

**OFFICE  
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**OPEN JOINT STOCK  
COMPANY  
BANK OF AZERBAIJAN**

**Financial Statements**  
For the Year Ended 31 December 2008

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

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# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

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The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditors' report set out on pages 2-3, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the financial statements of Open Joint Stock Company Bank of Azerbaijan (the "Bank").

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Bank at 31 December 2008, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

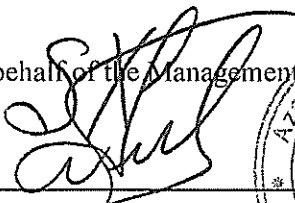
- Selecting suitable accounting principles and applying them consistently;
- Making judgements and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Preparing the financial statements on a going concern basis, unless it is inappropriate to presume that the Bank will continue in business for the foreseeable future.

Management is also responsible for:

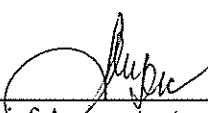
- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Bank;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Bank, and which enable them to ensure that the financial statements of the Bank comply with IFRS;
- Maintaining statutory accounting records in compliance with the legislation of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Bank; and
- Detecting and preventing fraud and other irregularities.

The financial statements for the year ended 31 December 2008 were authorized for issue on 4 August 2009 by the Management Board.

On behalf of the Management Board

  
Chairman  
Mr. Khayal Sharif-zade



  
Chief Accountant  
Mrs. Letafat Aliyeva

4 August 2009

4 August 2009

## INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of Open Joint Stock Company Bank of Azerbaijan:

### Report on the financial statements

We have audited the accompanying financial statements of Open Joint Stock Company Bank of Azerbaijan, which comprise the balance sheet as at 31 December 2008, the income statement, statements of changes in equity and cash flows for the year ended 31 December 2008, and a summary of significant accounting policies and other explanatory notes.

### Management's responsibility for the financial statements

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

### Auditors' responsibility

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

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

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

## Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Open Joint Stock Company Bank of Azerbaijan as at 31 December 2008, and its financial performance and cash flows for the year ended 31 December 2008 in accordance with International Financial Reporting Standards.

## Emphasis of matter

Without further qualifying our opinion, we draw attention to Note 2 to the accompanying financial statements "Going Concern", which indicates, due to various matters as set forth in the Note, the existence of a material uncertainty which may cast significant doubt about the Bank's ability to continue as a going concern.

*Deloitte + Touche LLC*

4 August 2009  
Baku, Azerbaijan

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

	Notes	Year ended 31 December 2008	Year ended 31 December 2007
Interest income	4, 24	13,362,532	8,154,551
Interest expense	4, 24	(6,883,431)	(3,595,423)
NET INTEREST INCOME BEFORE (PROVISION)/RECOVERY OF PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS		6,479,101	4,559,128
(Provision)/recovery of provision for impairment losses on interest bearing assets	5, 24	(1,845,227)	36,311
NET INTEREST INCOME		4,633,874	4,595,439
Net gain on foreign exchange operations	6	101,664	93,618
Fee and commission income	7, 24	2,689,647	3,604,183
Fee and commission expense	7	(360,639)	(197,023)
Other income		-	12
NET NON-INTEREST INCOME		2,430,672	3,500,790
OPERATING INCOME		7,064,546	8,096,229
OPERATING EXPENSES	8, 24	(6,876,720)	(3,992,849)
OPERATING PROFIT		187,826	4,103,380
Provision for impairment losses on other transactions		(1,517)	(152,839)
PROFIT BEFORE INCOME TAX		186,309	3,950,541
Income tax expense	9	(86,855)	(1,004,682)
NET PROFIT		99,454	2,945,859
EARNINGS PER SHARE <i>Basic and diluted (AZN)</i>	10	0.177	5.892

On behalf of the Management Board

Chairman  
Mr. Khayat Sharif-zade

4 August 2009  
Baku



Chief Accountant  
Mrs. Letafat Aliyeva

4 August 2009  
Baku

The notes on pages 9 to 52 form an integral part of these financial statements.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## BALANCE SHEET AS AT 31 DECEMBER 2008 (in Azerbaijan Manats)

	Notes	31 December 2008	31 December 2007
<b>ASSETS</b>			
Cash and balances with the National Bank of the Republic of Azerbaijan	11	6,737,856	10,901,470
Due from banks	12	701,645	234,062
Loans to customers	13, 24	92,881,832	76,885,517
Property and equipment	14	2,529,156	2,196,069
Intangible assets	15	126,389	145,442
Prepaid taxes		487,506	-
Deferred income tax assets	9	62,288	-
Other assets	16	2,327,999	139,124
<b>TOTAL ASSETS</b>		<b>105,854,671</b>	<b>90,501,684</b>
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES:</b>			
Due to banks and other credit institutions	17	43,808,236	38,924,460
Customer accounts	18, 24	42,896,157	36,522,197
Current income tax liabilities		-	497,786
Deferred income tax liabilities	9	-	39,617
Obligations under finance leases	19	232,566	512,870
Other liabilities	20, 24	754,825	576,321
<b>Total liabilities</b>		<b>87,691,784</b>	<b>77,073,251</b>
<b>EQUITY:</b>			
Share capital	21	14,635,000	10,000,000
Retained earnings		3,527,887	3,428,433
<b>Total equity</b>		<b>18,162,887</b>	<b>13,428,433</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>105,854,671</b>	<b>90,501,684</b>

On behalf of the Management Board

Chairman  
Mr. Khayal Sharif-zade

4 August 2009  
Baku



Chief Accountant  
Mrs. Letafat Aliyeva

4 August 2009  
Baku

The notes on pages 9 to 52 form an integral part of these financial statements.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2008

(in Azerbaijan Manats)

	Share capital	Retained earnings	Total equity
<b>31 December 2006</b>	10,000,000	1,874,759	11,874,759
Dividends declared (Note 21)	-	(1,392,185)	(1,392,185)
Net profit	-	2,945,859	2,945,859
<b>31 December 2007</b>	10,000,000	3,428,433	13,428,433
Share capital increase (Note 21)	4,635,000	-	4,635,000
Net profit	-	99,454	99,454
<b>31 December 2008</b>	<u>14,635,000</u>	<u>3,527,887</u>	<u>18,162,887</u>

On behalf of the Management Board

Chairman  
Mr. Khayal Sharif-zade

4 August 2009  
Baku



Chief Accountant  
Mrs. Letafat Aliyeva

4 August 2009  
Baku

The notes on pages 9 to 52 form an integral part of these financial statements.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

	Notes	Year ended 31 December 2008	Year ended 31 December 2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Profit before income tax		186,309	3,950,541
Adjustments for:			
Provision/(recovery of provision) for impairment losses on interest bearing assets	5	1,845,227	(36,311)
Provision for impairment losses on other transactions	5	1,517	152,839
Translation loss on foreign exchange operations	6	296,204	36,217
Depreciation and amortization expense	8	482,711	376,360
Loss on disposal of property and equipment		7,916	-
Change in interest accruals, net		(3,046,611)	175,008
Cash (outflow)/inflow from operating activities before changes in operating assets and liabilities		(226,727)	4,654,654
Changes in operating assets and liabilities			
Decrease/(increase) in operating assets:			
Minimum reserve deposit with the National Bank of the Republic of Azerbaijan		1,260,652	(2,185,165)
Due from banks		(166,068)	(50,503)
Loans to customers		(15,575,817)	(28,045,211)
Other assets		(2,213,457)	(9,213)
Increase in operating liabilities:			
Due to banks and other credit institutions		4,853,838	11,337,116
Customer accounts		7,054,862	22,323,442
Other liabilities		248,879	299,477
Cash (outflow)/inflow from operating activities before taxation		(4,763,838)	8,324,597
Income tax paid		(1,174,052)	(1,025,094)
Net cash (outflow)/inflow from operating activities		(5,937,890)	7,299,503
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of property, equipment and intangible assets	14, 15	(804,661)	(405,939)
Proceeds on sale of property and equipment		-	50,082
Net cash outflow from investing activities		(804,661)	(355,857)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Issue of share capital		4,635,000	-
Repayment of finance lease obligation		(280,304)	(207,617)
Dividends paid		-	(1,392,185)
Net cash inflow/(outflow) from financing activities		4,354,696	(1,599,802)

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## STATEMENT OF CASH FLOWS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

	Notes	Year ended 31 December 2008	Year ended 31 December 2007
Effect of changes in foreign exchange rate fluctuations on cash and cash equivalents		(215,928)	(39,238)
NET(DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		(2,387,855)	5,343,844
CASH AND CASH EQUIVALENTS, beginning of year	11	<u>7,500,913</u>	<u>2,196,307</u>
CASH AND CASH EQUIVALENTS, end of year	11	<u><u>4,897,130</u></u>	<u><u>7,500,913</u></u>

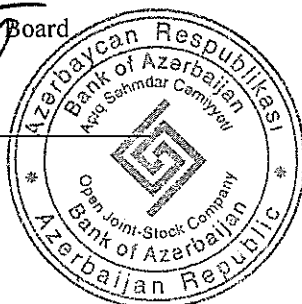
Interest paid and received by the Bank in cash during the year ended 31 December 2008 amounted to AZN 6,734,449 and AZN 10,166,939, respectively.

Interest paid and received by the Bank in cash during the year ended 31 December 2007 amounted to AZN 3,664,226 and AZN 8,398,362, respectively.

On behalf of the Management Board

Chairman  
Mr. Khayal Sherifzade

4 August 2009  
Baku



Chief Accountant  
Mrs. Letafat Aliyeva

4 August 2009  
Baku

The notes on pages 9 to 52 form an integral part of these financial statements.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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### 1. ORGANIZATION

Bank of Azerbaijan is a joint stock company, which was founded in the Republic of Azerbaijan in 1993. The address of its registered office is 3, S. Vurgun street, Baku, Azerbaijan. The Bank is regulated by the license number 166 issued on 1 December 1993 by the National Bank of the Republic of Azerbaijan (the "NBA") and conducts its business under general license for banking activities and foreign currency operations number 02-10/101 issued on 25 February 1998, and number 02-10/285 dated 14 August 2002 as renewed by the NBA letter dated 24 January 2005. The Bank's primary business consists of origination of loans and guarantees, and trading with foreign currencies. The Bank had 19 branches in Azerbaijan as at 31 December 2008 (2007: 19 branches).

As at 31 December 2008 and 2007 the following shareholders owned the issued shares of the Bank:

	31 December 2008, %	31 December 2007, %
Mammadov Anar Ziya	74.72	81.00
Mammadov Mubariz Mejid	24.60	18.00
"Nem Holdings Limited" Company	0.68	1.00
<b>Total</b>	<b>100.00</b>	<b>100.00</b>

The ultimate controlling party of the Bank is Mr. Anar Mammadov.

These financial statements were authorized for issue by the Management Board on 4 August 2009.

### 2. BASIS OF PRESENTATION

#### Accounting basis

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

These financial statements are presented in Azerbaijan Manats ("AZN") unless otherwise indicated. These financial statements have been prepared under the historical cost convention, except for the measurement at fair value of finance leases according to International Accounting Standard ("IAS") No. 17 "Leases".

