YAPI KREDI BANK AZERBAIJAN
Closed Joint Stock Company

International Financial Reporting Standards Consolidated Financial Statements and Independent Auditor’s Report
31 December 2008

CONTENTS

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors of Yapı Kredi Bank Azerbaijan Closed Joint Stock Company:

We have audited the accompanying consolidated financial statements of Yapı Kredi Bank Azerbaijan Closed Joint Stock Company (the "Bank") and its brokerage subsidiary (together referred to as the "Group") which comprise the consolidated balance sheet as at 31 December 2008 and the consolidated income statement, 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 Consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated 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 2008, 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, Republic of Azerbaijan
6 May 2009

Yapı Kredi Bank Azerbaijan Closed Joint Stock Company
Consolidated Balance Sheet

In thousands of Azerbaijani Manats	Note	2008	2007
ASSETS			
Cash and cash equivalents	7	26,251	23,364
Mandatory cash balances with the NBAR		3,725	2,328
Due from other banks	8	4,108	2,772
Loans and advances to customers	9	9,567	14,463
Investment securities available for sale	10	57,269	55,822
Deferred income tax asset	24	-	44
Fixed assets	11	2,996	426
Intangible assets	11	67	22
Other financial assets	12	24	29
Other assets	13	320	448
TOTAL ASSETS		**104,327**	**99,718**
LIABILITIES			
Due to other banks	14	6,282	3,300
Customer accounts	15	58,636	83,137
Current income tax liability		411	190
Deferred income tax liability	24	7	-
Other financial liabilities	16	84	202
Other liabilities	17	920	260
Subordinated loan from the Affiliated Bank	18	161	339
TOTAL LIABILITIES		**66,501**	**87,428**
EQUITY			
Share capital	19	14,496	6,349
Additional paid-in capital	19	12,713	-
Capital contribution		515	515
Retained earnings		10,102	5,426
TOTAL EQUITY		**37,826**	**12,290**
TOTAL LIABILITIES AND EQUITY		**104,327**	**99,718**

Approved for issue and signed on behalf of the Board of Directors on 6 May 2009.

Mr. M. Coskun Bulak
Chairman and Chief Executive Officer

Ms. Khalida Hasanova
Chief of Accounting Control Department

The notes set out on pages 5 to 51 form an integral part of these consolidated financial statements.

In thousands of Azerbaijani Manats	Note	2008	2007
Interest income	20	7,614	6,078
Interest expense	20	(1,321)	(1,143)
Net interest income		**6,293**	**4,935**
Recovery of provision for impairment of amounts due from other banks	8	16	23
Recovery of/(provision) for impairment of loans to customers	9	72	(176)
Net interest income after provision for loan impairment		**6,381**	**4,782**
Fee and commission income	21	3,952	3,351
Fee and commission expense	21	(738)	(1,166)
Gains less losses from trading in foreign currencies		884	757
Foreign exchange translation losses less gains		(300)	(99)
Other operating income	22	45	17
Administrative and other operating expenses	23	(3,943)	(2,359)
Profit before tax		**6,281**	**5,283**
Income tax expense	24	(1,605)	(1,201)
Profit for the year		**4,676**	**4,082**

In thousands of Azerbaijani Manats	Note	Share capital	Additional paid-in capital	Capital contribution	Retained earnings	Total equity
Balance at 1 January 2007		**6,349**	**-**	**515**	**1,344**	**8,208**
Profit for the year		-	-	-	4,082	4,082
Total recognized income for 2007		-	-	-	4,082	4,082
Balance at 31 December 2007		**6,349**	**-**	**515**	**5,426**	**12,290**
Profit for the year		-	-	-	4,676	4,676
Total recognized income for 2008		-	-	-	4,676	4,676
Share issue	19	8,147	12,713	-	-	20,860
Balance at 31 December 2008		**14,496**	**12,713**	**515**	**10,102**	**37,826**

In thousands of Azerbaijani Manats	Note	2008	2007
Cash flows from operating activities			
Interest received		7,417	5,482
Interest paid		(1,372)	(1,099)
Fees and commissions received		4,448	3,351
Fees and commissions paid	21	(738)	(1,166)
Income received from trading in foreign currencies		884	757
Other operating income received		-	4
Staff costs paid		(1,983)	(1,119)
Administrative and other operating expenses paid		(1,496)	(1,115)
Income tax paid		(1,334)	(1,427)
Cash flows from operating activities before changes in operating assets and liabilities		**5,826**	**3,668**
Changes in operating assets and liabilities			
Net (increase)/decrease in due from other banks		(1,360)	2,690
Net (increase)/decrease in mandatory cash balances		(1,397)	353
Net decrease/(increase) in loans and advances to customers		4,880	(7,861)
Net decrease in other financial assets		5	61
Net decrease/(increase) in other assets		164	(217)
Net increase in due to other banks		2,993	1,108
Net (decrease)/increase in customer accounts		(24,461)	36,726
Net decrease in debt securities		-	(823)
Net (decrease)/increase in other financial liabilities		(118)	52
Net increase in other liabilities		48	24
Net cash (used in)/from operating activities		**(13,420)**	**35,781**
Cash flows from investing activities			
Acquisition of investment securities available for sale	10	(310,522)	(436,783)
Proceeds from redemption of investment securities available for sale	10	309,108	404,048
Proceeds from share issue	19	20,860	-
Acquisition of fixed assets	11	(2,857)	(243)
Acquisition of intangible assets	11	(60)	(1)
Dividends received	22	45	9
Net cash from/(used in) investing activities		**16,574**	**(32,970)**
Cash flows from financing activities			
Proceeds from subordinated debt from the Affiliated Bank		12,739	-
Repayment of subordinated debt from the Affiliated Bank		(12,917)	(187)
Net cash used in financing activities		**(178)**	**(187)**
Effect of exchange rate changes on cash and cash equivalents		**(89)**	**(51)**
Net increase in cash and cash equivalents		**2,887**	**2,573**
Cash and cash equivalents at the beginning of the year	7	23,364	20,791
Cash and cash equivalents at the end of the year	7	**26,251**	**23,364**

1 Introduction

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2008 for Yapı Kredi Bank Azerbaijan Closed Joint Stock Company (the "Bank"), which was formerly known as Koçbank Azerbaijan Limited and its brokerage subsidiary (together referred to as the "Group").

The Bank was incorporated and is domiciled in the Republic of Azerbaijan. The Bank is a closed joint-stock company limited by shares and was set up in accordance with Azerbaijani regulations. The Group had 104 employees at 31 December 2008 (2007: 60) of which 102 employees were employed by the Bank and 2 - by the Subsidiary.

The Bank was originally established as a subsidiary of Koçbank A.S. (Turkey) ("Affiliated Bank"). In September 2002, the Affiliated Bank transferred its shares to Koç Financial Services ("KFS"). On 8 March 2006, ownership of KFS in the Bank increased from 79.8% to 99.8%. The ultimate shareholders of KFS are UniCredito Italiano SPA ("UCI") and Koç Holding, with 50% ownership each.

On 31 July 2007, the Bank registered its full-owned brokerage subsidiary, "Yapi Kredi Invest LLC" with Ministry of Justice of the Republic of Azerbaijan. The subsidiary commenced its operations in February 2008. The activity of the Subsidiary includes dealing and brokerage operations. The official address of the subsidiary is: J Jafar Jabbarli street 32/12, Baku, AZ1065, The Republic of Azerbaijan.

Principal activity. The Group's principal business activity is commercial and retail banking operations within the Republic of Azerbaijan. The Bank has operated under a full banking licence issued by the National Bank of the Republic of Azerbaijan ("NBAR") since 11 January 2000 under registration number 243. 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:

- from 1 January 2008 until 1 January 2010 – up to AZN 6,000;
- 1 January 2010 and afterwards – up to AZN 8,000.

The Bank has 4 branches (2007: 3 branches) within the Republic of Azerbaijan.

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

32/12 Jafar Jabbarli street
Baku, AZ1065, The Republic of Azerbaijan

Presentation currency. These consolidated financial statements are presented in thousands of Azerbaijani Manats ("AZN thousands"). The Azerbaijani Manat ("AZN") is the official currency of the Republic of Azerbaijan.

2 Operating Environment of the Group

The Republic of Azerbaijan displays certain characteristics of an emerging market, including the existence of a currency that is in practice not 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 and may occasionally experience reductions in liquidity. The Bank's management is unable to predict all developments which could have an impact on the banking sector and consequently what effect, if any, they 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 changes, which can occur frequently. Furthermore, the need for further developments in the bankruptcy laws, the absence of formalised procedures for the registration and enforcement of collateral, and other legal and fiscal impediments contribute to the difficulties experienced by banks currently operating in the Republic of Azerbaijan. 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 its 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 consolidated financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. 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

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated (refer to Note 4).

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 Bank and its subsidiary use uniform accounting policies consistent with the Group’s policies.

Key measurement terms. Depending on their classification, financial instruments are carried at cost, 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.

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 consolidated financial statements if changing any such assumptions to a reasonably possible alternative would result in significantly different profit, income, total assets or total liabilities.

3 Summary of Significant Accounting Policies (Continued)

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 and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments.

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 and sales are recognised on the settlement date with the change in value between the commitment date and settlement date not recognised for assets carried at cost or amortised cost; recognised in profit or loss for trading securities, derivatives and other financial assets at fair value through profit or loss; and recognised in equity for assets classified as available for sale.

Cash and cash equivalents. Cash and cash equivalents are items which, can be converted into cash within a day, including mandatory cash balances in AZN held with the National Bank of the Republic of Azerbaijan. All short-term inter-bank placements, beyond overnight placements, are included in due from other banks. Amounts, which relate to funds that are of a restricted nature, are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

Mandatory cash balances with the NBAR. Mandatory cash balances with the NBAR are carried at amortised cost and represent non-interest bearing mandatory reserve deposits, which are not available to finance the Group’s day to day operations and hence are not considered as part of cash and cash equivalents for the purposes of the consolidated cash flow statement.

