

**Closed Joint Stock
Commercial Bank
“BANK OF BAKU”**

Independent Auditors' Report

Financial Statements
Year Ended 31 December 2003

CLOSED JOINT STOCK COMMERCIAL BANK “BANK OF BAKU”

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheet of the Closed Joint Stock Commercial Bank "Bank of Baku" ("the Bank") as at 31 December 2003 and the related profit and loss account and statements of cash flows and changes in shareholders' equity for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

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



2 April 2004

CLOSED JOINT STOCK COMMERCIAL BANK "BANK OF BAKU"

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

	Notes	2003	2002
Interest income	4, 23	10,181,150	5,440,239
Interest expense	4, 23	<u>(3,644,569)</u>	<u>(1,917,518)</u>
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES		6,536,581	3,522,721
Provision for loan losses	5	<u>(117,340)</u>	<u>(432,157)</u>
NET INTEREST INCOME		<u>6,419,241</u>	<u>3,090,564</u>
Net gain on foreign exchange operations	6	141,133	308,796
Fees and commission income	7, 23	2,232,956	1,418,873
Fees and commission expense	7	(634,657)	(402,072)
Other income	8	<u>45,291</u>	<u>18,957</u>
NET NON-INTEREST INCOME		<u>1,784,723</u>	<u>1,344,554</u>
OPERATING INCOME		8,203,964	4,435,118
OPERATING EXPENSES	9, 23	<u>(4,467,294)</u>	<u>(1,923,133)</u>
PROFIT BEFORE PROVISION FOR GUARANTEES AND OTHER COMMITMENTS AND INCOME TAX		3,736,670	2,511,985
Recovery of provision/(provision) for guarantees and other commitments	5	<u>42,025</u>	<u>(42,025)</u>
PROFIT BEFORE INCOME TAX		3,778,695	2,469,960
Income tax expense	10	<u>(948,484)</u>	<u>(725,469)</u>
NET PROFIT		<u><u>2,830,211</u></u>	<u><u>1,744,491</u></u>

On behalf of the Management Board

Chairman

Chief Accountant

The notes on pages 7 to 36 form an integral part of these financial statements. The Independent Auditors' Report is presented on page 1.

CLOSED JOINT STOCK COMMERCIAL BANK "BANK OF BAKU"

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

	Notes	2003	2002
ASSETS:			
Cash and balances with the National Bank of Azerbaijan	11	5,504,494	4,907,126
Loans and advances to banks, less allowance for loan losses	12	8,535,188	1,053,621
Loans and advances to customers, less allowance for loan losses	13, 23	48,832,162	31,785,601
Investment securities:			
- debt securities available-for-sale	14	-	400,227
Fixed and intangible assets, less accumulated depreciation	15	2,303,458	1,610,957
Income tax assets	10	7,483	237,645
Other assets	16	134,222	638,431
TOTAL ASSETS		65,317,007	40,633,608
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES:			
Deposits from banks and other credit institutions	17	24,988,099	14,913,012
Customer accounts	18, 23	26,175,815	11,220,805
Provisions	19	-	42,025
Income tax liabilities	10	4,080	487,099
Other liabilities	20	277,067	632,932
Total liabilities		51,445,061	27,295,873
SHAREHOLDERS' EQUITY:			
Share capital	21	10,677,106	10,677,106
Reserves		3,194,840	2,660,629
Total shareholders' equity		13,871,946	13,337,735
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		65,317,007	40,633,608
FINANCIAL COMMITMENTS AND CONTINGENCIES	22	5,445,096	2,326,703

On behalf of the Management Board

Chairman

Chief Accountant

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CLOSED JOINT STOCK COMMERCIAL BANK "BANK OF BAKU"

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

	Share capital	Revenue reserve	Total shareholders' equity
31 December 2001	8,220,756	1,011,138	9,231,894
Share capital increase	2,456,350	-	2,456,350
Net profit	-	1,744,491	1,744,491
Dividends	-	(95,000)	(95,000)
31 December 2002	10,677,106	2,660,629	13,337,735
Net profit	-	2,830,211	2,830,211
Dividends	-	(2,296,000)	(2,296,000)
31 December 2003	<u>10,677,106</u>	<u>3,194,840</u>	<u>13,871,946</u>

On behalf of the Management Board

Chairman

Chief Accountant

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CLOSED JOINT STOCK COMMERCIAL BANK "BANK OF BAKU"

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

	Notes	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income taxes		3,778,695	2,469,960
Adjustments for:			
Provision for loan losses, net of write-offs		81,957	319,360
(Recovery of provision)/provision for guarantees and other commitments		(42,025)	42,025
Depreciation charge on fixed and intangible assets		446,370	274,809
Loss on disposal of fixed assets		2,013	21,327
Net change in accruals		(601,448)	8,322
		<u>3,665,562</u>	<u>3,135,803</u>
Cash flow from operating activities before changes in operating assets and liabilities		3,665,562	3,135,803
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the National Bank of Azerbaijan		(187,937)	(694,036)
Loans and advances to banks		(7,558,032)	(226,583)
Loans and advances to customers		(16,793,777)	(13,647,567)
Other assets		504,209	(601,238)
Increase in operating liabilities:			
Deposits from banks and other credit institutions		10,084,022	8,007,561
Customer accounts		14,861,090	2,950,788
Other liabilities		1,790	4,050
		<u>4,576,927</u>	<u>(1,071,222)</u>
Cash inflow/(outflow) from operating activities before income taxes		4,576,927	(1,071,222)
Income tax paid		(1,201,341)	(155,001)
		<u>3,375,586</u>	<u>(1,226,223)</u>
Net cash inflow/(outflow) from operating activities		3,375,586	(1,226,223)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of fixed and intangible assets		(1,175,757)	(422,369)
Proceeds on sale of fixed assets		34,873	-
Purchase of available-for-sale debt securities		-	(189,576)
Sales of available-for-sale debt securities		381,603	-
		<u>(759,281)</u>	<u>(611,945)</u>
Net cash outflows from investing activities		(759,281)	(611,945)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Share capital increase		-	2,456,350
Dividends paid		(2,296,000)	-
		<u>(2,296,000)</u>	<u>2,456,350</u>
Net cash (outflow)/inflow from financing activities		(2,296,000)	2,456,350

