

Commercial Bank MUGAN

Independent Auditors' Report

Financial Statements
Year Ended 31 December 2003

COMMERCIAL BANK MUGAN

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INDEPENDENT AUDITORS' REPORT

To the Owners and the Board of Directors of Commercial Bank Mugan:

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

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

We did not observe the cash counting as of 31 December 2003 and 2002, since those dates were prior to the time we were initially engaged as auditors of the Bank. Owing to the nature of the Bank's records we were unable to satisfy ourselves as to the cash balances by other audit procedures.

As more fully described in Note 3, the Bank has not presented a comparative profit and loss account, statement of cash flows, and related notes to the financial statements for the year ended 31 December 2002. In our opinion, disclosure of such information is required by the International Accounting Standard 1 "Presentation of Financial Statements".

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to the cash balances as of 31 December 2003 and 2002 and the omission of comparative information for the year ended 31 December 2002 as described in the preceding paragraph, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2003, and the results of its operations and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.



23 June 2004

COMMERCIAL BANK MUGAN

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

	Notes	2003
Interest income	4, 18	4,598,701
Interest expense	4, 18	<u>(1,299,137)</u>
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES		3,299,564
Provision for loan losses	5	<u>(5,544,774)</u>
NET INTEREST EXPENSE		<u>(2,245,210)</u>
Net gain on foreign exchange operations	6	920,108
Fees and commission income	7	5,136,164
Fees and commission expense	7	(319,366)
Other income		<u>27,657</u>
NET NON-INTEREST INCOME		<u>5,764,563</u>
OPERATING INCOME		3,519,353
OPERATING EXPENSES	8, 18	<u>(2,036,087)</u>
PROFIT BEFORE INCOME TAX		1,483,266
Income tax expense	9	<u>(171,500)</u>
NET PROFIT		<u><u>1,311,766</u></u>

On behalf of the Management Board

Chairman

Chief Accountant

The notes on pages 6 to 33 form an integral part of these financial statements. The Independent Auditors' Report is presented on page 1.

COMMERCIAL BANK MUGAN

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

	Notes	2003	2002
ASSETS			
Cash and balances with the National Bank of Azerbaijan	10	3,553,270	3,125,878
Advances to banks, less allowance for loan losses	11	7,248,438	6,254,957
Loans and advances to customers, less allowance for loan losses	12, 18	37,715,272	7,701,679
Securities available for sale		42,279	42,279
Fixed and intangible assets, less accumulated depreciation	13	1,262,593	904,298
Other assets		<u>32,206</u>	<u>45,100</u>
TOTAL ASSETS		<u><u>49,854,058</u></u>	<u><u>18,074,191</u></u>
LIABILITIES AND OWNERS' EQUITY			
LIABILITIES:			
Deposits and loans from banks and other institutions	14	21,377,615	2,153,054
Customer accounts	15, 18	13,368,754	4,612,084
Current income tax liabilities	9	1,978	11,271
Deferred income tax liabilities	9	36,702	-
Other liabilities		<u>43,212</u>	<u>15,740</u>
Total liabilities		<u><u>34,828,261</u></u>	<u><u>6,792,149</u></u>
OWNERS' EQUITY:			
Owners' capital	16	14,392,797	11,960,808
Revenue reserves/(accumulated deficit)		<u>633,000</u>	<u>(678,766)</u>
Total owners' equity		<u><u>15,025,797</u></u>	<u><u>11,282,042</u></u>
TOTAL LIABILITIES AND OWNERS' EQUITY		<u><u>49,854,058</u></u>	<u><u>18,074,191</u></u>
FINANCIAL COMMITMENTS AND CONTINGENCIES	17	<u><u>11,857,045</u></u>	<u><u>9,354,718</u></u>

On behalf of the Management Board

Chairman

Chief Accountant

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COMMERCIAL BANK MUGAN

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

	Owners' capital	Revenue reserves/ (accumulated deficit)	Total owners' equity
31 December 2001 (unaudited)	9,985,808	76,959	10,062,767
Owners' capital increase (unaudited)	1,975,000	-	1,975,000
Net loss (unaudited)	-	(755,725)	(755,725)
31 December 2002	11,960,808	(678,766)	11,282,042
Owners' capital increase	2,431,989	-	2,431,989
Net profit	-	1,311,766	1,311,766
31 December 2003	<u>14,392,797</u>	<u>633,000</u>	<u>15,025,797</u>

On behalf of the Management Board

Chairman

Chief Accountant

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COMMERCIAL BANK MUGAN

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

	Notes	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Profit before income taxes		1,483,266
Adjustments for:		
Provision for loan losses		5,544,774
Write-off of loans		(3,075,756)
Recovery of loans previously written-off		31,083
Depreciation and amortization		89,114
Net change in accruals		<u>(582,882)</u>
Cash flow from operating activities before changes in operating assets and liabilities		3,489,599
Changes in operating assets and liabilities		
(Increase)/decrease in operating assets:		
Minimum reserve deposit with the National Bank of Azerbaijan		(95,478)
Advances to banks and other institutions		2,405,551
Loans and advances to customers		(31,839,198)
Other assets		12,894
Increase/(decrease) in operating liabilities:		
Deposits and loans from banks and other institutions		19,172,937
Customer accounts		8,668,627
Other liabilities		<u>27,472</u>
Cash inflow from operating activities before income taxes		1,842,404
Income tax paid		<u>(144,091)</u>
Net cash inflow from operating activities		<u>1,698,313</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of fixed and intangible assets		<u>(447,409)</u>
Net cash outflows from investing activities		<u>(447,409)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase in owners' capital		<u>2,431,989</u>
Net cash inflows from financing activities		<u>2,431,989</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS		3,682,893
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD	10	<u>3,949,285</u>
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	10	<u><u>7,632,178</u></u>

