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Introduction







Foreword by Chairman of the Supervisory Board and Chairman of the Executive Board

Dear shareholders, clients and partners,

The year 2009 presented a challenging year for the global economy – a year into the crisis that has affected many ventures.

It was an even more challenging year for PASHA Bank, a financial institution which was established only two years ago with a striving goal to take its place among top five banks of the country.

Quality, integrity and profitability are three pillars on which the mission of PASHA Bank has been built upon. Despite the difficulties of the crisis year, we did not compromise on any of the principles of our brand.

The global crisis we have witnessed at the very start of our operations has become a good proof-test for PASHA Bank's internal processes and risk management.

The Bank has demonstrated itself as a prudent lender in the market – an approach which proved not to be inconsistent with the desire to be profitable.

Right from the very start we declared that our aim was to be customer-oriented and transparent.

We planned to establish broad international relations and to be perceived as a reliable partner and stable organization. Time has demonstrated that such business idea has the right appeal and surely deserves a future.

These were not the only aspirations for the year 2009. PASHA Bank's three-year strategy spanning the period of 2009-2011 is well on its way. The bank's commitment for the first year was:

- to reinforce its positions as a corporate institution that provides a broad range of services to its corporate customers,
- to establish and develop long-term and trust-based relations with its customers and
- to deliver banking services at the highest level of transparency and service quality.

Firmly believing in the importance of small and medium enterprises (SMEs) for the private sector and economy of Azerbaijan in general and recognizing its potential for further growth, PASHA Bank has developed tailor-made products for the companies that are qualified by the bank as SMEs and supported its SME clients throughout these difficult days. This will remain a strategic focus for the years ahead.

Because of the deteriorated loan market in Azerbaijan and continued credit demand PASHA Bank

benefited efficiently from its strong capital position throughout the crisis and established itself in the market as a strong partner for companies with transparent and sustainable management.

2009 was the year when PASHA Bank continued its effort to recruit talented individuals through open recruitment practice. The strategic goal is to establish a professional team of highly motivated employees capable of handling complex challenges of today's and tomorrow's banking and financial services sectors. We attach a great importance to the personal development of our staff – a key to the sustained organizational performance.

PASHA Bank has taken an active part in the life of international banking community, presenting the Bank and the country to the leading financial institutions of the world. The results were rewarding: the trust in the newly-founded Bank with prudent and responsible banking ethics has been established and a network of relations with corresponding banks has grown. Thanks to successful negotiations with international financial institutions PASHA Bank has been able to offer its clients a greater range of financial instruments.

As a result of its strategy, the Bank has efficiently and prudently managed its balance sheet to achieve one of the market highest returns on assets 5.53% and income (before tax and provision) per employee ratios 182,2 thousands, to reach a well-structured diversification of its asset base both between sectors of the economy and the classes of assets, and to meet the strategic imperative for cost-income ratio 25.3%.

We attach a great importance to the personal development of our staff – a key to the sustained organizational performance

Total assets of PASHA Bank have increased by 55% in comparison with the previous year reaching AZN 306 million. The Bank's loan portfolio has grown 2.6-fold and reached AZN 122 million compared to AZN 46 million back in 2008. The Bank's net profit for 12 months ended 2009 rising by 49% in comparison with the same period of 2008 and reached to AZN 16 million. Interest income of the Bank reached over AZN 24 million while non interest income grew 2.3 times and was AZN 2.6 million.

The results of 2009 placed PASHA Bank among five most profitable banks of Azerbaijan and the 8th in terms of asset size. The Bank has kept its position as the largest commercial bank by total equity which reached the level of AZN 126.6 million.

With a dedicated focus on trade and corporate finance services, the bank offers a range of products and services including those within the framework of project and trade finance-related partnerships with foreign banks. As a result, in 2009 the trade finance portfolio increased almost a 2.3-fold: from AZN 10 million in 2008 to AZN 22.9 million in 2009.

The year 2009 was indeed successful, but we still have a long way to go: the Bank has set new goals for 2010. By the end of 2010, we are planning to increase the assets to over AZN400 million with a gross loan portfolio reaching AZN200 million. The Bank's trade-related portfolio including both on- and off-balance sheet exposures is expected to reach AZN 60 million reflecting the Bank's focus on new opportunities for growth within the SME sector of Azerbaijan.

According to our development strategy for the next few years, we plan to establish offices in the major regions of the country. PASHA Bank will expand into the northern, northwest, western and southern regions of the country and this network will offer services to small and medium businesses.

PASHA Bank is developing its work with financial services providers in Azerbaijan including both banks and non-bank credit institutions. The Bank has established itself as a market maker in the interbank and foreign exchange markets in Azerbaijan giving preference to work with institutions capable and willing to support international standards of settlements.

The development of the wealth management services, another strategic focus area, is firmly on the agenda of the Bank and the year 2010 will mark a crucial step in that direction, too.

With the team of motivated professionals we are full of energy and drive to take the Bank further to the top league of banking service providers in Azerbaijan. We are confident our values and business focus will help us to achieve the goals.

PASHA Bank's business is built on the basis of a common corporate philosophy and culture. Being a new bank, we are open to cooperation with any company that shares our approach to financial resource management and our core values.

On behalf of PASHA Bank team we would like to use the opportunity to thank our customers and partners for their contributions to our success: for their support, for their cooperation and, ultimately, for their trust.

Yours sincerely,

Mir Jamal Pashaev
Chairman of the Supervisory Board



Farid Akhundov
Chairman of the Executive Board



National Economy in 2009

Despite a time of great global economic difficulties, real GDP expanded by 9.3%, one of the highest rates in the region. Investments decreased by 43% compared to 2008 and totaled to approximately USD 10 billion, mostly reflecting the drop in foreign investment inflows to oil sector since the most intensive stages of major oil and gas projects are past. Also noteworthy, the current-account surplus is estimated to have fallen to USD 10.2 billion (equivalent to 23.6% of GDP), owing to the decline in oil prices.

Annual inflation had significantly decreased to 1.5%, whereas average nominal wages rose by 8.6 % year on year terms in 2009. This combination supported domestic demand, as highlighted by the 8.9% expansion in retail sales. The Manat, national currency, not just remained stable but even continued a trend of previous years and slightly appreciated against the U.S. dollar, with the nominal exchange rate of 0.8030 AZN as of January 1, 2010. In December 2009, S&P revised the outlook on Azerbaijan to positive from stable, and affirmed the 'BB+' long-term and 'B'

short-term sovereign credit ratings. The transfer and convertibility assessment remained 'BBB-'.

Despite a time of great global economic difficulties, real GDP expanded by 9.3%, one of the highest rates in the region

As for the forecast for 2010, real GDP is due to expand by 6-7%, being supported by approximately 5% increase in oil production; in addition, country economy will benefit from the effects of higher oil prices and increased external demand. Investments are expected to expand up to USD 14 billion (+40%), major of which to be domestic public investments in non-oil sectors, specifically such as agriculture and manufacturing. An increase in energy prices and higher external demand mean that the surplus will be around 25-30% of GDP.

Increasing oil revenue inflows will push up consumer prices, to a forecast average of 6%. The currency is forecast to remain stable, at Manat 0.8 : USD 1.

Business environment. Economy overview.

International assumptions summary (% unless otherwise indicated)	2008	2009	2010	2011
Real GDP growth				
World	2.9	-0.9	3.8	3.5
EU27	0.7	-4.2	0.9	1.1
Euro area	0.6	-4.0	0.8	1.0
Turkey	0.9	-5.3	3.6	3.8
Exchange rates				
¥:US\$	103.4	93.7	90.9	90.0
US\$:EURO	1.470	1.393	1.365	1.323
SDR:US\$	0.629	0.646	0.650	0.642
Financial indicators				
EURO 3-month interbank rate	4.65	1.23	0.70	0.93
US\$ 3-month commercial paper rate	2.18	0.26	0.20	0.50
Commodity prices				
Oil (Brent; US\$/b)	97.7	61.9	77.0	73.0
Gold (US\$/troy oz)	871.8	973.0	1,150.0	1,213.8
Food, feedstuffs & beverages (% change in US\$ terms)	29.5	20.6	2.0	-3.0
Industrial raw materials (%change in US\$ terms)	-5.1	-25.6	31.5	0.6

Business environment. Economy overview.

