

**OPEN JOINT STOCK  
COMPANY  
MUGANBANK**

**Independent Auditors' Report  
and Financial Statements**

For the Year Ended 31 December 2006

# OPEN JOINT STOCK COMPANY MUGANBANK

## TABLE OF CONTENTS

---

	<b>Page</b>
STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS	1
INDEPENDENT AUDITORS' REPORT	2-3
FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006:	
Income statement	4
Balance sheet	5
Statement of changes in equity	6
Statement of cash flows	7-8
Notes to the financial statements	9-43

## **STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006**

---

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 to 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 Muganbank (the "Bank").

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Bank as at 31 December 2006, 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 legislation and accounting standards 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 2006 were authorized for issue on 24 May 2007 by the Management Board.

**On behalf of the Management Board**

---

**Chairman**  
**Shaig Alakbarov**

24 May 2007

---

**Head of Finance Department**  
**Galina Sidneva**

24 May 2007

## **INDEPENDENT AUDITORS' REPORT**

To the Shareholders and Management Board of the Open Joint Stock Company Muganbank:

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Open Joint Stock Company Muganbank, which comprise the balance sheet as at 31 December 2006, and the income statement, statements of changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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

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

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these 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 Muganbank as at 31 December 2006, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

A handwritten signature in black ink that reads "Deloitte & Touche". The signature is written in a cursive, flowing style.

24 May 2007

# OPEN JOINT STOCK COMPANY MUGANBANK

## INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2006

(in New Azerbaijan Manats and in thousands, except for earnings per share which is in Manats)

	Notes	2006	2005
Interest income	4, 24	3,622	1,935
Interest expense	4, 24	<u>(1,521)</u>	<u>(616)</u>
NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS		2,101	1,319
Provision for impairment losses on interest bearing assets	5, 24	<u>(620)</u>	<u>(327)</u>
NET INTEREST INCOME		<u>1,481</u>	<u>992</u>
Net loss on foreign exchange operations	6	(58)	(197)
Fee and commission income	7	1,508	901
Fee and commission expense	7	(144)	(101)
Net (loss)/gain on securities available-for-sale		(3)	2
Liquidation fee	8	60	-
Other income		<u>1</u>	<u>-</u>
NET NON-INTEREST INCOME		<u>1,364</u>	<u>605</u>
OPERATING INCOME		2,845	1,597
(Provision)/recovery of provision for impairment losses on other transactions	5	(2)	59
OPERATING EXPENSES	9, 24	<u>(1,766)</u>	<u>(1,020)</u>
OPERATING PROFIT BEFORE INCOME TAX		1,077	636
Income tax expense	10	<u>(248)</u>	<u>(158)</u>
NET PROFIT		<u>829</u>	<u>478</u>
EARNINGS PER SHARE	11		
Basic (AZN)		<u>26.164</u>	<u>17.704</u>

**On behalf of the Management Board**

\_\_\_\_\_  
**Chairman**  
**Shaig Alakbarov**

24 May 2007

\_\_\_\_\_  
**Head of Finance Department**  
**Galina Sidneva**

24 May 2007

The notes on pages 9 to 43 form an integral part of these financial statements. The Independent Auditors' Report is on pages 2 and 3.

# OPEN JOINT STOCK BANK MUGANBANK

## BALANCE SHEET

AS AT 31 DECEMBER 2006

(in New Azerbaijan Manats and in thousands)

	Notes	2006	2005
<b>ASSETS</b>			
Cash and balances with the National Bank of Azerbaijan	12	4,539	1,554
Due from banks	13	5,337	4,152
Loans to customers	14, 24	24,128	13,875
Securities available-for-sale	15	646	-
Property, equipment and intangible assets	16	5,102	1,810
Other assets	17	245	35
<b>TOTAL ASSETS</b>		<b>39,997</b>	<b>21,426</b>
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES:</b>			
Due to banks and other institutions	18	12,696	5,042
Customer accounts	19, 24	16,576	9,997
Current income tax liabilities	10	97	65
Deferred income tax liabilities	10	266	33
Allowance for losses on other transactions	5	9	7
Other liabilities	20, 24	257	87
<b>Total liabilities</b>		<b>29,901</b>	<b>15,231</b>
<b>EQUITY:</b>			
Share capital	21	7,800	5,400
Revaluation reserve		702	-
Retained earnings		1,594	795
<b>Total equity</b>		<b>10,096</b>	<b>6,195</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>39,997</b>	<b>21,426</b>

### On behalf of the Management Board

\_\_\_\_\_  
**Chairman**  
**Shaig Alakbarov**

24 May 2007

\_\_\_\_\_  
**Head of Finance Department**  
**Galina Sidneva**

24 May 2007

The notes on pages 9 to 43 form an integral part of these financial statements. The Independent Auditors' Report is on pages 2 and 3.

# OPEN JOINT STOCK COMPANY MUGANBANK

## STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2006 (in New Azerbaijan Manats and in thousands)

	Share capital	Revaluation reserve	Retained earnings	Total equity
<b>31 December 2004</b>	4,388	-	317	4,705
Share capital increase	1,012	-	-	1,012
Net profit	-	-	478	478
<b>31 December 2005</b>	5,400	-	795	6,195
Share capital increase	2,400	-	-	2,400
Fixed assets revaluation, net of tax effect	-	702	-	702
Dividends paid	-	-	(30)	(30)
Net profit	-	-	829	829
<b>31 December 2006</b>	<u>7,800</u>	<u>702</u>	<u>1,594</u>	<u>10,096</u>

### On behalf of the Management Board

\_\_\_\_\_  
**Chairman**  
**Shaig Alakbarov**

24 May 2007

\_\_\_\_\_  
**Head of Finance Department**  
**Galina Sidneva**

24 May 2007

The notes on pages 9 to 43 form an integral part of these financial statements. The Independent Auditors' Report is on pages 2 and 3.