Interest paid and received by the Bank in cash during the year ended 31 December 2003 amounted to AZM 1,159,470 thousand and AZM 3,876,152 thousand, respectively.

On behalf of the Management Board

Chairman

Chief Accountant

The notes on pages 6 to 33 form an integral part of these financial statements. The Independent Auditors' Report is presented on page 1.

COMMERCIAL BANK MUGAN

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2003 (in Azerbaijan Manats and in thousands)

1. ORGANISATION

Commercial bank Mugan (“the Bank”) is a limited liability partnership, which was founded in the Azerbaijan Republic in 1992. The address of its registered office is 4, 28 May Street, Baku, Azerbaijan. The Bank is regulated by the National Bank of the Azerbaijan Republic (the “NBA”) and conducts its business under general license for banking activities and foreign currency operations # 29 issued on 25 November 1992 and renewed by the letter # 02-10/508 on 10 November 2000. The Bank had 13 and 4 branches in Azerbaijan as of 31 December 2003 and 2002, respectively. The Bank’s primary business consists of making payments and money transfers, commercial activities, trading with foreign currencies and originating loans and deposits.

The number of employees of the Bank as of 31 December 2003 and 2002 was 158 and 143, respectively.

As of 31 December 2003 and 2002, the following individuals and legal entities owned more than 5% of the owners’ capital of the Bank:

Owner	2003 Ownership interest, %	2002 Ownership interest, %
Mehdiyev Maqbet	9.60	3.34
Eli Cam	6.83	-
Veliyeva Vefa	6.60	7.94
Seferov Rafiq	6.08	7.32
Goyusov Rufet	5.68	6.84
Esrefov Vidadi	5.56	6.69
Goyusova Gulmire	5.56	6.69
Nebiyev Tofiq	5.56	6.69
Novruzova Leyla	5.56	6.69
Suleymanova Peri	5.37	6.46
Qarayev Iskender	5.15	6.20
Other individuals	22.53	23.20
Mugan Insurance	-	5.02
Other legal entities	9.92	6.92
Total	100	100

These financial statements were authorized for issue by the Management Board on 23 June 2004.

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

2. BASIS OF PRESENTATION

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

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

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

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

3. SIGNIFICANT ACCOUNTING POLICIES

Initial application of International Financial Reporting Standards - The period ended 31 December 2003 was the first period in respect of which the Bank presented information in accordance with International Financial Reporting Standards. Previously, the Bank had presented its financial statements using only Azerbaijan accounting rules. The Bank did not prepare a comparative profit and loss account, statement of cash flows, and related notes to the financial statements for the year ended 31 December 2002 as it was impracticable to do so, and this represents a departure from IFRS.

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

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

Cash and cash equivalents - Cash and cash equivalents include cash unrestricted balances on correspondent and time deposit accounts with the National Bank of Azerbaijan with an original maturity within 90 days, advances to banks in countries included in the Organization for Economic Co-operation and Development (“OECD”), except for margin deposits for operations with plastic cards. For the purposes of determining cash flows, the minimum reserve deposit required by the National Bank of Azerbaijan is not included as a cash equivalent due to restrictions on its availability (Note 10).

Advances to banks - In the normal course of business, the Bank maintains advances or deposits for various periods of time with other banks. Advances to banks do not have fixed maturities and are carried at cost net of any allowance for losses.

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

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

Write off of loans - Loans are written off against the allowance for loan losses in the case of the uncollectibility of loans and advances, including through repossession of collateral. In accordance with the statutory legislation, loans may only be written off with the approval of the owners and, in certain cases, with the respective decision of the Court.

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

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

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

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

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

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

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

31 December 2003

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

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

Impairment loss - If the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable value. The difference being an impairment loss is recognized as an expense in the profit and loss account for the year in which it arises.

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

Deferred income tax assets and liabilities are offset when:

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

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

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

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

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

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

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

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

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

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

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

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.

