PASHA Bank

Annual report 2010

Contents

ASPIRATIONS ARE
WHAT WE ALWAYS
ENDEAVOR
TOGETHER

Introduction

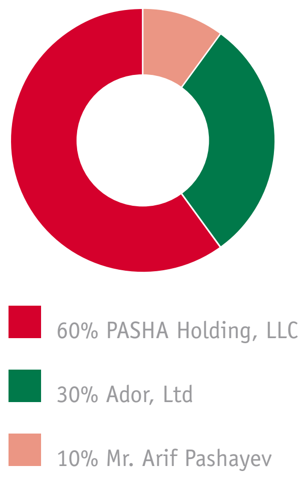
PASHA BANK – A Brief Overview

PASHA Bank registered with the Ministry of Justice of the Republic of Azerbaijan as an open joint stock company on June 18, 2007. The bank began its business operation on November 28, 2008 under a license issued by the Central Bank of Azerbaijan.

	Year end 2008	Year end 2009	6 months ended 30 June2010	Total for the year ended 31 Dec 2010
Total assets	197,637	306,433	340,965	512,304
Loans to customers	44,207	119,520	178,588	187,868
Customers' time deposits	40,020	72,610	71,134	147,080
Customers' current accounts	42,256	93,780	110,264	191,519
Shareholders' equity	110,511	126,570	135,110	136,815
Interest income	18,639	24,384	16,050	33,842
Fee & commission income	1,527	1,445	967	2,065
Net gains on dealings with currency	433	1,781	2,013	3,750
Operating profit	18,209	22,677	15,121	30,343
Net profit	10,765	16,059	8,649	13,871
Income per employee	255	176	220	196
Total operating expenses	2,407	5,731	4,099	4,787
Cost per employee	39	62	82	87
ROA (average for the year)	7.29 %	7.05 %	6.40 %	4.10 %
ROE (average for the year)	12.52 %	16.95 %	18.91 %	18.20 %
Loans to deposits	56.00 %	73.37 %	101.11 %	57.91 %
Cost to income	11.90 %	25.27 %	27.11 %	30.79 %
Non % income total income	9.70 %	14.11 %	18.15 %	17.38 %

"PASHA Bank", OJSC Shareholders

Shareholder	Share in Bank Capital (in AZN)	Percentage
PASHA Holding, LLC	69,240,260	60%
Ador, Ltd	34,622,130	30%
Mr. Arif Pashayev (ultimate beneficial owner)	11,544,710	10%
Total	115,407,100	100%



PASHA Holding, LLC is the controlling shareholder in "PASHA Bank", OJSC (holding 60%).

Ador Ltd. holds a 30% share, with Mr. Arif Pashayev holding 10%.

Mission Statement

Adhering to transparent business practices, "PASHA Bank", OJSC seeks to become a leader in the field of private banking and serving corporate customers. "PASHA Bank", OJSC is committed to increasing transparency within Azerbaijan's banking sector.

Corporate values: Integrity, Quality and Profitability.

Goals

"PASHA Bank" OJSC strives to become a leader in the financial sector.

Strategic Growth Focus:

Corporate and institutional banking, private banking.

PASHA Holding

PASHA Bank
PASHA Insurance
PASHA Travel
PASHA Construction
PASHA Life
KAPİTAL BANK

Message from the Chairman of the Supervisory Board and the Chairman of the Executive Board

Dear shareholders, customers and partners,

Although the positive dynamics in Azerbaijan's banking sector continued in 2010, it was a year when we all felt the global financial crisis especially poignantly. However, the fact that 2010 presented one of the most challenging periods throughout the banking sector did not prevent PASHA Bank from closing that year posting a profit. In 2010, "PASHA Bank" OJSC increased its overall capital to 136,814,979 manats (171,468,829 US dollars) and succeeded in retaining its positioning as Azerbaijan's largest commercial bank in terms of paid-in capital.

In 2010, the bank's profits were 13,870,970 manats (17,384,346 US dollars), representing a 14% drop compared to the 50% increase in the previous year, reflecting the combination of lower interest rates, high deposit levels and lower than expected levels of loan demand. Profitability was also affected by additional provisions and operating expenses.

A strategic decision to diversify the asset portfolio enabled the bank to successfully maintain balance in the services offered to customers. The bank's assets constituted 512,304,248 manats (642,065,732 US dollars), representing a 67% increase over the previous year (306,433,000 manats, i.e. 384,049,380 US dollars). Credits to customers constituted 37%, securities portfolio – 31%; cash and cash equivalents -26% and credits to banks -5% of the assets.

The bank's interest income was 33,841,578 manats (42,413,307 US dollars), while non-interest income has doubled to 5,258,000 manats (6,589,798 US dollars).

PASHA Bank's credit portfolio totaled to 196,081,000 manats (245,746,334 US dollars), representing a 160% increase. A change in the bank's valuation methods resulted in bad debts totaling 0.6% of the overall portfolio by the close of 2010, as opposed to 0.3% at year end in 2009.

Trade finance transactions increased by 130% to 30,330,115 manats (38,012,426 US dollars).

Return on Assets (ROA) of PASHA Bank came to 4.1%, while Return on Equity (ROE) was 18.2 % (as opposed to 5.5% and 16.9% respectively for 2009).

PASHA Bank's statistical indicators enable us to state with all confidence that our institution will remain prepared to provide corporate customers with the fastest, most reliable, and highest quality service in the coming years.

By the close of 2010, the bank's investment portfolio stood at 156 million manats, constituting 31% of its assets. Investments were made in securities, including mortgage securities, national bonds of the Ministry of Finance of Azerbaijan, Central Bank notes, and repo operations. Mortgage loans constitute approximately 35 million manats of the total portfolio. Few corporate bonds are issued in Azerbaijan; hence, this portfolio has rather low profitability. In fact, these securities constitute 9% of the total portfolio, primarily stemming from bonds for leasing, IT and similar companies.

The bank has seen an increase in its corporate loan portfolio. Given that small and medium businesses are becoming increasingly important in the economy, PASHA Bank has expanded its activities in this field. This provided a very early yield - to the extend where loans to large businesses, which had constituted no less than 5% of the bank's overall capital, fell to 159,431,826 manats (a 225,190,578.44 drop in this loan portfolio).

Currently, investments of local currency yield low interest on the securities market and the bank is also looking at foreign markets as an option for liquid funds. At the same time, however, PASHA Bank is also keeping securities portfolios and instruments released by local issuers within its scope of interest and it intends to increase this portfolio. The bank has drawn up a new draft investment policy for this purpose.

Initially we were interested in investing in bonds issued by CIS and Central European companies, as well as state sovereign bonds. Besides expanding its activities on treasury and capital markets, PASHA Bank has also increased the volume of its foreign currency exchange operations several-fold in 2010. During the past year, the bank has gained the status of a market maker in the AZN/USD and AZN/EUR exchange market. PASHA Bank is currently an official dealer for Republic of Azerbaijan State Oil Fund foreign currency exchange operations.

As part of its strategy, PASHA Bank continued to expand and strengthen relationships with foreign partners. During 2010, the bank focused on those countries which its customers want to establish economic ties with, European countries being at the top of the list.

In addition to establishing new relationships with foreign banks, PASHA Bank was also committed to expanding its existing ties. A delegation from the bank have conducted road-shows in Germany and Austria for the first time, holding meetings with leading banks of those countries and providing them with detailed information about the Bank. With PASHA Bank being committed to corporate governance, ethical business practices, and full transparency in its operations, these meetings promoted stronger mutual trust and understanding. We will be continuing such engagements in the coming years.

Increasing lines of credit for trade finance transactions is one of the most important goals the bank is pursuing. Despite the international financial crisis and the situation in international trade, PASHA Bank has continued to strengthen its positions as a strong and reliable partner supporting its customers' international projects. The portfolio realized an overall increase of 32% for trade financing, whereas trade financing loans allocated by leading western banks rose 29%.

Discussions with German counterparts resulted in PASHA Bank's offering its customers loans as part of the project financing process for the first time. Along with traditional instruments, such as guarantees and letters of credit, this financial tool will make it possible to sign more advantageous and effective agreements with PASHA Bank's foreign partners.

One of the most significant events among PASHA Bank's international activities was its participation at the SIBOS exhibition in Amsterdam. We would like to point out that it was the first time that any Azerbaijani bank participated at this important banking event as an exponent.

During the event, bank representatives attended a number of meetings and seminars, and also gave presentations on investment opportunities in Azerbaijan. PASHA Bank's participation attracted media attention, and articles on our institution's activities have been published in the British, German and Swiss press.

One of our strategic goals has been for our bank to be recognized as an innovator in the market. In 2010, we made great strides in this direction. PASHA Bank set up a special department to provide banking services to wealthy customers.

Moreover, the bank has developed a number of unique card services and introduced them to its customers. The creation of these products was the culmination of two years of hard work by our employees, which was aimed at establishing a fully integrated service system.

By the end of 2010, our institution was fully ready to transition to a modern banking system. Of course, we immediately embarked upon a process of continuously expanding its capabilities. Implementing this system enabled us to re-examine and optimize our current business processes. This, in turn, has resulted in our ability to provide our customers with more practical and higher quality services. PASHA Bank has very successfully implemented this system in a record time and in a manner that exceeded all expectations.

In terms of its paid-in capital, PASHA Bank is Azerbaijan's largest commercial banking institution. However, the Bank's greatest assets are his employees. This is why the Bank considers the most important investment to be the one made in its staff members. Employee training and professional development are a major part of PASHA Bank's internal growth strategy. In 2010, for the first time, the bank allotted discounted credit to finance the education of several employees abroad. Bank employees are currently continuing their education at a number of respected universities in the United Kingdom.

Integrity is one of the bank's main values and we strive to instill this value into our employees from day one. Our hiring procedures reflect this even before employees start working for us. All candidates for employment undergo a transparent hiring procedure, with on-line testing as one of its stages. This makes it possible to attract employees who have the required capacity, knowledge and skills to work together , to meet the needs of today and tomorrow, while at the same time ensuring that the hiring process is completely transparent and impartial.

We accomplished a lot during 2010. But the future holds even greater and more purposeful work things for us to achieve. PASHA Bank has the all resources it needs for that, and most of all - a professional team committed to the values of Integrity, Quality and Profitability – a team that works with the faith and strength to accomplish the goals we have set up and make us one of the region's leading banks.

Sincerely,

Mir Jamal Pashaev
Chairman of the Supervisory Board

Farid Akhundov
Chairman of the Executive Board

Macro-economic Indicators

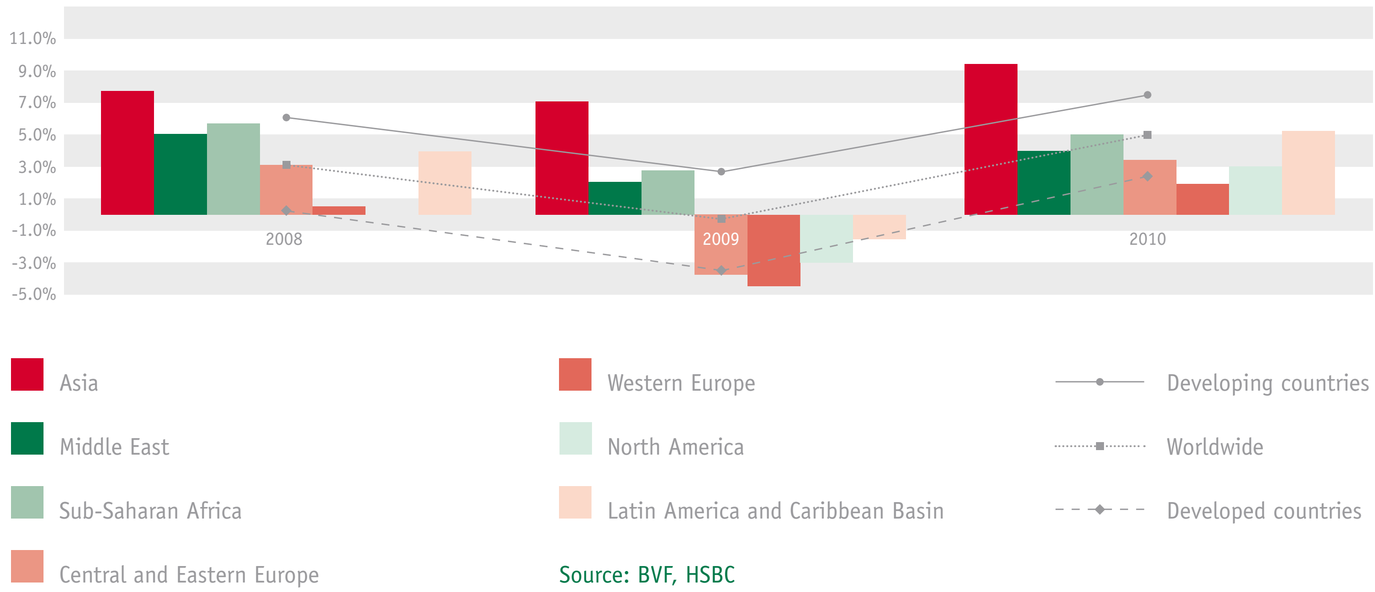
Summary of Macro-Economics

The year 2010 stands out in memory as the time of the much-awaited recovery following the deep two-year-long world economic crisis. The world managed to avoid a number of quite real and disastrous scenarios during the crisis, and there are a number of indicators that it is now returning to its pre-crisis footing.

Preliminary estimates indicate that the global volume of goods showed 3.3% upswing in 2010 as compared with a 2.1% drop in 2009. Developing countries are responsible for the bulk of this increase, showing GDP growth of 6% as opposed to 2% for developed countries. This trend was also evident in pre-crisis statistics and it is projected to continue during the post-crisis years given the great base growth potential of developing economies. Moreover, many developing countries suffered only relatively minor damage from the global depression, meaning they benefit more from revived world trade that is seeing an 11% increase in volume.

Estimating the year's economic results at the regional level, the leaders were: Canada (+3.1%), Argentina (+7.5%), and Brazil (+7.5%) among North-American and Latin-American countries; Germany (+3.3%) and Turkey (+7.8%) for the Euro zone and other European countries; Singapore (+15%) and China (+9.4%) in the Asia-Pacific region; and Qatar (+16%), Lebanon (+8%), and Morocco (+4%) in the Middle East-North Africa (MENA) region. Although the average growth varied significantly among regions, the Asia-Pacific region continued to be the prime mover in global economic development.

Dynamics of Global Economic Development Rate, Real GDP



Source: BVF, HSBC

Thus, in 2010 all regions of the world exhibited economic recovery, although in some (e.g. Europe and North America) it failed to compensate for the losses of previous years. Increased reserves and government spending were the general driving forces that kick-started recovery. Economic activity was mainly tied to government stimulus packages whereas private sector investing activity was not particularly high at the time. This, in turn, hindered recovery in the labor market and the return of consumer demand to previous levels.

High financial risks posed the main threat against the stability of positive economic trends. The rapidly increasing national debts of various EU countries as well as the USA presented a particular danger, which shook investor confidence in treasury bonds until the end of 2010. High unemployment and a weak real estate market were pressing factors for the USA. The role that pressure on the Japanese yen, as well as the Chinese economy's being threatened with high inflation and sudden stagnation, cannot be understated when discussing unstable development factors that appeared in other large economies.

Financial institutions in the EU and US used a tried and true method to resolve problems such as national debt and budget deficits – more specifically, by infusing funds into the market. In particular, the early 2010 creation of the 750 billion Euro European Financial Stability Fund made it possible to resolve the national defaults of Greece and Ireland. In the second half of the year, a new infusion of funds totaling 600 billion dollars was invested under second phase of the US stimulus program. Seventy five billion dollars were spent monthly to purchase long-term government bonds.

Issuance of high volumes of money caused indicators at stock and commodities exchanges to rise, as well as inflation of prices for raw materials and food products. Most of the world's stock exchanges ended the year with a post-crisis high and posted 10-20% growth. Japan's and China's stock exchanges were the exception. The Chinese stock market closed 2010 at a loss due to the country's tightening its monetary policy, while Japan's negative indicators stemmed from the yen becoming stronger. During the year, oil prices rose 19% while the prices of base metals rose between 8 and 35%. The currencies of most commodity-producing nations grew 3-12% stronger against the dollar over the course of the year.