The Bank maintains its accounting records in accordance with Azerbaijan law. These financial statements have been prepared based on the Azerbaijani statutory accounting records and have been adjusted to conform with IFRS. These adjustments include certain reclassifications to reflect the economic substance of underlying transactions including reclassifications of certain assets and liabilities, income and expenses to appropriate financial statement captions.

#### Functional currency

Items included in the financial statements of the Bank are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to the Bank (the "functional currency"). The reporting currency of the financial statements is the Azerbaijan Manat ("AZN").

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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### Going concern

The Bank is exposed to a concentration of funding sources (Note 17) and a negative liquidity gap amounting to AZN 3,182,073, AZN 11,734,388 and AZN 125,181 in the “up to 1 month” period, “1 year to 5 years” period and “over 5 years” period, respectively, after 31 December 2008 (Note 29).

As part of management’s efforts to address negative liquidity expectations, the following prolongations and new loan originations have been agreed with the NBA. Management also believes that it will be able to further prolong these loans:

- Loan with the NBA amounting to AZN 2,000,000 maturing in March 2009 has been prolonged for six months;
- Loan with the NBA amounting to AZN 2,000,000 maturing in February 2009 has been prolonged for six months;
- New loan in the amount of AZN 5,000,000 has been taken from the NBA in July 2009 for six months.

Management believes that the probability that banks and other major creditors of the Bank will demand repayment of outstanding amounts prior to alternative sources of financing being obtained is low. Management has an intention to obtain sufficient repayments of loans to customers and raise sufficient financing which will allow the Bank to settle a substantial portion of its current liabilities and improve working capital ratios. Management has prepared its forecasts for 2009 and believes that future cash flows from operating and financing activities will be sufficient for the Bank to meet its obligations as they become due.

Should the Bank be unsuccessful in meeting its operating and financing cash flows plans and the concentrated fund are withdrawn, it may not be able to continue as a going concern. These financial statements do not include any adjustments that might result from the outcome of these uncertainties as stated above.

### 3. SIGNIFICANT ACCOUNTING POLICIES

#### Recognition and measurement of financial instruments

The Bank recognizes financial assets and liabilities on its balance sheet when it becomes a party to the contractual obligation of the instrument. Regular way purchases and sales of the financial assets and liabilities are recognized using settlement date accounting. Regular way purchases of financial instruments that will be subsequently measured at fair value between trade date and settlement date are accounted for in the same way as for acquired instruments.

Financial assets and liabilities are initially recognized at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. The accounting policies for subsequent re-measurement of these items are disclosed in the respective accounting policies set out below.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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### **Cash and cash equivalents**

Cash and cash equivalents include cash on hand, unrestricted balances on correspondent and time deposit accounts with the National Bank of the Republic of Azerbaijan with original maturity within 90 days, advances to banks in countries included in the Organization for Economic Cooperation and Development ("OECD"). For the purposes of determining cash flows, the minimum reserve deposit required by the National Bank of the Republic of Azerbaijan is not included as a cash equivalent due to restrictions on its availability (Note 11).

### **Due from banks**

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

### **Loans to customers**

Loans to customers are non-derivative assets with fixed or determinable payments that are not quoted in an active market other than those classified in other categories of financial assets.

Loans to customers granted by the Bank with fixed maturities are initially recognized at fair value plus related transaction costs. Where the fair value of consideration given does not equal the fair value of the loan, for example where the loan is issued at lower than market rates, the difference between the fair value of consideration given and the fair value of the loan is recognized as a loss on initial recognition of the loan and included in the income statement according to nature of the losses. Subsequently, loans are carried at amortized cost using the effective interest rate method. Loans to customers are carried net of any allowance for impairment losses.

### **Write off of loans and advances**

Loans and advances are written off against the allowance for impairment losses when deemed uncollectible. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Bank and after the Bank has sold all available collateral. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the income statement in the period of recovery. In accordance with the statutory legislation, loans may only be written off with approval at the Supervisory Board Meeting and, in certain cases, with the respective decision of the Court.

### **Allowance for impairment losses**

#### *Assets carried at amortised cost*

The Bank accounts for impairment losses of financial assets when there is objective evidence that a financial asset or group of financial assets is impaired. The impairment losses are measured as the difference between carrying amounts and the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted at the financial asset's original effective interest rate.

Such impairment losses are not reversed unless 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 recognized, such as recoveries, in which case the previously recognized impairment loss is reversed by adjusting an allowance account.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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For financial assets carried at cost the impairment losses are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

### **Derecognition of financial assets and liabilities**

#### *Financial assets*

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized where:

- the rights to receive cash flows from the asset have expired;
- the Bank has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- the Bank either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial asset is derecognized when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Bank either: (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Bank reassesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. If substantially all the risks and rewards have been retained, the asset remains on the balance sheet. If substantially all of the risks and rewards have been transferred, the asset is derecognized. If substantially all the risks and rewards have been neither retained nor transferred, the Bank assesses whether or not it has retained control of the asset. If it has not retained control, the asset is derecognized.

Where the Bank has retained control of the asset, it continues to recognize the asset to the extent of its continuing involvement.

#### *Financial liabilities*

A financial liability is derecognized when the obligation is discharged, cancelled, or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a de-recognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the income statement.

### **Finance leases**

Financial leases are leases that transfer substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. The lease is classified as a finance lease if:

- The lease transfers ownership of the asset to the lessee by the end of the lease term;
- The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;
- The lease term is for the major part of the economic life of the asset even if title is not transferred;

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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- At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
- The leased assets are of a specialized nature such that only the lessee can use them without major modifications being made.

### *The Bank as a lessee*

At the commencement of the lease term, the Bank as a lessee recognizes finance leases as assets and liabilities in its balance sheet at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments. Subsequently, the minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability so as to produce a constant periodic rate of interest on the remaining balance of the liability. Finance charges are charged directly to profit or loss, unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with the Bank's general policy on borrowing costs. Contingent rents are charged as expenses in the periods in which they are incurred. Depreciation of the lease property is charged in accordance with depreciation policy that is applied to property owned by the Bank.

### **Property, equipment and intangible assets**

Property, equipment and intangible assets are carried at historical cost less accumulated depreciation and amortization and any recognized impairment loss.

Depreciation and amortization is charged on the carrying value of property, equipment and intangible assets and is designed to write off assets over their useful economic lives. Depreciation and amortization is calculated on a straight line basis at the following annual prescribed rates:

Buildings	10%
Furniture and equipment	20%
Computers	25%
Vehicles	25%
Other property and equipment	20%
Leasehold improvements	10%
Intangible assets	10%

Leasehold improvements are amortized over the life of the related leased asset. Expenses related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization.

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

### **Taxation**

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

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

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the Bank's income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the balance sheet if:

- The Bank has a legally enforceable right to set off current income tax assets against current income tax liabilities; and
- Deferred tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

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

### **Due to banks and other credit institutions and customer accounts**

Due to banks and other credit institutions and customer accounts are initially recognized at fair value. Subsequently amounts due are stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the income statement over the period of the borrowings, using the effective interest rate method.

### **Provisions**

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

### **Financial guarantee contracts issued and letters of credit**

Financial guarantee contracts and letters of credit issued by the Bank provide for specified payments to be made in order to reimburse the holder for a loss it incurred such that payments are made when a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. Such financial guarantee contracts and letters of credit issued are initially recognized at fair value. Subsequently they are measured at the higher of (a) the amount recognized as a provision in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets"; and (b) the amount initially recognized less (where appropriate) cumulative amortization of initial premium revenue received over the financial guarantee contract or the letter of credit issued.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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### **Contingencies**

Contingent liabilities are not recognized in the balance sheet but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognized in the balance sheet but disclosed when an inflow of economic benefits is probable.

### **Share capital**

Share capital is recognized at cost.

Dividends on ordinary shares are recognized in equity as a reduction in the period in which they are declared. Dividends that are declared after the balance sheet date are treated as a subsequent event under International Accounting Standard 10 "Events after the Balance Sheet Date" ("IAS 10") and disclosed accordingly.

### **Retirement and other benefit obligations**

In accordance with the requirements of the legislation of the Republic of Azerbaijan, the Bank withholds amounts of pension contributions from employee salaries and pays them to the state pension fund. Such expense is charged in the period in which the related salaries are earned. Upon retirement all retirement benefit payments are made by the state pension fund. The Bank does not have any pension arrangements separate from the state pension system of Azerbaijan, which requires current contributions by the employer to be calculated as a percentage of current gross salary payments. In addition, the Bank has no post-retirement benefits or other significant compensated benefits requiring accrual.

### **Recognition of income and expense**

#### *Recognition of interest income and expense*

Interest income and expense are recognized on an accrual basis using the effective interest rate method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

Once a financial asset or a group of similar financial assets has been written down (partly written down) as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest income also includes interest income earned on investments in securities. Other income is credited to the income statement when the related transactions are completed.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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### *Recognition of fee and commission income and expense*

Loan origination fees are deferred, together with the related direct and incremental costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in the income statement over the remaining period of the loan commitment. Where a loan commitment expires without resulting in a loan, the loan commitment fee is recognized in the income statement on expiry. Loan servicing fees are recognized as revenue as the services are provided. All other commissions are recognized when services are provided.

### **Foreign currency translation**

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

### **Rates of exchange**

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

31 December 2008		31 December 2007	
USD 1	=	AZN 0.8010	USD 1 = AZN 0.8453
EUR 1	=	AZN 1.1292	EUR 1 = AZN 1.2450
GBP 1	=	AZN 1.1621	GBP 1 = AZN 1.6876
RUR 1	=	AZN 0.0272	RUR 1 = AZN 0.0346

### **Offset of financial assets and liabilities**

Financial assets and liabilities are offset and reported net on the balance sheet when the Bank has a legally enforceable right to set off the recognized amounts and the Bank intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. In accounting for a transfer of a financial asset that does not qualify for derecognition, the Bank does not offset the transferred asset and the associated liability.

### **Segment reporting**

A segment is a distinguishable component of the Bank 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 per cent or more of all the segments are reported separately. Geographical segment of the Bank has been concentrated in the Republic of Azerbaijan.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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### **Areas of significant management judgment and sources of estimation uncertainty**

The preparation of the Bank's financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the balance sheet date and the reported amount of income and expenses during the period ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The following estimates and judgments are considered important to the portrayal of the Bank's financial condition.

#### *Allowance for impairment of loans*

The Bank regularly reviews its loans and receivables to assess for impairment. The Bank's loan impairment provisions are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Bank considers accounting estimates related to allowance for impairment of loans and receivables a key source of estimation uncertainty because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and receivables are based on recent performance experience, and (ii) any significant difference between the Bank's estimated losses and actual losses would require the Bank to record provisions which could have a material impact on its financial statements in future periods.

The Bank uses management's judgment to estimate the amount of any impairment loss in cases where a borrower has financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on past performance, past customer behavior, observable data indicating an adverse change in the payment status of borrowers in a group, and 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 group of loans and receivables. The Bank uses management's judgment to adjust observable data for a group of loans or receivables to reflect current circumstances not reflected in historical data.

The allowances for impairment of financial assets in the financial statements have been determined on the basis of existing economic and political conditions. The Bank is not in a position to predict what changes in conditions will take place in the Republic of Azerbaijan and what effect such changes might have on the adequacy of the allowances for impairment of financial assets in future periods.