4. NET INTEREST INCOME

Net interest income comprises:

	2003
Interest income	
Interest on loans and advances to customers	4,163,527
Interest on advances to banks	381,977
Other interest income	<u>53,197</u>
Total interest income	<u>4,598,701</u>
Interest expense	
Interest on customer accounts	567,539
Interest on deposits and loans from banks and other institutions	<u>731,598</u>
Total interest expense	<u>1,299,137</u>
Net interest income before provision for loan losses	<u>3,299,564</u>

5. ALLOWANCE FOR LOSSES

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

	Loans and advances to customers	Loans and advances to banks	Total
31 December 2001 (unaudited)	(700,567)	-	(700,567)
Provision (unaudited)	(4,326,954)	(102,668)	(4,429,622)
Write-offs of assets (unaudited)	3,101,600	-	3,101,600
Recoveries of assets previously written off (unaudited)	<u>(448,000)</u>	<u>-</u>	<u>(448,000)</u>
31 December 2002	<u>(2,373,921)</u>	<u>(102,668)</u>	<u>(2,476,589)</u>
(Provision)/Recovery	(5,592,827)	48,053	(5,544,774)
Write-offs of assets	3,075,756	-	3,075,756
Recoveries of assets previously written off	<u>(31,083)</u>	<u>-</u>	<u>(31,083)</u>
31 December 2003	<u><u>(4,922,075)</u></u>	<u><u>(54,615)</u></u>	<u><u>(4,976,690)</u></u>

Allowances for losses on assets are deducted from the related assets.

6. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprise:

	2003
Dealing, net	845,681
Translation differences, net	74,427
	<hr/>
Total net gain on foreign exchange operations	<u><u>920,108</u></u>

7. FEES AND COMMISSION INCOME AND EXPENSE

Fees and commission income and expense comprise:

	2003
Fees and commission income:	
Cash operations	2,409,732
Settlements	2,144,562
Foreign exchange operations	471,023
Documentary operations	1,719
Other operations	109,128
	<hr/>
Total fees and commission income	<u><u>5,136,164</u></u>

	2003
Fees and commission expense:	
Settlements	308,410
Servicing guarantees	2,965
Servicing letters of credit	491
Other operations	7,500
	<hr/>
Total fees and commission expense	<u><u>319,366</u></u>

8. OPERATING EXPENSES

Operating expenses comprise:

	2003
Salary and bonuses	1,054,228
Communication	232,269
Office supplies	212,951
Depreciation of fixed and intangible assets	89,114
Payroll taxes and social security costs	87,195
Advertising and marketing	84,964
Rent	71,915
Premises security	69,680
Business travel	22,902
Repairs and maintenance expenses	19,945
Taxes other than income tax	8,209
Other	82,715
	<hr/>
Total operating expenses	<u><u>2,036,087</u></u>

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. During the years ended 31 December 2003 and 2002, Azerbaijan's tax rate for corporations' profits was 25% and 27%, respectively. Effective from 1 January 2004 Azerbaijan's tax rate for corporations' profits is 24%.

Tax assets and liabilities consist of the following:

	2003	2002
Current income tax liabilities	(1,978)	(11,271)
Deferred income tax liabilities	<u>(36,702)</u>	<u>-</u>
Income tax liabilities	<u>(38,680)</u>	<u>(11,271)</u>

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

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

Temporary differences as of 31 December 2003 and 2002 comprise:

	2003	2002
Deferred assets:		
Loans to banks	54,615	102,668
Loans to customers	<u>-</u>	<u>775,334</u>
Total deferred assets	<u>54,615</u>	<u>878,002</u>
Deferred liabilities:		
Fixed assets	(123,295)	(3,931)
Loans to customers	<u>(84,244)</u>	<u>-</u>
Total deferred liabilities	<u>(207,539)</u>	<u>(3,931)</u>
Net deferred tax (liabilities)/assets	<u>(152,924)</u>	<u>874,071</u>
Deferred income tax (liability)/asset at statutory rate 24% (2002: 25%)	(36,702)	218,518
Less valuation allowance	<u>-</u>	<u>(218,518)</u>
Deferred income tax liability	<u>(36,702)</u>	<u>-</u>

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

	2003
Profit / (loss) before income taxes	<u>1,483,266</u>
Statutory tax rate	25%
Theoretical tax at the statutory tax rate	370,817
Tax effect of permanent differences	(200,846)
Effect of changes in income tax rate	<u>1,529</u>
Income tax expense	<u>171,500</u>
Current income tax expense	134,798
Deferred income tax expense	<u>36,702</u>
Income tax expense	<u>171,500</u>

	2003
Deferred income tax liabilities	
At beginning of the period	-
Increase in deferred income tax liabilities for the period	<u>36,702</u>
At end of the period	<u>36,702</u>

10. CASH AND BALANCES WITH THE NATIONAL BANK OF AZERBAIJAN

Cash and balances with the National Bank of Azerbaijan (“the NBA”) comprise:

	2003	2002
Cash on hand	1,567,980	844,655
Balances with the National Bank of Azerbaijan	<u>1,985,290</u>	<u>2,281,223</u>
Total cash and balances with the National Bank of Azerbaijan	<u>3,553,270</u>	<u>3,125,878</u>

The balances with the NBA as of 31 December 2003 and 2002 include AZM 496,207 thousand and AZM 400,729 thousand, respectively, which represent the minimum reserve deposits required by the NBA. The Bank is required to maintain the reserve balance at the NBA at all times.

