

Bank of Baku

Independent Auditors' Report

Financial Statements

Year Ended 31 December 2002

BANK OF BAKU

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INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of the Joint Stock Commercial Bank "Bank of Baku".

We have audited the accompanying balance sheet of the Joint Stock Commercial Bank "Bank of Baku" ("the Bank") as at 31 December 2002 and the related profit and loss account, statement of cash flows and statement of 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 of the Bank for the year ended 31 December 2001 were audited by another auditor whose report dated 10 May 2002 expressed an unqualified opinion on those statements with emphasis to the state of the Azerbaijan economy.

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 2002, and the results of its operations and its cash flows for the year then ended, in accordance with International Accounting Standards.

Deloitte & Touche

24 April 2003

BANK OF BAKU

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2002 (in thousands of Azerbaijan Manats (AZM))

	Notes	2002	2001
Interest income	3, 19	5,440,239	2,464,124
Interest expenses	3, 19	<u>(1,917,518)</u>	<u>(829,013)</u>
NET INTEREST INCOME BEFORE PROVISION FOR POSSIBLE LOAN LOSSES		3,522,721	1,635,111
Provision for possible loan losses	4	<u>(432,157)</u>	<u>(779,444)</u>
NET INTEREST INCOME		<u>3,090,564</u>	<u>855,667</u>
Net gain on foreign exchange operations		308,796	382,573
Fee and commission income		1,418,873	830,930
Fee and commission expense		(402,072)	(343,086)
Other income		<u>18,957</u>	<u>-</u>
NET NON-INTEREST INCOME		<u>1,344,554</u>	<u>870,417</u>
OPERATING INCOME		4,435,118	1,726,084
OPERATING EXPENSES	5	<u>(1,923,133)</u>	<u>(1,079,097)</u>
PROFIT BEFORE OTHER PROVISIONS AND LOSSES AND INCOME TAX		2,511,985	646,987
Provision for possible losses on other transactions	4	<u>(42,025)</u>	<u>-</u>
PROFIT BEFORE INCOME TAX		2,469,960	646,987
Income tax expense	6	<u>(725,469)</u>	<u>(229,028)</u>
NET PROFIT		<u><u>1,744,491</u></u>	<u><u>417,959</u></u>

On behalf of the Board

Chairman

Chief Accountant

The notes on pages 7 to 25 form an integral part of these financial statements. The Independent Auditors' Report is on page 1.

BANK OF BAKU

BALANCE SHEET

AT 31 DECEMBER 2002

(in thousands of Azerbaijan Manats (AZM))

	Notes	2002	2001
ASSETS:			
Cash and balances with the NBA	7	4,907,126	2,082,028
Loans and advances to banks, less allowance for possible loan losses	8	1,053,621	2,355,661
Loans and advances to customers, less allowance for possible loan losses	9, 19	31,785,601	18,141,484
Investment securities	10	400,227	200,000
Fixed and intangible assets, less accumulated depreciation	11	1,610,957	1,484,724
Other assets	12	638,431	246,820
Deferred tax asset	6	237,645	111,387
TOTAL ASSETS		40,633,608	24,622,104
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES:			
Deposits from banks	13	14,913,012	6,925,030
Customer accounts	14, 19	11,220,805	8,234,195
Other liabilities	15	1,162,056	230,985
Total liabilities		27,295,873	15,390,210
SHAREHOLDERS' EQUITY:			
Share capital	16	10,677,106	8,220,756
Retained earnings		2,660,629	1,011,138
Total shareholders' equity		13,337,735	9,231,894
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		40,633,608	24,622,104

On behalf of the Board

Chairman

Chief Accountant

The notes on pages 7 to 25 form an integral part of these financial statements. The Independent Auditors' Report is on page 1.

