Raiffeisen Bank under letters of credit.

As of 31 December 2004 and 2003 the Bank had advances of AZM 2,515,830 thousand and AZM 2,677,462 thousand, respectively, to Raiffeisen Bank. As of 31 December 2004 the Bank had a loan to Azerdemiryolbank JSB of AZM 2,451,500 thousand. These exposures exceeded 10% of the Bank's equity as of 31 December 2004 and 2003.

As of 31 December 2004 the Bank's advance of AZM 1,225,750 thousand to Bank of Baku OJSB and loan of AZM 2,451,500 thousand to Azerdemiryolbank JSB were counterbalanced with the same amounts of a loan taken from Bank of Baku OJSB and an amount held on Loro account with Azerdemiryolbank JSB.

13. 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 was payable to the Bank on these bonds. As of 31 December 2003 included in securities purchased under agreement to resell was accrued interest income on the bonds of the Ministry of Finance of Azerbaijan of AZM 2,412 thousand.

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

Loans and advances to customers comprise:

	2004	2003
Originated loans	98,358,184	51,816,151
Accrued interest income on loans and advances to customers	<u>1,168,731</u>	<u>1,247,664</u>
	99,526,915	53,063,815
Less allowance for loan losses	<u>(4,314,346)</u>	<u>(2,318,671)</u>
Total loans and advances to customers, net	<u>95,212,569</u>	<u>50,745,144</u>
Loans collateralized by real estate	39,474,352	13,780,032
Unsecured loans	30,042,608	36,291,187
Loans collateralized by guarantees	10,989,604	-
Loans collateralized by equipment	8,950,756	114,487
Loans collateralized by securities	6,834,199	1,408,152
Loans collateralized by cash	1,415,138	-
Loans collateralized by gold	651,527	222,293
Accrued interest income on loans and advances to customers	<u>1,168,731</u>	<u>1,247,664</u>
	99,526,915	53,063,815
Less allowance for loan losses	<u>(4,314,346)</u>	<u>(2,318,671)</u>
Total loans and advances to customers, net	<u>95,212,569</u>	<u>50,745,144</u>

Movements in allowances for loan losses for the years ended 31 December 2004 and 2003 are disclosed in Note 5.

As of 31 December 2004 and 2003 the Bank had credit exposures to 4 and 6 borrowers totaling AZM 15,365,853 thousand and AZM 17,471,948 thousand, which individually exceeded 10% of the Bank's equity. As of 31 December 2004 and 2003 included in loans and advances to customers are non-accrual loans amounting to AZM 65,280 thousand and AZM 686,566 thousand respectively, on which interest was not accrued.

Analysis by industry	2004	2003
Manufacturing	26,626,115	2,516,931
Trading	21,480,148	22,614,023
Individuals	17,259,205	16,698,032
Construction	10,274,301	5,035
Communication	8,029,996	8,105,020
Services	7,470,277	1,029,093
Agriculture	7,218,142	848,017
Accrued interest income on loans and advances to customers	<u>1,168,731</u>	<u>1,247,664</u>
	99,526,915	53,063,815
Less allowance for loan losses	<u>(4,314,346)</u>	<u>(2,318,671)</u>
Total loans and advances to customers, net	<u>95,212,569</u>	<u>50,745,144</u>

15. INVESTMENT SECURITIES

Investment securities comprise:

Name	Country of incorporation	Ownership interest	2004	2003
CB Azinvestbank	Azerbaijan	1%	550,000	550,000
JSIB Azerigazbank	Azerbaijan	1.88%	452,600	452,600
Baku Stock Exchange	Azerbaijan	2.78%	<u>150,000</u>	<u>150,000</u>
Total equity securities available for sale			<u>1,152,600</u>	<u>1,152,600</u>

