

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

Independent Auditors' Report and

Financial Statements
Year Ended 31 December 2004

OPEN JOINT STOCK COMMERCIAL BANK “BANK OF BAKU”

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheet of the Open Joint Stock Commercial Bank "Bank of Baku" ("the Bank") as at 31 December 2004 and the related profit and loss account and statements of cash flows and changes in shareholders' equity for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2004, and the results of its operations and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.



15 March 2005

OPEN JOINT STOCK COMMERCIAL BANK "BANK OF BAKU"

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

	Notes	2004	2003
Interest income	4, 23	13,933,854	10,181,150
Interest expense	4, 23	<u>(5,304,662)</u>	<u>(3,644,569)</u>
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES		8,629,192	6,536,581
Recovery of Provision/Provision for loan losses	5	<u>238,355</u>	<u>(117,340)</u>
NET INTEREST INCOME		<u>8,867,547</u>	<u>6,419,241</u>
Net gain on foreign exchange operations	6	38,545	141,133
Fees and commission income	7, 23	3,834,532	2,232,956
Fees and commission expense	7	(1,426,743)	(634,657)
Other income	8	<u>139,700</u>	<u>45,291</u>
NET NON-INTEREST INCOME		<u>2,586,034</u>	<u>1,784,723</u>
OPERATING INCOME		11,453,581	8,203,964
OPERATING EXPENSES	9, 23	<u>(5,882,719)</u>	<u>(4,467,294)</u>
OPERATING PROFIT		5,570,862	3,736,670
Recovery of provision/(provision) for guarantees and other commitments	5	<u>(164,783)</u>	<u>42,025</u>
PROFIT BEFORE INCOME TAX		5,406,079	3,778,695
Income tax expense	10	<u>(1,336,569)</u>	<u>(948,484)</u>
NET PROFIT		<u><u>4,069,510</u></u>	<u><u>2,830,211</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.

OPEN JOINT STOCK COMMERCIAL BANK "BANK OF BAKU"

BALANCE SHEET

AS OF 31 DECEMBER 2004

(in Azerbaijan Manats and in thousands)

	Notes	2004	2003
ASSETS:			
Cash and balances with the National Bank of Azerbaijan	11	6,027,404	5,504,494
Loans and advances to banks, less allowance for loan losses	12	17,119,157	8,535,188
Loans and advances to customers, less allowance for loan losses	13, 23	73,029,095	48,832,162
Investment securities:			
- debt securities available-for-sale	14	102,905	-
Fixed assets, less accumulated depreciation	15	2,896,434	2,164,134
Intangible assets, less accumulated amortization	16	456,855	139,324
Income tax assets	10	-	7,483
Deferred tax assets	10	14,777	-
Other assets	17	296,194	134,222
		-	-
TOTAL ASSETS		99,942,821	65,317,007
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES:			
Deposits from banks and other credit institutions	18	39,794,541	24,988,099
Customer accounts	19, 23	41,645,165	26,175,815
Income tax liabilities	10	617,491	-
Deferred tax liabilities	10	-	4,080
Other liabilities	20	375,144	277,067
		-	-
Total liabilities		82,432,341	51,445,061
SHAREHOLDERS' EQUITY:			
Share capital	21	13,290,120	10,677,106
Reserves		4,220,360	3,194,840
		-	-
Total shareholders' equity		17,510,480	13,871,946
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		99,942,821	65,317,007
FINANCIAL COMMITMENTS AND CONTINGENCIES	22	8,039,085	5,445,096

On behalf of the Management Board

Chairman

Chief Accountant

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OPEN JOINT STOCK COMMERCIAL BANK "BANK OF BAKU"

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

	Share capital	Revenue reserve	Total shareholders' equity
31 December 2002	10,667,106	2,660,629	13,337,735
Net profit	-	2,830,211	2,830,211
Dividends	-	(2,296,000)	(2,296,000)
31 December 2003	10,677,106	3,194,840	13,871,946
Share capital increase	2,613,014	-	2,613,014
Net profit	-	4,069,510	4,069,510
Dividends	-	(3,043,991)	(3,043,991)
31 December 2004	<u>13,290,120</u>	<u>4,220,359</u>	<u>17,510,479</u>

On behalf of the Management Board

Chairman

Chief Accountant

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OPEN JOINT STOCK COMMERCIAL BANK "BANK OF BAKU"

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

	Notes	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income taxes		5,406,079	3,778,695
Adjustments for:			
Provision for loan losses, net of write-offs		(279,748)	81,957
(Recovery of provision)/provision for guarantees and other commitments		164,783	(42,025)
Depreciation charge on fixed and intangible assets		477,042	446,370
Loss on disposal of fixed assets		-	2,013
Net change in accruals		(25,158)	(601,448)
Cash flow from operating activities before changes in operating assets and liabilities		5,742,998	3,665,562
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the National Bank of Azerbaijan		7,898	(187,937)
Loans and advances to banks		(7,237,397)	(7,558,032)
Loans and advances to customers		(23,945,766)	(16,793,777)
Other assets		(203,029)	504,209
Increase in operating liabilities:			
Deposits from banks and other credit institutions		14,798,532	10,084,022
Customer accounts		15,419,904	14,861,090
Other liabilities		(18,166)	1,790
Cash inflow from operating activities before income taxes		4,564,974	4,576,927
Income tax paid		(737,935)	(1,201,341)
Net cash inflow from operating activities		3,827,039	3,375,586
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of fixed and intangible assets		(1,526,873)	(1,175,757)
Proceeds on sale of fixed assets		-	34,873
Purchase of available-for-sale debt securities		(100,000)	-
Sales of available-for-sale debt securities		-	381,603
Net cash outflows from investing activities		(1,626,873)	(759,281)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Share capital increase		2,613,014	-
Dividends paid		(3,043,991)	(2,296,000)
Net cash outflow from financing activities		(430,977)	(2,296,000)

