

**TURANBANK OPEN-JOINT  
STOCK COMPANY**

**International Financial Reporting Standards  
Consolidated Financial Statements and  
Independent Auditor's Report**

**31 December 2009**

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of Turanbank Open Joint Stock Company:

We have audited the accompanying consolidated financial statements of Turanbank Open Joint Stock Company and its subsidiary (the "Group") which comprise the consolidated statement of financial position as at 31 December 2009 and consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2009, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.


*PricewaterhouseCoopers Audit Azerbaijan LLC*

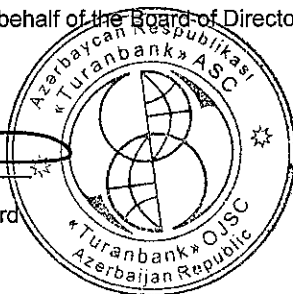
Baku, the Republic of Azerbaijan  
18 May 2010

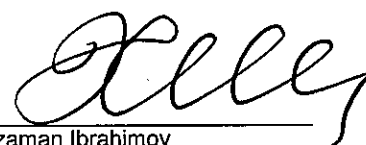
**Turanbank Open Joint-Stock Company**  
**Consolidated Statement of Financial Position**

<i>In thousands of Azerbaijani Manats</i>	Note	31 December 2009	31 December 2008
<b>ASSETS</b>			
Cash and cash equivalents	7	17,364	6,637
Due from other banks	8	750	142
Loans and advances to customers	9	76,506	65,534
Investment securities available for sale	10	3,375	2,186
Investment property		358	358
Premises and equipment	12	7,549	7,604
Intangible assets	12	72	67
Deferred income tax asset	26	7	-
Other financial assets	13	37	25
Other assets	14	65	109
<b>TOTAL ASSETS</b>		<b>106,083</b>	<b>82,662</b>
<b>LIABILITIES</b>			
Due to other banks	15	7,579	18,674
Customer accounts	16	44,776	30,851
Other borrowed funds	17	32,542	12,622
Deferred income tax liability	26	-	121
Current income tax liability	26	78	94
Other financial liabilities	18	152	165
Other liabilities	19	45	155
<b>TOTAL LIABILITIES</b>		<b>85,172</b>	<b>62,682</b>
<b>EQUITY</b>			
Share capital	20	17,000	16,000
Other reserves	21	1,068	1,041
Retained earnings		2,843	2,939
<b>TOTAL EQUITY</b>		<b>20,911</b>	<b>19,980</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>106,083</b>	<b>82,662</b>

Approved for issue and signed on behalf of the Board of Directors on 18 May 2010.

  
 Mr. Nazim Sadigov  
 Chairman of the Management Board



  
 Mr. Alizaman Ibrahimov  
 Chief Accountant

**Turanbank Open Joint-Stock Company**  
**Consolidated Statement of Comprehensive Income**

<i>In thousands of Azerbaijani Manats</i>	<b>Note</b>	<b>2009</b>	<b>2008</b>
Interest income	22	10,465	10,046
Interest expense	22	(4,960)	(5,056)
<b>Net interest income</b>		<b>5,505</b>	<b>4,990</b>
Provision for loan impairment	9	(1,035)	(390)
<b>Net interest income after provision for loan impairment</b>		<b>4,470</b>	<b>4,600</b>
Fee and commission income	23	1,175	1,141
Fee and commission expense	23	(204)	(144)
Gains less losses from trading in foreign currencies		274	260
Foreign exchange translation gains less losses		24	17
Other operating income	24	118	98
Change in fair value of investment property		-	108
Administrative and other operating expenses	25	(3,709)	(3,264)
<b>Profit before tax</b>		<b>2,148</b>	<b>2,816</b>
Income tax expense	26	(133)	(563)
<b>Profit for the year</b>		<b>2,015</b>	<b>2,253</b>
<b>Other comprehensive income:</b>			
Revaluation of premises		-	208
Income tax effect		27	(46)
<b>Other comprehensive income for the year</b>		<b>27</b>	<b>162</b>
<b>Total comprehensive income for the year</b>		<b>2,042</b>	<b>2,415</b>
<b>Earnings per share for profit attributable to the equity holders of the Group during the year (expressed in AZN per share):</b>			
- Basic/Diluted	27	0.12	0.16

**Turanbank Open Joint-Stock Company**  
**Consolidated Statement of Changes in Equity**

<i>In thousands of Azerbaijani Manats</i>	Note	Share capital	Retained earnings	Other reserves	Total equity
Balance at 1 January 2008		12,500	2,710	879	16,089
Total comprehensive income for 2008		-	2,253	162	2,415
Share issue	20	3,500	-	-	3,500
Dividends declared		-	(2,024)	-	(2,024)
Balance at 31 December 2008		16,000	2,939	1,041	19,980
Total comprehensive income for 2009		-	2,015	27	2,042
Share issue	20	1,000	-	-	1,000
Dividends declared		-	(2,111)	-	(2,111)
Balance at 31 December 2009		17,000	2,843	1,068	20,911

**Turanbank Open Joint-Stock Company**  
**Consolidated Statement of Cash Flows**

<i>In thousands of Azerbaijani Manats</i>	<b>Note</b>	<b>2009</b>	<b>2008</b>
<b>Cash flows from operating activities</b>			
Interest received		9,689	9,628
Interest paid		(4,581)	(5,047)
Fees and commissions received	23	1,175	1,141
Fees and commissions paid	23	(204)	(144)
Income received from trading in foreign currencies		298	277
Other operating income received	24	118	98
Staff costs paid	25	(2,031)	(1,523)
Administrative and other operating expenses paid		(1,128)	(1,347)
Income tax paid		(250)	(805)
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>		<b>3,086</b>	<b>2,278</b>
<b>Changes in operating assets and liabilities</b>			
Net increase in loans and advances to customers		(11,357)	(18,352)
Net (increase)/decrease in due from other banks		(608)	132
Net increase in other financial assets		(12)	(28)
Net decrease/(increase) in other assets		43	(69)
Net (decrease)/increase in due to other banks		(11,095)	5,760
Net increase in customer accounts		13,653	5,851
Net (decrease)/increase in other liabilities		(110)	25
Net decrease in other financial liabilities		(13)	(37)
<b>Net cash used in operating activities</b>		<b>(6,413)</b>	<b>(4,440)</b>
<b>Cash flows from investing activities</b>			
Acquisition of investment securities available for sale		(2,931)	(1,508)
Proceeds from disposal and redemption of investment securities available for sale	10	1,742	-
Acquisition of premises and equipment	12	(431)	(1,657)
Proceeds from disposal of premises and equipment		4	65
Acquisition of intangible assets	12	(19)	-
Dividend income received	24	76	57
<b>Net cash used in investing activities</b>		<b>(1,559)</b>	<b>(3,043)</b>
<b>Cash flows from financing activities</b>			
Proceeds from other borrowed funds		22,044	8,520
Repayment of other borrowed funds		(2,167)	(1,067)
Issue of ordinary shares	20	1,000	3,500
Dividends paid	28	(2,111)	(2,024)
<b>Net cash from financing activities</b>		<b>18,766</b>	<b>8,929</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>		<b>(67)</b>	<b>(1)</b>
<b>Net increase in cash and cash equivalents</b>		<b>10,727</b>	<b>1,445</b>
Cash and cash equivalents at the beginning of the year	7	6,637	5,192
<b>Cash and cash equivalents at the end of the year</b>		<b>17,364</b>	<b>6,637</b>

The notes set out on pages 5 to 60 form an integral part of these financial statements.

## **1 Introduction**

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2009 for Turanbank Open Joint-Stock Company (the "Bank") and its subsidiary (together referred to as the "Group").

The Bank was incorporated and is domiciled in the Republic of Azerbaijan. The Bank is a joint stock company limited by shares and was set up in accordance with Azerbaijani regulations.

On 21 August 2006, the Bank registered TuranLizing LLC ("TuranLizing") with the Ministry of Justice of the Republic of Azerbaijan. The company commenced its operations in September 2006, and is owned 100% by the Bank.

**Principal activity.** The Bank's principal business activity is commercial and retail banking operations within the Republic of Azerbaijan. The Bank has operated under a full banking license issued by the Central Bank of the Republic of Azerbaijan ("CBAR") since December 1992. The Bank participates in the State deposit insurance scheme, which was introduced by the Azeri Law, "Deposits of individuals insurance in Azerbaijan Republic" dated 29 December 2006. The State Deposit Insurance Fund guarantees repayment of 100% of individual deposits in the following order:

- until 1 January 2008 – up to AZN 4,000;
- from 1 January 2008 until 1 January 2010 – up to AZN 6,000;
- 1 January 2010 and afterwards – up to AZN 30,000.

The Bank has eleven (2008: eleven) branches within the Republic of Azerbaijan.

**Registered address and place of business.** The Bank's registered address is:

Ismayil bey Gutgashinly 85 Street  
AZ1073  
Baku, The Republic of Azerbaijan

**Presentation currency.** These consolidated financial statements are presented in thousands of Azerbaijani Manats ("AZN thousands").

## **2 Operating Environment of the Group**

**The Republic of Azerbaijan.** The Republic of Azerbaijan displays certain characteristics of an emerging market, including the existence of a currency that is not freely convertible in most countries outside of the Republic of Azerbaijan, relatively high inflation and strong economic growth. The banking sector in the Republic of Azerbaijan is sensitive to adverse fluctuations in confidence and economic conditions. The Azerbaijani economy occasionally experiences falls in confidence in the banking sector accompanied by reductions in liquidity. Management is unable to predict economic trends and developments in the banking sector and consequently what effect, if any, a deterioration in the liquidity of or confidence in the Azerbaijani banking system could have on the financial position of the Group.

The tax, currency and customs legislation within the Republic of Azerbaijan is subject to varying interpretations and frequent changes. Furthermore, the need for further developments in the bankruptcy laws, the absence of formalized procedures for the registration and enforcement of collateral, and other legal and fiscal impediments contribute to the challenges faced by banks currently operating in the Republic of Azerbaijan. Major changes made to the law on central bank in 2009 was aimed at increased flexibility of monetary policy, securing liquidity in economy through allowing banks to issue longer term loans in different currencies as well as issuing subordinated loans. Based on main macroeconomic tendencies, during 2009 Central Bank reduced refinancing rates from 15% to 2% and mandatory reserve requirements from 12% to 0.5%. As part of its anti-crisis policy, Central Bank has promoted mortgage financing, which had stabilizing impact on construction and property market. The future economic direction of the Republic of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

## **2 Operating Environment of the Group (Continued)**

**Recent volatility in global financial markets.** The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, at times much higher than normal interbank lending rates, and lower liquidity levels across the Republic of Azerbaijan banking sector resulting in a significant reduction in the number of new loans and advances made to customers, and higher funding costs where it remains possible to obtain debt finance from International Institutions or other local banks. The uncertainties in the global financial market, has also led to bank failures and bank rescues in the United States of America, Western Europe and in Russia. Such circumstances could affect the ability of the Group to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions. The borrowers of the Group may also be affected by the lower liquidity situation which could in turn impact their ability to repay their outstanding loans. Deteriorating operating conditions for borrowers may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets.

To the extent that information is available, management has reflected revised estimates of expected future cash flows in their impairment assessments.

Management is unable to reliably estimate the effects on the Group's financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets, however, is confident that it can secure new funding when required and in fact, obtained new borrowings during 2009. The Group did not experience any problems with repayment of its funding obligations. Management believes that they are taking all the necessary measures to support the sustainability and growth of the Group's business in the current circumstances.

## **3 Summary of Significant Accounting Policies**

**Basis of Preparation.** These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the revaluation of premises and equipment, investment properties and available-for-sale financial assets. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

**Consolidated financial statements.** Subsidiaries are those companies and other entities (including special purpose entities) in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain benefits. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are de-consolidated from the date that control ceases.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Group and its subsidiary use uniform accounting policies consistent with the Group's policies.

Minority interest is that part of the net results and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly, by the Group. Minority interest forms a separate component of the Group's equity.

**Key measurement terms.** Depending on their classification financial instruments are carried at fair value or amortised cost as described below.

**Fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair value is the current bid price for financial assets and current asking price for financial liabilities which are quoted in an active market. For assets and liabilities with offsetting market risks, the Group may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange or other institution and those prices represent actual and regularly occurring market transactions on an arm's length basis.

### **3 Summary of Significant Accounting Policies (Continued)**

Valuation techniques such as discounted cash flows models or models based on recent arms length transactions or consideration of financial data of the investees are used to fair value certain financial instruments for which external market pricing information is not available. Valuation techniques may require assumptions not supported by observable market data. Disclosures are made in these financial statements if changing any such assumptions to a reasonably possible alternative would result in significantly different profit, income, total assets or total liabilities.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes transaction costs. Measurement at cost is only applicable to investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured.

*Transaction costs* are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

*Amortised cost* is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method.

Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related balance sheet items.

*The effective interest method* is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate (refer to income and expense recognition policy).

**Initial recognition of financial instruments.** Trading securities, derivatives and other financial instruments at fair value through profit or loss are initially recorded at fair value. All other financial instruments are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date that the Group commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument

**Derecognition of financial assets.** The Group derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

### **3 Summary of Significant Accounting Policies (Continued)**

**Cash and cash equivalents.** Cash and cash equivalents are items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents include mandatory reserve deposits with the CBAR and all interbank placements with original maturities of less than three months. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

**Due from other banks.** Amounts due from other banks are recorded when the Group advances money to counterparty banks with no intention of trading the resulting unquoted non-derivative receivable due on fixed or determinable dates. Amounts due from other banks are carried at amortised cost.

**Loans and advances to customers.** Loans and advances to customers are recorded when the Group advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates and has no intention of trading the receivable. Loans and advances to customers are carried at amortised cost. When impaired financial assets are renegotiated and the renegotiated terms and conditions differ substantially from the previous terms, the new asset is initially recognised at its fair value.

**Impairment of financial assets carried at amortised cost.** Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Group determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Group considers in determining whether a financial asset is impaired are its overdue status and realisability of related collateral, if any.

The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

- any instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the borrower experiences a significant financial difficulty as evidenced by the borrower's financial information that the Group obtains;
- the borrower considers bankruptcy or a financial reorganisation;
- there is an adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrower; or

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

### **3 Summary of Significant Accounting Policies (Continued)**

If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss for the year.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to impairment loss account in profit or loss for the year.

**Credit related commitments.** The Group enters into credit related commitments, including letters of credit and financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At each balance sheet date, the commitments are measured at the higher of (i) the unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the balance sheet date.

**Investment securities available for sale.** This classification includes investment securities which the Group intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Investment securities available for sale are carried at cost. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit or loss for the year. Dividends on available-for-sale equity instruments are recognised in profit or loss for the year when the Group's right to receive payment is established and it is probable that the dividends will be collected. All other elements of changes in the fair value are recognised in other comprehensive income until the investment is derecognised or impaired, at which time the cumulative gain or loss is reclassified from other comprehensive income to profit or loss for the year.

Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of investment securities available for sale. A significant or prolonged decline in the fair value of an equity security below its cost is an indicator that it is impaired. The cumulative impairment loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised in profit or loss – is reclassified from other comprehensive income to profit or loss for the year. Impairment losses on equity instruments are not reversed and any subsequent gains are recognised in other comprehensive income. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss for the year.

**Investment property.** Investment property is property held by the Group to earn rental income or for capital appreciation, or both and which is not occupied by the Group.

### **3 Summary of Significant Accounting Policies (Continued)**

Investment property is initially recognised at cost, including transaction costs, and subsequently remeasured at fair value updated to reflect market conditions at the end of the reporting period. Fair value of investment property is the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction. A "willing seller" is not a forced seller prepared to sell at any price. The best evidence of fair value is given by current prices in an active market for similar property in the same location and condition. In the absence of current prices in an active market, the Group considers information from a variety of sources, including:

- (a) current prices in an active market for properties of different nature, condition or location, adjusted to reflect those differences;
- (b) recent prices of similar properties on less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices; and
- (c) discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts and (when possible) by external evidence such as current market rents for similar properties in the same location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows.

Subsequent expenditure is capitalised to the asset's carrying amount only when it is probable that future economic benefits associated with the expenditure will flow to the Group and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred.

**Premises and equipment.** Premises and equipment are stated at cost, or revalued amounts as described below, less accumulated depreciation and provision for impairment, where required.

Starting from 2005, the Group has changed its accounting policy for measurement of its premises from the cost model to the revaluation model in order to provide a more accurate presentation of the value of its property given the rapid increases in local property prices. The premises of the Group are subject to revaluation on a regular basis. The frequency of revaluation depends upon the movements in the fair values of the premises being revalued. The revaluation reserve for premises included in equity is transferred directly to retained earnings when any surplus is realised, for example, either on the retirement or disposal of the asset, or as the asset is used by the Group; in the latter case, the amount of the surplus realised is the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost.

All items of equipment are stated at cost less accumulated depreciation and impairment losses, if any.

Costs of minor repairs and maintenance are expensed when incurred. The cost of replacing major parts or components of premises and equipment items are capitalised and the replaced part is retired.

If impaired, premises and equipment are written down to the higher of their value in use and fair value less costs to sell. The decrease in carrying amount is charged to profit or loss. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss.

**Depreciation.** Land is not depreciated. Depreciation on other items of premises and equipment is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives at the following annual rates:

Buildings	3%;
Computers and communication equipment	25%;
Furniture, fixture and other equipment	20%;
Motor vehicles	20%; and
Leasehold improvements	over the term of the underlying lease.

### **3 Summary of Significant Accounting Policies (Continued)**

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

**Intangible assets.** All of the Group's intangible assets have a definite useful life and primarily include capitalised computer software and licences.

Acquired computer software licences are capitalised based on the costs incurred to acquire and bring to use the specific software. Development costs that are directly associated with identifiable and unique software controlled by the Group are recorded as intangible assets if the inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred. Other intangible assets are amortised over their estimated useful lives of 7 to 10 years on a straight-line basis.

**Operating leases.** Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit or loss on a straight-line basis over the period of the lease.

Leases embedded in other agreements are separated if (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets and (b) the arrangement conveys a right to use the asset.

When assets are leased out under an operating lease, the lease payments receivable are recognised as rental income on a straight-line basis over the lease term.

**Finance lease receivables.** Where the Group is a lessor in a lease which transfers substantially all the risks and rewards incidental to ownership to the lessee, the assets leased out are presented as a finance lease receivable and carried at the present value of the future lease payments. Finance lease receivables are initially recognised at commencement (when the lease term begins) using a discount rate determined at inception (the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease).

The difference between the gross receivable and the present value represents unearned finance income. This income is recognised over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return. Incremental costs directly attributable to negotiating and arranging the lease are included in the initial measurement of the finance lease receivable and reduce the amount of income recognised over the lease term. Finance income from leases is recorded within [other operating income] in profit or loss for the year.

Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of finance lease receivables. The Group uses the same principal criteria to determine whether there is objective evidence that an impairment loss has occurred as for loans carried at amortised cost. Impairment losses are recognised through an allowance account to write down the receivables' net carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the interest rates implicit in the finance leases. The estimated future cash flows reflect the cash flows that may result from obtaining and selling the assets subject to the lease.

**Due to other banks.** Amounts due to other banks are recorded when money or other assets are advanced to the Group by counterparty banks. The non-derivative liability is carried at amortised cost.

**Customer accounts.** Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at amortised cost.

**Income taxes.** Income taxes have been provided for in these financial statements in accordance with Azerbaijani legislation enacted or substantively enacted by the balance sheet date. The income tax charge comprises current tax and deferred tax and is recognised in the income statement except if it is recognised directly in equity because it relates to transactions that are also recognised, in the same or a different period, directly in equity.

### **3 Summary of Significant Accounting Policies (Continued)**

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if financial statements are authorised prior to filing relevant tax returns. Taxes, other than on income, are recorded within administrative and other operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit.

**Deferred tax.** On 14 November 2008, a new Law on "Stimulation of Increasing the Capitalization of Banks, Insurance and Reinsurance Companies" ("the Law") was enacted. According to the law the profit tax rate for banks, insurance and reinsurance companies is reduced to 0% for three fiscal years from 1 January 2009, provided profit for the fiscal year is transferred to share capital. The law does not clarify whether the profit to be transferred to share capital should be from finance or tax books. The management interpreted the law to imply transfer of profit per finance books and adopted the policy to transfer about 50% of its profit per finance books to share capital during and therefore accrued a current tax liability AZN 234 thousand, being 22% of the excess of profit per tax books over profit from finance books transferred to share capital.

Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

**Uncertain tax positions.** The Group's uncertain tax positions are reassessed by management at every balance sheet date. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the balance sheet date and any known Court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognised based on management's best estimate of the expenditure required to settle the obligations at the balance sheet date.

**Dividends.** Dividends are recorded in equity in the period in which they are declared. Dividends declared after the balance sheet date and before the financial statements are authorised for issue are disclosed in the subsequent events note. The statutory accounting reports of the Group are the basis for profit distribution and other appropriations. Azerbaijani legislation identifies the basis of distribution as the current year net profit.

**Income and expense recognition.** Interest income and expense are recorded in the income statement for all debt instruments on an accrual basis using the effective interest method. This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Group to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Group does not designate loan commitments as financial liabilities at fair value through profit or loss.

When loans and other debt instruments become doubtful of collection, they are written down to present value of expected cash inflows and interest income is thereafter recorded for the unwinding of the present value discount based on the asset's effective interest rate which was used to measure the impairment loss.

### **3 Summary of Significant Accounting Policies (Continued)**

All other fees, commissions and other income and expense items are generally recorded on an accrual basis by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

**Foreign currency translation.** Functional currency of the Group is the currency of the primary economic environment in which it operates. The Group's functional and presentation currency is the national currency of the Republic of Azerbaijan, Azerbaijani Manat ("AZN").

Monetary assets and liabilities are translated into entity's functional currency at the official exchange rate of the CBAR at the respective balance sheet dates. Foreign exchange gains and losses resulting from the settlement of transactions and from the translation of monetary assets and liabilities into entity's functional currency at year-end official exchange rates of the CBAR are recognised in profit or loss. Translation at year-end rates does not apply to non-monetary items, including equity investments. Effects of exchange rate changes on the fair value of equity securities are recorded as part of the fair value gain or loss.

At 31 December 2009, the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 0.8031 and EUR 1 = AZN 1.1499 (31 December 2008: USD 1 = AZN 0.8010 and EUR 1 = AZN 1.1292).

**Staff costs and related contributions.** Wages, salaries, contributions to the state pension and social insurance funds of the Republic of Azerbaijan, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the period in which the associated services are rendered by the employees of the Group.

**Segment reporting.** Operating segments are reported in a manner consistent with the internal reporting provided to the Group's chief operating decision maker. Segments whose revenue, result or assets are ten percent or more of all the segments are reported separately.

**Changes in accounting policies and presentation.** Any changes to these financial statements require approval of the Group's management who authorised these financial statements for issue.

### **4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies**

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial period. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

**Tax legislation.** Azerbaijani tax, currency and customs legislation is subject to varying interpretations. Refer to Note 32.

**Impairment losses on loans and advances.** Management regularly reviews the Group's loan portfolios to assess impairment. In determining whether an impairment loss should be recorded in the income statement, management makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. To the extent that the assessed delay in repayment of principal on 5% of the total loans and advances to customers differs by +/- one month, the provision would be approximately AZN 328 thousand (31 December 2008: AZN 197 thousand) higher or lower.

#### **4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)**

**Going concern.** Management has prepared these financial statements on a going concern basis. In making this judgement management has considered the current macroeconomic environment for financial institutions operating in Azerbaijan and the profitability of its operations and access to local financial resources as required.

As set out in consolidated statement of cash flows, the Group had a negative cash flow of AZN 6,413 thousand (2008: negative cash flow of AZN 4,440 thousands) used in its operating activities. While recent global events have had a significant impact on the ability to obtain new or extended term borrowings from International Financial Institutions, and where available, the cost of funding has typically increased, management are actively managing this position and as a result of the following actions believe that the Group will have access to sufficient resources in order to continue to meet all liabilities as they fall due:

- management have analyzed the level of customer accounts including term deposits during the past three years and consider that this is evidence that such amounts provide a stable funding source for the Group. As such, while the liquidity position in Note 30 records the contractual maturity dates when the amounts are repayable, management are confident that a substantial portion of the existing amounts will remain with the Group, and new customer accounts and term deposits will continue to be attracted;
- the Group is continuing negotiations with International Financial Institutions, both current lenders to the Group and with other parties, with an understanding that new or amended borrowing agreements will be agreed and funding in place during the next twelve months; and
- in spite of the fact that cash flows used in operating activities continue to be negative, cash is nonetheless available based on historic trends and current observations management believes that as of the date of this report, the Group had not experienced any adverse consequences or lack of liquid assets required to meet all liabilities as they fall due.

Management is confident that the Group will be able to obtain required funds in order to settle its current obligations and continue to operate within its business course in the nearest future. Management believes that through the continued support of its shareholders and access to borrowings from local and international financial institutions this will be sufficient for the Group to obtain appropriate resources should all liabilities mature as disclosed in Note 30.

**Revaluation of premises.** Management uses judgement to determine when factors dictate that a revaluation of the Group's premises is appropriate in order for the balance sheet to reflect fair value at each balance sheet date and how the assessment of the fair value of investment properties is performed. The fair value of premises and investment property is usually determined from market-based evidence by an appraisal that is undertaken by professionally qualified valuers. The evidence used by the valuers includes estimates of prevailing market prices per square metre of properties with characteristics similar to those of the Group's properties. These estimates are based on the valuer's experience using comparable sale information and represent a benchmark of the current situation and trends in the market. The valuer also calculates valuations using an income capitalisation approach taking into account future rental incomes and other factors before confirming an overall valuation for each of the Group's properties. The most significant estimate made in performing the valuations is the sale price per square metre for comparable buildings. To the extent that the estimate for the sale price per square metre used in the independent valuation differed by 5%, the revalued amounts of premises and investment property as at 31 December 2009 would differ by +/- AZN 127 thousand.

**Initial recognition of related party transactions.** In the normal course of business the Group enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

**Loans and advances to customers.** The Group has acquired long term financing from the National Fund for Support of Entrepreneurship of the Republic of Azerbaijan and Mortgage Fund of the Republic of Azerbaijan at interest rates below those at which similar organisations ordinarily lend in emerging markets and which may be lower than rates at which the Group could source the funds from other lenders. Management have considered whether gains or losses should arise on initial recognition of such instruments. As the transactions are with unrelated parties, management's judgement is that these funds and the related lending are at the market rates and no initial recognition gains or losses should arise. In making this judgement management also considered that these instruments are a separate market segment.

#### **4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)**

**Other borrowed funds.** The Group obtains long-term financing from the government at interest rates which are lower than rates at which the Group could source the funds from local lenders. As a result of such financing, the Group is able to advance funds to specific customers (under specific lending programmes) at advantageous rates. Loans issued under these government programmes are issued to customers at lower than market rates. As at 31 December 2009 total assets and liabilities affected under these specific lending programmes were AZN 25,785 thousand (31 December 2008: AZN 11,373 thousand). Management have considered whether gains or losses should arise on initial recognition of such instruments. As the transactions are with unrelated parties, management's judgement is that these funds and the related lending are at the market rates and no initial recognition gains or losses should arise. In making this judgement management also considered that these instruments are a separate market segment. Borrowings from government and international financial institutions are carried at amortised cost.

**Agreement with the Azerbaijan Mortgage Fund.** Management has assessed the nature of the agreement with the Azerbaijan Mortgage Fund, and in particular whether the Group is acting as an agent of the Fund, or as a principal with the borrowers under this programme. Having considered the risks and rewards of the programme, it has been concluded that the Group is acting as principal and accordingly the accounting in these financial statements follows this judgment. Had an alternative conclusion been reached, the gross amount of loans to customers and due to the Fund, of AZN 3,711 thousand as at 31 December 2009 (31 December 2008: AZN 1,824 thousand), would have been excluded from the Group's financial statements.

#### **5 Adoption of New Revised Standards and Interpretations**

Certain new standards and interpretations became effective for the Group from 1 January 2009:

**IFRS 8, Operating Segments.** The standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments, with segment information presented on a similar basis to that used for internal reporting purposes.

**IAS 23, Borrowing Costs, revised in March 2007.** The main change is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale (a qualifying asset) form part of the cost of that asset, if the commencement date for capitalisation is on or after 1 January 2009. Other borrowing costs are recognised as an expense using the effective interest method.

**IAS 1, Presentation of Financial Statements, revised in September 2007.** The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which includes all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities are allowed to present two statements: a separate income statement and a statement of comprehensive income. The Group has elected to present a single statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The revised IAS 1 had an impact on the presentation of the Group's financial statements but had no impact on the recognition or measurement of specific transactions and balances.

**5 Adoption of New or Revised Standards and Interpretations (Continued)**

**Improvements to International Financial Reporting Standards** (issued in May 2008). In 2008, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting.

**Puttable Financial Instruments and Obligations Arising on Liquidation—IAS 32 and IAS 1 Amendment.** The amendment requires classification as equity of some financial instruments that meet the definition of financial liabilities.

**Vesting Conditions and Cancellations—Amendment to IFRS 2, Share-based Payment.** The amendment clarified that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment.

**IFRIC 13, Customer Loyalty Programmes.** IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values.

**IFRIC 15, Agreements for the Construction of Real Estate.** The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions.

**Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate—IFRS 1 and IAS 27 Amendment, issued in May 2008.** The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying value as deemed cost in the separate financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss for the year rather than as a recovery of the investment.