16. FIXED ASSETS, LESS ACCUMULATED DEPRECIATION

	Buildings	Computers	Furniture and equipment	Vehicles	Total
At cost/revalued amount					
31 December 2003	2,667,940	763,161	1,742,345	219,171	5,392,617
Additions	375,186	296,012	579,300	286,099	1,536,597
Revaluation	6,023,290	-	-	-	6,023,290
Disposals	-	(5,194)	(2,630)	-	(7,824)
Transfers	-	(18,378)	18,378	-	-
31 December 2004	<u>9,066,416</u>	<u>1,035,601</u>	<u>2,337,393</u>	<u>505,270</u>	<u>12,944,680</u>
Accumulated depreciation					
31 December 2003	463,431	581,581	1,084,788	63,872	2,193,672
Charge for the period	83,393	45,140	135,408	62,977	326,918
Revaluation	(546,824)	-	-	-	(546,824)
Disposals	-	(433)	(2,630)	-	(3,063)
Transfers	-	(10,823)	10,823	-	-
31 December 2004	<u>-</u>	<u>615,465</u>	<u>1,228,389</u>	<u>126,849</u>	<u>1,970,703</u>
Net book value					
31 December 2004	<u><u>9,066,416</u></u>	<u><u>420,136</u></u>	<u><u>1,109,004</u></u>	<u><u>378,421</u></u>	<u><u>10,973,977</u></u>
Net book value					
31 December 2003	<u><u>2,297,262</u></u>	<u><u>533,723</u></u>	<u><u>240,576</u></u>	<u><u>127,384</u></u>	<u><u>3,198,945</u></u>

All buildings of the Bank were revalued by the independent appraisers and their revalued amounts reflect market values of these buildings as of 31 December 2004.

A building with cost of AZM 250,000 thousand was reclassified by the Bank from properties received in satisfaction of non-performing loans in other assets to buildings and is included in additions in the table above as a non-cash item.

As of December 2003 fixed assets include two ATM machines held under a finance lease agreement (Note 22). Upon the expiration of the lease term in 2004 the Bank took ownership over the equipment.

As of 31 December 2003 fixed assets include an ATM machine held under a servicing agreement (Note 23). Upon the full settlement of the liability under the servicing agreement in 2004 the Bank took ownership of the equipment.

17. INTANGIBLE ASSETS, LESS ACCUMULATED AMORTIZATION

	2004	2003
At cost		
1 January	29,000	29,000
Additions	-	-
Disposals	(29,000)	-
	<hr/>	<hr/>
31 December	-	29,000
Accumulated amortization		
1 January	13,856	8,056
Charge for the year	15,144	5,800
Disposals	(29,000)	-
	<hr/>	<hr/>
31 December	-	13,856
Net book value		
31 December	<hr/> <hr/>	<hr/> <hr/>
	-	15,144

18. OTHER ASSETS

Other assets comprise:

	2004	2003
Properties received in satisfaction of non-performing loans	193,675	443,675
Receivables from Western Union	163,712	110,853
Accrued dividends receivable	62,830	-
Prepayments and receivables on other transactions	38,559	-
Settlements on plastic cards	18,344	-
Prepaid taxes other than income tax	305	469
	<hr/>	<hr/>
	477,425	554,997
Provision for doubtful other assets	(151,675)	(167,000)
	<hr/>	<hr/>
Total other assets	<hr/> <hr/>	<hr/> <hr/>
	325,750	387,997

19. DEPOSITS AND LOANS FROM BANKS AND OTHER INSTITUTIONS

Deposits and loans from banks and other institutions comprise:

	2004	2003
Time deposits	27,874,067	8,122,361
Demand deposits	3,923,167	1,048,715
Accrued interest payable	96,550	-
	<u>31,893,784</u>	<u>9,171,076</u>

As of 31 December 2004 the Bank's time deposit of AZM 1,225,750 thousand from Bank of Baku OJSB and demand deposit of AZM 2,451,500 thousand from Azerdemiryolbank JSB were counterbalanced with the same amounts held on Nostro account with Bank of Baku OJSB and loan issued to Azerdemiryolbank JSB.

As of 31 December 2004 and 2003 included in time deposits from banks and other credit institutions are loans from the National Bank of Azerbaijan amounting to AZM 4,200,000 thousand and AZM 2,000,000 thousand, respectively. As of 31 December 2004 and 2003 these liabilities were secured by the real estate in the amount of AZM 4,240,000 thousand and AZM 866,474 thousand, respectively.

As of 31 December 2004 and 2003 included in deposits from banks and other credit institutions is a credit line provided by the International Finance Corporation amounting to AZM 5,883,600 thousand and AZM 1,166,751 thousand, respectively. This 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 6 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 National Fund for Support of Entrepreneurship as a means of support of small and medium-sized entrepreneurs in Azerbaijan. Under the agreement with the Fund as of 31 December 2004 and 2003 the Bank obtained loans amounting to AZM 13,848,667 thousand and AZM 4,611,000 thousand with maturity periods from 3 to 5 years, bearing annual interest rates ranging from 1% to 4%. Subsequently, these funds were used by the Bank to issue loans with the same maturity periods to the companies and individual entrepreneurs in Azerbaijan at annual interest rates of up to 7%. These rates are prescribed by the National Fund for Support of Entrepreneurship and the Bank cannot exceed them.