# OPEN JOINT STOCK COMPANY MUGANBANK

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2006 (in New Azerbaijan Manats and in thousands)

	Notes	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Profit before income taxes		1,077	636
Adjustments for:			
Provision for impairment losses on interest bearing assets		620	327
Provision/(recovery of provision) for impairment losses on other transactions		2	(59)
Depreciation and amortization		236	163
Net change in accruals		(318)	4
Net unrealized loss arising from changes in foreign currency exchange rates		117	333
Gain/(loss) on disposal of investments		3	(2)
Net change in recovery value of derivative financial instruments		(38)	(16)
Cash flow from operating activities before changes in operating assets and liabilities		1,699	1,386
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the National Bank of Azerbaijan		(984)	(91)
Due from banks		(2,948)	666
Loans to customers		(10,861)	(3,083)
Other assets		(216)	(35)
Increase/(decrease) in operating liabilities:			
Due to banks and other institutions		7,771	(3,319)
Customer accounts		6,864	6,276
Other liabilities		173	70
Cash inflow from operating activities before income taxes		1,498	1,870
Income tax paid		(181)	(109)
Net cash inflow from operating activities		1,317	1,761
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of fixed and intangible assets		(2,627)	(132)
Net proceeds from sale of investments available-for-sale		(648)	359
Net cash (outflow)/inflow from investing activities		(3,275)	227

# OPEN JOINT STOCK COMPANY MUGANBANK

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

	Notes	2006	2005
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Issue of ordinary share capital		2,400	1,012
Dividends paid		(30)	-
Net cash inflow from financing activities		<u>2,370</u>	<u>1,012</u>
Effect of foreign exchange rate changes on cash and cash		<u>(30)</u>	<u>(26)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS		382	2,974
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	12	<u>3,493</u>	<u>519</u>
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	12	<u><u>3,875</u></u>	<u><u>3,493</u></u>

Interest paid and received by the Bank in cash during the year ended 31 December 2006 amounted to AZN 1,417 and AZN 3,200 thousand, respectively. Interest paid and received by the Bank in cash during the year ended 31 December 2005 amounted to AZN 541 and AZN 1,863 thousand, respectively.

### On behalf of the Management Board

\_\_\_\_\_  
**Chairman**  
**Shaig Alakbarov**

24 May 2007

\_\_\_\_\_  
**Head of Finance Department**  
**Galina Sidneva**

24 May 2007

The notes on pages 9 to 43 form an integral part of these financial statements. The Independent Auditors' Report is on pages 2 and 3.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (in New Azerbaijan Manats and in thousands)

---

### 1. ORGANISATION

Open Joint Stock Company Muganbank (“the Bank”) was incorporated in Azerbaijan in 1992 as a closed joint stock company and in 2005 it became an open joint stock company. The Bank is regulated by the National Bank of the Republic of Azerbaijan (the “NBA”) and conducts its business under the general license for banking activities and foreign currency operations number 29 issued on 25 November 1992 and renewed by the letter number 02-10/508 on 10 November 2000. The Bank had 15 and 14 branches in Azerbaijan as at 31 December 2006 and 2005, 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 address of its registered office is 4, 28 May Street, Baku, Azerbaijan.

As at 31 December 2006 and 2005 the following individuals and legal entities owned the share capital of the Bank:

Owner	31 December 2006 %	31 December 2005 %
Mehdiyev Elmir	79.21	81.09
Mehdiyev Maqbet	7.90	7.71
Veliyeva Vefa	7.82	7.59
Mehdiyeva Farida	5.07	3.61
Total	<u>100.00</u>	<u>100.00</u>

These financial statements were authorized for issue by the Management Board on 24 May 2007.

### 2. BASIS OF PRESENTATION

#### Accounting basis

These financial statements of the Bank 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 thousands of New Azerbaijan Manats (“AZN”), unless otherwise indicated. These financial statements have been prepared on accrual basis and under the historical cost conversion, except for the measurement at fair value of certain financial instruments and revaluation of certain properties according to International Accounting Standard (“IAS”) No. 16 “Property, Plant and Equipment”.

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

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

---

### Key assumptions

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 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 impairment losses and the fair value of financial instruments.

Key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial period include:

	31 December 2006	31 December 2005
Loans to customers	24,128	13,875
Securities available-for-sale	646	-

Loans to customers and securities available-for-sale are measured at amortized cost/cost less allowance for impairment losses. The estimation of allowance for impairment losses involves an exercise of judgment. It is impracticable to assess the extent of the possible effects of key assumptions or other sources of uncertainty on these balances at the balance sheet date.

### Functional currency

The functional currency of these financial statements is the New Azerbaijan Manat (“AZN”).

## 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 the trade date and the 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 MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

---

### **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 Co-operation and Development ("OECD"), except for margin deposits for operations with plastic cards, which may be converted to cash within a short period of time. For 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 12).

### **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 with a fixed maturity term are subsequently measured at amortized cost using the effective interest method. Those that do not have fixed maturities are accounted for under the effective interest method based on expected maturity. 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 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 these losses. Subsequently, loans are carried at amortized cost using the effective interest method. Loans to customers are carried net of any allowance for impairment losses.

Loans to customers originated by the Bank in AZN are linked to the foreign currency with one-way currency clause. Due to this clause, the Bank has an option to revalue the asset at foreign exchange rate favourable for the Bank, comparing to the foreign exchange rate valid as of the balance sheet date. Embedded financial instruments are initially recorded and subsequently measured at fair value which approximates the fair value of the consideration given, with their subsequent re-measurement to fair value. Due to the special circumstances of the market in Azerbaijan, the fair value of this option can not be calculated since the forward rates for AZN are not available. Result of translation of these loans at the favourable rate are reported in assets (aggregate of positive market values). Positive valuation results are recognized in the profit and loss for the year in which they arise under net gain on foreign exchange operations.

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

Loans and advances are written off against the allowance for impairment losses in the case of the uncollectibility of loans and advances, including the repossession of collateral. Loans and advances are written off after management has exercised all possibilities available to collect the amounts due to the Bank and after the Bank has sold all available collateral. In accordance with the statutory legislation, loans may only be written off with the approval of the Supervisory Board and, in certain cases, with the respective decision of the Court.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) *(in New Azerbaijan Manats and in thousands)*

---

### **Allowance for impairment losses**

The Bank establishes an allowance for impairment losses of financial assets when there is objective evidence that a financial asset or group of financial assets is impaired. The allowance for impairment losses is measured as the difference between the carrying amount 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, for financial assets which are carried at amortized cost. 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, the previously recognized impairment loss is reversed by adjusting an allowance account. For financial assets carried at cost the allowance for impairment losses is 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.

The determination of the allowance for impairment losses is based on an analysis of the risk assets and reflects the amount which, in the judgment of management, is adequate to provide for losses incurred. Allowances are made as a result of an individual appraisal of risk assets for financial assets that are individually significant, and an individual or collective assessment for financial assets that are not individually significant.