BANK OF BAKU

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2002 (in thousands of Azerbaijan Manats (AZM))

	Notes	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income taxes		2,469,960	646,987
Adjustments for:			
Provisions for possible loan losses, net of write-offs		432,157	779,444
Net change in accruals		(186,633)	205,802
Depreciation charge on fixed and intangible assets		274,809	222,714
		<u>2,990,293</u>	<u>1,854,947</u>
Operating profit before changes in operating assets and liabilities and interest paid and received			
Changes in operating assets and liabilities:			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the NBA		(694,036)	(133,823)
Loans and advances to banks		360,105	(7,162)
Loans and advances to customers		(13,760,364)	(10,131,433)
Other assets		(391,612)	(463,442)
Increase in operating liabilities:			
Deposits from banks		8,007,561	19,464
Customer accounts		2,950,788	4,394,457
Other liabilities		126,404	5,544,763
Cash outflow from operating activities before income taxes and interest paid and received		<u>(410,861)</u>	<u>1,077,771</u>
Income taxes paid		<u>(155,001)</u>	<u>(213,684)</u>
Net cash (outflow) / inflow from operating activities		<u>(565,862)</u>	<u>864,087</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of fixed and intangible assets		(401,042)	(1,247,004)
Purchase of investment securities		(389,576)	(61,220)
Net cash outflows from investing activities		<u>(790,618)</u>	<u>(1,308,224)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Share capital issued		2,456,350	2,250
Dividends paid		(95,000)	-
Net cash inflow from financing activities		<u>2,361,350</u>	<u>2,250</u>

BANK OF BAKU

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2002 (CONTINUED) *(in thousands of Azerbaijan Manats (AZM))*

	Notes	2002	2001
NET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS		1,004,870	(441,887)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	7	<u>3,641,973</u>	<u>4,083,860</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	7	<u><u>4,646,843</u></u>	<u><u>3,641,973</u></u>

On behalf of the Board

Chairman

Chief Accountant

The notes on pages 7 to 25 form an integral part of these financial statements. The Independent Auditors' Report is on page 1.

BANK OF BAKU

STATEMENT OF SHAREHOLDERS' EQUITY FOR THE YEAR ENDED 31 DECEMBER 2002 (in thousands of Azerbaijan Manats (AZM))

	Notes	Share capital	Retained earnings	Total shareholders' equity
Balance 31 December 2000		8,218,506	593,179	8,811,685
Issue of share capital		2,250	-	2,250
Net profit		-	417,959	417,959
		<hr/>	<hr/>	<hr/>
Balance 31 December 2001	16	8,220,756	1,011,138	9,231,894
Issue of share capital		2,456,350	-	2,456,350
Net profit		-	1,744,491	1,744,491
Dividends		-	(95,000)	(95,000)
		<hr/>	<hr/>	<hr/>
Balance 31 December 2002	16	<u>10,677,106</u>	<u>2,660,629</u>	<u>13,337,735</u>

On behalf of the Board

Chairman

Chief Accountant

The notes on pages 7 to 25 form an integral part of these financial statements. The Independent Auditors' Report is on page 1.

BANK OF BAKU

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2002
(in thousands of Azerbaijan Manats (AZM))**

1. ORGANISATION

“Bank of Baku” (the “Bank”) is a joint stock society, which was established on 14 February 1994 as the commercial bank “Tugai”. On 18 September 1997 it was re-registered as “Bank of Baku”, Closed Joint Stock Commercial Bank with the Ministry of Justice of the Azerbaijan Republic. The address of its registered office is as follows: 40/42 Ataturk Avenue, Baku, 370069, Azerbaijan. The Bank is regulated by the National Bank of Azerbaijan (the “NBA”) and conducts its business under a general banking license # 191. The Bank’s principal business activities are commercial and retail banking operations.

The Bank provides commercial banking services to its customers through the Head Office and a branch located at the following address: 65 Neftchilar Avenue, Baku, 370004, Azerbaijan.

The number of employees of the Bank at 31 December 2002 and 2001 was 50 and 23, respectively.

These financial statements were authorized for issue by the Board of Directors on 24 April 2003.

The Bank’s principal business activities are within the Azerbaijan Republic. Laws and regulations affecting businesses operating 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.

Business risks - In spite of the progress of the economy the Azerbaijan Republic has been experiencing political and economic changes which affected, and may continue to affect, the activities of enterprises operating in this environment. The economy is largely dependent on the success of oil sector development and fluctuations in oil prices. Consequently, operations in the Azerbaijan Republic involve risks, which do not typically exist in markets of developed countries.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting basis - These financial statements of the Bank have been prepared on the accruals basis of accounting, under the historical cost convention.

The Bank maintains its accounting records in accordance with the legislative requirements of the Azerbaijan Republic. These financial statements have been prepared from the Azerbaijan statutory accounting records and have been adjusted to conform to the International Accounting Standards (“IAS”).

The preparation of financial statements in conformity with IAS 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 the fair value of financial instruments.