3 Summary of Significant Accounting Policies (Continued)

As at 31 December 2008, the Bank classified all mandatory reserve balances held in foreign currency and in AZN within the mandatory reserve balances with the NBAR caption of the consolidated financial statements whereas as at 31 December 2007 the AZN portion of mandatory reserves was disclosed in Cash and Cash equivalents according to NBAR regulations.

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 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 whether a financial asset is impaired is its overdue status and realisability of related collateral, if any. The following other principal criteria are also used to determine that 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 borrower's financial information that the bank obtains;
- the borrower considers bankruptcy or a financial reorganisation;
- there is adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrowers; and/or
- the value of collateral significantly decreases as a result of deteriorating market conditions

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.

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.

3 Summary of Significant Accounting Policies (Continued)

Non-collectible 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.

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. The Group classifies investments as available for sale at the time of purchase.

Investment securities available for sale are carried at fair value. Interest income on available for sale debt securities is calculated using the effective interest method and recognised in profit or loss. Dividends on available-for-sale equity instruments are recognised in profit or loss 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 deferred in equity until the investment is derecognised or impaired, at which time the cumulative gain or loss is removed from equity to profit or loss.

Impairment losses are recognised in profit or loss 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 removed from equity and recognised in profit or loss. Impairment losses on equity instruments are not reversed through profit or loss. 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 current period's profit or loss.

Fixed assets. Fixed assets are stated at cost less accumulated depreciation and provision for impairment, where required.

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

If impaired, fixed assets 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. Depreciation on fixed assets is calculated, using the straight-line method to allocate its cost to its residual values over its estimated useful lives at the following annual rates:

Computers, communication and other fixed assets	20%
Furniture, fixtures and other	20%
Motor vehicles	20%
Leasehold improvements	10%

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. Intangible assets are amortised over their estimated useful lives of 5 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 lesser to the Group, the total lease payments are charged to profit or loss on a straight-line basis over the period of 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. If the Group purchases its own debt, it is removed from the balance sheet and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from early retirement of debt.

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

Subordinated debt. Subordinated debt includes long-term non-derivative liabilities to international financial institutions and is carried at amortised cost. Debt is classified as subordinated debt when its repayment ranks after all other creditors in case of liquidation. Subordinated debt is included in "tier 2 capital" of the Group.

Income taxes. Income taxes have been provided for in the consolidated financial statements in accordance with Azerbaijan 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.

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 consolidated 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 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 and liabilities are netted only within the individual companies of the Group. 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.

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.

3 Summary of Significant Accounting Policies (Continued)

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.

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. Loan syndication fees are recognised as income when the syndication has been completed and the Group retained no part of the loan package for itself or retained a part at the same effective interest rate for the other participants.

Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, which are earned on execution of the underlying transaction are recorded on its completion.

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

Monetary assets and liabilities are translated into Group's functional currency at the official exchange rate of the NBAR 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 Group's functional currency at year-end official exchange rates of the NBAR 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 2008, the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 0.8010 (2007: USD 1 = AZN 0.8453).

Offsetting. Financial assets and liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

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

***Segment reporting*.** A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segments with a majority of revenue earned from sales to external customers and whose revenue, result or assets are ten percent or more of all the segments are reported separately. Geographical segments of the Group have been reported separately within these consolidated financial statements based on the ultimate domicile of the counterparty, e.g. based on economic risk rather than legal risk of the counterparty.

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 year. 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 consolidated 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 28.

***Deferred Taxation*.** 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 starting from 1 January 2009, for the portion of the profit which is transferred to share capital. Management of the Bank considered the impact of the enactment of the Law on the Bank's deferred tax calculation. As the management is expecting to transfer all of the current year profit to share capital, the Bank will be able to utilise the benefits of this Law. As a result of that, all temporary taxable and deductible differences which are fully realised in three years time from 1 January 2009 are not subject to deferred taxation. The management believes that all temporary differences at the balance sheet date will reverse within the next three year period other than the temporary differences arising due to Property, Plant and Equipment which only certain portion will reverse in the three years period covered by the Law.

Impairment losses on loans and advances. The Group regularly reviews its loan portfolios to assess impairment. In determining whether an impairment loss should be recorded in the consolidated income statement, the Group 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 4 thousand (2007: AZN 8 thousand) higher or lower. Given the limited number of individual loans in the Group's portfolio, deterioration in the status of any one of these borrowers could have a significant impact on the income statement for the year.

Capital Adequacy Ratio. Capital Adequacy is calculated in accordance with the International Convergence of Capital Measurement and Capital Standards (July 1988, updated to November 2005) (or Basel Capital Accord) requirements. Such requirements are subject to interpretation and accordingly the appropriateness of the inclusion, exclusion, and/or classification of amounts included in the calculation of the Capital Adequacy Ratio requires management judgement.

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.

5 Adoption of New or Revised Standards and Interpretations

Certain new interpretations became effective for the Group from 1 January 2008:

- ***IFRIC 11, IFRS 2—Group and Treasury Share Transactions*** (effective for annual periods beginning on or after 1 March 2007);
- ***IFRIC 12, Service Concession Arrangements*** (effective for annual periods beginning on or after 1 January 2008); and
- ***IFRIC 14, IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*** (effective for annual periods beginning on or after 1 January 2008).

These interpretations did not have any significant effect on the Group's consolidated financial statements.

Reclassification of Financial Assets—Amendments to IAS 39, Financial Instruments: Recognition and Measurement, and IFRS 7, Financial Instruments: Disclosures **and a subsequent amendment,** ***Reclassification of Financial Assets: Effective Date and Transition.*** The amendments allow entities the options (a) to reclassify a financial asset out of the held to trading category if, in rare circumstances, the asset is no longer held for the purpose of selling or repurchasing it in the near term; and (b) to reclassify an available-for-sale asset or an asset held for trading to the loans and receivables category, if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity (subject to the asset otherwise meeting the definition of loans and receivables). The amendments may be applied with retrospective effect from 1 July 2008 for any reclassifications made before 1 November 2008; the reclassifications allowed by the amendments may not be applied before 1 July 2008 and retrospective reclassifications are only allowed if made prior to 1 November 2008. Any reclassification of a financial asset made on or after 1 November 2008 takes effect only from the date when the reclassification is made. The Group has not elected to make any of the optional reclassifications during the year.

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 2008 or later periods and which the Group has not early adopted:

IFRS 8, Operating Segments *(effective for annual periods beginning on or after 1 January 2009).* 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 and specifies how an entity should report such information. The Group is currently assessing what impact the standard will have on segment disclosures in the consolidated financial statements.

Puttable financial instruments and obligations arising on liquidation — IAS 32 and IAS 1 Amendment *(effective from 1 January 2009).* The amendment requires classification as equity of some financial instruments that meet the definition of a financial liability. The Group is currently assessing the impact of the amendment on its consolidated financial statements.

IAS 23, Borrowing Costs *(revised March 2007; effective for annual periods beginning on or after 1 January 2009).* The revised IAS 23 was issued in March 2007. The main change to IAS 23 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. An entity is, therefore, required to capitalise such borrowing costs as part of the cost of the asset. The revised standard applies prospectively to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

IAS 1, Presentation of Financial Statements *(revised September 2007; effective for annual periods beginning on or after 1 January 2009).* The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities will be allowed to present two statements: a separate income statement and a 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 Group expects the revised IAS 1 to affect the presentation of its consolidated financial statements but to have no impact on the recognition or measurement of specific transactions and balances.

6 New Accounting Pronouncements (Continued)

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. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

Vesting Conditions and Cancellations—Amendment to IFRS 2, Share-based Payment *(issued in January 2008; effective for annual periods beginning on or after 1 January 2009).* The amendment clarifies 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 The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

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. 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. IFRS 3 is not relevant to the Group as it does not expect a business combination to occur.

IFRIC 13, Customer Loyalty Programmes *(effective for annual periods beginning on or after 1 July 2008).* 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. The Group does not operate any loyalty programmes.

IFRIC 15, Agreements for the Construction of Real Estate *(effective for annual periods beginning on or after 1 January 2009).* 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. IFRIC 15 is not relevant to the Group's operations because it does not have any agreements for the construction of real estate.

IFRIC 16, Hedges of a Net Investment in a Foreign Operation *(effective for annual periods beginning on or after 1 October 2008).* 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 gain or loss recycled from the currency translation reserve to profit or loss is calculated on disposal of the hedged foreign operation.

Reporting entities will apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16. IFRIC 16 is not relevant to the Group's operations because it does not apply hedge accounting.

6 New Accounting Pronouncements (Continued)

Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate—IFRS 1 and IAS 27 Amendment *(revised May 2008; effective for annual periods beginning on or after 1 January 2009).* 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 rather than as a recovery of the investment. The amendments will not have an impact on the Group’s consolidated financial statements.

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, with earlier application permitted).* 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. The amendment is not expected to have an impact on the Group's consolidated financial statements as the Group does not apply hedge accounting.

Improvements to International Financial Reporting Standards *(issued in May 2008).* In 2007, 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 issued in May 2008 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. The Group does not expect the amendments to have any material effect on its consolidated financial statements.

IFRIC 17, Distribution of Non-Cash Assets to Owners *(effective for annual periods beginning on or after 1 July 2009, with earlier application permitted).* The amendment 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 when the entity settles the dividend payable. IFRIC 17 is not relevant to the Group’s operations because it does not distribute non-cash assets to owners.

IFRS 1, First-time Adoption of International Financial Reporting Standards (*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 consolidated financial statements.