The carrying amount of the allowance for impairment of loans is AZN 5,057,540 and AZN 3,212,313 as at 31 December 2008 and 2007, respectively.

### **Adoption of new and revised international financial reporting standards**

In the current year, the Bank has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the "IASB") and the International Financial Reporting Interpretations Committee (the "IFRIC") of the IASB that are relevant to its operations and effective for annual reporting periods ending on 31 December 2008. The adoption of these new and revised Standards and Interpretations has not resulted in significant changes to the Bank's accounting policies that have affected the amounts reported for the current or prior years.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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Amendments to IAS 1 “Capital Disclosures” (“IAS 1”) – On 18 August 2005, the IASB issued an amendments to IAS 1 which requires certain disclosures to be made regarding the entity’s objectives, policies and processes for managing capital. Additional information was disclosed in the financial statements for the current and comparative reporting periods as required by amended IAS 1.

Amendments to IAS 39, “Financial Instruments: Recognition and Measurement”, and IFRS 7, “Financial Instruments: Disclosures”, titled “Reclassification of Financial Assets” – On 13 October 2008 IASB issued amendments to IAS 39 and IFRS 7 which permits certain reclassifications of non-derivative financial assets (other than those designated as at fair value through profit or loss at initial recognition under the fair value option) out of the fair value through profit or loss category and also allows reclassification of financial assets from the available for sale category to the loans and receivables category in particular circumstances. The amendments to IFRS 7 introduce additional disclosure requirements if an entity has reclassified financial assets in accordance with the amendments to IAS 39. The amendments are effective as of 13 October 2008 and in certain circumstances can be applied retrospectively from 1 July 2008. The Bank has elected not to apply the amendments to IAS 39 and IFRS 7 retrospectively.

### **Standards and interpretations issued and not yet adopted**

At the date of authorization of these financial statements, other than the Standards and Interpretations adopted by the Bank in advance of their effective dates, the following Interpretations were in issue but not yet effective.

**IFRIC 9** “Reassessment of Embedded Derivatives” which requires that there should be no reassessment of whether an embedded derivative should be separated from the host contract after initial recognition, unless there have been changes to the contract. The adoption of IFRIC 9 had no impact on the Bank’s profit or loss or financial position.

**IFRS 8** – The IASB issued IFRS 8 “Operating Segments” in December 2006. This will replace IAS 14 “Segment Reporting” for accounting periods beginning on or after 1 January 2009. IFRS 8 requires segmental analysis reported by an entity to be based on information used by management. Management is currently assessing the impact of the adoption of IFRS 8.

**IAS 1** – On 6 September 2006, the IASB issued an amendment to IAS 1 which changes the way in which non-owner changes in equity are required to be presented to in IFRS but does not require that these be renamed in an entity’s financial statements. The amendment to IAS 1 is effective for periods beginning on or after 1 January 2009.

**IAS 23** – On March 2007 the IASB issued a revised IAS 23 “Borrowing Costs”. The main change is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalise borrowing costs as part of the cost of such asset. The Standard applies to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

### 4. NET INTEREST INCOME

	Year ended 31 December 2008	Year ended 31 December 2007
<b>Interest income comprises:</b>		
Interest income on financial assets recorded at amortized cost:		
- interest income on impaired financial assets	9,404,198	6,114,748
- interest income on unimpaired financial assets	<u>3,914,633</u>	<u>1,857,806</u>
Total interest income on financial assets recorded at amortized cost	13,318,831	7,972,554
Interest on off-balance sheet contingencies	<u>43,701</u>	<u>181,997</u>
<b>Total interest income</b>	<b><u>13,362,532</u></b>	<b><u>8,154,551</u></b>
<b>Interest income on financial assets recorded at amortized cost comprises:</b>		
Interest on loans to customers	13,318,530	7,951,067
Interest on due from banks	301	1,030
Interest on other operations	<u>-</u>	<u>20,457</u>
Total interest income on financial assets recorded at amortized cost	13,318,831	7,972,554
Interest on off-balance sheet contingencies	<u>43,701</u>	<u>181,997</u>
<b>Total interest income</b>	<b><u>13,362,532</u></b>	<b><u>8,154,551</u></b>
<b>Interest expense comprises:</b>		
Interest on customer accounts	4,840,184	1,989,683
Interest on due to banks and other credit institutions	<u>2,043,247</u>	<u>1,605,740</u>
Total interest expense on financial liabilities recorded at amortized cost	<u>6,883,431</u>	<u>3,595,423</u>
<b>Net interest income before (provision)/recovery of provision for impairment losses on interest bearing financial assets</b>	<b><u>6,479,101</u></b>	<b><u>4,559,128</u></b>

### 5. ALLOWANCE FOR IMPAIRMENT LOSSES AND OTHER PROVISIONS

The movements in allowance for impairment losses on interest earning assets were as follows:

	Due from banks	Loans to customers	Total
31 December 2006	1,705	3,248,392	3,250,097
Recovery of provision	<u>(232)</u>	<u>(36,079)</u>	<u>(36,311)</u>
31 December 2007	1,473	3,212,313	3,213,786
Additional provisions recognized	-	1,845,227	1,845,227
Write off of assets	<u>(1,473)</u>	<u>-</u>	<u>(1,473)</u>
31 December 2008	<u>-</u>	<u>5,057,540</u>	<u>5,057,540</u>

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

The movements in provision for impairment losses on other transactions were as follows:

	Other assets	Guarantees and other commitments	Total
<b>31 December 2006</b>	-	110,031	110,031
Additional provisions recognized	<u>118,800</u>	<u>34,039</u>	<u>152,839</u>
<b>31 December 2007</b>	118,800	144,070	262,870
Additional provisions recognized	<u>-</u>	<u>1,517</u>	<u>1,517</u>
<b>31 December 2008</b>	<u><u>118,800</u></u>	<u><u>145,587</u></u>	<u><u>264,387</u></u>

### 6. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprise:

	Year ended 31 December 2008	Year ended 31 December 2007
Dealing, net	397,868	129,835
Translation differences, net	<u>(296,204)</u>	<u>(36,217)</u>
<b>Total net gain on foreign exchange operations</b>	<u><u>101,664</u></u>	<u><u>93,618</u></u>

### 7. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended 31 December 2008	Year ended 31 December 2007
<b>Fee and commission income:</b>		
Cash operations	1,806,244	2,812,207
Settlements	504,718	442,548
Foreign exchange operations	220,629	292,302
Plastic card operations	93,452	55,241
Other	<u>64,604</u>	<u>1,885</u>
<b>Total fee and commission income</b>	<u><u>2,689,647</u></u>	<u><u>3,604,183</u></u>
<b>Fee and commission expense:</b>		
Cash operations	208,074	1,313
Settlements	109,629	83,699
Plastic cards services	6,581	68,061
Foreign currency operations	2,434	3,956
Documentary operations	507	1,696
Other	<u>33,414</u>	<u>38,298</u>
<b>Total fee and commission expense</b>	<u><u>360,639</u></u>	<u><u>197,023</u></u>

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

### 8. OPERATING EXPENSES

Operating expenses comprise:

	Year ended 31 December 2008	Year ended 31 December 2007
Staff costs	3,950,379	1,952,045
Operating leases	834,040	544,753
Depreciation and amortization	482,711	376,360
Security expenses	254,406	131,464
Professional services	226,212	145,633
Communications	202,319	178,254
Stationery	121,451	85,783
Transportation and business trip expenses	97,113	44,210
Property and equipment repair and maintenance	84,981	50,686
Membership fees	66,225	28,014
Finance charges	66,080	110,563
Charity and sponsorship expenses	48,840	37,030
Taxes, other than income tax	43,277	27,007
Utilities	38,689	32,472
Advertising and marketing expenses	34,314	94,275
Printing expenses	32,256	25,008
Insurance	28,474	45,691
Other expenses	264,953	83,601
<b>Total operating expenses</b>	<b><u>6,876,720</u></b>	<b><u>3,992,849</u></b>

### 9. INCOME TAXES

The Bank provides for taxes based on the statutory tax accounts maintained and prepared in accordance with the Azerbaijan statutory tax regulations which may differ from International Financial Reporting Standards.

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

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at 31 December 2008 and 2007 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Temporary differences as at 31 December 2008 and 2007 comprise:

	31 December 2008	31 December 2007
<b>Deductible temporary differences:</b>		
Loans to customers	635,969	-
Other assets	118,800	102,239
Other liabilities	-	42,904
<b>Total deductible temporary differences</b>	<b><u>754,769</u></b>	<b><u>145,143</u></b>

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

	31 December 2008	31 December 2007
<b>Taxable temporary differences:</b>		
Property and equipment	(25,217)	(296,242)
Intangible assets	(21,573)	(28,980)
Other liabilities	(424,853)	-
<b>Total taxable temporary differences</b>	<u>(471,643)</u>	<u>(325,222)</u>
Net deferred deductible/(taxable) temporary differences	<u>283,126</u>	<u>(180,079)</u>
<b>Net deferred tax assets/(liabilities) at the statutory tax rate (22%)</b>	<u><u>62,288</u></u>	<u><u>(39,617)</u></u>

Relationships between tax expenses and accounting profit for the years ended 31 December 2008 and 2007 are explained as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
<b>Profit before income tax</b>	<u>186,309</u>	<u>3,950,541</u>
Tax at the statutory tax rate	40,988	869,119
Tax effect of permanent differences	<u>45,867</u>	<u>135,563</u>
<b>Income tax expense</b>	<u><u>86,855</u></u>	<u><u>1,004,682</u></u>
Current income tax expense	188,760	1,040,000
Deferred income tax expense	<u>(101,905)</u>	<u>(35,318)</u>
<b>Income tax expense</b>	<u><u>86,855</u></u>	<u><u>1,004,682</u></u>

The tax rate used for the 2008 and 2007 reconciliations above is the corporate tax rate of 22% payable by corporate entities in the Republic of Azerbaijan on taxable profits under tax law in that jurisdiction.

<b>Deferred income tax assets/( liabilities)</b>	2008	2007
<b>Beginning of the year</b>	(39,617)	(74,935)
Decrease in deferred income tax liabilities for the year charged to profit	<u>101,905</u>	<u>35,318</u>
<b>End of the year</b>	<u><u>62,288</u></u>	<u><u>(39,617)</u></u>

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

### 10. EARNINGS PER SHARE

The earnings per share are calculated as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
<b>Profit:</b>		
Net profit for the year	<u>99,454</u>	<u>2,945,859</u>
Weighted average number of ordinary shares for basic earnings per share	<u>561,588</u>	<u>500,000</u>
<b>Earnings per share – basic and diluted (AZN)</b>	<u><u>0.177</u></u>	<u><u>5.892</u></u>

### 11. CASH AND BALANCES WITH THE NATIONAL BANK OF THE REPUBLIC AZERBAIJAN

	31 December 2008	31 December 2007
Cash	2,394,783	5,857,890
Balances with the National Bank of the Republic of Azerbaijan	<u>4,343,073</u>	<u>5,043,580</u>
<b>Total cash and balances with the National Bank of the Republic of Azerbaijan</b>	<u><u>6,737,856</u></u>	<u><u>10,901,470</u></u>

The balances with the NBA as at 31 December 2008 and 2007 include AZN 2,260,115 and AZN 3,520,767, respectively, which represent the minimum reserve deposits required by the NBA. The Bank is entitled to use all funds on its correspondent account provided that average daily balance for a month period will be eventually higher than the required mandatory reserve. The Bank was not able to maintain the required reserve balance in foreign currency at the NBA from July 2008 on. The NBA imposed restrictions on loan origination, dividend payment and new transactions with related parties of the Bank with the letter dated 21 July 2008 as a result of the above described fact.