Reporting currency - The currency used in these financial statements is the Azerbaijan Manat (“AZM”).

Cash and cash equivalents - Cash and cash equivalents include cash, unrestricted balances with the NBA, advances to banks and public debt securities of the trading portfolio, which may be converted to cash within a short period of time. For the purposes of determining cash flows, the minimum reserve deposit required by the NBA is not included as cash equivalents due to restrictions on its availability.

Originated loans - Loans originated by the Bank are financial assets that are created by the Bank by providing money directly to a borrower or by participating in loan facilities. Originated loans are carried at amortized cost, less any provision for possible loan losses.

Allowance for possible loan losses - The determination of the allowance for possible loan losses is based on an analysis of the loan portfolio and reflects the amount that, 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 the previous experience.

The total increase in the allowance for possible loan losses is charged to profit and loss account and the total of the allowance for possible loan losses is deducted in arriving at loans and advances to customers and banks. 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 borrowers' ability to repay, the estimated value of any underlying collateral and current economic conditions.

It should be understood that estimates of possible 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 estimated allowance for possible loan losses, it is the judgment of management that the allowance for possible loan losses is adequate to absorb losses inherent in the loan portfolio.

Write off of loans - Loans are written off against the allowance for possible loan losses in case of the uncollectibility of loans and advances, including the repossession of collateral.

Non-accrual loans - Loans are placed on a non-accrual status when interest is in arrears of payment for more than 30 days.

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.

Depreciation - 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	3%
Vehicles	20%
Computer equipment	20%
Furniture and fixtures	14%
Intangible assets	25%

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.

Foreign currency transactions - Assets and liabilities denominated in foreign currencies are translated at the appropriate spot rates of exchange ruling at the balance sheet date. Profits and losses arising from these translations are included in net gain on foreign exchange operations.

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.

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 2002	31 December 2001
AZM/USD	4,893.00	4,775.00
AZM/EUR	5,080.16	4,230.00
AZM/RUR	153.94	158.43

Income tax - 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 liability method at the statutory tax rate. Deferred tax assets and liabilities, if any, which result from temporary differences, are provided for in full. 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;
- 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 each future period in which significant amounts of deferred tax liabilities and assets are expected to be settled or recovered.

Reclassification - The comparative figures for 2001 were reclassified and restated to comply with the financial statements presentation requirements as at 31 December 2002.

3. NET INTEREST INCOME BEFORE PROVISION FOR POSSIBLE LOAN LOSSES

	2002	2001
Interest income		
Interest on loans and advances to customers	5,292,559	2,314,981
Interest on loans and advances to banks	82,308	110,974
Interest on trading and investment securities	62,272	38,169
Other interest income	3,100	-
	<u>5,440,239</u>	<u>2,464,124</u>
Interest expenses		
Interest on customer accounts	(895,175)	(360,978)
Interest on deposits from banks	(1,019,955)	(468,035)
Interest on debt securities issued	(2,388)	-
	<u>(1,917,518)</u>	<u>(829,013)</u>
Net interest income before provision for possible loan losses	<u><u>3,522,721</u></u>	<u><u>1,635,111</u></u>

4. PROVISION FOR POSSIBLE LOAN LOSSES

	2002	2001
Provisions for possible loan losses		
Provision for loans and advances to banks	9,131	7,162
Provision for loans and advances to customers	423,026	772,282
	<u>432,157</u>	<u>779,444</u>
Provisions for possible losses on other transactions		
Provision for guarantees	42,025	-
	<u>42,025</u>	<u>-</u>

5. OPERATING EXPENSES

	2002	2001
Staff costs	872,148	307,474
Depreciation	274,809	222,714
Rent expenses	169,092	24,304
Communication expenses	109,723	86,087
Advertising and marketing expenses	85,815	26,353
Printing expenses	63,574	9,977
Office supplies expenses	61,074	10,225
Repairs and maintenance expense	59,264	39,395
Business trip expenses	46,699	47,256
Professional services fees	24,587	148,754
Building security	19,272	16,993
Software costs	19,087	1,421
Taxes, other than income tax	19,006	7,058
Membership fees	15,814	16,931
Utility expenses (municipal services)	8,283	63,875
Insurance expenses	2,196	12,437
Other expenses	72,690	37,843
	<u>1,923,133</u>	<u>1,079,097</u>

6. INCOME TAX

The Bank provides for taxes based on the statutory tax accounts maintained and prepared in AZM and in accordance with the Azerbaijan statutory tax regulations, which may differ from IAS.