Forecast summary for Azerbaijan (% unless otherwise indicated)	2008a	2009b	2010c	2011c
Real GDP growth	10.8	9.3a	8.9	8.4
Industrial production growth	6.0	8.6a	9.5	9.0
Gross fixed investment growth	5.8b	5.0	6.0	5.5
Unemployment rate (av)	0.9	1.0	1.0	1.1
Consumer price inflation (av)	20.8	1.5a	5.5	5.1
Consumer price inflation (year-end)	15.4	0.6a	5.4	5.2
Short-term interbank rate	19.8	20.0	19.6	19.4
Consolidated government balance (% of GDP)	-5.1b	-7.0	-5.0	-4.6
Exports of goods fob (US\$ bn)	30.6	19.9	27.5	27.1
Imports of goods fob (US\$ bn)	7.6	6.8	7.4	8.1
Current-account balance (US\$ bn)	16.5	8.0	14.5	13.2
Current-account balance (% of GDP)	33.7	14.1	21.5	16.2
External debt (year-end; USS bn)	2.6b	2.4	2.4	2.4
Exchange rate Manat: US\$ (av)	0.82	0.80a	0.80	0.77
Exchange rate Manat: Rb (av)	0.03	0.03a	0.03	0.03
Exchange rate Manat: YTL (av)	0.63	0.52a	0.51	0.48

a – Actual. b – Economist Intelligence Unit estimates. c – Economist Intelligence Unit forecasts.

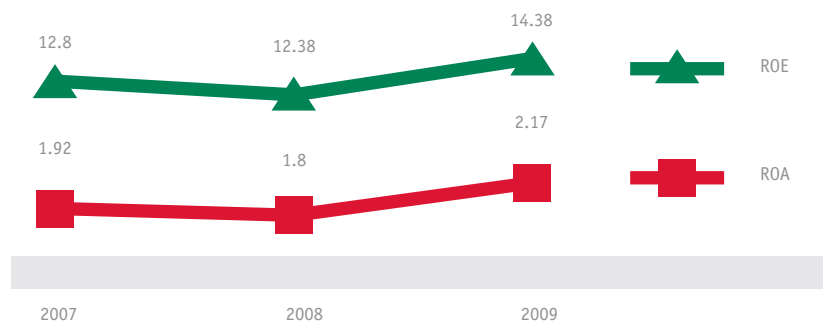
© The Economist Intelligence Unit Limited 2010

Banking Sector in 2009

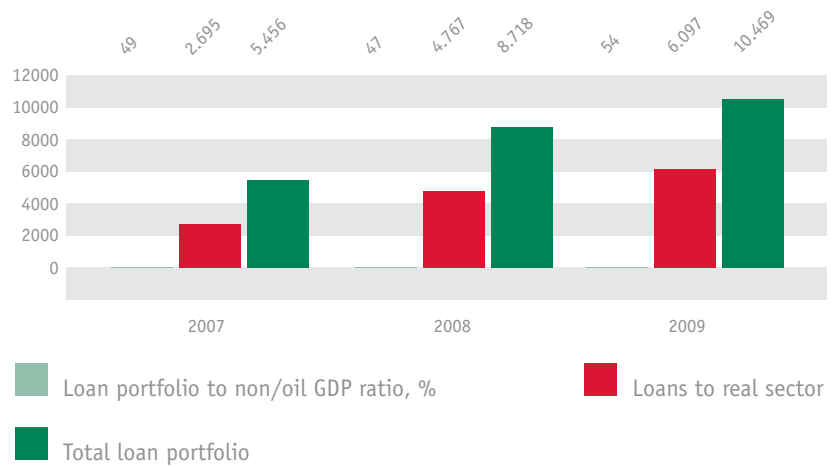
Providing of liquidity due to the anti-crisis measures of the government has kept stability and trust in the banking sector. A subject of concerns was the quality of the bank assets where the overdue loans' share had an increasing trend. In 2010 it is expected the share will reach its peak and start to decrease.

Toughening the bank capitalization requirements on the one hand, and profit tax privileges on the other, maintained the current level of capital adequacy (17,8 % by January 1, 2010). Despite the reduction of the bank margins and profitability of crediting operations, profitability of the bank sector has continued to show the growth tendency (+40 % in 2009).

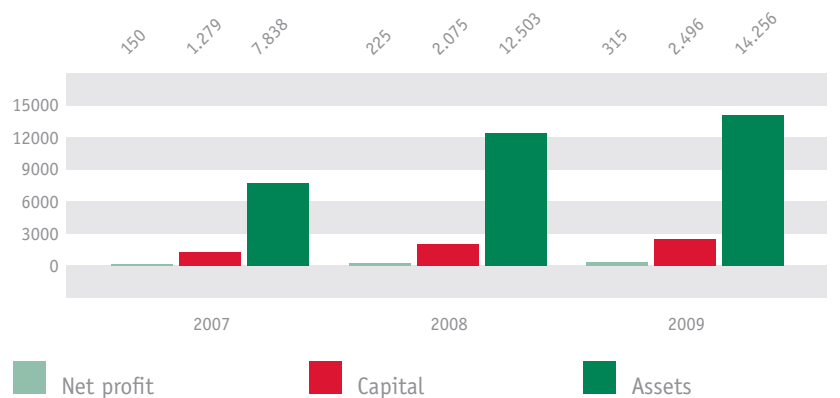
Efficiency of the banking system of Azerbaijan



Banking sector, Credit portfolio, mln. USD



Banking sector indicators, mln. USD



PASHA Bank OJSC

PASHA Bank OJSC was registered by the Azerbaijani Ministry of Justice as an open joint-stock company on 18 June 2007.

The Bank's license issued by the Central Bank of Azerbaijan followed on 28 November 2007.

The Bank took 4th position in terms of profit and 8th position on the basis of asset size by the end of the year. The financial statements of PASHA Bank are audited by Ernst & Young. The Bank is, amongst others, cooperating with international companies such as Deloitte, PricewaterhouseCoopers, Baker & McKenzie and others on tax and legal issues.

The Bank took 4th position in terms of profit and 8th position on the basis of asset size by the end of the year



PASHA Bank market positions	2008	2009	2010*
By profit	5	4	3
By capital	2	2	2
By assets	12	8	6

Source: CBA Fineco

* Forecasted

Mission

Our mission is to become a leading bank providing financial services of the highest quality based on principles of ethical business conduct. Corporate philosophy of the Bank is based on the following three principles: Transparency, Quality and Profitability.

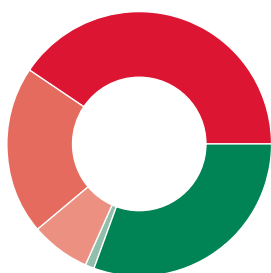
Corporate philosophy of the Bank is based on the following three principles: Transparency, Quality and Profitability.

The Bank. Performance.

(in thousands of Azerbaijani Manats)	Year end 2008	Year end 2009	Q1/10
Total assets	197 637	306 443	329 897
Loans to customers	44 207	119 520	134 034
Customers' time deposits	40 020	72 609	77 315
Customers' current accounts	42 526	93 780	104 225
Shareholders equity	110 551	126 570	126 226
Interest income	18 639	24 384	7 593
Fee and commission income	1 527	1 445	396
Net gains on dealings with currency	433	1 781	877
Net income	10 765	16 059	2 010
Income per employee	255	176	19
Total expenses	2 407	5 731	1 084
Cost per employee	39	32	5
ROA	7.29%	7.05%	7.18%
ROE	12.52%	16.95%	23.00%
Loans to Deposits	56.00%	73.37%	77.41%
Cost/Income	11.90%	25.27%	19.88%
Non % income/Total income	9.70%	14.11%	12.65%

Based on audited financial statements. © 2010 PASHA Bank, as of 31.03.2010.

Assets breakdown, Q1 2010



■	30.33% Investments
■	1.23% Other assets
■	7.27% Cash and balances with the CBA
■	40.63% Loans to customers
■	20.54 Due from credit institutions

- Loans to customers at the level of 40.63% represent major part of assets
- Followed by investments with share 30.33% and due from credit institutions by 20.54%
- Cash and balances with the CBA reach share of 7.27%

Financial Services

PASHA Bank is a full-fledged commercial bank offering its services to the following client segments in the market: corporate clients and SMEs, banks and non-bank financial institutions and higher-net-worth individuals (HNWIs).

The Bank offers payment, foreign exchange, cash management, deposit, current account and many other services, and have a range of credit products for its clients, namely short working capital financing through loans, documentary credits, guarantees, invoice discounting, factoring and others and longer-term project financing.