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 obtained a credit line limited to 800,000 US dollars to finance the projects undertaken by small and medium-sized enterprises with substantial business development impact. As of 31 December 2004 the amount of loan received from the Islamic Corporation for the Development of the Private Sector amounted to AZM 1,225,750 thousand. 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 months 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.

20. CUSTOMER ACCOUNTS

Customer accounts comprise:

	2004	2003
Repayable on demand	46,872,687	30,996,774
Time deposits	37,161,310	22,363,860
Accrued interest expense on customer accounts	697,674	391,522
Total customer accounts	84,731,671	53,752,156

As of 31 December 2003 customer accounts amounting to AZM 30,715,595 thousand were due to 8 customers representing significant concentration forming 57% of customer accounts.

As of 31 December 2004 and 2003 customer accounts of AZM 343,210 thousand and AZM 152,377 thousand, respectively, were held as security against letters of credit issued by the Bank.

Analysis of customer accounts by industry:

	2004	2003
Communication	14,855,004	21,434,354
Individuals	39,222,494	16,902,464
Trading	9,186,398	7,398,496
Construction	15,417,307	4,905,865
Manufacturing	4,332,052	1,867,268
Agriculture	653,690	347,941
Energy	12,835	12,835
Other	354,217	491,411
Accrued interest expense on customer accounts	697,674	391,522
Total customer accounts	84,731,671	53,752,156

21. DEBT SECURITIES ISSUED

Debt securities issued comprise:

	Maturity date	Annual coupon rate	2004	2003
1 year bonds	16 April 2005	10%	5,000,000	-
Total debt securities issued			5,000,000	-

22. 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 2004 and 2003 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:

	2004	2003
Not later than 1 year	-	47,912
Total minimum lease payments	-	47,912
Less interest charges related to future periods	-	(2,291)
Present value of minimum lease payments	-	45,621

23. OTHER LIABILITIES

Other liabilities comprise:

	2004	2003
Provision for claims, guarantees and other commitments	1,041,949	198,787
Professional fees payable	69,426	-
Taxes payable, other than income tax	59,898	34,000
Accrued expenses payable	54,064	-
Settlements on plastic cards	15,043	-
Temporary accounts	50	-
Payable for an ATM machine	-	22,356
Total other liabilities	1,240,430	255,143

Movements in provision for claims, guarantees, and other commitments for the year ended 31 December 2003 are disclosed in Note 5.

In 2002 the Bank entered into a servicing agreement with Azeurotel JV, under which it received an ATM machine. 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.

24. SHARE CAPITAL

As of 31 December 2003 the authorized, issued and fully paid share capital of the Bank amounted to AZM 12,443,231 thousand and comprised 40,195 ordinary shares with par values of AZM 100 thousand, AZM 500 thousand, AZM 1,000 thousand, AZM 5,000 thousand, AZM 10,000 thousand, AZM 20,000 thousand, AZM 25,000 thousand, AZM 40,000 thousand, AZM 50,000 thousand and AZM 100,000 thousand and 20,000 preference shares with a par value of AZM 100 thousand each.

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 104,432 ordinary shares with par value of AZM 100 thousand each and 20,000 preference shares with a par value of AZM 100 thousand each.

On 5 March 2004 the shareholders approved an additional issue of 20,000 ordinary shares with a par value of AZM 100 thousand each. AZM 1,000,000 thousand of these new shares were paid during 2004 resulting in AZM 13,443,231 thousand of authorized, issued and fully paid share capital as of 31 December 2004.

As of 31 December 2004 and 2003 included in share capital is an adjustment of AZM 3,734,580 thousand resulting from the restatement of share capital due to hyperinflationary period of Azerbaijan economy between 1990 and end of 1997.

The holders of ordinary shares are entitled to dividends after holders of preference shares are paid dividends as decided by the shareholders' meeting as well as to the share in the property of the bank in case of liquidation. The holders of preference shares are entitled to receive dividends but are not entitled to vote at shareholders' meeting.