**Improving Disclosures about Financial Instruments - Amendment to IFRS 7, Financial Instruments: Disclosures, issued in March 2009.** The amendment requires enhanced disclosures about fair value measurements and liquidity risk. The entity is required to disclose an analysis of financial instruments using a three-level fair value measurement hierarchy. The amendment (a) clarifies that the maturity analysis of liabilities should include issued financial guarantee contracts at the maximum amount of the guarantee in the earliest period in which the guarantee could be called; and (b) requires disclosure of remaining contractual maturities of financial derivatives if the contractual maturities are essential for an understanding of the timing of the cash flows. An entity will further have to disclose a maturity analysis of financial assets it holds for managing liquidity risk, if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk. The enhanced disclosures are included in these financial statements.

## **5 Adoption of New or Revised Standards and Interpretations (Continued)**

**Embedded Derivatives - Amendments to IFRIC 9 and IAS 39, issued in March 2009.** The amendments clarify that on reclassification of a financial asset out of the 'at fair value through profit or loss' category, all embedded derivatives have to be assessed and, if necessary, separately accounted for.

**IFRIC 16, Hedges of a Net Investment in a Foreign Operation.** The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied. The IFRIC allows the hedging instrument to be held by any entity or entities within a group except the foreign operation that itself is being hedged. The interpretation also clarifies how the currency translation gain or loss reclassified from other comprehensive income to profit or loss is calculated on disposal of the hedged foreign operation. Reporting entities apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16.

**The International Financial Reporting Standard for Small and Medium-sized Entities (issued in July 2009) is a self-contained standard, tailored to the needs and capabilities of smaller businesses.** Many of the principles of full IFRS for recognising and measuring assets, liabilities, income and expense have been simplified, and the number of required disclosures have been simplified and significantly reduced. The IFRS for SMEs may be applied by entities which publish general purpose financial statements for external users and do not have public accountability. The Group is not eligible to apply the IFRS for SMEs due to the public accountability of its banking business.

Unless otherwise stated above, the amendments and interpretations did not have any significant effect on the Group's consolidated financial statements.

## **6 New Accounting Pronouncements**

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2010 or later periods and which the Group has not early adopted:

**IFRIC 17, Distributions of Non-Cash Assets to Owners** (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss for the year when the entity settles the dividend payable.

**IFRIC 18, Transfers of Assets from Customers** (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers.

**Classification of Rights Issues - Amendment to IAS 32** (issued 8 October 2009; effective for annual periods beginning on or after 1 February 2010). The amendment exempts certain rights issues of shares with proceeds denominated in foreign currencies from classification as financial derivatives.

**IAS 27, Consolidated and Separate Financial Statements** (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value.

**6 New Accounting Pronouncements (Continued)**

**IFRS 3, Business Combinations** (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer will have to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss for the year. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone.

**Eligible Hedged Items—Amendment to IAS 39, Financial Instruments: Recognition and Measurement** (effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations.

**IFRS 1, First-time Adoption of International Financial Reporting Standards** (following an amendment in December 2008, effective for the first IFRS financial statements for a period beginning on or after 1 July 2009). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The Group concluded that the revised standard does not have any effect on its financial statements.

**Group Cash-settled Share-based Payment Transactions - Amendments to IFRS 2, Share-based Payment** (effective for annual periods beginning on or after 1 January 2010). The amendments provide a clear basis to determine the classification of share-based payment awards in both consolidated and separate financial statements. The amendments incorporate into the standard the guidance in IFRIC 8 and IFRIC 11, which are withdrawn. The amendments expand on the guidance given in IFRIC 11 to address plans that were previously not considered in the interpretation. The amendments also clarify the defined terms in the Appendix to the standard.

**Additional Exemptions for First-time Adopters - Amendments to IFRS 1, First-time Adoption of IFRS** (effective for annual periods beginning on or after 1 January 2010). The amendments exempt entities using the full cost method from retrospective application of IFRSs for oil and gas assets and also exempt entities with existing leasing contracts from reassessing the classification of those contracts in accordance with IFRIC 4, 'Determining Whether an Arrangement Contains a Lease' when the application of their national accounting requirements produced the same result. The amendments will not have any impact on the Group's financial statements.

**6 New Accounting Pronouncements (Continued)**

**Improvements to International Financial Reporting Standards (issued in April 2009; amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010).** The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss for the year and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. The Group does not expect the amendments to have any material effect on its financial statements.

**Amendment to IAS 24, Related Party Disclosures** (issued in November 2009 and effective for annual periods beginning on or after 1 January 2011). IAS 24 was revised in 2009 by: (a) simplifying the definition of a related party, clarifying its intended meaning and eliminating inconsistencies; and by (b) providing a partial exemption from the disclosure requirements for government-related entities.

**IFRS 9, Financial Instruments Part 1: Classification and Measurement.** IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets. Key features are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
- While adoption of IFRS 9 is mandatory from 1 January 2013, earlier adoption is permitted.

The Management of the Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

**6 New Accounting Pronouncements (Continued)**

**IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments** (effective for annual periods beginning on or after 1 July 2010). This IFRIC clarifies the accounting when an entity renegotiates the terms of its debt with the result that the liability is extinguished through the debtor issuing its own equity instruments to the creditor. A gain or loss is recognised in the profit and loss account based on the fair value of the equity instruments compared to the carrying amount of the debt. The Interpretation will not have any impact on the Group's financial statements as the Group does not extinguish its financial liabilities with equity instruments.

**Prepayments of a Minimum Funding Requirement – Amendment to IFRIC 14** (effective for annual periods beginning on or after 1 January 2011). This amendment will have a limited impact as it applies only to companies that are required to make minimum funding contributions to a defined benefit pension plan. It removes an unintended consequence of IFRIC 14 related to voluntary pension prepayments when there is a minimum funding requirement. The amendment will not have any impact on the Group's financial statements.

**Limited exemption from comparative IFRS 7 disclosures for first-time adopters - Amendment to IFRS 1** (effective for annual periods beginning on or after 1 July 2010). Existing IFRS preparers were granted relief from presenting comparative information for the new disclosures required by the March 2009 amendments to IFRS 7 'Financial Instruments: Disclosures'. This amendment to IFRS 1 provides first-time adopters with the same transition provisions as included in the amendment to IFRS 7. The amendment will not have any impact on the Group's financial statements.

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Groups financial statements.

**7 Cash and Cash Equivalents**

<i>In thousands of Azerbaijani Manats</i>	31 December 2009	31 December 2008
Cash on hand	3,424	1,316
Cash balances with the CBAR (other than mandatory reserve deposits)	8,326	1,780
Mandatory cash balances with CBAR	140	1,862
Correspondent accounts and overnight placements with other banks	1,644	888
Placements with other banks with original maturities of less than three	3,830	791
<b>Total cash and cash equivalents</b>	<b>17,364</b>	<b>6,637</b>

Analysis by credit quality of the cash and cash equivalents at 31 December 2009 is as follows:

	Cash on hand	Cash balances with the CBAR, including mandatory reserves	Correspondent accounts and overnight placements with other banks	Placements with other banks	Total
<i>In thousands of Azerbaijani Manats</i>					
<i>Neither past due nor impaired</i>					
- Cash on hand	3,424	-	-	-	3,424
- Central Bank of Azerbaijan	-	8,466	-	-	8,466
- Top 15 Azerbaijani banks	-	-	31	3,106	3,137
- Top 20 Azerbaijani banks	-	-	1,209	-	1,209
- Small banks	-	-	-	321	321
- OECD banks	-	-	371	-	371
- Non-OECD banks	-	-	33	403	436
<b>Total cash and cash equivalents, excluding cash on hand</b>	<b>3,424</b>	<b>8,466</b>	<b>1,644</b>	<b>3,830</b>	<b>17,364</b>

**7 Cash and Cash Equivalents (Continued)**

Analysis by credit quality of the cash and cash equivalents at 31 December 2008 is as follows:

	Cash on hand	Cash balances with the CBAR, including mandatory reserves	Correspondent accounts and overnight placements with other banks	Placements with other banks	Total
<i>In thousands of Azerbaijani Manats</i>					
<i>Neither past due nor impaired</i>					
- Cash on hand	1,316	-	-	-	1,316
- Central Bank of Azerbaijan	-	3,642	-	-	3,642
- Top 15 Azerbaijani banks	-	-	7	-	7
- OECD banks	-	-	809	-	809
- Non-OECD banks	-	-	72	791	863
<b>Total cash and cash equivalents, excluding cash on hand</b>	<b>1,316</b>	<b>3,642</b>	<b>888</b>	<b>791</b>	<b>6,637</b>

Included in correspondent accounts and overnight placements with other banks are nostro accounts in nine resident banks of AZN 1,240 thousand and sixteen not resident banks of AZN 403 thousand bearing annual interest rates of nil% (31 December 2008: AZN 7 thousand and AZN 881 thousand bearing annual interest rates of nil%).

Included in placements with other banks are three short-term deposits in resident banks of AZN 3,427 thousand and one not resident bank of AZN 805 thousand bearing market interest rates (31 December 2008: short-term deposits in resident bank of AZN 790 thousand bearing market interest rates). Cash on hand, cash balances with the CBAR and mandatory reserve deposits are non-interest bearing. Interest rate analysis of cash and cash equivalents is disclosed in Note 30.

**8 Due from Other Banks**

<i>In thousands of Azerbaijani Manats</i>	31 December 2009	31 December 2008
Short-term placements with other banks with original maturities of more than three months	609	1
Blocked accounts	141	141
<b>Total due from other banks</b>	<b>750</b>	<b>142</b>

As at 31 December 2009, blocked accounts include placement with a resident banks of AZN 141 thousand bearing annual interest rates of nil% (31 December 2008: placement with a resident banks of AZN 141 thousand bearing annual interest rates of nil%).

Amounts due from other banks are not collateralised. Analysis by credit quality of the amounts due from other banks outstanding at 31 December 2009 is as follows:

	Short-term placements with other banks	Blocked accounts with resident banks	Total
<i>In thousands of Azerbaijani Manats</i>			
<i>Neither past due nor impaired</i>			
-Top 5 Azerbaijani banks	1	8	9
-Top 25 Azerbaijani banks	200	133	333
-Small Azerbaijani banks	6	-	6
-Non-OECD Banks	402	-	402
<b>Total neither past due nor impaired</b>	<b>609</b>	<b>141</b>	<b>750</b>
<b>Total due from other banks</b>	<b>609</b>	<b>141</b>	<b>750</b>

**8 Due from Other Banks (Continued)**

Analysis by credit quality of amounts due from other banks outstanding at 31 December 2008 is as follows:

<i>In thousands of Azerbaijani Manats</i>	Short-term placements with other banks	Blocked accounts with resident banks	Total
<i>Neither past due nor impaired</i>			
-Top 5 Azerbaijani banks	1	8	9
-Top 25 Azerbaijani banks	-	133	133
<b>Total neither past due nor impaired</b>	<b>1</b>	<b>141</b>	<b>142</b>
<b>Total due from other banks</b>	<b>1</b>	<b>141</b>	<b>142</b>

The carrying value of each class of amounts due from other banks approximates fair value at 31 December 2009 and 31 December 2008. At 31 December 2009 the estimated fair value of due from other banks was AZN 750 thousand (31 December 2008: AZN 142 thousand). Refer to Note 33.

Interest rate analysis of due from other banks is disclosed in Note 30.

**9 Loans and Advances to Customers**

<i>In thousands of Azerbaijani Manats</i>	31 December 2009	31 December 2008
Corporate loans	43,938	38,101
Loans to individuals – entrepreneurs	17,372	16,353
Loans to individuals - consumer loans	11,761	9,027
Mortgage loans	5,625	3,613
Other	823	418
Less: Provision for loan impairment	(3,013)	(1,978)
<b>Total loans and advances to customers</b>	<b>76,506</b>	<b>65,534</b>

Movements in the provision for loan impairment during 2009 are as follows:

<i>In thousands of Azerbaijani Manats</i>	Corporate loans	Loans to individuals- consumer loans	Loans to individuals- entrepreneurs	Mortgage loans	Other	Total
Provision for loan impairment as at 1 January 2009	1,249	280	322	72	55	1,978
Provision for impairment during the year	67	372	160	311	125	1,035
<b>Provision for loan impairment as at 31 December 2009</b>	<b>1,316</b>	<b>652</b>	<b>482</b>	<b>383</b>	<b>180</b>	<b>3,013</b>

**9 Loans and Advances to Customers (Continued)**

Movements in the provision for loan impairment during 2008 are as follows:

<i>In thousands of Azerbaijani Manats</i>	Corporate loans	Loans to individuals-consumer loans	Loans to individuals-entrepreneurs	Mortgage loans	Other	Total
Provision for loan impairment as at 1 January 2008	1,016	228	262	59	45	1,610
Provision for impairment during the year	255	52	60	13	10	390
Amounts written-off during the year as uncollectible	(22)	-	-	-	-	(22)
<b>Provision for loan impairment as at 31 December 2008</b>	<b>1,249</b>	<b>280</b>	<b>322</b>	<b>72</b>	<b>55</b>	<b>1,978</b>

Provision for loan impairment includes both collective and individual loan provision.

Economic sector risk concentrations within the customer loan portfolio are as follows:

<i>In thousands of Azerbaijani Manats</i>	31 December 2009		31 December 2008	
	Amount	%	Amount	%
<i>Retail loans</i>				
Trade and services	3,103	4	3,036	5
Purchase of apartments and mortgages	5,625	7	3,613	5
Manufacturing	6,305	8	7,464	11
Agriculture	5,108	6	2,101	3
Construction	2,997	4	3,724	6
Consumer loans	11,761	15	9,055	13
Other	65	-	418	1
<b>Total retail loans</b>	<b>34,964</b>	<b>44</b>	<b>29,411</b>	<b>44</b>
<i>Corporate loans</i>				
Trade and services	13,927	17	16,066	24
Construction	7,129	9	8,536	13
Production	11,354	14	6,383	9
Agriculture	11,470	15	6,965	10
Other	675	1	151	-
<b>Total corporate loans</b>	<b>44,555</b>	<b>56</b>	<b>38,101</b>	<b>56</b>
<b>Total loans and advances to customers (before impairment)</b>	<b>79,519</b>	<b>100</b>	<b>67,512</b>	<b>100</b>

**9 Loans and Advances to Customers (Continued)**

At 31 December 2009, the Group had 113 borrowers (31 December 2008: 127 borrowers) with aggregated loan amounts above AZN 100 thousand. The total aggregate amount of these loans was AZN 58,708 thousand (31 December 2008: AZN 50,012 thousand) or 75% of the gross loan portfolio (31 December 2008: 74%).

Of the AZN 5,242 thousand (31 December 2008: AZN 3,541 thousand) total mortgage loans, AZN 3,711 thousand (31 December 2008: AZN 1,824 thousand) have been provided under the programme covered by the borrowing agreement with the Azerbaijan Mortgage Fund. Refer to Note 17.

