THE INTERNATIONAL BANK OF AZERBAIJAN

Annual Report 2004

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Save the Past, Build the Future!

The Silk Road's caravans moved through Azerbaijan, getting loaded here with sweet-scented saffron, thin silk, white salt and combustible oil in wine-skins. Warriors of Alexander the Great, troops from neighboring tribes, Vikings floating by the Caspian – many of them were arriving here with an idea to conquer this rich country. Nasiraddin Tusi was building here his astronomical observatory, and Nizami was collecting his wise pearl-words into "The Treasury of Secrets"... And every morning during millenniums local women were baking their fragrant bread in tandir-ovens. At the dawn of XX c. here was born a boy, who grew up to a great scientist, created the best airplane fuel and thus helped the world to get rid from fascist occupation, founded the modern science of oil chemistry. And another one turned to be All-National leader, who provided in vague time the desired peace and formed the basement for the country's economical development and prosperity, having arranged the Contract of the Century.

The Contract of the Century – Baku-Tbilisi-Ceyhan pipeline – hydrocarbon treasure of the country – these positive factors had allowed national economy to stop its collapse. Now the country becomes more and more strong, involved with restoration of its industry, installation of newer technologies and equipment, re-construction of big plants and factories. International exhibitions are regularly arranged in Azerbaijan. They help local businesses to introduce their production and become aware about achievements of foreign colleagues.

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GENERAL INFORMATION ON THE BANK

IBA's Calling Card

Full Name	«The International Bank of Azerbaijan» Joint Stock Commercial Bank
Short Name	IBA
Date of Establishment	10th January 1992
Trademark	License #20040124 given by the State Agency of Standards, Metrology and Patents of the Azerbaijan Republic on 23rd March 2004
Legal Address	Azerbaijan, Baku, AZ1005, Nizami, 67
Code	805250
Taxpayer's Identification Number	9900001881
Correspondent Account	0137010002031
SWIFT	IBAZAZ2X
Telex	142159 DOSTAI
REUTERS Dealing	AZBB
Telephones	(994 12) 4930091, 4989127, 4987593
Fax	(994 12) 4934091, 4989128
E-Mail	ibar@ibar.az
Web	www.ibar.az

License

General Banking License No. 2 of 30 December, 1992 issued by the National Bank of Azerbaijan

Membership of Professional Associations, Unions, Exchanges and Payment Systems

- **Azerbaijan Banking Association (ABA)**
- **Baku Interbank Currency Exchange (BICEX)**
- **Baku Stock Exchange (BSE)**
- **MasterCard International payment system**
- **VISA International payment system**
- **Society of Worldwide Interbank Financial Telecommunication (SWIFT)**
- **Reuters international information and dealing system**
- **MoneyGram international payment system**

Main Financial Indicators as on 31.12.2004 (in millions of AZM)

Assets	4 323 107
Shareholders' Equity	266 061
Net profit	69 470

As on 31.12.2004:

Shareholders	22 juridical persons, 1,408 Individuals
Staff	1 170
Branch Network	35 Branches, over 100 Sub-branches
Representative Offices	2 (Great Britain, London; Germany, Frankfurt)
Correspondent Banks	64
Customer Base	22 261 Juridical Persons, 165 402 Individuals
Auditor	«PriceWaterhouseCoopers» (since 1995)

IBA's Associates and Subsidiaries

- **"The International Bank of Azerbaijan – Moscow"**
- **International Insurance Company**
- **AzeriCard Ltd**
- **"Azerileasing Company"**
- **Inter Protect Re AG**
- **"Inter Baku" Professional Football Club**
- **Baku Stock Exchange**
- **Baku Interbank Currency Exchange**
- **Trans-service Ltd**
- **A'Visual Ltd**
- **"Business Rabita" Ltd.**

IBA's Governing Bodies

- **General Meeting of Shareholders**
- **Supervisory Board**
- **Board**
- **Audit Committee**

Shareholders and Share Capital

Shareholders	**Share Capital**	
	Amount (million AZM)	***Share (%)***
Ministry of Finance	50,200	50.2
Other Juridical Persons (21)	32,929.9	32.9
IBA's Staff (193 persons)	7,859.4	7.6
Other Natural Persons (1,215)	9,010.7	9.3
Authorized Capital Stock – Total	**100 000**	**100.0**

Supervisory Board

Chairman
ASADOV, HEYDAR KHANISH OGLU Deputy Minister of Finance of the Azerbaijan Republic, Director, State Treasury
Members of Board
HASANOV, KARAM AVAZ OGLU Chairman of the State Committee on Managing State Property of the Azerbaijan Republic
IBRAHIMOV, VUGAR EMIN OGLU Deputy Director, Section of Inner Debts, Ministry of Finance, Azerbaijan Republic
ALAKBAROV, FUZULI HASAN OGLU President, Improtex Group Ltd.
IBRAHIMOV, HEYDAR RZA OGLU Chairman of the Board, KovsarBank
MUSTAFAYEV, FIKRET AHMAD OGLU Director, Bazis Ltd. Company
HASSAN BARGSHADI Chairman of the Board, Capital Investment Bank