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

	31 December 2008	31 December 2007
Cash and balances with the National Bank of the Republic of Azerbaijan	6,737,856	10,901,470
Due from banks in OECD countries	<u>419,389</u>	<u>120,210</u>
	7,157,245	11,021,680
Less minimum reserve deposit with the National Bank of the Republic of Azerbaijan	<u>(2,260,115)</u>	<u>(3,520,767)</u>
<b>Total cash and cash equivalents</b>	<u><u>4,897,130</u></u>	<u><u>7,500,913</u></u>

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

### 12. DUE FROM BANKS

Due from banks comprise:

	31 December 2008	31 December 2007
<b>Recorded as loans:</b>		
Correspondent accounts with other banks	477,505	173,270
Restricted deposits	224,140	62,265
	<u>701,645</u>	<u>235,535</u>
Less allowance for impairment losses	-	(1,473)
	<u>701,645</u>	<u>234,062</u>
<b>Total due from banks</b>	<b><u>701,645</u></b>	<b><u>234,062</u></b>

Movements in allowances for impairment losses on balances due from banks for the years ended 31 December 2008 and 2007 are disclosed in Note 5.

As at 31 December 2008 and 2007 accrued interest income included in due from banks amounted to nil and AZN 5,856, respectively.

As at 31 December 2008 and 2007 the Bank had restricted deposits under operations with plastic cards totaling AZN 23,890 and AZN 62,265, respectively.

As at 31 December 2008 included in balances due from banks is blocked deposit placed by the Bank for guarantee letter issued in the amount of AZN 200,250.

As at 31 December 2008 and 2007 the maximum credit risk exposure of due from banks and nonbank credit institutions amounted to AZN 701,645 and AZN 234,062, respectively.

### 13. LOANS TO CUSTOMERS

Loans to customers comprise:

	31 December 2008	31 December 2007
<b>Recorded as loans:</b>		
Loans to customers	97,939,372	80,097,830
Less allowance for impairment losses	<u>(5,057,540)</u>	<u>(3,212,313)</u>
<b>Total loans to customers</b>	<b><u>92,881,832</u></b>	<b><u>76,885,517</u></b>

As at 31 December 2008 and 2007 accrued interest income included in loans to customers amounted to AZN 7,088,509 and AZN 3,898,388, respectively.

Movements in allowances for impairment losses for the years ended 31 December 2008 and 2007 are disclosed in Note 5.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

The table below summarizes the amount of loans secured by collateral, rather than the fair value of the collateral itself:

	31 December 2008	31 December 2007
Loans collateralized by pledge of real estate	68,660,431	60,414,654
Loans collateralized by pledge of vehicles	5,802,010	5,096,911
Loans collateralized by pledge of equipment	1,384,754	521,411
Loans collateralized by pledge of corporate shares	984,415	880,000
Loans collateralized by pledge of deposits	61,595	370,523
Other collateral	791,875	1,993,710
Unsecured loans	<u>20,254,292</u>	<u>10,820,621</u>
	97,939,372	80,097,830
Less allowance for impairment losses	<u>(5,057,540)</u>	<u>(3,212,313)</u>
<b>Total loans to customers</b>	<b><u>92,881,832</u></b>	<b><u>76,885,517</u></b>
	31 December 2008	31 December 2007
<b>Analysis by sector:</b>		
Trade	31,449,135	22,259,614
Individuals	30,770,355	29,257,357
Manufacturing	13,177,417	12,225,076
Construction	9,792,053	6,586,184
Agriculture	8,862,777	6,405,121
Transport and communication	3,483,619	3,364,478
Other	<u>404,016</u>	<u>-</u>
	97,939,372	80,097,830
Less allowance for impairment losses	<u>(5,057,540)</u>	<u>(3,212,313)</u>
<b>Total loans to customers</b>	<b><u>92,881,832</u></b>	<b><u>76,885,517</u></b>

Loans to individuals comprise the following products:

	31 December 2008	31 December 2007
Business loans	9,588,447	8,454,310
Mortgage loans	7,304,490	6,870,405
Consumer loans	6,018,606	7,819,703
Car loans	5,632,839	5,087,648
Plastic cards	1,887,294	1,025,291
Other	<u>338,679</u>	<u>-</u>
	30,770,355	29,257,357
Less allowance for impairment losses	<u>(807,980)</u>	<u>(624,131)</u>
<b>Total loans to individuals</b>	<b><u>29,962,375</u></b>	<b><u>28,633,226</u></b>

## OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

### NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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As at 31 December 2008 and 2007 the Bank granted 5 loans and 5 loans totaling AZN 11,697,499 and AZN 9,656,940, respectively, which individually exceeded 10% of the Bank's equity.

As at 31 December 2008 and 2007 a significant amount of loans (100% of total portfolio) is granted to companies operating in the Republic of Azerbaijan, which represents a significant geographical concentration in one region.

As at 31 December 2008 and 2007 the maximum credit risk exposure on loans to customers amounted to AZN 92,881,832 and AZN 76,885,517, respectively. As at 31 December 2008 and 2007 a maximum credit risk exposure on loan commitments and overdrafts extended by the Bank to its customers amounted to AZN 7,433,772 and AZN 2,353,596, respectively.

As at 31 December 2008 and 2007 loans to customers included loans in amount of AZN 19,227,111 and AZN 7,799,062, respectively, whose terms have been renegotiated. Otherwise these loans would be past due or impaired.

As at 31 December 2008 and 2007 included in the loans to customers were loans in the amount of AZN 31,911,203 and AZN 31,969,982, respectively, that were individually determined to be impaired. As at 31 December 2008 these loans were secured with collateral with fair value of AZN 48,077,738. As at 31 December 2007 these loans were secured with collateral with fair value of AZN 47,145,281. For the purposes of estimating impairment of specific loans the Bank analyses the financial condition, debt service, credit history and the collateral level and quality.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

### 14. PROPERTY AND EQUIPMENT

	Land and buildings	Furniture and equipment	Computers	Vehicles	Other property and equipment	Leasehold improvements	Total
<b>At initial cost</b>							
31 December 2006	453,367	1,599,823	252,621	288,455	25,971	329,540	2,949,777
Additions	47,076	75,231	38,771	136,783	82,953	18,252	399,066
Disposals	-	-	-	(117,151)	-	-	(117,151)
31 December 2007	500,443	1,675,054	291,392	308,087	108,924	347,792	3,231,692
Additions	-	95,319	627,873	37,260	44,209	-	804,661
Disposals	-	-	-	(34,978)	-	-	(34,978)
31 December 2008	500,443	1,770,373	919,265	310,369	153,133	347,792	4,001,375
<b>Accumulated depreciation</b>							
31 December 2006	(177,719)	(270,165)	(99,051)	(111,210)	(22,476)	(62,629)	(743,250)
Charge for the year	(47,682)	(135,933)	(59,455)	(68,627)	(9,625)	(38,120)	(359,442)
Eliminated on disposals	-	-	-	67,069	-	-	67,069
31 December 2007	(225,401)	(406,098)	(158,506)	(112,768)	(32,101)	(100,749)	(1,035,623)
Charge for the year	(50,583)	(206,449)	(72,849)	(79,459)	(20,354)	(33,964)	(463,658)
Eliminated on disposals	-	-	-	27,062	-	-	27,062
31 December 2008	(275,984)	(612,547)	(231,355)	(165,165)	(52,455)	(134,713)	(1,472,219)
<b>Net book value</b>							
<b>As at</b>							
31 December 2008	<u>224,459</u>	<u>1,157,826</u>	<u>687,910</u>	<u>145,204</u>	<u>100,678</u>	<u>213,079</u>	<u>2,529,156</u>
<b>As at</b>							
31 December 2007	<u>275,042</u>	<u>1,268,956</u>	<u>132,886</u>	<u>195,319</u>	<u>76,823</u>	<u>247,043</u>	<u>2,196,069</u>

As at 31 December 2008 and 2007 the building of the Bank's head office was pledged as collateral against a loan received from the NBA in the amount of AZN 2,000,000 and AZN 2,000,000, respectively (Note 17). As at 31 December 2008 and 2007 the real estate used as security under these loans was valued in the amount of AZN 2,500,000.

Property and equipment of the Bank include ATMs and point-of-sale machines with historical cost of AZN 1,031,686, mostly financed under the finance lease (Note 19).

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

As at 31 December 2008 and 2007 included in property and equipment were fully depreciated assets of AZN 311,188 and AZN 276,566, respectively.

### 15. INTANGIBLE ASSETS

	Computer software	Licenses	Building design	Total 2008	Computer software	Licenses	Building design	Total 2007
<b>At initial cost</b>								
1 January	108,485	45,967	33,984	188,436	103,485	45,967	-	149,452
Additions	-	-	-	-	5,000	-	33,984	38,984
31 December	108,485	45,967	33,984	188,436	108,485	45,967	33,984	188,436
<b>Accumulated amortization</b>								
1 January	(32,120)	(10,874)	-	(42,994)	(19,798)	(6,278)	-	(26,076)
Charge for the year	(10,969)	(4,648)	(3,436)	(19,053)	(12,322)	(4,596)	-	(16,918)
31 December	(43,089)	(15,522)	(3,436)	(62,047)	(32,120)	(10,874)	-	(42,994)
<b>Net book value</b>								
31 December	65,396	30,445	30,548	126,389	76,365	35,093	33,984	145,442

### 16. OTHER ASSETS

Other assets comprise:

<b>Other financial assets recorded as loans and receivables in accordance with IAS 39:</b>	<b>31 December 2008</b>	<b>31 December 2007</b>
Settlements on money transfers	137,715	18,094
Accrued interest income on off-balance sheet contingencies	46,877	35,549
Prepayments and receivables on other transactions	507	37,465
	185,099	91,108
<b>Other non-financial assets:</b>		
Prepayments for purchase of property and equipment	2,116,595	140,800
Commemorative coins	98,438	-
Deferred expenses on plastic cards	30,618	26,016
Prepayment for revaluation of property and equipment	12,252	-
Advances to employees	3,797	-
	2,446,799	257,924
Less allowance for impairment losses	(118,800)	(118,800)
<b>Total other assets</b>	<b>2,327,999</b>	<b>139,124</b>

Movements in allowances for impairment losses on other assets for the years ended 31 December 2008 and 2007 are disclosed in Note 5.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

### 17. DUE TO BANKS AND OTHER CREDIT INSTITUTIONS

Due to banks and other credit institutions comprise:

	31 December 2008	31 December 2007
<b>Recorded at amortized cost:</b>		
Azerbaijan National Fund for Support of Entrepreneurship	32,098,827	26,377,647
Loans from National Bank of the Republic of Azerbaijan	7,000,000	6,000,000
Term deposits and loans from banks	2,258,400	4,006,374
Amount due to Azerbaijan Mortgage Fund	1,750,908	1,808,275
Correspondent accounts of other banks and credit institutions	101	382,087
Amount due to the State Committee on Agriculture Loans under Ministry of Agriculture of the Republic of Azerbaijan	700,000	350,077
<b>Total due to banks and other credit institutions</b>	<b>43,808,236</b>	<b>38,924,460</b>

As at 31 December 2008 and 2007 accrued interest expense included in due to banks and other credit institutions amounted to AZN 7,937 and AZN 22,419, respectively.