By the end of 2010 the Bank plans to increase this loan portfolio from current AZN122 million to AZN 200 million with its trade finance portfolio up to AZN 60 million from current AZN 29 million

The rising demand for the credit in the market and the continuous improvement of the bank's internal processes and risk management structure create the right foundation for the growth plans set for the year 2010. By the end of 2010 the Bank plans to increase this loan portfolio from current AZN122 million to AZN200 million with its trade finance portfolio up to AZN 60 million from current AZN 29 million. The Bank will target clients from SME sector to serve the growing needs for financial services of the sector and to diversify its loan portfolio in terms of industry exposures. To meet the goal the Bank has lined up trade and export credit lines from foreign partner banks and export agencies abroad and has become a member of the Fund for Entrepreneurship in Azerbaijan.

PASHA Bank is also the member of the Azerbaijan Mortgage Fund and Deposit Insurance Fund both under the Central Bank of the Republic of Azerbaijan.

The Bank's strategy is focused on the non-oil sectors of the economy such as telecommunications, transport, trade and services, agro-industry and others – the industries actively supported by the government through various strategies. The annual growth of economy of Azerbaijan and the importance of the

The Bank is a member of National clearing system and is also an associated member in both MasterCard and VISA payments systems

development of the non-oil sector in the country are firmly believed to promote demand for banking services and, therefore, open new opportunities for the Bank. The Bank is developing its infrastructure capable of handling complex and numerous banking transactions.

The Bank has not limited itself to financing the needs of our clients within Azerbaijan but is ready to support the geographical expansion of our clients by way of direct financing, co-financing with foreign partners and arranging financing from foreign financial institutions.

Our wealth management division is well advanced in the development of strategy aimed at providing services to the higher-net-worth individuals. It is now getting involved in product development and drafting operational guidelines.

The Bank is a member of National clearing system and is also an associated member in both MasterCard and VISA payments systems. The latest technology being implemented in the bank will allow fast and efficient processing of payments in line with the requirements of modern times.

Branding, image promoting and product development remain priority. The focus will be on strengthening the brand appeal, its openness to targeted customer groups, the ease of access to the Bank for financing and other financial services and the development of tailor-made services to clients. The emphasis on relationship banking not transaction banking will be a key in achieving the trust of general public, and our clients in particular.

1. Better

1.1 Tieto Software

We strongly believe that information and telecommunication technologies are one of the essential factors that guarantee high quality of services. We are now in the process of implementing the new banking software, BankSyst, a product of Tieto, an international IT company. The first phase of the project started in January 2009 was successfully completed. Besides the operating system, the Bank is now working on fine-tuning the asset management, treasury control, cards management and management information/reporting modules. The new technology will be gradually

rolled on for the benefit of the bank and its clients in 2010 and 2011. The major benefits for our clients will include but not be limited to the remote access to accounts, the faster speed of processing transactions and flexibility of product development to meet the needs of our clients.

The Card Suite module implemented by the Bank jointly with Tieto and AzeriCard Processing centre will ensure on-line acquiring and processing of the cards issued by PASHA Bank and other issuers. The integration of the new cards platform was completed in six months. The cooperation with Tieto allowed PASHA Bank to concentrate on the core business and rely on the outsourced IT expertise leading to more effective use of resources and a faster time-to-market ratio for the technology.

1.2 Public Relations and Marketing

The Bank's branding, image promotion and marketing effort are in line with the strategic goal of becoming a preferred bank for business and private clients valuing integrity, professionalism, long-term relationship and reliability. The Bank continued its endeavors to target business clients with transparent ownership structures and sustainable management teams.

To promote the brand PASHA Bank in the market and build the image of modern bank caring for the future of our clients and the country as a whole the Bank has been supporting the transparent disclosures of its activities and plans in media, developing seminars on bank products and services for professional audience and participating in industrial and other exhibitions in Azerbaijan and abroad. Within the framework of proprietary Social Responsibility Policy the Bank supported projects aimed at youth education, cultural development and sports.

1.3 Wealth Management

The on-shore wealth management model developed by the Bank will have a phased approach whereby needs-based service proposition will prevail. The client package and diversity of services offered will depend on the needs of our clients not the wishes of sales and service agents.

The Bank, right from the beginning in 2007, declared its strategy will focus on the higher-net-worth

individuals. A reflection of this declaration was the minimum amount of deposit required by the Bank for private account opening (100,000AZN/USD/EUR). In line with our strategy, the wealth management products will be made available to our clients during 2011.

Recognizing the complexities of the wealth management the Bank was in no rush to engage in the business and choose instead to develop its strategy and resources over time to provide professional services for a long-term horizon based on trust.

1.4 Master Card & VISA

The Bank has become an associated certified member of Master Card and Visa payments systems to ensure our corporate and private clients have card in a step card product. Since we are not a retail bank, these directions just supplement the services we provide. We are now working on branding and creation of products for our corporate customers: business cards, credit cards and salary cards.

We are now working on branding and creation of card products for our corporate customers: business cards, credit cards and salary cards

2. Safer

2.1 Corporate Governance

PASHA Bank pays particular attention to best practices in corporate governance, viewing them as an essential element of successful long-term development.

The Bank's core values are integrity, quality and profitability. The Bank strives to deliver the highest quality financial services and believes partnership to be the basis of client relations. The Bank acts with honesty and integrity with its employees, clients, competitors and partners. Our Banks seeks to be in the front line of innovations and technology. In 2008, we opted for an information systems solution that meets our requirements and will ensure seamless services for our clients. The new IT infrastructure is currently being implemented in all areas of Bank's activities.

Prudence, fairness, immediacy and other values as a concept overall and in financial management particularly is the ground-breaking achievement of PASHA Bank

2.2 Prudent Financial Management

Banking system of Azerbaijan managed to avoid many of the financial problems that afflicted the banks in the U.S. and Europe. PASHA Bank has put a lot of efforts not to affect and be affected by the financial crises which could have adversely influenced the situation in sound banking system and affect the stable growth the economy. Thus, the prudent financial management concept became a cornerstone in PASHA Bank's operations and the Bank has insured itself on the consequences of such possible negatives.

The essence of Financial Management policy of the Bank provides a comprehensive overview of the theory and main techniques of financial management. It assists managers to assess financial matters, and gives them a full understanding of the financial objectives of a business, the environment in which the business operates, and fundamental accounting concepts such as the statement of financial position, statement of comprehensive income, statement of changes in equity and statement of cash flows. All this process is supported by the efficient and timely reporting, which is one of the main tools of financial management in the Bank.

Prudence, fairness, immediacy and other values as a concept overall and in financial management particularly is the ground-breaking achievement of PASHA Bank. The ability to control consistency of the financial position of the Bank with financial targets develop and adhere the strategy is a key element of financial management in PASHA Bank. This is confirmed by the financial highlights and ratios of the Bank as the evidence of the rapid expansion of the Bank within the acceptable risk.

2.3 Card Module

PASHA Bank is a modern, innovative financial institution that focuses on the commercial and corporate sectors and affluent private clients. The banking business is growing rapidly in the country and PASHA Bank aims at entering the card business with the help of an innovative, flexible platform on which it

can build and continuously enhance its payment card product portfolio.

PASHA Bank has chosen the Tieto Card Suite to deliver a total package for establishing the Bank's card business operations.

The Tieto Card Suite is a payment card solution for issuing, acquiring, switching, clearing, settlement and fraud management. It is used by banks and large payment card transaction processing centers in 30 countries worldwide. Card Suite customers have chosen Tieto for its capability to deliver innovative solutions with a solid return on investment.

Implementing Tieto's Card Suite issuing solution will enable the Bank to increase the number and quality of payment products and services it offers to its clients.

3. Closer

3.1 Website

PASHA Bank identifies as an innovative financial institution that embraces new IT solutions. Its website features comprehensive information about bank's activity, rendered services, offered products, projects and contacts.

Visit www.pashabank.az and you will surely find all the answers pertaining to our business, ranging from information on the Bank's mission and vision, management, correspondent ties, financial statements, to our risk management policy, news, and social activities. Whether you are a corporate or a private client, our website can help you to understand the way we do business and offer you a solution in just seconds, wherever you are.