STATEMENT OF THE CHAIRMAN OF THE BOARD OF THE INTERNATIONAL BANK OF AZERBAIJAN

Esteemed shareholders, customers and partners, dear colleagues and friends,

In 2001 we declared a priority objective of positioning the International Bank of Azerbaijan as the Bank of National Development, and that has been the main guideline in our development since then.

Declaring this goal, we well understood that as a bank aiming at becoming the Bank of National Development, the IBA must have the capacity to finance projects important for the national economy, to get stronger and more competitive than even before, and further enhance its professional capabilities with the view of offering a wide range of banking products and services of the highest quality standards. Today, I am proud to state that we have accomplished that ambitious goal, and have turned the IBA into our country's Bank of National Development. As a result, the IBA's great role in the implementation of socially significant projects, development of the national economy in general and enhancing the image of the Azerbaijani banking system among international financial institutions has been universally recognized. In 2004, the IBA enhanced its status of an advanced, stable and trustworthy financial institution possessing a wide regional network servicing customers of all social groups, and providing on the international markets services meeting high standards.

Strong and balanced resource base made it possible to increase the volume and extend the term of loans, widen the range of banking services, and ensure growth in documentary transactions, as well as in operations related to trade and project financing.

Over the reported period, the number of corporate customers and loan portfolio increased by 15% and 90%, respectively. Retail business has grown significantly, too. This growth was reflected in the deposits of individuals (52.4%), loan portfolio (52.9%), emission of plastic cards (86 thous.) and increasing consumer lending.

We have been providing services to a broad social spectrum of customers in all regions of the country, trying to be closer to clients. Expansion of the regional branch network is especially important for the IBA in the context of the implementation of the State Program of Social Development of the Regions. Thus, in 2004 the groundwork was laid for further broadening of the regional composition of the IBA's branch network in 2005. A valuable component of our development strategy is the active integration of our "IBA-Moscow" subsidiary in Russian markets, important step in the increasing participation of the IBA in the processes of globalization.

The Bank's successful performance was reflected in the growth of profits, capital, assets and balances on the customer accounts. In 2004, the assets grew by 72.2% as against the previous year, net profit by 45.8% and share capital by 48.8%. High returns on working capital, efficient use of funds and technological upgrades enabled us to reduce costs. Beside that, the IBA strengthened its technological base, sustained competitiveness of its products and services, and developed advanced pricing and technology standards.

The Bank's strategy is based on the dynamism of development, improvement of banking techniques, introduction of new, more advanced technology, as well as striking optimal compromise between new and traditional profitable methods. It is an established fact that in terms of technological level of conducting business we are ahead of other domestic banks. Improving internet-banking techniques, management and risk control mechanisms has also been among our priorities.

During 2004, the Bank worked hard to increase the volume of credit portfolio and further improve the quality of its services. New credit products were offered to individuals. To anticipate the time and get ahead of trends has turned into a characteristic trait of the IBA's operations.

We owe our success, first of all, to our customers. Thanks to their confidence in us, in the reported period, customer balances grew 1.8 times. One of the main factors of the Bank's comprehensive and rapid development has been high professionalism and creativity of our staff. Qualified and well-organized staff is central to the success of any business, especially banking. Keeping that in mind we base our human resources policies on such critical principles as raising professional level, adequate and fair compensation policy, effective motivation system and openness in dealing with the employees.

Today, the IBA constitutes the core of a financial group that comprises banks and companies operating in various areas of business, such as banking, insurance, leasing and processing. The specialization of the members of the IBA group of companies by different segments of the financial market greatly broadens the range of offered services.

All of these enable the Bank to lay the ground for achieving a qualitatively new level of service and consolidate its position of the biggest, reliable, advanced and the fastest growing bank in the Caucasus region. The IBA's dynamic development has been recognized internationally: in 2004, Fitch rating agency raised the Bank's rating from "B" to "BB-", just one point lower than Azerbaijan's sovereign rating ("BB").

The Bank is determined to consistently develop over the coming years as a universal credit institution-the Bank of National development. It is our purpose to increase, without detriment to growing business with corporate clients, the volume of services to individuals through broad customer service network and improving quality of service. Our purpose is to maintain the leading position of the IBA in the contest for customers in the conditions of the increasing competition in the financial market of Azerbaijan.