25. 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 2004 and 2003, the nominal or contract amounts and the risk weighted credit equivalents of instruments with off-balance sheet risks were:

	2004		2003	
	Nominal Amount	Risk Weighted Amount	Nominal Amount	Risk Weighted Amount
Guarantees issued and similar commitments	11,880,340	11,880,340	6,356,666	6,356,666
Commitments on credits and unused credit lines	14,716,167	3,274,942	2,088,687	-
Letters of credit secured by customer funds	343,210	-	152,377	-
Total contingent liabilities and credit commitments	26,939,717	15,155,282	8,597,730	6,356,666

The Bank has made a provision of AZM 1,041,949 thousand and AZM 198,787 thousand against guarantees issued as of 31 December 2004 and 2003.

Capital commitments - The Bank had no material commitments for capital expenditures outstanding as of 31 December 2004 and 2003.

Insurance - As of 31 December 2004 and 2003 the Bank's premises were insured for 545,696 US Dollars, commercial liabilities were insured for 1,400,000 US Dollars and 600,000 US Dollars, respectively, 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 are 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 - Azerbaijan commercial legislation and tax legislation in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result 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 has been 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 2004 and 2003, the Bank was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

Operating Environment - The Bank's principal business activities are within Azerbaijan. Laws and regulations affecting the business environment in Azerbaijan 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.

26. 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:

	2004		2003	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Loans to customers, gross	19,074	98,358,184	11,806,725	51,816,151
Accrued interest on loans to customers	273	1,168,731	372,332	1,247,664
Allowance for loans to customers	(381)	(4,314,346)	(366,356)	(2,318,671)
Loans to customers, net	<u>18,966</u>	<u>95,212,569</u>	<u>11,812,701</u>	<u>50,745,144</u>
Customer accounts	<u>1,792,031</u>	<u>84,731,671</u>	<u>15,378,095</u>	<u>53,752,156</u>
Debt securities issued	<u>200,000</u>	<u>5,000,000</u>	<u>-</u>	<u>-</u>
Other liabilities	<u>-</u>	<u>1,240,430</u>	<u>22,355</u>	<u>255,143</u>

During the year ended 31 December 2004 the Bank originated loans and advances to related party customers amounting to AZM 24,240 thousand, and received loans and advances repaid of AZM 11,811,891 thousand. During the year ended 31 December 2003 the Bank originated loans and advances to related party customers amounting to AZM 18,989,920 thousand, and received loans and advances repaid of AZM 15,083,118 thousand.

During the year ended 31 December 2004 the Bank received deposits from related party customers of AZM 4,386,925 thousand and repaid deposits totaling AZM 17,972,989 thousand. During the year ended 31 December 2003 the Bank received deposits from related party customers of AZM 174,055,975 thousand and repaid deposits totaling AZM 159,255,981 thousand.

Included in the profit and loss account for the years ended 31 December 2004 and 2003 are the following amounts, which arose due to transactions with related parties:

	2004		2003	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
	<hr/>	<hr/>	<hr/>	<hr/>
Interest income		9,660,947		5,895,157
- related companies	-		2,152,478	
- key management personnel	1,787		-	
Interest expense		(4,135,375)		(2,059,800)
- related companies	(24,828)		(40,250)	
- key management personnel	(27,096)		(31,725)	
Commission income		5,344,915		4,081,365
- related companies	5,542		718,985	
- key management personnel	439		-	
Operating expenses		(5,748,429)		(3,851,893)
- related companies	(478,678)		(271,566)	
- key management personnel	(190,415)		(91,520)	

Transactions with related parties entered into by the Bank during the years ended 31 December 2004 and 2003 and outstanding as of 31 December 2004 and 2003 were made in the normal course of business and mostly under arms length conditions.

27. 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 2004 and 2003 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 2004 and 2003 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 2004 and 2003 equity securities available for sale are stated at estimated fair value amounting to AZM 1,152,600 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.

Deposits and loans from banks and other institutions - As of 31 December 2004 and 2003 the carrying amount of short-term deposits and deposits repayable on demand of AZM 10,935,767 thousand and AZM 3,393,325 thousand, respectively, is a reasonable estimate of their fair value. As of 31 December 2004 and 2003 long-term deposits from banks other credit institutions are stated at cost of AZM 20,958,017 thousand and AZM 5,777,751 thousand, respectively, which management estimate approximates fair value.

Customer accounts - As of 31 December 2004 and 2003 the carrying amount of short-term deposits and current accounts of the Bank’s customers of AZM 70,289,254 thousand and AZM 43,441,403 thousand, respectively, is a reasonable estimate of their fair value. As of 31 December 2004 and 2003 long-term customer accounts are stated at cost of AZM 14,442,417 thousand and AZM 10,310,753 thousand, respectively, which management estimate approximates fair value.