As at 31 December 2008 and 2007 the loans from the NBA in the amount of AZN 2,000,000 were secured by the pledge of the Bank's building. As at 31 December 2008 and 2007 the real estate used as security under these loans was valued in the amount of AZN 2,500,000 (Note 14). Other real estates belonging to one of the shareholder and customer of the Bank valued in the amount of AZN 12,600,000 and AZN 5,100,000 were also used as security under the loans from the NBA as at 31 December 2008 and 2007, respectively.

As at 31 December 2008 and 2007 the Bank had due to 1 credit institution totaling AZN 32,098,827 and AZN 26,377,647, respectively, representing significant concentration, forming 73% and 68% of due to banks and other credit institutions.

These liabilities are measured at amortised cost.

### 18. CUSTOMER ACCOUNTS

Customer accounts comprise:

	31 December 2008	31 December 2007
<b>Recorded at amortized cost:</b>		
Time deposits	34,417,495	22,370,150
Repayable on demand	8,478,662	14,152,047
<b>Total customer accounts</b>	<b>42,896,157</b>	<b>36,522,197</b>

As at 31 December 2008 and 2007 accrued interest expense included in customer accounts amounted to AZN 413,526 and AZN 250,062, respectively.

As at 31 December 2008 and 2007 customer accounts amounting to AZN 9,743,753 and AZN 7,415,270 were due to 7 and 6 customers representing a significant concentration, being approximately 23% and 20% of customer accounts, respectively.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

	31 December 2008	31 December 2007
<b>Analysis by sector:</b>		
Individuals	33,485,720	27,962,563
Insurance	3,629,519	2,353,134
Trade	3,024,756	3,143,285
Transport and communication	1,570,323	200,722
Construction	908,052	2,361,918
Manufacturing	152,472	13,056
Public organizations	77,916	62,672
Agriculture	23,177	280,407
Energy	8,572	9,640
Other	15,650	134,800
<b>Total customer accounts</b>	<b><u>42,896,157</u></b>	<b><u>36,522,197</u></b>

These liabilities are measured at amortised cost.

### 19. OBLIGATIONS UNDER FINANCE LEASE

Obligations under finance lease comprise:

	31 December 2008	31 December 2007
Not later than one year	249,662	337,055
Later than one year not later than five years	-	260,627
<b>Total minimum lease payments</b>	<b>249,662</b>	<b>597,682</b>
Less: deferred finance expenses	(17,096)	(84,812)
<b>Net payables under finance lease</b>	<b><u>232,566</u></b>	<b><u>512,870</u></b>
Current portion	232,566	308,021
Long-term portion	-	204,849
<b>Net payables under finance lease</b>	<b><u>232,566</u></b>	<b><u>512,870</u></b>

The Bank obtained ATMs and point-of-sale machines with historical cost of AZN 1,031,686, mostly financed under the lease. The lease term is 3 years. For the year ended 31 December 2008 the effective borrowing rate was 18.36%. Interest rates are fixed at the contract date, and thus expose the Bank to fair value interest rate risk. The lease is on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

These liabilities are measured at fair value.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

### 20. OTHER LIABILITIES

Other liabilities comprise:

	31 December 2008	31 December 2007
<b>Other financial liabilities:</b>		
Payables of individuals to state authorities	250,216	60,939
Payables to state and local funds	115,833	65,250
Payables to employees	80,137	94,772
Professional fees payable	64,900	118,400
Payables for money transfers	12,086	36,437
Other creditors	54,899	28,090
	<u>578,071</u>	<u>403,888</u>
<b>Other non-financial liabilities:</b>		
Provision for guarantees and other commitments	145,587	144,070
Taxes payable other than income tax	31,167	28,363
	<u>176,754</u>	<u>172,433</u>
<b>Total other liabilities</b>	<u><u>754,825</u></u>	<u><u>576,321</u></u>

Movements in provision for guarantees and other commitments for the years ended 31 December 2008 and 2007 are disclosed in Note 5.

These liabilities are measured at amortised cost.

### 21. SHARE CAPITAL

As at 31 December 2008 and 2007 share capital authorized consisted of 731,750 and 500,000 ordinary shares with par value of AZN 20 each. All shares are ranked equally and bear one vote.

In 2008 the shareholders approved an increase in share capital of AZN 4,635,000 by issuing additional 231,750 ordinary shares with par value of AZN 20 each.

In 2007 the Bank declared dividends of AZN 1,392,185 on ordinary shares for the financial results of 2006 financial year.

### 22. COMMITMENTS AND CONTINGENCIES

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

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

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

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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Provision for losses on contingent liabilities amounted to AZN 145,587 and AZN 144,070 as at 31 December 2008 and 2007, respectively.

As at 31 December 2008 and 2007, the nominal or contract amounts were:

	31 December 2008 Nominal Amount	31 December 2007 Nominal Amount
<b>Contingent liabilities and credit commitments</b>		
Letter of credit and other transaction related contingent obligations	17,491,714	-
Commitments on credits and unused credit lines	7,433,772	2,353,596
Guarantees issued and similar commitments	4,047,734	6,191,276
	<hr/>	<hr/>
<b>Total contingent liabilities and credit commitments</b>	<b>28,973,220</b>	<b>8,544,872</b>

Extension of loans to customers within credit line limits is approved by the Bank on a case-by-case basis and depends on borrowers' financial performance, debt service and other conditions. As at 31 December 2008 and 2007 such unused credit lines come to AZN 7,433,772 and AZN 2,353,596, respectively.

**Capital commitments** – The Bank had no material commitments for capital expenditures outstanding as at 31 December 2008.

**Legal proceedings** - From time to time and in the normal course of business, claims against the Bank are received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these financial statements.

The Bank is receiving claims from individual customers with respect to certain commissions withheld by the Bank for loan agreements service. Management is of the opinion that such claims would not have adverse consequences for the Bank, and is in the process of establishing procedures on disclosing additional information in loan agreements in compliance with the NBA instructions.

**Taxation** - Azerbaijan commercial legislation and tax legislation in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result the Bank may be assessed additional taxes, penalties and interest. Tax years remain open to review by the tax authorities for three years. Management believes that the Bank has already made all tax payments that are due, and therefore no provisions have been made in these financial statements for any potential liabilities.

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

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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**Recent volatility in global financial markets and its effects on Azerbaijan** - In recent months a number of major economies around the world have experienced volatile capital and credit markets. A number of major global financial institutions have either been placed into bankruptcy, taken over by other financial institutions and/or supported by government funding. Notwithstanding any potential economic stabilisation measures that may be put into place by the Azerbaijan Government, as a consequence of this turmoil in capital and credit markets there exists, as at the date these financial statements are authorised for issue, globally and in Azerbaijan, economic uncertainties surrounding the continual availability, and cost, of credit both for the entity and its counterparties globally and in Azerbaijan. These economic uncertainties may continue in the foreseeable future which could to some degree have an impact on the Bank's profitability and recoverability of the assets at their carrying amount.

**Government programs** - The Azerbaijan Government continues to exercise significant influence over the Azerbaijan economy. In response to the economic crisis and to support Azerbaijan businesses, the government of Azerbaijan has introduced significant measures including taxation holidays for the banking sector from 1 January 2009, support from the National Bank of the Republic of Azerbaijan and continued support for the local currency, the Azerbaijan Manat. As Azerbaijan is heavily dependent on hydrocarbon revenues, the economy's size and reserves are affected by oil prices fluctuations in the global market.

**Inflation** - The annual rate of inflation, as measures by changes in the Consumer Price Index, was 20.8% for 2008, 16.7% for 2007 (according to the State Statistics Committee of the Republic of Azerbaijan) and is projected at the rate of approximately 13% for 2009. The financial results in the Azerbaijan economy and, consequently, the Bank's financial results will be affected if inflation is not controlled effectively.

**Recoverability of financial assets** - As a result of recent economic turmoil in capital and credit markets globally, and the consequential economic uncertainties existing as at balance sheet date, there exists the potential that assets may not be recovered at their carrying amount in the regular course of business.

As at 31 December 2008, the Bank has financial assets amounting to AZN 100,506,432 (31 December 2007: AZN 88,112,157). The recoverability of these financial assets depends on a large extent on the efficacy of the fiscal measures and other measures and other actions, beyond the Bank's control, undertaken within various countries to achieve economic stability and recovery. The recoverability of the Bank's financial assets is determined based on conditions prevailing and information available as at balance sheet date. Management of the Bank is aware of these potential areas of concern and is taking various preventative measures (e.g. revised risk management, credit policy strategy, etc.) to minimise such risks. It is the management's opinion that no additional provision on financial assets is needed at present based on prevailing conditions and available information.

### 23. SUBSEQUENT EVENTS

Subsequently, with the letter dated 25 February 2009 the NBA lifted the restrictions on loan origination, dividend payment and new transactions with related parties of the Bank because of the non-compliance with the required reserve balance in foreign currency at the NBA (Note 11).

Following the year end, authorised, issued and paid share capital of the Bank increased by AZN 365,000.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

In June 2009 with the purpose of optimization of the branch network and increasing of effectiveness of the Bank's activities at the Supervisory Board's meeting it was decided to close 4 branches and combine these closed branches with other 4 branches of the Bank.