The Bank is subject to certain permanent tax differences due to non-tax 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 at 31 December 2002 and 2001 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

The components of deferred tax asset at 31 December 2002 and 2001 were as follows:

	2002	2001
Deferred assets:		
Loans and advances to banks, less allowance for possible loan losses	14,955	-
Loans and advances to customers, less allowance for possible loan losses	750,919	215,535
Tangible and intangible assets, less accumulated depreciation	86,844	81,186
Other liabilities	97,860	126,776
Total deferred assets	<u>950,578</u>	<u>423,497</u>
Deferred liabilities:		
Other assets, less allowance for possible losses	-	10,951
Total deferred liabilities	<u>-</u>	<u>10,951</u>
Net deferred assets	<u>950,578</u>	<u>412,546</u>
Net deferred tax asset at the statutory rate (25% for 2002, 27% for 2001)	<u>237,645</u>	<u>111,387</u>

The relationships between tax expenses and accounting profit for the year ended 31 December 2002 and 2001 are explained as follows:

	2002	2001
Profit before income taxes	<u>2,469,960</u>	<u>646,987</u>
Tax at the statutory tax rate (27% for 2002 and 2001)	666,889	174,686
Tax effect of permanent differences	77,591	54,342
Effect of changes in income tax rate	<u>(19,011)</u>	<u>-</u>
Income tax expense	<u>725,469</u>	<u>229,028</u>
Current income tax expense	851,727	36,698
Deferred tax (credit)/ expense	<u>(126,258)</u>	<u>192,330</u>
Income tax expense	<u>725,469</u>	<u>229,028</u>
Deferred income tax assets		
At beginning of the period	111,387	303,717
Increase/(decrease) in deferred income tax for the period	<u>126,258</u>	<u>(192,330)</u>
At end of the period	<u>237,645</u>	<u>111,387</u>

7. CASH AND BALANCES WITH THE NBA

The balances with the NBA are AZM 2,098,974 thousand and AZM 584,508 thousand as at 31 December 2002 and 2001, respectively. These balances include a mandatory reserve deposit of AZM 1,109,235 thousand and AZM 415,199 thousand as at 31 December 2002 and 2001, respectively.

Cash and cash equivalents for the purposes of the statement of cash flows are comprised of the following:

	2002	2001
Cash and balances with the NBA	4,907,126	2,082,028
Loans and advances to banks maturing up to 3 months	848,952	1,775,144
Investment securities with original maturities of less than 3 months	-	200,000
Less minimum reserve deposit with the NBA	<u>(1,109,235)</u>	<u>(415,199)</u>
Cash and cash equivalents	<u>4,646,843</u>	<u>3,641,973</u>

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

	2002	2001
Loans to banks	29,775	842,654
Advances to banks	1,040,562	1,520,169
	<u>1,070,337</u>	<u>2,362,823</u>
Less allowance for possible loan losses	<u>(16,716)</u>	<u>(7,162)</u>
	<u>1,053,621</u>	<u>2,355,661</u>
Allowance for possible loan losses:	2002	2001
At beginning of the period	7,162	-
Provision for the period	9,131	7,162
Foreign exchange difference	423	-
	<u>16,716</u>	<u>7,162</u>

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

	2002	2001
Originated loans	33,964,781	19,967,146
Less allowance for possible loan losses	<u>(2,179,180)</u>	<u>(1,825,662)</u>
	<u>31,785,601</u>	<u>18,141,484</u>
	2002	2001
Loans collateralized by deposits and securities	2,491,798	-
Loans collateralized by real estate	6,724,543	10,627,177
Loans collateralized by inventories	11,757,118	4,416,646
Loans collateralized by other types of collateral	5,532,020	-
Non-collateralized loans	7,459,302	4,923,323
	<u>33,964,781</u>	<u>19,967,146</u>
Less allowance for possible loan losses	<u>(2,179,180)</u>	<u>(1,825,662)</u>
	<u>31,785,601</u>	<u>18,141,484</u>
Allowance for possible loan losses	2002	2001
At beginning of the period	1,825,662	1,301,208
Provision for the period	423,026	772,282
Loan write-offs against provision	(112,797)	(247,828)
Foreign exchange differences	43,289	-
	<u>2,179,180</u>	<u>1,825,662</u>

As at 31 December 2002 the Bank had two exposures totaling AZM 6,393,159 thousand, which individually exceeded 10% of the Bank's equity at the respective date.