3.2 e-Terminal

As of 11 August 2009, PASHA Bank introduced its new facility, the cash exchange machine. This cash

Whether you are a corporate or a private client, our website can help you to understand the way we do business and offer you a solution wherever you are

exchange machine, which is the only one in the local market at present, is located at PASHA Bank's e-Terminal in "Shuvalan-Park" business center. Using this facility, which is most convenient to use, clients will be able to buy (AZN & USD) and sell (AZN, EUR and USD) local and foreign currencies throughout all week days, including holidays and days-off.

3.3 Treasury and Risk Management

Treasury Management is also the Management of Risks. The Bank utilizes various financial instruments in order to:

- address the needs of our borrowers
- manage its exposure to market fluctuations in interest rates and currency exchange rates, and
- temporarily invest Bank's liquidity prior to disbursement.

The Bank is currently at the stage of creating its own customer rating policy. This will enable us to mitigate risks by using internal ratings and comparing it with the external ones.

The Bank maintains framework of exposure limits based on counterparty credit rating and size, subject to a maximum of the relevant percent of the Bank's total tier capital. The Bank is currently at the stage of creating its own customer rating policy. This will enable us to mitigate risks by using internal ratings and comparing it with the external ones.

The treasury risk managers play a strategic role in the monitoring such exposures and reporting on a regular basis. Thus, the treasury is supported by the Treasury Control division which is an integral part of the financial and risk management of the Bank.

Funding, liquidity, capital and foreign exchange exposures are managed on a centralized basis through Assets and Liability Management Committee (ALCO), which includes the CEO, members of the Executive Board, CFO and Head of Treasury. It is ALCO's responsibility to review the capital situation, key financial ratios development, current and pro-

spective funding and foreign exchange exposures and to define and monitor adherence to internal treasury risk limits.

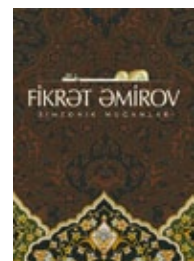
3.4 Social Responsibility

PASHA Bank is a responsible corporate citizen of Azerbaijan. Therefore social and charity projects represent an important aspect of PASHA Bank's activities. They include projects supporting development of sports and culture in the country. The projects, supported by PASHA Bank, are seen to promote Azerbaijan on the international arena, as well as to increase awareness about our country's culture and historical heritage worldwide.

Being a socially active organization, PASHA Bank became one of the sponsors of the 2009 XXV Rhythmic Gymnastics European Championships held in Baku. Our Bank introduced a special "People's Choice Award" for the Championship.

By taking an active part in the social and cultural life of our country, PASHA Bank supported production of the film "The Precinct", co-produced by Azerbaijan (Narimanfilm Studio) and Georgia (Georgian film, Bagirafilms) and directed by Ilgar Safat.

With the support of PASHA Bank, a collection comprised of symphonic mugam works of Fikret Amirov was released. The collection was presented during the opening day of The World of Mugam International Festival held in Baku for the first time from 18-25 March 2009.





OJSC PASHA Bank **Financial Statements**

Year ended 31 December 2009
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 2009, 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 notes.

Management's responsibility for the financial statements

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

Auditors' responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 2009, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

31 March 2010

Ernst & Young Holdings (CIS) B.V.

Statement of financial position, as at 31 December 2009

(in thousands of Azerbaijani Manats)	Notes	31 December 2009	31 December 2008
Assets			
Cash and cash equivalents	5	50,456	38,711
Trading securities	6	858	598
Securities purchased under agreements to resell	7	499	6,202
Amounts due from credit institutions	8	46,506	5,475
Investment securities available-for-sale	9	82,027	92,681
Investment securities held to maturity	9	714	–
Loans to banks	10	1,909	7,800
Loans to customers	11	119,520	44,207
Property and equipment	12	1,400	1,002
Intangible assets	13	712	239
Other assets	14	1,832	722
Total assets		306,433	197,637
Liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	15	12,486	1,485
Amounts due to customers	16	166,391	82,546
Current income tax liability	17	–	2,508
Deferred income tax liabilities	17	–	450
Provision for guarantees and other commitments	19,23	781	–
Other liabilities	14	205	137
Total liabilities		179,863	87,126
Equity			
Share capital	18	100,000	100,000
Retained earnings		26,570	10,511
Total equity		126,570	110,511
Total liabilities and equity		306,433	197,637

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

31 March 2010

Farid Akhundov
Chairman of the Board of Directors



Shahin Mammadov
Financial Management Department Director



Statement of comprehensive income, for the year ended 31 December 2009

(in thousands of Azerbaijani Manats)	Notes	Year ended 31 December 2009	Year ended 31 December 2008
Interest income			
Loans to customers		11,344	6,129
Amounts due from credit institutions		7,754	7,484
Investment securities		3,766	3,126
Guarantees and letters of credit		831	724
Loans to banks		647	999
Securities purchased under agreements to resell		42	177
		24,384	18,639
Interest expense			
Amounts due to customers		(4,009)	(1,513)
Guarantees and letters of credit		(282)	(34)
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies		(55)	(17)
Other		–	(2)
		(4,346)	(1,566)
Net interest income		20,038	17,073
Provision for impairment losses on interest bearing assets		(556)	(2,018)
Provision for guarantees and other commitments		(781)	–
Provision for impairment losses on interest bearing assets, guarantees and other commitments	23	(1,337)	(2,018)
Net interest income after provision for impairment losses		18,701	15,055
Net fee and commission income	20	619	1,074
Net gains/(losses) from trading securities		265	(368)
Net gains/(losses) from foreign currencies: dealings		1,781	433
translation differences		(30)	(3)
Other income		4	–
Non-interest income		2,639	1,136
Personnel expenses	21	(3,396)	(1,310)
General and administrative expenses	22	(1,939)	(850)
Depreciation and amortisation	12,13	(396)	(247)
Non-interest expenses		(5,731)	(2,407)
Profit before income tax benefit/(expense)		15,609	13,784
Income tax benefit/(expense)	17	450	(3,019)
Net profit for the year		16,059	10,765
Other comprehensive income		–	–
Total comprehensive income for the year		16,059	10,765

Statement of changes in equity, for the year ended 31 December 2009

(in thousands of Azerbaijani Manats)	Share capital	(Accumulated losses) / Retained earnings	Total equity
31 December 2007	10,000	(254)	9,746
Issuance of share capital (Note 18)	90,000	–	90,000
Total comprehensive income for the year	–	10,765	10,765
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

Statement of cash flows, for the year ended 31 December 2009

(in thousands of Azerbaijani Manats)	Notes	Year ended 31 December 2009	Year ended 31 December 2008
Cash flows from operating activities			
Interest received		23,164	17,128
Interest paid		(4,352)	(1,564)
Fees and commissions received		1,445	1,527
Fees and commissions paid		(826)	(453)
Realised gains less losses from dealing in foreign currencies		1,781	433
Personnel expenses		(3,396)	(1,310)
General and administrative expenses paid		(1,931)	(850)
Other operating income received		4	–
Cash flows from operating activities before changes in operating assets and liabilities		15,889	14,911
<hr/>			
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		(38,722)	5,545
Trading securities		7	(966)
Securities purchased under agreements to resell		5,703	(6,202)
Loans to banks		6,196	(7,800)
Loans to customers		(75,560)	(35,519)
Other assets		10	(643)
Net increase/(decrease) in operating liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies		11,045	28,918
Amounts due to customers		82,194	43,695
Other liabilities		65	18
Net cash from operating activities before income tax		6,827	41,957
Income tax paid		(2,508)	–
Net cash from operating activities		4,319	41,957
<hr/>			
Cash flows from investing activities			
Purchase of investment securities available-for-sale		(374,882)	(413,969)
Proceeds from sale and redemption of investment securities available-for-sale		385,125	332,167
Purchases of investment securities held to maturity		(688)	–
Purchase of property and equipment		(1,897)	(493)
Acquisition of intangible assets		(512)	(94)
Proceeds from sale of property and equipment		72	–
Net cash from/(used in) investing activities		7,218	(82,389)
<hr/>			
Cash flows from financing activities			
Proceeds from issuance of share capital	18	–	65,000
Net cash from financing activities		–	65,000
Effect of exchange rates changes on cash and cash equivalents		208	(3)
Net increase in cash and cash equivalents		11,745	24,565
Cash and cash equivalents, beginning	5	38,711	14,146
Cash and cash equivalents, ending	5	50,456	38,711

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 2009 (2008: none).

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

As of 31 December 2009 and 2008 the following shareholders owned the outstanding shares of the Bank:

Shareholder	31 December 2009 (%)	31 December 2008 (%)
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 of trading and available for sale securities which have been measured at fair value.