Although the surplus of money accompanied by the rise in commodity prices drastically increased the inflation projections of many investors, the world managed to avoid inflation on a global scale. Surplus production capacity and high unemployment in developed countries provided a buffering effect against these factors. The inflation rate in those countries rose from 0% to 1.25% during 2009. In the USA, inflation dropped to 1.5% as compared with 2.7% in 2009. In Europe, inflation rose by 2.6%, precisely as experts had projected. Inflation in developing countries rose to 6%, as compared with 5.2% the previous year.

Azerbaijan Economy and Banking Sector

Economy

Certain pessimistic forecasts that Azerbaijan would feel the financial crisis later have not proven to be true. The economic results of the past year have solidly demonstrated that Azerbaijan enjoyed a stable macro-economic situation both during and after the crisis. That stability was clearly due to high energy resource prices.

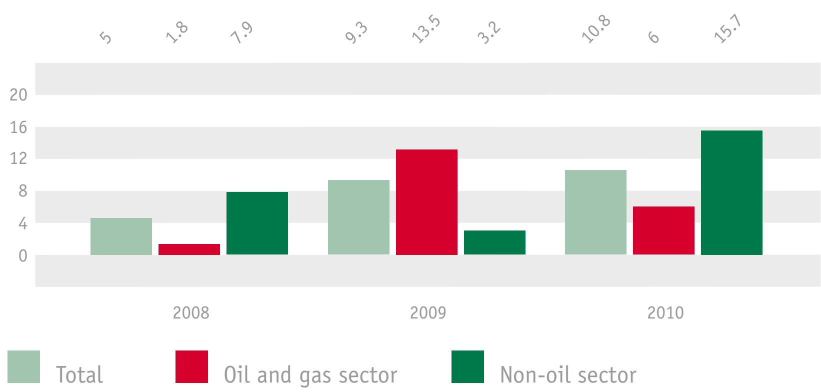
However, once again, the economic growth nature of last year was such that, given the impact of the drop in production in the oil and gas sector, Azerbaijan's actual growth rate (GDP) was 5% versus an average of 15% for the previous 3 years and exhibited a downward trend. The country's GDP indicator was nominally 41.6 billion manats (51.8 billion USD), i.e. it exceeded 20%. The main factor in the increase of this indicator and country's foreign trade (31.4%) was a 27% rise in the average oil price on the world market.

The GDP growth rate in the non-oil sector (7.9%) surpassed earlier forecasts (4%) and was also quite higher than that of the oil and gas sector (1.8%). However, the influence of the non-oil sector was limited in that it represents a relatively small portion of the GDP. This portion even dropped somewhat (-1%). Moreover, the fact that the non-oil segment's representative share in export volume rose from 5% to 7% can be pointed to as a positive change in the non-oil sector indicators for the accounting period.

Aside commodities, the following economic sectors exhibited the main growth: processing industry (+9%), telecommunications and information technologies (+29.7%), construction (+20.3%), transportation of goods (+3.1%), and service sector (+7.2%). This was due to the recovery of the world economy, as well as a rise in both foreign and domestic demand. Growth in demand on the domestic market is particularly reflected in the volume of retail turnover and paid services. Indicators for these fields were +9% and +10.8% respectively in 2009.

Unfortunately, important sectors unrelated to the hydrocarbon industry, such as agriculture, lost their growth footing last year. Production in this field fell 2.2%. This drop was due to poor weather conditions and brought about a sharp decline in crop production (down 8.9%), although the opposite was the case in animal husbandry (up 6.1%).

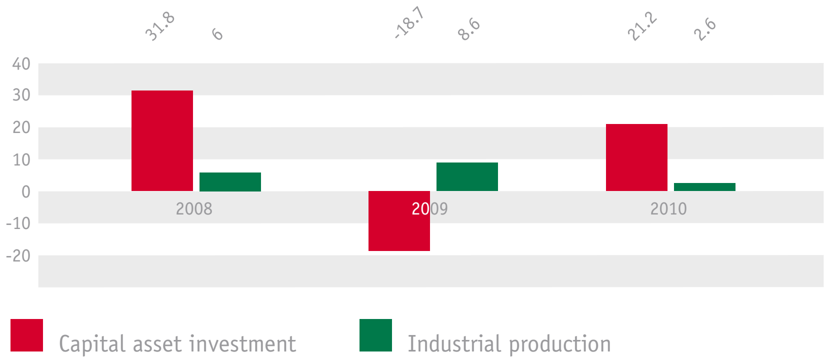
GDP Dynamics by Sector



Source: State Committee for Statistics of Azerbaijan

As far as demand is concerned, capital investment played the role of the primary stimulus, with the volume increasing to 9.2 billion USD, i.e. 21.2%. This amount breaks down as follows: foreign capital investments – 24.8% and domestic capital investments – 75.2%. The non-oil sector dropped to representing 70% of the total capital investment. The government sector continues to represent a high portion, as it had in the past, constituting 60% of total investments. This reflects the government's continuous efforts to stimulate the economy during the post-crisis period. In 2009, a total of 115 million dollars of discounted loans were granted through the National Fund for Assistance to Business.

Dynamics of Industrial Production and Capital Asset Investments, %

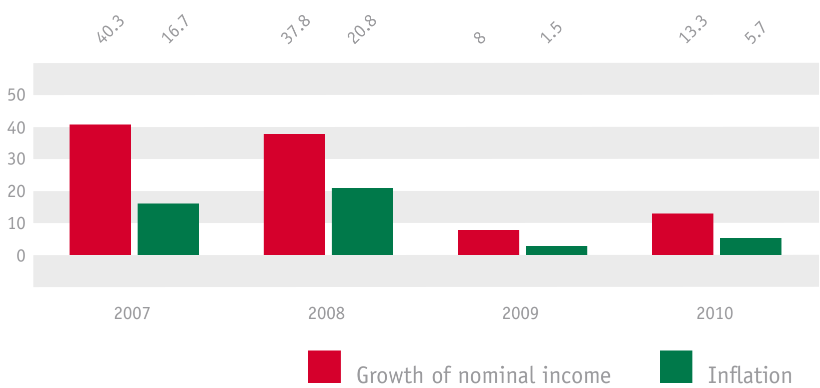


Source: State Committee for Statistics of Azerbaijan

In 2010, inflation became a pressing issue, as had been the case previously, with the inflation rate increasing throughout the year and comprising 5.7% annually. In 2009, this indicator was 1.5%. The inflation rate has been increasing further since the 3rd quarter of 2010. Rising food prices resulting from the downward swing in agriculture and an increase in food imports were the root cause of this acceleration. An upswing in inflation pressure and saturation of the market with liquidity caused interest rates for refinancing to climb from 2% to 3%, which analysts sees as the beginning of tighter monetary policy in the near future.

The exchange rate of the Azerbaijani manat saw relative surges in both the first and second halves of 2010. However, the year end result shows the manat strengthened by 0.65% and 8.9% against the dollar and euro respectively. The primary factor in this strengthening trend for the Azerbaijani manat was that the payment balance was in the black and there was a budge surplus of 16 billion USD. In turn, the manat's stability brought about a 13.3% increase in individual income.

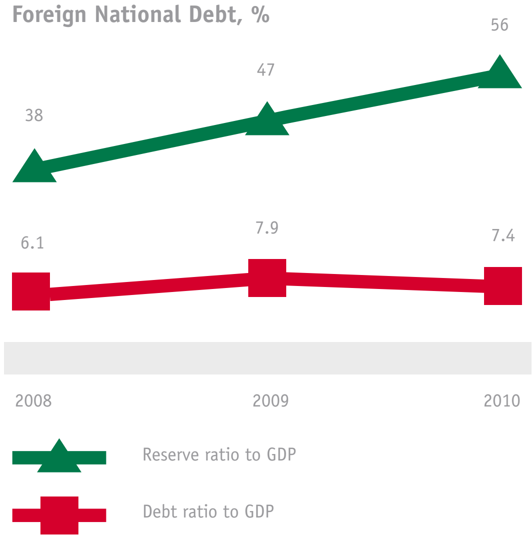
Increase in Individual Income



Source: Central Bank of Azerbaijan

Increased financial flows in the economy due to growth in the nation's export revenues produced an increase in strategic currency reserves. Including resources in the oil fund (22.8 billion US dollars), the nation's reserves of foreign currency topped 29.1 billion USD by the end of the year. Foreign currency assets of the Central Bank of Azerbaijan were 6.4 billion USD, representing an increase of 1.25 billion USD. Maintaining a stable exchange rate and increased liquidity in the banking system made it possible to offset the losses (-15.7%) of 2009 and achieve net growth in the amount of 284.5 million US dollars over 2 years. Azerbaijan's total strategic reserves reached the highest level ever (56 %) against the GDP.

Strategic Currency Reserves and Foreign National Debt, %



Source: Central Bank of Azerbaijan, State Committee for Statistics

The nation's foreign debt rose 12.7%, reaching 3.86 billion USD over the year. This represents 423 US dollars per capita. This means that the nation's foreign debt fell to represent 7.4% of the GDP, down from 7.9% in 2009. Foreign loans to the banking sector were less than 5% of the GDP.

The Banking Sector

Despite weakening economic conditions, Azerbaijan's banking sector did not deviate from the growth trend of previous years. Global economic conditions did, however, slow down growth and reduce the quality of assets. Hence, a positive dynamic continued within the banking system in 2010. The role that regulatory agencies played in this cannot be understated, nor can the effective measures taken by the government to counter the crisis, as well as the continued successful monetary policy.

The fact that the sector was saturated with liquidity during the second half of the fiscal year resulted in a 1% rise in the discounted interest rate. The discounted interest rate comprised 3% as of November. For many participants, this change points to tighter monetary policy in the near future.

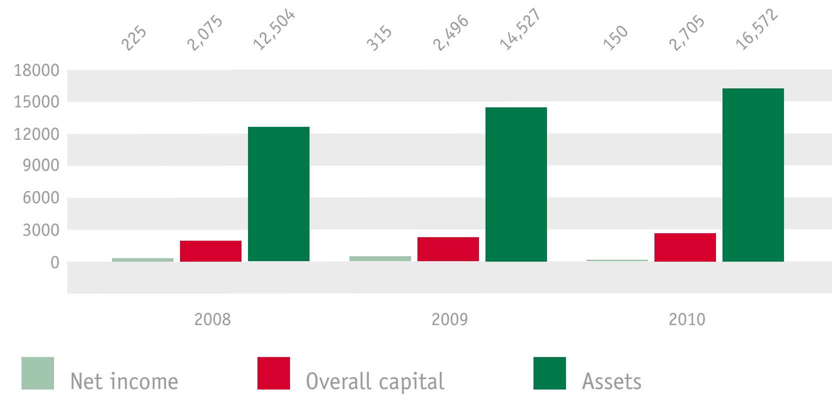
Bank capitalization was the primary focus of regulatory agencies. By the end of the year, the level of capitalization in 42 out of 45 banks exceeded 10 million manats (CBA standard), comprising 99% of the total bank capital. Capital adequacy ratio per sector remained at a relatively high level and constituted almost 17%, exceeding the established standard by two-fold.

The banking system's total assets rose by 14%. In spite of tighter lending procedures at many banks, asset quality in the banking sector weakened considerably. The year end result shows that delinquent loans increased from 3.6% of the total portfolio in 2009, to 5.4% in 2010.

Allocation of reserve funds for potential losses by banks also points to a deterioration in the quality of the credit portfolio: the ratio of reserves to assets increased from 3.3% to 5.4% over the course of the year. Considerable growth of reserves negatively impacted the profitability of the entire sector (-52%), causing a number of lending institution to post losses. This year 13 banks posted losses for the first time.

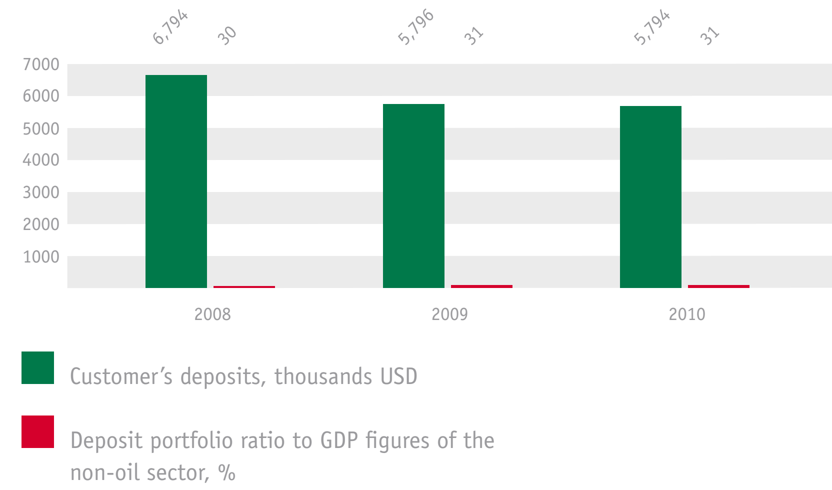
The main funding source for banks, i.e. monies in customer deposit accounts, showed a 17% increase, stimulating an increase in lending during 2011. Relatively low inflation and a drop in prices on the real estate market – a sector that was successfully competing as an alternative investment area due to its profitability in previous years – played a role in providing additional incentive for placing bank deposits. The sudden increase caused individual deposits (+30%) to grow to the point where they represented 56% of the total banking deposit portfolio. The currency structure of the deposit portfolio underwent a change favoring the Azerbaijani manat, which climbed to represent 49% of the portfolio as compared with 41% during the previous year.

Banking System Indicators, in thousands of USD



Source: Central Bank of Azerbaijan

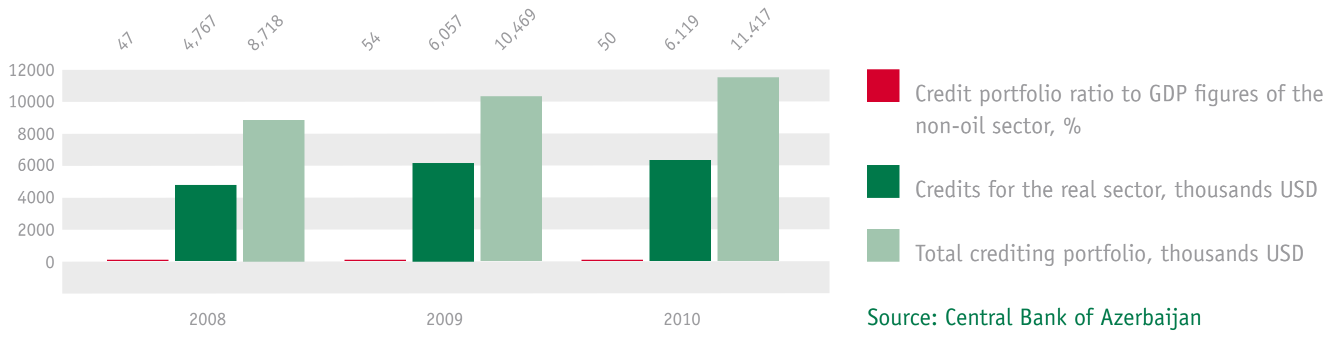
Deposit Portfolio



Source: Central Bank of Azerbaijan

The total credit portfolio grew 9% over the year. Tighter requirements for borrowers influenced the downward trend in loan transactions. Moreover, customer demand for loan products also declined against the backdrop of sluggish economic activity. Active recovery of consumer product and automobile financing caused the growth rate for home loans (16%) to exceed that of the corporate segment (6%).

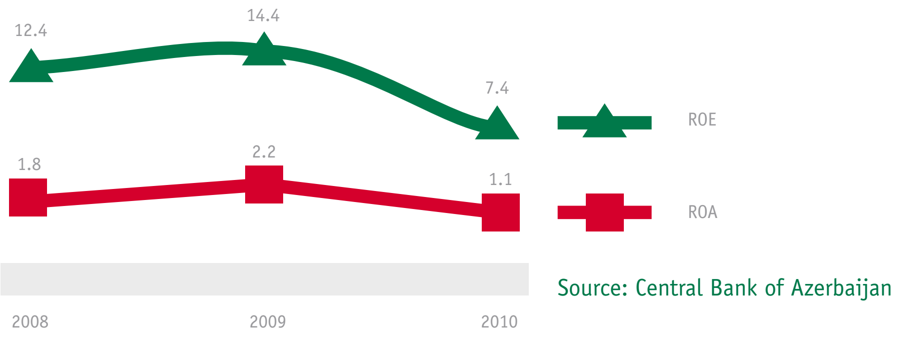
Credit Portfolio



Source: Central Bank of Azerbaijan

During the accounting period, the non-oil sector's ratio to the GDP in the credit portfolio dropped from 54% to 50% (GDP of the non-oil sector shows that banking services penetrated into the non-oil sector). Moreover, lending exhibited a shift in favor of the Azerbaijani manat, with manats representing 64% of credit transactions (as opposed to 58% in 2009). The Central Bank reports that the average interest rate for credits in Azerbaijani manats dropped by 1.7%, comprising 14.2%. The same rate for foreign currency remained unchanged at an annual level of 17.2%.