OPEN JOINT STOCK COMMERCIAL BANK "BANK OF BAKU"

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

	Notes	2004	2003
NET INCREASE IN CASH AND CASH EQUIVALENTS		1,769,189	320,305
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD	11	<u>4,380,460</u>	<u>4,060,155</u>
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	11	<u><u>6,149,649</u></u>	<u><u>4,380,460</u></u>

Interest paid and received by the Bank in cash during the year ended 31 December 2004 amounted to AZM 5,362,019 thousand and AZM 13,851,339 thousand, respectively.

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.

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.

OPEN JOINT STOCK COMMERCIAL BANK “BANK OF BAKU”

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2004

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

1. ORGANISATION

Open Joint Stock Commercial Bank “Bank of Baku” (the “Bank”) is an open joint stock bank, 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. On 20 October 2004, the Bank has re-registered as an Open Joint Stock Commercial Bank. 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 Head Office of the Bank is providing all range of commercial and retail banking operations. In addition, the Bank has 3 branches in Azerbaijan.

The number of employees of the Bank at 31 December 2004 and 2003 was 104 and 78, respectively.

As of 31 December 2004 and 2003 the share capital was owned as follows:

	%
Mr. E. Isayev	51.16
Ms. H. Ragimova	0.04
NAB Holding	48.80
	<hr/>
	100
	<hr/> <hr/>

The Bank signed a merger agreement with IlkBank CJSCB on 1 December 2004. As per merger agreement, share capital of the new bank to be established in 2005 is approved in the amount of AZM 34,000,000 thousand with face value of each share of AZM 10 thousand. On 18 February 2005 the new merged banks has been granted from the NBA with a new banking license # 247. The name of the new bank remained the same. Planned shareholding structure of the new bank is as follows:

	%
NAB Holding	40.000
Azpetrol Neft Shirketi LLC	17.655
Azertrans LLC	11.235
Mr. R. Aliyev	11.215
Mr. E. Isayev	10.000
Azinvest LLC	9.895
	<hr/>
	100
	<hr/> <hr/>

These financial statements were authorized for issue by the Management Board on 15 March 2005.

2. BASIS OF PRESENTATION

Accounting basis - These financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (“IFRS”). These financial statements are presented in thousands of Azerbaijan Manats (“AZM”) unless otherwise indicated. These financial statements have been prepared on the historical cost basis, except for the revaluation of certain properties and financial instruments.

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

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

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

3. SIGNIFICANT ACCOUNTING POLICIES

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

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

Cash and cash equivalents - Cash and cash equivalents include cash on hand, unrestricted balances on correspondent accounts with the National Bank of Azerbaijan and central banks of other countries and advances to banks in countries included in the Organization for Economic Co-operation and Development (“OECD”). For the purposes of determining cash flows, the minimum reserve deposit required by the National Bank of Azerbaijan is not included as a cash equivalent due to restrictions on its availability (Note 11).

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

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

Loans granted by the Bank with fixed maturities are initially recognized in accordance with the policy stated below. The difference between the nominal amount of consideration given and the amortized cost of loans issued at lower than market rates is recognized in the period the loan is issued as an initial recognition adjustment discounted using market rates at inception and included in the profit and loss account as losses on origination of assets. Subsequently, the carrying amount of such loans is adjusted for amortization of the losses on origination and the related income is recorded as interest income within the profit and loss account using the effective interest method. Loans to customers that do not have fixed maturities are carried at cost. Loans and advances to customers are carried net of any allowance for loan losses.

Write off of loans and advances - Loans and advances are written off against allowance for loan losses in case of the uncollectibility of loans and advances, including through repossession of collateral. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Bank and after the Bank has received all available collateral.

Non-accrual loans - Loans are placed on a non-accrual status when interest or principal is delinquent for a period in excess of 30 days, except when all amounts due are fully secured by cash or marketable securities and collection proceedings are in process. Interest income is not recognized if recovery is doubtful. Subsequent payments by borrowers are applied to either principal or delinquent interest based on individual arrangements with the borrower. A non-accrual loan is restored to accrual status when all principal and interest amounts contractually due are reasonably assured of repayment within a reasonable period.

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

The determination of the allowance for losses is based on an analysis of the risk assets and reflects the amount, which, in the judgment of management, is adequate to provide for losses inherent in the risk assets. Provisions are made as a result of a detailed appraisal of risk assets.

The change in the allowance for loan losses is charged to the profit and loss account and the total of the allowance for losses is deducted in arriving at assets as shown in the balance sheet. Management's evaluation of the allowance is based on the Bank's past loss experience, known and inherent risks in the risk assets, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral and current economic conditions.

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

Securities available for sale - Securities available for sale represent debt and equity investments that are intended to be held for an indefinite period of time. Such securities are initially recorded at cost which approximates the fair value of the consideration given. Subsequently the securities are measured at fair value, with such re-measurement included in the profit and loss account, plus accrued coupon income.