CLOSED JOINT STOCK COMMERCIAL BANK "BANK OF BAKU"

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

	Notes	2003	2002
NET INCREASE IN CASH AND CASH EQUIVALENTS		320,305	618,182
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD	11	<u>4,060,155</u>	<u>3,441,973</u>
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	11	<u><u>4,380,460</u></u>	<u><u>4,060,155</u></u>

Interest paid and received by the Bank in cash during the year ended 31 December 2003 amounted to AZM 3,559,584 thousand and AZM 9,852,372 thousand, respectively.

Interest paid and received by the Bank in cash during the year ended 31 December 2002 amounted to AZM 1,933,761 thousand and AZM 5,126,321 thousand, respectively.

On behalf of the Management Board

Chairman

Chief Accountant

The notes on pages 7 to 36 form an integral part of these financial statements. The Independent Auditors' Report is presented on page 1.

CLOSED JOINT STOCK COMMERCIAL BANK “BANK OF BAKU”

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2003

(in Azerbaijan Manats and in thousands, unless otherwise indicated)

1. ORGANISATION

Closed Joint Stock Commercial Bank “Bank of Baku” (the “Bank”) is a closed joint stock company, 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, AZ1069, Azerbaijan. The Bank is regulated by the National Bank of Azerbaijan (the “NBA”) and conducts its business under the general banking license # 191. The Bank’s principal business activities are commercial and retail banking operations.

The Bank has 2 branches in Azerbaijan.

The number of employees of the Bank at 31 December 2003 and 2002 was 78 and 50, respectively.

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

	%
Individuals	56.9
Legal entities	43.1
	<hr/>
	100
	<hr/> <hr/>

These financial statements were authorized for issue by the Management Board on 2 April 2004.

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

2. BASIS OF PRESENTATION

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

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

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

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

3. SIGNIFICANT ACCOUNTING POLICIES

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

Financial assets and liabilities are initially recognized at cost, which is the fair value of consideration given or received, respectively, including or net of any transaction costs incurred, respectively. The accounting policies for subsequent re-measurement of these items are disclosed in the respective accounting policies set out below.

Cash and cash equivalents - Cash and cash equivalents include cash, unrestricted balances on correspondent and time deposit accounts with the National Bank of Azerbaijan with original maturity within 90 days, advances to banks in countries included in the Organization for Economic Co-operation and Development (“OECD”), except for margin deposits for operations with plastic cards. For the purposes of determining cash flows, the minimum reserve deposit required by the National Bank of Azerbaijan is not included as a cash equivalent due to restrictions on its availability (Note 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.

Originated loans - Loans originated by the Bank are financial assets that are created by the Bank by providing money directly to a borrower.

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

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

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

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

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

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

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

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

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

Buildings	5%
Vehicles	20%
Computers	20-25%
Furniture and equipment	20-25%
Other fixed assets	20%
Intangible assets	10%

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

Impairment loss - If the recoverable amount of an asset is less 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.

Operating leases - Leases of assets under which the risks and rewards of ownership are effectively retained with the lesser are classified as operating leases.

Bank as lessee - Lease payments under operating leases are recognized as expenses on a straight-line basis over the lease term and included into operating expenses.

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

Deferred income tax assets and liabilities are offset when:

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

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

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

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

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

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

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

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

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

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

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

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

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

4. NET INTEREST INCOME

Net interest income comprises:

	2003	2002
Interest income		
Interest on loans and advances to customers	10,075,147	5,292,559
Interest on loans and advances to banks	86,630	82,308
Interest on debt securities	19,373	62,272
Other interest income	-	3,100
	<u>10,181,150</u>	<u>5,440,239</u>
Interest expense		
Interest on customer accounts	2,256,700	895,175
Interest on deposits from banks and other credit institutions	1,386,901	1,019,955
Other interest expense	968	2,388
	<u>3,644,569</u>	<u>1,917,518</u>
Net interest income before provision for loan losses	<u>6,536,581</u>	<u>3,522,721</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 2001	7,162	1,825,662	1,832,824
Provision	9,131	423,026	432,157
Write-offs of assets	-	(112,797)	(112,797)
Foreign exchange difference	423	43,289	43,712
	<u>16,716</u>	<u>2,179,180</u>	<u>2,195,896</u>
31 December 2002	16,716	2,179,180	2,195,896
(Recovery)/provision	(13,078)	130,418	117,340
Write-offs of assets	-	(35,383)	(35,383)
Foreign exchange difference	(1,143)	17,100	15,957
	<u>(1,143)</u>	<u>17,100</u>	<u>15,957</u>
31 December 2003	<u>2,495</u>	<u>2,291,315</u>	<u>2,293,810</u>

The movements in allowances for guarantees and other commitments were as follows:

	Guarantees and other commitments
31 December 2001	-
Provision	42,025
	<u>42,025</u>
31 December 2002	42,025
Recovery of provision	(42,025)
	<u>-</u>
31 December 2003	<u>-</u>

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

6. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprise:

	2003	2002
Dealing, net	110,937	139,625
Translation differences, net	30,196	169,171
Total net gain on foreign exchange operations	141,133	308,796

7. FEES AND COMMISSION INCOME AND EXPENSE

Fees and commission income and expense comprise:

	2003	2002
Fees and commission income:		
Cash operations	823,094	593,206
Settlements	606,155	367,601
Foreign exchange operations	368,198	229,820
Plastic cards operations	249,537	74,874
Loans origination fees	177,747	46,565
Documentary operations	5,941	87,704
Other operations	2,284	19,103
Total fees and commission income	2,232,956	1,418,873

	2003	2002
Fees and commission expense:		
Settlements	324,048	289,969
Plastic cards operations	218,229	49,813
Cash transactions	83,155	30,606
Foreign exchange operations	7,117	686
Documentary operations	1,660	30,398
Other operations	448	600
Total fees and commission expense	634,657	402,072

8. OTHER INCOME

Other income comprises AZM 45,291 thousand and AZM 18,957 thousand of fines received from the customers for delays in repayments of loan principals and interests for the years ended 31 December 2003 and 2002, respectively.