As at 31 December 2002 and 2001 included in loans and advances to banks are non-performing loans amounting to AZM 120,779 thousand and AZM 245,905 thousand, respectively.

Analysis by sector	2002	2001
Manufacturing	7,469,649	1,143,840
Agricultural	1,420,819	451,046
Construction	145,471	1,192,327
Wholesale and retailing	10,079,977	5,420,110
Consumer loans	13,998,853	11,759,823
Other	850,012	-
	<u>33,964,781</u>	<u>19,967,146</u>
Less allowance for possible loan losses	<u>(2,179,180)</u>	<u>(1,825,662)</u>
	<u>31,785,601</u>	<u>18,141,484</u>

10. INVESTMENT SECURITIES

Treasury bills are short-term government securities issued by the Ministry of Finance of the Azerbaijan Republic and purchased at a discount.

	2002 Carrying value	2001 Carrying value
Treasury bills	381,603	192,027
Accrued interest receivable	<u>18,624</u>	<u>7,973</u>
	<u>400,227</u>	<u>200,000</u>

11. FIXED AND INTANGIBLE ASSETS, LESS ACCUMULATED DEPRECIATION

	Building	Computers and office equipment	Furniture and fixtures	Other tangible and intangible assets	Total
At cost					
At 31 December 2001	1,159,700	567,933	227,140	205,104	2,159,877
Additions	-	313,870	51,740	56,759	422,369
Disposals	-	(107)	(2,924)	(37,300)	(40,331)
	<u>1,159,700</u>	<u>881,696</u>	<u>275,956</u>	<u>224,563</u>	<u>2,541,915</u>
At 31 December 2002	1,159,700	881,696	275,956	224,563	2,541,915
Accumulated depreciation					
At 31 December 2001	-	(444,002)	(162,931)	(68,220)	(675,153)
Charge for the period	(35,139)	(142,846)	(33,835)	(62,989)	(274,809)
Disposals	-	-	2,842	16,162	19,004
	<u>-</u>	<u>-</u>	<u>2,842</u>	<u>16,162</u>	<u>19,004</u>
At 31 December 2002	(35,139)	(586,848)	(193,924)	(115,047)	(930,958)
	<u>(35,139)</u>	<u>(586,848)</u>	<u>(193,924)</u>	<u>(115,047)</u>	<u>(930,958)</u>
Net book value					
At 31 December 2002	<u><u>1,124,561</u></u>	<u><u>294,848</u></u>	<u><u>82,032</u></u>	<u><u>109,516</u></u>	<u><u>1,610,957</u></u>
Net book value					
At 31 December 2001	<u><u>1,159,700</u></u>	<u><u>123,931</u></u>	<u><u>64,209</u></u>	<u><u>136,884</u></u>	<u><u>1,484,724</u></u>

12. OTHER ASSETS

	2002	2001
Prepaid taxes	365,305	245,478
Deferred expenses	160,566	-
Items in course of collection	79,470	-
Other	33,090	1,342
	<u>638,431</u>	<u>246,820</u>

13. DEPOSITS FROM BANKS

	2002	2001
Demand deposits	6,515,161	727,473
Term deposits	8,397,851	6,197,557
	<u>14,913,012</u>	<u>6,925,030</u>

14. CUSTOMER ACCOUNTS

	2002	2001
Repayable on demand	2,895,084	2,365,047
Term deposits	8,325,721	5,869,148
	<u>11,220,805</u>	<u>8,234,195</u>

15. OTHER LIABILITIES

	2002	2001
Withholdings and other taxes payable	897,938	-
Accrued expenses	97,860	205,802
Deferred income on Treasury Bills	-	7,974
Items in course of settlement	-	17,209
Leases received y the bank	29,358	-
Provision on off-balance sheet commitments	42,025	-
Payables to shareholders	94,875	-
	<u>1,162,056</u>	<u>230,985</u>

In March 2002 upon the decision of the General Board Meeting of the Bank dividends for 2001 in the amount of AZM 95,000 thousand were declared. In 2002 the shareholders allocated AZM 94,875 thousand of dividends as a contribution to the share capital (AZM 95,000 thousand less 10% tax paid on the dividends to the legal entity). However, as at 31 December 2002 and up to the date when these financial statements were authorized for issue this share capital increase was not yet registered by the State Securities Committee.