The change in the allowance for impairment losses is charged to the income statement and the total of the allowance for impairment losses is deducted in arriving at assets as shown in the balance sheet. Factors that the Bank considers in determining whether it has objective evidence that an impairment loss has been incurred include information about the debtors' or issuers' liquidity, solvency and business and financial risk exposures, levels of and trends in delinquencies for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees. These and other factors may, either individually or taken together, provide sufficient objective evidence that an impairment loss has been incurred in a financial asset or group of financial assets.

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

### **Investments available-for-sale**

Investments available-for-sale represent debt investments that are intended to be held for an indefinite period of time. Such securities are initially recorded at fair value. Subsequently the securities are measured at fair value, with such re-measurement recognized directly in equity until sold when gain/loss previously recorded in equity recycles through the income statement, except for impairment losses, foreign exchange gains or losses and interest income accrued using the effective interest method, which are recognized directly in the income statement.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

---

The Bank uses quoted market prices to determine the fair value for the Bank's investments available-for-sale. If such quotes do not exist, management use appropriate valuation techniques. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the Bank uses that technique. Dividends received are included in dividend income in the income statement.

Non-marketable debt securities are stated at amortized cost and cost, respectively, less impairment losses, if any, unless fair value can be reliably measured.

When there is objective evidence that such securities have been impaired, the cumulative loss previously recognized in equity is removed from equity and recognized in the income statement for the period. Reversals of such impairment losses on debt instruments, which are objectively related to events occurring after the impairment, are recognized in the income statement for the period. Reversals of such impairment losses on equity instruments are not recognized in the income statement.

### **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 on assets under construction and those not placed in service commences from the date the assets are ready for their intended use.

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

	<b>31 December 2006</b>
Buildings	5%
Furniture and fixtures	20%
Computer equipment	25%
Vehicles	20%
Other fixed assets	20%
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.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) *(in New Azerbaijan Manats and in thousands)*

---

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 the estimated recoverable amounts, the assets are written down to their recoverable amounts. 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.

Buildings held by the Bank are stated in the balance sheet at their revalued amounts, being the fair value at the date of revaluation, determined from market-based evidence by appraisal undertaken by professional valuers, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Any revaluation increase arising on the revaluation of buildings is credited to the fixed assets revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense, in which case the increase is credited to the profit and loss account to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of buildings is charged as an expense to the extent that it exceeds the balance, if any, held in the properties revaluation reserve relating to a previous revaluation of that asset.

Depreciation on revalued buildings is charged to income statement. On the subsequent sale or retirement of a revalued property, the attributable revaluation surplus remaining in the properties revaluation reserve is transferred directly to retained earnings.

### **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 by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally 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 the initial recognition of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the 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.

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.



# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

---

### **Deposits from banks and customers**

Deposits from banks and customers 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 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 are credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because 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 and (b) the amount initially recognized less, where appropriate, cumulative amortization of initial premium revenue received over the financial guarantee contracts or letter of credit issued.

### **Share capital**

Share capital is recognized at cost. External costs directly attributable to the issue of new shares, other than on a business combination, are deducted from equity net of any related income taxes.

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 Azerbaijan legislation, the Bank withholds amounts of pension contributions from employee salaries and pays them to the state pension fund. In addition such pension system provides for the calculation of current payments by the employer as a percentage of current total disbursements to staff. Such expense is charged in the period 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 employer 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.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

---

### Recognition of 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 income earned on investments in securities. Other income is credited to the income statement when the related transactions are completed.

Loan origination fees are deferred, together with the related direct 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. Loan syndication fees are recognized in the income statement when the syndication has been completed. All other commissions are recognized when services are provided.

### Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into New 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 operations.

### Rates of exchange

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

	31 December 2006	31 December 2005
AZN/1 US Dollar	0.8714	0.9186
AZN/1 Euro	1.1471	1.0918
AZN/1 GBP	1.7113	1.5858
AZN/1 RUR	0.0331	0.0319

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

---

### **Implementation of New Azerbaijan Manat**

The Azerbaijan Manat was denominated on 1 January 2006 and, starting from that date, AZN 5 thousand is equal to 1 New Azerbaijan Manat (“AZN”). The corresponding figures for the year ended 31 December 2005 were appropriately restated.

### **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.

### **Adoption of new 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 beginning on 1 January 2006. The adoption of these new and revised Standards and Interpretations has not resulted in changes to the Bank’s accounting policies that have affected the amounts reported for the current or prior years. The following standards were adopted in 2006:

The IASB’s amendment to IAS 39, ‘Cash Flow Hedge Accounting of Forecast Intragroup Transactions’, published in April 2005, amended IAS 39 to permit the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in consolidated financial statements. The amendment, effective for annual periods beginning on or after 1 January 2006, had no material effect on the financial statements of the Bank.

The IASB’s amendment to IAS 39, ‘Financial Guarantee Contracts’, published in August 2005, amended IAS 39 and IFRS 4. The amendment defines a financial guarantee contract and requires such contracts to be recorded initially at fair value and subsequently at higher of the provision determined in accordance with IAS 37 ‘Provisions, Contingent Liabilities and Contingent Assets’ and the amount initially recognised less amortisation. The amendment, effective for annual periods beginning on or after 1 January 2006, had no material effect on the Bank.

At the date of authorization of these consolidated financial statements, the following Standards and Interpretations applicable to the Bank were issued but not yet effective:

The IASB issued IFRS 7 ‘Financial Instruments: Disclosures’ in August 2005. The standard replaces IAS 30 ‘Disclosures in the Financial Statements of Banks and Similar Financial Institutions’ and the disclosure provisions in IAS 32. IFRS 7 requires disclosure of the significance of financial instruments for an entity’s financial position and performance and of qualitative and quantitative information about exposure to risks arising from financial instruments. The standard is effective for annual periods beginning on or after 1 January 2007.

In August 2005, the IASB issued an amendment, ‘Capital Disclosures’, to IAS 1 ‘Presentation of Financial Statements’. It requires disclosures about an entity’s capital and the way it is managed. This amendment is also effective for annual periods beginning on or after 1 January 2007.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

---

The IFRIC issued interpretation IFRIC 9 'Reassessment of Embedded Derivatives' in March 2006. Entities are required to assess financial instruments for the existence of embedded derivatives; this interpretation prohibits subsequent reassessment unless there is a change of terms that significantly changes the terms of the financial instrument. The interpretation is effective for accounting periods starting on or after 1 June 2006.

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 entities to report segment information as reported to management and reconcile it to the financial statements.

Management of the Bank is currently assessing the impact of the adoption of these new and revised Standards and Interpretations in future periods.