Not intent to remain content with its achievements, the Bank is bent to move forward. Being determined to show their best qualities, the IBA and its staff are focused on sustaining the traditions of fair competition and the honorable name of "people's bank". I am confident that a sensitive and caring attitude to each customer will bring by results and increase trust either to our bank or to the country's banking system on the whole.

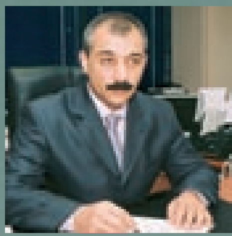
Over the period of our operation within the banking community, tens of thousands of customers have demonstrated their confidence in us and become our business partners, shareholders and friends. I want to thank them for all these years of mutually beneficial cooperation, and expressing my appreciation of their loyalty and dedication, I would like to remind that in business there is no final point and each outcome marks the beginning of a new development.

Good service meeting your interests, and our joint activities are the most valuable capital the IBA has gained so far. I hope, our cooperation will go on for many years and we will accomplish our most daring goals.

Sincerely,

Jahanghir Hajiyev,
Chairman of Board

Management of the IBA


Vagif AKBAROV
Deputy Chairman of the Board

Asgar MAMMADOV
Deputy Chairman of the Board

Emil MUSTAFAYEV
Deputy Chairman of the Board


Sayyad YOLCHUYEV
Advisor to the Chairman of the Board

Fuad MURSHUDLI
Advisor to the Chairman of the Board

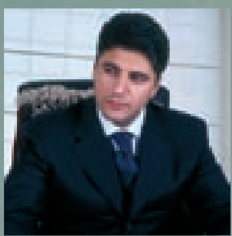
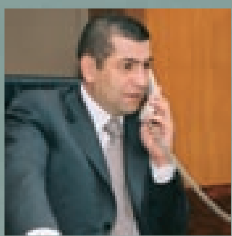
Rovshan ISMAYILOV
Financial Management Department Director

Fuad ABDULLAYEV
Chairman of the Board, "IBA-Moscow"

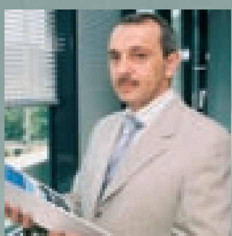
Akif ALIYEV
Credit department Director, Chairman of the credit committee

Mazahir DADASHOV
Internal Audit Department Director

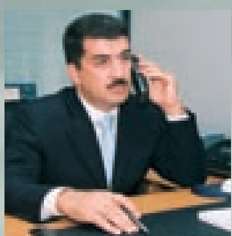
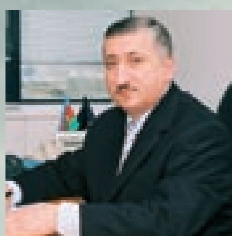
Zumrud AGAYEVA
Correspondent Accounts and Settlements Department Director

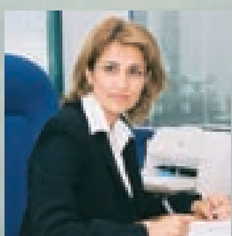









Hasan HASHIMZADE
Bank's Managerial Structures Department Director

Rovshan KARIMOV
Corporate Customers Service Department Director

Elmar SADIKHOV
Informational Technologies Department Director

Rauf KHALILOV
Legal Department Director

Tahir MAHMUDOV
Bad Loans Department Director

Gubad HUSEYNOV
Bank's Security Department Director

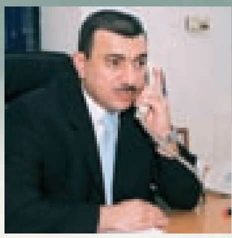
Emin IBRAHIMOV
Central Management Department Director

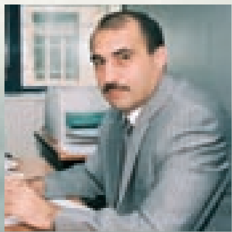
Irada HASANOVA
Human Resources Department Director

Ilgar HUSEYNOV
Departrment of Coordination of Branches and Subsidiaries Activity, Director

Aydin SALIMOV
Cash Management Department Director

Mayya DURSUNOVA
Strategic Development Department Director





Anar NAJAFLI
Marketing Department Director

Aydin ISMAYILOV
Treasury Department Director

Farhad GASIMOV
Bank Cards Department Director

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Save the Past...

Natural resources of Azerbaijan include oil and gas, mineral wealth for metallurgy, gold and silver, salt and saffron, relict woods of the iron tree and oriental plane-tree, construction stone and sturgeon family fishes, springs rich with minerals and potentially competing with the brands most famous over the world, Naphthalanum and curative products of mud volcanoes. From total 11 climate zones existing on the Earth 9 can be found here – from subtropics up to Alpine meadows. Ancient inhabitants lived here over million years ago (the cave of Azykh). In early Medieval (6th century) the entire of the country's historical territory was named Adar-Bad-Agan (Azerbaijan). The roots of Azerbaijanian ethnos appear in the 3rd millennium BC, and during the following millenniums our people moved over its own, unique way from past to present, from tribes to the Nation directed towards the future.