Efficiency of the Bank System, %



Source: Central Bank of Azerbaijan

"PASHA Bank" OJSC in 2010

Strategy and Business Overview

Financial Management Department

Financial Management Department has set a number of goals for the year 2010. The most noteworthy of these are: automating all accounting operations by entering all accounting data into the new bank system; maximum automation of prudential, currency position and other similar accounts; developing a single methodology document for calculating all financial and non-financial ratios; and preparing a document reflecting strict control over transaction limits.
The bank has made great strides in this area. A budget was successfully planned and applied, and full oversight was exercised over its implementation. The bank's Accounting Rules were developed and approved. Division of employee duties was successfully implemented and reflected in job descriptions. One of the strides made was that the bank's acquisitions and procurements process was completely formalized and strict oversight implemented. In 2010, PASHA Bank has successfully switched its operations to the new operation system.

Along with other departments of the Bank, Credit Control Department plays important role in forming the culture of credit risk management

The department is establishing a number of goals for 2011. Enhanced financial control at the bank will make it possible to perform comprehensive analysis of the profit and loss Centres at the bank. Improvement and optimization of current business processes, increased oversight of treasury operations, and draft of the Unified Reporting Policy for Taxation Targets at the Bank are just few of many outcome of the goals that have been set. Creating an archive base of scanned copies of all accounting documents, and improving oversight of reaching milestones shown in the budget were also geared to ensure PASHA Bank's successful operation in 2011.

Credit Control Department

Credit Control Department has been operating since May 3, 2010. Its goals included automation and elimination of manual labour by entering all information about loans and trade financing transactions into the new system; development and authorisation of the department's regulations; preparation of a unified credit control document; and to finalise establishing and optimizing all business processes relating to the department. The new department successfully carried out a number of tasks in half of the year. The department's rules were ratified and the department fully oversaw and assessed payment and early payment of loans and trade financing transactions. The department is responsible for all credit-related transactions as of the beginning of 2010 and has set important goals to achieve in 2011. These include formulating and adopting credit control methods, separating trade financing from standard loans, optimizing the loan payment process, and establishing an automatic credit portfolio. Along with other departments of the Bank, Credit Control Department plays important role in forming the culture of credit risk management.

Operations

Correspondent Banking

Last year the bank has successfully finalised deploying a modern automated banking system, which is its first large-scale project of this kind. The Tieto BankSyst Automated Banking System automates the majority of the banks transactions, increases functional versatility and enhances control system over operations. All basic system modules (Customer Module, Control Ledger, Clearing off, Account, etc.) were up and running within a period of 18 months.

In addition to BanksSyst, PASHA Bank has also delveloped another software program named Cart Suite, which is a special card module produced by one of the world's leaders in card systems, Tieto. The bank has also deployed an enhanced inter-system interface. Consequently, the bank can now use its human resources more efficiently, reduce the use of paper, and provide higher quality customer service with greater versatility.

Treasury

In 2010, PASHA Bank has successfully joined the Reuters and Bloomberg systems and actively used them in foreign currency and securities transactions. The bank increased its investment portfolio 20% to AZN 156.6 million through active successful trading in gold and on the foreign currency exchange.

In 2010 PASHA Bank started investments of fixed capital in equities of international issuers. PASHA Bank aims to increase its corporate bond portfolio (both domestic and international) to AZN 50 million.

Card Products

Developing and distributing new card products is another way that "PASHA Bank", OJSC provides corporate customers with higher quality and wider range products and services.

Custom Card: This specialized card product makes it syplify the procedure of payment of customs duties. Since these cards can be used onlhy on specifically designated customs terminals, they prove to be an excellent tool for expense control.

Corporate Card: This card is an efficient tool to provide effective control on business related expences. The corporate cards may be issued to authorized employees of PASHA Bank's corporate customers for payment of official entertainment and administrative expenses as well as out-of-pocket expenses. This card is widely accepted throughout the world. The card has some unique features. One such feature is the "Solve" command, which is active worldwide 24/7. The "Solve" command receives information about a lost or stolen card and replaces it with a new one within 48 hours. When needed, the card can provide the holder with an emergency cash advance within 2 hours. Additionally, card holders travelling abroad can receive legal or medical advice services 24 hours a day. Another unique feature of the card is that it provides customers with medical and travel insurance while travelling abroad.

PASHA Bank aims to increase its corporate bond portfolio (both domestic and international) to AZN 50 million

In order to make it easier for its corporate customers to pay employee salaries, "PASHA Bank", OJSC has released Salary Cards with unique features that only our bank can offer.

Moreover, "PASHA Bank", OJSC has developed and produced some card products for its current individual customers, in particular the Flexy and Premium cards. These cards come with some unique and exclusive features. Although they are designed for corporate customers, the premium products will be an integral part of them.

International Payment Systems

Our bank is expanding its relations with international payment systems. Last year the bank has obtained Principal Membership in the MasterCard payment system. This kind of membership will provide our bank with advantages such as optimizing payments made using MasterCard, which in turn will improve the quality of banking services. We are moving towards obtaining the same level of membership in the VISA international payment system.

As part of Azerbaijan's policy on expanding non-cash payments, PASHA Bank has made strides in growing its network of POS terminal. We have installed POS terminals at 50 new locations, bringing the total number of terminals to 68. At the same time, we offer e-commerce services to corporate customers via our web site. This makes it possible to make payments via our Virtual POS Terminal system.

Following the organizational changes in the Bank, Correspondent Accounts Division and a Service Centre were established within the department. The procedures for these new divisions have been elaborated. Although these divisions are still in the formation process, they already have a number of achievements to their credit. The bank's correspondent network has expanded to include corporate and financial organizations, with the help of the Banking Department and the Corresponding Accounts Division. Three new correspondent accounts have been opened. Moreover, in order to enhance the bank's rate policy, new internal accounting has been set up for corresponding accounts. With regard to the Service Centre, we are pleased to note that we have established the procedural foundation for that division, preliminary internal training has been conducted with the newly hired employees, and the centre has already started providing services.

Service Centre

Setting up the Service Centre for cardholders was the first step in making customers aware of the banking services. This service will be available 15 hours a day till December 31, 2010. In 2011 the operation will expand to 24 hours a day. Although the Service Centre began rendering services only for card transaction, there are plans for it to provide 24-hour service and advising on all topics without the customer having to come to the bank's offices. Eventually, the Call Centre services will cover all types of banking services.

We strive for the IT support of all of the bank's Service Centres to meet the highest international standards and to be on top of the latest developments

The availability of the services mentioned above depends on the level of demand placed on the bank's IT infrastructure. Our business is continuously focusing on this area. We strive for the IT support of all of the bank's Service Centres to meet the highest international standards and to be on top of the latest developments.

Back Office

It goes without saying that our bank's strategic goals also have a direct impact on activities of the back office. One of these is the task of bringing banking services up to the highest standards. This is why the system used by the back office must ensure that transactions are completed correctly and without interruption. Therefore, the back office has to be involved in the implementation of projects aimed at providing continuous enhancements of hardware and software.

The year 2010 was critical in this regard. The process of installing the bank's payment system, which began with the launch of the Card Suite module in late 2009, produced the intended result. Earlier in the year, the Operations Department's has set up a main goal to implement the new BankSyst system. Testing was completed in May 2010 and the system began operating in tangent with the existing system. Certain adjustments became necessary as a result of the new software. These included troubleshooting a number of technical migrations and, most importantly, bringing the procedural base in line with the system. The task has been completed successfully. In addition to the adjustments, we continued to master and use the capabilities of the highly specialized Cart Suite card module. Currently, there are plans to expand the module for such functions as SMS, P N-Change and P2P ("card to card"). Also, we would like to point out that employees of the relevant division had an active hand in creating new card products. New rates were set up for the card products and relevant marketing tools have been assigned for each product. The necessary preparations were made, and the procedures for acquiring the Master Card International Payment System Principal Membership have been completed. Successful negotiations with the partners, consideration of the technical details and signature of the agreement on implementing a personal acquiring project - these were the main steps for this project. The following are the division's main achievements for 2010 year:

- Successfully implemented a new ABS system;
- Successfully developed and implemented a new interface between the BankSyst and Card Suite systems;
- Completed certification for acquiring and issuing VISA cards. A new functional for improvement of the Visa Payment System has been added to the card module, which is available at the Bank. This enables the bank to improve the processing of card transactions using another payment system;
- Master Card International Payment System Principal Membership has been acquired;
- Formed a first-class collections division at the bank;
- Took part in establishing a recount office and division of responsibilities and powers between transaction treasurers and recount treasurers;
- As a result of the use of the ATM PAYMENTS Project, holders of bank cards can now pay for cellular phone and Internet services. Also, other persons can make payments using their own cards at any ATM connected to Azerikard.
- Installed 50 (fifty) POS-terminals and 2 (two) automated teller machines at various shopping centres of our customers.

2011 is the final year in the bank's strategic plan and, as such, it will obviously be critical in terms of developing payment infrastructure.

Below are some of the goals of different divisions within the bank's Operation Department.

- Participate in creating new products using the Bank's system capabilities;
- Implement the Personal Acquiring project;
- Finalize the VISA International Payment System principal membership;
- Seek solutions for expanding relationships with International Payment Systems;
- Implement Chargeback, Dispute Resolution and Fraud Management;

- Participate in developing different bonus programs for card products;
- Full implementation of the "Call-Centre" services;
- Prepare Internet Banking services for offering to customers from an operational standpoint.
- Expand networks of POS-terminals and other facilities (AVMQ, IK, etc.).
- Apply operational risk management to all fields of the Operation Department's work.

Sales and work with clients at the PASHA Bank in 2010

In 2010, the bank worked with customers in the following two main directions:

- Expanding customer base;
- Continuing to work actively with customers using the individual approach, along with high-quality effective services.

The bank's specialist provide clients on expert advise on currency control and conducting international settlements under international trade agreements. Such expert assistance helps the bank's customers comply with the currency laws in effect. Using the advice of PASHA Bank's experts in their work enables the bank's customers to meet their contractual obligations and to avoid many problems related to currency control sight procedures.

Capitalisation of the profits earned in preceding year has increased shareholder and depositor confidence in the Bank and enhanced financing resources for the bank's commercial projects.

Deposits

PASHA Bank's paid-in capital is the largest among commercial banks in the country. Moreover, the Bank participates at mandatory deposit insurance programs. These two factors give our customers a great confidence in the strength and reliability of the bank, which in its turn has resulted in increased deposits and bank balances in 2010.

At the close of 2010, deposits and bank balances constituted AZN 191.6 million, representing an increase of 104% over the AZN 93.8 million posted for the same period for 2009. At the same time, term deposits increased by 101% from AZN 73 million to AZN 147 million.

Credits

The credit market in Azerbaijan hasn't been drastically shaken in 2010 as the result of the global economic crisis of 2008-2009. However, 2010 can be considered a difficult year. This was primarily due to the fact that various players in the market reduced their loan portfolios and paid back outstanding debts as a reaction to the financial crisis.

Loans to small and medium businesses was one of the main direction of the bank's operations. At the close of 2010, the loan portfolio amounted to AZN 196 million. This growth was the result of an increased customer base, as well as existing customers refinancing. 86.5% of the bank's loans were granted in AZN.

Main industries financed in 2010 were:

- Trade and services – 43,5 %;
- Production sector – 20,4 %;
- Construction – 17,9 %;
- Other sectors – 18.2 %.

71.8% of the loans were granted for increasing turnover and maintaining current liquidity, while 28.2% were allocated for investment activities.

PASHA Bank actively builds relationships with foreign banks and explores new opportunities for cooperation

Moreover, medium-term and long-term loans constituted 57% and 31% of the portfolio respectively. It should be mentioned that short-term loans constituted only 12% of the total volume of loans.

The growth in loan allocations shows a positive trend of the bank's corporate lending.

PASHA Bank actively builds relationships with foreign banks and explores new opportunities for cooperation. In 2010, the bank has expanded relationships with international financial institutions even further.

In October, the Bank held a workshop titled "Financing Foreign Business" in cooperation with Commerzbank AG. Such issues as mitigation of risks originating from conducting foreign trade transactions, the potential for using foreign trade loans as a financial instrument, bank guarantees as well as the particularities of using letters of credit as a financing tool were examined.

Because third party banks have increased confidence in PASHA Bank, guarantees issued by our institution are accepted without the co-signature of a top-ranked bank. As an example, we can point the fact that the Black Sea Trade and Development Bank financed a major project for a developer under a guarantee from our bank.

Commerzbank opened credit lines totalling 9 million Euros and 20 million Euros for PASHA Bank with operations funded in collaboration with Euler Hermes AG respectively. Raiffeisen Bank International AG opened a line of credit for PASHA Bank totaling 5 million Euros and LBBW opened one for 3.5 million Euros. As part of these credit lines, customers received post-financing opportunities for both foreign trade loans and loans taken out.

As regards the volume of documentary operations, the bank has seen 32% growth, i.e. from AZN 22.9 million to AZN 30.3. Funds obtained from third party banks has totalled in AZN 6.7 million.

In order to further enhance a quality of the portfolio, in 2010 PASHA Bank imposed stricter customer requirements. Consequently, outstanding debts were no greater than 4.4% of the bank's loan portfolio for that year. This is a good example of the quality of the portfolio and effectiveness of the control over the customers capability to repay the loan.

Despite imposing stricter customer requirements, the bank still remained loyal to its customers with good credit histories.

In 2010, PASHA Bank has implemented a range of structural reforms in order to improve banking service quality. Some examples of these include among many establishing a quality control function and introducing a CRM system at the bank and many more.

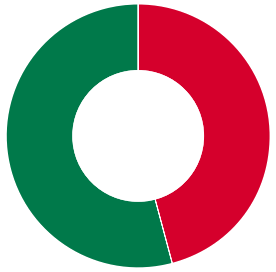
Despite imposing stricter customer requirements, the bank still remained loyal to its customers with good credit histories

Outstanding debts were no greater than 4.4% of the bank's loan portfolio for that year. This is a good example of the quality of the portfolio and effectiveness of the control over the customers capability to repay the loan

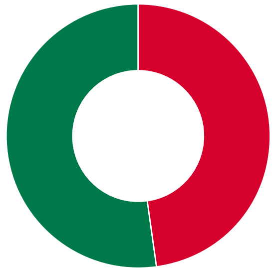
People

Key Human Resources Figures in 2010

Total Staff Members – 107
Training hours per employee – 15 hours
Female: 46 (%)
Male: 54 (%)



52% of the managerial staff is comprised of female employees and 48% of male employees.



One of PASHA Bank's most important goals is to breed a highly-skilled team of professionals, because the bank's employees are its greatest assets. This is why the bank is committed to the personal growth of each employee, supporting employee initiative to increase their knowledge and skills, and creating an environment necessary to achieve this. This enhances the growth of the employee not only as a good professional and efficient team member, but also as a gifted individual. The bank's HR Policy and training plan carefully designed for the individual needs of the employees help reaching established targets and developing employees' skills in order to create and maintain a positive and efficient working environment at the bank.

Along with training courses , workshops and conferences offered by different foreign and local training companies or other agencies, the Bank allocates each member a of staff annual allowance for obtaining professional literature for their personal development.

In 2010 the Bank as in previous years has covered medical insurance of its employees as well as their family members

Thus, in 2010 about 50 employees of the bank has participated at training courses, workshops and conferences held in Germany, Great Britain, Ukraine, Turkey, Latvia, Netherland, France, United Arab Emirates, Austria, Belgium, Croatia, Russia and Indonesia. 43 employees of the bank have benefited from domestic training courses held in the course of year. Furthermore, in 2010 a trainer with an extensive work experience in the bank has been specially invited and held training courses for a group of the Bank's employees.

In compliance with the Human Resources Policy and supporting initiative of the Bank's employees to improve their language skills, the Bank has organized relevant courses.