9. OPERATING EXPENSES

Operating expenses comprise:

	2003	2002
Salary and bonuses	1,525,534	680,741
Advertising and marketing expenses	707,233	85,815
Rent of office premises	478,951	169,092
Depreciation of fixed and intangible assets	446,370	274,809
Social security costs	400,688	191,407
Professional services fees	257,060	24,587
Office supplies	108,839	124,648
Communication	107,133	109,723
Repairs and maintenance expenses	96,635	59,264
Utilities	61,802	8,283
Travel expenses	53,191	46,699
Premises security	34,391	19,272
Insurance	22,645	2,196
Taxes, other than income tax	21,146	19,006
Software costs	7,861	19,087
Legal fees	7,817	8,350
Loss on disposal of fixed assets	2,013	21,327
Other	127,985	58,827
Total operating expenses	4,467,294	1,923,133

10. INCOME TAXES

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

Income tax assets and liabilities consist of the following:

	2003	2002
Current income tax asset	7,483	-
Deferred income tax asset	-	237,645
Income tax assets	7,483	237,645
	2003	2002
Deferred income tax liability	4,080	-
Current income tax liability	-	487,099
Income tax liabilities	4,080	487,099

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

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as of 31 December 2003 and 2002 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Temporary differences as of 31 December 2003 and 2002 comprise:

	2003	2002
Deferred assets:		
Fixed and intangible assets	192,137	86,844
Loans and advances to banks and customers	-	765,874
Other liabilities	-	97,860
Total deferred assets	192,137	950,578
	2003	2002
Deferred liabilities:		
Provisions	209,135	-
Total deferred liabilities	209,135	-
Net deferred (liabilities)/assets	(16,998)	950,578
Deferred income tax (liability)/asset at the statutory rate of 24 %: 2003 (25 %; 2002)	(4,080)	237,645

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

	2003	2002
Profit before income taxes	3,778,695	2,469,960
Statutory tax rate	25%	27%
Theoretical tax at the statutory tax rate	944,674	666,889
Tax effect of permanent differences	5,732	77,591
Effect of changes in income tax rate	(1,922)	(19,011)
Income tax expense	948,484	725,469
Current income tax expense	706,759	851,727
Deferred income tax expense/(credit)	241,725	(126,258)
Income tax expense	948,484	725,469
	2003	2002
Deferred income tax (liabilities)/assets		
At beginning of the period	237,645	111,387
(Decrease)/increase in the deferred income tax for the period	(241,725)	126,258
At end of the period	(4,080)	237,645

11. CASH AND BALANCES WITH THE NATIONAL BANK OF AZERBAIJAN

Cash and balances with the National Bank of Azerbaijan comprise:

	2003	2002
Cash on hand	2,895,057	1,343,591
Balances with the National Bank of Azerbaijan	<u>2,609,437</u>	<u>3,563,535</u>
Total cash and balances with the National Bank of Azerbaijan	<u>5,504,494</u>	<u>4,907,126</u>

The balances with the NBA as of 31 December 2003 and 2002 include AZM 1,297,172 thousand and AZM 1,109,235 thousand, respectively, which represent the minimum reserve deposits required by the NBA. The Bank is required to maintain the reserve balance at the NBA at all times.

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

	2003	2002
Cash and balances with the National Bank of Azerbaijan	5,504,494	4,907,126
Loans and advances to banks in OECD countries	<u>173,138</u>	<u>262,264</u>
	5,677,632	5,169,390
Less minimum reserve deposit with the National Bank of Azerbaijan	<u>(1,297,172)</u>	<u>(1,109,235)</u>
Total cash and cash equivalents	<u>4,380,460</u>	<u>4,060,155</u>

12. LOANS AND ADVANCES TO BANKS

Loans and advances to banks comprise:

	2003	2002
Loans to banks	8,285,469	221,385
Advances to banks	252,214	848,535
Accrued interest income on loans and advances to banks	<u>-</u>	<u>417</u>
	8,537,683	1,070,337
Less allowance for loan losses	<u>(2,495)</u>	<u>(16,716)</u>
Total loans and advances to banks, net	<u>8,535,188</u>	<u>1,053,621</u>

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

As of 31 December 2003 and 2002, loans and advances to banks include fixed amounts of AZM 147,690 thousand and AZM 146,790 thousand, respectively, placed with the International Bank of Azerbaijan as a guarantee deposit on operations with plastic cards.

As of 31 December 2002 included in loans and advances to banks is a fixed amount of AZM 29,358 thousand placed with Dresdner Bank AG, Germany as a guarantee deposit on Western Union money transfer operations.

As of 31 December 2003 included in loans and advances to banks is cash collateral with Dresdner Bank AG, Germany totaling AZM 8,112,214 thousand, which the Bank is obliged to maintain for the whole lifetime of the credit facility provided by the counterparty. As determined by the loan agreement the cash collateral is remunerated by an annual interest rate of 2% which is fixed for the whole lifetime of the credit facility (Note 17).

As of 31 December 2003 the Bank had loans and advances placed with Dresdner Bank AG, Germany totaling AZM 8,216,547 thousand which exceeded 10% of the Bank's equity and represents significant geographical concentration in Germany forming 96.2% of loans and advances to banks.