The Bank uses quoted market prices to determine fair value for the Bank's securities available for sale. If such quotes do not exist, management estimation is used. Realised and unrealised gains and losses arising from changes in the fair value of securities available-for-sale are included in the profit and loss account in the period in which they arise. Interest earned on securities available-for-sale is reflected in the profit and loss account as interest income on investment securities. Dividends received are included in dividend income in the profit and loss account.

Fixed and intangible assets - Fixed and intangible assets are stated at cost less accumulated depreciation and any recognized impairment loss. Depreciation and amortization on fixed and intangible assets is charged to write off the cost of assets over their estimated useful lives, using the straight-line method at the following annual rates:

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

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.

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

The current tax expense is based on taxable profit for the year. Taxable profit differs from net profit as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Bank's current tax expense is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

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

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the consolidated profit and loss account, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

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

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

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

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

Retirement and other benefit obligations - The Bank does not incur any expenses in relation to provision of pensions to its employees. In accordance with the legal requirements of Azerbaijan, the Bank withholds pension contributions from employee salaries and transfers them into state pension fund. Current contributions by the Bank are calculated as a percentage of current gross salary payments with the expense charged in the period in which the related salaries are earned. Upon retirement of employees, all pension payments are administered by the above pension fund.

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

Recognition of income and expense - Interest income and expense are recognized on an accrual basis. The recognition of interest income is suspended when loans become overdue by more than 30 days. Interest income also includes income earned on investment securities. Loan origination fees are recognized in the period occurred as they are not equally spread over the life of loans originated. Commission income/expenses are recognized on an accrual basis. Other income is credited to profit and loss account when the related transactions are completed.

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

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

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

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 statements as of 31 December 2003 and for the year then ended to conform to the presentation as of 31 December 2004 and for the year then ended.

4. NET INTEREST INCOME

Net interest income comprises:

	2004	2003
Interest income		
Interest on loans and advances to customers	13,626,616	10,075,147
Interest on loans and advances to banks	300,087	86,630
Interest on debt securities	7,151	19,373
	<u>13,933,854</u>	<u>10,181,150</u>
Interest expense		
Interest on customer accounts	3,666,463	2,256,700
Interest on deposits from banks and other credit institutions	1,637,489	1,386,901
Other interest expense	710	968
	<u>5,304,662</u>	<u>3,644,569</u>
Net interest income before provision for loan losses	<u><u>8,629,192</u></u>	<u><u>6,536,581</u></u>

5. ALLOWANCE FOR LOAN LOSSES

The movements in allowance for loan losses were as follows:

	Loans and advances to banks	Loans and advances to customers	Total
31 December 2002	(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)
23			
31 December 2003	(2,495)	(2,291,315)	(2,293,810)
Provision	(32,827)	(505,981)	(538,808)
Recovery	7,375	769,788	777,163
Write-offs of assets	-	41,393	41,393
	<u>(27,947)</u>	<u>(1,986,115)</u>	<u>(2,014,062)</u>
31 December 2004	(27,947)	(1,986,115)	(2,014,062)

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

	Other assets	Guarantees and other commitments
31 December 2002	-	(42,025)
Recovery of provision	-	42,025
	<u>-</u>	<u>(42,025)</u>
31 December 2003	-	-
Provision	(48,540)	(116,243)
	<u>(48,540)</u>	<u>(116,243)</u>
31 December 2004	(48,540)	(116,243)

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:

	2004	2003
Dealing, net	150,395	110,937
Translation differences, net	<u>(111,850)</u>	<u>30,196</u>
Total net gain on foreign exchange operations	<u>38,545</u>	<u>141,133</u>

7. FEES AND COMMISSION INCOME AND EXPENSE

Fees and commission income and expense comprise:

	2004	2003
Fees and commission income:		
Cash operations	1,127,278	823,094
Settlements	658,606	606,155
Foreign exchange operations	567,656	368,198
Plastic cards operations	420,445	249,537
Loans origination fees	1,026,710	177,747
Documentary operations	33,002	5,941
Other operations	<u>835</u>	<u>2,284</u>
Total fees and commission income	<u>3,834,532</u>	<u>2,232,956</u>

	2004	2003
Fees and commission expense:		
Settlements	448,960	324,048
Plastic cards operations	365,021	218,229
Insurance of loans	423,569	-
Cash transactions	119,994	83,155
Foreign exchange operations	763	7,117
Documentary operations	19,006	1,660
Other operations	<u>49,430</u>	<u>448</u>
Total fees and commission expense	<u>1,426,743</u>	<u>634,657</u>

The Bank insures a proportion of the consumer and micro loans at the expense of customers of the Bank and has started to collect the insurance fees on behalf of the insurance companies in 2004.

8. OTHER INCOME

Other income includes AZM 124,870 thousand and AZM 45,291 thousand of fines received from the customers for delays in repayments of loan principals and interests for the years ended 31 December 2004 and 2003, respectively.