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

	2003	2002
Cash and balances with the National Bank of Azerbaijan	3,553,270	3,125,878
Advances to banks in OECD countries	<u>4,575,115</u>	<u>1,224,136</u>
Less minimum reserve deposit with the National Bank of Azerbaijan	8,128,385	4,350,014
	<u>(496,207)</u>	<u>(400,729)</u>
Total cash and cash equivalents	<u>7,632,178</u>	<u>3,949,285</u>

11. ADVANCES TO BANKS, LESS ALLOWANCE FOR LOAN LOSSES

Advances to banks comprise:

	2003	2002
Advances to banks	<u>7,303,053</u>	<u>6,357,625</u>
Less allowance for loan losses	<u>(54,615)</u>	<u>(102,668)</u>
Total advances to banks, net	<u>7,248,438</u>	<u>6,254,957</u>

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

12. LOANS AND ADVANCES TO CUSTOMERS, LESS ALLOWANCE FOR LOAN LOSSES

Loans and advances to customers comprise:

	2003	2002
Originated loans	41,717,595	9,878,397
Accrued interest income on loans and advances to customers	<u>919,752</u>	<u>197,203</u>
	42,637,347	10,075,600
Less allowance for loan losses	<u>(4,922,075)</u>	<u>(2,373,921)</u>
Total loans and advances to customers, net	<u>37,715,272</u>	<u>7,701,679</u>

	2003	2002
Loans collateralized by corporate guarantees	11,015,092	293,580
Loans collateralized by real estate	8,525,743	1,526,173
Loans collateralized by bank guarantees	7,977,080	-
Loans collateralized by inventories	6,291,124	796,178
Loans collateralized by vehicles	4,083,317	765,265
Loans collateralized by deposits	1,325,085	-
Unsecured loans	652,168	5,784,995
Loans collateralized by equipment	247,090	402,423
Loans collateralized by others	1,600,896	309,783
Accrued interest income on loans and advances to customers	<u>919,752</u>	<u>197,203</u>
	42,637,347	10,075,600
Less allowance for loan losses	<u>(4,922,075)</u>	<u>(2,373,921)</u>
Total loans and advances to customers, net	<u>37,715,272</u>	<u>7,701,679</u>

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

As of 31 December 2003 and 2002 included in loans and advance to customers are non-accrual loans amounting to AZM 2,527,087 thousand and AZM 984,622 thousand, respectively, on which interest was not accrued.

Analysis by industry	2003	2002
Individuals	30,931,937	4,658,598
Trading	3,360,155	2,953,301
Manufacturing	3,321,641	-
Agriculture	2,686,712	636,297
Construction	1,142,150	1,630,201
Transportation	275,000	-
Accrued interest income on loans and advances to customers	<u>919,752</u>	<u>197,203</u>
	42,637,347	10,075,600
Less allowance for loan losses	<u>(4,922,075)</u>	<u>(2,373,921)</u>
Total loans and advances to customers, net	<u>37,715,272</u>	<u>7,701,679</u>

13. FIXED AND INTANGIBLE ASSETS, LESS ACCUMULATED DEPRECIATION

	Buildings	Furniture and fixtures	Computer equipment	Vehicles	Other fixed assets	Intangible assets	Total
At cost							
31 December 2002	950,000	88,062	71,037	54,780	1,502	3,301	1,168,682
Additions	<u>230,000</u>	<u>21,442</u>	<u>85,103</u>	<u>-</u>	<u>44,142</u>	<u>66,722</u>	<u>447,409</u>
31 December 2003	<u>1,180,000</u>	<u>109,504</u>	<u>156,140</u>	<u>54,780</u>	<u>45,644</u>	<u>70,023</u>	<u>1,616,091</u>
Accumulated depreciation							
31 December 2002	134,041	60,333	45,832	23,713	162	303	264,384
Charge for the year	<u>49,673</u>	<u>7,092</u>	<u>14,620</u>	<u>10,956</u>	<u>1,945</u>	<u>4,828</u>	<u>89,114</u>
31 December 2003	<u>183,714</u>	<u>67,425</u>	<u>60,452</u>	<u>34,669</u>	<u>2,107</u>	<u>5,131</u>	<u>353,498</u>
Net book value							
31 December 2003	<u>996,286</u>	<u>42,079</u>	<u>95,688</u>	<u>20,111</u>	<u>43,537</u>	<u>64,892</u>	<u>1,262,593</u>
Net book value							
31 December 2002	<u>815,959</u>	<u>27,729</u>	<u>25,205</u>	<u>31,067</u>	<u>1,340</u>	<u>2,998</u>	<u>904,298</u>

As of 31 December 2003 and 2002 there were certain fixed assets used by the Bank but legally belonging to its owners, which were not recorded on the balance sheet.

14. DEPOSITS AND LOANS FROM BANKS AND OTHER INSTITUTIONS

Deposits and loans from banks and other institutions comprise:

	2003	2002
Loans from banks	14,769,000	97,860
Amount due to the State Fund for Support of Entrepreneurs	4,739,900	1,294,300
Demand deposits	1,816,936	760,739
Accrued interest	51,779	155
Total deposits from banks and other institutions	21,377,615	2,153,054

The Bank receives loans from the State Fund for Support of Entrepreneurs as a means of support of small and medium-sized entrepreneurs in Azerbaijan. Under the agreement with the Fund as of 31 December 2003 and 2002 the Bank obtained loans for AZM 4,739,900 thousand and AZM 1,294,300 thousand, respectively with maturity periods from 2 to 5 years and bearing annual interest rates ranging from 0.5% to 4%. Subsequently, these funds were used by the Bank to issue loans with the same maturity periods to the individual entrepreneurs in Azerbaijan at annual interest rates from 5% to 7%.