IFRIC 18, Transfers of Assets from Customers *(effective for annual periods beginning on or after 1 July 2009; not yet adopted by the EU).* 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.

6 New Accounting Pronouncements (Continued)

Improving Disclosures about Financial Instruments- Amendment to IFRS 7, Financial Instruments: Disclosures (effective for annual periods beginning on or after 1 January 2009; not yet adopted by the EU). The amendment requires enhanced disclosures about fair value measurements and liquidity risk. The entity will be 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.

7 Cash and Cash Equivalents

In thousands of Azerbaijani Manats	**2008**	**2007**
Cash on hand	4,133	2,452
Cash balances with the NBAR (other than mandatory reserve deposits)	11,150	8,428
Correspondent accounts and overnight placements with other banks:		
- Republic of Azerbaijan	4,680	518
- Other countries	6,288	11,966
Total cash and cash equivalents	**26,251**	**23,364**

At 31 December 2008, balances on correspondent accounts and overnight placements with non-resident banks included balances with the Affiliated Bank of AZN 5,347 thousand (2007: AZN 11,790 thousand), which comprised 5.1% of the total assets of the Group (2007: 11.8%).

Included in the correspondent accounts and overnight placements with other resident banks as at 31 December 2008 are short-term placements of the Group with resident banks amounting to AZN 4,576 thousand (2007: AZN 7 thousand) placed on 30 December 2008. The placements bear interest rates of 0.33% per annum with maturity on 5 January 2009. Subsequent to the balance sheet date, the placements have been repaid on initial maturity.

The average interest rates on correspondent accounts with the Affiliated Bank during the year ended 31 December 2008 were 1.0% p.a. for USD denominated balances and 1.5% p.a. for EUR denominated balances (2007: 0.5% p.a. and 1.5% p.a., respectively). The average interest rates for demand deposits with the Affiliated Bank were 5.95% p.a. for USD denominated deposits and 5.00% p.a. for EUR denominated deposits (2007: 6.95% p.a. and 4.75%, respectively).

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

In thousands of Azerbaijani Manats	**Cash on hand**	**Cash balances with the NBAR**	**Correspondent accounts and overnight placements with other banks**	**Total**
Current and not impaired				
- Cash on hand	4,133	-	-	4,133
- The NBAR	-	11,150	-	11,150
- Top 15 Azerbaijani banks	-	-	4,680	4,680
- OECD banks	-	-	6,257	6,257
- Non-OECD banks	-	-	31	31
Total current and not impaired	**4,133**	**11,150**	**10,968**	**26,251**
Total cash and cash equivalents	**4,133**	**11,150**	**10,968**	**26,251**

7 Cash and Cash Equivalents (Continued)

An analysis by credit quality of the cash and cash equivalents at 31 December 2007 is as follows:

In thousands of Azerbaijani Manats	**Cash on hand**	**Cash balances with the NBAR**	**Correspondent accounts and overnight placements with other banks**	**Total**
Current and not impaired				
- Cash on hand	2,452	-	-	2,452
- The NBAR	-	8,428	-	8,428
- Top 15 Azerbaijani banks	-	-	518	518
- OECD banks	-	-	11,925	11,925
- Non-OECD banks	-	-	41	41
Total current and not impaired	**2,452**	**8,428**	**12,484**	**23,364**
Total cash and cash equivalents	**2,452**	**8,428**	**12,484**	**23,364**

Currency, interest rate and geographical risk concentrations of cash and cash equivalents are disclosed in Note 27. The information on related party balances is disclosed in Note 31.

8 Due from Other Banks

In thousands of Azerbaijani Manats	**2008**	**2007**
Short-term placements with other banks	4,148	2,828
Less: Provision for impairment	(40)	(56)
Total due from other banks	**4,108**	**2,772**

Included in the balances of short-term placements with other banks at 31 December 2008 are loans issued to four (2007: five) resident and non-resident banks of total AZN 4,148 thousand (2007: AZN 2,828 thousand) with an average effective interest rate of 9.2% p.a., maturities in January and February 2009. (2007: 11.1% p.a.). At 31 December 2008, short-term placements with other banks included a loan to a resident bank in the amount of AZN 931 thousand for which AZN 1,129 thousand was blocked by the Group on the correspondent account of the same resident bank. Refer to Note 14.

Amounts due from other banks are not collateralised. An analysis by credit quality of the amounts due from other banks outstanding at 31 December 2008 and 2007 is as follows:

In thousands of Azerbaijani Manats	**2008**	**2007**
Current and not impaired		
- Top 15 Azerbaijan banks	2,088	2,575
- Other Azerbaijan banks	931	253
- OECD banks	1,129	-
Total current and not impaired	**4,148**	**2,828**
Less: provision for impairment	(40)	(56)
Total due from other banks	**4,108**	**2,772**

The primary factor that the Group considers whether a deposit is impaired is its overdue status.

8 Due from Other Banks (Continued)

Movements in the provision for impairment of due from other banks are as follows:

In thousands of Azerbaijani Manats	2008	2007
Provision for impairment at 1 January	56	79
Provision for impairment during the year	(16)	(23)
Provision for impairment at 31 December	**40**	**56**

The carrying value of each class of amounts due from other banks approximates fair value at 31 December 2008 and 31 December 2007. Refer to Note 29.

Currency, interest rate, geographical and liquidity risk of due from other banks are disclosed in Note 27.

9 Loans and Advances to Customers

In thousands of Azerbaijani Manats	2008	2007
Corporate loans	6,793	13,112
Loans to individuals - mortgage loans	1,159	163
Loans to individuals - entrepreneurs	666	297
Loans to individuals - flat refurbishment loans	503	947
Loans to individuals - consumer loans	461	97
Loans to individuals - car purchase loans	45	84
Loans to individuals - other purposes	215	110
Less: Provision for loan impairment	(275)	(347)
Total loans and advances to customers	**9,567**	**14,463**

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

In thousands of Azerbaijani Manats	Corporate loans	Loans to individuals - mortgage loans	Loans to individuals - entrepreneurs	Loans to individuals - flat refurbishment loans	Loans to individuals - consumer loans	Loans to individuals - car purchase loans	Loans to individuals - other purposes	Total
Provision for loan impairment at 1 January 2008	**272**	**4**	**6**	**39**	**12**	**3**	**11**	**347**
(Recovery of)/provision for impairment during the year	(135)	20	7	18	(2)	(2)	22	(72)
Provision for loan impairment at 31 December 2008	**137**	**24**	**13**	**57**	**10**	**1**	**33**	**275**

9 Loans and Advances to Customers (Continued)

Movements in the provision for loan impairment during 2007 are as follows:

In thousands of Azerbaijani Manats	**Corporate loans**	**Loans to individuals - mortgage loans**	**Loans to individuals - entrepreneurs**	**Loans to individuals - flat refurbishment loans**	**Loans to individuals - consumer loans**	**Loans to individuals - car purchase loans**	**Loans to individuals - other purposes**	**Total**
Provision for loan impairment at 1 January 2007	**310**	**4**	**-**	**14**	**19**	**3**	**3**	**353**
(Recovery of)/provision for impairment during the year	144	-	6	25	(7)	-	8	176
Amounts written off during the year as uncollectible	(182)	-	-	-	-	-	-	(182)
Provision for loan impairment at 31 December 2007	**272**	**4**	**6**	**39**	**12**	**3**	**11**	**347**

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

	2008		**2007**	
In thousands of Azerbaijani Manats	**Amount**	**%**	**Amount**	**%**
Trade and service	4,075	41.4	9,325	63.0
Individuals	3,049	31.0	1,698	11.5
Manufacturing	2,628	26.7	1,756	11.8
Construction	90	0.9	2,031	13.7
Total loans and advances to customers (before impairment)	**9,842**	**100.0**	**14,810**	**100.0**

At 31 December 2008, the Group had eleven borrowers (2007: seven borrowers) with aggregated loan amounts above AZN 200 thousand (2007: AZN 200 thousand). The aggregate amount of these loans was AZN 7,954 thousand (2007: AZN 12,581 thousand) or 81% of the gross loan portfolio (2007: 85%).

Information about collateral at 31 December 2008 is as follows:

In thousands of Azerbaijani Manats	**Corporate loans**	**Loans to individuals - mortgage loans**	**Loans to individuals - entrepreneurs**	**Loans to individuals - flat refurbishment loans**	**Loans to individuals - consumer loans**	**Loans to individuals - car purchase loans**	**Loans to individuals - other purposes**	**Total**
Unsecured loans								
Loans collateralised by:								
- motor vehicle								
- residential real estate								
- cash deposits								
- third party guarantees								
- commercial real estate								
Total loans and advances to customers								

9 Loans and Advances to Customers (Continued)

Information about collateral at 31 December 2007 is as follows:

In thousands of Azerbaijani Manats	Corporate loans	Loans to individuals - mortgage loans	Loans to individuals - entrepreneurs	Loans to individuals - flat refurbishment loans	Loans to individuals - consumer loans	Loans to individuals - car purchase loans	Loans to individuals - other purposes	Total
Unsecured loans								
Loans collateralised by:								
- third party guarantees								
- motor vehicle								
- residential real estate								
- cash deposits								
- commercial real estate								
Total loans and advances to customers								

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

In thousands of Azerbaijani Manats	Corporate loans	Loans to individuals - mortgage loans	Loans to individuals - entrepreneurs	Loans to individuals - flat refurbishment loans	Loans to individuals - consumer loans	Loans to individuals - car purchase loans	Loans to individuals - other purposes	Total
Current and not impaired								
- Large borrowers with credit history over two years								
- Large new borrowers								
- Loans to medium size entities								
- Loans to small entities								
- Loans to individuals								
Total current and not impaired								
Past due but not impaired								
- 30 to 90 days overdue								
- 90 to 180 days overdue								
Total past due but not impaired								
Loans individually determined to be impaired (gross)								
- 180 to 360 days overdue								
Total individually impaired loans (gross)								
Gross carrying value of loans								
Less provisions for loan impairment								
Total loans and advances to customers								

9 Loans and Advances to Customers (Continued)

The Group applied the portfolio provisioning methodology prescribed by IAS 39, *Financial Instruments: Recognition and Measurement*, and created portfolio provisions for impairment losses that were incurred but have not been specifically identified with any individual loan by the balance sheet date. The Group's policy is to classify each loan as 'current and not impaired' until a specific objective evidence of impairment of the loan is identified. The impairment provisions exceed the total gross amount of individually impaired loans as a result of this policy and the portfolio impairment methodology.