### 4. NET INTEREST INCOME

	Year ended 31 December 2006	Year ended 31 December 2005
<b>Interest income</b>		
Interest on loans to customers	3,280	1,836
Interest on due from banks	138	17
Interest on debt securities	129	19
Interest on guarantees	75	54
Interest on REPO transactions	-	9
	<hr/>	<hr/>
Total interest income	<b>3,622</b>	<b>1,935</b>
	<hr/> <hr/>	<hr/> <hr/>
<b>Interest expense</b>		
Interest on customer accounts	1,184	368
Interest on due to banks and other institutions	337	248
	<hr/>	<hr/>
Total interest expense	<b>1,521</b>	<b>616</b>
	<hr/> <hr/>	<hr/> <hr/>
Net interest income before provision for impairment losses on interest bearing assets	<b>2,101</b>	<b>1,319</b>
	<hr/> <hr/>	<hr/> <hr/>

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

### 5. ALLOWANCE FOR IMPAIRMENT LOSSES

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

	Loans to customers	Due from banks	Total
<b>31 December 2004</b>	601	52	653
Provision/(recovery)	379	(52)	327
Write-off of assets	(579)	-	(579)
<b>31 December 2005</b>	<b>401</b>	<b>-</b>	<b>401</b>
Provision	620	-	620
Write-off of assets	(465)	-	(465)
<b>31 December 2006</b>	<b>556</b>	<b>-</b>	<b>556</b>

Allowances for impairment losses on securities available-for-sale were as follows:

	Securities available- for-sale
<b>31 December 2004</b>	7
Recovery	(6)
Write-offs of assets	(1)
<b>31 December 2005</b>	<b>-</b>
Provision/(recovery)	-
Write-offs of assets	-
<b>31 December 2006</b>	<b>-</b>

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

	Guarantees and other commitments
<b>31 December 2004</b>	60
Recovery	(53)
<b>31 December 2005</b>	<b>7</b>
Provision	2
<b>31 December 2006</b>	<b>9</b>

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

### 6. NET LOSS ON FOREIGN EXCHANGE OPERATIONS

	Year ended 31 December 2006	Year ended 31 December 2005
Dealing, net	21	120
Translation differences, net	<u>(79)</u>	<u>(317)</u>
Total net loss on foreign exchange operations	<u><b>(58)</b></u>	<u><b>(197)</b></u>

### 7. FEE AND COMMISSION INCOME AND EXPENSE

	Year ended 31 December 2006	Year ended 31 December 2005
<b>Fee and commission income:</b>		
Cash operations	638	379
Settlements	520	246
Foreign exchange and securities operations	154	164
Documentary operations	40	6
Plastic cards operations	29	9
Other operations	<u>127</u>	<u>97</u>
Total fee and commission income	<u><b>1,508</b></u>	<u><b>901</b></u>
<b>Fee and commission expense:</b>		
Plastic cards operations	62	27
Correspondent bank services	44	28
Cash operations	23	37
Foreign exchange and securities operations	9	3
Documentary operations	3	6
Other operations	<u>3</u>	<u>-</u>
Total fee and commission expense	<u><b>144</b></u>	<u><b>101</b></u>

### 8. LIQUIDATION FEE

For the year ended 31 December 2006 liquidation fee represents proceeds amounting to AZN 60 thousand received from the former associate of the Bank liquidated in 2006.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

---

### 9. OPERATING EXPENSES

	Year ended 31 December 2006	Year ended 31 December 2005
Staff costs	853	351
Depreciation and amortization	236	163
Advertising costs	148	71
Communications	104	86
Rent	87	60
Professional services	86	80
Security	66	42
Stationery	47	37
Taxes, other than income tax	39	31
Fixed assets maintenance	31	8
Occupancy costs	17	12
Business trip expenses	12	6
Insurance	8	24
Membership fee	3	2
Other	29	47
	<hr/>	<hr/>
Total operating expenses	<b>1,766</b>	<b>1,020</b>

### 10. INCOME TAXES

The Bank provides for taxes based on the statutory tax accounts maintained and prepared in accordance with the Azerbaijan statutory tax regulations that differ from International Financial Reporting Standards. The Bank is subject to certain permanent tax differences due to non-tax deductibility of certain expenses.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at 31 December 2006 and 2005 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

Temporary differences as at 31 December 2006 and 2005 comprise:

	<b>31 December 2006</b>	<b>31 December 2005</b>
<b>Deferred assets:</b>		
Other assets	5	33
Other liabilities	32	-
	<u>37</u>	<u>33</u>
Total deferred assets	<u><b>37</b></u>	<u><b>33</b></u>
<b>Deferred liabilities:</b>		
Due from banks	-	(39)
Embedded derivatives	(54)	(16)
Allowance for off-balance sheet items	(103)	(39)
Fixed assets	(1,088)	(90)
	<u>(1,245)</u>	<u>(184)</u>
Total deferred liabilities	<u><b>(1,245)</b></u>	<u><b>(184)</b></u>
Net deferred liabilities	<u><b>(1,208)</b></u>	<u><b>(151)</b></u>
Deferred income tax liability at statutory rate 22%	<u><b>(266)</b></u>	<u><b>(33)</b></u>

Relationships between tax expenses and accounting profit for the year ended 31 December 2006 and 2005 are explained as follows:

	<b>Year ended 31 December 2006</b>	<b>Year ended 31 December 2005</b>
Profit before income tax	<u><b>1,077</b></u>	<u><b>636</b></u>
Statutory tax rate	22%	24%
Theoretical tax at the statutory tax rate	237	153
Tax effect of permanent differences	11	9
Effect of changes in income tax rate	-	(4)
Income tax expense	<u><b>248</b></u>	<u><b>158</b></u>
Current income tax expense	214	129
Deferred income tax expense	34	29
Income tax expense	<u><b>248</b></u>	<u><b>158</b></u>
	<b>31 December 2006</b>	<b>31 December 2005</b>
<b>Deferred income tax liabilities</b>		
At beginning of the period	33	4
Increase in the deferred income tax recognized in income statement	34	29
Increase in the deferred income tax recognized in equity	199	-
At end of the period	<u><b>266</b></u>	<u><b>33</b></u>



# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

Income tax liabilities consist of the following:

	31 December 2006	31 December 2005
Current income tax liability	97	65
Deferred income tax liability	266	33
	<u>363</u>	<u>98</u>
Income tax liabilities	<u><u>363</u></u>	<u><u>98</u></u>