15. CUSTOMER ACCOUNTS

Customer accounts comprise:

	2003	2002
Time deposits	7,161,975	2,297,834
Repayable on demand	6,092,493	2,288,007
Accrued interest expense on customer accounts	114,286	26,243
Total customer accounts	13,368,754	4,612,084

Analysis of customer accounts by industry:

	2003	2002
Individuals	7,776,254	1,817,084
Trade	3,636,321	1,893,702
Insurance	1,005,248	706,234
Construction	591,826	36,804
Energy and chemical	105,135	13,873
Agriculture	21,053	117,835
Manufacturing	9,857	212
Transport and communications	374	15
Other	108,400	82
Accrued interest expense on customer accounts	114,286	26,243
Total customer accounts	13,368,754	4,612,084

16. OWNERS' CAPITAL

The owners' capital of the Bank has been contributed by the owners in both AZM and USD. Owners are entitled to dividends and capital distributions in the currency in which their contribution was made.

During 2003 and 2002 owners' capital of the Bank was increased by AZM 2,431,989 thousand and AZM 1,975,000 thousand (not audited), respectively.

As of 31 December 2003 and 2002 the Bank's owners' capital amounted to AZM 14,392,797 thousand and AZM 11,960,808 thousand, respectively, and comprised of contributions made by individuals and legal entities, all of which were fully paid.

17. FINANCIAL COMMITMENTS AND CONTINGENCIES

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

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

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

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

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

	2003		2002	
	Nominal Amount	Risk Weighted Amount	Nominal Amount	Risk Weighted Amount
Contingent liabilities and credit commitments				
Guarantees issued and similar commitments	3,289,561	3,289,561	4,488,496	4,488,496
Commitments on credits and unused credit lines	8,567,484	-	4,866,222	-
Total contingent liabilities and credit commitments	11,857,045	3,289,561	9,354,718	4,488,496

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

Insurance - As of 31 December 2003 and 2002 the Bank's fixed assets were insured for AZM 550,000 thousand and AZM 220,000 thousand, respectively.

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.

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

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

18. TRANSACTIONS WITH RELATED PARTIES

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

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

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

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

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

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

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

	2003		2002	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Loans to customers, gross	9,030	42,637,347	3,523	10,075,600
Allowance for loans to customers	<u>(699)</u>	<u>(4,922,075)</u>	<u>(633)</u>	<u>(2,373,921)</u>
Loans to customers, net	<u>8,331</u>	<u>37,715,272</u>	<u>2,890</u>	<u>7,701,679</u>
Customer accounts	<u>543,030</u>	<u>13,368,754</u>	<u>509,144</u>	<u>4,612,084</u>

During the year ended 31 December 2003 the Bank originated loans and advances to related party customers amounting to AZM 9,472 thousand, and received loans and advances repaid of AZM 3,965 thousand. The Bank has interest income accrued in respect of loans and advances granted to related parties totaling AZM 70 thousand as of 31 December 2003.

During the year ended 31 December 2003 the Bank received deposits from related party customers of AZM 2,321,634 thousand and repaid deposits totaling AZM 2,287,748 thousand. The Bank has interest expense accrued in respect of deposits and advances received from related parties, totaling AZM 10,720 thousand as of 31 December 2003.

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

	2003	
	Related party transactions	Total category as per financial statements caption
	<u> </u>	<u> </u>
Interest income	-	4,598,701
- directors	329	-
Interest expense	-	(1,299,137)
- related companies	(93,806)	-
Operating expenses	-	(2,036,087)
- related companies	(672,040)	-
- directors	(223,557)	-

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

19. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

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

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

Securities available-for-sale - As of 31 December 2003 and 2002 equity investments are stated at fair value amounting to AZM 42,279 thousand. Since there is no active market for these securities and no market prices of securities with similar characteristics exist, management estimation was used.

Deposits and loans from banks and other institutions - As of 31 December 2003 and 2002 the carrying amount of short-term deposits and deposits repayable on demand of AZM 16,637,715 thousand and AZM 858,754 thousand, respectively, is a reasonable estimate of their fair value. As of 31 December 2003 and 2002 long-term borrowings are stated at cost of AZM 4,739,900 thousand and AZM 1,294,300 thousand, respectively, which approximates fair value.

Customer accounts - As of 31 December 2003 and 2002 the carrying amount of short-term deposits and current accounts of the Bank’s customers of AZM 9,867,208 thousand and AZM 4,256,640 thousand, respectively, is a reasonable estimate of their fair value. As of 31 December 2003 and 2002 long-term customer accounts are stated at cost of AZM 3,387,260 thousand and AZM 329,201 thousand, respectively, which approximates fair value.