13. LOANS AND ADVANCES TO CUSTOMERS

Loans and advances to customers comprise:

	2003	2002
Originated loans	50,158,223	33,347,346
Accrued interest income on loans and advances to customers	<u>965,254</u>	<u>617,435</u>
	51,123,477	33,964,781
Less allowance for loan losses	<u>(2,291,315)</u>	<u>(2,179,180)</u>
Total loans and advances to customers, net	<u>48,832,162</u>	<u>31,785,601</u>
	2003	2002
Loans collateralized by real estate	15,612,226	6,602,300
Loans collateralized by insurance policies	10,709,999	4,953,502
Loans collateralized by goods in turnover	6,442,512	11,543,389
Loans collateralized by deposits and securities	1,650,000	2,446,500
Loans collateralized by others	14,438,984	477,953
Unsecured loans	1,304,502	7,323,702
Accrued interest income on loans and advances to customers	<u>965,254</u>	<u>617,435</u>
	51,123,477	33,964,781
Less allowance for loan losses	<u>(2,291,315)</u>	<u>(2,179,180)</u>
Total loans and advances to customers, net	<u>48,832,162</u>	<u>31,785,601</u>

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

As of 31 December 2003 and 2002 the Bank had 4 and 2 loans totaling AZM 7,469,200 thousand and AZM 6,393,159 thousand, respectively, which individually exceeded 10% of the Bank's equity.

As of 31 December 2003 and 2002 included in loans and advances to customers are non-accrual loans amounting to AZM 519,101 thousand and AZM 738,215 thousand respectively, on which interest was not accrued.

Analysis by industry	2003	2002
Individuals	23,764,479	13,744,372
Trading	13,918,427	9,896,736
Manufacturing	6,097,702	7,333,861
Construction	3,099,891	142,827
Agriculture	1,883,441	1,394,990
Other	1,394,283	834,560
Accrued interest income on loans and advances to customers	965,254	617,435
	51,123,477	33,964,781
Less allowance for loan losses	(2,291,315)	(2,179,180)
Total loans and advances to customers, net	48,832,162	31,785,601

14. INVESTMENT SECURITIES

Investment securities comprised of debt securities available for sale totaling AZM 400,227 thousand as of 31 December 2002.

As of 31 December 2002 included in debt securities available-for-sale above was accrued discount income amounting to AZM 18,624 thousand.

Debt securities available-for-sale are short-term bonds issued by the Ministry of Finance of Azerbaijan at discount to nominal value. The securities are denominated in Azerbaijan Manats with maturity periods of up to one year. The average effective interest rate is 6.7%.

15. FIXED AND INTANGIBLE ASSETS, LESS ACCUMULATED DEPRECIATION

	Buildings	Computers	Furniture and equipment	Vehicles	Other fixed assets	Intangible assets	Total
At cost							
31 December 2002	1,159,700	881,696	275,074	130,059	882	94,504	2,541,915
Additions	-	348,654	608,205	77,424	21,298	120,176	1,175,757
Disposals	-	(21,287)	(27,017)	(55,200)	-	-	(103,504)
Transfers	-	(24,679)	20,818	-	(460)	4,321	-
31 December 2003	<u>1,159,700</u>	<u>1,184,384</u>	<u>877,080</u>	<u>152,283</u>	<u>21,720</u>	<u>219,001</u>	<u>3,614,168</u>
Accumulated depreciation							
31 December 2002	35,139	586,848	193,137	50,593	787	64,454	930,958
Charge for the period	57,985	196,084	141,429	33,631	2,018	15,223	446,370
Disposals	-	(17,824)	(22,586)	(26,208)	-	-	(66,618)
Transfers	-	46,103	(48,924)	2,693	128	-	-
31 December 2003	<u>93,124</u>	<u>811,211</u>	<u>263,056</u>	<u>60,709</u>	<u>2,933</u>	<u>79,677</u>	<u>1,310,710</u>
Net book value							
31 December 2003	<u><u>1,066,576</u></u>	<u><u>373,173</u></u>	<u><u>614,024</u></u>	<u><u>91,574</u></u>	<u><u>18,787</u></u>	<u><u>139,324</u></u>	<u><u>2,303,458</u></u>
Net book value							
31 December 2002	<u><u>1,124,561</u></u>	<u><u>294,848</u></u>	<u><u>81,937</u></u>	<u><u>79,466</u></u>	<u><u>95</u></u>	<u><u>30,050</u></u>	<u><u>1,610,957</u></u>

16. OTHER ASSETS

Other assets comprise:

	2003	2002
Unsettled payments on plastic cards operations and money transfers	52,764	73,891
Prepayments and receivables on other transactions	80	451
Taxes receivable, other than income tax	-	365,305
Prepaid office rent	-	160,566
Other	81,378	38,218
Total other assets	<u><u>134,222</u></u>	<u><u>638,431</u></u>

17. DEPOSITS FROM BANKS AND OTHER CREDIT INSTITUTIONS

Deposits from banks and other credit institutions comprise:

	2003	2002
Time deposits	24,752,701	8,378,272
Demand deposits	224,754	6,515,161
Accrued interest expense on deposits from banks and other credit institutions	<u>10,644</u>	<u>19,579</u>
Total deposits from banks and other credit institutions	<u>24,988,099</u>	<u>14,913,012</u>

As of 31 December 2003 and 2002 included in demand deposits from banks is AZM 210,423 thousand with one and AZM 6,505,207 thousand with two Azerbaijan banks, respectively.

In 2003 the Bank entered into a loan agreement with Dresdner Bank AG, Germany. Under the agreement the Bank obtained an AZM 5,285,254 thousand USD denominated credit line with a maturity period of one year. This credit facility is collateralized by a cash deposit included in loans and advances to banks at fair value of AZM 8,112,214 thousand. Under the loan agreement the interest rate applicable to the outstanding amount of the credit facility may be changed at the option of the lender at any time according to changing market conditions. As of 31 December 2003 it was fixed at an annual interest rate of 3%.