The analysis by credit quality of loans outstanding at 31 December 2007 is as follows:

In thousands of Azerbaijani Manats	**Corporate loans**	**Loans to individuals - mortgage loans**	**Loans to individuals - entrepreneurs**	**Loans to individuals - flat refurbishment loans**	**Loans to individuals - consumer loans**	**Loans to individuals - car purchase loans**	**Loans to individuals - other purposes**	**Total**
Current and not impaired								
- Large borrowers with credit history over two years								
- Large new borrowers								
- Loans to medium size entities								
- Loans to small entities								
- Loans to individuals								
Total current and not impaired								
Past due but not impaired								
- 30 to 90 days overdue								
- 90 to 180 days overdue								
- 180 to 360 days overdue								
Total past due but not impaired	**-**							
Loans individually determined to be impaired (gross)								
- 30 to 90 days overdue								
- 90 to 180 days overdue								
- 180 to 360 days overdue								
- over 360 days overdue								
Total individually impaired loans (gross)								
Gross carrying value of loans								
Less provisions for loan impairment								
Total loans and advances to customers								

9 Loans and Advances to Customers (Continued)

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, if any. As a result, the Group presents above an ageing analysis of loans that are individually determined to be impaired.

The Group does not provide information on the fair value of collateral for "past due but not impaired" and "individually determined to be impaired" loans as it believes that the fair value of collateral can not be reliably measured, except for liquid assets. However, management consider that the fair value of the collateral related to individual "past due but not impaired", and "individually determined to be impaired" loans not to be less than the values assessed when the loans were originally issued.

The carrying value of each class of loans and advances to customers approximates fair value at 31 December 2008 and 31 December 2007. At 31 December 2008, the estimated fair value of loans and advances to customers was AZN 9,567 thousand (2007: AZN 14,463 thousand).

Credit, currency, interest rate, geographical and liquidity risk of loans and advances to customers are disclosed in Note 27. The information on related party balances is disclosed in Note 31.

10 Investment Securities Available for Sale

In thousands of Azerbaijani Manats	**2008**	**2007**
Notes of the NBAR	20,539	35,248
Treasury bills of the Ministry of Finance ("MoF") of the Republic of Azerbaijan	36,670	20,514
Corporate unquoted shares	60	60
Total investment securities available for sale	**57,269**	**55,822**

Notes of the NBAR represent short-term government securities issued by the NBAR through the Baku Stock Exchange purchased by the Group at a discount. The notes outstanding at 31 December 2008 had an average interest rate of 4.3% p.a. (2007: 9.8% p.a.).

Treasury bills represent short-term government securities issued by the Ministry of Finance of the Republic of Azerbaijan through the Baku Stock Exchange purchased by the Group at a discount. Treasury bills outstanding at 31 December 2008 had an average interest rate of 9.7% p.a. (2007: 10.3% p.a).

The analysis by credit quality of debt securities which are all current and not impaired outstanding at 31 December 2008 is as follows:

In thousands of Azerbaijani Manats	**Notes of the NB**	**Treasury bills o**	**Total debt se**	**Corporate unq**	**Total debt secu**
Current and not impaired					
- Azerbaijan	20,	36,6	57		57,2
Total	**20,**	**36,6**	**57**		**57,2**

The international rating for Azerbaijan has been published as Ba1/Stable (Moody's).

10 Investment Securities Available for Sale (Continued)

The analysis by credit quality of debt securities which are all current and not impaired outstanding at 31 December 2007 is as follows:

In thousands of Azerbaijani Manats	**Notes of the**	**Treasury bills of Mo**	**Total de**	**Corporate unq**	**Total**
Current and not impaired					
- Azerbaijan	3	20,514	5		55,822
Total	**3**	**20,514**	**5**		**55,822**

The primary factor that the Group considers whether a debt security is impaired is its overdue status. As At 31 December 2008, the Group had no debt securities that are individually determined to be impaired (2007: nil).

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

In thousands of Azerbaijani Manats	**Note**	**2008**	**2007**
Carrying amount at 1 January		**55,822**	**22,563**
Interest income accrued	20	3,449	3,411
Interest income received		(3,416)	(2,887)
Disposals and redemption of investment securities available for sale		(309,108)	(404,048)
Purchases		310,522	436,783
Carrying amount at 31 December		**57,269**	**55,822**

At 31 December 2008 and 31 December 2007, the principal equity investment security available for sale is:

Name	**Nature of business**	**Country of registration**	**Fair value 2008**	**Fair value 2007**
Baku Stock Exchange	Stock exchange	Republic of Azerbaijan	60	60
Total			**60**	**60**

This investment in Baku Stock Exchange was made in 2000 and represents 5.56% of the total share capital of Baku Stock Exchange. Currently the stock market in the Republic of Azerbaijan is practically non-existent, and the activity of Baku Stock Exchange at the reporting date remains limited. Management have used the cost of this investment as the most reliable indicator of the current fair value of this investment, in the absence of any more precise information.

The carrying value of each class of investment securities available for sale at 31 December 2008 and 31 December 2007 approximates their fair value. Refer to Note 29.

Currency, interest rate, geographical and liquidity risk of investment securities available for sale are disclosed in Note 27.

11 Fixed and Intangible Assets

In thousands of Azerbaijani Manats	Note	Computer, communication and other fixed assets	Furniture, fixture and other	Motor vehicles	Leasehold improvements	Total fixed assets	Computer software and licenses	Total
Cost at 1 January 2007		716	117	63	-	896	73	969
Accumulated depreciation		(444)	(88)	(51)	-	(583)	(39)	(622)
Carrying amount at 1 January 2007		**272**	**29**	**12**	**-**	**313**	**34**	**347**
Additions		190	16	37	-	243	1	244
Disposals		-	-	(30)	-	(30)	-	(30)
Depreciation charge/Amortisation	23	(108)	(11)	(11)	-	(130)	(13)	(143)
Accumulated depreciation in respect of disposals		-	-	30	-	30	-	30
Carrying amount at 31 December 2007		**354**	**34**	**38**	**-**	**426**	**22**	**448**
Cost at 31 December 2007		906	133	70	-	1,109	74	1,183
Accumulated depreciation		(552)	(99)	(32)	-	(683)	(52)	(735)
Carrying amount at 31 December 2007		**354**	**34**	**38**	**-**	**426**	**22**	**448**
Additions		650	249	77	1,881	2,857	60	2,917
Disposals		(136)	(48)	-	-	(184)	(5)	(189)
Depreciation charge/Amortisation	23	(150)	(30)	(15)	(92)	(287)	(15)	(302)
Accumulated depreciation in respect of disposals		136	48	-	-	184	5	189
Carrying amount at 31 December 2008		**854**	**253**	**100**	**1,789**	**2,996**	**67**	**3,063**
Cost at 31 December 2008		1,420	334	147	1,881	3,782	129	3,911
Accumulated depreciation		(566)	(81)	(47)	(92)	(786)	(62)	(848)
Carrying amount at 31 December 2008		**854**	**253**	**100**	**1,789**	**2,996**	**67**	**3,063**

12 Other Financial Assets

In thousands of Azerbaijani Manats	**2008**	**2007**
Credit and debit cards receivables	24	29
Total other financial assets	**24**	**29**

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

In thousands of Azerbaijani Manats	**Credit and debit cards receivables**	**Total**
Current and not impaired		
- Financial institutions	24	24
Total other financial receivables	**24**	**24**

The analysis by credit quality of other financial receivables outstanding at 31 December 2007 is as follows:

In thousands of Azerbaijani Manats	**Credit and debit cards receivables**	**Total**
Current and not impaired		
- Financial institutions	29	29
Total other financial receivables	**29**	**29**

The primary factors that the Group considers whether a receivable is impaired is its overdue status and realisability of related collateral, if any.

The carrying value of each class of other financial assets approximates fair value at 31 December 2008 and 31 December 2007. Refer to Note 29 .

Geographical, currency and maturity analyses of other financial assets are disclosed in Note 27.

13 Other Assets

In thousands of Azerbaijani Manats	**2008**	**2007**
Amounts receivable from the Ministry of Taxes of the Republic of Azerbaijan	164	200
Prepaid expenses	71	71
Prepayments for installation and repair works	53	163
Other	32	14
Total other assets	**320**	**448**
Current	320	448
Non-current	-	-

Amounts receivable from the Ministry of Taxes of the Republic of Azerbaijan represent withholding tax on interest received from placements with the Affiliated Bank. This amount represents tax receivable from the Ministry of Taxes of Azerbaijan under the Double Tax Treaty between the Republic of Azerbaijan and Republic of Turkey. Management expects to recover during 2009 the total amount of AZN 164 thousand being the sum of AZN 107 thousand and AZN 57 thousand, which represent the receivables for the years ended 31 December 2007 and 2008, respectively.

Geographical, currency and maturity analyses of other assets are disclosed in Note 27.