20. SUBSEQUENT EVENTS

During 2004 the owners’ capital of the Bank was increased by AZM 1,923,859 thousand by accepting new members and from certain additional contributions made by the existing members.

During 2004 a new branch “Paytaht” has been opened by the Bank.

21. REGULATORY MATTERS

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

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

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

Estimate	Description of position
0%	Cash and balances with the National Bank of Azerbaijan
0%	State debt securities in Azerbaijan Manats
20%	Loans and advances to banks for up to 1 year
100%	Loans and advances to customers
100%	Other assets
0%	Standby letters of credit secured by customer funds
	Other standby letters of credit and other transaction related contingent obligations and commitments on unused loans with the initial maturity of over 1 year
50%	
100%	Guarantees issued and similar commitments

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

Capital amounts and ratios	Actual Amount in AZM thousand	For Capital Adequacy purposes Amount in AZM thousand	Ratio For Capital Adequacy purposes	Minimum Required Ratio
As of 31 December 2003				
Total capital	15,025,797	15,440,135	47%	8%
Tier 1 capital	15,025,797	15,025,797	45%	4%
As of 31 December 2002				
Total capital	11,282,042	11,452,914	84%	8%
Tier 1 capital	11,282,042	11,282,042	83%	4%

22. RISK MANAGEMENT POLICIES

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

The Bank manages the following risks:

Liquidity risk

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

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

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

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Overdue	Maturity undefined (incl. allowance for losses and impairment)	2003 AZM thousand Total
ASSETS								
Fixed interest bearing								
Advances to banks, less allowance for loan losses	7,303,053	-	-	-	-	-	(54,615)	7,248,438
Loans and advances to customers, less allowance for loan losses	10,090,717	8,953,809	10,064,825	8,866,807	-	-	(992,022)	36,984,136
Total fixed interest bearing assets	17,393,770	8,953,809	10,064,825	8,866,807	-	-	(1,046,637)	44,232,574
Cash and balances with the NBA	3,553,270	-	-	-	-	-	-	3,553,270
Loans and advances to customers, less allowance for loan losses	-	-	-	-	-	3,741,437	(3,741,437)	-
Available for sale securities, less allowance for impairment	-	-	-	-	42,279	-	-	42,279
Interest accrued on interest bearing assets	661,498	11,506	-	-	-	246,748	(188,616)	731,136
Fixed and intangible assets, less accumulated depreciation	-	-	-	201,415	1,061,178	-	-	1,262,593
Other assets	17,437	-	-	14,769	-	-	-	32,206
Total non-interest bearing assets	4,232,205	11,506	-	216,184	1,103,457	3,988,185	(3,930,053)	5,621,484
TOTAL ASSETS	21,625,975	8,965,315	10,064,825	9,082,991	1,103,457	3,988,185	(4,976,690)	49,854,058
LIABILITIES								
Deposits and loans from banks and other institutions	1,868,715	-	14,769,000	4,739,900	-	-	-	21,377,615
Customer accounts	469,938	364,302	2,940,475	3,387,260	-	-	-	7,161,975
Total fixed interest rate bearing liabilities	2,338,653	364,302	17,709,475	8,127,160	-	-	-	28,539,590
Customer accounts	6,092,493	-	-	-	-	-	-	6,092,493
Interest accrued on interest bearing liabilities	35,740	1,786	25,929	50,831	-	-	-	114,286
Current income tax liabilities	1,978	-	-	-	-	-	-	1,978
Deferred income tax liabilities	-	-	-	36,702	-	-	-	36,702
Other liabilities	43,212	-	-	-	-	-	-	43,212
Total non-interest bearing liabilities	6,173,423	1,786	25,929	87,533	-	-	-	6,288,671
TOTAL LIABILITIES	8,512,076	366,088	17,735,404	8,214,693	-	-	-	34,828,261

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years
Liquidity gap	<u>13,113,899</u>	<u>8,599,227</u>	<u>(7,670,579)</u>	<u>868,298</u>	<u>1,103,457</u>
Interest sensitivity gap	<u>15,055,117</u>	<u>8,589,507</u>	<u>(7,644,650)</u>	<u>739,647</u>	<u>-</u>
Cumulative interest sensitivity gap	<u><u>15,055,117</u></u>	<u><u>23,644,624</u></u>	<u><u>15,999,974</u></u>	<u><u>16,739,621</u></u>	<u><u>16,739,621</u></u>
Cumulative interest sensitivity gap as a percentage of total assets	<u><u>30%</u></u>	<u><u>47%</u></u>	<u><u>32%</u></u>	<u><u>34%</u></u>	<u><u>34%</u></u>