Reclassification

The following reclassification relating to a demand deposit of an investment holding company had been made to the 2008 balances to conform to the 2009 presentation.

	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

While IAS 1 (revised) requires presentation of the beginning of the earliest comparative period in case of reclassification, no such presentation was made as the relevant reclassified accounts have nil balance as of 31 December 2007.

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:

Improvements to IFRS

In May 2008, the IASB issued amendments to IFRS, which resulted from the IASB's annual improvements project. They comprise amendments that result in accounting changes for presentation, recognition or measurement purposes as well as terminology or editorial amendments related to a variety of individual IFRS standards. Most of the amendments are effective for annual periods beginning on or after 1 January 2009, with earlier application permitted. Amendments included in May 2008 "Improvements to IFRS" did not have any impact on the accounting policies, financial position or performance of the Bank.

IAS 1 Presentation of Financial Statements (Revised)

A revised IAS 1 was issued in September 2007, and became effective for annual periods beginning on or after 1 January 2009. This revised Standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income: it presents all items of recognised income and expense, either in one single statement, or in two linked statements. The revised standard also requires that the income tax effect of each component of comprehensive income be disclosed. In addition, it requires entities to present a comparative statement of financial position as at the beginning of the earliest comparative period when the entity has applied an accounting policy retrospectively, makes a retrospective restatement, or reclassifies items in the financial statements.

The Bank has selected to present a single statement of comprehensive income. The Bank has not provided a restated comparative set of financial position for the earliest comparative period though it has retrospectively reclassified items in the financial

statements, as the relevant reclassified accounts have nil balance as of beginning of the earliest comparative period.

IFRS 7 "Financial Instruments: Disclosures"

The amendments to IFRS 7 were issued in March 2009, to enhance fair value and liquidity disclosures. With respect to fair value, the amendments require disclosure of a three-level fair value hierarchy, by class, for all financial instruments recognized at fair value and specific disclosures related to the transfers between levels in the hierarchy and detailed disclosures related to level 3 of the fair value hierarchy. In addition, the amendments modify the required liquidity disclosures with respect to derivative transactions and assets used for liquidity management. Comparative information has not been provided as permitted by the transition provisions of the amendment.

IAS 23 "Borrowing Costs" (Revised)

A revised IAS 23 Borrowing costs was issued in March 2007, and became effective for financial years beginning on or after 1 January 2009. The standard has been revised to require capitalization of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. This amendment did not have any impact on the financial position or performance of the Bank as currently no borrowing costs exist.

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. This amendment did not have any impact on the financial position or performance of the Bank.

Amendments to IAS 32 “Financial Instruments: Presentation” and IAS 1 “Presentation of Financial Statements” – Puttable Financial Instruments and Obligations Arising on Liquidation

These amendments were issued in February 2008, and became effective for annual periods beginning on or after 1 January 2009. The amendments require puttable instruments that represent a residual interest in an entity to be classified as equity, provided they satisfy certain conditions. These amendments did not have any impact on the Bank.

Amendments to IFRS 2 “Share-based Payment” - Vesting Conditions and Cancellations

Amendments to IFRS 2 were issued in January 2008 and became effective for annual periods beginning on or after 1 January 2009. This amendment clarifies the definition of vesting conditions and prescribes the accounting treatment of an award that is effectively cancelled because a non-vesting condition is not satisfied. This amendment did not have any impact on the financial position or performance of the Bank.

IFRS 8 “Operating Segments”

IFRS 8 became effective for annual periods beginning on or after 1 January 2009. This Standard requires disclosure of information about the Bank’s operating segments and replaces the requirement to determine primary (business) and secondary (geographical) reporting segments of the Bank. This standard is not applicable to the Bank.

IFRIC 13 “Customer Loyalty Programmes”

IFRIC Interpretation 13 was issued in June 2007 and became effective for annual periods beginning on or after 1 July 2008. This Interpretation requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. This interpretation did not have any impact on the Bank’s financial statements as no such schemes currently exist.

IFRIC 15 “Agreements for the Construction of Real Estate”

IFRIC Interpretation 15 was issued in July 2008 and is applicable retrospectively for annual periods begin-

ning on or after 1 January 2009. IFRIC 15 clarifies when and how revenue and related expenses from the sale of a real estate unit should be recognized if an agreement between a developer and a buyer is reached before the construction of the real estate is completed. The interpretation also provides guidance on how to determine whether an agreement is within the scope of IAS 11 “Construction Contracts” or IAS 18 “Revenue” and supersedes the current guidance for real estate in the Appendix to IAS 18. This interpretation did not have any impact on the Bank’s financial statements.

IFRIC 16 “Hedges of a Net Investment in a Foreign Operation”

IFRIC Interpretation 16 was issued in July 2008 and is applicable for annual periods beginning on or after 1 October 2008. This Interpretation provides guidance on identifying the foreign currency risks that qualify for hedge accounting in the hedge of net investment, where within the group the hedging instrument can be held and how an entity should determine the amount of foreign currency gain or loss, relating to both the net investment and the hedging instrument, to be recycled on disposal of the net investment. This interpretation did not have any impact on the Bank’s financial statements.

Amendments to IFRIC 9 “Reassessment of Embedded Derivatives”

The amendments require entities to assess whether to separate an embedded derivative from a host contract in the case where the entity reclassifies a hybrid financial asset out of the fair value through profit or loss category. This assessment is to be made based on circumstances that existed on the later of the date the entity first became a party to the contract and the date of any contract amendments that significantly change the cash flows of the contract.

The amendments are applicable for annual periods ending on or after 30 June 2009. This interpretation did not have any impact on the Bank’s financial statements as the Bank has no embedded derivatives.

IFRIC 18 Transfers of Assets from Customers

IFRIC 18 was issued in January 2009 and becomes effective for transfers of assets from customers received on or after 1 July 2009 with early application permitted, provided valuations were obtained at the date

those transfers occurred. This interpretation should be applied prospectively. IFRIC 18 provides guidance on accounting for agreements in which an entity receives from a customer an item of property, plant and equipment that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services or to do both. This interpretation did not have any impact on the financial position or performance of the Bank as the Bank has no transfers of assets from its customers.

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 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.

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, 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
Furniture and fixtures	4
Computers and other equipment	4
Vehicles	4
Other	5
Leasehold improvements	10

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

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 2009 and 2008 in the preparation of these financial statements:

	31 December 2009	31 December 2008
1 US Dollar	AZN 0.8031	AZN 0.8010
1 Euro	AZN 1.1499	AZN 1.1292
1 Russian Rouble	AZN 0.0266	AZN 0.0272
1 Pound sterling	AZN 1.2759	AZN 1.1621

Future changes in accounting policies

Standards and interpretations issued but not yet effective

Amendment to IAS 39 "Financial Instruments: recognition and measurement" – Eligible Hedged Items

The amendment to IAS 39 was issued in August 2008, and becomes 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. Management does not expect the amendment to IAS 39 to 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 become 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 will impact the amount of goodwill recognized, 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 will have no impact on goodwill, nor will it give 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 must be applied prospectively and will affect only future acquisitions and transactions with minority interests.

IFRS 2 Share-based Payment: Group Cash-settled Share-based Payment Transactions

The amendment to IFRS 2 was issued in June 2009 and become 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. The Bank expects that this amendment will have 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 recognized when the dividend is appropriately authorized 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 recognize 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. The Bank expects that this interpretation will have 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" will have 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.

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.
- IAS 36 Impairment of Assets: The amendment clarifies that the largest unit permitted for allocating goodwill, acquired in a business combination, is the operating segment as defined in IFRS 8 before aggregation for reporting purposes. The amendment will have no impact on the Bank as the annual impairment test is performed before aggregation.

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 amortized 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.

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 3 years including the year of review. Management believes that as at 31 December 2009 its interpretation of the relevant legislation is appropriate and that the Company'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 2009	31 December 2008
Cash on hand	6,132	1,834
Current accounts with the Central Bank of the Republic of Azerbaijan	17,659	4,043
Current accounts with other credit institutions	1,475	3,546
Time deposits	25,190	29,288
Cash and cash equivalents	50,456	38,711

Current accounts with other credit institutions consist of non-interest bearing correspondent accounts balances with resident and non-resident banks in the amount of AZN 921 thousands (2008–AZN 816 thousands) and AZN 554 thousands (2008–AZN 2,730 thousands), respectively.