14 Due to Other Banks

In thousands of Azerbaijani Manats	2008	2007
Correspondent accounts and overnight placements of other banks	4,953	3,300
Blocked accounts of resident banks	1,329	-
Total due to other banks	**6,282**	**3,300**

The Group pays interest on the correspondent account balances at the rates ranging from 1.35% to 5.00% p.a. depending on the outstanding balance (2007: 1.35% to 5.00% p.a.).

At 31 December 2008, included in the blocked accounts of resident banks is AZN 1,129 thousand against AZN 931 thousand due from a resident bank. Corresponding placement of the Group with this resident bank was recorded in due from other banks. Refer to Note 28.

The carrying value of each class of due to other banks approximates fair value at 31 December 2008 and 31 December 2007. Refer to Note 29.

Currency, interest rate risk, geographical and liquidity risk of due to other banks is disclosed in Note 27.

15 Customer Accounts

In thousands of Azerbaijani Manats	2008	2007
State and public organisations	**1,814**	**1,280**
- Current/settlement accounts	1,814	1,280
Other legal entities	**43,385**	**67,710**
- Current/settlement accounts	35,512	51,424
- Term deposits	6,929	13,696
- Restricted customer deposits	944	2,590
Individuals	**13,437**	**14,147**
- Current/demand accounts	10,793	12,888
- Term deposits	2,579	1,212
- Restricted customer deposits	65	47
Total customer accounts	**58,636**	**83,137**

The average interest rate on term deposits of individual customers outstanding at 31 December 2008 comprised 2.9% p.a. (2007: 3.2% p.a.), while the average interest rate on term deposits of legal entities outstanding at 31 December 2008 was 3.9% p.a. (2007: 4.3% p.a.). In addition, in the course of 2008 the Group paid interest of 1% p.a. (2007: 1% p.a.) on current account balances of legal entities with average annual balances in excess of AZN 50 thousand and USD 57 thousand (2007: AZN 50 thousand and USD 57 thousand).

At 31 December 2008, the Group had fourteen customers (2007: fourteen) with balances above AZN 1,000 thousand. The aggregate balance of these customers was AZN 27,276 thousand at 31 December 2008 (2007: AZN 40,965 thousand), which represented 46% (2007: 49%) of total customer accounts and 25% (2007: 47%) of total liabilities.

15 Customer Accounts (Continued)

Economic sector concentrations within customer accounts are as follows:

	2008		2007	
In thousands of Azerbaijani Manats	**Amount**	**%**	**Amount**	**%**
Trade and services	29,153	49.7	49,879	60.0
Individuals	13,437	22.9	14,147	17.0
Construction	6,186	10.5	4,793	5.8
Transportation and communication	4,965	8.5	5,159	6.2
Insurance	3,081	5.3	5,553	6.7
Public organisations	1,814	3.1	1,280	1.5
Agriculture	-	-	2,326	
Total customer accounts	**58,636**	**100.0**	**83,137**	**100.0**

The carrying value of each class of customer accounts approximates fair value at 31 December 2008 and 31 December 2007. Refer to Note 29.

Currency, interest rate risk, geographical and liquidity risk of customer accounts are disclosed in Note 27. The information on related party balances is disclosed in Note 31.

16 Other Financial Liabilities

Other financial liabilities comprise the following:

In thousands of Azerbaijani Manats		
Trade creditors	31	134
Debit or credit card payables	14	40
Other	39	28
Total other financial liabilities	**84**	**202**

The carrying value of each class of other financial liabilities approximates fair value at 31 December 2008 and 31 December 2007. At 31 December 2008, the estimated fair value of other financial liabilities was AZN 84 thousand (2007: AZN 202 thousand). Refer to Note 29.

Currency, interest rate risk, geographical and liquidity risk of other liabilities are disclosed in Note 27.

17 Other Liabilities

Other liabilities comprise the following:

In thousands of Azerbaijani Manats	**2008**	
Deferred revenue	497	
Accrued employee costs	319	204
Service payables	97	
Taxes other than on income payable		56
Other	7	
Total other liabilities	**920**	**260**
Current	920	260
Non-current		

At 31 December 2008, deferred revenue of AZN 497 thousand includes unearned portion of fee and commission income received as arrangement fee in total amount of AZN 517 thousand (2007: nil).

Accrued employee costs includes bonuses for employees based on the financial performance of the Group of AZN 266 thousand (2007: AZN 148 thousand) and an accrual for unused vacations of AZN 53 thousand (2007: AZN 56 thousand).

Currency, interest rate risk, geographical and liquidity risk of other liabilities are disclosed in Note 27.

18 Subordinated Loan from the Affiliated Bank

In thousands of Azerbaijani Manats	**2008**	**2007**
Funds borrowed from the Affiliated Bank	161	339
Total subordinated loans from the Affiliated Bank	**161**	**339**

In August 2004, the Bank signed a subordinated loan agreement with the Affiliated Bank for USD 1,000 thousand. The loan agreement sets out that USD 200 thousand is to be repaid each year through to a final maturity date of 2 December 2009. The loan bears an interest rate of LIBOR+3.5% p.a. with interest payable every six months. The Group repaid USD 200 thousand of this loan in December 2008.

On 15 January 2008, Bank signed a subordinated loan agreement with the Affiliated Bank in the amount of EUR 10,000 thousand for a period of 5 years. The disbursement of total funds on this facility was made available to the Group in July 2008. The borrowing bore a market interest rate and was to be repaid in one full instalment on 1 February 2013. The Group utilized amounts borrowed under this agreement for its general corporate purposes. The borrowing was prematurely repaid by the Bank in December 2008.

The carrying value of subordinated loan from the Affiliated Bank approximates fair value at 31 December 2008 and 31 December 2007. Refer to Note 29.

Currency, interest rate risk, geographical and liquidity risk of the subordinated loan from the Affiliated Bank are disclosed in Note 27. The information on related party balances is disclosed in Note 31.

19 Share Capital

At 31 December 2008 and 2007, the share capital of the Bank was, as follows:

In thousands of AZN except for number of shares	**Number of outstanding ordinary shares**	**Total nominal value of paid-in and registered ordinary shares**
At 1 January 2007	**70,000**	**6,349**
New shares issued	-	-
At 31 December 2007	**70,000**	**6,349**
Conversion effect with new nominal share price	0.00002	1
Paid-in shares after conversion	**317,450,000**	**6,349**
New shares paid-in	1,043,020,000	8,147
At 31 December 2008	**1,360,470,000**	**14,496**

At 31 December 2007, the share capital of the Bank in the amount of AZN 6,349 thousand was comprised of 70,000 ordinary shares each with a nominal value of USD 100. The balance of AZN 6,349 thousand represented the AZN equivalent of US Dollar contributions to share capital calculated at the historical exchange rates as at the dates of the contributions.

According to the Civil Code of the Republic of Azerbaijan, and based on the resolution of the shareholders of the Bank dated 29 August 2008, it was decided to convert the existing 70,000 ordinary shares each with a nominal value of USD 100 to 317,450 thousand ordinary shares with a nominal value of AZN 0.02 each without changing the shareholding structure. The State Committee for Securities of the Republic of Azerbaijan registered and approved the emission on 19 September 2008.

On 19 November 2008, the State Committee for Securities of the Republic of Azerbaijan registered the issue of 407,350 thousand additional shares each with a nominal value of AZN 0.02 to increase the share capital of the Bank to AZN 14,496 thousand. These additional shares had been fully paid-in by 31 December 2008.

At 31 December 2008, additional paid-in capital in the amount of AZN 12,713 thousand represents payment made by the Parent in December 2008 prior to the decision of the Board of Directors on, and state registration of issue of additional 635,670 thousand ordinary shares each with a nominal value of AZN 0.02. At 31 December 2008, issue of additional ordinary shares was in the process of registration at the State Committee for Securities of the Republic of Azerbaijan. Subsequent to the balance sheet date, the State Committee for Securities of the Republic of Azerbaijan registered the issue of the additional paid-in capital as share capital. Refer to the Note 32.

All ordinary shares have a nominal value of AZN 0.02 per share (2007: USD 100 per share) and rank equally. Each share carries one vote.

20 Interest Income and Expense

In thousands of Azerbaijani Manats	2008	2007
Interest income		
Interest income on investment securities available for sale	3,449	3,411
Interest income on loans and advances to customers	2,453	1,345
Interest income on correspondent accounts	1,113	678
Interest Income on due from other banks	599	644
Total interest income	**7,614**	**6,078**
Interest expense		
Interest expense on customer accounts	837	908
Interest expense on subordinated loans from the Affiliated Bank	284	44
Interest expense on correspondent accounts of other banks	200	190
Interest expense on debt securities		1
Total interest expense	**1,321**	**1,143**
Net interest income	**6,293**	**4,935**

21 Fee and Commission Income and Expense

In thousands of Azerbaijani Manats	2008	2007
Fee and commission income		
- Settlement transactions	1,218	770
- Cash transactions	1,088	1,204
- Transactions with foreign currencies	1,042	720
- Guarantees issued	234	250
- Plastic cards operations	188	166
- Letters of credit issued	78	88
- Other	104	153
Total fee and commission income	**3,952**	3,351
Fee and commission expense		
- Transactions with securities	221	250
- Settlement transactions	183	157
- Plastic cards operations	161	134
- Cash transactions	70	562
- Transactions with foreign currencies	28	21
- Other	75	42
Total fee and commission expense	**738**	**1,166**
Net fee and commission income	**3,214**	**2,185**

22 Other Operating Income

In thousands of Azerbaijani Manats	2008	2007
Dividend income	45	9
Other	-	8
Total other operating income	**45**	**17**

During the year ended 31 December 2008, the Group received a dividend from the Baku Stock Exchange of AZN 45 thousand (2007: AZN 9 thousand).