9. OPERATING EXPENSES

Operating expenses comprise:

	2004	2003
Salary and bonuses	2,352,324	1,525,534
Advertising and marketing expenses	597,283	707,233
Rent of office premises	680,345	478,951
Depreciation of fixed and intangible assets	477,042	446,370
Social security costs	623,705	400,688
Professional services fees	169,470	257,060
Office supplies	141,924	108,839
Communication	186,522	107,133
Repairs and maintenance expenses	178,783	96,635
Utilities	74,152	61,802
Travel expenses	66,491	53,191
Premises security	72,600	34,391
Insurance	30,682	22,645
Taxes, other than income tax	28,927	21,146
Software costs	40,427	7,861
Legal fees	13,326	7,817
Loss on disposal of fixed assets	-	2,013
Other	148,716	127,985
	<u>5,882,719</u>	<u>4,467,294</u>
Total operating expenses	<u>5,882,719</u>	<u>4,467,294</u>

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

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as of 31 December 2004 and 2003 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Income tax assets and liabilities consist of the following:

	2004	2003
Current income tax asset	-	7,483
Deferred income tax asset	14,777	-
	<u>14,777</u>	<u>-</u>
Income tax assets	<u>14,777</u>	<u>7,483</u>
	2004	2003
Deferred income tax liability	-	4,080
Current income tax liability	617,491	-
	<u>617,491</u>	<u>-</u>
Income tax liabilities	<u>617,491</u>	<u>4,080</u>

Temporary differences as of 31 December 2004 and 2003 comprise:

	2004	2003
Deferred assets:		
Fixed and intangible assets	154,609	192,137
Total deferred assets	<u>154,609</u>	<u>192,137</u>
	2004	2003
Deferred liabilities:		
Provisions for claims, guarantees and commitments	93,037	209,135
Total deferred liabilities	<u>93,037</u>	<u>209,135</u>
Net deferred assets/(liabilities)	<u>61,572</u>	<u>(16,998)</u>
Deferred income tax assets/(liabilities) at statutory rate of 24%	<u>14,777</u>	<u>(4,080)</u>

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

	2004	2003
Profit before income taxes	<u>5,406,079</u>	<u>3,778,695</u>
Statutory tax rate	24%	25%
Theoretical tax at the statutory tax rate	1,297,459	944,674
Tax effect of permanent differences	39,110	5,732
Effect of changes in income tax rate	-	(1,922)
Income tax expense	<u>1,336,569</u>	<u>948,484</u>
Current income tax expense	1,355,426	706,759
Deferred income tax (credit)/expense	<u>(18,857)</u>	<u>241,725</u>
Income tax expense	<u>1,336,569</u>	<u>948,484</u>
	2004	2003
Deferred income tax assets/(liabilities)		
At beginning of the period	(4,080)	237,645
Increase/(decrease) in the deferred income tax for the period	<u>18,857</u>	<u>(241,725)</u>
At end of the period	<u>14,777</u>	<u>(4,080)</u>

11. CASH AND BALANCES WITH THE NATIONAL BANK OF AZERBAIJAN

Cash and balances with the National Bank of Azerbaijan comprise:

	2004	2003
Cash on hand	4,043,947	2,895,057
Balances with the National Bank of Azerbaijan	<u>1,983,457</u>	<u>2,609,437</u>
Total cash and balances with the National Bank of Azerbaijan	<u>6,027,404</u>	<u>5,504,494</u>

The balances with the NBA as of 31 December 2004 and 2003 include AZM 1,289,274 thousand and AZM 1,297,172 thousand, respectively, which represent the minimum reserve deposits required by the NBA. The Bank is required to maintain the reserve balance at the NBA at all times.

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

	2004	2003
Cash and balances with the National Bank of Azerbaijan	6,027,404	5,504,494
Loans and advances to banks in OECD countries	<u>1,411,519</u>	<u>173,138</u>
	7,438,923	5,677,632
Less minimum reserve deposit with the National Bank of Azerbaijan	<u>(1,289,274)</u>	<u>(1,297,172)</u>
Total cash and cash equivalents	<u>6,149,649</u>	<u>4,380,460</u>

12. LOANS AND ADVANCES TO BANKS

Loans and advances to banks comprise:

	2004	2003
Advances to banks	1,583,559	252,214
Loans to banks and other institutions	1,225,746	143,897
Restricted deposits	14,204,156	8,141,572
Accrued interest income on loans and advances to banks	<u>133,643</u>	<u>-</u>
	17,147,104	8,537,683
Less allowance for loan losses	<u>(27,947)</u>	<u>(2,495)</u>
Total loans and advances to banks, net	<u>17,119,157</u>	<u>8,535,188</u>

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

As of 31 December 2004 and 2003 included in restricted deposits above is cash collateral with Dresdner Bank AG, Germany totaling AZM 14,031,801 thousand and AZM 8,112,214 thousand respectively, 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 earns an annual interest rate of 2% which is fixed for the whole lifetime of the credit facility (Note 18).

As of 31 December 2004 and 2003 the Bank had loans and advances placed with Dresdner Bank AG, Germany totaling AZM 15,393,943 thousand and AZM 8,216, 547 thousand respectively, which exceeded 10% of the Bank's equity and represents significant geographical concentration in Germany forming 90% and 96.2% respectively of loans and advances to banks.

13. LOANS AND ADVANCES TO CUSTOMERS

Loans and advances to customers comprise:

	2004	2003
Originated loans	74,103,989	50,158,223
Accrued interest income on loans and advances to customers	911,221	965,254
	<u>75,015,210</u>	<u>51,123,477</u>
Less allowance for loan losses	(1,986,115)	(2,291,315)
	<u>73,029,095</u>	<u>48,832,162</u>
	2004	2003
Loans collateralized by real estate	22,695,731	15,612,226
Loans collateralized by insurance policies	6,360,261	10,709,999
Loans collateralized by goods in turnover	34,956,470	6,442,512
Loans collateralized by deposits and securities	713,433	1,650,000
Loans collateralized by others	8,859,744	14,438,984
Unsecured loans	518,350	1,304,502
Accrued interest income on loans and advances to customers	911,221	965,254
	<u>75,015,210</u>	<u>51,123,477</u>
Less allowance for loan losses	(1,986,115)	(2,291,315)
	<u>73,029,095</u>	<u>48,832,162</u>

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

As of 31 December 2004 and 2003 the Bank had 2 and 4 loans totaling AZM 4,656,855 thousand and AZM 7,469,200 thousand, respectively, which individually exceeded 10% of the Bank's equity.