As of 31 December 2003 and 2002 included in deposits from banks and other credit institutions are credit lines provided by the German-Azerbaijan Fund amounting to AZM 10,067,444 thousand and AZM 3,636,423 thousand, respectively. The credit lines were provided to the Bank solely for the Small and Medium Enterprises Loan Program financing under the Framework Agreement concluded on 31 March 2001 with the German-Azerbaijan Fund and the Kreditanstalt fuer Wiederaufbau, Germany. This credit facility has a maturity period of six years and bears a floating interest rate based on six months EURIBOR plus 3.5% premium.

As of 31 December 2003 and 2002 included in deposits from banks and other credit institutions are loans from the National Bank of Azerbaijan amounting to AZM 9,400,000 thousand and AZM 2,540,000 thousand, respectively. The loans have 1 year maturity and bear an annual interest rate of 7%. Subsequently, these credits were released to the corporate borrowers at an annual interest rate of 10%.

18. CUSTOMER ACCOUNTS

Customer accounts comprise:

	2003	2002
Time deposits	20,354,173	8,261,239
Repayable on demand	5,663,240	2,895,084
Accrued interest expense on customer accounts	<u>158,402</u>	<u>64,482</u>
Total customer accounts	<u>26,175,815</u>	<u>11,220,805</u>

Analysis of customer accounts by industry:

	2003	2002
Individuals	18,087,118	9,288,447
Trade	4,784,440	877,360
Manufacturing	127,487	351
Agriculture	13,994	842
Transport and communication	8,627	82,288
Construction	163	1,343
Other	2,995,584	905,692
Accrued interest expense on customer accounts	158,402	64,482
Total customer accounts	<u>26,175,815</u>	<u>11,220,805</u>

19. PROVISIONS

Provisions comprised of the following:

	2003	2002
Provisions for guarantees and other commitments	<u>-</u>	<u>42,025</u>
Total provisions	<u>-</u>	<u>42,025</u>

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

20. OTHER LIABILITIES

Other liabilities comprise:

	2003	2002
Professional fees payable	151,044	97,860
Payables to shareholders	94,875	94,875
Settlements on other transactions	2,500	-
Taxes payable, other than income tax	-	410,839
Other	28,648	29,358
Total other liabilities	<u>277,067</u>	<u>632,932</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% withholding tax paid on dividends to a legal entity). However, as at 31 December 2003 and 2002 and up to the date when these financial statements were authorized for issue this capital increase was not yet registered by the State Securities Committee.

21. SHARE CAPITAL

At 31 December 2003 and 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. All shares are ranked equally and carry one vote.

The total nominal value of the paid-in share capital as at 31 December 2003 and 2002 comprised AZM 10,677,106 thousand.

On 7 March 2003 505 ordinary shares with par value of USD 1,000 each paid in during 2002 were registered with the State Security Committee.

During 2003 AZM 2,296,000 thousand of dividends declared for 2002 were paid to the shareholders.

22. FINANCIAL COMMITMENTS AND CONTINGENCIES

In the normal course of business the Bank is a party to financial instruments with off-balance sheet risk in order to meet the needs of its customers. These instruments, involving varying degrees of credit risk, are not reflected in the balance sheet.

The Bank's maximum exposure to credit loss under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

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

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

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

	2003		2002	
	Nominal Amount	Risk Weighted Amount	Nominal Amount	Risk Weighted Amount
Guarantees issued and similar commitments	-	-	360,000	360,000
Commitments on credits and unused credit lines	5,198,783	-	1,257,649	1,257,649
Total contingent liabilities and credit commitments	5,198,783	-	1,617,649	1,617,649

The Bank has made a provision of AZM 42,025 thousand against guarantees issued as of 31 December 2002.

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

Operating Leases - The Bank's future minimum rental payments under non-cancelable operating leases of the office building in effect as of 31 December 2003 and 2002 are presented in the table below.

	2003	2002
Not later than 1 year	246,313	462,741
Later than 1 year but not later than 5 years	-	246,313
Total operating leases	246,313	709,054

Legal proceedings - As of 31 December 2003 and 2002, the Bank was not engaged in any litigation proceedings. From time to time and in the normal course of business, claims against the Bank can be received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these financial statements.

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

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

23. TRANSACTIONS WITH RELATED PARTIES

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

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

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

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

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

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

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

	2003		2002	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Loans to customers, gross	18,131	51,123,477	11,643	33,964,781
Allowance for loans to customers	(361)	(2,291,315)	(232)	(2,179,180)
Customer deposits	175,991	26,175,815	826,452	11,220,805

During the year ended 31 December 2003 the Bank originated loans to customers - related parties amounting to AZM 49,230 thousand and received loans repaid of AZM 42,742 thousand. The Bank has interest income accrued in respect of loans and advances granted to related parties totaling AZM 88 thousand and AZM 270 thousand as of 31 December 2003 and 2002, respectively.

During the year ended 31 December 2003 the Bank received deposits from customers - related parties totaling AZM 65 thousand and repaid deposits totaling AZM 650,526 thousand. The Bank has interest expense accrued in respect of deposits received from related parties totaling AZM 1,791 thousand and AZM 5,617 thousand as of 31 December 2003 and 2002, respectively.

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

	2003		2002	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Interest income		10,181,150		5,440,239
- directors	16,427		385	
Interest expense		(3,644,569)		(1,917,518)
- directors	(3,389)		(10,988)	
Commission income		2,232,956		1,418,873
- directors	-		1,698	
Operating expenses		(4,467,294)		(1,923,133)
- related companies	(478,951)		(169,092)	
- directors	(280,462)		(186,000)	

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

24. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments is made in accordance with the requirements of IAS 32 “Financial Instruments: Disclosure and Presentation” and IAS 39 “Financial Instruments: Recognition and Measurement”. Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm’s length transaction, other than in a forced or liquidation sale. As no readily available market exists for a large part of the Bank’s financial instruments, judgment is necessary in arriving at fair value, based on current economic conditions and specific risks attributable to the instrument. The estimates presented herein are not necessarily indicative of the amounts the Bank could realize in a market exchange from the sale of its full holdings of a particular instrument.