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Overdue	Maturity undefined (incl. allowance for losses and impairment)	2002 AZM thousand Total
ASSETS								
Fixed interest bearing								
Advances to banks, less allowance for loan losses	6,357,625	-	-	-	-	-	(102,668)	6,254,957
Loans and advances to customers, less allowance for loan losses	1,511,780	2,490,606	3,390,202	2,022,529	-	-	(1,758,961)	7,656,156
Total fixed interest bearing assets	7,869,405	2,490,606	3,390,202	2,022,529	-	-	(1,861,629)	13,911,113
Cash and balances with the NBA	3,125,878	-	-	-	-	-	-	3,125,878
Loans and advances to customers, less allowance for loan losses	-	-	-	-	-	463,280	(463,280)	-
Available for sale securities, less allowance for impairment	-	-	-	-	42,279	-	-	42,279
Interest accrued on interest bearing assets	35,517	7,595	-	-	-	154,091	(151,680)	45,523
Fixed and intangible assets, less accumulated depreciation	-	-	-	85,341	818,957	-	-	904,298
Other assets	30,421	-	-	14,679	-	-	-	45,100
Total non-interest bearing assets	3,191,816	7,595	-	100,020	861,236	617,371	(614,960)	4,163,078
TOTAL ASSETS	11,061,221	2,498,201	3,390,202	2,122,549	861,236	617,371	(2,476,589)	18,074,191
LIABILITIES								
Deposits and loans from banks and other institutions	760,894	-	97,860	1,294,300	-	-	-	2,153,054
Customer accounts	1,440,478	-	528,155	329,201	-	-	-	2,297,834
Total fixed interest rate bearing liabilities	2,201,372	-	626,015	1,623,501	-	-	-	4,450,888
Customer accounts	2,288,007	-	-	-	-	-	-	2,288,007
Interest accrued on interest bearing liabilities	20,091	-	2,655	3,497	-	-	-	26,243
Current income tax liabilities	11,271	-	-	-	-	-	-	11,271
Other liabilities	15,740	-	-	-	-	-	-	15,740
Total non-interest bearing liabilities	2,335,109	-	2,655	3,497	-	-	-	2,341,261
TOTAL LIABILITIES	4,536,481	-	628,670	1,626,998	-	-	-	6,792,149

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years
Liquidity gap	<u>6,524,740</u>	<u>2,498,201</u>	<u>2,761,532</u>	<u>495,551</u>	<u>861,236</u>
Interest sensitivity gap	<u>5,668,033</u>	<u>2,490,606</u>	<u>2,764,187</u>	<u>399,028</u>	<u>-</u>
Cumulative interest sensitivity gap	<u><u>5,668,033</u></u>	<u><u>8,158,639</u></u>	<u><u>10,922,826</u></u>	<u><u>11,321,854</u></u>	<u><u>11,321,854</u></u>
Cumulative interest sensitivity gap as a percentage of total assets	<u>31%</u>	<u>45%</u>	<u>60%</u>	<u>63%</u>	<u>63%</u>

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

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

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

Interest rate risk

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

	AZM	USD	2003 Other currencies	AZM	USD	2002 Other currencies
ASSETS						
Loans and advances to customers	9.5%	18.2%	26.0%	9.8%	40.4%	-
LIABILITIES						
Deposits and loans from banks and other institutions	6.9%	3.2%	-	2.1%	-	-
Customer accounts	12.0%	11.7%	14.0%	11.7%	12.8%	15.0%

The Bank receives loans from the State Fund for Support of Entrepreneurs as a means of support of small and medium-sized entrepreneurs in Azerbaijan. Under the agreement with the Fund as of 31 December 2003 and 2002 the Bank obtained loans for AZM 4,739,900 thousand and AZM 1,294,300 thousand, respectively with maturity periods from 2 to 5 years bearing the annual interest rates ranging from 0.5% to 4%. Subsequently, these funds were used by the Bank to issue loans with the same maturity periods to the individual entrepreneurs in Azerbaijan at annual interest rates from 5% to 7%. These rates are prescribed by the State Fund for Support of Entrepreneurs and the Bank cannot exceed them. These rates are significantly lower than market rates. This resulted in a decrease in the effective interest rates on loans and advances to customers granted in AZM and deposits from banks and other institutions.

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

Currency risk

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

	AZM	USD 1 USD= AZM 4,923	EUR 1 EUR= AZM 6,195	Other currencies	Currency undefined (incl. allowance for losses and impairment)	2003 AZM thousand Total
ASSETS						
Cash and balances with the NBA	2,063,261	1,480,545	9,337	127	-	3,553,270
Advances to banks, less allowance for loan losses	-	7,250,351	3,653	49,049	(54,615)	7,248,438
Loans and advances to customers, less allowance for loan losses	9,093,765	33,258,786	284,796	-	(4,922,075)	37,715,272
Available for sale securities, less allowance for impairment	42,279	-	-	-	-	42,279
Fixed and intangible assets, less accumulated depreciation	1,262,593	-	-	-	-	1,262,593
Other assets	-	400	31,806	-	-	32,206
TOTAL ASSETS	<u>12,461,898</u>	<u>41,990,082</u>	<u>329,592</u>	<u>49,176</u>	<u>(4,976,690)</u>	<u>49,854,058</u>
LIABILITIES						
Deposits and loans from banks and other institutions	4,740,163	16,636,317	1,135	-	-	21,377,615
Customer accounts	5,664,950	7,586,106	67,868	49,830	-	13,368,754
Current income tax liabilities	1,978	-	-	-	-	1,978
Deferred income tax liabilities	36,702	-	-	-	-	36,702
Other liabilities	42,375	837	-	-	-	43,212
TOTAL LIABILITIES	<u>10,486,168</u>	<u>24,223,260</u>	<u>69,003</u>	<u>49,830</u>	<u>-</u>	<u>34,828,261</u>
OPEN POSITION	<u>1,975,730</u>	<u>17,766,822</u>	<u>260,589</u>	<u>(654)</u>		