As of 31 December 2009 the Bank placed AZN 25,190 thousands (2008–AZN 29,288 thousands) in time deposits with resident and non-resident banks maturing through 30 March 2010, and with effective annual interest rate of 0.2%-14.0%.

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 2009 trading securities amounted to AZN 858 thousands (2008–AZN 598 thousands).

Note 7

Securities purchased under agreements to resell

As of 31 December 2009 the Bank had entered into agreements to resell with a resident credit institution. The subject of these agreements is short-term notes issued by the CBA with total fair value of AZN 499 thousands (2008–AZN 6,202 thousands).

Note 8

Amounts due from credit institutions

(in thousands of Azerbaijani Manats)	31 December 2009	31 December 2008
Time deposits	45,900	8
Obligatory reserve with the Central Bank of the Republic of Azerbaijan	605	4,322
Blocked deposits	1	1,145
Amounts due from credit institutions	46,506	5,475

As of 31 December 2009, AZN 24,610 thousands (54% of total time deposits) (2008–nil) was placed on inter-bank deposits with four local commercial banks maturing through 19 October 2010 and with effective annual interest rate of 6% –18%.

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBA at 0.5% (2008–6%) 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.

Note 9

Investment securities

Available-for-sale securities comprise:

(in thousands of Azerbaijani Manats)	31 December 2009		31 December 2008	
	Carrying value	Nominal value	Carrying value	Nominal value
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	32,832	33,095	58,222	59,134
Treasury bills issued by the Ministry of Finance of the Republic of Azerbaijan	38,513	39,137	–	–
Notes issued by the Azerbaijan Mortgage Fund	10,682	10,667	–	–
Notes issued by the National Bank of the Republic of Azerbaijan	–	–	34,459	34,502
Investment securities available-for-sale	82,027	82,899	92,681	93,636

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

	31 December 2009		31 December 2008	
	%	Maturity	%	Maturity
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	1.7% –2.9%	January – November 2010	5.9% –10.8%	January – April 2009
Treasury bills issued by the Ministry of Finance of the Republic of Azerbaijan	4.0% –6.8%	October 2010 – June 2012	–	–
Notes issued by Azerbaijan Mortgage Fund	3.0%	May 2016	–	–
Notes issued by the National Bank of the Republic of Azerbaijan	-	-	4.0% –4.7%	January 2009

Held to maturity securities comprise:

(in thousands of Azerbaijani Manats)	31 December 2009	31 December 2008
Corporate bonds issued by Azel Closed Joint Stock Company(CJSC)	428	–
Corporate bonds issued by Omni Finance LLC non-bank credit institution	300	–
	728	–
Less–Allowance for impairment (Note 23)	(14)	–
Held to maturity securities	714	–

Corporate bonds issued by Azel CJSC are US-dollar denominated coupon bonds with annual interest rate of 14.0%. Security matures in 16 July 2011. The principal amount and interest on these securities is repaid semi-annually.

Corporate bonds issued by OMNI Finance (non-bank credit institution) are AZN-denominated coupon bonds with annual interest rate of 14.0% paid on a semi-annual basis and maturing in December 2010.

Note 10

Loans to banks

As of 31 December 2009 the Bank had outstanding amount of AZN 1,909 thousands (2008–AZN 7,800 thousands) unsecured short-term loans denominated in Azerbaijani Manat and US dollar, issued to two resident commercial banks with contractual maturities in July and October 2010 and annual interest rate of 17.5% (2008: 17%–19%).

Note 11

Loans to customers

Loans to customers comprise:

(in thousands of Azerbaijani Manats)	31 December 2008	31 December 2009
Legal entities	117,256	41,916
Individuals	4,824	4,309
Loans to customers (gross)	122,080	46,225
Less—Allowance for impairment (Note 23)	(2,560)	(2,018)
Loans to customers (net)	119,520	44,207

(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

(in thousands of Azerbaijani Manats)	Corporate lending 31 December 2008	Individual lending 31 December 2008	Total 31 December 2008
Individual impairment	(1,264)	(754)	(2,018)
Collective impairment	—	—	—
	(1,264)	(754)	(2,018)
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	7,091	1,186	8,277

Loans are made within Azerbaijan in the following industry sectors:

(in thousands of Azerbaijani Manats)	31 December 2008	31 December 2009
Trade and services	59,979	29,464
Construction	24,424	3,359
Manufacturing	21,905	—
Transport and telecommunication	6,332	766
Individuals	4,824	4,309
Agriculture and food processing	4,067	8,126
Energy	362	—
Other	187	201
Total loans (gross)	122,080	46,225

As of 31 December 2009, the Bank granted loans to 5 customers (2008—1 customer) totalling AZN 60,520 thousands (2008—AZN 8,080 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)	Furniture and fixtures	Computers and other equipment	Vehicles	Other equipment	Leasehold improvements	Total
Cost						
31 December 2007	246	284	195	31	–	756
Additions	205	93	153	7	58	516
Disposals	–	–	(30)	–	–	(30)
Transfers	24	(5)	–	(19)	–	–
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
Accumulated depreciation						
31 December 2007	(10)	(6)	(8)	(1)	–	(25)
Depreciation charge	(92)	(76)	(51)	(3)	–	(222)
Disposals	–	–	7	–	–	7
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)
Net book value:						
31 December 2009	595	517	173	24	91	1,400
31 December 2008	373	290	266	15	58	1,002

Note 13

Intangible assets

The movements in intangible assets were as follows:

	Licenses	Computer software	Installations in progress	Total
Cost				
31 December 2007	173	–	–	173
Additions	20	75	–	95
Disposals	(4)	–	–	(4)
31 December 2008	189	75	–	264
Additions	104	125	283	512
Disposals	(5)	–	–	(5)
31 December 2009	288	200	283	771
Accumulated amortization				
31 December 2007	(4)	–	–	(4)
Amortisation charge	(21)	(4)	–	(25)
Disposals	4	–	–	4
31 December 2008	(21)	(4)	–	(25)
Amortisation charge	(29)	(10)	–	(39)
Disposals	5	–	–	5
31 December 2009	(45)	(14)	–	(59)
Net book value:				
31 December 2009	243	186	283	712
31 December 2008	168	71	–	239

Note 14

Other assets and liabilities

Other assets comprise:

(in thousands of Azerbaijani Manats)	31 December 2009	31 December 2008
Other financial assets		
Accrued interest receivable on guarantees and letters of credit	98	85
Other	–	8
	98	93
Other non-financial assets		
Prepayments for acquisition of property, equipment and intangible assets	1,529	459
Deferred expenses	150	46
Other prepayments and receivables	55	124
	1,734	629
Other assets	1,832	722

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

Other liabilities comprise:

(in thousands of Azerbaijani Manats)	31 December 2009	31 December 2008
Other financial liabilities		
Payable to employees	101	41
Payables for professional services	38	46
Accrued expenses	8	13
Other	7	28
	154	128
Other non-financial liabilities		
Deferred income	40	–
Other	11	9
	51	9
Other liabilities	205	137

Note 15

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

(in thousands of Azerbaijani Manats)	31 December 2009	31 December 2008
Loans from the Central Bank of the Republic of Azerbaijan	7,000	–
Loans from the National Fund for Support of Entrepreneurship	5,485	1,485
Correspondent accounts with other banks	1	–
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	12,486	1,485

As of 31 December 2009 the Bank had loans from the Central Bank of the Republic of Azerbaijan amounting to AZN 7,000 thousand (2008–nil), maturing through 2011 and bearing interest rate of 2.5% p.a.

As of 31 December 2009 the Bank had four loans from the National Fund for Support of Entrepreneurship amounting to AZN 5,485 thousands (2008–AZN 1,485 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 the entrepreneurship environment in Azerbaijan under the government program on entrepreneurship.

Note 16

Amounts due to customers

The amounts due to customers include the following:

(in thousands of Azerbaijani Manats)	31 December 2009	31 December 2008
Demand deposits	93,781	42,526
Time deposits	72,610	40,020
Amounts due to customers	166,391	82,546
Held as security against letter of credits and guarantees	–	1,145

An analysis of customer accounts by economic sector follows:

(in thousands of Azerbaijani Manats)	31 December 2009	31 December 2008
Individuals	95,419	16,934
Investment holding companies	35,179	61,309
Construction	18,588	1,629
Trade and services	12,260	1,978
Agriculture	2,001	–
Manufacturing	1,443	56
Insurance	1,210	261
Transport and communication	60	43
Energy	20	9
Other	211	327
Amounts due to customers	166,391	82,546

As of 31 December 2009 customer deposits included balances with four largest customers amounting to AZN 107,499 thousands (2008–AZN 62,597 thousands). These deposits comprise significant concentration of approximately 65% (2008–76%) of the total customer deposits portfolio.