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

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

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

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 2002 securities available-for-sale are stated at fair value amounting to AZM 381,603 thousand plus accrued discount totaling AZM 18,624 thousand. Fair value of securities available-for-sale was determined with reference to an active market for those securities.

Deposits from banks and other credit institutions - As of 31 December 2003 and 2002 the carrying amount of short-term deposits and deposits repayable on demand of AZM 14,910,011 thousand and AZM 11,257,010 thousand, respectively, is a reasonable estimate of their fair value. As of 31 December 2003 and 2002 long-term deposits from banks other credit institutions are stated at cost of AZM 10,067,444 thousand and AZM 3,636,423 thousand, respectively, which approximates fair value.

Customer accounts - As of 31 December 2003 and 2002 the carrying amount of short-term deposits and current accounts of the Bank’s customers of AZM 19,994,648 thousand and AZM 11,156,323 thousand, respectively, is a reasonable estimate of their fair value. As of 31 December 2003 long-term customer accounts are stated at cost of AZM 6,022,765 thousand which approximates fair value.

25. SUBSEQUENT EVENTS

On 5 January 2004 dividends in the amount of AZM 3,043,991 thousand were declared.

On 5 January 2004 the shareholders approved an additional issuance of 500 ordinary shares with a par value of USD 1,000 each. The shares were paid by the shareholders during March 2004. However, the process of the registration of the changes in share capital with the State Security Committee is still pending.

On 13 February 2004 the Bank entered into a loan agreement with the European Bank for Reconstruction and Development. Under this agreement the Bank will be provided a USD 1,000,000 credit line solely for the purpose of granting loans to small and medium-sized enterprises as defined in the agreement.

26. REGULATORY MATTERS

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

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

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

Estimate	Description of position
0%	Cash and balances with the National Bank of Azerbaijan
0%	State debt securities in Azerbaijan Manats
20%	Loans and advances to banks for up to 1 year
100%	Loans and advances to customers
100%	Other assets
0%	Standby letters of credit secured by customer funds
	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 2003				
Total capital	13,871,946	14,662,204	34.77%	8%
Tier 1 capital	13,857,632	13,857,632	32.86%	4%
As of 31 December 2002				
Total capital	13,337,735	13,338,185	34.52%	8%
Tier 1 capital	13,323,421	13,323,421	34.48%	4%

27. RISK MANAGEMENT POLICIES

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

The Bank manages the following risks:

Liquidity risk

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

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

The following tables present an analysis of the interest rate risk and the liquidity risk on the balance sheet.

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Overdue	Maturity undefined (incl. allowance for losses)	2003 AZM thousand Total
ASSETS								
Loans and advances to banks, less allowance for loan losses	-	-	8,112,214	24,615	-	-	(492)	8,136,337
Loans and advances to customers, less allowance for loan losses	2,284,215	3,468,344	31,230,319	11,148,872	-	1,507,372	(1,772,214)	47,866,908
Total fixed interest rate bearing assets	<u>2,284,215</u>	<u>3,468,344</u>	<u>39,342,533</u>	<u>11,173,487</u>	<u>-</u>	<u>1,507,372</u>	<u>(1,772,706)</u>	<u>56,003,245</u>
Cash and balances with the NBA	4,207,322	-	-	-	-	-	1,297,172	5,504,494
Loans and advances to banks, less allowance for loan losses	252,214	-	-	148,640	-	-	(2,003)	398,851
Loans and advances to customers, less allowance for loan losses	-	-	-	-	-	519,101	(519,101)	-
Interest accrued on interest bearing assets	965,254	-	-	-	-	-	-	965,254
Fixed and intangible assets, less accumulated depreciation	-	-	-	1,236,882	1,066,576	-	-	2,303,458
Income tax asset	7,483	-	-	-	-	-	-	7,483
Other assets	52,844	-	-	81,378	-	-	-	134,222
Total non-interest bearing assets	<u>5,485,117</u>	<u>-</u>	<u>-</u>	<u>1,466,900</u>	<u>1,066,576</u>	<u>519,101</u>	<u>776,068</u>	<u>9,313,762</u>
TOTAL ASSETS	<u>7,769,332</u>	<u>3,468,344</u>	<u>39,342,533</u>	<u>12,640,387</u>	<u>1,066,576</u>	<u>2,026,473</u>	<u>(996,638)</u>	<u>65,317,007</u>
LIABILITIES								
Fixed interest rate bearing								
Deposit from banks and other credit institutions	1,500,000	500,000	12,685,257	-	-	-	-	14,685,257
Customer accounts	1,277,995	2,197,445	10,855,968	6,022,765	-	-	-	20,354,173
Total fixed interest rate bearing liabilities	<u>2,777,995</u>	<u>2,697,445</u>	<u>23,541,225</u>	<u>6,022,765</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>35,039,430</u>
Floating interest rate bearing								
Deposit from banks and other credit institutions	-	-	-	-	10,067,444	-	-	10,067,444
Total interest bearing liabilities	<u>2,777,995</u>	<u>2,697,445</u>	<u>23,541,225</u>	<u>6,022,765</u>	<u>10,067,444</u>	<u>-</u>	<u>-</u>	<u>45,106,874</u>
Deposits from banks	224,754	-	-	-	-	-	-	224,754
Customer accounts	5,663,240	-	-	-	-	-	-	5,663,240
Interest accrued on interest bearing liabilities	158,402	-	10,644	-	-	-	-	169,046
Deferred income tax liability	-	-	-	4,080	-	-	-	4,080
Other liabilities	31,148	-	151,044	-	-	-	94,875	277,067
Total non-interest bearing liabilities	<u>6,077,544</u>	<u>-</u>	<u>161,688</u>	<u>4,080</u>	<u>-</u>	<u>-</u>	<u>94,875</u>	<u>6,338,187</u>
TOTAL LIABILITIES	<u>8,855,539</u>	<u>2,697,445</u>	<u>23,702,913</u>	<u>6,026,845</u>	<u>10,067,444</u>	<u>-</u>	<u>94,875</u>	<u>51,445,061</u>