23 Administrative and Other Operating Expenses

In thousands of Azerbaijani Manats	Note	2008	2007
Staff costs		2,098	1,101
Rent expenses		610	285
Depreciation of fixed assets	11	287	130
Communication expenses		193	108
Security services		169	39
Repair and maintenance		143	69
Professional services		88	156
Insurance expenses		59	11
Stationary, printing and other office supplies		49	35
Advertising and marketing services		41	17
Taxes other than on income		25	30
Utilities		20	10
Service fee		19	216
Amortisation of software and licenses	11	15	13
Other expenses		127	139
Total administrative and other operating expenses		**3,943**	**2,359**

Included in staff costs are statutory social security contributions of AZN 167 thousand (2007: AZN 108 thousand).

24 Income Taxes

Income tax expense comprises the following:

In thousands of Azerbaijani Manats	2008	2007
Current tax expense	1,554	1,192
Deferred tax expense	51	9
Income tax expense for the year	**1,605**	**1,201**

Income taxes are calculated at the rate of 22% (2007: 22%) in accordance with Azerbaijani tax and accounting legislation.

24 Income Taxes (Continued)

Reconciliation between the expected and the actual taxation charge is provided below.

In thousands of Azerbaijani Manats	2008	2007
IFRS profit before tax	**6,281**	**5,283**
Theoretical tax charge at statutory rate 2008: 22% (2007: 22%)	1,382	1,162
Tax effect of items which are not deductible or assessable for taxation purposes:		
- Non deductible expenses	62	39
- Effect of three-year tax holiday	161	-
Income tax expense for the year	**1,605**	**1,201**

Differences between IFRS and the Azerbaijani statutory taxation rules give rise to certain temporary differences between tax bases of certain assets and liabilities and their carrying values for financial reporting purposes. The tax effect of the movements in these temporary differences is recorded at the rate of 22% (2007: 22%).

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

In thousands of Azerbaijani Manats	31 December 2007	Recorded in the income statement	31 December 2008
Tax effect of deductible/(taxable) temporary differences			
Fixed assets	11	(18)	(7)
Loan impairment provision	(19)	19	-
Accrued expenses	52	(52)	-
Net deferred tax asset/(liability)	**44**	**(51)**	**(7)**

In the context of the Group's current structure and Azerbaijani tax legislation, tax losses and current tax assets of different group companies may not be offset against current tax liabilities and taxable profits of other group companies and, accordingly, taxes may accrue even where there is a tax loss. Therefore, deferred tax assets and liabilities are offset only when they relate to the same taxable entity and the same taxation authority.

At 31 December 2007, the temporary differences giving rise to the deferred tax assets and liabilities are, as follows:

In thousands of Azerbaijani Manats	31 December 2006	Recorded in the income statement	31 December 2007
Tax effect of deductible/(taxable) temporary differences			
Fixed assets	-	11	11
Loan impairment provision	(19)	-	(19)
Accrued expenses	72	(20)	52
Net deferred tax asset	**53**	**(9)**	**44**

On 14 November 2008, a new law on "Stimulation of Increasing the Capitalization of Banks, Insurance and Reinsurance Companies" 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, where all profits are retained within the business. Management considered the impact of the enactment of this law on the Group's deferred tax calculation.

Deferred tax balances at 31 December 2008 represent deferred tax impact of temporary differences reversing after 1 January 2012.

25 Management of Capital

The objectives of management when managing the Bank's capital are (i) to comply with the capital requirements set by the National Bank of the Azerbaijan Republic ("NBAR"), (ii) to safeguard the Bank'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 National Bank of Azerbaijan Republic is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Chief Executive Officer and Chief Accountant. The other objectives of capital management are evaluated annually.

The NBAR requires each bank or banking group to: (a) hold the minimum level of share capital AZN 10,000 thousand (2007: 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% (2007: 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% (2007: 6%).

Management believes that the Bank was in compliance with the statutory capital ratio throughout 2008 and 2007. Refer to Note 28.

The composition of the Group's capital calculated in accordance with Basel 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 based on the consolidated financial statements of the Group, is as follows:

In thousands of Azerbaijani Manats	**2008**	**2007**
Tier 1 capital		
Share capital	14,496	6,349
Additional paid-in capital	12,713	-
Capital contribution	515	515
Retained earnings	10,102	5,426
Total qualifying Tier 1 capital	**37,826**	**12,290**
Total regulatory capital	**37,826**	**12,290**
Net off specific provision risk-weighted assets:		
On-balance sheet	22,556	21,235
Off-balance sheet	8,469	35,607
Total risk-weighted assets:	**31,025**	**56,842**
Basel ratio	**121.9%**	**21.6%**

Management considers that the Bank has complied with all externally imposed capital requirements throughout 2008 and 2007.

26 Segment Analysis

The Group's primary format for reporting segment information is business segments and the secondary format is geographical segments.

Business Segments. The Group is organised on a basis of two 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, and foreign currency products.

Transactions between the business segments are on normal commercial terms and conditions. Funds are ordinarily reallocated between segments, resulting in funding cost transfers disclosed in operating income. Interest charged for these funds is based on the Bank's cost of capital. There are no other material items of income or expense between the business segments. Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balances sheet, but excluding taxation. Internal charges and transfer pricing adjustments have been reflected in the performance of each business segment.

Segment information for the main reportable business segments of the Group for the years ended 31 December 2008 and 2007 is set out below:

In thousands of Azerbaijani Manats	**Retail banking**	**Corporate banking**	**Other/ Unallocated**	**Total**
2008				
Total segment revenues	**864**	**10,747**	-	**11,611**
Total segment revenues comprise:				
- Interest income	346	7,268	-	7,614
- Fee and commission income	518	3,434	-	3,952
- Other operating income	-	45	-	45
Total segment revenues	**864**	**10,747**	**-**	**11,611**

26 Segment Analysis (Continued)

In thousands of Azerbaijani Manats	Retail banking	Corporate banking	Other/ Unallocated	Total
2008 (continued)				
Segment result	**95**	**5,603**	-	**5,697**
Other gains				584
Profit before tax				**6,281**
Income tax expense				(1,605)
Profit for the year				**4,676**
Total segment assets	32,319	72,008	-	104,327
Total assets	**32,319**	**72,008**	-	**104,327**
Total segment liabilities	15,144	50,939	-	66,083
Other segment liabilities:				
- Current income tax liability	-	-	411	411
- Deferred income tax liability	-	-	7	7
Total liabilities	**15,144**	**50,939**	**418**	**66,501**
Other segment items				
Capital expenditure	133	2,784	-	2,917
Depreciation and amortisation expense	15	287	-	302
Other non-cash income	4	84	-	88

26 Segment Analysis (Continued)

In thousands of Azerbaijani Manats	Retail banking	Corporate banking	Other/ Unallocated	Total
2007				
Total segment revenues	**782**	**8,664**	**-**	**9,446**
Total segment revenues comprise:				
- Interest income	246	5,832	-	6,078
- Fee and commission income	536	2,815	-	3,351
- Other operating income	-	17	-	17
Total segment revenues	**782**	**8,664**		**9,446**
Segment result	**14**	**4,611**	-	**4,625**
Other gains				658
Profit before tax				**5,283**
Income tax expense				(1,201)
Profit for the year				**4,082**
Total segment assets	15,948	83,726	-	99,674
Other segment assets:				
- Deferred tax asset	-	-	44	44
Total assets	**15,948**	**83,726**	**44**	**99,718**
Total segment liabilities	13,958	73,280	-	87,238
Other segment liabilities:				
- Current income tax liability	**-**	**-**	190	190
Total liabilities	**13,958**	**73,280**	**190**	**87,428**
Other segment items				
Capital expenditure	38	206	-	244
Depreciation and amortisation expense	13	130	-	143
Other non-cash expenses	-	17	-	17
Other	1	3	-	4

26 Segment Analysis (Continued)

Geographical segments. Segment information for the main geographical segments of the Group is set out below for the years ended 31 December 2008 and 2007:

In thousands of Azerbaijani Manats	Republic of Azerbaijan	OECD*	Non-OECD	Total
2008				
Segment assets	96,893	7,403	31	**104,327**
External revenues	10,502	1,109	-	**11,611**
Capital expenditure	2,668	249	-	**2,917**
Credit related commitments (Note 28)	5,418	6,033	-	**11,451**
2007				
Segment assets	87,752	11,925	41	**99,718**
External revenues	8,751	695	-	**9,446**
Capital expenditure	244	-	-	**244**
Credit related commitments (Note 28)	47,708	35,000	-	**82,708**

** OECD – Organisation of Economic Cooperation and Development*

External revenues and assets, other than as detailed below, and credit related commitments have generally been allocated based on domicile of the counterparty. Cash on hand, fixed assets and capital expenditure have been allocated based on the country in which they are physically held.

27 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 the proper functioning of internal policies and procedures to minimise operational and legal risks.

Credit risk. The Group takes on exposure to credit risk, which is the risk that a counterparty will be unable to pay all amounts in full when due. The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers. Such limits are monitored on a revolving basis and subject to an annual or more frequent review.

The exposure to any one borrower including banks is further restricted by sub-limits covering on and off-balance sheet exposures. Actual exposures against limits are monitored daily.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed, in part, by obtaining collateral, corporate and personal guarantees.

The Group's maximum exposure to credit risk is primarily reflected in the carrying amounts of financial assets on the balance sheet. For guarantees and commitments to extend credit, the maximum exposure to credit risk is the amount of the commitment.

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

27 Financial Risk Management (Continued)

The Group reviews the ageing analysis of outstanding loans and follows up past due balances. Management therefore considers it appropriate to provide the ageing analysis and other information about credit risk as disclosed in Note 9.

The risk management process of the Group includes implementation by the Credit Committee of the limits on exposures in accordance with the requirements of the National Bank of Azerbaijan. In addition, the Board of Directors of YKB Azerbaijan reviews and approves limits above AZN equivalent of EUR 4,500 thousand.