In 2010, for the first time the Bank has allocated heavily subsidised educational loan to three of its employees for their education abroad. Now all three members of PASHA Bank staff continue their education at prestigious universities of Great Britain and upon graduation will return to the Bank to pursue with their career.

Moreover, the Human Resources Department held a number of on-line trainings. For this purpose "Training Academy" web portal was established in PASHA Bank intranet. Presentations the employees made for their colleagues on the basis of knowledge obtained at trainings and workshops held abroad and domestically, were placed on the Training Academy portal. Furthermore, literature for learning foreign languages and different computer programs for members of staff wishing to further their self-education, special introductory courses for our newly joined colleagues, as well as a vast resource of useful reading material is available in this platform.

In 2010 the Bank as in previous years has covered medical insurance of its employees as well as their family members. In order to support the employees in keeping the right work-life balance the bank allocates each member of staff sports activities allowance as well.

In 2010 the Human Resources Department has also adjusted the bank's labour procedures with the relevant legislation (procedures related to annual leaves, business trips, maternal leave, submission of reports to different authorized bodies and proposals on granting financial aid, etc.).

The significance of employing a capable job applicant can not be underestimated in any organization. That's why clear and transparent recruitment practice is so important. PASHA Bank's employment policy is transparent, consistent and non-discriminatory of age, nationality, religion, gender or physical disability. PASHA Bank's unique recruitment procedure makes it different from anything the other institutions do in Azerbaijan. The process constitutes of several stages with on-line test for all candidates as initial screening and subsequent interviews successful candidates who passed the tests. This allows the Bank to attract the employees with high capabilities, vast knowledge and good skills to meet current and future demands of the Bank.

Headcount of the "PASHA Bank", OJSC, which has started its operations in 2007, increases from day to day. By the end of 2010 there were 107 employees of the Bank, 19 of them promoted to various positions in the course of the year. A number of redundant employees made 5 people for the year. The Bank strives to keep the gender balance – thus, it's safe to say that gender proportion among employees is equal, while age of an average employee is 33 years. As the result of the new recruitment campaign in the last months of the 2010 year, nearly 30 employees will join us in 2011.

One of the most important objectives of the HR Department is to determine the Bank's human resources policy and use of the most rational method implementing it. As in preceding years, in 2011 the HR Department will determine training and development needs of the employees and will establish relevant information database. In 2011 the Department will make use of trainings and workshops both in-house and abroad to enhance the professional and managerial skills the Bank's employees. We have also arranged to invite a well-known western training agency with state of the art training program for management and leadership skills. As in 2010, special attention will be paid to providing the employees with more opportunities to study various aspects of banking in general. Another plan is to tackle the improvement of language skills of our employees in 2011.

PASHA Bank is a new, growing and strengthening entity. And as a result, new employees join the Bank every year. This constantly changing environment generates new objectives of the staff. One of such objectives is constant encouragement and inspiration of new employees to consider themselves full-fledged members of the PASHA Bank's family. Just for this reason strengthening of internal communication is of one of the top priorities of the Bank's management. As in the past year, we intend to continue implementing corporate activities in order to strengthen team sprit and enhance the bonds between the employees of PASHA Bank and getting more acquainted with the values and philosophy of PASHA Bank.

Risk Management: Ideology

PASHA Bank sets a high value on risk management. The key objective of the bank's risk management to is to optimize the risk/return ratio. Risk management assumed great importance in 2010, given the financial crisis in the world, it was critical to assess internal and external risk factors as part of future contracts and the existing bank portfolio. The work Risk Management Department has done in 2010 made it possible to avoid financial losses and make the best profitability possible under the given economic circumstances.

Currently, we use integrated risk management to manage financial and operational risks.

Financial risk management requires identifying a risk limit and ensuring that potential exposure not to exceed that limit. Operational risk management consists of establishing the procedures and processes required to protect the operations against internal and external risk factors.

Under the bank's risk management philosophy, each employee regardless of his work status is a risk manager in PASHA Bank.

Risks Management: Organisational Structure.

The bank's Executive Board oversees the internal control structure, management of primary risks, and any operations that could damage the majority of the capital.

Responsibilities of the Risk Management Committee include monitoring and implementation of measures for minimizing risks, as well as overseeing established risk parameters. The Committee gives opinion on the development of the risk management structure, its quality and relevant regulations.

The Risk Management Department enforces broad risk management principles within the framework of the risk management system and produces relevant reports.

The Department arranges for internal audits, evaluates risk management compliance and ensures the bank's operations comply with the current laws in effect.

Credit, market and liquidity risks are managed by the Treasury, the Risk Management Department, Credit Control Department, the Credit Committee, and the Assets and Liabilities Management Committee.

In order to increase efficiency of decision-making process, "PASHA Bank", OJSC has elaborated a hierarchal system for decision-making structures in the bank depending on type and volume of the risk and its appropriate limits.

The Credit Control Department deals with credit risks related to corporate clients.

The Treasury Department controls liquidity risks as well as credit risks related to financial structures.

Risk Management: Evaluation, Management and Supervision

Although accounting and control procedures for evaluation of risks at the PASHA Bank OJSC differ depending on the type of risk, they all fall under a unified methodology established and is constantly improved by the Risk Management Department.

The adherence to this methodology is determined by periodic assessments conducted by the Internal Audit Department. The results of the audit is discussed with the heads of the relevant organizational structure before being submitted to the Audit Committee and Supervisory Board.

In 2011 the Department will make use of trainings and workshops both in-house and abroad to enhance the professional and managerial skills the Bank's employees

Management and Corporate Governance Practice

The Executive Board of the Bank and its Structure

The Bank is represented and managed by its Executive Board

According to the relevant Article of the Law on Banks, the appointed and acting Board consists of three members. Members of the Board are appointed by the Supervisory Board of "PASHA Bank", OJSC upon nomination of the Executive Board and after obtaining the relevant certification from the Central Bank. The Executive Board meets weekly.

- The Chairman of the Executive Board – Farid Azer oglu Akhundov;
- The Deputy-Chairman of the Executive Board – Rovshan Shamil oglu Allahverdiyev.
- The Member of the Executive Board – Emil Daud oglu Hajiyev.

Farid Akhundov

Mr. Akhundov has been appointed as a Chairman of the Executive Board of "PASHA Bank", OJSC on June 30, 2007. Before joining PASHA Bank, Mr. Akhundov held leading positions at a number of banks and financial institutions. From 1996 to 2003, he held positions as Financial Control Manager, Customer Services Manager, and Deputy CEO at the British Bank of the Middle East, which later operated under the name of HSBC Azerbaijan. From 2003 to 2005, he worked as a Chairman of the Executive Board at Bank Standard, JSC. Mr. Akhundov worked as a financial consultant from 2005 to 2007.

Mr. Akhundov obtained his higher education at the Faculty for economy planning at the Azerbaijan Institute of National Economy in 1987-1992. In 1993 he completed the Management Training Course organised by the Nottingham Trent University in Baku. In 1995 Mr. Akhundov has obtained his MBA Degree from Salford University in Manchester, United Kingdom,.

Rovshan Allahverdiyev

Mr. Allahverdiyev has been working as a Deputy Chairman of the Executive Board at "PASHA Bank", OJSC since October 16, 2007.

From 1992 to present, from the early days of development of commercial banking in Azerbaijan Mr. Allahverdiyev has held leading positions at several Azerbaijani banks, gaining in-depth experience and knowledge in commercial and corporate banking. From 1992 to 1996, he held positions as lead expert in the Operations Division, and subsequently as a Chief Financial Officer (CFO) of Garagaya Commercial Bank. From 1996 to 2002, he acted as Deputy CFO and then Deputy Chairman of the Executive Board at Agrobank Commercial Bank. From 2003 to 2006, Mr. Allahverdiyev worked as a Director of "Autoinvest", an affiliate of Tekhnikabank Commercial Bank. From 2006 to 2007 he held the position of the Director of the Nasimi District Branch No 1 of CapitalBank JSC.

Mr. Allahverdiev is a graduate from Baku Branch of the Leningrad Financial and Economic Institute, where he studied from 1989 to 1997.

Emil Hajiyev

Member of the Executive Board, Director of the Operational Department

Mr. Hajiyev has been working as the Director of the Operations Department at "PASHA Bank", OJSC since August 1, 2007. He has been appointed as a member of the Executive Board on May 13, 2009.

Mr. Hajiyev has obtained his higher education degree from the faculty of Industrial Automation Processes at Azerbaijan Institute of Oil and Chemistry named after M. Azizbayov in 1990-1995. In 1993 he has graduated with Honours from the International Business School of Baku Social Management and Political Science Institute under International Institutional Development Association.

From 2000 to 2002 studied at the faculty of International Relations of Azerbaijan State University of Economy and graduated with a degree in Economics.

From May 15, 1995 to July 30, 2007, he held positions as an economist at the Operational Unit, an economist and leading economist at the Department of Exchange Regulation, the Head of SWIFT group at the Accounts Department of the National Bank of Azerbaijan (NBA), and Chief Economist at the Payment Systems and, following NBA reorganization, at the Accounts Department of NBA.

Members of the Board are appointed by the Supervisory Board of "PASHA Bank", OJSC upon nomination of the Executive Board and after obtaining the relevant certification from the Central Bank. The Executive Board meets weekly

Supervisory Board

- The Chairman of the Supervisory Board – Mr. Jamal Pashayev;
- The Member of the Supervisory Board – Mr. Arif Mir Pashayev;
- The Member of the Supervisory Board – Mr. Nariman Sardarli.

Mir Jamal Pashayev

In 1993 Mr. Pashayev graduated from the Faculty of Physics at Lomonosov's Moscow State University, and then obtained Master's degree in engineering from the University of California and Business School of the American University in Washington D.C.

From 1999 to 2000, he worked as a consultant at the Azerbaijani National Bank. From 2000 to 2005, he worked at the European Bank of Reconstruction and Development (EBRD) and was promoted from financial analyst to a principal banker for infrastructure projects. Since 2005 he has been engaged in consulting on matters of infrastructure, telecommunications and financial instruments. Since 2007 Mr. Pashayev is the Chairman of Supervisory Board of "PASHA Bank", OJSC.

Arif Pashayev

Mr. Arif Mirjalal oglu Pashayev has graduated from Odessa Electro-technical Communication Institute in 1957 majoring in Radiophysics. In 1960-1964 he studied at "GIREDMET" Institute in Moscow as a post-graduate student. In 1966 defended his candidacy work on the theme "Exploitation of asocial methods and appliances of contactless measuring of semi-conductors' parameters at high and ultra-high frequencies" and received degree of Technical Sciences Candidate.

In 1978 he defended his doctoral thesis on "Physical grounds, development principles and application perspectives of non-destructive methods in semi-conductors". Doctor of Science in Physico-mathematics, Mr. Pashayev is an inventor and the full member of Azerbaijan National Academy of Science, the winner of Azerbaijan Republic State Award, full member of International Transport, International Engineering, International Ecoenergy, International Infomatisation Academies and the International Academy of Sciences for his achievements in the scientific field he has been awarded with the Medal named after Academician Yusif Mammadaliyev, Order of Fame and other many other awards.

From 1996 Mr. Pashayev is a rector of National Aviation Academy of Azerbaijan Airlines State Concern, co-chairman of the joint specialised board of Azerbaijan National Aerospace Agency and National Aviation Agency, member of coordination council on training of aviation specialists within Intergovernmental Aviation Committee. A. Pashayev is an author of more than 400 scientific articles, 30 books and monographs, numerous inventions and patents.

Nariman Sardarli

Mr. Sardarli received his bachelor's degree from the City University of New York at Brooklyn College (business, management and finance) in USA and at the National Aeronautical Academy (economics and law of civil aviation). He worked as intern at the Republic of Azerbaijan's Permanent Mission to the United Nations Organization (New-York, January 2003 – May, 2003).

He worked as Audit Associate at the Deloitte Company from 2004 to 2005 and then at Pricewaterhouse-Coopers Company (2005-2006. From 2006 to 2007 he worked as a Financial Manager at the Avromed Company. From 2007 to 2009 he served as the Head of the Audit Committee at "PASHA Bank", OJSC.

Since April 1, 2009 Mr. Sardarli is a Project Manager at the Department of Investment and Project Operations at PASHA Holding.

Assets and Liabilities Management Committee:

- The Chairman of the Executive Board – Farid Akhundov – the Chairman;
- The Deputy-Chairman of the Executive Board – Rovshan Allahverdiyev – a member;
- The Member of the Executive Board, the Director of the Operations Department – Emil Hajiyev – a member;
- The Director of the Treasury Department – Taleh Kazimov – a member;
- The Director of Financial Management Department – Shahin Mamedov – a member.

Risk Management Committee:

- The Chairman of the Executive Board Farid Akhundov – Chairman;
- The Director of the Risk Management Department Kyamalya Nuriyeva – a member;

- The Director of Human Resources Department Sevinj Asadova – a member;
- The Director of Financial Management Department Shahin Mamedov – a member;
- The Director of the Treasury Department Taleh Kazimov – a member;

Credit Committee:
- The Deputy-Chairman of the Executive Board – Rovshan Allahverdiyev – chairman;
- The Director of Financial Management Department Shahin Mamedov – a member;
- The Director of the Treasury Department Taleh Kazimov – a member;
- The Manager of Legal Department – Anar Kerimov – a member;
- The Manager of Analysis Department Anar Ismailov – a member.

Committee of Information Technologies:
- The Member of the Executive Board, the Director of the Operations Department – Emil Hajiyev – chairman
- The Director of the Department of Information Technologies Orkhan Tagi-zade – a member;
- The Manager of the Security Department – Fuad Pashayev – a member;
- The Director of the Administration Department – Rasim Hajiyev – a member;
- Chief Accountant Elmina Ahmed gizi Nabiyeva – a member.

Human Resources Committee:
- The Chairman of the Executive Board Farid Akhundov – chairman;
- The Member of the Executive Board, the Director of the Operations Department - Emil Hajiyev – a member;
- The Director of Human Resources Department Sevinj Asadova – a member.

One of PASHA Bank's biggest achievements in 2010 was the launch of BankSyst, a new automated banking system

Internal Audit

One of PASHA Bank's biggest achievements in 2010 was the launch of BankSyst, a new automated banking system. A prerequisite to the launch of this system was optimisation and detailed description of the main business processes at the bank. The Internal Audit Department continues to participate actively in this process from the viewpoint of assessing efficiency and reliability of the internal control system and risk management service.

In line with the schedule for 2010 approved by the Audit Committee, the following units underwent internal audit: the Bridge Plaza and Shuvelyan Business Centres, the Treasury Department, the Department of Operational Management and the Department of Public Relations and Marketing. The reports submitted contained current control procedures and an assessment of their efficiency, as well as recommendations for improving control procedures in order to minimize risk of non-achievement of the bank's strategic goals.

The relationship of the Internal Audit Committee's with the bank's management and Supervisory Board is based on the corporate governance guidelines set forth by Central Bank's "Basel Committee on Banking Supervision" Regulations. Internal audit of the bank is working in accordance with the Statement of Auditing Standards and with the principles of independence, objectivity and professionalism.

The main strategic goal set by the Internal Auditing Department for 2011 is to establish an internal auditing service that uses efficient and up-to-date risk-oriented approach. The following actions will be performed in order to create a high-quality and documented methodological basis for internal audits: draft and adopt operational regulations for the department; draft policy and procedures; form a stable and efficient team; highly professional performance of audits.

Azerbaijan's banking system has seen high growth rates in recent years. The global economic crisis had little impact on the country and Azerbaijani banking system did not suffer as severely as those of other countries

Corporate Governance

Azerbaijan's banking system has seen high growth rates in recent years. The global economic crisis had little impact on the country and Azerbaijani banking system did not suffer as severely as those of other countries. Third-generation laws, such as "Law on the National Bank" and "Law on the Banks", which regulated banking have been adopted and resulted in further improvement of the bank regulation. At the same time, adoption of the Deposit Insurance Law has increased the public's confidence in the banking system and promoted additional deposits.

Laws and regulations governing the current banking system generally meet international requirements. For example, "Law on the Banks" was drafted based on Basel standards and adopted in 2004. It proved to be an important stimulus for the banking system - the backbone of the economy - to transition to a corporate governance system. Moreover, adoption of the Civil Code in 2000 has provided the legal basis for commercial relationship and defending the rights of legal entities operating within Azerbaijan.