Information about collateral at 31 December 2009 is as follows:

<i>In thousands of Azerbaijani Manats</i>	Corporate loans	Loans to individuals-consumer loans	Loans to individuals-entrepreneurs	Mortgage loans	Other	Total
Unsecured loans	4,482	999	6,358	-	199	12,038
Loans collateralised by:						
- real estate	30,417	2,695	10,699	5,519	623	49,953
- vehicles	5,619	1,874	10	106	-	7,609
- cash deposits	1,059	2,663	147	-	-	3,869
- tradable securities	2,105	-	-	-	-	2,105
- jewellery	3	2,091	-	-	-	2,094
- letter of guarantee	253	1,339	158	-	-	1,750
- equipment	-	101	-	-	-	101
<b>Total loans and advances to customers</b>	<b>43,938</b>	<b>11,762</b>	<b>17,372</b>	<b>5,625</b>	<b>822</b>	<b>79,519</b>

Information about collateral at 31 December 2008 is as follows:

<i>In thousands of Azerbaijani Manats</i>	Corporate loans	Loans to individuals-consumer loans	Loans to individuals-entrepreneurs	Mortgage loans	Other	Total
Unsecured loans	2,825	1,974	5,024	-	418	10,241
Loans collateralised by:						
- real estate	27,084	1,232	7,343	3,544	-	39,203
- vehicles	298	864	-	-	-	1,162
- cash deposits	2,026	114	20	-	-	2,160
- tradable securities	2,837	-	-	-	-	2,837
- jewellery	13	2,091	201	-	-	2,305
- letter of guarantee	340	2,780	3,730	69	-	6,919
- equipment	2,678	-	7	-	-	2,685
<b>Total loans and advances to customers</b>	<b>38,101</b>	<b>9,055</b>	<b>16,325</b>	<b>3,613</b>	<b>418</b>	<b>67,512</b>

**9 Loans and Advances to Customers (Continued)**

Analysis by credit quality of loans outstanding at 31 December 2009 is as follows:

<i>In thousands of Azerbaijani Manats</i>	Corporate loans	Loans to individuals-consumer loans	Loans to individuals-entrepreneurs	Mortgage loans	Other	Total
<i>Neither past due nor impaired</i>						
- loans not renegotiated in 2009	38,740	10,096	14,334	5,458	525	69,153
- loans renegotiated in 2009	2,908	120	2,575	-	-	5,603
<b>Total neither past due nor impaired</b>	<b>41,648</b>	<b>10,216</b>	<b>16,909</b>	<b>5,458</b>	<b>525</b>	<b>74,756</b>
<i>Past due but not impaired</i>						
- less than 30 days overdue	1,142	139	52	56	-	1,389
- 30 to 90 days overdue	250	365	32	110	-	757
<b>Total past due but not impaired</b>	<b>1,392</b>	<b>504</b>	<b>84</b>	<b>166</b>	<b>-</b>	<b>2,146</b>
<i>Loans individually determined to be impaired (gross)</i>						
- less than 30 days overdue	235	180	19	-	99	533
- 30 to 90 days overdue	400	309	6	-	90	805
- 90 to 180 days overdue	70	43	47	-	6	166
- 180 to 360 days overdue	2	284	17	-	100	403
- over 360 days overdue	191	226	290	-	3	710
<b>Total individually impaired loans (gross)</b>	<b>898</b>	<b>1,042</b>	<b>379</b>	<b>-</b>	<b>298</b>	<b>2,617</b>
<b>Less provision for loan impairment</b>	<b>(1,316)</b>	<b>(652)</b>	<b>(482)</b>	<b>(383)</b>	<b>(180)</b>	<b>(3,013)</b>
<b>Total loans and advances to customers</b>	<b>42,623</b>	<b>11,109</b>	<b>16,890</b>	<b>5,242</b>	<b>642</b>	<b>76,506</b>

Loans which are past due for less than 30 days but are not impaired represents all outstanding loans which relates to these borrowers. Actual overdue amount as at 31 December 2009 is AZN 1,538 thousand, (31 December 2008: 757 thousand) and relates to overdue interest income.

**9 Loans and Advances to Customers (Continued)**

Analysis by credit quality of loans outstanding at 31 December 2008 is as follows:

<i>In thousands of Azerbaijani Manats</i>	Corporate loans	Loans to individuals-consumer loans	Loans to individuals-entrepreneurs	Mortgage loans	Other	Total
<i>Neither past due nor impaired</i>						
- loans not renegotiated in 2008	34,465	6,607	11,123	3,566	30	55,791
- loans renegotiated in 2008	2,098	521	3,291	47	137	6,094
<b>Total neither past due nor impaired</b>	<b>36,563</b>	<b>7,128</b>	<b>14,414</b>	<b>3,613</b>	<b>167</b>	<b>61,885</b>
<i>Past due but not impaired</i>						
- less than 30 days overdue	786	629	1,395	-	138	2,948
- 30 to 90 days overdue	321	720	523	-	-	1,564
<b>Total past due but not impaired</b>	<b>1,107</b>	<b>1,349</b>	<b>1,918</b>	<b>-</b>	<b>138</b>	<b>4,512</b>
<i>Loans individually determined to be impaired (gross)</i>						
- less than 30 days overdue	-	95	-	-	61	156
- 30 to 90 days overdue	241	404	1	-	51	697
- 90 to 180 days overdue	4	51	7	-	-	62
- 180 to 360 days overdue	185	11	4	-	-	200
<b>Total individually impaired loans (gross)</b>	<b>430</b>	<b>561</b>	<b>12</b>	<b>-</b>	<b>112</b>	<b>1,115</b>
<b>Less provision for loan impairment</b>	<b>(1,249)</b>	<b>(280)</b>	<b>(322)</b>	<b>(72)</b>	<b>(55)</b>	<b>(1,978)</b>
<b>Total loans and advances to customers</b>	<b>36,851</b>	<b>8,758</b>	<b>16,022</b>	<b>3,541</b>	<b>362</b>	<b>65,534</b>

The primary factors that management consider as to whether a loan is impaired is its overdue status and ability to realise value from the related collateral. As a result, the table above presents an ageing analysis of loans that are individually determined to be impaired.

Neither past due nor impaired, but renegotiated loans, represent the carrying amount of loans that would otherwise be past due or impaired whose terms have been renegotiated. Past due but not impaired loans represent loans and advances less than 90 days past due and collateralised loans where the fair value of collateral covers the overdue interest and principal repayments. The amount reported as past due but not impaired is the whole balance of such loans, not only the individual instalments that are past due.

**9 Loans and Advances to Customers (Continued)**

The fair value of collateral in respect of loans past due but not impaired and in respect of loans individually determined to be impaired at 31 December 2009 was as follows:

<i>In thousands of Azerbaijani Manats</i>	Corporate loans	Consumer loans	Individuals entrepreneurs	Mortgage loans	Other	Total
<i>Fair value of collateral - loan past due but not impaired</i>						
- real estate	800	524	157	158	-	1,639
- letter of guarantee	-	3	-	-	-	3
- cash deposits	178	-	-	-	-	178
- vehicles	-	345	-	-	-	345
- jewellery	-	274	-	-	-	274
<i>Fair value of collateral - individually impaired loans</i>						
- real estate	473	977	571	-	320	2,341
- letter of guarantee	-	109	-	-	-	109
- tradable securities	163	-	-	-	-	163
- cash deposits	-	39	-	-	-	39
- vehicles	41	276	-	-	-	317
- jewellery	-	765	-	-	-	765
<b>Total</b>	<b>1,655</b>	<b>3,312</b>	<b>728</b>	<b>158</b>	<b>320</b>	<b>6,173</b>

Fair value of collateral in respect of loans past due but not impaired and in respect of loans individually determined to be impaired at 31 December 2008 was as follows:

<i>In thousands of Azerbaijani Manats</i>	Corporate loans	Consumer loans	Individuals entrepreneurs	Mortgage loans	Other	Total
<i>Fair value of collateral - loan past due but not impaired</i>						
- real estate	1,114	1,625	-	-	-	2,739
- letter of guarantee	-	2,967	-	-	-	2,967
- cash deposits	-	635	-	-	-	635
- vehicles	-	32	-	-	-	32
- jewellery	-	46	-	-	-	46
<i>Fair value of collateral - individually impaired loans</i>						
- real estate	1,172	113	74	-	-	1,359
- letter of guarantee	-	108	-	-	-	108
- tradable securities	164	-	-	-	-	164
- cash deposits	29	254	-	-	-	283
<b>Total</b>	<b>2,479</b>	<b>5,780</b>	<b>74</b>	<b>-</b>	<b>-</b>	<b>8,333</b>

The fair value of real estate as at the balance sheet date was estimated by indexing the values determined by the Group's internal credit department staff at the time of loan inception for the average increases in real estate prices by city and region. The fair value of other real estate and other assets was determined by the Group's credit department using the Group's internal guidelines.

The carrying value of each class of loans and advances to customers approximates fair value at 31 December 2009 and 31 December 2008. At 31 December 2009 the estimated fair value of loans and advances to customers was AZN 76,506 thousand (31 December 2008: AZN 65,534 thousand). Refer to Note 33.

Interest rate analysis of loans and advances to customers is disclosed in Note 30. The information on related party balances is disclosed in Note 35.

**Turanbank Open Joint-Stock Company**  
**Notes to the Financial Statements – 31 December 2009**

**10 Investment Securities Available for Sale**

<i>In thousands of Azerbaijani Manats</i>	<b>31 December 2009</b>	<b>31 December 2008</b>
Coupon securities	2,007	-
REPO securities issued by the CBAR	499	-
Notes issued by the CBAR	49	1,508
<b>Total debt securities</b>	<b>2,555</b>	<b>1,508</b>
Corporate shares – unquoted	820	678
<b>Total investment securities available for sale</b>	<b>3,375</b>	<b>2,186</b>

Analysis by credit quality of debt securities outstanding at 31 December 2009 and 31 December 2008 is as follows:

<i>In thousands of Azerbaijani Manats</i>	<b>31 December 2009</b>	<b>31 December 2008</b>
<i>Neither past due nor impaired</i>		
- Government of the Republic of Azerbaijan	2,555	1,508
<b>Total neither past due nor impaired</b>	<b>2,555</b>	<b>1,508</b>
<b>Total debt securities available for sale</b>	<b>2,555</b>	<b>1,508</b>

The published international rating for the Republic of Azerbaijan is BB+/Stable (Fitch Ratings - affirmed on 2 June 2009).

Debt securities are not collateralised. The movements in investment securities available for sale are as follows:

<i>In thousands of Azerbaijani Manats</i>	<b>Note</b>	<b>2009</b>	<b>2008</b>
<b>Carrying amount at 1 January</b>		<b>2,186</b>	<b>677</b>
Interest income accrued	24	4	-
Purchases		2,927	1,509
Disposals of investment securities available for sale		(1,742)	-
<b>Carrying amount at 31 December</b>		<b>3,375</b>	<b>2,186</b>

The investment securities disposed of during the year ended 31 December 2009 had a fair value of AZN 1,742 thousand (2008: nil) and the gain arising on disposal was nil (2008: nil). Refer to Note 33. Majority of purchases and disposals of investment securities available for sale during 2009 represent coupon securities of the Ministry of Finance and Mortgage Fund of the Republic of Azerbaijan.

**10 Investment Securities Available for Sale (Continued)**

The principal equity investment securities available for sale are:

Name	Nature of business	Country of registration	Fair value	
			31 December 2009	31 December 2008
Azer-Turk Bank	Banking	Republic of Azerbaijan	400	400
Bashak Inam Insurance	Insurance	Republic of Azerbaijan	300	158
Milli Kart	Card Processing	Republic of Azerbaijan	120	120
<b>Total</b>			<b>820</b>	<b>678</b>

During 2009, the Group increased its investment in the total share capital of Bashak Inam Insurance to AZN 300 thousand (2008: 158 thousand). Currently the stock market in the Republic of Azerbaijan is practically non-existent, and the activity of Baku Stock Exchange at the reporting date is still at the start-up stage. Management was unable to determine reliably fair value of this investment and it is therefore carried at cost. The investee companies have not published recent financial information about its operations, its shares are not quoted and recent trade prices are not publicly accessible.

Interest rate analysis of investment securities available for sale is disclosed in Note 30. The information on related party debt investment securities available for sale is disclosed in Note 35.

**11 Investment Properties**

<i>In thousands of Azerbaijani Manats</i>	2009	2008
Investment properties at fair value as at 1 January	358	250
Fair value gains	-	108
<b>Investment properties at fair value as at 31 December</b>	<b>358</b>	<b>358</b>

As at 31 December 2009, the carrying value of investment property approximated its market value, since it did not change significantly within reporting period, which was concluded through using current prices in an active market for properties of different nature, condition or location, adjusted to reflect those differences.

The rental income on investment property in 2009 amounted to AZN 39 thousand (2008: AZN 36 thousand) and is included in other operating income.

The Group did not classify any operating leases as investment properties.

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**12 Premises, Equipment and Intangible Assets**

*In thousands of Azerbaijani Manats*

	Premises	Leasehold improvement	Office and computer equipment	Furniture, fixtures and other	Other fixed assets	Total premises and equipment	Intangible assets	Total
Cost/revalued amount at 31 December 2007	5,601	85	220	422	125	6,453	130	6,583
Accumulated depreciation/amortisation	(66)	(9)	(106)	(176)	(72)	(429)	(50)	(479)
<b>Carrying amount at 31 December 2007</b>	<b>5,535</b>	<b>76</b>	<b>114</b>	<b>246</b>	<b>53</b>	<b>6,024</b>	<b>80</b>	<b>6,104</b>
Additions	1,179	-	195	297	79	1,750	-	1,750
Revaluation	158	-	-	-	-	158	-	158
Revaluation depreciation	210	-	-	-	-	210	-	210
Disposals	(165)	-	(1)	-	(1)	(167)	-	(167)
Depreciation charge	(154)	(8)	(71)	(110)	(28)	(371)	(13)	(384)
<b>Carrying amount at 31 December 2008</b>	<b>6,763</b>	<b>68</b>	<b>237</b>	<b>433</b>	<b>103</b>	<b>7,604</b>	<b>67</b>	<b>7,671</b>
Cost/revalued at 31 December 2008	6,763	85	401	716	188	8,153	130	8,283
Accumulated depreciation/amortisation	-	(17)	(164)	(283)	(85)	(549)	(63)	(612)
<b>Carrying amount at 31 December 2008</b>	<b>6,763</b>	<b>68</b>	<b>237</b>	<b>433</b>	<b>103</b>	<b>7,604</b>	<b>67</b>	<b>7,671</b>
Additions	96	135	43	127	30	431	19	450
Disposals	-	-	-	(3)	(1)	(4)	-	(4)
Depreciation charge	(203)	(21)	(87)	(141)	(30)	(482)	(14)	(496)
<b>Carrying amount at 31 December 2009</b>	<b>6,656</b>	<b>182</b>	<b>193</b>	<b>416</b>	<b>102</b>	<b>7,549</b>	<b>72</b>	<b>7,621</b>
Cost/revalued at 31 December 2008	6,859	207	436	824	209	8,535	149	8,684
Accumulated depreciation/amortisation	(203)	(25)	(243)	(408)	(107)	(986)	(77)	(1,063)
<b>Carrying amount at 31 December 2009</b>	<b>6,656</b>	<b>182</b>	<b>193</b>	<b>416</b>	<b>102</b>	<b>7,549</b>	<b>72</b>	<b>7,621</b>

Included in the closing balance of premises and equipment at 31 December 2009, are fully depreciated assets still in use of AZN 577 thousand (31 December 2008: AZN 145 thousand).