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	2003 Overdue
Liquidity gap	<u>(1,086,207)</u>	<u>770,899</u>	<u>15,639,620</u>	<u>6,613,542</u>	<u>(9,000,868)</u>	<u>2,026,473</u>
Interest sensitivity gap	<u>(493,780)</u>	<u>770,899</u>	<u>15,801,308</u>	<u>5,150,722</u>	<u>(10,067,444)</u>	
Cumulative interest sensitivity gap	<u>(493,780)</u>	<u>277,119</u>	<u>16,078,427</u>	<u>21,229,149</u>	<u>11,161,705</u>	
Cumulative interest sensitivity gap as a percentage of total assets	<u>(0.76%)</u>	<u>0.42%</u>	<u>24.62%</u>	<u>32.50%</u>	<u>17.09%</u>	

	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)	2002 AZM thousand Total
ASSETS								
Loans and advances to banks, less allowance for loan losses	-	-	29,358	-	-	-	(1,761)	27,597
Loans and advances to customers, less allowance for loan losses	6,512,665	3,899,169	13,093,558	9,103,739	-	-	(2,040,564)	30,568,567
Investment securities available-for-sale	-	-	381,603	-	-	-	-	381,603
Total fixed interest rate bearing assets	<u>6,512,665</u>	<u>3,899,169</u>	<u>13,504,519</u>	<u>9,103,739</u>	<u>-</u>	<u>-</u>	<u>(2,042,325)</u>	<u>30,977,767</u>
Cash and balances with the NBA	3,797,891	-	-	-	-	-	1,109,235	4,907,126
Loans and advances to banks, less allowance for loan losses	848,535	-	14,679	177,348	-	-	(14,955)	1,025,607
Loans and advances to customers, less allowance for loan losses	-	-	-	-	-	738,215	(138,616)	599,599
Interest accrued on interest bearing assets	617,852	-	18,624	-	-	-	-	636,476
Fixed and intangible assets, less accumulated depreciation	-	-	-	486,396	1,124,561	-	-	1,610,957
Deferred income tax asset	-	-	-	237,645	-	-	-	237,645
Other assets	401,591	-	-	236,840	-	-	-	638,431
Total non-interest bearing	<u>5,665,869</u>	<u>-</u>	<u>33,303</u>	<u>1,138,229</u>	<u>1,124,561</u>	<u>738,215</u>	<u>955,664</u>	<u>9,655,841</u>
TOTAL ASSETS	<u>12,178,534</u>	<u>3,899,169</u>	<u>13,537,822</u>	<u>10,241,968</u>	<u>1,124,561</u>	<u>738,215</u>	<u>(1,086,661)</u>	<u>40,633,608</u>
LIABILITIES								
Fixed interest rate bearing								
Deposits from banks and other credit institutions	-	978,600	3,763,250	-	-	-	-	4,741,850
Customer accounts	732,414	1,020,191	6,508,634	-	-	-	-	8,261,239
Total fixed interest rate bearing liabilities	<u>732,414</u>	<u>1,998,791</u>	<u>10,271,884</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>13,003,089</u>
Floating interest rate bearing								
Deposits from banks and other credit institutions	-	-	-	3,636,423	-	-	-	3,636,423
Total interest bearing liabilities	<u>732,414</u>	<u>1,998,791</u>	<u>10,271,884</u>	<u>3,636,423</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>16,639,512</u>
Deposits from banks	6,515,160	-	-	-	-	-	-	6,515,160
Customer accounts	2,895,084	-	-	-	-	-	-	2,895,084
Interest accrued on interest bearing liabilities	84,061	-	-	-	-	-	-	84,061
Provisions	-	-	-	-	-	-	42,025	42,025
Income tax liability	487,099	-	-	-	-	-	-	487,099
Other liabilities	440,197	-	97,860	-	-	-	94,875	632,932
Total non-interest bearing liabilities	<u>10,421,601</u>	<u>-</u>	<u>97,860</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>136,900</u>	<u>10,656,361</u>
TOTAL LIABILITIES	<u>11,154,015</u>	<u>1,998,791</u>	<u>10,369,744</u>	<u>3,636,423</u>	<u>-</u>	<u>-</u>	<u>136,900</u>	<u>27,295,873</u>

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	2002 Overdue
Liquidity gap	<u>1,024,519</u>	<u>1,900,378</u>	<u>3,168,078</u>	<u>6,605,545</u>	<u>1,124,561</u>	<u>738,215</u>
Interest sensitivity gap	<u>5,780,251</u>	<u>1,900,378</u>	<u>3,232,635</u>	<u>5,467,316</u>	-	
Cumulative interest sensitivity gap	<u>5,780,251</u>	<u>7,680,629</u>	<u>10,913,264</u>	<u>16,380,580</u>	-	
Cumulative interest sensitivity gap as a percentage of total assets	<u>14.23%</u>	<u>18.90%</u>	<u>26.86%</u>	<u>40.31%</u>	-	

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

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

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

Interest rate risk

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

	2003			2002		
	AZM	USD	EUR	AZM	USD	EUR
ASSETS						
Loans and advances to banks	-	2%	2%	-	23%	-
Loans and advances to customers						
- consumer loans	-	9.5%-36%	24%-30%	16%	9.5%-36%	28%
- commercial loans	10%	15%-28%	20%-30%	9.5%-28%	14%-28%	18%-30%
Investment securities available-for-sale	-	-	-	6.7%	-	-
LIABILITIES						
Deposits from banks and other credit institutions	7%	3%	5.6%	7%	8%-15%	6.9%-8.1%
Customer accounts	17%	5.4%-16%	9%-16%	12%	4%-15%	5%