Implementation of corporate governance practices is one of the primary tasks that the bank's shareholders have set before the "PASHA Bank", OJSC's and are monitoring it continuously. Under the corporate governance system, Pasha OJSC has a General Shareholders' Meeting as the supreme management body for the bank. A Supervisory Board oversees the bank's management and business. An Audit Committee handles the audits at the bank, and Executive Board is the responsible executive body. Each body operates in accordance with policies and procedures that comply with current laws and reflect the company's principles.

Decisions made by each authorized body at "PASHA Bank", OJSC enter into force after the Legal Department renders the relevant opinion. The Legal Department, within the scope of its power, ensures that decisions made at the bank are in compliance with the principles of corporate governance.

The bank has five committees (Credit, Assets and Liability Management, Information Technology, Risk Management, and Human Resources) and a Complaints Group pursuant to the policies and procedures approved by the Supervisory Board.

In addition to these, the Executive Board regularly reviews the bank's structure and submits new proposals concerning the structure to the Supervisory Board.

The legal department routinely monitors changes occurring in laws on corporate governance and makes proposals to management for implementation. Furthermore, "PASHA Bank", OJSC works with international organizations, such as the IFC, to implement corporate governance and ensure international requirements are always met.

Social Responsibility

Within the framework of its Corporate Social Responsibility Programme "PASHA Bank", OJSC has carried out numerous projects in 2010.

One of the biggest achievements of the bank in this field was sponsoring a performance of the "Intizar" opera composed by Firangiz Alizadeh. The opera was performed in May 2010 as part of an international music project. This event marked a great importance to the musical and national culture of Azerbaijan.

"PASHA Bank", OJSC was an official partner of the Baku Jazz Festival held in October 2010. The Bank took this initiative as part of a social responsibility program aimed at supporting Azerbaijan's culture, art, and sports projects both in Azerbaijan and abroad.

"PASHA Bank", OJSC has also sponsored "Azerbaijan Open 2010" golf tournament held in November 2010 in Dubai. The tournament has been held since 2002 and draws nearly 100 amateur golfers from every corner of the world. The funds taken in from the tournament went to charity, and were donated to finance projects carried out by several Azerbaijan charity organizations.

"PASHA Bank", OJSC has also sponsored the Christmas Bazaar organized by the Embassy of Germany. The funds collected at the bazaar went to charity to finance the "Saray" and "Goy-Gol" projects for disabled children.

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OUR VISION
OF A BETTER
TOMORROW
WE SHAPE –
TOGETHER

Financial Statements

Year ended
31 December 2010
Together with
Independent
Auditors' Report

Independent auditors' report

To the Shareholders and Board of Directors of OJSC PASHA Bank

We have audited the accompanying financial statements of OJSC PASHA Bank, which comprise the statement of financial position as at 31 December 2010, and the statements of comprehensive income, of changes in equity and of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

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, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about 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 auditors' 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 OJSC PASHA Bank as at 31 December 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

28 February 2011

Ernst & Young Holdings (CIS) B.V.

Statement of financial position, as at 31 December 2010

(in thousands of Azerbaijani Manats)	Notes	31 December 2010	31 December 2009
Assets			
Cash and cash equivalents	5	132,892	50,456
Trading securities	6	897	858
Securities purchased under agreements to resell	7	5,775	499
Amounts due from credit institutions	8	22.676	46,506
Investment securities available–for–sale	9	149,400	82,027
Investment securities held to maturity	9	506	714
Loans to banks	10	4,379	1,909
Loans to customers	11	187,868	119,520
Property and equipment	12	3,549	1,400
Intangible assets	13	1,607	712
Other assets	14	2,755	1,832
Total assets			**306,433**
Liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	**15**	**24,007**	**12,486**
Amounts due to customers	16	338,599	166,391
Current income tax liability	17	6,786	–
Deferred income tax liabilities	18	573	–
Provision for guarantees and other commitments	20,24	1,582	781
Other liabilities	14	3,942	205
Total liabilities		**375,489**	**179,863**
Equity			
Share capital	19	115,407	100,000
Retained earnings		21,408	26,570
Total equity		**136,815**	**126,570**
Total liabilities and equity		**512,304**	**306,433**

Signed and authorised for release on behalf of the Management Board of the Bank:

28 February 2011

Farid Akhundov
Chairman of the Executive Board

Shahin Mammadov
Chief Financial Officer

Statement of comprehensive income, for the year ended 31 December 2010

(in thousands of Azerbaijani Manats)	Notes	Year ended 31 December 2010	Year ended 31 December 2009
Interest income			
Loans to customers		22,680	11,344
Amounts due from credit institutions		5,478	7,754
Investment securities		3,741	3,766
Guarantees and letters of credit		1,184	831
Loans to banks		741	647
Securities purchased under agreements to resell		18	42
		33,842	**24,384**
Interest expense			
Amounts due to customers		(7,844)	(4,009)
Guarantees and letters of credit		(431)	(282)
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies		(359)	(55)
Amounts due to credit institutions		(111)	–
Other		(11)	–
		(8,756)	**(4,346)**
Net interest income		**25,086**	**20,038**
Provision for impairment losses on interest bearing assets		(5,649)	(556)
Provision for guarantees and other commitments		(801)	(781)
Impairment losses on interest bearing assets, and provisions for guarantees and other commitments	**24**	**(6,450)**	**(1,337)**
Net interest income after provision for impairment losses		**18,636**	**18,701**
Net fee and commission income	21	1,403	619
Net unrealized gains from trading securities		49	265
Net gains on sale of investment securities available-for sale		280	–
Net gains/(losses) from foreign currencies:			
dealings		3,750	1,781
translation differences		(224)	(30)
Other income		–	4
Non–interest income		**5,258**	**2,639**
Personnel expenses	22	(5,680)	(3,396)
General and administrative expenses	23	(2,936)	(1,939)
Depreciation and amortisation	12, 13	(726)	(396)
Non-interest expenses		**(9,342)**	**(5,731)**
Profit before income tax benefit/(expense)		**14,552**	**15,609**
Income tax benefit/(expense)	18	(681)	450
Net profit for the year		**13,871**	**16,059**
Other comprehensive income		–	–
Total comprehensive income for the year		**13,871**	**16,059**

Statement of changes in equity, for the year ended 31 December 2010

(in thousands of Azerbaijani Manats)	Share capital	Retained earnings	Total equity
31 December 2008	**100,000**	**10,511**	**110,511**
Total comprehensive income for the year	–	16,059	16,059
31 December 2009	**100,000**	**26,570**	**126,570**
Capitalization of net profit for the year 2009 to share capital (Note 19)	15,407	(15,407)	–
Tax on capitalized profit of 2009 and 2010	–	(2,645)	(2,645)
Dividends declared (Note 19)	–	(981)	(981)
Total comprehensive income for the year	–	13,871	13,871
31 December 2010	**115,407**	**21,408**	**136,815**

Statement of cash flows, for the year ended 31 December 2010

(in thousands of Azerbaijani Manats)	Notes	Year ended 31 December 2010	Year ended 31 December 2009
Cash flows from operating activities			
Interest received		33,485	23,164
Interest paid		(8,617)	(4,352)
Fees and commissions received		2,065	1,445
Fees and commissions paid		(662)	(826)
Net gains on sale of investment securities available-for-sale		280	-
Realised gains less losses from dealing in foreign currencies		3,750	1,781
Personnel expenses		(4,047)	(3,396)
General and administrative expenses paid		(2,857)	(1,931)
Other operating income received		-	4
Cash flows from operating activities before changes in operating assets and liabilities		**23,397**	**15,889**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		20,657	(38,722)
Trading securities		4	7
Loans to banks		(2,199)	6,196
Loans to customers		(72,427)	(75,560)
Withholding tax paid on capitalization		(1,541)	
Other assets		(265)	10
Net increase/(decrease) in operating liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies		11,521	11,045
Amounts due to customers		173,481	82,194
Amounts due to credit institutions		6,545	
Other liabilities		(97)	65
Net cash from operating activities before income tax		**159,076**	**1,124**
Income tax paid		(108)	(2,508)
Net cash from/(used in) operating activities		**158,968**	**(1,384)**
Cash flows from investing activities			
Purchase of investment securities available-for-sale		(183,734)	(374,882)
Proceeds from sale and redemption of investment securities available-for-sale		116,637	385,125
Purchases of investment securities held to maturity		(400)	(688)
Proceeds from investment securities held to maturity		598	
Purchase of property and equipment		(3,784)	(1,897)
Securities purchased under agreements to resell		(5,275)	5,703
Acquisition of intangible assets		(691)	(512)
Proceeds from sale of property and equipment		-	72
Net cash (used in)/ from investing activities		**(76,649)**	**12,921**
Effect of exchange rates changes on cash and cash equivalents		117	208
Net increase in cash and cash equivalents		**82,436**	**11,745**
Cash and cash equivalents, beginning	**5**	**50,456**	**38,711**
Cash and cash equivalents, ending	5	**132,892**	**50,456**

Note 1
Principal activities

OJSC PASHA Bank (the "Bank") was formed on 18 June 2007 as an open joint stock company under the laws of the Republic of Azerbaijan. The Bank operates under a banking licence issued by the Central Bank of the Republic of Azerbaijan ("CBA") on 28 November 2007.

The Bank accepts deposits from the public and extends credit, transfers payments, exchanges currencies and provides other banking services to its commercial and retail customers.

The Bank has 2 service points in Azerbaijan as of 31 December 2010 (2009: two).

The Bank's registered legal address is 15 Yusif Mammadaliyev Street, Baku, AZ1005, Azerbaijan.

As of 31 December 2010 and 2009 the following shareholders owned the outstanding shares of the Bank:

Shareholder	31 December 2010 (%)	31 December 2009 (%)
Pasha Holding Ltd.	60	60
Ador Ltd.	30	30
Mr. Arif Pashayev	10	10
Total	**100**	**100**

The Bank is ultimately controlled by Mr. Arif Pashayev.

Note 2
Basis of preparation

General

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The Azerbaijani Manat is the functional and presentation currency of the Bank as the majority of the transactions are denominated, measured, or funded in Azerbaijani Manat. Transactions in other currencies are treated as transactions in foreign currencies.

The Bank is required to maintain its records and prepare its financial statements in Azerbaijani Manats and in accordance with IFRS.

These financial statements are presented in thousands of Azerbaijani Manat ("AZN"), except per share amounts and unless otherwise indicated.

The financial statements have been prepared under the historical cost convention except for trading and available for sale securities which have been measured at fair value.

	As previously reported	Effect of reclassifications	As reclassified
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	28,918	(27,433)	1,485
Amounts due to customers	55,113	27,433	82,546

Note 3 Summary of significant accounting policies

Changes in accounting policies

The Bank has adopted the following amended IFRS and new International Financial Reporting Interpretations Committee (IFRIC) Interpretations effective during the year. The principal effects of these changes are as follows:

Amendment to IAS 39 "Financial Instruments: recognition and measurement" – Eligible Hedged Items
The amendment to IAS 39 was issued in August 2008, and became effective for annual periods beginning on or after 1 July 2009. The amendment addresses the designation of a one-sided risk in a hedged item, and designation of inflation as a hedged risk or portion in particular situations. It clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as hedged item. The amendment did not affect the Bank's financial statements as the Bank has not entered into any such hedges.

IFRS 3 "Business Combinations" (revised in January 2008) and IAS 27 "Consolidated and Separate Financial Statements" (revised in January 2008)
The revised standards were issued in January 2008 and became effective for financial years beginning on or after 1 July 2009. Revised IFRS 3 introduces a number of changes in the accounting for business combinations that impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. Revised IAS 27 requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change has no impact on goodwill, nor it gives rise to a gain or loss. Furthermore, the revised standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes introduced by the revised Standards are applied prospectively and will affect only future acquisitions and transactions with non-controlling interests.

IFRS 2 Share-based Payment: Group Cash-settled Share-based Payment Transactions
The amendment to IFRS 2 was issued in June 2009 and became effective for financial years beginning on or after 1 January 2010. The amendment clarifies the scope and the accounting for group cash-settled share-based payment transactions. This amendment also supersedes IFRIC 8 and IFRIC 11. This amendment had no impact on the Bank's financial statements.

IFRIC 17 "Distribution of Non-Cash Assets to Owners"
IFRIC Interpretation 17 was issued on 27 November 2008 and is effective for annual periods beginning on or after 1 July 2009. IFRIC 17 applies to pro rata distributions of non-cash assets except for common control transactions and requires that a dividend payable should be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity; an entity should measure the dividend payable at the fair value of the net assets to be distributed; an entity should recognise the difference between the dividend paid and the carrying amount of the net assets distributed in profit or loss. The Interpretation also requires an entity to provide additional disclosures if the net assets being held for distribution to owners meet the definition of a discontinued operation. This interpretation had no impact on the Bank's financial statements.

Improvements to IFRSs
In April 2009 the IASB issued the second omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. Most of the amendments are effective for annual periods beginning on or after 1 January 2010. There are separate transitional provisions for each standard. Amendments included in April 2009 "Improvements to IFRS" had no impact on the accounting policies, financial position or performance of the Bank, except the following amendments resulting in changes to accounting policies, as described below.

- IFRS 5 Non-current Assets Held for Sale and Discontinued Operations: clarifies that the disclosures required in respect of non-current assets and disposal groups classified as held for sale or discontinued operations are only those set out in IFRS 5. The disclosure requirements of other IFRSs only apply if specifically required for such non-current assets or discontinued operations.
- IFRS 8 Operating Segment Information: clarifies that segment assets and liabilities need only be reported when those assets and liabilities are included in measures that are used by the chief operating decision maker. As the Bank's chief operating decision maker does not review segment assets and liabilities, the Bank does not disclose this information.
- IAS 7 Statement of Cash Flows: Explicitly states that only expenditure that results in recognising an asset can be classified as a cash flow from investing activities.

Financial assets

Initial recognition
Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognized initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition
All regular way purchases and sales of financial assets are recognized on the trade date i.e. the date that the Bank commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss
Financial assets classified as held for trading are included in the category 'financial assets at fair value through profit or loss'. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognized in current year profit.

Held to maturity investments
Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held to maturity when the Bank has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held to maturity investments are subsequently measured at amortized cost. Gains and losses are recognized in current year profit when the investments are impaired, as well as through the amortization process.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in current year profit when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets
Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for-sale financial assets are measured at fair value with gains or losses being recognized in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to current year profit. However, interest calculated using the effective interest method is recognized in the current year profit.

Determination of fair value
The fair value for financial instruments traded in active market at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

Offsetting

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the statement of financial position.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- a financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity;
- other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Bank has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the CBA, excluding obligatory reserves, and amounts due from credit institutions with no maturity and less than 90 days and that are free from contractual encumbrances.

Repurchase and reverse repurchase agreements

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the statement of financial position and, in case the transferee has the right by contract or custom to sell or repledge them, reclassified as securities pledged under sale and repurchase agreements. The corresponding liability is presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as separate account on the statement of financial position if material or as cash and cash equivalents or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies, amounts due to credit institutions and amounts due to customers. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in current year profit when the borrowings are derecognised as well as through the amortisation process.

Impairment of financial assets

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Amounts due from credit institutions and loans to customers

For amounts due from credit institutions and loans to customers carried at amortized cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant.

If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in current year profit. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to current year profit.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Held to maturity financial investments

For held to maturity investments the Bank assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognized in current year profit.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, any amounts formerly charged are credited to the statement of comprehensive income.

Available-for-sale financial investments
For available-for-sale financial investments, the Bank assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognized in current year profit is reclassified from other comprehensive income to current year profit. Impairment losses on equity investments are not reversed through current year profit; increases in their fair value after impairment are recognized in other comprehensive income.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

The interest income is recognized in current year profit. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in current year profit and loss, the impairment loss is reversed through current year profit.

Renegotiated loans
Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

Derecognition of financial assets and liabilities

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

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

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank's continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities
A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

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

Financial guarantees
In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit and guarantees. Financial guarantees are initially recognized in the financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortized premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to current year profit. The premium received is recognized in current year profit on a straight-line basis over the life of the guarantee.

Taxation

The current income tax expense is calculated in accordance with the regulations of the Republic of Azerbaijan.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting date.

Azerbaijan also has various operating taxes that are assessed on the Bank's activities. These taxes are included as a component of general and administrative expenses.