**12 Premises, Equipment and Intangible Assets (Continued)**

Premises of the Group were independently valued as at 31 December 2008. The valuation was carried out by an independent firm of valuers, REC-Invest, who hold a recognised and relevant professional qualification and who have recent experience in valuation of assets of similar location and category. The basis used for the appraisal was market value.

Included in the above carrying amount AZN 357 thousand (31 December 2008: AZN 368 thousand) represents the revaluation surplus relating to the buildings, net of a deferred tax liability of AZN 70 thousand (31 December 2008: AZN 81 thousand), was recorded within "Revaluation of premises" in the statement of changes in equity of the Group. At 31 December 2009, the carrying amount of premises would have been AZN 5,615 thousand (2008: AZN 5,722 thousand) had the assets been carried at cost less depreciation.

**13 Other Financial Assets**

<i>In thousands of Azerbaijani Manats</i>	<b>31 December 2009</b>	<b>31 December 2008</b>
Credit and debit cards receivables	37	25
<b>Total other financial assets</b>	<b>37</b>	<b>25</b>

Analysis by credit quality of other financial receivables outstanding at 31 December 2009 is as follows:

<i>In thousands of Azerbaijani Manats</i>	<b>Credit and debit cards receivables</b>	<b>Total</b>
<i>Neither past due nor impaired</i> - Medium-sized companies	37	37
<b>Total neither past due nor impaired</b>	<b>37</b>	<b>37</b>
<b>Total other financial receivables</b>	<b>37</b>	<b>37</b>

Analysis by credit quality of other financial receivables outstanding at 31 December 2008 is as follows:

<i>In thousands of Azerbaijani Manats</i>	<b>Credit and debit cards receivables</b>	<b>Total</b>
<i>Neither past due nor impaired</i> - Medium - sized companies	25	25
<b>Total neither past due nor impaired</b>	<b>25</b>	<b>25</b>
<b>Total other financial receivables</b>	<b>25</b>	<b>25</b>

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**14 Other Assets**

<i>In thousands of Azerbaijani Manats</i>	<b>31 December 2009</b>	<b>31 December 2008</b>
Prepayments for purchase of fixed and intangible assets	38	45
Prepayment for insurance and other services	27	55
Other	-	9
<b>Total other assets</b>	<b>65</b>	<b>109</b>

Included in prepayments for purchase of fixed and intangible assets is a prepayment for a new software of AZN 35 thousand (31 December 2008: AZN 29 thousand).

**15 Due to Other Banks**

<i>In thousands of Azerbaijani Manats</i>	<b>31 December 2009</b>	<b>31 December 2008</b>
Short- term placements of other banks	5,973	17,327
Correspondent accounts and overnight placements of other banks	1,606	1,347
<b>Total due to other banks</b>	<b>7,579</b>	<b>18,674</b>

At 31 December 2009, short term deposits of other banks include deposits received from resident and non-resident banks at interest rates ranging between 2%-6% (31 December 2008: 14%-17% per annum).

The carrying value of each class of due to other banks approximates fair value at 31 December 2009 and 31 December 2008. At 31 December 2009 the estimated fair value of due to other banks was AZN 7,579 thousand (31 December 2008: AZN 18,674 thousand). Refer to Note 33.

Interest rate analysis of due to other banks is disclosed in Note 30.

**16 Customer Accounts**

<i>In thousands of Azerbaijani Manats</i>	<b>31 December 2009</b>	<b>31 December 2008</b>
<b>State and public organisations</b>		
- Current/settlement accounts	11	28
- Term deposits	-	500
<b>Other legal entities</b>		
- Current/settlement accounts	8,310	2,911
- Term deposits	5,485	877
- Restricted customer deposits	4,500	-
<b>Individuals</b>		
- Current/demand accounts	5,735	6,304
- Term deposits	19,525	18,020
- Restricted customer deposits	1,210	2,211
<b>Total customer accounts</b>	<b>44,776</b>	<b>30,851</b>

**16 Customer Accounts (Continued)**

Economic sector concentrations within customer accounts are as follows:

<i>In thousands of Azerbaijani Manats</i>	31 December 2009		31 December 2008	
	Amount	%	Amount	%
Individuals	30,063	67.14%	26,268	85.14%
Construction	5,299	11.84%	1,386	4.49%
Financial services	3,896	8.70%	-	-
Insurance	2,595	5.79%	1,341	4.35%
Trade and services	707	1.58%	1,207	3.91%
Transportation	109	0.24%	492	1.59%
Agriculture	100	0.22%	111	0.36%
Government bodies	11	0.02%	33	0.11%
Manufacturing	7	0.02%	8	0.03%
Other	1,989	4.45%	5	0.02%
<b>Total customer accounts</b>	<b>44,776</b>	<b>100%</b>	<b>30,851</b>	<b>100%</b>

At 31 December 2009, the Group had 31 customers (31 December 2008: 22 customers) with balances above AZN 200 thousand. The aggregate balance of these customers was AZN 22,252 thousand (31 December 2008: AZN 18,798 thousand) or 50% (31 December 2008: 61%) of total customer accounts.

The carrying value of each class of customer accounts approximates fair value at 31 December 2009 and 31 December 2008. At 31 December 2009 the estimated fair value of customer accounts was AZN 44,776 thousand (31 December 2008: AZN 30,851 thousand). Refer to Note 33.

Interest rate analysis of customer accounts is disclosed in Note 30. The information on related party balances is disclosed in Note 35.

**17 Other Borrowed Funds**

<i>In thousands of Azerbaijani Manats</i>	31 December 2009	31 December 2008
Funds borrowed from the National Fund for Support of Entrepreneurship of the Republic of Azerbaijan	15,185	7,462
Funds borrowed from the State Agency for Agricultural Credits	6,889	2,087
Funds borrowed from World Business Capital Inc (WBC)	5,220	-
Funds borrowed from Azerbaijan Mortgage Fund	3,711	1,824
Funds borrowed from Islamic Cooperation for the Development	831	792
Funds borrowed from International Fund for Agricultural development (IFAD)	706	457
<b>Total other borrowed funds</b>	<b>32,542</b>	<b>12,622</b>

On September 2002, the Group signed credit agreement with the National Fund for Support of Entrepreneurship, a programme under the auspices of the Ministry for Economic Development of the Republic of Azerbaijan, for financing of small and medium size enterprises. Under this programme, funds are made available to the Group at an interest rate of 1.0%-2.0% per annum and the Group further on lends these funds to eligible borrowers at rates not higher than 7.0%-8.0% per annum. The borrowing agreement does not include any financial covenants.

On 30 July 2007, the Group signed credit agreement with the State Agency for Agricultural Credits, a programme under the auspices of the Ministry for Agriculture of the Republic of Azerbaijan, for financing of small and medium size enterprises. Under this programme, funds are made available to the Group at an interest rate of 2.0% per annum and the Group further on lends these funds to eligible borrowers at rates not higher than 7.0% per annum. The borrowing agreement does not include any financial covenants.

## **17 Other Borrowed Funds (Continued)**

On 25 May 2006, the Group signed revolving loan agreement with World Business Capital, Inc on obtaining a credit line up to USD 7,500 thousand to be used for financing small and medium-sized enterprises of the Republic of Azerbaijan. As at 31 December 2009, the Group had fully drawn down the credit amounted AZN 5,220 thousand (31 December 2008: nil) at an interest rate of 4.1% per annum. The Group is obliged to comply with certain financial covenants stipulated by the aforementioned loan agreement. Refer to Note 32.

On 17 February 2006, the Group signed borrowing agreement with the Mortgage Fund, a programme under the auspices of the National Group of Azerbaijan, on initial financing of mortgage loans to individuals. Under this programme, funds are made available to the Group at an interest rate of 1.0%-8.0% per annum and the Group further on lends these funds to eligible borrowers at rates ranging between 4.0%-8.0% per annum. There are no financial covenants with regard to borrowing from Azerbaijan Mortgage Fund that the Group should comply with.

On 2 April 2008, the Group signed revolving loan agreement with Islamic Cooperation for the Development of the Private Sector on obtaining a credit line up to USD 1,000 thousand to be used for financing small and medium-sized enterprises of the Republic of Azerbaijan. As at 31 December 2009, the outstanding amount of debt under this credit agreement was AZN 831 thousand (31 December 2008: AZN 792 thousand) at market interest rates. The Group is obliged to comply with certain financial covenants stipulated by the aforementioned loan agreement. Refer to Note 32.

On 12 October 2004, the Group signed credit agreement with the International Fund for Agricultural development (IFAD), a programme under the auspices of the Ministry for Agriculture of the Republic of Azerbaijan, for financing of small and medium size enterprises. As at 31 December 2009, the Group had drawn down the credit amounted to AZN 707 thousand (31 December 2008: AZN 457 thousand) at market interest rates. The borrowing agreement does not include any financial covenants.

The carrying value of each class of borrowings from government and international financial institutions approximates fair value at 31 December 2009 and 31 December 2008 in the context of the programmes under the auspices of various Ministries and governmental organisations of the Republic of Azerbaijan and their lower interest rates are considered market related in a separate market segment. At 31 December 2009 the estimated fair value of borrowings from government and international financial institutions was AZN 32,542 thousand (31 December 2008: AZN 12,622 thousand). Refer to Note 33.

Excluding the National Fund for Support of Entrepreneurship of the Republic of Azerbaijan, State Agency for Agricultural Credits and Mortgage Fund of the Republic of Azerbaijan, the market interest rates for all other borrowings range between 4% and 9% per annum for the year ended 31 December 2009 (4% and 8% per annum for the year ended 31 December 2008). Refer to Note 30.

## **18 Other Financial Liabilities**

Other financial liabilities comprise the following:

<i>In thousands of Azerbaijani Manats</i>	<b>31 December 2009</b>	<b>31 December 2008</b>
Amounts in the course of settlement	121	153
Other accrued liabilities	31	12
<b>Total other financial liabilities</b>	<b>152</b>	<b>165</b>

Carrying value of each class of other financial liabilities approximates fair value at 31 December 2009 and 31 December 2008. At 31 December 2009 the estimated fair value of other financial liabilities was AZN 152 thousand (31 December 2008: AZN 165 thousand). Refer to Note 33.

**19 Other Liabilities**

Other liabilities comprise the following:

<i>In thousands of Azerbaijani Manats</i>	<b>31 December 2009</b>	<b>31 December 2008</b>
Other provision	45	76
Taxes payable other than on income	-	79
<b>Total other liabilities</b>	<b>45</b>	<b>155</b>

**20 Share Capital**

<i>In thousands of AZN except for number of shares</i>	<b>Number of ordinary shares</b>	<b>Ordinary shares</b>	<b>Total</b>
<b>At 1 January 2008</b>	<b>12,500</b>	<b>12,500</b>	<b>12,500</b>
New shares issued	3,500	3,500	3,500
<b>At 31 December 2008</b>	<b>16,000</b>	<b>16,000</b>	<b>16,000</b>
New shares issued	1,000	1,000	1,000
<b>At 31 December 2009</b>	<b>17,000</b>	<b>17,000</b>	<b>17,000</b>

All ordinary shares have a nominal value of AZN 1,000 per share (2008: AZN 1,000 per share) and rank equally. Each share carries one vote.

At 15 February 2009, individuals and legal entities own 78% and 22%, respectively, of the total share capital of the Group (31 December 2008: 73% and 27%).

On 31 January 2008, a decision was made by the Supervisory Board of the Group to increase the number of shares in issue to 17,000 with the additional issue of 1,000 shares at nominal value of AZN 1 per share. The new shares were fully paid during 2009 and formally registered at the State Securities Committee.

**21 Other Reserves**

<i>In thousands of Azerbaijani Manats</i>	<b>Premises and equipment</b>	<b>Total revaluation reserves</b>
<b>At 1 January 2008</b>	<b>879</b>	<b>879</b>
Revaluation	368	368
Decrease in value of premises	(160)	(160)
Income tax effects	(46)	(46)
<b>At 31 December 2008</b>	<b>1,041</b>	<b>1,041</b>
Income tax effects	27	27
<b>At 31 December 2009</b>	<b>1,068</b>	<b>1,068</b>

The revaluation reserve for premises and equipment is transferred to retained earnings when realised through depreciation, sale or other disposal. As at 31 December 2009, the income tax effect of AZN 27 thousand arisen as result in changes of income tax rates from 22 to 20 per cents effective from 1 January 2010.

**22 Interest Income and Expense**

<i>In thousands of Azerbaijani Manats</i>	<b>2009</b>	<b>2008</b>
<b>Interest income</b>		
Loans and advances to customers	9,601	9,336
Interest income on impaired financial assets	678	521
Correspondent accounts with other banks	95	23
Due from other banks	37	57
Interest income on financial lease	40	35
Debt investment securities available for sale	14	74
<b>Total interest income</b>	<b>10,465</b>	<b>10,046</b>
<b>Interest expense</b>		
Term deposits of individuals	2,751	3,048
Term placements of other banks	1,019	1,253
Term deposits of legal entities	666	561
Other borrowed funds	467	194
Correspondent accounts of other banks	57	-
<b>Total interest expense</b>	<b>4,960</b>	<b>5,056</b>
<b>Net interest income</b>	<b>5,505</b>	<b>4,990</b>

**23 Fee and Commission Income and Expense**

<i>In thousands of Azerbaijani Manats</i>	<b>2009</b>	<b>2008</b>
<b>Fee and commission income</b>		
- Cash transactions	632	592
- Servicing customers accounts	177	259
- Guarantees issued	135	62
- Plastic card operations	109	111
- Transactions with foreign currencies	86	117
- Settlement transactions	7	-
- Other	29	-
<b>Total fee and commission income</b>	<b>1,175</b>	<b>1,141</b>
<b>Fee and commission expense</b>		
- Plastic card operations	63	52
- International financial institutions	52	-
- Servicing corresponding accounts	48	52
- Cash collection	34	33
- Guarantees issued	7	-
- Other	-	7
<b>Total fee and commission expense</b>	<b>204</b>	<b>144</b>
<b>Net fee and commission income</b>	<b>963</b>	<b>997</b>

**24 Other Operating Income**

<i>In thousands of Azerbaijani Manats</i>	<b>2009</b>	<b>2008</b>
Dividend income	76	57
Rent income	39	36
Other income	3	5
<b>Total other operating income</b>	<b>118</b>	<b>98</b>

**25 Administrative and Other Operating Expenses**

<i>In thousands of Azerbaijani Manats</i>	<b>Note</b>	<b>2009</b>	<b>2008</b>
Staff costs		2,031	1,523
Depreciation of premises and equipment	12	483	371
Security services		193	153
Communication		165	158
Rent expenses		134	146
Professional services		148	353
Advertising and marketing services		101	48
Other costs of premises and equipment		74	68
Taxes other than on income		56	46
Insurance of Customer Deposits		55	127
Stationery and supplies		43	110
Business travel		35	23
Utilities		32	23
Amortisation of software and other intangible assets	12	13	13
Other		146	102
<b>Total administrative and other operating expenses</b>		<b>3,709</b>	<b>3,264</b>

Included in staff costs are statutory social security and pension contributions of AZN 360 thousand and AZN 49 thousand, respectively (31 December 2008: AZN 210 thousand and AZN 37 thousand).