28. SUBSEQUENT EVENTS

The Bank opened 2 new branches (“Gandja” and “Shamahi”) in Azerbaijan.

The debt securities issued by the Bank described in the Note 21 were fully redeemed at maturity.

The authorized and issued but not paid share capital in the amount of AZM 1,000,000 thousand, as discussed in the Note 24, was paid. Additional 25,000 shares with a par value of 100 thousand each amounting to AZM 2,500,000 thousand were authorized, issued and fully paid.

The shareholders resolved to pay a 12.5% dividend (AZM 250,000 thousand) on the preference shares, which is AZM 12.5 thousand per share.

29. 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.

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
	Other standby letters of credit and other transaction related contingent obligations and commitments on unused loans with the initial maturity of over 1 year
50%	
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 2004				
Total capital	23,533,818	22,531,218	18%	8%
Tier 1 capital	16,963,704	15,961,104	13%	4%
As of 31 December 2003				
Total capital	14,819,816	3,147,768	5%	8%
Tier 1 capital	14,819,816	10,082,626	16%	4%

30. 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 Assets and Liabilities Management Committee 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.

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.

	2004			2003	
	AZM	USD	EUR	AZM	USD
ASSETS					
Loans and advances to banks	-	10%	-	1%	-
Securities purchased under agreement to resell	-	-	-	5%	-
Loans and advances to customers	13%	19%	-	21%	20%
LIABILITIES					
Deposits from banks and other credit institutions:					
- due to the National Bank of Azerbaijan	7%	-	-	7%	-
- due to the State Fund for Support of Entrepreneurs	1%-4%	-	-	2%	-
- due to the International Finance Corporation	-	5.40%-6.47%	-	-	5.42%
- deposits from commercial banks	-	8%-14%	-	-	10%
Customer accounts	8%	12%	12%	12%	15%
Finance lease liability	-	-	-	-	20%

As disclosed in the maturity analysis below, 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.

The analysis of interest rate and liquidity risk on balance sheet transactions is presented in the following tables:

	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 and impairment)	2004 AZM thousand Total
ASSETS								
Loans and advances to customers, net	12,018,022	9,063,319	47,128,355	26,478,253	600,000	3,004,955	(4,243,466)	94,049,438
Total interest bearing assets	12,018,022	9,063,319	47,128,355	26,478,253	600,000	3,004,955	(4,243,466)	94,049,438
Cash and balances with the NBA	27,227,515	-	-	-	-	-	4,935,692	32,163,207
Loans and advances to banks, net	6,653,562	343,210	-	-	-	-	(49,030)	6,947,742
Loans and advances to customers, net	-	-	-	-	-	65,280	(65,280)	-
Investment securities	-	-	-	-	-	-	1,152,600	1,152,600
Fixed assets, net	-	-	-	1,907,561	9,066,416	-	-	10,973,977
Other assets, net	220,920	62,830	193,675	-	-	-	(151,675)	325,750
Interest accrued on interest bearing assets	34,919	1,128,212	-	-	-	5,600	(5,600)	1,163,131
TOTAL ASSETS	46,154,938	10,597,571	47,322,030	28,385,814	9,666,416	3,075,835	1,573,241	146,775,845
LIABILITIES								
Deposits and loans from banks and other institutions	2,652,847	2,000,000	3,690,300	19,732,267	1,225,750	-	-	29,301,164
Customer accounts	2,679,940	2,144,034	17,894,919	14,377,545	64,872	-	-	37,161,310
Debt securities issued	-	-	5,000,000	-	-	-	-	5,000,000
Total interest bearing liabilities	5,332,787	4,144,034	26,585,219	34,109,812	1,290,622	-	-	71,462,474
Deposits and loans from banks and other institutions	2,496,070	-	-	-	-	-	-	2,496,070
Customer accounts	46,872,687	-	-	-	-	-	-	46,872,687
Income tax liabilities	376,142	-	-	-	-	-	-	376,142
Other liabilities	198,481	-	-	-	-	-	1,041,949	1,240,430
Interest accrued on interest bearing liabilities	697,674	96,550	-	-	-	-	-	794,224
TOTAL LIABILITIES	55,973,841	4,240,584	26,585,219	34,109,812	1,290,622	-	1,041,949	123,242,027
Liquidity gap	(9,818,903)	6,356,987	20,736,811	(5,723,998)	8,375,794			
Interest sensitivity gap	6,685,235	4,919,285	20,543,136	(7,631,559)	(690,622)			
Cumulative interest sensitivity gap	6,685,235	11,604,520	32,147,656	24,516,097	23,825,475			
Cumulative interest sensitivity gap as a percentage of total assets	5%	8%	22%	17%	16%			