Property and equipment

Property and equipment are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of property and equipment when that cost is incurred if the recognition criteria are met.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	20
Furniture and fixtures	4
Computers and other equipment	4
Vehicles	4
Other	5
Leasehold improvements	15

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

Leasehold improvements are depreciated of over the useful life of the leased assets.

Costs related to repairs and renewals are charged when incurred and included in general and administrative expenses, unless they qualify for capitalization.

Intangible assets

Intangible assets consist of licenses and computer software.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be finite. Intangible assets with finite lives are amortised over the useful economic lives of 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Provisions

Provisions are recognised 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 amount of obligation can be made.

Retirement and other employee benefit obligations

The Bank does not have any pension arrangements separate from the State pension system of the Republic of Azerbaijan, 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. In addition, the Bank has no post-retirement benefits.

Share capital

Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognised as additional paid-in capital.

Dividends

Dividends are recognised as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the financial statements are authorised for issue.

Contingencies

Contingent liabilities are not recognised in the statement of financial position but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognised in the statement of financial position but disclosed when an inflow of economic benefits is probable.

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. Expenses are recognized when incurred. The following specific recognition criteria must also be met before revenue and expense is recognised:

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense. Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Fee and commission income and expense

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee and commission income includes cash collection and withdrawal fees and customer services fees, which are recognized as revenue as the services are provided. Fee and commission expense consists of customer, external manager, brokerage and custodian fees.

Foreign currency translation

The financial statements are presented in AZN, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in current year profit as gains less losses from foreign currencies – translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the CBA exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies.

The Bank used the following official exchange rates at 31 December 2010 and 2009 in the preparation of these financial statements:

	31 December 2010	31 December 2009
1 US Dollar	AZN 0.7979	AZN 0.8031
1 Euro	AZN 1.0560	AZN 1.1499
1 Russian Rouble	AZN 0.0263	AZN 0.0266
1 Pound Sterling	AZN 1.2377	AZN 1.2759

Future changes in accounting policies

Standards and interpretations issued but not yet effective

IAS 24 "Related party disclosures" (Revised)

The revised IAS 24, issued in November 2009, simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. Previously, an entity controlled or significantly influenced by a government was required to disclose information about all transactions with other entities controlled or significantly influenced by the same government. The revised standard requires disclosure about these transactions only if they are individually or collectively significant. The revised IAS 24 is effective for annual periods beginning on or after 1 January 2011, with earlier application permitted. The Bank expects that revised standard will have no impact on the Bank's financial statements.

Amendments to IAS 32 "Financial instruments: Presentation": Classification of Rights Issues"

In October 2009, the IASB issued amendment to IAS 32. Entities shall apply that amendment for annual periods beginning on or after 1 February 2010. Earlier application is permitted. The amendment alters the definition of a financial liability in IAS 32 to classify rights issues and certain options or warrants as equity instruments. This is applicable if the rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, in order to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. The Bank expects that this amendment will have no impact on the Bank's financial statements.

IFRS 9 "Financial Instruments"

In November 2009 the IASB issued the first phase of IFRS 9 Financial instruments. This Standard will eventually replace IAS 39 Financial Instrument: Recognition and Measurement. IFRS 9 becomes effective for financial years beginning on or after 1 January 2013. Entities may adopt the first phase for reporting periods ending on or after 31 December 2009. The first phase of IFRS 9 introduces new requirements on classification and measurement of financial assets. In particular, for subsequent measurement all financial assets are to be classified at amortised cost or at fair value through profit or loss with the irrevocable option for equity instruments not held for trading to be measured at fair value through other comprehensive income. The Bank now evaluates the impact of the adoption of the new Standard and considers the initial application date.

IFRIC 14 Amendment – Prepayments of a Minimum Funding Requirement

The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction was developed by the International Financial Reporting Interpretations Committee and issued by the International Accounting Standards Board in July 2007. IFRIC 14 and its accompanying documents have been amended by Prepayments of a Minimum Funding Requirement (issued November 2009). Those amendments have an effective date of 1 January 2011. IFRIC 14 is not expected to have any material impact on the Bank's financial statements.

IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments"

IFRIC Interpretation 19 was issued in November 2009 and is effective for annual periods beginning on or after 1 July 2010. The interpretation clarifies the accounting when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor to extinguish all or part of the financial liability. IFRIC 19 is not expected to have any material impact on the Bank's financial statements.

Improvements to IFRSs

In May 2010 the IASB issued the third omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. Most of the amendments are effective for annual periods beginning on or after 1 January 2011. There are separate transitional provisions for each standard. Amendments included in May 2010 "Improvements to IFRS" will have impact on the accounting policies, financial position or performance of the Bank, as described below.

- IFRS 3 Business combinations: limits the scope of the measurement choices that only the components of NCI that are present ownership interests that entitle their holders to a proportionate share of the entity's net assets, in the event of liquidation, shall be measured either at fair value or at the present ownership instruments' proportionate share of the acquiree's identifiable net assets. As the amendment should be applied from the date the Bank applies IFRS 3 Revised, it may be required to restate for effects incurred under IFRS 3 Revised, but before the adoption of this amendment. The Bank expects that other amendments to IFRS 3 will have no impact on financial statements of the Bank.
- IFRS 7 Financial instruments: Disclosures; introduces the amendments to quantitative and credit risk disclosures. The additional requirements are expected to have minor impact as information is expected to be readily available.
- IAS 34 Interim Financial Reporting: adds disclosure requirements about the circumstances affecting fair values and classification of financial instruments, about transfers of financial instruments between levels of the fair value hierarchy, changes in classification of financial assets and changes in contingent liabilities and assets. Additional disclosures required will be introduced in interim financial statements of the Bank.
- Amendments to IFRS 1, IAS 1, IAS 27 and IFRIC 13 will have no impact on the accounting policies, financial position or performance of the Bank.

IFRS 1 – Structural Amendment

This version was issued in November 2008. Its effective date is 1 July 2009. It includes amendments made by IFRSs issued up to 31 December 2009 with an effective date no later than 1 January 2010.
IFRS 1 and its accompanying documents have been amended by:

- IFRS 9 Financial Instruments (issued November 2009) (effective date 1 January 2013)
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (issued November 2009) (effective date 1 July 2010)

Note 4
Significant accounting judgments and estimates

In the process of applying the Bank's accounting policies, management has made the following judgements and made estimates which have affected the amounts recognised in the financial statements:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values.

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management interpretation of such legislation and changes, including the new law allowing financial institutions to be exempt from payment of profit tax starting 1 January 2009 (for 3 consequent years) if the current year profit is capitalized, as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. As such, additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three years including the year of review. Management believes that as at 31 December 2010 its interpretation of the relevant legislation is appropriate and that the Bank's tax position will be sustained.

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its experienced judgement to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its experienced judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

Note 5
Cash and cash equivalents

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Cash on hand	5,611	6,132
Current accounts with the Central Bank of the Republic of Azerbaijan	78,458	17,659
Current accounts with other credit institutions	19,348	1,475
Time deposits	29,475	25,190
Cash and cash equivalents	**132,892**	**50,456**

Current accounts with other credit institutions consist of non–interest bearing correspondent account balances with resident and non–resident banks in the amount of AZN 18,719 thousands (2009–AZN 921 thousands) and AZN 629 thousands (2009–AZN 554 thousands), respectively.

As of 31 December 2010 the Bank placed AZN 29,475 thousands (2009–AZN 25,190 thousands) in time deposits with resident and non-resident banks maturing through 22 February 2011 (2009–30 March 2010), and with effective annual interest rate of 0.3%-15.0% (2009– 0.2%-14.0%).

Non-cash transaction performed by the Bank during 2010 is represented by capitalization of net profit for the year 2009 to share capital in the amount AZN 15,407 thousands (2009–nil).

Note 6
Trading securities

The Bank placed investments in US Dollars with an external asset manager and appointed it as its agent and delegated it to manage the investment and reinvestment of certain monies and assets. It also entered into a Custodian Agreement with a non–related international financial institution to serve as the Custodian of the investment portfolios. The funds and assets are held by the Custodian, which monitors portfolios and is provided by the Bank the authority to release or deliver securities of the portfolio, register securities, and conduct transactions based on the asset manager's requests on buy/sell decisions. The Custodian provides the Bank a monthly report of all monies received in respect of the portfolio or paid out of the portfolio. The assets placed with the external manager can be recalled by the Bank upon 20 days' written notice in advance.

The external asset manager, acting as an agent, have complete discretion but within the set of investment guidelines prescribed by the Bank, for the account of the Bank to buy, sell, retain, exchange or otherwise deal in investments and other assets, make deposits, subscribe to issues and offers for sale, and accept placements, underwritings and sub-underwritings, of any investments, advise on or execute transactions in unregulated collective investment schemes, effect transactions on all markets, negotiate and execute counterparty and account opening documentation, take all day to day decisions and otherwise act as the external manager judge appropriate in relation to the management of the funds.

Trading securities are corporate US dollar, Euro and Norwegian Crone denominated corporate shares traded internationally, and were held and managed by the Bank's external manager. As of 31 December 2010 trading securities amounted to AZN 897 thousands (2009–AZN 858 thousands).

Note 7
Securities purchased under agreements to resell

As of 31 December 2010 the Bank had entered into agreements to resell short-term notes issued by the CBA with total fair value of AZN 5,775 thousands (2009–AZN 499 thousands) to a resident credit institution.

Note 8
Amounts due from credit institutions

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Time deposits	19,947	45,900
Obligatory reserve with the Central Bank of the Republic of Azerbaijan	836	605
Blocked deposits	1,893	1
Amounts due from credit institutions	**22,676**	**46,506**

As of 31 December 2010, AZN 13,075 thousands (66% of total time deposits) (2009–AZN 24,610 thousands) was placed on inter-bank deposits with three (2009–four) local commercial banks maturing through 20 September 2011 (2009–19 October 2010) and with effective annual interest rate of 7%-19% (2009–6%-18%).

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBA at 0.5% (2009–0.5%) of the previous month average of funds attracted from customers by the credit institution. The Bank's ability to withdraw such deposit is restricted by statutory legislation.

Blocked deposits as of 31 December 2010 relate to letters of credit issued by the Bank and blocked in a non-resident bank.

Note 9
Investment securities

Available-for-sale securities comprise:

	31 December 2010		31 December 2009	
(in thousands of Azerbaijani Manats)	Carrying value	Nominal value	Carrying value	Nominal value
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	47,428	47,681	32,832	33,095
Treasury bills issued by the Ministry of Finance of the Republic of Azerbaijan	62,239	62,573	38,513	39,137
Notes issued by the Azerbaijan Mortgage Fund	34,737	34,668	10,682	10,667
Notes issued by the National Bank of the Republic of Azerbaijan	4,996	5,001	–	–
Investment securities available-for-sale	**149,400**	**149,923**	**82,027**	**82,899**

Nominal interest rates per annum and maturities of these securities are as follows:

	31 December 2010		31 December 2009	
	%	Maturity	%	Maturity
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	1.46% –2.99%	January – May 2011	1.7% –2.9%	January – November 2010
Treasury bills issued by the Ministry of Finance of the Republic of Azerbaijan	3.75% –6.9%	January 2011 – June 2012	4.0% –6.8%	October 2010 – June 2012
Notes issued by Azerbaijan Mortgage Fund	3.0%	May 2016	3.0%	May 2016
Notes issued by the National Bank of the Republic of Azerbaijan	1.99% –2.2%	January 2011	–	–

Held to maturity securities comprise:

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Corporate bonds issued by FinansLizinq Open Joint Stock Company (OJSC)	303	–
Corporate bonds issued by Azel Closed Joint Stock Company (CJSC)	213	428
Corporate bonds issued by Omni Finance LLC, a non-bank credit institution	–	300
	516	728
Less–Allowance for impairment (Note 24)	(10)	(14)
Held to maturity securities	**506**	**714**

Corporate bonds issued by Azel CJSC are US–dollar denominated coupon bonds with annual interest rate of 14.0%. Bonds mature on 16 July 2011. The principal and interest on these securities is repaid semi-annually. Corporate bonds issued by FinansLizinq OJSC are AZN–denominated coupon bonds with annual interest rate of 15.0%. Bonds mature in 18 December 2012. The interest on these securities is repaid monthly.

Corporate bonds issued by OMNI Finance are AZN–denominated coupon bonds with annual interest rate of 14.0% paid on a semi-annual basis and matured in December 2010.

Note 10
Loans to banks

As of 31 December 2010 the Bank had outstanding amount of AZN 4,379 thousands (2009–AZN 1,909 thousands) unsecured loans denominated in Azerbaijani Manat and US dollar, issued to two resident commercial banks with contractual maturities through April 2011 and May 2012 (2009– July 2010 and October 2010) and annual interest rate of 16% (2009–17.5%).

Note 11
Loans to customers

Loans to customers comprise:

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Legal entities	191,497	117,256
Individuals	4,584	4,824
Loans to customers (gross)	**196,081**	**122,080**
Less–Allowance for impairment (Note 24)	(8,213)	(2,560)
Loans to customers (net)	**187,868**	**119,520**

(in thousands of Azerbaijani Manats)	Corporate lending 31 December 2010	Individual lending 31 December 2010	Total 31 December 2010
Individual impairment	(7,005)	(314)	(7,319)
Collective impairment	(831)	(63)	(894)
	(7,836)	**(377)**	**(8,213)**
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	9,650	433	10,083

(in thousands of Azerbaijani Manats)	Corporate lending 31 December 2009	Individual lending 31 December 2009	Total 31 December 2009
Individual impairment	(2,208)	(352)	(2,560)
Collective impairment	–	–	-
	(2,208)	**(352)**	**(2,560)**
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	13,067	365	13,432

Loans are made within Azerbaijan in the following industry sectors:

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Trade and services	85,324	59,979
Manufacturing	39,961	21,905
Construction	35,180	24,424
Hotel business	20,049	-
Individuals	4,584	4,824
Agriculture and food processing	3,855	4,067
Transport and telecommunication	3,630	6,332
Leasing	3,338	-
Energy	-	362
Other	160	187
Total loans (gross)	**196,081**	**122,080**

As of 31 December 2010, the Bank granted loans to 10 customers (2009–5 customers) totalling AZN 139,103 thousands (2009–AZN 60,520 thousands), which individually exceeded 5% of the Bank's equity.

Note 12
Property and equipment

The movements in property and equipment were as follows:

(in thousands of Azerbaijani Manats)	Buildings	Furniture and fixtures	Computers and other equipment	Vehicles	Other equipment	Leasehold improvements	Total
Cost							
31 December 2008	**–**	**475**	**372**	**318**	**19**	**58**	**1,242**
Additions	–	376	338	56	17	40	827
Disposals	–	–	–	(76)	(3)	–	(79)
31 December 2009	**–**	**851**	**710**	**298**	**33**	**98**	**1,990**
Additions	2,151	249	158	128	4	10	2,700
31 December 2010	**2,151**	**1,100**	**868**	**426**	**37**	**108**	**4,690**
Accumulated depreciation							
31 December 2008	**–**	**(102)**	**(82)**	**(52)**	**(4)**	**–**	**(240)**
Depreciation charge	–	(154)	(111)	(79)	(6)	(7)	(357)
Disposals	–	–	–	6	1	–	7
31 December 2009	**–**	**(256)**	**(193)**	**(125)**	**(9)**	**(7)**	**(590)**
Depreciation charge	–	(222)	(205)	(102)	(6)	(16)	(551)
31 December 2010	**–**	**(478)**	**(398)**	**(227)**	**(15)**	**(23)**	**(1,141)**
Net book value:							
31 December 2010	**2,151**	**622**	**470**	**199**	**22**	**85**	**3,549**
31 December 2009	**–**	**595**	**517**	**173**	**24**	**91**	**1,400**

Note 13
Intangible assets

The movements in intangible assets were as follows:

	Licenses	Computer software	Installations in progress	Total
Cost				
31 December 2008	**189**	**75**	**–**	**264**
Additions	104	125	283	512
Disposals	(5)	–	–	(5)
31 December 2009	**288**	**200**	**283**	**771**
Additions	143	927	–	1,070
Disposals	(55)	–	–	(55)
Transfers	–	283	(283)	–
31 December 2010	**376**	**1,410**	**–**	**1,786**
Accumulated amortization				
31 December 2008	**(21)**	**(4)**	**–**	**(25)**
Amortisation charge	(29)	(10)	–	(39)
Disposals	5	–	–	5
31 December 2009	**(45)**	**(14)**	**–**	**(59)**
Amortisation charge	(80)	(95)	–	(175)
Disposals	55	–	–	55
31 December 2010	**(70)**	**(109)**	**–**	**(179)**
Net book value:				
31 December 2010	**306**	**1,301**	**–**	**1,607**
31 December 2009	**243**	**186**	**283**	**712**

Note 14
Other assets and liabilities

Other assets comprise:

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Other financial assets		
Accrued interest receivable on guarantees and letters of credit	127	98
Settlements on money transfers	32	–
	159	98
Other non–financial assets		
Prepayments for acquisition of property, equipment and intangible assets	2,235	1,529
Deferred expenses	321	150
Other	40	55
	2,596	1,734
Other assets	**2,755**	**1,832**

As of 31 December 2010 prepayments for the purchase of property, equipment and intangible assets of AZN 2,235 thousands (2009–AZN 1,529 thousands), related to premises for the Bank's new branches located in Baku and regions of the Republic of Azerbaijan.