**26 Income Tax**

Income tax expense comprises the following:

<i>In thousands of Azerbaijani Manats</i>	<b>2009</b>	<b>2008</b>
Current tax	234	552
Deferred tax	(101)	11
<b>Income tax expense for the year</b>	<b>133</b>	<b>563</b>

The Group calculates income taxes at the rate of 22% (2008:22%) in accordance with Azerbaijani tax and accounting legislation.

**26 Income Taxes (Continued)**

A reconciliation between the expected and the actual taxation charge is provided below:

<i>In thousands of Azerbaijani Manats</i>	2009	2008
<b>IFRS profit before tax</b>	<b>2,148</b>	<b>2,816</b>
Theoretical tax charge at statutory rate 2009: 22% (2008: 22%)	473	620
Effect of change in tax rates 2%:	11	-
Effect of 3 years tax holiday	8	-
Transfer to share capital	(286)	-
Tax effect of items which are not deductible or assessable for taxation purposes:		
- Non deductible expenses	(73)	(57)
<b>Income tax expense for the year</b>	<b>133</b>	<b>563</b>

Differences between IFRS and the Azerbaijani statutory taxation rules give rise to certain temporary differences between the carrying value of certain assets and liabilities for purposes of both financial reporting and income tax calculation purposes. The tax effect of the movements in these temporary differences is recorded at the rate of 22% (2008: 22%).

On 19 June 2009, the Republic of Azerbaijan reduced the standard corporate income tax rate from 22% to 20% with effect from 1 January 2010. The impact of the change in tax rate presented above represents the effect of applying the reduced 20% tax rate to deferred tax balances at 31 December 2008.

At 31 December 2009, the tax effects of the temporary differences giving rise to the deferred tax assets and liabilities are as follows:

<i>In thousands of Azerbaijani Manats</i>	31 December 2008	Credited/ (charged) to profit or loss	Credited directly to equity	31 December 2009
<b>Tax effect of taxable temporary differences</b>				
Premises and equipment:	(142)	22	27	(94)
Intangible assets	2	-	-	2
Investment property	(24)	2	-	(22)
Fair valuation of investment securities available for sale	(4)	3	-	(1)
Loans to customers	47	74	-	121
<b>Net deferred tax liability</b>	<b>(121)</b>	<b>101</b>	<b>27</b>	<b>6</b>
Recognised deferred tax asset	49	101	27	177
Recognised deferred tax liability	(170)	-	-	(170)
<b>Net deferred tax asset/(liability)</b>	<b>(121)</b>	<b>101</b>	<b>27</b>	<b>7</b>

**26 Income Taxes (Continued)**

At 31 December 2008, the tax effects of the temporary differences giving rise to the deferred tax assets and liabilities are as follows:

<i>In thousands of Azerbaijani Manats</i>	31 December 2007	Credited/ (charged) to profit or loss	Charged directly to equity	31 December 2008
<b>Tax effect of taxable temporary differences</b>				
Premises and equipment:	(74)	(22)	(46)	(142)
Intangible assets	1	1	-	2
Investment property	-	(24)	-	(24)
Fair valuation of investment securities available for sale	(4)	-	-	(4)
Loans to customers	13	34	-	47
<b>Net deferred tax liability</b>	<b>(64)</b>	<b>(11)</b>	<b>(46)</b>	<b>(121)</b>
Recognised deferred tax asset	14	35	-	49
Recognised deferred tax liability	(78)	(46)	(46)	(170)
<b>Net deferred tax liability</b>	<b>(64)</b>	<b>(11)</b>	<b>(46)</b>	<b>(121)</b>

**27 Earnings per Share**

Basic earnings per share are calculated by dividing the profit or loss attributable to equity holders of the Group by the weighted average number of ordinary shares in issue during the year.

The Group has no dilutive potential ordinary shares; therefore, the diluted earnings per share equal the basic earnings per share.

<i>In thousands of Azerbaijani Manats except for number of shares</i>	2009	2008
Profit attributable to equity holders of the Group	2,015	2,253
Weighted average number of ordinary shares in issue (expressed in thousands of shares)	16,361	14,093
Basic earnings per share (expressed in AZN per share)	0.12	0.16

**28 Dividends**

<i>In thousands of Azerbaijani Manats</i>	<b>2009</b>	<b>2008</b>
	<b>Ordinary</b>	<b>Ordinary</b>
<b>Dividends payable at 1 January</b>	-	-
Dividends declared during the year	2,111	2,024
Dividends paid during the year	(2,111)	(2,024)
<b>Dividends payable at 31 December</b>	-	-
<b>Dividends per share declared during the year</b>	<b>0.12</b>	<b>0.13</b>

All dividends are declared and paid in Azerbaijani Manats.

**29 Segment Analysis**

Starting from 1 January 2009, the Group prepares its segment analysis in accordance with IFRS 8, *Operating segments*, which replaced IAS 14, *Segment reporting*. Comparatives were adjusted to conform to the presentation of current period amounts.

Following the management approach of IFRS 8, operating segments are reported in accordance with the internal reporting provided to the Board of Directors (the chief operating decision-maker), which is responsible for allocating resources to the reportable segments and assesses its performance. All operating segments used by the Group meet the definition of a reportable segment under IFRS 8.

**Business Segments.** The Group is organised in to two main business segments:

- Retail banking – representing private banking services, private customer current accounts, savings, deposits, investment savings products, custody, credit and debit cards, consumer loans and mortgages.
- Corporate banking – representing direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, foreign currency and derivative products.

There are no other material items of income or expense outside of the business segments. Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balance sheet, but excluding taxation.

The Board of Directors reviews financial information prepared based on Azerbaijan accounting standards adjusted to meet the requirements of internal reporting. Such financial information differs in certain aspects from International Financial Reporting Standards:

- (i) funds are generally reallocated between segments at internal interest rates set by the treasury department, which are determined by reference to market interest rate benchmarks, contractual maturities for loans and observed actual maturities of customer accounts balances;
- (ii) income taxes are not allocated to segments;
- (iii) loan provisions are recognized based on management judgment and availability of information rather than based on the incurred loss model prescribed in IAS 39;
- (iv) gains less losses arising from trading in foreign currencies and foreign exchange translation gains less losses are not allocated to segments;
- (v) investment property is recognized based on cost method rather than fair value method.

**29 Segment Analysis (Continued)**

Segment information for the main reportable business segments of the Group for the years ended 31 December 2009 and 31 December 2008 is set out below:

<i>In thousands of Azerbaijani Manats</i>	<b>Retail banking</b>		<b>Corporate banking</b>		<b>Total</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Total segment revenues</b>	<b>6,402</b>	<b>7,188</b>	<b>5,356</b>	<b>4,097</b>	<b>11,758</b>	<b>11,285</b>
<b>Total revenues comprise:</b>						
- Interest income	5,698	6,399	4,767	3,647	10,465	10,046
- Fee and commission income	640	727	535	414	1,175	1,141
- Other activities	64	62	54	36	118	98
<b>Total segment revenues</b>	<b>6,402</b>	<b>7,188</b>	<b>5,356</b>	<b>4,097</b>	<b>11,758</b>	<b>11,285</b>
Interest expense	(2,700)	(3,221)	(2,260)	(1,881)	(4,960)	(5,102)
Fee and commission expense	(111)	(92)	(93)	(52)	(204)	(144)
Provision for loan impairment	(323)	(248)	(270)	(142)	(593)	(390)
Administrative and other operating expenses	(2,020)	(2,079)	(1,689)	(1,139)	(3,709)	(3,218)
<b>Adjusted profit before income tax</b>	<b>1,248</b>	<b>1,548</b>	<b>1,044</b>	<b>883</b>	<b>2,292</b>	<b>2,431</b>

<i>In thousands of Azerbaijani Manats</i>	<b>2009</b>	<b>2008</b>
<b>Adjusted profit before income tax for reportable segments</b>	<b>2,292</b>	<b>2,431</b>
Gains less losses arising from trading in foreign currencies	274	260
Foreign exchange translation gains less losses	24	17
Change in fair value of investment property	-	108
Adjustments to bring management information in line with IFRS:		
- Reversal of statutory charge for impairment	(442)	-
<b>Profit before income tax</b>	<b>2,148</b>	<b>2,816</b>

**29 Segment Analysis (Continued)**

<i>In thousands of Azerbaijani Manats</i>	Retail banking		Corporate banking		Total		
	31 December 2009	31 December 2008	31 December 2009	31 December 2008	31 December 2009	31 December 2008	
Total segment assets	53,934	46,715	52,585	35,947	106,519	82,662	
Deferred income tax asset	-	-	-	-	6	-	
<b>Total assets</b>		-		-	106,525	82,662	
Total segment liabilities	24,488	19,855	60,606	42,612	85,094	62,467	
Current income tax liability	-	-	-	-	78	94	
Deferred income tax liability	-	-	-	-	-	121	
<b>Total liabilities</b>	-	-	-	-	85,172	62,682	
<i>In thousands of Azerbaijani Manats</i>					<b>2009</b>	<b>2008</b>	
Total segment assets						106,525	82,662
Adjustments to bring management information in line with IFRS:							
- Reversal of statutory charge for impairment						(442)	-
<b>Total assets per balance sheet</b>						<b>106,083</b>	<b>82,662</b>

***Geographical segments***

As at 31 December 2009 (31 December 2008) all non-current assets are located in Azerbaijan.

***Major customers***

As at 31 December 2009 and 31 December 2008 the Group had no major customers representing 10% or more of the total revenues.

### **30 Financial Risk Management**

The risk management function within the Group is carried out in respect of financial risks (credit, market, geographical, currency, liquidity and interest rate), operational risks and legal risks. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stay within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimise operational and legal risks.

**Credit risk.** Credit risk is the risk of financial loss to the Group if a customer or counterparty fails to meet its contractual obligations when due. The major portion of credit risk arises from the Group's loans and advances to customers and banks and other on and off balance sheet credit exposures. For risk reporting purposes, the Group considers and consolidates all elements of credit risk exposures such as individual customer and counterparty default risk and industry risk. At present, the only credit risk arising from market operations is Azerbaijani government bonds and the notes issued by the Central Bank of the Republic of Azerbaijan. These securities are used exclusively to help manage the liquidity position of the Group.

The general credit risk approval structure, for corporate legal entities, private individuals and financial organisations, is as follows:

For secured loans:

- The Supervisory Board reviews and approves limits over 250,000 two hundred fifty thousand meets on a regular basis;
- The Junior Credit Committee reviews and approves limits up to a maximum limit of AZN 100,000 thousand and meets on a regular basis; and
- The Senior Credit Committee reviews and approves limits up to a maximum limit of AZN from 100,000 thousand to 250,000 two hundred fifty thousand and meets on a regular basis.

The Assets and Liabilities Committee (ALCO) approves general limits so as to control and manage risk diversification:

- Portfolio limits: Corporate loans, retail loans and interbank exposures as percentages of the total portfolio;
- Portfolio limits: Secured facilities and unsecured facilities as percentages of the total portfolios and as a percentage of the retail portfolio; and
- Economic sector and product exposures: as a percentage of the corporate and retail portfolios.

The Supervisory Board also approves limits and authority levels for exposures, as follows:

- By branch;
- By collateral type and loan to value ratios; and
- By individual authority.

As of 31 December 2009, the breakdown of the loan portfolio by economic and product sectors is provided in Note 9.

**Credit Risk Management.** Credit risk policy is developed by the Risk Management Department and Executive Board in line with the risk profile and strategic plans of the Group. It is approved by the Supervisory Board.

### **30 Financial Risk Management (Continued)**

This policy establishes:

- Procedures for generating, analysing, reviewing and approving counterparty risk exposures;
- The methodology for the credit assessment of counterparties;
- The methodology for the evaluation and control of collateral;
- Credit documentation requirements;
- Loan administration procedures;
- Procedures for the ongoing monitoring of credit exposures;
- Environmental policy; and
- Loan loss provisioning policy.

At the first stage, a loan officer generates an initial meeting with the client. Credit applications within approved authority limits are approved by the branches or relevant business generating units. Subsequently, the loan officer visits the client's premises. At the second stage, the loan officer is responsible for holding discussions, gathering and analysing financial, collateral and other information on client. Copies of these documents with a summary memorandum are submitted to the Credit Committee for approval. If the credit request is below a certain authorised limit and receives a positive opinion from Credit Committee, and is signed off by the appropriate individuals, then the request is considered approved. If the credit request is above a certain authorised limit then it is sent to ALCO. Large transactions, as defined above, have to be submitted to the Supervisory Board for approval. After the approval is received from Committee, ALCO and the Supervisory Board, the client gets a final notification of the decision made. The contract is prepared and respective loan is issued as the last stage of the process.

A customer rating is generated based on an analysis of six basic criteria: creditworthiness, financial performance, cash flow analysis, credit history, collateral value and other.

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of a party to a financial instrument failing to perform in accordance with the terms of the contract. The Group uses the same credit policies in entering into conditional obligations as it does for on-balance sheet financial instruments through established credit approvals, risk control limits and monitoring procedures.

For certain retail loan products, a credit scoring system is used, plus the Group uses its internal procedures and enquires of a database administered by the Central Bank of the Republic of Azerbaijan to identify potentially risky customers. Credit assessments are done on a portfolio basis concentrating on amount and term limits, approval procedures, target groups, types of product, default statistics, loan/value ratios (if applicable), and pricing.

**Collateral and other credit enhancements.** Exposure to credit risk is also assessed and managed, in part, by obtaining, controlling and monitoring collateral in the form of mortgage interests over property, pledge of assets and securities and other collateral including deposits, corporate and personal guarantees.

While collateral is an important mitigating factor in assessing the credit risk, it is the Group's policy to establish that loans are within the customer's capacity to repay rather to rely solely on security. Collateral is considered as a secondary source of repayment. In limited cases, depending on the customer's standing or on the type of product or amounts, the facilities may be unsecured. The Group has in place various limits on the unsecured portions of its risk portfolio.

The principal types of collateral accepted by the Group are as follows:

- Commercial real estate
- Residential real estate
- Corporate capital assets
- Corporate liquid assets
- Transport vehicles
- Term deposits
- Other including precious metals

**30 Financial Risk Management (Continued)**

Strict appraisal, documentation and, where applicable, registration procedures are in place for all forms of collateral accepted. The maximum loan to value ratios are approved by Supervisory Board and controlled by the Risk Management Department. The loan to value limits as of 31 December 2009 are as follows:

Type of collateral	Ratio of loan amount to liquid value of collateral
• Other assets (vehicles, securities, inventory)	up to 60%
• Real estate	up to 70%
• Precious metals	up to 80%
• Cash deposits	up to 80%

The Risk Management Department is charged with compiling and reporting on all counterparty credit risk issues, including compliance with all limits, risk concentrations, portfolio trends, past due and default statistics, loan loss reserves and collateral statistics. Besides regular monthly reporting, they also compile reports on adherence to selected credit procedures.