As of 31 December 2004 and 2003 included in loans and advances to customers are non-accrual loans amounting to AZM 107,959 thousand and AZM 519,101 thousand respectively, on which interest was not accrued.

	2004	2003
Analysis by industry		
Individuals	42,643,443	23,764,479
Trading	19,595,114	13,918,427
Manufacturing	7,679,477	6,097,702
Construction	1,715,055	3,099,891
Agriculture	2,470,900	1,883,441
Other	-	1,394,283
Accrued interest income on loans and advances to customers	911,221	965,254
	<u>75,015,210</u>	<u>51,123,477</u>
Less allowance for loan losses	(1,986,115)	(2,291,315)
	<u>73,029,095</u>	<u>48,832,162</u>

14. INVESTMENT SECURITIES

Debt securities available-for-sale is short-term securities issued by JSCB RabitaBank 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 9.97%.

As of 31 December 2004 debt securities comprised of face value of AZM 100,000 thousand and accrued interest income of AZM 2,905 thousand.

15. FIXED ASSETS, LESS ACCUMULATED DEPRECIATION

	Buildings	Computers	Furniture and equipment	Vehicles	Other fixed assets	Total
At cost						
31 December 2003	1,159,700	1,184,384	877,080	152,283	21,720	3,395,167
Additions	31,518	427,626	682,050	46,009	4,899	1,192,102
Transfers	-	(11,518)	21,084	-	(9,566)	-
31 December 2004	<u>1,191,218</u>	<u>1,600,492</u>	<u>1,580,214</u>	<u>198,292</u>	<u>17,053</u>	<u>4,587,269</u>
Accumulated depreciation						
31 December 2003	93,124	811,211	263,056	60,709	2,933	1,231,033
Charge for the period	138,816	(49,959)	345,320	23,052	2,573	459,802
Transfers	-	(75)	1,300	-	(1,225)	-
31 December 2004	<u>231,940</u>	<u>761,177</u>	<u>609,676</u>	<u>83,761</u>	<u>4,281</u>	<u>1,690,835</u>
Net book value						
31 December 2004	<u>959,278</u>	<u>839,315</u>	<u>970,538</u>	<u>114,531</u>	<u>12,772</u>	<u>2,896,434</u>
Net book value						
31 December 2003	<u>1,066,576</u>	<u>373,173</u>	<u>614,024</u>	<u>91,574</u>	<u>18,787</u>	<u>2,164,134</u>

16. INTANGIBLE ASSETS, LESS ACCUMULATED AMORTIZATION

	Software & licenses
At cost	
31 December 2003	219,001
Additions	<u>334,771</u>
31 December 2004	<u>553,772</u>
Accumulated amortization	
31 December 2003	79,677
Charge for the year	<u>17,240</u>
31 December 2004	<u>96,917</u>
Net book value	
31 December 2004	<u><u>456,855</u></u>
Net book value	
31 December 2003	<u><u>139,324</u></u>

17. OTHER ASSETS

Other assets comprise:

	2004	2003
Unsettled payments on plastic cards operations and money transfers	305,935	52,764
Prepayments and receivables on other transactions	6,620	80
Other	<u>32,179</u>	<u>81,378</u>
	344,734	134,222
Less allowance for losses on other assets	<u>(48,540)</u>	<u>-</u>
Total other assets	<u><u>296,194</u></u>	<u><u>134,222</u></u>

18. DEPOSITS FROM BANKS AND OTHER CREDIT INSTITUTIONS

Deposits from banks and other credit institutions comprise:

	2004	2003
Demand deposits	2,994,558	24,752,701
Time deposits	36,781,429	224,754
Accrued interest expense on deposits from banks and other credit institutions	<u>18,554</u>	<u>10,644</u>
Total deposits from banks and other credit institutions	<u><u>39,794,541</u></u>	<u><u>24,988,099</u></u>

As of 31 December 2004 and 2003, the Bank had the credit facility from Dresdner Bank AG, Germany. Under the agreement the Bank obtained an AZM 10,366,740 thousand and AZM 5,285,254 thousand respectively, USD denominated credit line with a maturity up to 1 year. As of 31 December 2004 and 2003 this credit facility is collateralized by a cash deposit included in loans and advances to banks at fair value of AZM 14,031,801 thousand and AZM 8,112,214 thousand respectively. 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 2004 and 2003 it was fixed at an annual interest rate of 2.75% and 3% respectively.

As of 31 December 2004 and 2003 included in deposits from banks and other credit institutions are EUR denominated credit lines provided by the German-Azerbaijan Fund amounting to AZM 13,363,540 thousand and AZM 10,067,444 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 2004 and 2003 included in deposits from banks and other credit institutions are loans from the National Bank of Azerbaijan amounting to AZM 500,000 thousand and AZM 9,400,000 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 of the Bank at an annual interest rate of 10%.

As of 31 December 2004 included in deposits from banks and other credit institutions are credit facility provided by the European Bank for Reconstruction and Development amounting to AZM 4,903,000 thousand which is fully utilized by the Bank as of year end. This credit facility has a maturity period of 1 year and bears a floating interest rate based on LIBOR plus 5.5% margin.