### 11. EARNINGS PER SHARE

	Year ended 31 December 2006	Year ended 31 December 2005
<b>Profit:</b>		
Net profit for the year	829	478
	<u>829</u>	<u>478</u>
<b>Weighted average number of ordinary shares</b> for basic earnings per share	31,685	27,000
	<u>31,685</u>	<u>27,000</u>
<b>Earnings per share – basic AZN</b>	<u><u>26.164</u></u>	<u><u>17.704</u></u>

### 12. CASH AND BALANCES WITH THE NATIONAL BANK OF AZERBAIJAN

	31 December 2006	31 December 2005
Cash on hand	1,039	751
Balances with the National Bank of Azerbaijan	3,500	803
	<u>4,539</u>	<u>1,554</u>
Total cash and balances with the National Bank of Azerbaijan	<u><u>4,539</u></u>	<u><u>1,554</u></u>

The balances with the NBA as at 31 December 2006 and 2005 include AZN 1,217 and AZN 266 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:

	31 December 2006	31 December 2005
Cash and balances with the National Bank of Azerbaijan	4,539	1,554
Loans and advances to banks in OECD countries	553	2,205
	<u>5,092</u>	<u>3,759</u>
Less minimum reserve deposit with the National Bank of Azerbaijan	(1,217)	(266)
	<u>(1,217)</u>	<u>(266)</u>
Total cash and cash equivalents	<u><u>3,875</u></u>	<u><u>3,493</u></u>

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

---

### 13. DUE FROM BANKS

	31 December 2006	31 December 2005
Correspondent accounts with other banks	5,334	4,149
Loans to banks	<u>3</u>	<u>3</u>
Total loans and advances to banks, net	<u><u>5,337</u></u>	<u><u>4,152</u></u>

Movements in allowances for impairment losses on balances due from banks for the years ended 31 December 2006 and 2005 are disclosed in Note 5.

As at 31 December 2006 and 2005 the Bank had advances to 2 banks totaling AZN 3,929 and AZN 3,445 thousand, respectively, which individually exceeded 10% of the Bank's equity which represents significant concentration of 74% and 83%, respectively.

As at 31 December 2006 and 2005 maximum credit risk exposure of due from banks amounted to AZN 5,337 and AZN 4,152 thousand, respectively.

### 14. LOANS TO CUSTOMERS

	31 December 2006	31 December 2005
Originated loans	24,684	14,276
Less allowance for impairment losses	<u>(556)</u>	<u>(401)</u>
Total loans to customers, net	<u><u>24,128</u></u>	<u><u>13,875</u></u>

As at 31 December 2006 and 2005 accrued interest income included in loans to customers amounted to AZN 696 and AZN 275 thousand, respectively.

Movements in allowances for impairment losses for the years ended 31 December 2006 and 2005 are disclosed in Note 5.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

	31 December 2006	31 December 2005
Loans collateralized by real estate	15,086	9,057
Loans collateralized by vehicles	5,079	2,027
Loans collateralized by deposits	1,203	492
Loans collateralized by guarantees	1,045	930
Loans collateralized by inventories	722	427
Loans collateralized by securities	417	312
Loans collateralized by others	86	31
Unsecured loans	490	599
	<u>24,128</u>	<u>13,875</u>
Total loans to customers, net	<u>24,128</u>	<u>13,875</u>

	31 December 2006	31 December 2005
<b>Analysis by industry</b>		
Individuals	9,448	7,615
Trading	6,816	3,772
Construction	2,945	378
Manufacturing	2,526	934
Agriculture	2,053	1,127
Other	340	49
	<u>24,128</u>	<u>13,875</u>
Total loans to customers, net	<u>24,128</u>	<u>13,875</u>

As at 31 December 2006 and 2005 the Bank had loans to 2 and 1 customers totaling AZN 3,466 and AZN 1,315 thousand, respectively, which individually exceeded 10% of the Bank's equity.

As at 31 December 2006 and 2005 maximum credit risk exposure of loans to customers amounted to AZN 24,684 and AZN 14,276 thousand, respectively.

### 15. SECURITIES AVAILABLE-FOR-SALE

	Interest to nominal %	31 December 2006	Interest to nominal %	31 December 2005
<b>Debt securities</b>				
<i>National Bank of the Republic of Azerbaijan</i>	12.99%	<u>646</u>	-	<u>-</u>
Total debt securities available-for-sale		<u>646</u>		<u>-</u>

As at 31 December 2006 accrued interest income included in debt securities amounted to AZN 1 thousand.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

### 16. PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS

	Buildings	Furniture and fixtures	Computer equipment	Vehicles	Other fixed assets	Intangible assets	Construc- tion in progress	Total
<b>At cost</b>								
31 December 2005	1,608	257	120	11	7	100	-	2,103
Additions	2,030	227	70	266	8	11	15	2,627
Revaluation	<u>671</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>671</u>
31 December 2006	<u>4,309</u>	<u>484</u>	<u>190</u>	<u>277</u>	<u>15</u>	<u>111</u>	<u>15</u>	<u>5,401</u>
<b>Accumulated depreciation</b>								
31 December 2005	151	72	46	11	1	12	-	293
Charge for the year	87	72	36	28	2	11	-	236
Eliminated on revaluation	<u>(230)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(230)</u>
31 December 2006	<u>8</u>	<u>144</u>	<u>82</u>	<u>39</u>	<u>3</u>	<u>23</u>	<u>-</u>	<u>299</u>
<b>Net book value</b>								
31 December 2006	<u><u>4,301</u></u>	<u><u>340</u></u>	<u><u>108</u></u>	<u><u>238</u></u>	<u><u>12</u></u>	<u><u>88</u></u>	<u><u>15</u></u>	<u><u>5,102</u></u>
<b>Net book value</b>								
31 December 2005	<u><u>1,457</u></u>	<u><u>185</u></u>	<u><u>74</u></u>	<u><u>-</u></u>	<u><u>6</u></u>	<u><u>88</u></u>	<u><u>-</u></u>	<u><u>1,810</u></u>

The Bank's head quarter premises and branches were revalued based on the independent appraisal of "DTZ Debenham Tie Leung" dated 20 December 2006. The revaluation was performed using the comparative sales method. Had the buildings been carried under the cost method the net book value of property, equipment and intangible assets as at 31 December 2006 would be AZN 4,201 thousand.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

### 17. OTHER ASSETS

	31 December 2006	31 December 2005
Prepayments	29	8
Plastic cards settlements	21	-
Receivables from Western Union	88	22
Receivables from Migom	80	5
Receivables from Lider Money	27	-
	<u>245</u>	<u>35</u>
Total other assets	<u>245</u>	<u>35</u>

### 18. DUE TO BANKS AND OTHER INSTITUTIONS

	31 December 2006	31 December 2005
Amount due to the National Fund for Support of Entrepreneurs	7,987	2,192
Demand deposits	1,776	1,850
Time deposits and loans	2,933	1,000
	<u>12,696</u>	<u>5,042</u>
Total due to banks and other institutions	<u>12,696</u>	<u>5,042</u>

As at 31 December 2006 accrued interest expenses included in due to banks amounted to AZN 2 thousand (as at 31 December 2005 – nil).