Other liabilities comprise:

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Other financial liabilities		
Dividends payable (Note 19)	981	–
Payable to employees	113	101
Payables for professional services	64	38
Accrued interest payables on letters of credit	36	–
Settlements on money transfer	36	–
Payables on social security costs	25	–
Accrued expenses	14	8
Other	–	7
	1,269	154
Other non–financial liabilities		
Accrued staff bonuses	1,500	–
Taxes, other than income tax	1,124	–
Other	–	11
Deferred income	49	40
	2,673	51
Other liabilities	**3,942**	**205**

Note 15
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Loans from the Central Bank of the Republic of Azerbaijan	10,000	7,000
Loans from the National Fund for Support of Entrepreneurship	13,635	5,485
Amount due to Azerbaijan Mortgage Fund	369	–
Correspondent accounts with other banks	3	1
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	**24,007**	**12,486**

As of 31 December 2010 the Bank had loans from the Central Bank of the Republic of Azerbaijan amounting to AZN 10,000 thousands (2009–AZN 7,000 thousands), maturing through 2012 (2009–through 2011) and bearing interest rate of 2.5% p.a.

As of 31 December 2010 the Bank had seven loans (2009–four loans) from the National Fund for Support of Entrepreneurship amounting to AZN 13,635 thousands (2009–AZN 5,485 thousands), maturing through 2015 and bearing interest rate of 1.0% p.a. The loans were acquired for the purposes of assistance in gradually improving entrepreneurship environment in Azerbaijan under the government program.

As of 31 December 2010 the Bank had eight loans refinanced from the Azerbaijan Mortgage Fund amounting to AZN 369 thousands (2009–nil), maturing through 2035 and bearing interest rate of 4.0% p.a.

Note 16
Amounts due to customers

The amounts due to customers include the following:

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Demand deposits	191,519	93,781
Time deposits	147,080	72,610
Amounts due to customers	**338,599**	**166,391**
Held as security against guarantees	**967**	**–**

An analysis of customer accounts by economic sector follows:

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Investment holding companies	181,762	35,179
Individuals	102,226	95,419
Construction	22,342	18,588
Trade and services	17,043	12,260
Insurance	7,356	1,210
Energy	5,178	20
Manufacturing	2,256	1,443
Transport and communication	205	60
Agriculture	4	2,001
Other	227	211
Amounts due to customers	**338,599**	**166,391**

As of 31 December 2010 customer deposits included balances with five largest (2009–four) customers amounting to AZN 257,909 thousands (2009–AZN 107,499 thousands). These deposits comprise significant concentration of approximately 76% (2009–65%) of the total customer deposits portfolio.

As at 31 December 2010 time deposits amounting to AZN 967 thousands (2009–nil) were held as security against guarantees issued (Note 20).

Note 17
Amounts due to credit institutions

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Commerzbank Aktiengesellschaft	4,162	–
Landesbank Baden-Württemberg	1,294	–
Raiffeisen Bank International Aktiengesellschaft	1,330	–
Amounts due to credit institutions	**6,786**	**–**

As of 31 December 2010 amounts due to credit institutions included balances with 3 foreign banks amounting to AZN 6,786 thousands (2009–nil), maturing through 2011 and bearing interest rate of 2.72%–5.96% p.a. These borrowings are for trade finance of import operations (letters of credit) of the customers of the Bank.

Note 18
Taxation

The corporate income tax (expense)/benefit comprise:

(in thousands of Azerbaijani Manats)	Year ended 31 December 2010	Year ended 31 December 2009
Current tax expense	(681)	–
Deferred tax benefit	–	450
Income tax (expense)/benefit	**(681)**	**450**

In accordance with the Law of the Republic of Azerbaijan on enhancement of activities of banks, insurance and reinsurance companies (N710–IIIQ and dated 28 October 2008), financial institutions are exempt from payment of Profit Tax starting from 1 January 2009 for a period of 3 consecutive years, if the current year profit is capitalized. As a result, based on the shareholders' meeting dated 13 May 2009, the Bank has decided to avail of the tax exemption in accordance with the law for the years 2009–2011.

On 19 June 2009, an amendment to the Tax Code was enacted to reduce the corporate income tax rate from 22% to 20% effective from 1 January 2010. There is no deferred tax effect of the change in tax rates as of 31 December 2010 in view of the availment of the tax exemption.

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax (expense)/ benefit based on statutory rates with actual is as follows:

(in thousands of Azerbaijani Manats)	Year ended 31 December 2010	Year ended 31 December 2009
Profit before income tax (expense)/benefit	**14,552**	**15,609**
Statutory tax rate	20%	22%
Theoretical tax expense at the statutory rate	**(2,910)**	**(3,434)**
Tax effect of non–deductible expenses	(328)	(57)
Tax effect of tax–exempt income arising from capitalization of profit	2,557	3,941
Income tax (expense)/benefit	**(681)**	**450**

Current income tax payable is AZN 573 thousands (2009–nil).

Note 19
Equity

The share capital of the Bank was contributed by the shareholders in AZN and they are entitled to dividends and any capital distribution in AZN. No dividends were declared and paid to the shareholders of the Bank as of 31 December 2009. On 24 December 2010 the shareholders of the Bank declared dividends of AZN 981 thousands from the 2010 net profit of the Bank and was accrued accordingly as of 31 December 2010.

Following the availment of tax exemption as described in Note 18, on 03 May 2010 the shareholders decided to increase the share capital by AZN 15,407 thousands from AZN 100,000 thousands to AZN 115,407 thousands through capitalization of the profit earned for the year ended 31 December 2009. The Bank completed the registration of the increase in share capital on 12 June 2010, thus, bringing share par value to AZN 11,540.71 each and total paid–in share capital to AZN 115,407 thousands as of 31 December 2010.

As of 31 December 2010 the Bank authorized, issued and fully paid capital amounted to AZN 115,407 thousands (2009–AZN 100,000 thousands) and comprised 10,000 ordinary shares with a par value of AZN 11,540.71 per share (2009–AZN 10,000 thousands). Each share entitles one vote to the shareholder.

Note 20
Commitments and contingencies

Operating environment

As an emerging market, Azerbaijan does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature market economy. However, there have been a number of developments that positively affect the overall investment climate of the country.

While operations in Azerbaijan may involve risks that are not typically associated with those in developed markets (including the risk that the Azerbaijan Manat is not freely convertible outside of the country and undeveloped debt and equity markets), over the last few years the Azerbaijani government has made progress in implementing the reforms necessary to create banking, judicial, taxation and regulatory systems.

The existing tendency aimed at the overall improvement of the business environment is expected to persist. The future stability of the Azerbaijani economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government. However, the Azerbaijan economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The global financial crisis resulted in capital markets instability, deterioration of liquidity in the banking sector, and tighter credit conditions within Azerbaijan. The Azerbaijan Government has introduced a range of stabilization measures aimed at ensuring solvency and providing liquidity and supporting refinancing of foreign debt for Azerbaijan banks and companies.

While management believes it is taking appropriate measures to support the sustainability of the Bank's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Bank's results and financial position in a manner not currently determinable.

Legal

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank.

Taxation

Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within the Azerbaijan suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years proceeding the year of review.

Management believes that its interpretation of the relevant legislation as of 31 December 2010 is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Insurance

The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions. Liability insurance is generally not available in Azerbaijan at present.

Financial commitments and contingencies

The Bank provides guarantees and letters of credit to customers with primary purpose of ensuring that funds are available to a customer as required. Guarantees and standby letters of credit represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorizing a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralized by the underlying shipments of goods, to which they relate, or cash deposits and, therefore, carry less risk than a direct borrowing.

Financial commitments and contingencies comprise:

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Credit–related commitments		
Guarantees issued	19,958	17,854
Letters of credit	10,372	5,051
Unused credit lines	6,759	7,760
	37,089	**30,665**
Operating lease commitments		
Not later than 1 year	337	30
Later than 1 year but not later than 5 years	1,352	150
Later than 5 years	599	88
	2,288	268
Less – Provisions (Note 24)	(1,582)	(781)
Commitments and contingencies (before deducting collateral)	**37,795**	**30,152**
Less – Cash held as security against letters of credit and guarantees (Note 16)	(967)	–
Commitments and contingencies	**36,828**	**30,152**

Note 21
Net fee and commission income

(in thousands of Azerbaijani Manats)	Year ended 31 December 2010	Year ended 31 December 2009
Currency conversion operations	734	498
Settlements operations	694	500
Cash operations	367	350
Servicing plastic card operations	109	28
Guarantees and commitments	55	68
Other	106	1
Fee and commission income	**2,065**	**1,445**
Securities operations	(276)	(587)
Settlements operations	(214)	(188)
Servicing plastic card operations	(74)	(12)
Guarantees and commitments	(50)	(19)
Currency conversion operations	(27)	(10)
Cash operations	(4)	(2)
Other	(17)	(8)
Fee and commission expense	**(662)**	**(826)**
Net fee and commission income	1,403	619

Note 22
Personnel expenses

(in thousands of Azerbaijani Manats)	Year ended 31 December 2010	Year ended 31 December 2009
Salaries and bonuses	(4,382)	(2,468)
Social security costs	(979)	(557)
Other employee related expenses	(319)	(371)
Total personnel expenses	**(5,680)**	**(3,396)**

Note 23
General and administrative expenses

(in thousands of Azerbaijani Manats)	Year ended 31 December 2010	Year ended 31 December 2009
Professional services	(662)	(874)
Charity and sponsorship	(650)	(100)
Advertising costs	(381)	(197)
Transportation and business trip expenses	(315)	(221)
Taxes, other than income tax	(126)	(14)
Operating leases	(112)	(113)
Insurance	(97)	(70)
Software cost	(80)	(6)
Communications	(63)	(50)
Security expenses	(62)	(46)
Repair and maintenance	(52)	(27)
Utilities	(34)	(26)
Stationery	(26)	(33)
Membership fees	(18)	(13)
Printing expenses	(16)	(36)
Other expenses	(242)	(113)
Total general and administrative expenses	**(2,936)**	**(1,939)**

Note 24
Impairment losses on interest bearing assets, and provision for guarantees and other commitments

The movements in allowance for impairment losses on interest bearing assets and provisions for guarantees and letters of credit were as follows:

	Year ended 31 December 2010					
(in thousands of Azerbaijani Manats)	Corporate lending	Individual lending	Total loans to customers	Investment securities held to maturity	Guarantees and other commitments	Total allowances and provisions
At 1 January	**(2,208)**	**(352)**	**(2,560)**	**(14)**	**(781)**	**(3,355)**
(Charge)/reversal for the year	(5,628)	(25)	(5,653)	4	(801)	(6,450)
At 31 December	**(7,836)**	**(377)**	**(8,213)**	**(10)**	**(1,582)**	**(9,805)**

	Year ended 31 December 2009					
(in thousands of Azerbaijani Manats)	Corporate lending	Individual lending	Total loans to customers	Investment securities held to maturity	Guarantees and other commitments	Total allowances and provisions
At 1 January	**(1,264)**	**(754)**	**(2,018)**	**–**	**–**	**(2,018)**
(Charge)/reversal for the year	(944)	402	(542)	(14)	(781)	(1,337)
At 31 December	**(2,208)**	**(352)**	**(2,560)**	**(14)**	**(781)**	**(3,355)**

Allowance for impairment of assets is deducted from the carrying amount of the related assets. Provision for guarantees and other commitments are recorded in liabilities.

Note 25
Risk management

Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Risk management structure
The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors
The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles.

Audit Committee
The Audit Committee has the overall responsibility for the establishment and development of the audit mission and strategy. It is responsible for the fundamental audit issues and monitoring Internal Audit's activities.

Management Board
The Management Board has the responsibility to monitor the overall risk process within the Bank.

Risk Committee
The Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk deci

Risk Management
The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Bank Treasury
Bank Treasury is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

Internal Audit
Risk management processes throughout the Bank are audited annually by the internal audit function, which examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting systems
The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risks types and activities.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Management Board, the Risk Committee, and the head of each business division. The report includes aggregate credit exposure, hold limit exceptions and liquidity ratios. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Board of Directors receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

For all levels throughout the Bank, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

A daily briefing is given to the Management Board and all other relevant employees of the Bank on the utilisation of market limits and liquidity, plus any other risk developments.

Risk mitigation
Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration
Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location. In order to avoid excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits. The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Credit-related commitments risks
The Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

The table below shows the maximum exposure to credit risk for the components of the statement of financial position. The maximum exposure is shown net, after the effect of mitigation through the use of master netting and collateral agreements.

(in thousands of Azerbaijani Manats)	Notes	Gross maximum exposure 31 December 2010	Gross maximum exposure 31 December 2009
Cash and cash equivalents (excluding cash on hand)	5	127,281	44,324
Trading securities	6	897	858
Securities purchased under agreements to resell	7	5,775	499
Amounts due from credit institutions	8	22,676	46,506
Investment securities available–for–sale	9	149,400	82,027
Investment securities held to maturity	9	506	714
Loans to banks	10	4,379	1,909
Loans to customers	11	187,868	119,520
Other financial assets	14	159	98
		498,941	**296,455**
Financial commitments and contingencies	20	34,540	29,884
Total credit risk exposure		**533,481**	**326,339**

Where financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown below.

Credit quality per class of financial assets
The credit quality of financial assets is managed by the Bank internal credit ratings. The table below shows the credit quality by class of asset for loan-related statement of financial position lines, based on the Bank's credit rating system.

(in thousands of Azerbaijani Manats)	Notes	Neither past due nor impaired High grade 2010	Standard grade 2010	Sub-standard grade 2010	Past due but not impaired 2010	Individually impaired 2010	Total 2010
Securities purchased under agreements to resell	7	5,775	–	–	–	–	5,775
Amounts due from credit institutions	8	–	22,676	–	–	–	22,676
Investment securities available–for–sale	9	149,400	–	–	–	–	149,400
Investment securities held to maturity	9	–	516	–	–	–	516
Loans to banks	10	–	4,379	–	–	–	4,379
Loans to customers	11						
· Corporate lending		177,742	–	–	4,105	9,650	191,497
· Individual lending		3,209	–	–	942	433	4,584
Total		**336,126**	**27,571**	**–**	**5,047**	**10,083**	**378,827**

(in thousands of Azerbaijani Manats)	Notes	Neither past due nor impaired High grade 2009	Standard grade 2009	Sub-standard grade 2009	Past due but not impaired 2009	Individually impaired 2009	Total 2009
Securities purchased under agreements to resell	7	499	–	–	–	–	499
Amounts due from credit institutions	8	–	46,506	–	–	–	46,506
Investment securities available–for–sale	9	82,027	–	–	–	–	82,027
Investment securities held to maturity	9	–	728	–	–	–	728
Loans to banks	10	–	1,909	–	–	–	1,909
Loans to customers	11						
· Corporate lending		83,775	–	–	20,414	13,067	117,256
· Individual lending		4,459	–	–	–	365	4,824
Total		**170,760**	**49,143**	**–**	**20,414**	**13,432**	**253,749**

Past due loans to customers include those that are only past due by a few days. An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

(in thousands of Azerbaijani Manats)	Less than 30 days 2010	31 to 60 days 2010	61 to 90 days 2010	More than 90 days 2010	Total 2010
Loans to customers					
Corporate lending	38	–	–	4,067	4,105
Individual lending	215	–	–	727	942
Total	**253**	**–**	**–**	**4,794**	**5,047**

(in thousands of Azerbaijani Manats)	Less than 30 days 2009	31 to 60 days 2009	61 to 90 days 2009	More than 90 days 2009	Total 2009
Loans to customers					
Corporate lending	19,819	595	–	–	20,414
Total	**19,819**	**595**	**–**	**–**	**20,414**

The Bank classifies its loan related assets as follows:

- High grade – counterparties with excellent financial performance, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.
- Standard grade – counterparties with stable financial performance, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.
- Sub-Standard grade – counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and no overdue in principal and interest.
- Past due but not impaired – counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.
- Individually impaired – counterparties with satisfactory and unsatisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The attributable risk ratings are assessed and updated regularly.