19. CUSTOMER ACCOUNTS

Customer accounts comprise:

	2004	2003
Time deposits	33,521,622	20,354,173
Repayable on demand	7,915,695	5,663,240
Accrued interest expense on customer accounts	207,848	158,402
	<u>41,645,165</u>	<u>26,175,815</u>
Total customer accounts	<u>41,645,165</u>	<u>26,175,815</u>

Analysis of customer accounts by industry:

	2004	2003
Individuals	32,873,441	18,087,118
Trade	578,120	4,784,440
Manufacturing	3,114,662	127,487
Agriculture	15,445	13,994
Transport and communication	93,106	8,627
Construction	117	163
Other	4,732,426	2,995,584
Accrued interest expense on customer accounts	207,848	158,402
	<u>41,645,165</u>	<u>26,175,815</u>
Total customer accounts	<u>41,645,165</u>	<u>26,175,815</u>

20. OTHER LIABILITIES

Other liabilities comprise:

	2004	2003
Professional fees payable	78,448	151,044
Payables to shareholders	-	94,875
Provisions for credit lines and guarantees	116,243	-
Settlements on other transactions	50,265	2,500
Other	130,188	28,648
	<hr/>	<hr/>
Total other liabilities	375,144	277,067

21. SHARE CAPITAL

At 31 December 2004 the authorized and issued share capital comprised 1,189 ordinary shares (with a par value of AZM 4,000 thousand each) plus 1,823 ordinary shares (with a par value of USD 1,000 each) (2003: 1,758 ordinary shares (with a par value of AZM 4,000 thousand each) plus 765 ordinary shares (with a par value of 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 2004 and 2003 comprised AZM 13,290,120 thousand and AZM 10,677,106 thousand, respectively.

On 23 July 2004 500 ordinary shares with a par value of USD 1,000 each (AZM 4,938 thousand equivalent) was paid in 2004 and registered with the State Security Committee. Additionally, AZM 144,014 thousand was paid up by the shareholders which was registered with the State Security Committee in previous years.

During 2004 AZM 3,043,991 thousand of dividends declared for 2003 were paid to the shareholders.

22. FINANCIAL COMMITMENTS AND CONTINGENCIES

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

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

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

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

As of 31 December 2004 and 2003, the nominal or contract amounts and the risk weighted credit equivalents of instruments with off-balance sheet risks were:

	2004		2003	
	Nominal Amount	Risk Weighted Amount	Nominal Amount	Risk Weighted Amount
Guarantees issued and similar commitments	2,816,774	2,816,774	-	-
Commitments on credits and unused credit lines	4,828,210	4,828,210	5,198,783	-
Total contingent liabilities and credit commitments	7,644,984	7,644,984	5,198,783	-

The Bank has made a provision of AZM 116,243 thousand against guarantees issued as of 31 December 2004.

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

Operating Leases - The Bank's future minimum rental payments under non-cancelable operating leases of the office building in effect as of 31 December 2004 and 2003 are presented in the table below.

	2003	2003
Not later than 1 year	394,101	246,313
Total operating leases	394,101	246,313

Legal proceedings - As of 31 December 2004 and 2003, 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 - Azerbaijan commercial legislation and tax legislation in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result the Bank may be assessed additional taxes, penalties and interest. The Bank believes that it has already made all tax payments, and therefore no allowance has been made in the financial statements. Tax years remain open to review by the tax authorities for three years.

Pensions and retirement plans - Employees receive pension benefits from the Republic of Azerbaijan in accordance with the laws and regulations of the country. As of 31 December 2004 and 2003, the Bank was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

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

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:

	2004		2003	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Loans to customers	108,344	74,103,989	18,131	51,123,477
Accrued interest income	1,498	911,221	88	-
Allowance for loans to customers	(2,339)	(1,986,115)	(361)	(2,291,315)
Loans to customers, net	<u>107,503</u>	<u>73,029,095</u>	<u>17,858</u>	<u>48,832,162</u>
Customer deposits	578,935	41,437,317	175,991	26,017,413
Accrued interest expense on customer deposits	3,572	207,848	1,791	158,402

During the year ended 31 December 2004 and 2003 the Bank originated loans to customers – related parties of AZM 104,221 thousand and AZM 49,230 thousand respectively and repaid loans from customers - related parties amounting to AZM 14,008 thousand and AZM 42,742 thousand respectively.

During the year ended 31 December 2004 and 2003 the Bank received deposits from customers - related parties totaling AZM 2,749,181 thousand and AZM 65 thousand respectively, and repaid deposits totaling AZM 2,346,237 thousand and AZM 650,526 thousand respectively.

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

	2004		2003	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Interest income		13,933,854		10,181,150
- directors	13,506		16,427	
Interest expense		(5,304,662)		(3,644,569)
- directors	(28,161)		(3,389)	
Commission income		3,834,532		2,232,956
- directors	4,601		-	
Operating expenses		(5,882,719)		(4,467,294)
- related companies	(365,497)		(478,951)	
- directors	(334,465)		(280,462)	

Transactions with related parties entered into by the Bank during the years ended 31 December 2004 and 2003 and outstanding as of 31 December 2004 and 2003 were made in the normal course of business and under arms 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 arms length transaction, other than in a forced or liquidation sale. As no readily available market exists for a large part of the Bank's financial instruments, judgment is necessary in arriving at fair value, based on current economic conditions and specific risks attributable to the instrument. The estimates presented herein are not necessarily indicative of the amounts the Bank could realize in a market exchange from the sale of its full holdings of a particular instrument.