	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, net	1,147,669	-	-	-	-	-	-	1,147,669
Securities purchased under agreement to resell	9,000,000	-	-	-	-	-	-	9,000,000
Loans and advances to customers, net	<u>9,477,588</u>	<u>9,911,793</u>	<u>20,743,063</u>	<u>10,997,141</u>	<u>-</u>	<u>-</u>	<u>(1,659,560)</u>	<u>49,470,025</u>
Total interest bearing assets	<u>19,625,257</u>	<u>9,911,793</u>	<u>20,743,063</u>	<u>10,997,141</u>	<u>-</u>	<u>-</u>	<u>(1,659,560)</u>	<u>59,617,694</u>
Cash and balances with the NBA	6,936,094	-	-	-	-	-	3,087,589	10,023,683
Loans and advances to banks, net	2,951,193	-	-	-	-	-	-	2,951,193
Loans and advances to customers, net	-	-	-	-	-	686,566	(659,111)	27,455
Investment securities	-	-	-	-	1,152,600	-	-	1,152,600
Fixed assets, net	-	-	-	865,347	2,333,598	-	-	3,198,945
Intangible assets, net	-	-	-	-	15,144	-	-	15,144
Other assets, net	111,322	-	443,675	-	-	-	(167,000)	387,997
Interest accrued on interest bearing assets	<u>1,250,076</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,250,076</u>
TOTAL ASSETS	<u>30,873,942</u>	<u>9,911,793</u>	<u>21,186,738</u>	<u>11,862,488</u>	<u>3,501,342</u>	<u>686,566</u>	<u>601,918</u>	<u>78,624,787</u>
LIABILITIES								
Deposit from banks and other credit institutions	-	-	2,344,610	5,777,751	-	-	-	8,122,361
Customer accounts	7,049,692	413,207	4,590,208	10,280,875	29,878	-	-	22,363,860
Finance lease liability	<u>-</u>	<u>45,621</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>45,621</u>
Total interest bearing liabilities	<u>7,049,692</u>	<u>458,828</u>	<u>6,934,818</u>	<u>16,058,626</u>	<u>29,878</u>	<u>-</u>	<u>-</u>	<u>30,531,842</u>
Deposits from banks and other credit institutions	1,048,715	-	-	-	-	-	-	1,048,715
Customer accounts	30,996,774	-	-	-	-	-	-	30,996,774
Income tax liabilities	-	306,965	274,010	-	-	-	-	580,975
Other liabilities	56,356	-	-	-	-	-	198,787	255,143
Interest accrued on interest bearing liabilities	<u>391,522</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>391,522</u>
TOTAL LIABILITIES	<u>39,543,059</u>	<u>765,793</u>	<u>7,208,828</u>	<u>16,058,626</u>	<u>29,878</u>	<u>-</u>	<u>198,787</u>	<u>63,804,971</u>
Liquidity gap	<u>(8,669,117)</u>	<u>9,146,000</u>	<u>13,977,910</u>	<u>(4,196,138)</u>	<u>3,471,464</u>			
Interest sensitivity gap	<u>12,575,565</u>	<u>9,452,965</u>	<u>13,808,245</u>	<u>(5,061,485)</u>	<u>(29,878)</u>			
Cumulative interest sensitivity gap	<u>12,575,565</u>	<u>22,028,530</u>	<u>35,836,775</u>	<u>30,775,290</u>	<u>30,745,412</u>			
Cumulative interest sensitivity gap as a percentage of total assets	<u>16%</u>	<u>28%</u>	<u>46%</u>	<u>39%</u>	<u>39%</u>			

The majority 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 fluctuations in interest rates and exchange rates.

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 indicates that these deposits are a stable and long-term source of finance for the Bank.