Note 17

Taxation

The corporate income tax benefit/(expense) comprise:

(in thousands of Azerbaijani Manats)	Year ended 31 December 2009	Year ended 31 December 2008
Current tax expense	–	(2,508)
Deferred tax benefit/(expense)	450	(511)
Income tax benefit/(expense)	450	(3,019)

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 January 1, 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. The tax rate for banks for profits was 22% for 2009 and 2008. There is no deferred tax effect of the change in tax rates as of 31 December 2009 in view of the avilment of the tax exemption.

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

(in thousands of Azerbaijani Manats)	Year ended 31 December 2009	Year ended 31 December 2008
Profit before income tax benefit/(expense)	15,609	13,784
Statutory tax rate	22%	22%
Theoretical income tax expense at the statutory rate	(3,434)	(3,032)
Tax effect of non-deductible expenses	(57)	(19)
Tax-exempt income	3,941	32
Income tax benefit/(expense)	450	(3,019)

Deferred tax assets and liabilities as of 31 December and their movements for the respective years comprise:

(in thousands of Azerbaijani Manats)	31 December 2007	Origination and reversal of temporary differences	31 December 2008	Origination and reversal of temporary differences	31 December 2009
Tax effect of deductible temporary differences:					
Tax losses carried forward	126	(126)	–	–	–
Accrued expenses	13	4	17	(17)	–
Deferred tax assets	139	(122)	17	(17)	–
Tax effect of taxable temporary differences:					
Loans to customers	(47)	(383)	(430)	430	–
Property and equipment	(28)	(5)	(33)	33	–
Intangible assets	(3)	(1)	(4)	4	–
Deferred tax liabilities	(78)	(389)	(467)	467	–
Deferred tax assets/(liabilities)	61	(511)	(450)	450	–

Note 18

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.

As of 25 February 2008 the Bank has registered its share capital of AZN 35,000 thousands consisting of 10,000 shares with par value of AZN 3,500 each with the appropriate authorities.

On 18 January 2008 the Bank's shareholders have decided to increase the share capital from AZN 35 million to AZN 58 million and have made cash contribution of AZN 23 million for the increase in share capital.

On 21 May 2008 the shareholders further increased its share capital from existing AZN 58 million to AZN 100 million and made cash contribution of AZN 42 million on 22 May 2008. The Bank has completed the registration of the increases in share capital on 20 June 2008, thus, bringing share par value up to AZN 10,000 each and total paid-in share capital to AZN 100 million as of 31 December 2008.

As of 31 December 2009 the Bank's shareholders' authorized, issued and fully paid capital amounted to AZN 100,000 thousand and comprised 10,000 ordinary shares with a par value of AZN 10,000. Each share entitles one vote to the shareholder.

There has been no change in shareholders' capital of the Bank during 2009 year.

Note 19

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. This includes the adoption of a new body of legislation including new Tax Code, new Civil and Customs Codes, procedural laws and securities regulations. In management's view, these steps contribute to mitigate the risks of doing business in Azerbaijan.

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 ongoing global financial crisis has 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 2009 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 2009	31 December 2008
Credit-related commitments		
Guarantees issued	17,854	2,119
Unused credit lines	7,760	6,733
Letters of credit	5,051	7,881
	30,665	16,733
Operating lease commitments		
Not later than 1 year	30	–
Later than 1 year but not later than 5 years	150	–
Later than 5 years	88	–
	268	–
Less – Provisions (Note 23)	(781)	–
Commitments and contingencies (before deducting collateral)		
Less – Cash held as security against letters of credit and guarantees	–	(1,145)
Commitments and contingencies	30,152	15,588

Note 20

Net fee and commission income

(in thousands of Azerbaijani Manats)	Year ended 31 December 2009	Year ended 31 December 2008
Settlements operations	500	262
Currency conversion operations	498	446
Cash operations	350	811
Guarantees and commitments	68	–
Servicing plastic card operations	28	–
Other	1	8
Fee and commission income	1,445	1,527
Securities operations	(587)	(276)
Settlements operations	(188)	(99)
Guarantees and commitments	(19)	(65)
Servicing plastic card operations	(12)	–
Currency conversion operations	(10)	(2)
Cash operations	(2)	–
Other	(8)	(11)
Fee and commission expense	(826)	(453)
Net fee and commission income	619	1,074

Note 21

Personnel Expenses

(in thousands of Azerbaijani Manats)	Year ended 31 December 2009	Year ended 31 December 2008
Salaries and bonuses	(2,468)	(965)
Social security costs	(557)	(211)
Other employee related expenses	(371)	(134)
Total personnel expenses	(3,396)	(1,310)

Note 22

General and administrative expenses

(in thousands of Azerbaijani Manats)	Year ended 31 December 2009	Year ended 31 December 2008
Professional services	(874)	(426)
Transportation and business trip expenses	(221)	(90)
Advertising costs	(197)	–
Operating leases	(113)	(70)
Charity and sponsorship	(100)	–
Insurance	(70)	(92)
Communications	(50)	(33)
Security expenses	(46)	(26)
Printing expenses	(36)	(14)
Stationary	(33)	(13)
Repair and maintenance	(27)	(31)
Utilities	(26)	(15)
Taxes, other than income tax	(14)	(12)
Membership fees	(13)	(11)
Other expenses	(119)	(17)
Total general and administrative expenses	(1,939)	(850)

Note 23

Provision for impairment losses on interest bearing assets, 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 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)

Year ended 31 December 2008						
(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	–	–	–	–	–	–
Charge for the year	(1,264)	(754)	(2,018)	–	–	(2,018)
At 31 December	(1,264)	(754)	(2,018)	–	–	(2,018)

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 24

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 decisions.

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 2009	Gross maximum exposure 31 December 2008
Cash and cash equivalents (excluding cash on hand)	5	44,324	36,877
Trading securities	6	858	598
Securities purchased under agreements to resell	7	499	6,202
Amounts due from credit institutions	8	46,506	5,475
Investment securities available-for-sale	9	82,027	92,681
Investment securities held to maturity	9	714	–
Loans to banks	10	1,909	7,800
Loans to customers	11	119,520	44,207
Other financial assets	14	98	93
		296,455	193,933
Financial commitments and contingencies		29,884	15,588
Total credit risk exposure		326,339	209,521

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					Total 2009
		High grade 2009	Standard grade 2009	Sub- standard grade 2009	Past due but not impaired 2009	Individually impaired 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

(in thousands of Azerbaijani Manats)	Notes	Neither past due nor impaired					Total 2008
		High grade 2008	Standard grade 2008	Sub- standard grade 2008	Past due but not impaired 2008	Individually impaired 2008	
Securities purchased under agreements to resell	7	6,202	–	–	–	–	6,202
Amounts due from credit institutions	8	–	5,475	–	–	–	5,475
Investment securities available-for-sale	9	92,681	–	–	–	–	92,681
Loans to bank	10	–	7,800	–	–	–	7,800
Loans to customers	11						
Corporate lending		34,826	–	–	–	7,090	41,916
Individual lending		3,123	–	–	–	1,186	4,309
Total		136,832	13,275	–	–	8,276	158,383

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 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 rat-

ing 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 fol-

lowing 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:

(in '000 of Azerbaijani Manats)	31 December 2009				31 December 2008			
	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	30,916	19,531	9	50,456	35,980	2,677	54	38,711
Trading securities	–	843	15	858	598	–	–	598
Securities purchased under repurchase agreements	499	–	–	499	6,202	–	–	6,202
Amounts due from credit institutions	42,666	–	3,840	46,506	4,330	1,145	–	5,475
Investment securities available-for-sale	82,027	–	–	82,027	92,681	–	–	92,681
Investment securities held to maturity	714	–	–	714	–	–	–	–
Loans to banks	1,909	–	–	1,909	7,800	–	–	7,800
Loans to customers	119,520	–	–	119,520	44,207	–	–	44,207
Other financial assets	98	–	–	98	89	4	–	93
	278,349	20,374	3,864	302,587	191,887	3,826	54	195,767
Financial liabilities:								
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	12,486	–	–	12,486	1,485	–	–	1,485
Amounts due to customers	166,391	–	–	166,391	82,516	–	30	82,546
Other financial liabilities	154	–	–	154	128	–	–	128
	179,031	–	–	179,031	84,129	–	30	84,159
Net assets	99,318	20,374	3,864	123,556	107,758	3,826	24	111,608