Monitoring of these limits is implemented by the Credit Committee and Credit Risk Management Division. The Credit Department performs monitoring of potentially impaired loans, problematic loans and associated risks. For the purpose of risk minimisation, a Credit Specialist performs a thorough loans assessment before review by the Credit Committee. An event of default is identified in the course of periodic monitoring or on the basis of outside information in respect to an economic crisis. When an event of default occurs, the primary task is to identify whether the problem is short-term or accompanied with more serious problems.

In the decision making process, the Credit Committee adheres to regulations set by NBAR in relation to the loan portfolio and guarantees.

Market risk. The Group takes on exposure to market risks. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The Board of Directors 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.

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 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 31 December 2008:

	2008			**2007**		
In thousands of Azerbaijani Manats	**Monetary financial assets**	**Monetary financial liabilities**	**Net balance sheet position**	**Monetary financial assets**	**Monetary financial liabilities**	**Net balance sheet position**
Azerbaijani Manats	79,184	44,962	34,222	68,252	58,494	9,758
US Dollars	17,365	15,240	2,125	25,915	24,109	1,806
Euros	4,290	4,719	(429)	4,235	4,322	(87)
Other	105	242	(137)	376	53	323
Total	**100,944**	**65,163**	**35,781**	**98,778**	**86,978**	**11,800**

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.

27 Financial Risk Management (Continued)

The following table presents the sensitivities 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:

In thousands of Azerbaijani Manats	**2008** Impact on profit or loss	**2007** Impact on profit or loss
US Dollars strengthening by 5%	106	90
US Dollars weakening by 5%	(106)	(90)
Euro strengthening by 5%	(21)	(4)
Euro weakening by 5%	21	4
Total	-	-

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

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. The table below summarises the Group's exposure to interest rate risks. The table presents the aggregated amounts of the Group's financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest repricing or maturity dates.

In thousands of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 6 months**	**From 6 to 12 months**	**More than 1 year**	**Non-monetary**	**Total**
31 December 2008						
Total financial assets	54,816	35,410	3,890	6,768	60	100,944
Total financial liabilities	58,567	3,583	1,664	1,349	-	65,163
Net interest sensitivity gap at 31 December 2008	**(3,751)**	**31,827**	**2,226**	**5,419**	**60**	**35,781**
31 December 2007						
Total financial assets	64,625	16,064	14,228	3,801	60	98,778
Total financial liabilities	78,655	1,971	2,862	3,490	-	86,978
Net interest sensitivity gap at 31 December 2007	**(14,030)**	**14,093**	**11,366**	**311**	**60**	**11,800**

27 Financial Risk Management (Continued)

At 31 December 2008, 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 2 thousand (Year ended 31 December 2007: AZN 2 thousand) higher/lower, because of lower/higher interest expense on variable interest liabilities.

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

	2008			2007		
In % p.a.	AZN	USD	EUR	AZN	USD	EUR
Assets						
Cash and cash equivalents	-	5.9	5.0	-	6.9	4.7
Due from other banks	-	11.8	4.0	-	11.1	-
Loans and advances to customers	19.2	15.5	10.3	16.5	13.5	10.0
Investment securities available for sale	7.8	-	-	10.0	-	-
Liabilities						
Customer accounts	4.8	3.7	1.9	4.9	3.3	2.4
Due to other banks	4.9	3.3	-	-	4.9	3.3
Subordinated loans from the Affiliated Bank	-	6.0	-	-	8.9	-

The Group is exposed to prepayment risk through providing fixed or variable rate loans, including mortgages, which give the borrower the right to early repay the loans. The Group's current year profit and equity at the current balance sheet date would not have been significantly impacted by changes in prepayment rates because such loans are carried at amortised cost and the prepayment right is at or close to the amortised cost of the loans and advances to customers.

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

In thousands of Azerbaijani Manats	Republic of Azerbaijan	OECD	Non-OECD	Total
Assets				
Cash and cash equivalents	19,963	6,257	31	26,251
Mandatory cash balances with the NBAR	3,725	-	-	3,725
Due from other banks	2,962	1,146	-	4,108
Loans and advances to customers	9,567	-	-	9,567
Debt securities	57,269	-	-	57,269
Other financial assets	24	-	-	24
Total financial assets	**93,510**	**7,403**	**31**	**100,944**
Non-financial assets	**3,383**	-	-	**3,383**
Total assets	**96,893**	**7,403**	**31**	**104,327**

27 Financial Risk Management (Continued)

In thousands of Azerbaijani Manats	Republic of Azerbaijan	OECD	Non-OECD	Total
Liabilities				
Due to other banks	6,282	-	-	6,282
Customer accounts	58,636	-	-	58,636
Other financial liabilities	84	-	-	84
Subordinated loan from the Affiliated Bank	-	161	-	161
Total financial liabilities	**65,002**	**161**	-	**65,163**
Non-financial liabilities	**1,319**	**19**	-	**1,338**
Total liabilities	**66,321**	**180**	**-**	**66,501**
Net balance sheet position	**30,572**	**7,223**	**31**	**37,826**
Credit related commitments	**5,418**	**6,033**	**-**	**11,451**

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

The geographical concentration of the Group's assets and liabilities at 31 December 2007 is set out below:

In thousands of Azerbaijani Manats	Republic of Azerbaijan	OECD	Non-OECD	Total
Assets				
Cash and cash equivalents	11,398	11,925	41	23,364
Mandatory cash balances with the NBAR	2,328	-	-	2,328
Due from other banks	2,772	-	-	2,772
Loans and advances to customers	14,463	-	-	14,463
Debt securities	55,822	-	-	55,822
Other financial assets	29	-	-	29
Total financial assets	**86,812**	**11,925**	**41**	**98,778**
Non-financial assets	**940**	-	-	**940**
Total assets	**87,752**	**11,925**	**41**	**99,718**

27 Financial Risk Management (Continued)

In thousands of Azerbaijani Manats	Republic of Azerbaijan	OECD	Non-OECD	Total
Liabilities				
Due to other banks	3,300	-	-	3,300
Customer accounts	83,137	-	-	83,137
Other financial liabilities	202	-	-	202
Subordinated loan from the Affiliated Bank	-	339	-	339
Total financial liabilities	**86,639**	**339**	-	**86,978**
Non-financial liabilities	**450**	**-**	-	**450**
Total liabilities	**87,089**	**339**	-	**87,428**
Net balance sheet position	**663**	**11,586**	**41**	**12,290**
Credit related commitments	**47,708**	**35,000**	-	**82,708**

Liquidity risk. Liquidity risk is defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. 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 Bank.

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 Bank calculates its instant liquidity ratio at a required minimum of thirty percent on a monthly basis in accordance with the requirement of the National Bank of Azerbaijan. As at 31 December 2008, the actual ratio was 156.4% (2007: 93.5%).

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 daily liquidity position is monitored and regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Treasury Department.

The table below shows assets and liabilities at 31 December 2008 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. Some of the assets and liabilities, however, may be of a longer-term nature; for example, loans are frequently renewed and accordingly short-term loans can have longer term duration.

27 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 liabilities at 31 December 2008 is as follows:

In thousands of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 3 months**	**From 3 to 12 months**	**From 12 months to 5 years**	**Over 5 years**	**Total**
Liabilities						
Due to other banks	4,974	-	-	1,329	-	6,303
Customer accounts – individuals	10,971	1,948	558	21	-	13,498
Customer accounts – other	42,577	1,595	1,073	-	-	45,245
Subordinated loan from the Affiliated Bank	-	-	171	-	-	171
Other financial liabilities	84	-	-	-	-	84
Financial guarantees	1,000	352	3,855	2,419	-	7,626
Other credit related commitments	259	824	2,742	-	-	3,825
Total potential future payments for financial obligations	**59,865**	**4,719**	**8,399**	**3,769**	-	**76,752**

The undiscounted maturity analysis of financial liabilities at 31 December 2007 is as follows:

In thousands of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 3 months**	**From 3 to 12 months**	**From 12 months to 5 years**	**Over 5 years**	**Total**
Liabilities						
Due to other banks	3,313	-	-	-	-	3,313
Customer accounts – individuals	13,107	128	952	-	-	14,187
Customer accounts – other	62,396	1,353	2,025	3,366	-	69,140
Subordinated loan from the Affiliated Bank	-	-	206	187	-	393
Other financial liabilities	202	-	-	-	-	202
Financial guarantees	-	1,016	30,938		2,490	34,444
Other credit related commitments	2,611	5,416	9,304	2,326	-	19,657
Total potential future payments for financial obligations	**81,629**	**7,913**	**43,425**	**5,879**	**2,490**	**141,336**

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.