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. 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 4,903	EUR 1 EUR= AZM 6,682	Other currencies	Currency undefined (incl. allowance for losses and impairment)	2004 AZM thousand Total
ASSETS						
Cash and balances with the NBA	27,334,024	4,757,891	69,525	1,767	-	32,163,207
Loans and advances to banks, net	-	6,946,712	-	50,060	(49,030)	6,947,742
Loans and advances to customers, net	52,394,069	47,132,846	-	-	(4,314,346)	95,212,569
Investment securities	1,152,600	-	-	-	-	1,152,600
Fixed assets, net	10,973,977	-	-	-	-	10,973,977
Other assets	304,679	172,746	-	-	(151,675)	325,750
TOTAL ASSETS	92,159,349	59,010,195	69,525	51,827	(4,515,051)	146,775,845
LIABILITIES						
Deposits and loans from banks and other institutions	19,048,667	12,845,117	-	-	-	31,893,784
Customer accounts	40,986,875	42,527,942	1,165,001	51,853	-	84,731,671
Debt securities issued	5,000,000	-	-	-	-	5,000,000
Income tax liabilities	376,142	-	-	-	-	376,142
Other liabilities	129,040	69,426	15	-	1,041,949	1,240,430
TOTAL LIABILITIES	65,540,724	55,442,485	1,165,016	51,853	1,041,949	123,242,027
OPEN BALANCE SHEET POSITION	26,618,625	3,567,710	(1,095,491)	(26)		

	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	1,152,600	-	-	-	-	1,152,600
Fixed assets, less accumulated depreciation	3,198,945	-	-	-	-	3,198,945
Intangible assets, less accumulated amortization	15,144	-	-	-	-	15,144
Other assets	444,144	110,853	-	-	(167,000)	387,997
TOTAL ASSETS	48,986,224	31,986,801	1,091	136,342	(2,485,671)	78,624,787
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	17,643,363	911,836	(1,045,724)	(5,201)		

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 on its products which are subject to general and specific market fluctuations. The Bank manages market risk through periodic estimations of potential losses that could arise from adverse changes in market conditions and establishing and maintaining appropriate stop-loss limits and 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 Supervisory Board twice a year. Actual exposure per borrower against limits is monitored on new loans granted. The Credit Committee may initiate a change in the limits, however this must be approved by the Supervisory Board.

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 non- OECD countries	OECD countries	Undefined (incl. allowance for losses and impairment)	2004 AZM thousand Total
ASSETS					
Cash and balances with the NBA	32,163,207	-	-	-	32,163,207
Loans and advances to banks, net	3,832,684	47,158	3,116,930	(49,030)	6,947,742
Loans and advances to customers, net	99,526,915	-	-	(4,314,346)	95,212,569
Investment securities	1,152,600	-	-	-	1,152,600
Fixed assets, net	10,973,977	-	-	-	10,973,977
Other assets	296,215	8,188	173,022	(151,675)	325,750
TOTAL ASSETS	<u>147,945,598</u>	<u>55,346</u>	<u>3,289,952</u>	<u>(4,515,051)</u>	<u>146,775,845</u>
LIABILITIES					
Deposits and loans from banks and other institutions	23,258,430	2,655,204	5,980,150	-	31,893,784
Customer accounts	84,731,671	-	-	-	84,731,671
Debt securities issued	5,000,000	-	-	-	5,000,000
Income tax liabilities	376,142	-	-	-	376,142
Other liabilities	198,481	-	-	1,041,949	1,240,430
TOTAL LIABILITIES	<u>113,564,724</u>	<u>2,655,204</u>	<u>5,980,150</u>	<u>1,041,949</u>	<u>123,242,027</u>
NET BALANCE SHEET POSITION	<u>34,380,874</u>	<u>(2,599,858)</u>	<u>(2,690,198)</u>		

					2003
	Azerbaijan	Other CIS countries	OECD countries	Undefined (incl. allowance for losses)	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	1,152,600	-	-	-	1,152,600
Fixed assets, less accumulated depreciation	3,198,945	-	-	-	3,198,945
Intangible assets, less accumulated amortization	15,144	-	-	-	15,144
Other assets	444,144	110,853	-	(167,000)	387,997
TOTAL ASSETS	<u>76,982,609</u>	<u>245,491</u>	<u>3,882,358</u>	<u>(2,485,671)</u>	<u>78,624,787</u>
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	<u>62,434,605</u>	<u>4,828</u>	<u>1,166,751</u>	<u>198,787</u>	<u>63,804,971</u>
NET BALANCE SHEET POSITION	<u>14,548,004</u>	<u>240,663</u>	<u>2,715,607</u>		