The Bank receives loans from the National Fund for Support of Entrepreneurs (“NFSE”) as a means of support of small and medium-sized entrepreneurs in Azerbaijan. Under the agreement with the Fund as at 31 December 2006 and 2005 the Bank obtained loans for AZN 7,987 and AZN 2,192 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%.

Beside loans from NFSE mentioned above, as at 31 December 2006 and 2005 the Bank had loans and advances from 2 banks of AZN 3,943 and AZN 2,848 thousand in total, each of which individually exceeded 10% of the Bank’s equity.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

---

### 19. CUSTOMER ACCOUNTS

	<b>31 December 2006</b>	<b>31 December 2005</b>
Time deposits	10,844	8,660
Repayable on demand	<u>5,732</u>	<u>1,337</u>
Total customer accounts	<u><b>16,576</b></u>	<u><b>9,997</b></u>

As at 31 December 2006 and 2005 accrued interest expenses included in customers accounts amounted to AZN 261 and AZN 159 thousand, respectively.

As at 31 December 2005 the Bank had deposit from the shareholder Mehdiyev Elmir of AZN 1,577 thousand in total, which individually exceeded 10% of the Bank's equity.

Analysis of customer accounts by industry:

	<b>31 December 2006</b>	<b>31 December 2005</b>
Individuals	12,033	8,575
Trade	2,171	794
Insurance	1,438	253
Construction	586	22
Manufacturing	192	116
Transport and communications	94	14
Agriculture	37	184
Other	<u>25</u>	<u>39</u>
Total customer accounts	<u><b>16,576</b></u>	<u><b>9,997</b></u>

### 20. OTHER LIABILITIES

	<b>31 December 2006</b>	<b>31 December 2005</b>
Payables under finance lease	158	-
Accrued expenses	35	37
Taxes other than income tax payable	14	8
Settlements payable	9	29
Other creditors	<u>41</u>	<u>13</u>
Total other liabilities	<u><b>257</b></u>	<u><b>87</b></u>

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

The future minimum lease payments under finance leases of fixed assets are as follows:

	Minimum lease payments		Present value of minimum lease payments	
	31 December 2006	31 December 2005	31 December 2006	31 December 2005
Not later than 1 year	87	-	64	-
Later than 1 year and not later than 5 years	106	-	94	-
Less: future finance charges	<u>(35)</u>	<u>-</u>	<u>N/A</u>	<u>N/A</u>
Present value of lease obligations	<u><b>158</b></u>	<u><b>-</b></u>	<u><b>158</b></u>	<u><b>-</b></u>
Less: Amount due for settlement within 1 year			<u>(64)</u>	<u>-</u>
Amount due for settlement after 1 year not later than 5 years			<u><b>94</b></u>	<u><b>-</b></u>

## 21. SHARE CAPITAL

As at 31 December 2006 and 2005 the Bank's authorized and paid share capital comprised of ordinary shares amounting to AZN 7,800 and AZN 5,400 thousand.

On 24 May 2005 the Bank's shares were listed on the Baku Stock Exchange and the Bank became an open joint stock company. As at 31 December 2006 and 2005 the authorized, registered and paid up share capital consisted of 39,000 and 27,000 ordinary shares, respectively, with par value of AZN 200 each. All shares are ranked equally and carry one vote.

In 2006 and 2005 the shareholders of the Bank increased its share capital by AZN 2,400 and AZN 1,012 thousand, respectively.

In 2006 the Bank declared dividends of AZN 30 thousand for 2005 financial year on ordinary shares.

## 22. 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's 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 MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

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 at 31 December 2006 and 2005, the nominal or contract amounts and risk-weighted amounts were:

	31 December 2006		31 December 2005	
	Nominal Amount	Risk Weighted Amount	Nominal Amount	Risk Weighted Amount
<b>Contingent liabilities and credit commitments</b>				
Guarantees issued and similar commitments	5,150	5,150	1,970	1,970
Commitments on credits and unused credit lines	469	-	568	-
Total contingent liabilities and credit commitments	<u>5,619</u>	<u>5,150</u>	<u>2,538</u>	<u>1,970</u>

**Capital commitments** - The Bank had no material commitments for capital expenditures outstanding as at 31 December 2006.

**Operating leases** - The Bank has no rental commitments under non-cancelable operating lease agreements as at 31 December 2006 and 2005.

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

**Pensions and retirement plans** - Employees receive pension benefits in accordance with the laws and regulations of the Republic of Azerbaijan. As at 31 December 2006 and 2005, the Bank was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

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



# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) *(in New Azerbaijan Manats and in thousands)*

---

### 23. SUBSEQUENT EVENTS

In January 2007 the Bank concluded a brokerage contract with Parex Bank for issuing bonds of the Bank totaling USD 5 million. The bonds will be floated in Latvia in 2007 with fixed interest payable every six months over 3 years.

### 24. TRANSACTIONS WITH RELATED PARTIES

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

- (a) Enterprises that 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 (also non-executive directors and close members of the families of such individuals);
- (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.

## OPEN JOINT STOCK COMPANY MUGANBANK

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

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:

	31 December 2006		31 December 2005	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Loans to customers, gross	154	24,684	51	14,276
- <i>shareholders and entities in which a substantial interest is owned by the shareholders of the Bank</i>	71		32	
- <i>key management personnel</i>	83		19	
Allowance for loans to	3	556	1	401
- <i>shareholders and entities in which a substantial interest is owned by the shareholders of the Bank</i>	1		1	
- <i>key management personnel</i>	2		-	
Customer accounts	241	16,576	1,706	9,997
- <i>shareholders and entities in which a substantial interest is owned by the shareholders of the Bank</i>	55		1,598	
- <i>key management personnel</i>	186		108	
Other liabilities	17	257	-	87
- <i>shareholders and entities in which a substantial interest is owned by the shareholders of the Bank</i>	-		-	
- <i>key management personnel</i>	17		-	



# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

### 25. 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 forced or liquidation sale. As no readily available published price quotations in an active market exists for a large part of the Bank's financial instruments, judgment is necessary in arriving at fair value using a valuation technique, based on current economic conditions and specific risks attributable to the 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 2006		31 December 2005	
	Carrying value	Fair value	Carrying value	Fair value
Cash and balances with the National Bank of the Republic of Azerbaijan	4,539	4,539	1,554	1,554
Due from banks	5,337	5,337	4,152	4,152
Due to banks	12,696	12,696	5,042	5,042
Customer accounts	16,576	16,576	9,997	9,997

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

The fair value of available-for-sale securities can not be measured reliably since these securities are not publicly traded and the range of reasonable fair value estimates is significant.