As of 31 December 2004 and 2003 the following methods and assumptions were used by the Bank to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

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

Loans and advances to banks - As of 31 December 2004 and 2003, the carrying amount of short-term deposits and advances given is a reasonable estimate of their fair value.

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

Securities available-for-sale - As of 31 December 2004 securities available-for-sale are stated at fair value amounting to AZM 100,000 thousand plus accrued discount totaling AZM 2,905 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 2004 and 2003 the carrying amount of short-term deposits and deposits repayable on demand of AZM 26,412,447 thousand and AZM 14,910,011 thousand, respectively, is a reasonable estimate of their fair value. As of 31 December 2004 and 2003 long-term deposits from banks other credit institutions are stated at cost of AZM 13,363,540 thousand and AZM 10,067,444 thousand, respectively, which approximates fair value.

Customer accounts - As of 31 December 2004 and 2003 the carrying amount of short-term deposits and current accounts of the Bank's customers of AZM 23,306,934 thousand and AZM 19,994,648 thousand, respectively, is a reasonable estimate of their fair value. As of 31 December 2004 and 31 December 2003 long-term customer accounts are stated at cost of AZM 18,130,383 thousand and AZM 6,022,765 thousand, respectively, which approximates fair value.

25. SUBSEQUENT EVENTS

On 14 January 2005 the Bank declared dividends of AZM 4,080,633 thousand to shareholders and has not paid out those dividends as of 15 March 2005.

The Bank signed a merger agreement with IlkBank CJSCB on 1 December 2004. As per merger agreement, share capital of the new bank to be established in 2005 is approved in the amount of AZM 34,000,000 thousand with face value of each share of AZM 10 thousand. On 18 February 2005 the new merged banks has been granted from the NBA with a new banking license # 247. The name of the new bank remained the same.

On 16 February 2005 the Bank entered into a new 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 2004				
Total capital	17,510,479	17,510,479	21.28%	8%
Tier 1 capital	17,510,479	17,510,479	21.28%	4%
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%

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 Assets and Liabilities Management Committee sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

Interest rate risk 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. The Bank regulates its interest rate policy on the basis of fluctuation of interest rates on the market, borrowing costs and individual credit risks.

	AZM	USD	2004 EUR	AZM	USD	2003 EUR
ASSETS						
Loans and advances to banks	-	2.5%-12%	2%	-	2%	2%
Loans and advances to customers	18%-30%	15%-36%	26%	10%	9.5%-36%	20%-30%
Investment securities available-for-sale	9.97%	-	-	-	-	-
LIABILITIES						
Deposits from banks and other credit institutions	7%-11%	0%-12%	5.7%	7%	3%	5.6%
Customer accounts	8%-17%	3%-16%	3%-16%	17%	5.4%-16%	9%-16%

An analysis of the interest rate risk and the liquidity risk on the balance sheet is presented in the following table:

	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)	2004 AZM thousand Total
ASSETS								
Loans and advances to banks, net	1,225,746	-	14,031,801	24,515	-	-	(27,729)	15,254,333
Loans and advances to customers, net	1,672,438	6,119,037	27,478,549	38,483,834	-	-	(1,611,858)	72,142,000
Available for sale debt securities	-	-	100,000	-	-	-	-	100,000
Total fixed interest bearing assets	2,898,184	6,119,037	41,610,350	38,508,349	-	-	(1,639,587)	87,496,333
Cash and balances with the NBA	4,043,947	-	-	-	-	-	1,983,457	6,027,404
Loans and advances to banks, net	1,583,558	-	-	147,841	-	-	(218)	1,731,181
Loans and advances to customers, net	-	-	-	-	-	350,131	(350,131)	-
Interest accrued on interest bearing assets	914,126	-	133,643	-	-	-	(24,126)	1,023,643
Fixed assets, net	-	1,520	12,259	1,921,875	960,780	-	-	2,896,434
Intangible assets, net	-	-	-	9,655	447,200	-	-	456,855
Deferred tax assets	-	-	14,777	-	-	-	-	14,777
Other assets, net	344,734	-	-	-	-	-	(48,540)	296,194
Total non-interest bearing assets	6,886,365	1,520	160,679	2,079,371	1,407,980	350,131	1,560,442	12,446,488
TOTAL ASSETS	9,784,549	6,120,557	41,771,029	40,587,720	1,407,980	350,131	(79,145)	99,942,821
LIABILITIES								
Fixed interest bearing liabilities								
Deposit from banks and other credit institutions	2,954,058	3,970,901	17,976,090	-	-	-	-	24,901,049
Customer accounts	2,307,107	2,822,207	10,261,925	18,107,580	22,803	-	-	33,521,622
Total fixed interest bearing liabilities	5,261,165	6,793,108	28,238,015	18,107,580	22,803	-	-	58,422,671
Floating interest bearing liabilities								
Deposit from banks and other credit institutions	272,167	-	-	-	13,363,540	-	-	13,635,707
Total interest bearing liabilities	5,533,332	6,793,108	28,238,015	18,107,580	13,386,343	-	-	72,058,378
Deposits from banks	1,239,231	-	-	-	-	-	-	1,239,231
Customer accounts	7,915,695	-	-	-	-	-	-	7,915,695
Interest accrued on interest bearing liabilities	226,402	-	-	-	-	-	-	226,402
Income tax liability	-	617,491	-	-	-	-	-	617,491
Other liabilities	258,901	-	-	-	-	-	116,243	375,144
Total non-interest bearing liabilities	9,640,229	617,491	-	-	-	-	116,243	10,373,963
TOTAL LIABILITIES	15,173,561	7,410,599	28,238,015	18,107,580	13,386,343	-	116,243	82,432,341