	AZM	USD 1 USD= AZM 4,893	EUR 1 EUR= AZM 5,080	Other currencies	Currency undefined (incl. allowance for losses and impairment)	2002 AZM thousand Total
ASSETS						
Cash and balances with the NBA	2,454,816	670,945	-	117	-	3,125,878
Advances to banks, less allowance for loan losses	-	5,847,128	824	509,673	(102,668)	6,254,957
Loans and advances to customers, less allowance for loan losses	5,224,989	4,850,611	-	-	(2,373,921)	7,701,679
Available for sale securities, less allowance for impairment	42,279	-	-	-	-	42,279
Fixed and intangible assets, less accumulated depreciation	904,298	-	-	-	-	904,298
Other assets	-	45,100	-	-	-	45,100
TOTAL ASSETS	8,626,382	11,413,784	824	509,790	(2,476,589)	18,074,191
LIABILITIES						
Deposits and loans from banks and other institutions	1,294,300	858,754	-	-	-	2,153,054
Customer accounts	1,920,150	2,131,089	560,845	-	-	4,612,084
Current income tax liabilities	11,271	-	-	-	-	11,271
Other liabilities	15,740	-	-	-	-	15,740
TOTAL LIABILITIES	3,241,461	2,989,843	560,845	-	-	6,792,149
OPEN POSITION	5,384,921	8,423,941	(560,021)	509,790		

Market Risk

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

Credit risk

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

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers. Limits on the level of credit risk by borrower are reviewed and approved by the Supervisory Board twice a year. Actual exposure per borrower against limits is monitored on new loans granted. The Credit Committee may initiate a change in the limits, however this must be approved by the Supervisory Board.

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

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

Geographical concentration

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

						2003
	Azerbaijan	Other CIS countries	OECD countries	Other non- OECD countries	Undefined (incl. allowance for losses and impairment)	AZM thousand Total
ASSETS						
Cash and balances with the NBA	3,553,270	-	-	-	-	3,553,270
Advances to banks, less allowance for loan losses	37,471	277,285	4,575,115	2,413,182	(54,615)	7,248,438
Loans and advances to customers, less allowance for loan losses	42,637,347	-	-	-	(4,922,075)	37,715,272
Available for sale securities, less allowance for impairment	42,279	-	-	-	-	42,279
Fixed and intangible assets, less accumulated depreciation	1,262,593	-	-	-	-	1,262,593
Other assets	17,437	14,769	-	-	-	32,206
TOTAL ASSETS	<u>47,550,397</u>	<u>292,054</u>	<u>4,575,115</u>	<u>2,413,182</u>	<u>(4,976,690)</u>	<u>49,854,058</u>
LIABILITIES						
Deposits and loans from banks and other institutions	21,377,615	-	-	-	-	21,377,615
Customer accounts	13,368,754	-	-	-	-	13,368,754
Current income tax liabilities	1,978	-	-	-	-	1,978
Deferred income tax liabilities	36,702	-	-	-	-	36,702
Other liabilities	43,212	-	-	-	-	43,212
TOTAL LIABILITIES	<u>34,828,261</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>34,828,261</u>
NET POSITION	<u>12,722,136</u>	<u>292,054</u>	<u>4,575,115</u>	<u>2,413,182</u>		

						2002
	Azerbaijan	Other CIS countries	OECD countries	Other non- OECD countries	Undefined (incl. allowance for losses and impairment)	AZM thousand Total
ASSETS						
Cash and balances with the NBA	3,125,878	-	-	-	-	3,125,878
Advances to banks, less allowance for loan losses	495,220	535,449	1,224,136	4,102,820	(102,668)	6,254,957
Loans and advances to customers, less allowance for loan losses	10,075,600	-	-	-	(2,373,921)	7,701,679
Available for sale securities, less allowance for impairment	42,279	-	-	-	-	42,279
Fixed and intangible assets, less accumulated depreciation	904,298	-	-	-	-	904,298
Other assets	30,421	14,679	-	-	-	45,100
TOTAL ASSETS	<u>14,673,696</u>	<u>550,128</u>	<u>1,224,136</u>	<u>4,102,820</u>	<u>(2,476,589)</u>	<u>18,074,191</u>
LIABILITIES						
Deposits and loans from banks and other institutions	2,153,054	-	-	-	-	2,153,054
Customer accounts	4,612,084	-	-	-	-	4,612,084
Current income tax liabilities	11,271	-	-	-	-	11,271
Other liabilities	15,740	-	-	-	-	15,740
TOTAL LIABILITIES	<u>6,792,149</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,792,149</u>
NET POSITION	<u>7,881,547</u>	<u>550,128</u>	<u>1,224,136</u>	<u>4,102,820</u>		