16. SHARE CAPITAL

At 31 December 2002 the authorized and issued share capital comprised 1,758 ordinary shares with par value of AZM 4,000,000 each and 765 ordinary shares with par value of USD 1,000. At 31 December 2001 the authorized and issued share capital comprised 1,758 ordinary shares with par value of AZM 4,000,000 each and 260 ordinary shares with par value USD 1,000 each. All shares are ranked equally and carry one vote.

The total nominal value of the paid-in share capital as at 31 December 2002 and 2001 comprised AZM 10,677,106 and AZM 8,220,756 thousand, respectively.

According to the decision of the Board of Directors on 30 January 2002, the Bank increased its authorized share capital by 1,010,000 USD (1,010 shares with 1,000 USD par value). The capital increase was registered with the State Securities Committee on 26 March 2002. By 31 December 2002 505 shares were paid in.

At 31 December 2002 the paid-in share capital is held as follows:

Shareholder	2002 Paid-in capital (in AZM thousand)	2001 Paid-in capital (in AZM thousand)
Legal entities	4,621,158	2,189,128
Individuals	<u>6,055,948</u>	<u>6,031,628</u>
	<u>10,677,106</u>	<u>8,220,756</u>

17. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

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 operations.

As at 31 December 2002 and 2001, the nominal or contract amounts and the risk weighted credit equivalents of instruments with off-balance sheet risks were:

	31 December 2002		31 December 2001	
	Nominal Amount	Risk Weighted Amount	Nominal Amount	Risk Weighted Amount
Contingent liabilities and credit commitments				
Guarantees and similar commitments	360,000	360,000	747,700	747,700
Letters of credit and other transactions related to contingent obligations	-	-	398,617	398,617
Commitments on credits and unused credit lines	1,257,649	1,257,649	257,477	257,477

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.

18. CONTINGENCIES

Capital commitments - The Bank had no material commitments for capital expenditures outstanding as at 31 December 2002.

Rental commitments - No material rental commitments were outstanding as at 31 December 2002.

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 - 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 judgments of business activities, if a particular treatment based on Management's judgment of the Bank's business activities were 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 these financial statements. Tax years remain open to review by the state authorities for five years.

19. TRANSACTIONS WITH RELATED PARTIES

Related parties are considered to include shareholders, employees, affiliates and entities under common ownership, control/management with the Bank, or whose activities the Bank has an ability to control. As at 31 December 2002 and 2001, the Bank had advances and loans to customers totaling AZM 41,044 thousand and AZM 566,454 thousand to related parties, respectively. The Bank also held deposits from customers of AZM 961,753 thousand and AZM 135,494 thousand as at 31 December 2002 and 2001, respectively, from related parties.

Included in the profit and loss account for the years ended 31 December 2002 and 2001 is interest in the following amounts which arose due to transactions with related parties:

	2002	2001
Interest and commission income	2,083	59,754
Interest and commission expenses	19,858	4,307

All transactions with related parties entered by the Bank during the years ended 31 December 2002 and 2001 and outstanding as at 31 December 2002 and 2001 were made in the normal course of business and under arm-length conditions.

20. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments are made in accordance with the requirements of IAS 32 and IAS 39. 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 the market from the sale or realization of its full holdings of a particular instrument.

As at 31 December 2002 and 2001 the following methods and assumptions were used by the Bank to estimate the fair value of each class of financial instrument for which it was 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 - For these assets, the carrying amount is a reasonable estimate of fair value.

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 security obtained. Accordingly, the provision for loan losses is considered a reasonable estimate of the discount required to reflect the impact of credit risk for most loans.

Loans and advances from banks - The carrying amount of loans and advances from banks is a reasonable estimate of their fair value.

Customer accounts - The carrying amount of accounts of the Bank's customers is a reasonable estimate of their fair value.

21. POST BALANCE SHEET EVENTS

On 7 February 2003 dividends in the amount of AZM 2,296,000 for 2002 were declared.

22. CAPITAL ADEQUACY

The Basle Committee on banking supervision guidelines recommend that a bank maintains 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 condition that the total provision for possible loan losses does not exceed 1.25% of the risk weighted assets.