The Monitoring Division of the Risk Management Department is responsible for establishing a schedule of monitoring events, fulfilling this plan and notifying the appropriate parties if the monitoring results are unsatisfactory and recommending a plan of action. The Monitoring Division physically monitors all transactions above an established amount plus does selected checks of transactions below this amount. All transactions above a certain amount are first monitored either before or at least within one month of disbursement. Following this, risk exposures are monitored according to a schedule.

**Related Party Lending.** The Central Bank of the Republic of Azerbaijan has strict definitions regarding the category of "related parties". Mainly, these are corporate entities owned/controlled by the Shareholders or the private individuals themselves or immediate family members. Also included are individuals with senior management/authority positions in the Group. The largest loan per a related party private individual may not be more than 3% of the total capital of the Group. For a related corporate entity, the limit is 10%. The overall limit for related party risk exposure is 20%. Pricing and other terms and conditions must be determined on an arms-length basis. As at 31 December 2009 the Group has not breached any of the above covenants of the Central Bank of the Republic of Azerbaijan.

**Past Due, Non-Performing Loans.** The Group has in place procedures for reporting and dealing with past-due and non-performing loans from the first day past-due. Up to 30-day past-dues are all handled by the relevant business units unless obvious problems are identified earlier. Unsecured retail loans over 30-days past-due are automatically transferred to the Problematic Loans Division which functions within the Legal Department. Corporate loans over 60-days past-due are also transferred to this division. All loans are placed on non-accrual after 90 days past due. If the Problematic Loans Division is unsuccessful in collecting on these obligations, then legal proceedings are instituted. When a loan is deemed uncollectible, recommendations to write-off these amounts are presented to the Credit Committee and the Executive Board. Final decisions regarding write-offs are taken by the Supervisory Board.

All past-due statistics are reported to the Credit Committee in at least on a monthly basis. All corporate loan past-due issues are individually reported to the Credit Committee. The Credit Committee in turn reports to Supervisory Board.

**Allowance for loan losses – provision policy.** The Group establishes an allowance for loan losses that represents its estimate of losses incurred in its risk exposures.

The Central Bank of Azerbaijan Republic also has a provisioning policy which is a minimum standard for banks. The categories with reserve requirements are as follows:

Standard assets	2%
Controllable assets	10%
Unsatisfactory assets	30%
Assets-at-risk	60%
Hopeless assets	100%

These categories are strictly defined.

**30 Financial Risk Management (Continued)**

For reporting in accordance with IFRS, the Group utilises the methodology contained in IAS 39 as the basis for determining the level of provision for loan losses.

**Maximum exposure to credit risk.** The Group's maximum exposure to on balance sheet credit risk is generally reflected in the carrying amounts of financial assets on the balance sheet. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

The credit risk for off-balance items, mainly letters of credit and guarantees, is measured the same as for on-balance items. The Group's maximum exposure to off-balance credit risk is reflected in Note 32 "Contingencies and Commitments".

**Market risk.** The Group takes on exposure to market risks. Market risks arise from open positions in (a) currency, (b) interest rate and (c) equity products, all of which are exposed to general and specific market movements. Management sets limits on the value of risk that may be accepted, which is monitored on a daily basis. However, the use of this approach does not prevent losses outside of these limits in the event of more significant market movements.

The Group does not have any trading positions in financial instruments. Its only exposure to the securities market is the investment; from time to time, in the Central Bank of Azerbaijan Republic notes and Azerbaijan Ministry of Finance obligations in order to help manage its liquidity position. The Group does not normally trade in the derivatives market and has no exposure to this market.

**Currency risk.** The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The foreign exchange exposures are managed by the Treasury Department, who issue daily reports, reviewed by ALCO and controlled by the Risk Management Department.

The Board of Directors sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily.

The table below summarises the Group's exposure to foreign currency exchange rate risk at the balance sheet date:

<i>In thousands of Azerbaijani Manats</i>	At 31 December 2009			At 31 December 2008		
	Monetary financial assets	Monetary financial liabilities	Net position	Monetary financial assets	Monetary financial liabilities	Net position
Azerbaijani Manats	73,064	60,044	13,020	69,026	45,523	23,503
US Dollars	23,374	23,544	(170)	3,605	16,002	(12,397)
Euros	1,571	1,461	110	1,318	787	531
Other	23	-	23	575	-	575
<b>Total</b>	<b>98,032</b>	<b>85,049</b>	<b>12,983</b>	<b>74,524</b>	<b>62,312</b>	<b>12,212</b>

The above analysis includes only monetary assets and liabilities. Investments in equities and non-monetary assets are not considered to give rise to any material currency risk.

**30 Financial Risk Management (Continued)**

The following table presents the sensitivity of profit or loss and equity to reasonably possible changes in exchange rates applied at the balance sheet date, with all other variables held constant:

<i>In thousands of Azerbaijani Manats</i>	<b>At 31 December 2009</b>	<b>At 31 December 2008</b>
	<b>Impact on profit or loss</b>	<b>Impact on profit or loss</b>
US Dollars strengthening by 10%	11	775
US Dollars weakening by 10%	(11)	(775)
Euro strengthening by 10%	(10)	(48)
Euro weakening by 10%	10	48

Other than as a result of any impact on the Group's profit or loss, there is no other impact on the Group's equity as a result of such changes in exchange rates.

The exposures set out above are calculated only for monetary balances denominated in currencies other than the functional currency of Group.

**Open currency limits** In accordance with the Guidelines of the CBAR on Determining and Regulating the Open Foreign Currency Position, the open currency position of the Group in any single currency should not exceed ten per cent, and to all foreign currencies twenty per cent, of the Group's total equity.

Management believes that these statutory ratios have been complied with as at 31 December 2009. As at 31 December 2009, the Group's exposure to USD comprised 6.9% (2008: 0.36%).

In addition, the Group is subject to certain financial covenants on certain borrowings related to the open currency position. Management believes that these financial covenants ratios have been complied with as at 31 December 2009.

**Interest rate risk.** The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. Management monitors on a daily basis and sets limits on the level of mismatch of interest rate repricing that may be undertaken. As at 31 December 2009 (31 December 2008) interest rate repricing date coincides with expected maturities. Refer to liquidity risk.

At 31 December 2009, if interest rates at that date had been 50 basis points lower/higher with all other variables held constant, the profit for the year would have been AZN 35 thousand (2008: AZN 24 thousand) higher/lower, mainly as a result of lower/higher interest expense on variable interest liabilities

**30 Financial Risk Management (Continued)**

The Group monitors interest rates for its financial instruments. The table below summarises interest rates based on reports reviewed by key management personnel:

<i>In % p.a.</i>	31 December 2009			31 December 2008		
	AZN	USD	Euro	AZN	USD	Euro
<b>Assets</b>						
Cash and cash equivalents	14.0	8.2	1.2	-	-	2.0
Due from other banks	11.7	-	1.6	-	1.2	-
Loans and advances to customers	13.3	20.2	19.8	16.5	18.4	17.1
<b>Liabilities</b>						
Due to other banks	1.0	4.3	-	10.2	8.0	13.7
Customer accounts	14.3	15.6	14.0	15.2	13.2	-
Other borrowed funds	1.9	4.5	-	1.9	5.5	-

**Geographical risk concentrations.** The geographical concentration of the Group's financial assets and liabilities at 31 December 2009 is set out below:

<i>In thousands of Azerbaijani Manats</i>	Republic of Azerbaijan	OECD	Non-OECD	Total
<b>Financial assets</b>				
Cash and cash equivalents	16,558	371	435	17,364
Due from other banks	347	-	402	749
Loans and advances to customers	76,506	-	-	76,506
Investment securities available for sale	3,375	-	-	3,375
Other financial assets	37	-	-	37
<b>Total financial assets</b>	<b>96,824</b>	<b>371</b>	<b>837</b>	<b>98,032</b>
<b>Financial liabilities</b>				
Due to other banks	6,606	163	810	7,579
Customer accounts	44,749	27	-	44,776
Other borrowed funds	26,491	5,220	831	32,542
Other financial liabilities	152	-	-	152
<b>Total financial liabilities</b>	<b>77,998</b>	<b>5,410</b>	<b>1,641</b>	<b>85,049</b>
<b>Net position in on-balance sheet financial instruments</b>	<b>18,826</b>	<b>(5,039)</b>	<b>(804)</b>	<b>12,983</b>
<b>Credit related commitments</b>	<b>10,293</b>	<b>-</b>	<b>-</b>	<b>10,293</b>

Assets, liabilities and credit related commitments have generally been based on the country in which the counterparty is located. Cash on hand and premises and equipment have been allocated based on the country in which they are physically held.

**30 Financial Risk Management (Continued)**

The geographical concentration of the Group's assets and liabilities at 31 December 2008 is set out below:

<i>In thousands of Azerbaijani Manats</i>	Republic of Azerbaijan	OECD	Non-OECD	Total
<b>Financial assets</b>				
Cash and cash equivalents	4,966	809	862	6,637
Due from other banks	142	-	-	142
Loans and advances to customers	65,534	-	-	65,534
Investment securities available for sale	2,186	-	-	2,186
Other financial assets	25	-	-	25
<b>Total financial assets</b>	<b>72,853</b>	<b>809</b>	<b>862</b>	<b>74,524</b>
<b>Financial liabilities</b>				
Due to other banks	17,407	526	741	18,674
Customer accounts	30,835	16	-	30,851
Other borrowed funds	11,830	-	792	12,622
Other financial liabilities	165	-	-	165
<b>Total financial liabilities</b>	<b>60,237</b>	<b>542</b>	<b>1,533</b>	<b>62,312</b>
<b>Net position in on-balance sheet financial instruments</b>	<b>12,616</b>	<b>267</b>	<b>(671)</b>	<b>12,212</b>
<b>Credit related commitments</b>	<b>11,398</b>	<b>-</b>	<b>-</b>	<b>11,398</b>

**Liquidity risk.** Liquidity risk is defined as the risk when the maturity of assets and liabilities does not match. The Group is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw-downs and guarantees. The Group does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. Liquidity risk is managed by the Asset/Liability Committee of the Group.

The Group seeks to maintain a stable funding base comprising primarily amounts due to other banks, corporate and retail customer deposits and debt securities and invest the funds in diversified portfolios of liquid assets, in order to be able to respond quickly and smoothly to unforeseen liquidity requirements.

The liquidity management of the Group requires considering the level of liquid assets necessary to settle obligations as they fall due; maintaining access to a range of funding sources; maintaining funding contingency plans and monitoring balance sheet liquidity ratios against regulatory requirements. The Group calculates its instant liquidity ratio at a required minimum of thirty percent on a monthly basis in accordance with the requirement of the Central Bank of Azerbaijan. As at 31 December 2009, the actual ratio was 100.3% (31 December 2008: 51.9%).

The Treasury Department receives information about the liquidity profile of the financial assets and liabilities. The Treasury Department then provides for an adequate portfolio of short-term liquid assets, largely made up of short-term liquid trading securities, deposits with banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Group as a whole.

The table below shows assets and liabilities at 31 December 2009 by their remaining contractual maturity, unless there is evidence that any of the assets are impaired and will be settled after their contractual maturity dates, in which case the expected date of settlement of the assets is used.

**30 Financial Risk Management (Continued)**

Overdue liabilities, such as term deposits not withdrawn by the Group's customers, are classified within the "demand and less than 1 month" column. Overdue assets are allocated based on their expected maturity. Certain assets, which do not have a contractual maturity date, for example, available for sale equity securities, are assumed to mature on the expected date, on which the assets will be realised.

The undiscounted maturity analysis of financial instruments at 31 December 2009 is as follows:

<i>In thousands of Azerbaijani Manats</i>	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	Total
<b>Assets</b>						
Cash and cash equivalents	16,961	417	-	-	-	17,378
Due from other banks	-	636	-	-	175	811
Loans and advances to customers	5,785	22,650	13,741	39,450	12,019	93,645
Investment securities available for sale	3,375	-	-	-	-	3,375
Other financial assets	-	40	-	-	-	40
<b>Total financial assets</b>	<b>26,121</b>	<b>23,743</b>	<b>13,741</b>	<b>39,450</b>	<b>12,194</b>	<b>115,249</b>
<b>Liabilities</b>						
Due to other banks	2,579	2,617	-	5,074	-	10,270
Customer accounts	16,787	9,626	12,342	10,497	-	49,252
Other borrowed funds	-	-	-	31,551	7,066	38,617
Other financial liabilities	121	32	-	-	-	153
Other credit related commitments	207	3,195	3,859	3,032	-	10,293
<b>Total potential future payments for financial obligations</b>	<b>19,694</b>	<b>15,470</b>	<b>16,201</b>	<b>50,154</b>	<b>7,066</b>	<b>108,585</b>
<b>Liquidity gap arising from financial instruments</b>	<b>6,427</b>	<b>8,273</b>	<b>(2,460)</b>	<b>(10,704)</b>	<b>5,128</b>	<b>6,664</b>

**30 Financial Risk Management (Continued)**

The undiscounted maturity analysis of financial assets and financial liabilities at 31 December 2008 is as follows:

<i>In thousands of Azerbaijani Manats</i>	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	Total
<b>Assets</b>						
Cash and cash equivalents	6,636	-	-	-	-	6,636
Due from other banks	-	9	-	175	-	184
Loans and advances to customers	6,707	22,233	9,431	43,772	-	82,143
Investment securities available for sale	2,186	-	-	-	-	2,186
Other financial assets	-	14	-	-	-	14
<b>Total financial assets</b>	<b>15,529</b>	<b>22,256</b>	<b>9,431</b>	<b>43,947</b>	<b>-</b>	<b>91,163</b>
<b>Liabilities</b>						
Due to other banks	3,116	7,167	-	8,618	-	18,901
Customer accounts	10,129	16,099	4,672	1,753	-	32,653
Other borrowed funds	-	-	-	7,262	7,066	14,328
Other financial liabilities	153	13	-	-	-	166
Other credit related commitments	47	2,704	1,396	7,251	-	11,398
<b>Total potential future payments for financial obligations</b>	<b>13,445</b>	<b>25,983</b>	<b>6,068</b>	<b>24,884</b>	<b>7,066</b>	<b>77,446</b>
<b>Liquidity gap arising from financial instruments</b>	<b>2,084</b>	<b>(3,727)</b>	<b>3,363</b>	<b>19,063</b>	<b>(7,066)</b>	<b>13,717</b>

Customer accounts are classified in the above analysis based on contractual maturities. However, individuals have a right to withdraw their deposits prior to maturity if they forfeit their right to accrued interest.

**30 Financial Risk Management (Continued)**

The Group does not use the above maturity analysis based on undiscounted contractual maturities of liabilities to manage liquidity. Instead, the Group monitors expected maturities and the resulting expected liquidity gap as follows at 31 December 2009:

<i>In thousands of Azerbaijani Manats</i>	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	Over 12 months	Total
<b>At 31 December 2009</b>					
Financial assets	26,122	22,052	12,722	37,136	98,032
Financial liabilities	19,487	9,065	16,571	39,926	85,049
<b>Net liquidity gap based on expected maturities</b>	<b>6,635</b>	<b>12,987</b>	<b>(3,849)</b>	<b>(2,790)</b>	<b>12,983</b>
<b>At 31 December 2008</b>					
Financial assets	15,529	20,643	8,732	29,620	75,524
Financial liabilities	13,399	22,185	12,873	13,855	62,312
<b>Net liquidity gap based on expected maturities</b>	<b>2,130</b>	<b>(1,542)</b>	<b>(4,141)</b>	<b>15,765</b>	<b>12,212</b>

The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. It is unusual for banks ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Group and its exposure to changes in interest and exchange rates.