### 24. TRANSACTIONS WITH RELATED PARTIES

Related parties or transactions with related parties, as defined by IAS 24 "Related party disclosures", represent:

- (a) Parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Bank (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Bank that gives them significant influence over the Bank; and that have joint control over the Bank;
- (b) Associates – enterprises on which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;
- (c) Joint ventures in which the Bank is a venturer;
- (d) Members of key management personnel of the Bank or its parent;
- (e) Close members of the family of any individuals referred to in (a) or (d);
- (f) Parties that are entities controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
- (g) Post-employment benefit plans for the benefit of employees of the Bank, or of any entity that is a related party of the Bank.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Bank had the following transactions outstanding as at 31 December 2008 and 2007 with related parties:

	31 December 2008		31 December 2007	
	Related party balances	Total category as per financial statements caption	Related party balances	Total category as per financial statements caption
Loans to customers		97,939,372		80,097,830
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Bank</i>	10,885,608		3,032,635	
- <i>key management personnel of the Bank</i>	22,333		821,250	
Allowance for impairment losses		(5,057,540)		(3,212,313)
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Bank</i>	(113,818)		(182,975)	
- <i>key management personnel of the entity</i>	(4,121)		(59,173)	
Customer accounts		(42,896,157)		(36,522,197)
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Bank</i>	(104,049)		(2,693,400)	
- <i>key management personnel of the Bank</i>	(1,009,055)		(384,096)	
Other liabilities		(754,825)		(576,321)
- <i>key management personnel of the Bank</i>	(17,277)		-	

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

	31 December 2008		31 December 2007	
	Related party balances	Total category as per financial statements caption	Related party balances	Total category as per financial statements caption
Commitments on credits and unused credit lines		7,433,772		2,353,596
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Bank</i>	192,410		1,464,895	
- <i>key management personnel of the Bank</i>	6,170		18,160	
Letters of credit and other transaction related contingent obligations		17,491,714		-
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Bank</i>	17,154,563		-	

The remuneration of directors and other members of key management was as follows:

	Year ended 31 December 2008		Year ended 31 December 2007	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
<b>Key management personnel compensation:</b>		(3,950,379)		(1,952,045)
- <i>short-term employee benefits</i>	(402,607)		(284,592)	

Included in the income statement for the years ended 31 December 2008 and 2007 are the following amounts which arose due to transactions with related parties:

	Year ended 31 December 2008		Year ended 31 December 2007	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Interest income		13,362,532		8,154,551
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Bank</i>	1,256,405		344,842	
- <i>key management personnel of the entity</i>	15,900		78,280	
Interest expense		(6,883,431)		(3,595,423)
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Bank</i>	(80,732)		-	
- <i>key management personnel of the Bank</i>	(970)		(16,319)	

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

	Year ended 31 December 2008		Year ended 31 December 2007	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
(Provision)/recovery of provision for impairment losses		(1,845,227)		36,311
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Bank</i>	69,157		(80,701)	
- <i>key management personnel of the Bank</i>	55,052		(59,173)	
Fee and commission income		2,689,647		3,604,183
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Bank</i>	28,633		10,344	
- <i>key management personnel of the Bank</i>	1,128		2,343	
Operating expenses		(6,876,720)		(3,992,849)
- <i>key management personnel of the Bank</i>	(402,607)		(284,592)	

## 25. SEGMENT REPORTING

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

### *Business segments*

The Bank is organized on the basis of two main business segments:

- Retail banking – representing private banking services, private customer current accounts, savings, deposits, investment savings products, 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.

Transactions between the business segments are on normal commercial terms and conditions. There are no other material items of income or expense between the business segments.

Segment information about these businesses is presented below.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

	Retail banking	Corporate banking	Unallocated	As at and for the year ended 31 December 2008
Interest income	5,953,471	7,409,061	-	13,362,532
Interest expense	(4,495,527)	(2,387,904)	-	(6,883,431)
Provision for impairment losses on interest bearing assets	(761,189)	(1,084,038)	-	(1,845,227)
Net gain on foreign exchange operations	-	-	101,664	101,664
Fee and commission income	810,306	1,879,341	-	2,689,647
Fee and commission expense	-	(360,639)	-	(360,639)
<b>Total operating income</b>	<b>1,507,061</b>	<b>5,455,821</b>	<b>101,664</b>	<b>7,064,546</b>
Operating expenses	-	-	(6,876,720)	(6,876,720)
<b>Operating profit/(loss)</b>	<b>1,507,061</b>	<b>5,455,821</b>	<b>(6,775,056)</b>	<b>187,826</b>
Provision for impairment losses on other transactions	-	(1,517)	-	(1,517)
<b>Profit/(loss) before income tax</b>	<b>1,507,061</b>	<b>5,454,304</b>	<b>(6,775,056)</b>	<b>186,309</b>
Income tax expense	-	-	(86,855)	(86,855)
<b>Net profit/(loss)</b>	<b>1,507,061</b>	<b>5,454,304</b>	<b>(6,861,911)</b>	<b>99,454</b>
<b>Segment assets</b>	<b>29,503,655</b>	<b>71,032,888</b>	<b>5,318,128</b>	<b>105,854,671</b>
<b>Segment liabilities</b>	<b>(33,497,806)</b>	<b>(53,961,412)</b>	<b>(232,566)</b>	<b>(87,691,784)</b>
<b>Other segment items</b>				
Depreciation and amortization charge on property, equipment and intangible assets	-	-	(482,711)	(482,711)
Loans to customers	28,809,070	64,072,762	-	92,881,832
Property and equipment	-	-	2,529,156	2,529,156
Customer accounts	(33,485,720)	(9,410,437)	-	(42,896,157)

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

	Retail banking	Corporate banking	Unallocated	As at and for the year ended 31 December 2007
Interest income	3,324,268	4,830,283	-	8,154,551
Interest expense	(1,852,225)	(1,743,198)	-	(3,595,423)
(Provision)/recovery of provision for impairment losses on interest bearing assets	(552,096)	588,407	-	36,311
Net gain on foreign exchange operations	-	-	93,618	93,618
Fee and commission income	1,267,598	2,336,585	-	3,604,183
Fee and commission expense	-	(197,023)	-	(197,023)
Other income	12	-	-	12
<b>Total operating income</b>	<b>2,187,557</b>	<b>5,815,054</b>	<b>93,618</b>	<b>8,096,229</b>
Operating expenses	-	-	(3,992,849)	(3,992,849)
<b>Operating profit/(loss)</b>	<b>2,187,557</b>	<b>5,815,054</b>	<b>(3,899,231)</b>	<b>4,103,380</b>
Provision for impairment losses on other transactions	-	(152,839)	-	(152,839)
<b>Profit/(loss) before income tax</b>	<b>2,187,557</b>	<b>5,662,215</b>	<b>(3,899,231)</b>	<b>3,950,541</b>
Income tax expense	-	-	(1,004,682)	(1,004,682)
<b>Net profit/(loss)</b>	<b>2,187,557</b>	<b>5,662,215</b>	<b>(4,903,913)</b>	<b>2,945,859</b>
<b>Segment assets</b>	<b>28,945,699</b>	<b>59,155,009</b>	<b>2,400,976</b>	<b>90,501,684</b>
<b>Segment liabilities</b>	<b>(27,998,999)</b>	<b>(48,023,979)</b>	<b>(1,050,273)</b>	<b>(77,073,251)</b>
<b>Other segment items</b>				
Depreciation and amortization charge on property, equipment and intangible assets	-	-	(376,360)	(376,360)
Loans to customers	28,633,226	48,252,291	-	76,885,517
Property and equipment	-	-	2,196,069	2,196,069
Customer accounts	(27,962,562)	(8,559,635)	-	(36,522,197)

### *Geographical segments*

The Bank's assets are located in the Republic of Azerbaijan and major parts of its revenue and net profit arrives from operations in the Republic of Azerbaijan. Therefore no table is presented to disclose the geographical segments of the Bank.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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### 26. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. The estimates presented herein are not necessarily indicative of the amounts the Bank could realize in a market exchange from the sale of its full holdings of a particular instrument.

The fair value of financial assets and liabilities compared with the corresponding carrying amount in the balance sheet of the Bank is presented below:

	31 December 2008		31 December 2007	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and balances with the National Bank of the Republic of Azerbaijan	6,737,856	6,737,856	10,901,470	10,901,470
Due from banks	701,645	701,645	234,062	234,062
Other financial assets	185,099	185,099	91,108	91,108
Due to banks and other credit institutions	43,808,236	43,808,236	38,924,460	38,924,460
Customer accounts	42,896,157	42,896,157	36,522,197	36,522,197
Obligations under finance lease	232,566	232,566	512,870	512,870
Other financial liabilities	578,071	578,071	403,888	403,888

The fair value of loans to customers cannot be measured reliably as it is not practicable to obtain market information or apply any other valuation techniques on such instruments.

### 27. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total (12%) and tier 1 capital (6%) to risk weighted assets.

The ratio was calculated according to the principles employed by the Basel Committee by applying the risk estimates to the assets and off-balance sheet commitments net of allowances for impairment losses.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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

Capital amounts and ratios	Actual Amount in AZN	For Capital Adequacy purposes Amount in AZN	Ratio For Capital Adequacy purposes	Minimum Required Ratio
<b>As at 31 December 2008</b>				
Total capital	18,162,887	18,162,887	16%	12%
Tier 1 capital	18,162,887	18,162,887	16%	6%
<b>As at 31 December 2007</b>				
Total capital	13,428,433	13,428,433	16%	12%
Tier 1 capital	13,428,433	13,428,433	16%	6%

In addition, the Bank has to maintain a statutory capital adequacy ratio based on the NBA requirements. During the years ended 31 December 2008 and 2007 the Bank was in compliance with the minimum capital requirements imposed by the NBA.

### 28. CAPITAL RISK MANAGEMENT

The Bank manages its capital to ensure that the Bank will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance.

The capital structure of the Bank consists of equity attributable to equity holders of the Bank, comprising issued capital, and retained earnings as disclosed in the statement of changes in equity.

The Management Board reviews the capital structure on an annual basis. As a part of this review, the Board considers the cost of capital and the risks associated with each class of capital. Based on recommendations of the Board, the Bank balances its overall capital structure through the payment of dividends, new share issues as well as the issue of new debt or the redemption of existing debt.

The Bank's overall capital risk management policy remains unchanged from 2007.

### 29. RISK MANAGEMENT POLICIES

Management of risk is fundamental to the banking business and is an essential element of the Bank's operations. The main risks inherent to the Bank's operations are those related to:

- a) Credit risk
- b) Liquidity risk
- c) Market risk

The Bank recognizes that it is essential to have efficient and effective risk management processes in place. To enable this, the Bank has established a risk management framework, whose main purpose is to protect the Bank from risk and allow it to achieve its performance objectives. Through the risk management framework, the Bank manages the following risks:

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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### **Credit risk**

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

Risk management and monitoring is performed within set limits of authority. These processes are performed by the Credit Committees and the Bank's Management Board. Before any application is made by the Credit Committee, all recommendations on credit processes (borrower's limits approved, or amendments made to loan agreements, etc.) are reviewed and approved by the Credit Department. Daily risk management is performed by the Head of the Credit Department and Branch Credit Divisions.

The Bank structures the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Limits on the level of credit risk by a borrower and a product are approved quarterly by the Management Board. The exposure to any one borrower including banks is further restricted by sub-limits covering on and off-balance sheet exposures which are set by the Credit Committee. Actual exposures against limits are monitored daily.

Where appropriate, and in the case of most loans, the Bank obtains collateral, corporate and personal guarantees, but a significant portion is personal lending, where no such facilities can be obtained. Such risks are monitored on a continuous basis and subject to annual or more frequent reviews.

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

### **Maximum Exposure**

The Bank's maximum exposure to credit risk varies significantly and is dependant on both individual risks and general market economy risks.