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

Currency risk

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Management Board sets limits on the level of exposure by currencies and in total. These limits also comply with the minimum requirements of the NBA. The Bank's exposure to foreign currency exchange rate risk is presented in the table below:

	AZM	USD 1 USD= AZM 4,923	EUR 1 EUR= AZM 6,195	Other currencies	Currency undefined (incl. allowance for losses)	2003 AZM thousand Total
ASSETS						
Cash and balances with the NBA	3,099,814	2,232,026	171,451	1,203		5,504,494
Loans and advances to banks, less allowance for loan losses	950	388,396	8,147,899	438	(2,495)	8,535,188
Loans and advances to customers, less allowance for loan losses	8,452,191	40,183,382	2,487,904	-	(2,291,315)	48,832,162
Fixed and other intangible assets, less accumulated depreciation	2,303,458	-	-	-	-	2,303,458
Income tax asset	7,483	-	-	-	-	7,483
Other assets	32,720	101,502	-	-	-	134,222
TOTAL ASSETS	13,896,616	42,905,306	10,807,254	1,641	(2,293,810)	65,317,007
LIABILITIES						
Deposits from banks and other credit institutions	9,400,000	5,510,011	10,078,088	-	-	24,988,099
Customer accounts	2,841,071	22,610,356	724,371	17	-	26,175,815
Deferred income tax liability	4,080	-	-	-	-	4,080
Other liabilities	100,410	176,657	-	-	-	277,067
TOTAL LIABILITIES	12,345,561	28,297,024	10,802,459	17	-	51,445,061
OPEN POSITION	1,551,055	14,608,282	4,795	1,624		

	AZM	USD 1USD= AZM 4,893	EUR 1EUR= AZM 5,080	Other currencies	Currency undefined (incl. allowance for losses)	2002 AZM thousand 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 loan losses	1,200	844,129	155,400	69,608	(16,716)	1,053,621
Loans and advances to customers, less allowance for loan losses	4,045,167	25,594,963	4,324,651	-	(2,179,180)	31,785,601
Investment securities	400,227	-	-	-	-	400,227
Fixed and other intangible assets, less accumulated depreciation	1,610,957	-	-	-	-	1,610,957
Deferred income tax asset	237,645	-	-	-	-	237,645
Other assets	564,539	73,892	-	-	-	638,431
TOTAL ASSETS	10,059,809	28,192,154	4,507,016	70,525	(2,195,896)	40,633,608
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
Provisions	-	-	-	-	42,025	42,025
Income tax liability	487,099	-	-	-	-	487,099
Other liabilities	463,689	169,243	-	-	-	632,932
TOTAL LIABILITIES	4,133,114	19,172,439	3,887,117	61,178	42,025	27,295,873
OPEN POSITION	5,926,695	9,019,715	619,899	9,347		

Market Risk

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

Credit risk

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

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

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

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

Geographical concentration

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

						2003
	Azerbaijan	Other CIS countries	OECD countries	Other non- OECD countries	Undefined (incl. allowance for losses)	AZM thousand Total
ASSETS						
Cash and balances with the NBA	5,504,494	-	-	-	-	5,504,494
Loans and advances to banks, less allowance for loan losses	207,139	41,727	8,285,352	3,465	(2,495)	8,535,188
Loans and advances to customers, less allowance for loan losses	51,123,477	-	-	-	(2,291,315)	48,832,162
Fixed and other intangible assets, less accumulated depreciation	2,303,458	-	-	-	-	2,303,458
Income tax asset	7,483	-	-	-	-	7,483
Other assets	134,222	-	-	-	-	134,222
TOTAL ASSETS	<u>59,280,273</u>	<u>41,727</u>	<u>8,285,352</u>	<u>3,465</u>	<u>(2,293,810)</u>	<u>65,317,007</u>
LIABILITIES						
Deposits from banks	9,624,758	-	15,363,341	-	-	24,988,099
Customer accounts	26,175,815	-	-	-	-	26,175,815
Deferred income tax liability	4,080	-	-	-	-	4,080
Other liabilities	277,067	-	-	-	-	277,067
TOTAL LIABILITIES	<u>36,081,720</u>	<u>-</u>	<u>15,363,341</u>	<u>-</u>	<u>-</u>	<u>51,445,061</u>
NET BALANCE SHEET POSITION	<u>23,198,553</u>	<u>41,727</u>	<u>(7,077,989)</u>	<u>3,465</u>		

	Azerbaijan	Other CIS countries	OECD countries	Other non-OECD countries	Undefined (incl. allowance for losses)	2002 AZM thousand Total
ASSETS						
Cash and balances with the NBA	4,907,126	-	-	-	-	4,907,126
Loans and advances to banks, less allowance for loan losses	223,116	552,192	291,742	3,287	(16,716)	1,053,621
Loans and advances to customers, less allowance for loan losses	33,964,781	-	-	-	(2,179,180)	31,785,601
Investment securities	400,227	-	-	-	-	400,227
Fixed and other intangible assets, less accumulated depreciation	1,610,957	-	-	-	-	1,610,957
Deferred income tax asset	237,645	-	-	-	-	237,645
Other assets	638,431	-	-	-	-	638,431
TOTAL ASSETS	41,982,283	552,192	291,742	3,287	(2,195,896)	40,633,608
LIABILITIES						
Deposits from banks	5,000,857	-	3,636,422	6,275,733	-	14,913,012
Customer accounts	11,220,805	-	-	-	-	11,220,805
Provisions	-	-	-	-	42,025	42,025
Income tax liability	487,099	-	-	-	-	487,099
Other liabilities	632,932	-	-	-	-	632,932
TOTAL LIABILITIES	17,341,693	-	3,636,422	6,275,733	42,025	27,295,873
NET BALANCE SHEET POSITION	24,640,590	552,192	(3,344,680)	(6,272,446)		