Impairment assessment
The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances
The Bank determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial

support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to customers that are not individually significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the appropriate delay between the time a loss is likely to have been uncured and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. Local management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for loans.

The geographical concentration of the Bank's monetary assets and liabilities is set out below:

	31 December 2010				31 December 2009			
(in '000 of Azerbaijani Manats)	The Republic of Azerbaijan	OECD countries	CIS and other non-OECD countries	Total	The Republic of Azerbaijan	OECD countries	CIS and other non-OECD countries	Total
Financial assets:								
Cash and cash equivalents	105,488	27,396	8	132,892	30,916	19,531	9	50,456
Trading securities	–	871	26	897	–	843	15	858
Securities purchased under repurchase agreements	5,775	–	–	5,775	499	–	–	499
Amounts due from credit institutions	14,419	2,132	6,125	22,676	42,666	–	3,840	46,506
Investment securities available–for–sale	149,400	–	–	149,400	82,027	–	–	82,027
Investment securities held to maturity	506	–	–	506	714	–	–	714
Loans to banks	4,379	–	–	4,379	1,909	–	–	1,909
Loans to customers	187,868	–	–	187,868	119,520	–	–	119,520
Other financial assets	159	–	–	159	98	–	–	98
	467,994	**30,399**	**6,159**	**504,552**	**278,349**	**20,374**	**3,864**	**302,587**
Financial liabilities:								
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	24,007	–	–	24,007	12,486	–	–	12,486
Amounts due to customers	338,599	–	–	338,599	166,391	–	–	166,391
Amounts due to credit institutions	–	6,786	–	6,786	–	–	–	–
Other financial liabilities	1,269	–	–	1,269	154	–	–	154
	363,875	**6,786**	**–**	**370,661**	**179,031**	**–**	**–**	**179,031**
Net assets	**104,119**	**23,613**	**6,159**	**133,891**	**99,318**	**20,374**	**3,864**	**123,556**

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. In addition, the Bank maintains obligatory reserves with the CBA, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank based on certain liquidity ratios established by the CBA. As at 31 December 2010 and 2009 these ratios were as follows:

	31 December 2010, %	31 December 2009, %
Instant Liquidity Ratio (assets receivable or realisable within one day / liabilities repayable on demand)	171	77

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2010 and 2009 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

(in thousands of Azerbaijani Manats)	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total 2010
Financial liabilities (As at 31 December 2010)					
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	98	7,641	16,628	485	**24,852**
Amounts due to customers	254,282	67,249	26,362	-	**347,893**
Amounts due to credit institutions	1,395	5,553	-	-	**6,948**
Other financial liabilities	149	1,120	-	-	**1,269**
Total undiscounted financial liabilities	**255,924**	**81,563**	**42,990**	**485**	**380,962**

(in thousands of Azerbaijani Manats)	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total 2009
Financial liabilities (As at 31 December 2009)					
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	57	176	12,434	341	**13,008**
Amounts due to customers	134,482	34,182	-	-	**168,664**
Other financial liabilities	154	-	-	-	**154**
Total undiscounted financial liabilities	**134,693**	**34,358**	**12,434**	**341**	**181,826**

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies.

(in thousands of Azerbaijani Manats)	Less than 3 months	3 to 12 months	1 to 5 years	Maturity undefined	Total
As of 31 December 2010	12,036	20,859	4,194	–	37,089
As of 31 December 2009	14,931	12,719	3,015	–	30,665

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The Bank's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant concentration of deposits from organizations of related parties in the period of one year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than three months in the tables above.

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. The Bank manages exposures to market risk based of sensitivity analysis. The Bank has no significant concentration of market risk.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's current year profit.

The sensitivity of current year profit is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2010. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2010 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve. However, as interest rate of available–for–sale securities in the local market is based on the carried accrued discount or premiums on these securities at the time of purchase or sale (as included in actual price of purchased or sold securities), thus, any change in the rates to be applied to the fixed-rate available-for-sale financial assets does not have any impact or effect on equity.

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

As at 31 December 2010 the Bank had the following exposure to foreign currency exchange rate risk:

(in thousands of Azerbaijani Manats)	AZN	USD	EUR	OTHER	Total 2010
Financial assets					
Cash and cash equivalents	83,216	38,586	10,946	144	132,892
Trading securities	–	439	402	56	897
Securities purchased under agreements to resell	5,775	–	–	–	5,775
Amounts due from credit institutions	7,031	1,551	14,094	–	22,676
Investment securities available–for–sale	149,400	–	–	–	149,400
Investment securities held to maturity	304	202	–	–	506
Loans to banks	3,901	478	–	–	4,379
Loans to customers	161,668	15,788	10,412	–	187,868
Other financial assets	24	69	62	4	159
Total financial assets	**411,319**	**57,113**	**35,916**	**204**	**504,552**
Financial liabilities					
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	24,004	3	–	–	24,007
Amounts due to customers	273,782	34,438	30,350	29	338,599
Amounts due to credit institutions	–	1,330	5,456	–	6,786
Other financial liabilities	1,228	10	31	–	1,269
Total financial liabilities	**299,014**	**35,781**	**35,837**	**29**	**370,661**
Net financial position	**112,305**	**21,332**	**79**	**175**	**133,891**

As at 31 December 2009 the Bank had the following exposure to foreign currency exchange rate risk:

(in thousands of Azerbaijani Manats)	AZN	USD	EUR	OTHER	Total 2009
Financial assets					
Cash and cash equivalents	22,888	2,768	24,758	42	50,456
Trading securities	–	415	398	45	858
Securities purchased under agreements to resell	499	–	–	–	499
Amounts due from credit institutions	29,254	7,333	9,080	839	46,506
Investment securities available–for–sale	82,027	–	–	–	82,027
Investment securities held to maturity	294	420	–	–	714
Loans to banks	1,101	808	–	–	1,909
Loans to customers	105,406	13,889	225	–	119,520
Other financial assets	9	43	27	19	98
Total financial assets	**241,478**	**25,676**	**34,488**	**945**	**302,587**
Financial liabilities					
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	12,486	–	–	–	12,486
Amounts due to customers	103,502	28,074	34,801	14	166,391
Other financial liabilities	147	–	7	–	154
Total financial liabilities	**116,135**	**28,074**	**34,808**	**14**	**179,031**
Net financial position	**125,343**	**(2,398)**	**(320)**	**931**	**123,556**

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

Impact on profit before tax based on assets value as at 31 December 2010 and 2009:

	31 December 2010		31 December 2009	
	AZN/USD +10%	AZN/USD -10%	AZN/USD +10%	AZN/USD -10%
Impact on profit before tax	(2,133)	2,133	240	(240)

	31 December 2010		31 December 2009	
	AZN/EUR +10%	AZN/EUR -10%	AZN/EUR +10%	AZN/EUR -10%
Impact on profit before tax	(8)	8	31	(31)

Note 26
Fair values of financial instruments

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

(in '000 of Azerbaijani Manats)	Level 1	Level 2	Level 3	Total
At 31 December 2010				
Financial assets				
Trading securities	897	–	–	897
Investment securities available–for–sale	149,400	–	–	149,400
	150,297	**–**	**–**	**150,297**

(in '000 of Azerbaijani Manats)	Level 1	Level 2	Level 3	Total
At 31 December 2009				
Financial assets				
Trading securities	858	-	-	858
Investment securities available–for–sale	82,027	-	-	82,027
	82,885	**-**	**-**	**82,885**

Financial instruments recorded at fair value
The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Bank's estimate of assumptions that a market participant would make when valuing the instruments.

Fixed rate financial instruments
The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. For quoted debt issued the fair values are calculated based on quoted market prices. For those notes issued where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term to maturity.

Fair value of financial assets and liabilities not carried at fair value
Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

(in thousands of Azerbaijani Manats)	Carrying value 2010	Fair value 2010	Unrecognized gain/(loss) 2010	Carrying value 2009	Fair value 2009	Unrecognized gain/(loss) 2009
Financial assets						
Cash and cash equivalents	132,892	132,892	–	50,456	50,456	–
Amounts due from credit institutions	22,676	22,676	–	46,506	46,506	–
Investment securities held to maturity	506	506	–	714	714	–
Loans to banks	4,379	4,379	–	1,909	1,909	–
Loans to customers	187,868	187,868	–	119,520	119,520	–
Financial liabilities						
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	24,007	24,007	–	12,486	12,486	–
Amounts due to customers	338,599	338,599	–	166,391	166,391	–
Amounts due to credit institutions	6,786	6,786	–	–	–	–
Total unrecognised change in unrealised fair value			**–**			**–**

Assets for which fair value approximates carrying value
For financial assets and financial liabilities that are liquid or having a short term maturity (less than thee months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits, without a specific maturity and variable rate financial instruments.

Fixed and variable rate financial instruments
For quoted debt instruments the fair values are determined based on quoted market prices. The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

Note 27 Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled

See Note 25 "Risk management" for the Bank's contractual undiscounted repayment obligations.

(in thousands of Azerbaijani Manats)	31 December 2010 Within 1 year	More than 1 year	Total	31 December 2009 Within 1 year	More than 1 year	Total
Cash and cash equivalents	132,892	-	132,892	50,456	-	50,456
Trading securities	897	-	897	858	-	858
Securities purchased under agreements to resell	5,775	-	5,775	499	-	499
Amounts due from credit institutions	22,437	239	22,676	46,506	-	46,506
Investment securities available–for–sale	111,757	37,643	149,400	82,027	-	82,027
Investment securities held to maturity	209	297	506	513	201	714
Loans to banks	2,379	2,000	4,379	1,909	-	1,909
Loans to customers	59,540	128,328	187,868	63,981	55,539	119,520
Property and equipment	3,549	-	3,549	1,400	-	1,400
Intangible assets	1,607	-	1,607	712	-	712
Other assets	2,755	-	2,755	1,832	-	1,832
Total assets	**343,797**	**168,507**	**512,304**	**250,693**	**55,740**	**306,433**
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	7,002	17,005	24,007	1	12,485	12,486
Amounts due to customers	315,779	22,820	338,599	166,391	-	166,391
Amounts due to credit institutions	6,786	-	6,786	-	-	-
Current income tax liabilities	573	-	573	-	-	-
Provision for guarantees and other commitments	1,582	-	1,582	781	-	781
Other liabilities	3,942	-	3,942	205	-	205
Total liabilities	**335,664**	**39,825**	**375,489**	**167,378**	**12,485**	**179,863**

Long-term loans are generally not available in Azerbaijan except for programs set up by international financial institutions. However, in the Azerbaijan marketplace, many short-term credits are granted with the expectation of renewing the loans at maturity. As such, the ultimate maturity of assets may be different from the analysis presented above. In addition, the maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due on demand in the tables above. While trading securities are shown at demand, realizing such assets upon demand is dependent upon financial market conditions. Significant security positions may not be liquidated in a short period of time without adverse price effects.

Note 28
Related party disclosures

In accordance with IAS 24 “Related Party Disclosures”, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related party transactions were made on terms equivalent to those that prevail in arm’s length transactions.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

(in thousands of Azerbaijani Manats)	31 December 2010 Parent	31 December 2010 Entities under common control	31 December 2010 Key management personnel	31 December 2010 Other	31 December 2010 Total	31 December 2009 Parent	31 December 2009 Entities under common control	31 December 2009 Key management personnel	31 December 2009 Other	31 December 2009 Total	(in thousands of Azerbaijani Manats)
Loans outstanding at 1 January, gross	–	2,350	113	–	**2,463**	–	–	4	–	**4**	Loans outstanding at 1 January, gross
Loans issued during the year	–	21,371	528	–	**21,899**	–	4,539	172	–	**4,711**	Loans issued during the year
Loan repayments during the year	–	(2,479)	(407)	–	**(2,886)**	–	(2,189)	(63)	–	**(2,252)**	Loan repayments during the year
Interest accrual	–	85	2	–	**87**						Interest accrual
Loans outstanding at 31 December, gross	**–**	**21,327**	**236**	**–**	**21,563**	**–**	**2,350**	**113**	**–**	**2,463**	Loans outstanding at 31 December, gross
Less: allowance for impairment at 31 December	–	(102)	(1)	–	**(103)**	–	–	–	–	**–**	Less: allowance for impairment at 31 December
Loans outstanding at 31 December, net	**–**	**21,225**	**235**	**–**	**21,460**	**–**	**2,350**	**113**	**–**	**2,463**	Loans outstanding at 31 December, net
Interest income on loans	–	1,768	36	–	**1,804**	–	86	7	–	**93**	Interest income on loans
Deposits at 1 January	14,310	100	317	37,881	**52,608**	33,303	100	100	–	**33,503**	Deposits at 1 January
Deposits received during the year	52,523	6,800	303	77,564	**137,190**	20,753	–	217	51,777	**72,747**	Deposits received during the year
Deposits repaid during the year	(14,132)	(100)	(319)	(64,754)	**(79,305)**	(39,746)	–	–	(13,896)	**(53,642)**	Deposits repaid during the year
Deposits at 31 December	**52,701**	**6,800**	**301**	**50,691**	**110,493**	**14,310**	**100**	**317**	**37,881**	**52,608**	Deposits at 31 December
Current accounts at 31 December	16,010	49,408	31	30,262	**95,711**	6,101	32,994	21	35,354	**74,470**	Current accounts at 31 December
Interest expense on deposits	(1,988)	(60)	(27)	(3,497)	**(5,572)**	(1,230)	(9)	(10)	(1,790)	**(3,039)**	Interest expense on deposits
Guarantees issued	–	6,152	–	–	**6,152**	–	3,082	–	–	**3,082**	Guarantees issued
Letters of credit issued	–	948	–	–	**948**	–	–	–	–	**–**	Letters of credit issued
Unused credit lines	–	321	–	–	**321**	–	1,659	–	–	**1,659**	Unused credit lines
Fee and commission income	31	531	4	–	**566**	61	513	–	–	**574**	Fee and commission income
Other operating expenses	–	(30)	–	(70)	**(100)**	–	(154)	–	(60)	**(214)**	Other operating expenses

(in thousands of Azerbaijani Manats)	Year ended 31 December 2010	Year ended 31 December 2009
Salaries and other benefits	(1,222)	(811)
Social security costs	(269)	(178)
Total key management compensation	**(1,491)**	**(989)**

Note 29
Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the ratios established the CBA and the Basel Capital Accord 1988 in supervising the Bank.

During the past year, the Bank had complied in full with all it's externally imposed capital requirements

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

CBA capital adequacy ratio

The CBA requires banks to maintain a minimum capital adequacy ratio of 12% of risk-weighted assets. As of 31 December 2010 and 2009 the Bank's capital adequacy ratio on this basis was as follows:

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Tier 1 capital	124,216	108,809
Tier 2 capital	11,436	17,901
Less: Deductions from capital	(1,607)	(712)
Total regulatory capital	**134,045**	**125,998**
Risk-weighted assets	**269,457**	**199,549**
Capital adequacy ratio	50%	63%

Capital adequacy ratio under Basel Capital Accord 1988

The Bank's capital adequacy ratio, computed in accordance with the Basel Capital Accord 1988 (which recommends a minimum capital adequacy ratio of 8% for Tier 1and Total regulatory capital), with subsequent amendments including the amendment to incorporate market risks, as of 31 December 2010 and 2009, comprised:

(in thousands of Azerbaijani Manats)	31 December 2010	31 December 2009
Tier 1 capital	136,815	126,570
Tier 2 capital	-	-
Total regulatory capital	**136,815**	**126,570**
Risk-weighted assets	**222,371**	**163,377**
Tier 1 capital adequacy ratio	62%	77%
Total capital adequacy ratio	62%	77%

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