The following table presents the maximum exposure to credit risk of financial assets and contingent liabilities. For financial assets the maximum exposure equals to a carrying value of those assets prior to any offset or collateral. For financial guarantees and other contingent liabilities the maximum exposure to credit risk is the maximum amount the Bank would have to pay if the guarantee was called on or in the case of commitments, if the loan amount was called on.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

As at 31 December 2008:

	Maximum exposure	Net exposure after offset	Collateral Pledged	Net exposure after offset and collateral
Cash and balances with the National Bank of the Republic of Azerbaijan	6,737,856	6,737,856	-	6,737,856
Due from banks	701,645	701,645	-	701,645
Loans to customers	92,881,832	92,881,832	74,301,018	18,580,814
Other financial assets	185,099	185,099	-	185,099
Commitments on credits and unused credit lines	7,433,772	7,433,772	6,497,122	936,650
Guarantees issued and similar commitments	3,923,808	3,923,808	-	3,923,808
Letter of credit and other transaction related contingent obligations	17,516,929	17,516,929	-	17,516,929

As at 31 December 2007:

	Maximum exposure	Net exposure after offset	Collateral Pledged	Net exposure after offset and collateral
Cash and balances with the National Bank of the Republic of Azerbaijan	10,901,470	10,901,470	-	10,901,470
Due from banks	234,062	234,062	-	234,062
Loans to customers	76,885,517	76,885,517	60,932,815	15,952,702
Other financial assets	91,108	91,108	-	91,108
Commitments on credits and unused credit lines	2,353,596	2,353,596	395,521	1,958,075
Guarantees issued and similar commitments	6,082,755	6,082,755	-	6,082,755

Financial assets are graded according to the current credit rating they have been issued by an internationally regarded agency. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

The following table details the credit ratings of financial assets held by the Bank as at 31 December 2008:

	A+	BBB	BB+	B+	B-	Not rated	Total at 31 December 2008
Cash and balances with the National Bank of the Republic of Azerbaijan	-	-	-	-	4,343,073	2,394,783	6,737,856
Due from banks	419,389	13,353	32,806	21,152	5,166	209,779	701,645
Loans to customers	-	-	-	-	-	92,881,832	92,881,832
Other financial assets	-	-	-	-	-	185,099	185,099

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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As at 31 December 2007:

	AA	BBB	BB+	Not rated	Total at 31 December 2007
Cash and balances with the National Bank of the Republic of Azerbaijan	-	-	5,043,580	5,857,890	10,901,470
Due from banks	120,210	105,760	-	8,092	234,062
Loans to customers	-	-	-	76,885,517	76,885,517
Other financial assets	-	-	-	91,108	91,108

The banking industry is generally exposed to credit risk through its financial assets and contingent liabilities. Credit risk exposure of the Bank is concentrated within the Republic of Azerbaijan. The exposure is monitored on a regular basis to ensure that the credit limits and credit worthiness guidelines established by the Bank's risk management policy are not breached.

The Bank enters into numerous transactions where the counterparties are not rated by international rating agencies.

### Rating model

The Bank has developed an internal rating model, which allows it to determine the rating of counterparties. The rating of a corporate borrower is based on an analysis of the financial ratios of the borrower, and an analysis of the market and industry sector, in which the borrower operates. The model also takes into consideration various qualitative factors, such as management efficiency and borrower's market share.

The application of the internal rating model results in a standardized approach in the analysis of corporate borrowers and provides a quantitative assessment of the creditworthiness of a borrower that does not have a rating from an international rating agency. The model takes into account specific local market conditions.

The quality of the internal rating model is examined on a regular basis through an assessment of both its effectiveness and validity. The Bank revises the model when deficiencies are identified.

### Scoring model

The Bank uses scoring models as a statistical tool to assess the future creditworthiness of new and existing borrowers of the Bank. Scoring models are applied for assessment of the credit risk of individuals and small business enterprises.

The scoring models interpret socio-demographic and financial indicators, behavioral variables and the credit history of borrowers. Each of the parameters inserted into scoring model has a numeric value, the sum of which represents the borrower's internal credit score (rating). The assigned score reflects the probability of default of the borrower.

The scoring models standardize and automate the process of decision making and decrease the operating expenses and operational risks of the Bank. The scoring model is assessed on a continual basis for its effectiveness and validity.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

The Bank applies internal rating and scoring methodologies to specific corporate loans and groups of retail and small business loans, which incorporate various underlying master scales that are different from that used by international rating agencies. The scoring methodologies are tailor-made for specific products and are applied at various stages over the life of the loan. As a result, it is not possible to make a cross-product score comparison which would agree to the outstanding balance of loans to customers per the balance sheet. As such, more detailed information is not being presented.

The following table details the carrying value of assets that are impaired and the ageing of those that are past due but not impaired:

As at 31 December 2008:

	Neither past due nor impaired	Financial assets past due but not impaired				Financial assets that have been impaired	Total at 31 December 2008
		0-3 months	3-6 months	6 months to 1 year	Greater than one year		
Cash and balances with the National Bank of the Republic of Azerbaijan	6,737,856	-	-	-	-	-	6,737,856
Due from banks	701,645	-	-	-	-	-	701,645
Loans to customers	27,298,081	-	-	-	-	65,583,751	92,881,832
Other financial assets	185,099	-	-	-	-	-	185,099

As at 31 December 2007:

	Neither past due nor impaired	Financial assets past due but not impaired				Financial assets that have been impaired	Total at 31 December 2007
		0-3 months	3-6 months	6 months to 1 year	Greater than one year		
Cash and balances with the National Bank of the Republic of Azerbaijan	10,901,470	-	-	-	-	-	10,901,470
Due from banks	234,062	-	-	-	-	-	234,062
Loans to customers	15,742,647	-	-	-	-	61,142,870	76,885,517
Other financial assets	91,108	-	-	-	-	-	91,108

### Geographical concentration

The Assets and Liabilities Management Committee (“ALMC”) exercises control over the risk in the legislation and regulatory arena and assess its influence on the Bank’s activity. This approach allows the Bank to minimize potential losses from the investment climate fluctuations in the Republic of Azerbaijan.

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

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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

	The Republic of Azerbaijan	Other non-OECD countries	OECD countries	31 December 2008 Total
<b>FINANCIAL ASSETS</b>				
Cash and balances with the National Bank of the Republic of Azerbaijan	6,737,856	-	-	6,737,856
Due from banks	268,902	13,354	419,389	701,645
Loans to customers	92,881,832	-	-	92,881,832
Other financial assets	180,811	4,288	-	185,099
<b>TOTAL FINANCIAL ASSETS</b>	<b>100,069,401</b>	<b>17,642</b>	<b>419,389</b>	<b>100,506,432</b>
<b>FINANCIAL LIABILITIES</b>				
Due to banks and other credit institutions	43,808,236	-	-	43,808,236
Customer accounts	42,718,143	135,525	42,489	42,896,157
Obligations under finance lease	232,566	-	-	232,566
Other financial liabilities	568,268	9,803	-	578,071
<b>TOTAL FINANCIAL LIABILITIES</b>	<b>87,327,213</b>	<b>145,328</b>	<b>42,489</b>	<b>87,515,030</b>
<b>NET POSITION</b>	<b>12,742,188</b>	<b>(127,686)</b>	<b>376,900</b>	

	The Republic of Azerbaijan	Other non-OECD countries	OECD countries	31 December 2007 Total
<b>FINANCIAL ASSETS</b>				
Cash and balances with the National Bank of the Republic of Azerbaijan	10,901,470	-	-	10,901,470
Due from banks	90,292	23,560	120,210	234,062
Loans to customers	76,885,517	-	-	76,885,517
Other financial assets	73,130	17,978	-	91,108
<b>TOTAL FINANCIAL ASSETS</b>	<b>87,950,409</b>	<b>41,538</b>	<b>120,210</b>	<b>88,112,157</b>
<b>FINANCIAL LIABILITIES</b>				
Due to banks and other credit institutions	38,924,460	-	-	38,924,460
Customer accounts	36,522,197	-	-	36,522,197
Obligations under finance lease	512,870	-	-	512,870
Other financial liabilities	370,434	24,415	9,039	403,888
<b>TOTAL FINANCIAL LIABILITIES</b>	<b>76,329,961</b>	<b>24,415</b>	<b>9,039</b>	<b>76,363,415</b>
<b>NET POSITION</b>	<b>11,620,448</b>	<b>17,123</b>	<b>111,171</b>	

### Liquidity risk

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

The Assets and Liabilities Management Committee controls these types of risks by means of maturity analysis, determining the Bank's strategy for the next financial period. Current liquidity is managed by the Treasury Department, which deals in the money markets for current liquidity support and cash flow optimization.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

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

An analysis of the liquidity and interest rate risks is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the entity.

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2008 Total
<b>FINANCIAL ASSETS</b>							
Due from banks	13,354	-	-	-	-	5,000	18,354
Loans to customers	7,116,895	12,257,492	28,776,514	29,209,174	4,933,260	8,064,253	90,357,588
Total interest bearing financial assets	7,130,249	12,257,492	28,776,514	29,209,174	4,933,260	8,069,253	90,375,942
Cash and balances with the National Bank of the Republic of Azerbaijan	4,477,741	-	-	-	-	2,260,115	6,737,856
Due from banks	664,401	-	-	-	-	18,890	683,291
Loans to customers	118,738	162,459	228,157	255,063	-	1,759,827	2,524,244
Other financial assets	185,099	-	-	-	-	-	185,099
<b>Total financial assets</b>	<b>12,576,228</b>	<b>12,419,951</b>	<b>29,004,671</b>	<b>29,464,237</b>	<b>4,933,260</b>	<b>12,108,085</b>	<b>100,506,432</b>
<b>FINANCIAL LIABILITIES</b>							
Due to banks and other credit institutions	4,436,303	5,358,646	1,947,845	27,375,666	4,681,738	-	43,800,198
Customer accounts	2,534,531	2,750,643	14,932,659	13,822,959	376,703	-	34,417,495
Obligations under finance lease	26,053	47,716	158,797	-	-	-	232,566
Total interest bearing financial liabilities	6,996,887	8,157,005	17,039,301	41,198,625	5,058,441	-	78,450,259
Due to banks and other credit institutions	8,038	-	-	-	-	-	8,038
Customer accounts	8,478,662	-	-	-	-	-	8,478,662
Other financial liabilities	274,714	120,308	164,051	-	-	18,998	578,071
<b>Total financial liabilities</b>	<b>15,758,301</b>	<b>8,277,313</b>	<b>17,203,352</b>	<b>41,198,625</b>	<b>5,058,441</b>	<b>18,998</b>	<b>87,515,030</b>
Liquidity gap	(3,182,073)	4,142,638	11,801,319	(11,734,388)	(125,181)		
Interest sensitivity gap	133,362	4,100,487	11,737,213	(11,989,451)	(125,181)		
Cumulative interest sensitivity gap	133,362	4,233,849	15,971,062	3,981,611	3,856,430		
Cumulative interest sensitivity gap as a percentage of total assets	0.13%	4.00%	15.09%	3.76%	3.64%		