The capital adequacy 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 NBA
0%	State debt securities in AZM
20-100%	Loans and advances to banks
100%	Loans and advances to customers
100%	Guarantees
100%	Other assets

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

Capital amounts and ratios	Amount for capital adequacy purposes (in AZM thousand)	Ratio for capital adequacy purposes	Minimum Required Ratio
At 31 December 2002			
Tier 1 capital	13,339,999	34 %	4 %
Tier 2 capital	13,825,922	36 %	8 %
At 31 December 2001			
Tier 1 capital	9,231,894	36 %	4 %
Tier 2 capital	9,232,214	36 %	8 %

23. RISK MANAGEMENT POLICY

The Bank's activities expose it to a variety of financial risks, including currency risk, liquidity risk, credit risk and market risk. The Bank's overall risk management policy focuses on the unpredictability of financial markets and seeks to minimize the adverse effects on the financial performance of the Bank.

Credit risk -The Bank is monitoring debt service, security and appropriateness of collateral on loans to customers on a regular basis through a credit committee, which consists of members of the Bank's management.

Liquidity and cash flow risks - Liquidity risk is defined as the risk when the maturity of assets and liabilities does not match. The Bank manages this risk in accordance with the NBA regulations and internal control procedures.

Currency risk – Foreign currency denominated assets and liabilities together with purchase and sale commitments give rise to foreign exchange exposure. This exposure is managed by using natural hedges that arise from offsetting foreign currency denominated assets and liabilities. In 2001 the Bank established an Asset and Liability Committee (“ALCO”), which regularly monitors the foreign currency position and makes decisions in line with the expected movements in foreign exchange rates in order to reduce the risk.

Interest rate and market risks – The interest rate risk exposure is managed by using natural hedges that arise from offsetting interest rate sensitive assets and liabilities.

Generally, the Bank has the ability to change interest rates and consequently, changes in interest rates in the market has usually led to revision of contract terms of most financial instruments.

Country risk - The Bank has accounts in foreign banks however its principal business activities are within the Republic of Azerbaijan. The Bank does not contemplate active diversification of its business activities to other countries.

24. MATURITY AND INTEREST RATE RISK ANALYSIS

The following table presents an analysis of interest rate risk and liquidity risk.

							31 December 2002
	Up to 1 month	1 month to 3 months	3 months to 6 months	6 months to 1 year	Over 1 year	Maturity undefined	Total
ASSETS							
Loans and advances to banks, less allowance for possible loan losses	-	-	29,358	-	-	(1,761)	27,597
Loans and advances to customers, less allowance for possible loan losses	7,130,100	3,899,169	3,410,659	9,682,899	9,103,739	(2,040,564)	31,186,002
Investment securities	-	400,227	-	-	-	-	400,227
Total interest bearing assets	7,130,100	4,299,396	3,440,017	9,682,899	9,103,739	(2,042,325)	31,613,826
Cash and balances with the NBAR	3,797,891	-	-	-	-	1,109,235	4,907,126
Loans and advances to banks, less allowance for possible loan losses	848,952	-	14,679	-	177,348	(14,955)	1,026,024
Loans and advances to customers, less allowance for possible loan losses	738,215	-	-	-	-	(138,616)	599,599
Fixed and intangible assets, less accumulated depreciation	-	-	-	-	1,610,957	-	1,610,957
Other assets, less allowance for possible losses	401,591	-	-	-	204,200	32,640	638,431
Deferred tax asset	-	-	-	-	237,645	-	237,645
Total non-interest bearing assets	5,786,649	-	14,679	-	2,230,150	988,304	9,019,782
TOTAL ASSETS	12,916,749	4,299,396	3,454,696	9,682,899	11,333,889	(1,054,021)	40,633,608
LIABILITIES							
Deposits from banks	-	978,600	2,784,650	978,600	3,636,423	-	8,378,273
Customer accounts	732,414	1,020,191	1,525,275	4,983,359	-	-	8,261,239
Total interest bearing liabilities	732,414	1,998,791	4,309,925	5,961,959	3,636,423	-	16,639,512
Deposits from banks	6,534,739	-	-	-	-	-	6,534,739
Customer accounts	2,959,566	-	-	-	-	-	2,959,566
Other liabilities	897,938	-	127,218	94,875	-	42,025	1,162,056
Total non-interest bearing liabilities	10,392,243	-	127,218	94,875	-	42,025	10,656,361
TOTAL LIABILITIES	11,124,657	1,998,791	4,437,143	6,056,834	3,636,423	42,025	27,295,873