27 Financial Risk Management (Continued)

The Group does not use the above undiscounted maturity analysis to manage liquidity. Instead, the Group monitors contractual maturities, which may be summarised as follows at 31 December 2008:

In thousands of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 3 months**	**From 3 to 12 months**	**From 12 months to 5 years**	**Over 5 years**	**Total**
Assets						
Cash and cash equivalents	26,251	-	-	-	-	26,251
Mandatory cash balances with the NBAR	3,400	222	101	2	-	3,725
Due from other banks	2,024	2,060	-	24	-	4,108
Loans and advances to customers	1,186	769	814	6,138	660	9,567
Debt securities	21,862	19,591	15,756	-	60	57,269
Other financial assets	24	-	-	-	-	24
Total financial assets	**54,747**	**22,642**	**16,671**	**6,164**	**720**	**100,944**
Liabilities						
Due to other banks	4,953	-	-	1,329	-	6,282
Customer accounts	53,531	3,497	1,588	20	-	58,636
Other financial liabilities	84	-	-	-	-	84
Subordinated loan from the Affiliated Bank	-	-	161	-	-	161
Total financial liabilities	**58,568**	**3,497**	**1,749**	**1,349**	-	**65,163**
Net liquidity gap at 31 December 2008	**(3,821)**	**19,145**	**14,922**	**4,815**	**720**	**35,781**
Cumulative liquidity gap at 31 December 2008	**(3,821)**	**15,324**	**30,246**	**35,061**	**35,781**	

27 Financial Risk Management (Continued)

The analysis by expected maturities may be summarised as follows at 31 December 2007:

In thousands of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 3 months**	**From 3 to 12 months**	**From 12 months to 5 years**	**Over 5 years**	**Total**
Assets						
Cash and cash equivalents	23,364	-	-	-	-	23,364
Mandatory cash balances with the NBAR	2,328	-	-	-	-	2,328
Due from other banks	1,695	663	414	-	-	2,772
Loans and advances to customers	171	105	10,446	3,664	77	14,463
Debt securities	39,924	7,969	7,869	-	60	55,822
Other financial assets	29	-	-	-	-	29
Total financial assets	**67,511**	**8,737**	**18,729**	**3,664**	**137**	**98,778**
Liabilities						
Due to other banks	3,300	-	-	-	-	3,300
Customer accounts	75,478	1,469	2,868	3,322		83,137
Other financial liabilities	202	-	-	-	-	202
Subordinated loan from the Affiliated Bank	-	-	170	169	-	339
Total financial liabilities	**78,980**	**1,469**	**3,038**	**3,491**	**-**	**86,978**
Net liquidity gap at 31 December 2007	**(11,469)**	**7,268**	**15,691**	**173**	**137**	**11,800**
Cumulative liquidity gap at 31 December 2007	**(11,469)**	**(4,201)**	**11,490**	**11,663**	**11,800**	

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 being on demand, 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.

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.

28 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 both internal and external professional advice, the 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 consolidated 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. Recent events within the Republic of Azerbaijan suggest that the 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 2008 no provision for potential tax liabilities has been recorded (2007: no provision).

Capital expenditure commitments. At 31 December 2008, the Group does not have material contractual capital expenditure commitments. (2007: no capital expenditure commitments).

Operating lease commitments. Where the Group is the lessee, the future minimum lease payments under non-cancellable operating leases are as follows:

In thousands of Azerbaijani Manats	**2008**	**2007**
Not later than 1 year	354	-
Later than 1 year and not later than 5 years	1,273	-
Later than 5 years	1,068	-
Total operating lease commitments	**2,695**	-

Calculations in accordance with regulatory and other requirements. Management have used judgment in interpreting the requirements of statutory regulations and calculating compliance with NBAR covenants. If Management's understanding proved not to be correct, the Group may be subject to penalties or other consequences imposed by the National Bank of the Republic of Azerbaijan.

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, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. 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.

28 Contingencies and Commitments (Continued)

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:

In thousands of Azerbaijani Manats	**2008**	**2007**
Guarantee letters	7,626	34,444
Undrawn credit lines	2,139	45,937
Import letters of credit	1,686	2,327
Total credit related commitments	**11,451**	**82,708**

At 31 December 2008, import letters of credit of AZN 861 thousand and guarantee letters of AZN 27 thousand (2007: import letters of credit of AZN 2,326 thousand and guarantee letters of AZN 190 thousand) were collateralised in the form of blocked customer accounts of AZN 888 thousand (2007: AZN 2,516 thousand).

Guarantees were opened for several companies operating in the various fields of economy, such as trade and service, consulting firms, tourism companies and others.

Most of the guarantee letters outstanding as at 31 December 2008 and 31 December 2007 represent payment guarantees issued to clients as a pledge of their ability to make payments to the beneficiary for provision of goods and services, and tender guarantees issued to clients as a pledge of their intent to participate in a bidding tender, announced by various institutions.

The fair value of credit related commitments was AZN 98 thousand at 31 December 2008 (2007: AZN 59 thousand).

Credit related commitments are denominated in currencies as follows:

In thousands of Azerbaijani Manats	**2008**	**2007**
Azerbaijani Manats	2,955	1,083
US Dollars	4,213	75,188
Euro	4,065	6,437
Other	218	-
Total	**11,451**	**82,708**

Assets pledged and restricted. At 31 December 2008, the Group had no assets pledged as collateral (2007: nil).

29 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.

The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. The Republic of Azerbaijan continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may be outdated or reflect distress sale transactions and therefore not represent fair values of financial instruments. Management has used all available market information in estimating the fair value of financial instruments.

Financial instruments carried at fair value. Investment securities available for sale are carried on the balance sheet at their fair value unless otherwise disclosed in Note 10. Cash and cash equivalents are carried at amortised cost, which approximates current fair value.

Fair values were determined based on quoted market prices, except for the shares of Baku Stock Exchange. Refer to Note 10.

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. Refer to Notes 8 and 9 for the estimated fair values of due from other banks, loans and advances to customers, respectively.

	2008	**2007**
Due from other banks – Note 8		
Short-term placements with other banks	4% to 14% p.a.	9.5% to 14% p.a.
Loans and advances to customers – Note 9		
Corporate loans	7% to 21% p.a.	6% to 18% p.a.
Loans to individuals - mortgage loans	7% to 20% p.a.	7% to 19% p.a.
Loans to individuals - entrepreneurs	16% to 23% p.a.	17% to 21% p.a.
Loans to individuals - flat refurbishment loans	8% to 24% p.a.	7.5% to 23% p.a.
Loans to individuals - consumer loans	12% to 24% p.a.	7% to 20% p.a.
Loans to individuals - car purchase loans	16% to 20% p.a.	15% to 20% p.a.
Loans to individuals - other purposes	12% to 24% p.a.	16% to 19% p.a.

Liabilities carried at amortised cost. 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.

30 Reconciliation of Classes of Financial Instruments with Measurement Categories

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 classes of financial assets with these measurement categories as at 31 December 2008 and 31 December 2007:

		2008			2007	
In thousands of Azerbaijani Manats		**\vailable-fo**		**Loans and re**		
Assets						
Cash and cash equivalents	26,251	-	26,251	23,364	-	23,364
Mandatory cash balances with the NBAR	3,725	-	3,725	2,328	-	2,328
Due from other banks						
- Short-term placements with other banks with original maturities of more than three months	4,108	-	4,108	2,772	-	2,772
Loans and advances to customers						
Corporate loans	6,656	-	6,656	12,840	-	12,840
Loans to individuals - mortgage loans	1,135	-	1,135	159	-	159
Loans to individuals - entrepreneurs	653	-	653	291	-	291
Loans to individuals - flat refurbishment loans	446	-	446	908	-	908
Loans to individuals - consumer loans	451	-	451	85	-	85
Loans to individuals - car purchase loans	44	-	44	81	-	81
Loans to individuals - other purposes	182	-	182	99	-	99
Investment securities available for sale	-	57,269	57,269	-	55,822	55,822
Other financial assets	24	-	24	29	-	29
Total financial assets	**43,675**	**57,269**	**100,944**	**42,956**	**55,822**	**98,778**
Non-financial assets	**3,383**	**-**	**3,383**	**940**	**-**	**940**
Total assets	**47,058**	**57,269**	**104,327**	**43,896**	**55,822**	**99,718**

All of the Group's financial liabilities are carried at amortised cost.

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

In thousands of Azerbaijani Manats	**Parent company**	**Entities under common control**
Cash and cash equivalents	5,347	-
Due from other banks (contractual interest rate: 4.0% p.a.)	1,129	-
Customer current/settlement accounts (contractual interest rate 0%-4% p.a.)	-	1,133
Subordinated debt from the Affiliated Bank (contractual interest rate: LIBOR +3.50% p.a.)	161	-

Balances on correspondent accounts and overnight placements with the Affiliated Bank represent approximately 5.1% (2007: 11.8%) of the total assets of the Group and, therefore, represents a concentration risk with the Affiliated Bank.

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

In thousands of Azerbaijani Manats	**Parent company**	**Entities under common control**
Interest income	1,098	24
Interest expense	(284)	(17)
Recovery of impairment provision for loans and advances to customers	-	31
Fee and commission income	22	-
Service fee	(19)	-

Interest income earned from overnight placements and demand deposit with the Affiliated Bank represent 14.4% (2007: 9.4%) of the total interest income of the Group for the year ended 31 December 2008.

At 31 December 2007, the outstanding balances with related parties were, as follows:

In thousands of Azerbaijani Manats	**Parent company**	**Entities under common control**
Cash and cash equivalents	11,790	-
Loans and advances to customers (contractual interest rates: 6% and 9% p.a.)	-	1,573
Impairment provisions for loans and advances to customers	-	(31)
Customer current/settlement accounts (contractual interest rate 0%)	-	2,550
Subordinated debt from the Affiliated Bank (contractual interest rate: LIBOR +3.50% p.a.)	339	-

31 Related Party Transactions (Continued)

The income and expense items with related parties for the year ended 31 December 2007 were as follows:

In thousands of Azerbaijani Manats	**Parent company**	**Entities under common control**
Interest income	574	131
Interest expense	(44)	(66)
Provision for loan impairment	-	(3)
Fee and commission income	4	18
Service fee	(216)	-

Key management compensation is presented below:

In thousands of Azerbaijani Manats	**2008**	**2007**
Short-term benefits:		
- Salaries	173	227
- Unused vacations	-	20
Total	**173**	**247**

32 Subsequent events

On 21 January 2009, the total amount of additional paid-in capital of the Bank equaling to AZN 12,713 thousand comprised of 635,670 thousand ordinary shares each with a nominal value of AZN 0.02 was registered as share capital at the State Committee for Securities of the Republic of Azerbaijan.