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 2009 and 2008 these ratios were as follows:

	31 December 2009, %	31 December 2008, %
Instant Liquidity Ratio (assets receivable or realisable within one day / liabilities repayable on demand)	77	235

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2009 and 2008 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 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

(in thousands of Azerbaijani Manats)	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total 2008
Financial liabilities					
As at 31 December 2008					
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	8	11	1,205	341	1,565
Amounts due to customers	42,726	39,860	235	–	82,821
Other financial liabilities	44	84	–	–	128
Total undiscounted financial liabilities	42,778	39,955	1,440	341	84,514

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 2009	14,931	12,719	3,015	–	30,665
As of 31 December 2008	885	8,715	401	6,732	16,733

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 2009. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2009 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 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

As at 31 December 2008 the Bank had the following exposure to foreign currency exchange rate risk:

(in thousands of Azerbaijani Manats)	AZN	USD	EUR	OTHER	Total 2008
Financial assets					
Cash and cash equivalents	34,241	1,893	232	2,345	38,711
Trading securities	–	285	292	21	598
Securities purchased under agreements to resell	6,202	–	–	–	6,202
Amounts due from credit institutions	4,035	695	745	–	5,475
Investment securities available-for-sale	92,681	–	–	–	92,681
Loans to banks	7,800	–	–	–	7,800
Loans to customers	44,184	23	–	–	44,207
Other financial assets	92	1	–	–	93
Total financial assets	189,235	2,897	1,269	2,366	195,767
Financial liabilities					
Amounts due to Central Bank of the Republic of Azerbaijan, banks and government agencies	1,485	–	–	–	1,485
Amounts due to customers	79,168	3,210	165	3	82,546
Other financial liabilities	128	–	–	–	128
Total financial liabilities	80,781	3,210	165	3	84,159
Net financial position	108,454	(313)	1,104	2,363	111,608

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 2009 and 2008:

	31 December 2009		31 December 2008	
	AZN/USD +10%	AZN/USD -10%	AZN/USD +10%	AZN/USD -10%
Impact on profit before tax	240	(240)	31	(31)

	31 December 2009		31 December 2008	
	AZN/EUR +10%	AZN/EUR -10%	AZN/EUR +10%	AZN/EUR -10%
Impact on profit before tax	31	(31)	(110)	110

Note 25

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 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 2009	Fair value 2009	Unrecognized gain/(loss) 2009	Carrying value 2008	Fair value 2008	Unrecognized gain/(loss) 2008
Financial assets						
Cash and cash equivalents	50,456	50,456	–	38,711	38,711	–
Amounts due from credit institutions	46,506	46,506	–	5,475	5,475	–
Investment securities held to maturity	714	714	–	–	–	–
Loans to banks	1,909	1,909	–	7,800	7,800	–
Loans to customers	119,520	119,520	–	44,207	43,811	396
Financial liabilities						
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	12,486	12,486	–	1,485	1,046	(439)
Amounts due to customers	166,391	166,391	–	82,546	82,546	–
Total unrecognised change in unrealised fair value			–			(43)

**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 three 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 26

Maturity analysis of financial 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 24 "Risk management" for the Bank's contractual undiscounted repayment obligations.

(in thousands of Azerbaijani Manats)	31 December 2009			31 December 2008		
	Within 1 year	More than 1 year	Total	Within 1 year	More than 1 year	Total
Financial assets						
Cash and cash equivalents	50,456	–	50,456	38,711	–	38,711
Trading securities	858	–	858	598	–	598
Securities purchased under agreements to resell	499	–	499	6,202	–	6,202
Amounts due from credit institutions	46,506	–	46,506	5,475	–	5,475
Investment securities available-for-sale	82,027	–	82,027	92,681	–	92,681
Investment securities held to maturity	513	201	714	–	–	–
Loans to banks	1,909	–	1,909	7,800	–	7,800
Loans to customers	63,981	55,539	119,520	27,631	16,576	44,207
Property and equipment	1,400	–	1,400	1,002	–	1,002
Intangible assets	712	–	712	239	–	239
Other assets	1,832	–	1,832	722	–	722
Total assets	250,693	55,740	306,433	181,061	16,576	197,637
Financial liabilities						
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government agencies	1	12,485	12,486	–	1,485	1,485
Amounts due to customers	166,391	–	166,391	82,346	200	82,546
Current income tax liabilities	–	–	–	2,508	–	2,508
Deferred income tax liabilities	–	–	–	450	–	450
Provision for guarantees and other commitments	781	–	781	–	–	–
Other liabilities	205	–	205	137	–	137
Total liabilities	167,378	12,485	179,863	85,441	1,685	87,126

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 27

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 2009				
	Parent	Entities under common control	Key management personnel	Other	Total
Loans outstanding at 1 January, gross	–	–	4	–	4
Loans issued during the year	–	4,539	172	–	4,711
Loan repayments during the year	–	(2,189)	(63)	–	(2,252)
Loans outstanding at 31 December, gross	–	2,350	113	–	2,463
Less: allowance for impairment at 31 December	–	–	–	–	–
Loans outstanding at 31 December, net	–	2,350	113	–	2,463
Interest income on loans	–	86	7	–	93
Deposits at 1 January	33,303	100	100	–	33,503
Deposits received during the year	20,753	–	217	51,777	72,747
Deposits repaid during the year	(39,746)	–	–	(13,896)	(53,642)
Deposits at 31 December	14,310	100	317	37,881	52,608
Current accounts at 31 December	6,101	32,994	21	35,354	74,470
Interest expense on deposits	(1,230)	(9)	(10)	(1,790)	(3,039)
Commitments and guarantees issued	–	3,082	–	–	3,082
Commitments and guarantees received	–	1,659	–	–	1,659
Fee and commission income	61	513	–	–	574
Other operating expenses	–	(154)	–	(60)	(214)

(in thousands of Azerbaijani Manats)	Year ended 31 December 2009	Year ended 31 December 2008
Salaries and other benefits	811	335
Social security costs	178	74
Total key management compensation	989	409

31 December 2008					
Parent	Entities under common control	Key management personnel	Other	Total	(in thousands of Azerbaijani Manats)
–	–	–	–	–	Loans outstanding at 1 January, gross
–	–	–	6	6	Loans issued during the year
–	–	–	(2)	(2)	Loan repayments during the year
–	–	–	4	4	Loans outstanding at 31 December, gross
–	–	–	–	–	Less: allowance for impairment at 31 December
–	–	–	4	4	Loans outstanding at 31 December, net
–	–	–	–	–	Interest income on loans
2,536	–	–	–	2,536	Deposits at 1 January
71,000	5,908	100	–	77,008	Deposits received during the year
(40,233)	(5,808)	–	–	(46,041)	Deposits repaid during the year
33,303	100	100	–	33,503	Deposits at 31 December
3,902	1,973	17	6,791	12,683	Current accounts at 31 December
1,312	5	6	–	1,323	Interest expense on deposits
–	453	–	–	453	Commitments and guarantees issued
–	–	–	–	–	Commitments and guarantees received
–	–	–	–	–	Fee and commission income
–	–	–	–	–	Other operating expenses

Note 28

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 its 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 2009 and 2008 the Bank's capital adequacy ratio on this basis was as follows:

(in thousands of Azerbaijani Manats)	Year ended 31 December 2009	Year ended 31 December 2008
Tier 1 capital	108,809	99,480
Tier 2 capital	17,901	10,465
Less: Deductions from capital	(712)	(239)
Total regulatory capital	125,998	109,706
Risk-weighted assets	199,549	97,040
Capital adequacy ratio	63%	113%

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 1 and Total regulatory capital), with subsequent amendments including the amendment to incorporate market risks, as of 31 December 2009 and 2008, comprised:

(in thousands of Azerbaijani Manats)	Year ended 31 December 2009	Year ended 31 December 2008
Tier 1 capital	126,570	110,511
Tier 2 capital	–	–
Total regulatory capital	126,570	110,511
Risk-weighted assets	163,377	57,186
Tier 1 capital adequacy ratio	77%	193%
Total capital adequacy ratio	77%	193%

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