	Up to 1 month	1 month to 3 months	3 months to 6 months	6 months to 1 year	Over 1 year
Interest sensitivity gap	<u>6,397,686</u>	<u>2,300,605</u>	<u>(869,908)</u>	<u>3,720,940</u>	<u>5,467,316</u>
Cumulative interest sensitivity gap	<u>6,397,686</u>	<u>8,698,291</u>	<u>7,828,383</u>	<u>11,549,323</u>	<u>17,016,639</u>
Cumulative interest sensitivity gap as a percentage of total assets	<u>16%</u>	<u>21%</u>	<u>19%</u>	<u>28%</u>	<u>42%</u>

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

25. EFFECTIVE INTEREST RATE ANALYSIS

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 analysed by categories of financial assets and liabilities to determine interest rate exposure and effectiveness of the interest rate policy used by the Bank.

	USD		EUR		AZM	
	Min %	Max %	Min %	Max %	Min %	Max %
ASSETS						
Loans and advances to banks	21.0	23.0	-	-	-	-
Loans and advances to customers						
Consumer loans	9.5	56.0	28.0	28.0	16.0	16.0
Commercial loans	14.0	28.0	18.0	30.0	9.5	28.0
LIABILITIES						
Deposits from banks	8.0	15.0	6.9	8.1	7.0	7.0
Customer accounts	4.0	15.0	5.0	5.0	12.0	12.0

26. CURRENCY ANALYSIS

	AZM	USD 1USD= AZM 4,893	EUR 1EUR= AZM 5,080	RUR 1RUR= AZM 154	Currency undefined	31 December 2002 Total
ASSETS						
Cash and balances with the NBA	3,200,074	1,679,170	26,965	917	-	4,907,126
Loans and advances to banks, less allowance for possible loan losses	1,200	828,810	155,395	68,216	-	1,053,621
Loans and advances to customers, less allowance for possible loan losses	3,695,578	24,007,468	4,082,555	-	-	31,785,601
Investment securities	400,227	-	-	-	-	400,227
Fixed and other intangible assets, less accumulated depreciation	-	-	-	-	1,610,957	1,610,957
Other assets, less allowance for possible losses	564,539	73,892	-	-	-	638,431
Deferred tax asset	237,645	-	-	-	-	237,645
TOTAL ASSETS	<u>8,099,263</u>	<u>26,589,340</u>	<u>4,264,915</u>	<u>69,133</u>	<u>1,610,957</u>	<u>40,633,608</u>
LIABILITIES						
Deposits from banks	2,540,000	8,736,589	3,636,423	-	-	14,913,012
Customer accounts	642,326	10,266,607	250,694	61,178	-	11,220,805
Other liabilities	992,813	169,243	-	-	-	1,162,056
TOTAL LIABILITIES	<u>4,175,139</u>	<u>19,172,439</u>	<u>3,887,117</u>	<u>61,178</u>	<u>-</u>	<u>27,295,873</u>
OPEN BALANCE SHEET POSITION	<u>3,924,124</u>	<u>7,416,901</u>	<u>377,798</u>	<u>7,955</u>	<u>1,610,957</u>	

27. GEOGRAPHIC ANALYSIS

	OECD Countries	Non-OECD countries	31 December 2002 Total
ASSETS			
Cash and balances with the NBA	-	4,907,126	4,907,126
Loans and advances to banks, less allowance for possible loan losses	291,742	761,879	1,053,621
Loans and advances to customers, less allowance for possible loan losses	-	31,785,601	31,785,601
Investment securities, less allowance for impairment losses	-	400,227	400,227
Fixed and other intangible assets, less accumulated depreciation	-	1,610,957	1,610,957
Other assets, less allowance for possible losses	-	638,431	638,431
Deferred tax asset	-	237,645	237,645
TOTAL ASSETS	<u>291,742</u>	<u>40,341,866</u>	<u>40,633,608</u>
LIABILITIES			
Deposits from banks	3,636,422	11,276,590	14,913,012
Customer accounts	-	11,220,805	11,220,805
Other liabilities	-	1,162,056	1,162,056
TOTAL LIABILITIES	<u>3,636,422</u>	<u>23,659,451</u>	<u>27,295,873</u>
NET BALANCE SHEET POSITION	<u>(3,344,680)</u>	<u>16,682,415</u>	

The bank had no other balances with OECD countries except as those reported above.