Management considers that the current favourable macroeconomic environment for financial institutions operating in Azerbaijan, positive cash flows, the profitability of operations and access to foreign financial resources as required significantly decrease the risk of losses arising from current liquidity mismatches.

Management believes that in spite of a substantial portion of customers accounts falling due from six months, diversification of these deposits by number and type of depositors, and the past experience of the Group would indicate that these customer accounts provide a long-term and stable source of funding for the Group. Customer accounts are classified in the above analysis based on contractual maturities. However, in accordance with Azerbaijani Civil Code, individuals have a right to withdraw their deposits prior to maturity if they forfeit their right to accrued interest. Besides the group has cumulative liquidity surplus of AZN 19,622 thousand within first six months which compensates subsequent liquidity gap.

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Group does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

### 31 Management of Capital

The objectives of management when managing the Group's capital are (i) to comply with the capital requirements set by the Central Bank of the Azerbaijan Republic ("CBAR"), (ii) to safeguard the Group's ability to continue as a going concern and (iii) to maintain a sufficient capital base to achieve a capital adequacy ratio based on Basel Accord of at least 8%. Compliance with capital adequacy ratios set by the Central Bank of Azerbaijan Republic is monitored monthly with reports outlining their calculation reviewed and signed by the Group's Chief Executive Officer and Chief Accountant. The other objectives of capital management are evaluated annually.

The CBAR requires each bank or banking group to: (a) hold the minimum level of regulatory capital AZN 10,000 thousand (31 December 2008: AZN 10,000 thousand); (b) maintain a ratio of total regulatory capital to the risk-weighted assets (the 'total capital ratio') at or above the prescribed minimum of 12% (31 December 2008: 12%) and (c) maintain a ratio of tier 1 capital to the risk-weighted assets (the 'Tier 1 capital ratio') at or above the prescribed minimum of 6% (31 December 2008: 6%).

Management considers that the Group was in compliance with the statutory capital ratio during the years ended 31 December 2009 and December 2008.

The Group is subject to minimum capital requirements, including capital adequacy levels calculated in accordance with the requirements of the Basle Accord, as defined in the International Convergence of Capital Measurement and Capital Standards (updated April 1998) and Amendment to the Capital Accord to incorporate market risks (updated November 2005), commonly known as Basel I. The composition of the Group's capital calculated in accordance with Basel Accord is as follows:

<i>In thousands of Azerbaijani Manats</i>	31 December 2009	31 December 2008
<b>Tier 1 capital</b>		
Share capital	17,000	16,000
Retained earnings	2,843	2,939
Less: intangible assets	(72)	(67)
<b>Total tier 1 capital</b>	<b>19,771</b>	<b>18,872</b>
<b>Tier 2 capital</b>		
Reserves	1,322	1,176
Revaluation reserve – premises and equipment	1,068	1,041
<b>Total tier 2 capital</b>	<b>2,390</b>	<b>2,717</b>
Less: Investments	3,375	2,186
<b>Total regulatory capital</b>	<b>18,786</b>	<b>18,903</b>
Risk-weighted assets:		
On-balance sheet	90,443	74,803
Off-balance sheet	15,332	19,294
<b>Total risk-weighted assets</b>	<b>105,775</b>	<b>94,097</b>
<b>Basel ratio</b>	<b>17.76%</b>	<b>20.09%</b>

## **32 Contingencies and Commitments**

**Legal proceedings.** From time to time and in the normal course of business, claims against the Group are received. Based on their own estimates and internal professional advice, management is of the opinion that no material losses will be incurred in respect of claims and accordingly no provision has been made in these financial statements.

**Tax legislation.** Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and state authorities.

The Azerbaijani tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged.

As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained. Accordingly, at 31 December 2009 no provision for potential tax liabilities has been recorded (31 December 2008: no provision).

**Compliance with covenants.** The Group is subject to certain covenants related primarily to its borrowings. Non-compliance with such covenants may result in negative consequences for the Group, including growth in the cost of borrowings and the timing of repayment of existing facilities. Management believes that during the year ended 31 December 2009 the Group has materially complied with the covenants that were in force, except as detailed below.

At certain times during the year ended 31 December 2009, the Group failed to comply with financial covenants related to liquidity assets to weighted short term liabilities and liquidity ratio. However, it did not give rise to event of default in accordance with loan agreement and no actions have been undertaken or penalties charged by the related financial institutions.

Management believes that as of the date of this report, the Group had not experienced any adverse consequences of the breaches of the covenants specified in these loan agreements.

**Credit related commitments.** The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties. Documentary and commercial letters of credit, which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods, to which they relate, or cash deposits and, therefore, carry less risk than a direct borrowing.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group 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 Group monitors the term to maturity of credit related commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments. Outstanding credit related commitments are as follows:

<i>In thousands of Azerbaijani Manats</i>	<b>31 December 2009</b>	<b>31 December 2008</b>
Undrawn credit lines	8,066	9,474
Guarantees issued	2,227	1,924
<b>Total credit related commitments</b>	<b>10,293</b>	<b>11,398</b>

### 32 Contingencies and Commitments (Continued)

The total outstanding contractual amount of undrawn credit lines and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded. The fair value of credit related commitments was AZN 20 thousand at 31 December 2009 (31 December 2008: AZN 59 thousand). Credit related commitments are denominated in currencies as follows:

<i>In thousands of Azerbaijani Manats</i>	<b>31 December 2009</b>	<b>31 December 2008</b>
Azerbaijani Manats	6,374	10,816
US Dollars	3,167	-
Euro	572	582
GBP	180	-
<b>Total</b>	<b>10,293</b>	<b>11,398</b>

### 33 Fair Value of Financial Instruments

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price.

**Financial instruments carried at fair value.** Investment securities available for sale are carried on the consolidated statement of financial position at cost where the fair value cannot be reliably determined.

Cash and cash equivalents are carried at amortised cost, which approximates current fair value.

**Fair values of financial instruments carried at amortised cost.** At 31 December 2009 (31 December 2008), fair values of financial instruments carried at amortised cost approximated to their carrying values.

**Loans and receivables carried at amortised cost.** The fair value of floating rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on currency, maturity of the instrument and credit risk of the counterparty and were as follows:

<i>In thousands of Azerbaijani Manats</i>	<b>31 December 2009</b>	<b>31 December 2008</b>
<i>Due from other banks – Note 8</i>		
Short-term placements with other banks with original maturities of more than three months	1 % to 12 % p.a	1 % to 2 % p.a
<i>Loans and advances to customers – Note 9</i>		
Corporate loans	5% to 36% p.a.	5% to 39% p.a.
Loans to individuals - consumer loans	4% to 48% p.a.	7% to 45% p.a.
Loans to individuals – entrepreneurs	6% to 42% p.a.	7% to 45% p.a.
Mortgage loans	4% to 27% p.a.	4% to 27% p.a.

**Liabilities carried at amortised cost.** The fair value of debt securities in issue is based on quoted market prices. Refer to Note 10. The estimated fair value of instruments with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest rate instruments without a quoted market price is based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

**34 Presentation of Financial Instruments by Measurement Category**

For the purposes of measurement, IAS 39, *Financial Instruments: Recognition of Measurement*, classifies financial assets into the following categories: (a) loans and receivables; (b) available for sale financial assets; (c) financial assets held to maturity and (d) financial assets at fair value through profit or loss ("FVTPL"). Financial assets at fair value through profit or loss have two subcategories: (i) assets designated as such upon initial recognition, and (ii) those classified as held for trading. The following table provides a reconciliation of financial assets with these measurement categories as of 31 December 2009:

<i>In thousands of Azerbaijani Manats</i>	<b>Loans and receivables</b>	<b>Available-for-sale assets</b>	<b>Total</b>
<b>Assets</b>			
<b>Cash and cash equivalents</b>	<b>17,364</b>	-	<b>17,364</b>
<b>Due from other banks</b>	<b>750</b>	-	<b>750</b>
- Short-term placements with other banks with original maturities of more than three months	617	-	617
- Blocked accounts with non-resident banks	133	-	133
<b>Loans and advances to customers</b>	<b>76,506</b>	-	<b>76,506</b>
- Corporate loans	42,623	-	42,623
- Loans to individuals - consumer loans	11,109	-	11,109
- Loans to individuals - entrepreneurs	16,890	-	16,890
- Mortgage loans	5,242	-	5,242
- Car purchase	642	-	642
<b>Investment securities available for sale</b>	-	<b>3,375</b>	<b>3,375</b>
- Corporate shares	-	820	820
- Debt securities	-	2,555	2,555
<b>Other financial assets</b>	<b>37</b>	-	<b>37</b>
Credit and debit cards receivables	37	-	37
<b>TOTAL FINANCIAL ASSETS</b>	<b>94,657</b>	<b>3,375</b>	<b>98,032</b>

As of 31 December 2009 and 31 December 2008 all of the Group's financial liabilities were carried at amortised cost.

The following table provides a reconciliation of financial assets with the measurement categories defined in IAS 39, *Financial Instruments: Recognition and Measurement*, as of 31 December 2008:

<i>In thousands of Azerbaijani Manats</i>	<b>Loans and receivables</b>	<b>Available-for-sale assets</b>	<b>Total</b>
<b>Assets</b>			
<b>Cash and cash equivalents</b>	<b>6,637</b>	-	<b>6,637</b>
<b>Due from other banks</b>	<b>142</b>	-	<b>142</b>
- Short-term placements with other banks with original maturities of more than three months	142	-	142
- Blocked accounts with non-resident banks	-	-	-
<b>Loans and advances to customers</b>	<b>65,534</b>	-	<b>65,534</b>
- Corporate loans	36,851	-	36,851
- Loans to individuals - consumer loans	8,758	-	8,758
- Loans to individuals - entrepreneurs	16,022	-	16,022
- Mortgage loans	3,541	-	3,541
- Other	362	-	362
<b>Investment securities available for sale</b>	-	<b>2,186</b>	<b>2,186</b>
- Corporate shares	-	680	680
- Debt securities	-	1,506	1,506
<b>Other financial assets</b>	<b>25</b>	-	<b>25</b>
Credit and debit cards receivables	25	-	25
<b>TOTAL FINANCIAL ASSETS</b>	<b>72,338</b>	<b>2,186</b>	<b>74,524</b>

**35 Related Party Transactions**

Parties are generally considered to be related if the parties are under common control or one party has the ability to control the other party or can exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

At 31 December 2009, the outstanding balances with related parties were as follows:

	Significant shareholders	Key manage- ment personnel	Entities in which a substantial interest is owned by the shareholders of the Group	Other related parties
<i>In thousands of Azerbaijani Manats</i>				
Gross amount of loans and advances to customers (contractual interest rate: 4% - 38%)	111	686	9,090	56
Impairment provisions for loans and advances to customers at 31 December	(2)	(16)	(156)	(1)
Investment securities available for sale	300	-	-	-
Customer accounts (contractual interest rate: 8% - 16%)	4,032	123	943	3

The income and expense items with related parties for the year ended 31 December 2009 were as follows:

	Significant shareholders	Key Manage- ment personnel	Entities in which a substantial interest is owned by the shareholders of the Group	Other related parties
<i>In thousands of Azerbaijani Manats</i>				
Interest income	7	32	782	4
Interest expense	(191)	(7)	(95)	(32)
Provision for loan impairment	(1)	(10)	(98)	(1)
Fee and commission income	34	-	-	-
Administrative and other operating expenses	(92)	(552)	-	-

At 31 December 2009, other rights and obligations with related parties were as follows:

	Significant shareholders	Key management personnel	Entities in which a substantial interest is owned by the shareholders of the Group	Other related parties
<i>In thousands of Azerbaijani Manats</i>				
Undrawn credit lines	-	-	3,287	-

**35 Related Party Transactions (Continued)**

At 31 December 2008, the outstanding balances with related parties were as follows:

	Significant shareholders	Key manage- ment personnel	Entities in which a substantial interest is owned by the shareholders of the Group	Other related parties
<i>In thousands of Azerbaijani Manats</i>				
Gross amount of loans and advances to customers (contractual interest rate: 5% - 36%)	189	573	10,275	55
Impairment provisions for loans and advances to customers at 31 December	(4)	(11)	(498)	(1)
Investment securities available for sale	158	-	-	400
Due to other banks (contractual interest rate: 8 % - 14 %)	-	-	-	493
Customer accounts (contractual interest rate: 7 % - 15 %)	1,677	128	928	3

The income and expense items with related parties for the year ended 31 December 2008 were as follows:

	Significant shareholders	Key Manage- ment personnel	Entities in which a substantial interest is owned by the shareholders of the Group	Other related parties
<i>In thousands of Azerbaijani Manats</i>				
Interest income	210	455	848	32
Interest expense	(177)	(8)	(97)	(1)
Provision for loan impairment	(2)	(5)	(52)	-
Fee and commission income	7	4	8	-
Administrative and other operating expenses	(5)	(467)	(39)	-

At 31 December 2008, other rights and obligations with related parties were as follows:

	Significant shareholders	Key management personnel	Entities in which a substantial interest is owned by the shareholders of the Group	Other related parties
<i>In thousands of Azerbaijani Manats</i>				
Undrawn credit lines	-	-	2,061	-

Key management compensation is presented below:

<i>In thousands of Azerbaijani Manats</i>	2009	2008
<i>Short-term benefits:</i>		
- Salaries	605	467
<b>Total</b>	<b>605</b>	<b>467</b>

**36 Principal Subsidiaries, Associates and Joint Ventures**

<b>Name</b>	<b>Nature of business</b>	<b>Percentage of voting rights</b>	<b>Percentage of ownership</b>	<b>Country of registration</b>
TuranLizing LLC	Leasing	100.0%	100.0%	Azerbaijan

On 21 August 2006, the Group registered TuranLizing LLC ("TuranLizing") with the Ministry of Justice of the Republic of Azerbaijan. The company commenced its operations in September 2006, and is owned 100% by the Group.

**37 Events After the End of the Reporting Period**

Subsequent to the balance sheet date, according to the decision of General Assembly of Shareholders hold on 23 February 2010 the Group increased its share capital from AZN 17,000 thousand to AZN 18,500 thousand by utilising the portion of AZN 1,300 thousand of its statutory taxable profit for the year ended 31 December 2009 and AZN 200 thousand as additional contribution provided by shareholders.

On 5 January 2010, short-term placement with resident bank amounting to AZN 1,606 thousand bearing annual interest rate of 6% was fully repaid on its maturity date.

On 2 March 2010, short-term placement with UralsibBank amounting to AZN 402 thousand was fully repaid on its maturity date.