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	2004 Over 5 years
Liquidity gap	<u>(5,389,012)</u>	<u>(1,290,042)</u>	<u>13,533,014</u>	<u>22,480,140</u>	<u>(11,978,363)</u>
Interest sensitivity gap	<u>(2,635,148)</u>	<u>(674,071)</u>	<u>13,372,335</u>	<u>20,400,769</u>	<u>(13,386,343)</u>
Cumulative interest sensitivity gap	<u>(2,635,148)</u>	<u>(3,309,219)</u>	<u>10,063,116</u>	<u>30,463,885</u>	<u>17,077,542</u>
Cumulative interest sensitivity gap as a percentage of total assets	<u>(2.64%)</u>	<u>(3.31%)</u>	<u>10%</u>	<u>30%</u>	<u>17%</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)	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	2,284,215	3,468,344	39,342,533	11,173,487	-	1,507,372	(1,772,706)	56,003,245
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	5,485,117	-	-	1,466,900	1,066,576	519,101	776,068	9,313,762
TOTAL ASSETS	7,769,332	3,468,344	39,342,533	12,640,387	1,066,576	2,026,473	(996,638)	65,317,007
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	2,777,995	2,697,445	23,541,225	6,022,765	-	-	-	35,039,430
Floating interest rate bearing								
Deposit from banks and other credit institutions	-	-	-	-	10,067,444	-	-	10,067,444
Total interest bearing liabilities	2,777,995	2,697,445	23,541,225	6,022,765	10,067,444	-	-	45,106,874
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	6,077,544	-	161,688	4,080	-	-	94,875	6,338,187
TOTAL LIABILITIES	8,855,539	2,697,445	23,702,913	6,026,845	10,067,444	-	94,875	51,445,061

	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>	

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 4,903	EUR 1 EUR= AZM 6,882	Other currencies	Currency undefined (incl. allowance for losses)	2004 AZM thousand Total
ASSETS						
Cash and balances with the NBA	3,961,364	1,564,336	495,599	6,105	-	6,027,404
Loans and advances to banks, net	750	2,882,673	14,242,646	21,035	(27,947)	17,119,157
Loans and advances to customers, net	3,142,946	71,868,041	4,223	-	(1,986,115)	73,029,095
Available for sale debt securities	102,905	-	-	-	-	102,905
Fixed assets, net	2,896,434	-	-	-	-	2,896,434
Intangible assets, net	456,855	-	-	-	-	456,855
Deferred income tax assets	14,777	-	-	-	-	14,777
Other assets, net	41,939	302,795	-	-	(48,540)	296,194
TOTAL ASSETS	10,617,970	76,617,845	14,742,468	27,140	(2,062,602)	99,942,821
LIABILITIES						
Deposits from banks and other credit institutions	3,000,000	23,426,518	13,363,540	4,483	-	39,794,541
Customer accounts	3,697,740	36,703,699	1,242,849	878	-	41,645,165
Income tax liabilities	617,491	-	-	-	-	617,491
Other liabilities	133,115	115,582	10,204	-	116,243	375,144
TOTAL LIABILITIES	7,448,346	60,245,799	14,616,593	5,361	116,243	82,432,341
OPEN POSITION	3,169,624	16,372,046	125,875	21,779		

	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, net	950	388,396	8,147,899	438	(2,495)	8,535,188
Loans and advances to customers, net	8,452,191	40,183,382	2,487,904	-	(2,291,315)	48,832,162
Fixed and other intangible assets, net	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		

Market Risk

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

Credit risk

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

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

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

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

Geographical concentration

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

	Azerbaijan	Other CIS countries	OECD countries	Other non-OECD countries	Undefined (incl. allowance for losses)	2004 AZM thousand Total
ASSETS						
Cash and balances with the NBA	6,027,404	-	-	-	-	6,027,404
Loans and advances to banks, net	1,552,000	16,030	15,576,621	2,453	(27,947)	17,119,157
Loans and advances to customers, net	75,015,210	-	-	-	(1,986,115)	73,029,095
Available for sale debt securities	102,905	-	-	-	-	102,905
Fixed assets, net	2,896,434	-	-	-	-	2,896,434
Intangible assets, net	456,855	-	-	-	-	456,855
Deferred tax assets	14,777	-	-	-	-	14,777
Other assets	344,734	-	-	-	(48,540)	296,194
TOTAL ASSETS	86,410,319	16,030	15,576,621	2,453	(2,062,602)	99,942,821
LIABILITIES						
Deposits from banks	24,524,801	-	15,269,740	-	-	39,794,541
Customer accounts	41,645,165	-	-	-	-	41,645,165
Income tax liability	617,491	-	-	-	-	617,491
Other liabilities	258,901	-	-	-	116,243	375,144
TOTAL LIABILITIES	67,046,358	-	15,269,740	-	116,243	82,432,341
NET BALANCE SHEET POSITION	19,363,961	16,030	306,881	2,453		

						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, net	207,139	41,727	8,285,352	3,465	(2,495)	8,535,188
Loans and advances to customers, net	51,123,477	-	-	-	(2,291,315)	48,832,162
Fixed and other intangible assets, net	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>		