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2007 Total
<b>FINANCIAL ASSETS</b>							
Due from banks	23,560	-	-	-	-	-	23,560
Loans to customers	1,430,429	4,159,775	25,375,825	33,013,038	4,755,916	7,535,474	76,270,457
Total interest bearing financial assets	1,453,989	4,159,775	25,375,825	33,013,038	4,755,916	7,535,474	76,294,017
Cash and balances with the National Bank of the Republic of Azerbaijan	7,380,703	-	-	-	-	3,520,767	10,901,470
Due from banks	210,502	-	-	-	-	-	210,502
Loans to customers	10,109	61,508	107,036	30,128	-	406,279	615,060
Other financial assets	91,108	-	-	-	-	-	91,108
<b>Total financial assets</b>	<b>9,146,411</b>	<b>4,221,283</b>	<b>25,482,861</b>	<b>33,043,166</b>	<b>4,755,916</b>	<b>11,462,520</b>	<b>88,112,157</b>
<b>FINANCIAL LIABILITIES</b>							
Due to banks and other credit institutions	31,726	1,777,892	9,838,708	25,478,498	1,396,269	-	38,532,733
Customer accounts	1,740,473	1,857,019	12,416,193	6,363,803	11,942	-	22,379,790
Obligations under finance lease	27,696	54,240	226,085	204,849	-	-	512,870
Total interest bearing financial liabilities	1,799,895	3,689,151	22,480,986	32,047,150	1,408,211	-	61,425,393
Due to banks and other credit institutions	391,727	-	-	-	-	-	391,727
Customer accounts	14,142,407	-	-	-	-	-	14,142,407
Other financial liabilities	123,680	65,250	214,958	-	-	-	403,888
<b>Total financial liabilities</b>	<b>16,457,709</b>	<b>3,754,401</b>	<b>22,695,944</b>	<b>32,047,150</b>	<b>1,408,211</b>	<b>-</b>	<b>76,363,415</b>
Liquidity gap	(7,311,298)	466,882	2,786,917	996,016	3,347,705		
Interest sensitivity gap	(345,906)	470,624	2,894,839	965,888	3,347,705		
Cumulative interest sensitivity gap	(345,906)	124,718	3,019,557	3,985,445	7,333,150		
Cumulative interest sensitivity gap as a percentage of total assets	(0.38%)	0.14%	3.34%	4.40%	8.10%		

A further analysis of the liquidity and interest rate risks is presented in the following tables in accordance with IFRS 7. The amounts disclosed in these tables do not correspond to the amounts recorded on the balance sheet as the presentation below includes a maturity analysis for financial liabilities that indicates the total remaining contractual payments (including interest payments), which are not recognized in the balance sheet under the effective interest rate method.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2008 Total
<b>FINANCIAL LIABILITIES</b>								
Due to banks and other credit institutions	3.97%	4,558,370	5,479,985	2,224,647	28,057,688	4,976,768	-	45,297,458
Customer accounts	15.50%	2,970,390	3,582,306	17,429,119	16,140,290	426,887	-	40,548,992
Obligations under finance lease	18.36%	29,310	53,232	167,120	-	-	-	249,662
Total interest bearing financial liabilities		7,558,070	9,115,523	19,820,886	44,197,978	5,403,655	-	86,096,112
Due to banks and other credit institutions		8,038	-	-	-	-	-	8,038
Customer accounts		8,478,662	-	-	-	-	-	8,478,662
Other financial liabilities		274,714	120,308	164,051	-	-	18,998	578,071
<b>Total financial liabilities</b>		<b>16,319,484</b>	<b>9,235,831</b>	<b>19,984,937</b>	<b>44,197,978</b>	<b>5,403,655</b>	<b>18,998</b>	<b>95,160,883</b>

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2007 Total
<b>FINANCIAL LIABILITIES</b>								
Due to banks and other credit institutions	4.29%	180,667	3,274,569	10,743,046	26,455,207	1,476,204	-	42,129,693
Customer accounts	12.74%	2,023,548	2,401,311	14,060,808	8,051,012	2,367	-	26,539,046
Obligations under finance lease	18.36%	34,962	67,882	271,947	222,892	-	-	597,682
Total interest bearing financial liabilities		2,239,177	5,743,762	25,075,801	34,729,110	1,478,571	-	69,266,421
Due to banks and other credit institutions		391,727	-	-	-	-	-	391,727
Customer accounts		14,142,407	-	-	-	-	-	14,142,407
Other financial liabilities		123,680	65,250	214,958	-	-	-	403,888
<b>Total financial liabilities</b>		<b>16,896,991</b>	<b>5,809,012</b>	<b>25,290,759</b>	<b>34,729,110</b>	<b>1,478,571</b>	<b>-</b>	<b>84,204,443</b>

### Market Risk

Market risk covers interest rate risk, currency risk and other pricing risks to which the Bank is exposed. There have been no changes as to the way the Bank measures risk or to the risk it is exposed in 2008.

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

The Assets and Liabilities Management Committee also manages interest rate and market risks by matching the Bank's interest rate position, which provides the Bank with a positive interest margin. The Department of Financial Control conducts monitoring of the Bank's current financial performance, estimates the Bank's sensitivity to changes in interest rates and its influence on the Bank's profitability.

The majority of the Bank's loan contracts and other financial assets and liabilities that bear interest are either variable or contain clauses enabling the interest rate to be changed at the option of the lender. The Bank monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

### Interest rate sensitivity

The Bank manages fair value interest rate risk through periodic estimation of potential losses that could arise from adverse changes in market conditions.

The following table presents a sensitivity analysis of interest rate risk, which has been determined based on "reasonably possible changes in the risk variable". The level of these changes is determined by management and is contained within the risk reports provided to key management personnel.

Impact on profit before tax based on asset values as at 31 December 2008 and 31 December 2007:

	As at 31 December 2008		As at 31 December 2007	
	Interest rate +1%	Interest rate -1%	Interest rate -1%	Interest rate -1%
<b>Financial assets:</b>				
Due from banks	184	(184)	236	(236)
Loans to customers	903,576	(903,576)	762,705	(762,705)
<b>Financial liabilities:</b>				
Due to banks and other credit institutions	(438,002)	438,002	(385,327)	385,327
Customer accounts	(344,175)	344,175	(223,798)	223,798
Obligations under finance lease	(2,326)	2,326	(5,129)	5,129
<b>Net impact on profit before tax</b>	<b>119,257</b>	<b>(119,257)</b>	<b>148,687</b>	<b>(148,687)</b>

Impact on shareholders' equity:

	As at 31 December 2008		As at 31 December 2007	
	Interest rate +1%	Interest rate -1%	Interest rate -1%	Interest rate -1%
<b>Financial assets:</b>				
Due from banks	144	(144)	184	(184)
Loans to customers	704,789	(704,789)	594,910	(594,910)
<b>Financial liabilities:</b>				
Due to banks and other credit institutions	(341,642)	341,642	(300,555)	300,555
Customer accounts	(268,457)	268,457	(174,562)	174,562
Obligations under finance lease	(1,814)	1,814	(4,001)	4,001
<b>Net impact on shareholders' equity</b>	<b>93,020</b>	<b>(93,020)</b>	<b>115,976</b>	<b>(115,976)</b>

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

### Currency risk

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The ALMC controls currency risk by management of the open currency position on the estimated basis of fluctuations of different currencies and other macroeconomic indicators, which gives the Bank an opportunity to minimize losses from significant currency rates fluctuations toward its national currency. The Treasury Department performs daily monitoring of the Bank's open currency position with the aim to match the requirements of national banks.

The Bank's exposure to foreign currency exchange rate risk is presented in the table below:

	AZN	USD USD 1 = AZN 0.8010	EUR EUR 1 = AZN 1.1292	Other currency	31 December 2008 Total
<b>Financial assets</b>					
Cash and balances with the National Bank of the Republic of Azerbaijan	5,632,765	987,069	79,467	38,555	6,737,856
Due from banks	20,000	608,017	54,946	18,682	701,645
Loans to customers	77,752,198	14,702,588	427,046	-	92,881,832
Other financial assets	73,951	111,125	23	-	185,099
<b>Total financial assets</b>	<b>83,478,914</b>	<b>16,408,799</b>	<b>561,482</b>	<b>57,237</b>	<b>100,506,432</b>
<b>Financial liabilities</b>					
Due to banks and other credit institutions	41,549,735	101	2,258,400	-	43,808,236
Customer accounts	28,054,730	13,712,313	1,128,975	139	42,896,157
Obligations under finance lease	-	232,566	-	-	232,566
Other financial liabilities	566,482	11,288	301	-	578,071
<b>Total financial liabilities</b>	<b>70,170,947</b>	<b>13,956,268</b>	<b>3,387,676</b>	<b>139</b>	<b>87,515,030</b>
<b>OPEN BALANCE SHEET POSITION</b>	<b>13,307,967</b>	<b>2,452,531</b>	<b>(2,826,194)</b>	<b>57,098</b>	

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats)

	AZN	USD USD 1 = AZN 0.8453	EUR EUR 1 = AZN 1.2450	Other currency	31 December 2007 Total
<b>Financial assets</b>					
Cash and balances with the National Bank of the Republic of Azerbaijan	8,167,076	2,715,794	18,600	-	10,901,470
Due from banks	25,800	154,067	46,585	7,610	234,062
Loans to customers	66,085,289	10,727,513	72,715	-	76,885,517
Other financial assets	55,801	35,307	-	-	91,108
<b>Total financial assets</b>	<b>74,333,966</b>	<b>13,632,681</b>	<b>137,900</b>	<b>7,610</b>	<b>88,112,157</b>
<b>Financial liabilities</b>					
Due to banks and other credit institutions	37,354,784	1,380,943	188,733	-	38,924,460
Customer accounts	21,820,720	14,166,899	515,432	19,146	36,522,197
Obligations under finance lease	512,870	-	-	-	512,870
Other financial liabilities	370,434	33,454	-	-	403,888
<b>Total financial liabilities</b>	<b>60,058,808</b>	<b>15,581,296</b>	<b>704,165</b>	<b>19,146</b>	<b>76,363,415</b>
<b>OPEN BALANCE SHEET POSITION</b>	<b>14,275,158</b>	<b>(1,948,615)</b>	<b>(566,265)</b>	<b>(11,536)</b>	

### Currency risk sensitivity

The following table details the Bank's sensitivity to a 10% increase and decrease in the USD and EUR against the AZN. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Bank where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

Impact on net profit based on asset values as at 31 December 2008 and 31 December 2007:

	As at 31 December 2008		As at 31 December 2007	
	AZN/USD +10%	AZN/USD -10%	AZN/USD +10%	AZN/USD -10%
Impact on profit or loss	245,253	(245,253)	(194,862)	194,862

	As at 31 December 2008		As at 31 December 2007	
	AZN/ EUR +10%	AZN/EUR -10%	AZN/ EUR +10%	AZN/EUR -10%
Impact on profit or loss	(282,619)	282,619	(56,627)	56,627

# OPEN JOINT STOCK COMPANY BANK OF AZERBAIJAN

## NOTES TO THE FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2008 *(in Azerbaijan Manats)*

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### Limitations of sensitivity analysis

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analyses do not take into consideration that the Bank's assets and liabilities are actively managed. Additionally, the financial position of the Bank may vary at the time that any actual market movement occurs. For example, the Bank's financial risk management strategy aims to manage the exposure to market fluctuations. As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation and taking other protective action. Consequently, the actual impact of a change in the assumptions may not have any impact on the liabilities, whereas assets are held at market value on the balance sheet. In these circumstances, the different measurement bases for liabilities and assets may lead to volatility in shareholder equity.

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Bank's view of possible near-term market changes that cannot be predicted with any certainty; and the assumption that all interest rates move in an identical fashion.

### **Price risk**

The Bank is exposed to equity price risks arising from equity investments. Equity investments are held for strategic rather than trading purposes. The Bank does not actively trade these investments.