### 26. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (as set forth in the table below) of total (8%) and tier 1 capital (4%) to risk weighted assets.

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

Estimate	Description of position
0%	Cash and balances with the National Bank of Azerbaijan
0%	State debt securities in Azerbaijani Manats
20%	Loans and advances to banks for up to 1 year
100%	Loans and advances to customers
100%	Other assets
50%	Obligations and commitments on unused loans with the initial maturity of over 1 year
100%	Guarantees

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

---

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

Capital amounts and ratios	Actual Amount	For Capital Adequacy purposes Amount	Ratio For Capital Adequacy purposes	Minimum Required Ratio
<b>As at 31 December 2006</b>				
Total capital	10,096	10,096	29%	8%
Tier 1 capital	9,394	9,394	27%	4%
<b>As at 31 December 2005</b>				
Total capital	6,195	6,195	34%	8%
Tier 1 capital	6,195	6,195	34%	4%

### 27. RISK MANAGEMENT POLICIES

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

The Bank manages the following risks:

#### **Liquidity risk**

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

In order to manage liquidity risk, the Bank performs daily monitoring of expected future cash flows on clients' and banking operations, which is a part of the assets/liabilities management process. The Assets and Liabilities Management Committee (the "ALMC") 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.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

---

### Cash flow interest rate risk

Cash flow interest rate risk is the risk that the future cash flow of a financial instrument will fluctuate because of changes in market interest rates.

The ALMC 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.

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.

	2006			2005		
	AZN	USD	Other currencies	AZN	USD	Other currencies
<b>ASSETS</b>						
Due from banks	-	8%	2%	-	5.00%	-
Loans to customers	15.66%	24.35%	22.42%	9.04%	19.81%	25.41%
Securities available-for-sale	12.99%	-	-	-	-	-
<b>LIABILITIES</b>						
Due to banks and other institutions	1.27%	9.12%	-	3.18%	5.00%	-
Customer accounts	13.44%	15.55%	12.93%	3.32%	11.23%	9.16%

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

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

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Overdue	Maturity undefined	31 December 2006 Total
<b>ASSETS</b>								
Due from banks	2,815	-	-	-	-	-	-	2,815
Loans to customers	1,724	1,333	5,909	15,063	-	99	-	24,128
Securities available for sale	646	-	-	-	-	-	-	646
Total interest bearing assets	5,185	1,333	5,909	15,063	-	99	-	27,589
Cash and balances with the National Bank of Azerbaijan	3,322	-	-	-	-	-	1,217	4,539
Due from banks	2,519	-	-	-	-	-	3	2,522
Property, equipment and intangible assets	-	-	-	-	-	-	5,102	5,102
Other assets	245	-	-	-	-	-	-	245
<b>TOTAL ASSETS</b>	<b>11,271</b>	<b>1,333</b>	<b>5,909</b>	<b>15,063</b>	<b>-</b>	<b>99</b>	<b>6,322</b>	<b>39,997</b>
<b>LIABILITIES</b>								
Due to banks and other institutions	2,442	100	480	7,462	436	-	-	10,920
Customer accounts	2,732	920	5,892	3,642	-	-	-	13,186
Total interest bearing liabilities	5,174	1,020	6,372	11,104	436	-	-	24,106
Due to banks and other institutions	1,776	-	-	-	-	-	-	1,776
Customer accounts	3,390	-	-	-	-	-	-	3,390
Current income tax liabilities	97	-	-	-	-	-	-	97
Deferred income tax liabilities	-	-	-	266	-	-	-	266
Provisions	-	-	-	-	-	-	9	9
Other liabilities	106	10	47	94	-	-	-	257
<b>TOTAL LIABILITIES</b>	<b>10,543</b>	<b>1,030</b>	<b>6,419</b>	<b>11,464</b>	<b>436</b>	<b>-</b>	<b>9</b>	<b>29,901</b>
Liquidity gap	728	303	(510)	3,599	(436)			
Interest sensitivity gap	11	313	(463)	3,959	(436)			
Cumulative interest sensitivity gap	<b>11</b>	<b>324</b>	<b>(139)</b>	<b>3,820</b>	<b>3,384</b>			
Cumulative interest sensitivity gap as a percentage of total assets	<b>0%</b>	<b>1%</b>	<b>0%</b>	<b>10%</b>	<b>8%</b>			

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

	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	31 December 2005 Total
<b>ASSETS</b>								
Due from banks	1,841	-	-	-	-	-	-	1,841
Loans to customers	943	974	6,157	5,563	-	238	-	13,875
Total interest bearing assets	2,784	974	6,157	5,563	-	238	-	15,716
Cash and balances with the National Bank of Azerbaijan	1,288	-	-	-	-	-	266	1,554
Due from banks	2,308	-	-	-	-	-	3	2,311
Property, equipment and intangible assets	-	-	-	-	-	-	1,810	1,810
Other assets	35	-	-	-	-	-	-	35
<b>TOTAL ASSETS</b>	<b>6,415</b>	<b>974</b>	<b>6,157</b>	<b>5,563</b>	<b>-</b>	<b>238</b>	<b>2,079</b>	<b>21,426</b>
<b>LIABILITIES</b>								
Due to banks and other institutions	4	1,007	90	2,091	-	-	-	3,192
Customer accounts	1,351	155	1,836	5,318	-	-	-	8,660
Total interest bearing liabilities	1,355	1,162	1,926	7,409	-	-	-	11,852
Due to banks and other Customer accounts	1,850	-	-	-	-	-	-	1,850
Current income tax liabilities	1,337	-	-	-	-	-	-	1,337
Deferred income tax liabilities	65	-	-	-	-	-	-	65
Provisions	-	-	-	33	-	-	-	33
Other liabilities	-	-	-	-	-	-	7	7
Other liabilities	87	-	-	-	-	-	-	87
<b>TOTAL LIABILITIES</b>	<b>4,694</b>	<b>1,162</b>	<b>1,926</b>	<b>7,442</b>	<b>-</b>	<b>-</b>	<b>7</b>	<b>15,231</b>
Liquidity gap	1,721	(188)	4,231	(1,879)	-	-	-	-
Interest sensitivity gap	1,429	(188)	4,231	(1,846)	-	-	-	-
Cumulative interest sensitivity gap	<b>1,429</b>	<b>1,241</b>	<b>5,472</b>	<b>3,626</b>	<b>3,626</b>	-	-	-
Cumulative interest sensitivity gap as a percentage of total assets	<b>7%</b>	<b>6%</b>	<b>26%</b>	<b>17%</b>	<b>17%</b>	-	-	-



# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

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.

### 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:

	AZN	USD 1 USD= AZN 0.8714	EUR 1 EUR= AZN 1.1471	Other currencies	31 December 2006 Total
<b>ASSETS</b>					
Cash and balances with the National Bank of Azerbaijan	3,547	969	9	14	4,539
Due from banks	-	5,309	8	20	5,337
Loans to customers	16,279	7,775	74	-	24,128
Securities available for sale	646	-	-	-	646
Property, equipment and intangible assets	5,102	-	-	-	5,102
Other assets	48	197	-	-	245
<b>TOTAL ASSETS</b>	<b>25,622</b>	<b>14,250</b>	<b>91</b>	<b>34</b>	<b>39,997</b>
<b>LIABILITIES</b>					
Due to banks and other	8,088	4,608	-	-	12,696
Customer accounts	7,187	9,070	299	20	16,576
Current income tax liabilities	97	-	-	-	97
Deferred income tax liabilities	266	-	-	-	266
Provisions	1	8	-	-	9
Other liabilities	100	105	47	5	257
<b>TOTAL LIABILITIES</b>	<b>15,739</b>	<b>13,791</b>	<b>346</b>	<b>25</b>	<b>29,901</b>
<b>OPEN POSITION</b>	<b>9,883</b>	<b>459</b>	<b>(255)</b>	<b>9</b>	

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

	AZN	USD 1 USD= AZN 0.9186	EUR 1 EUR= AZN 1.092	Other currencies	31 December 2005 Total
<b>ASSETS</b>					
Cash and balances with the National Bank of Azerbaijan	852	685	16	1	1,554
Due from banks	-	4,131	2	19	4,152
Loans to customers	5,241	8,543	91	-	13,875
Property, equipment and intangible assets	1,810	-	-	-	1,810
Other assets	8	27	-	-	35
<b>TOTAL ASSETS</b>	<b>7,911</b>	<b>13,386</b>	<b>109</b>	<b>20</b>	<b>21,426</b>
<b>LIABILITIES</b>					
Due to banks and other	3,192	1,850	-	-	5,042
Customer accounts	1,749	7,858	376	14	9,997
Current income tax liabilities	65	-	-	-	65
Deferred income tax liabilities	33	-	-	-	33
Provisions	-	7	-	-	7
Other liabilities	87	-	-	-	87
<b>TOTAL LIABILITIES</b>	<b>5,126</b>	<b>9,715</b>	<b>376</b>	<b>14</b>	<b>15,231</b>
<b>OPEN POSITION</b>	<b>2,785</b>	<b>3,671</b>	<b>(267)</b>	<b>6</b>	

### Price Risk

Price 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 price risks of its products which are subject to general and specific market fluctuations.

The Bank manages price 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.

### Fair value interest rate risk

Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.

The Bank manages fair value interest rate risk through periodic estimation of potential losses that could arise from adverse changes in market conditions. The Management Board of the Bank conducts monitoring of the Bank's current financial performance, estimates the Bank's sensitivity to changes in fair value interest rates and its influence on the Bank's profitability.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) *(in New Azerbaijan Manats and in thousands)*

---

### **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.

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

### Geographical concentration

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

	Azerbaijan	CIS countries	OECD countries	Other non-OECD countries	31 December 2006 Total
<b>ASSETS</b>					
Cash and balances with the National Bank of Azerbaijan	4,539	-	-	-	4,539
Due from banks	4,453	331	553	-	5,337
Loans to customers	24,128	-	-	-	24,128
Securities available for sale	646	-	-	-	646
Property, equipment and intangible assets	5,102	-	-	-	5,102
Other assets	50	195	-	-	245
<b>TOTAL ASSETS</b>	<b>38,918</b>	<b>526</b>	<b>553</b>	<b>-</b>	<b>39,997</b>
<b>LIABILITIES</b>					
Due to banks and other institutions	12,696	-	-	-	12,696
Customer accounts	16,509	57	-	10	16,576
Current income tax liabilities	97	-	-	-	97
Deferred income tax liabilities	266	-	-	-	266
Provisions	9	-	-	-	9
Other liabilities	248	9	-	-	257
<b>TOTAL LIABILITIES</b>	<b>29,825</b>	<b>66</b>	<b>-</b>	<b>10</b>	<b>29,901</b>
<b>NET POSITION</b>	<b>9,093</b>	<b>460</b>	<b>553</b>	<b>(10)</b>	

# OPEN JOINT STOCK COMPANY MUGANBANK

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued) (in New Azerbaijan Manats and in thousands)

	Azerbaijan	CIS countries	OECD countries	Other non-OECD countries	31 December 2005 Total
<b>ASSETS</b>					
Cash and balances with the National Bank of Azerbaijan	1,554	-	-	-	1,554
Due from banks	1,861	34	2,205	52	4,152
Loans to customers	13,875	-	-	-	13,875
Property, equipment and intangible assets	1,810	-	-	-	1,810
Other assets	35	-	-	-	35
<b>TOTAL ASSETS</b>	<b>19,135</b>	<b>34</b>	<b>2,205</b>	<b>52</b>	<b>21,426</b>
<b>LIABILITIES</b>					
Due to banks and other credit institutions	5,042	-	-	-	5,042
Customer accounts	9,927	21	1	48	9,997
Current income tax liabilities	65	-	-	-	65
Deferred income tax liabilities	33	-	-	-	33
Provisions	7	-	-	-	7
Other liabilities	87	-	-	-	87
<b>TOTAL LIABILITIES</b>	<b>15,161</b>	<b>21</b>	<b>1</b>	<b>48</b>	<b>15,231</b>
<b>NET POSITION</b>	<b>3,974</b>	<b>13</b>	<b>2,204</b>	<b>4</b>	