...build the Future!

Flat roofs of old one-store buildings are covered with qyr – special oil product, traditionally used here to protect buildings from rain and snow. These old dwellings now pass to the history. Entire of the country turned to be filled with civil building sites: construction boom is an important integral part of the new stage of the oil/energy boom. Aiming to provide financial support to people buying flats, here was adopted new Law on Hypothec.

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ECONOMY AND BANKING OF AZERBAIJAN IN 2004

Macroeconomic Summary

The success which has been achieved in Azerbaijan's economic and social development for the last decade proves the correctness of the national economic policy. Not only has deep political stability been provided in these years, but also have that in socio-political and macroeconomic fields, the dynamic increase of economy and people's living standards, cardinal institutional reforming and the country's adequate placement in the world's economy. In 2004, a policy was carried out which was directed to support economic growth, to keep inflation, which is of the primary indicators of macroeconomic stability, at an acceptable level, to provide the competitiveness of the non-oil sector and to further improve the cash security of the economy, and all the projected goals were reached.

Structure of GDP. The main macroeconomic indicator, **GDP** increased by 10.2% (AZM3.6 trillion) and reached AZM41.9 trillion. It was the first time that GDP per capita exceeded USD1000 reaching USD1041. The non-oil sector of GDP was 69.4% having really increased by 13.7%.

As compared to the previous year, the growth was 5.7% in industry, 4.6% in agriculture, 36.1% in capital construction, and 13% in turnover of securities.

Investing Fixed Capital. The main factor of future economic development, investments into the fixed capital increased by 36.6% and reached AZM26.5 trillion. According to the information on balance on the capital account, in 2004 foreign capital inflow increased by 25.2% as compared to the previous year and reached USD4.09 billion. As a positive fact, investment from domestic sources increased 1.8 times from 17.8% of the whole investment in 2003 to 24% of that in 2004. Azerbaijan is taking the first position among the CIS's countries on investment per capita.

People's prosperity, cash income and salaries. Improving people's prosperity continued. In fact, average monthly salary increased by 26.2% and reached AZM483400 (USD98.3). People's cash income remains increased by 20% and reached AZM28.6 trillion (that is AZM3.5 million per capita). In the financial year, active income increase exceeded that of GDP and reached 12.4%. In its turn, people's income increase causing purchasing capacity growth was of the factors of developing the real sector.

State Budget. In the financial year, the state budget earnings were AZM7.6 trillion, which is AZM1.5 trillion (or 24.6 %) more than in 2003. The state budget income was 101.2% as compared to the prognosis.
The state budget income came to 18.2 % of 2004's GDP that is 1.1% more than in 2003.

Though the state budget expense was AZM7.5 trillion in 2004 (with AZM7.8 trillion prognosticated), it is AZM1.3 trillion (21.6%) more than in 2003.

The state budget expense made up 17.9% of 2004's GDP, which is 0.6 % more than in 2003.

It must be noted that, the first time for 13 years, the state budget had AZM 102.2 billion surplus.

Monetary and Credit Policy. The correct monetary and credit policy played an important role for economic achievements. Inflation level was 6.7% in 2003. By the end of 2004, the country's foreign currency reserve had achieved USD1.85 billion and increased by 22.3%. The country's foreign debt was USD1.6 billion, which was 18.6% of GDP (with 22% of GDP in 2003).

Legal fundament of economy. In 2004, the Azerbaijan Republic's laws were adopted which are "On Banks" and "On the Azerbaijan Republic's National Bank". This has completed the international eligibility of the national banking legislation. "The Law on the Hypothec" is to be adopted in the early 2005. This law will be not only the legislative fundament for people's housing requirements and improvement, but also an important institutional impulse for the development of all financial system.

Development of Banking Sector

By the end of 2004, 70 non-banking credit agencies and 44 **commercial banks** including 15 banks with foreign capital had acted in Azerbaijan.

By the end of the year, banking **assets** had increased by 60% and exceeded AZM8.4 trillion, with that of **authorized capital stock** 41% and AZM1.1 trillion respectively. At the same time, the total banking capital increased by 90.5% as compared to the previous year and reached AZM1.2 trillion.

In 2004, **crediting the economy** increased by 51.8% and reached AZM4.5 trillion. It can be noted that crediting increase was taking place in all the banks. With the

49% increase of short-term crediting, long-term one increased by 58%. The proportion of past-due credits decreased to 6.1%.

In 2004, banks' **liabilities** increased by 61.4% and reached AZM6.9 trillion. In the financial year, the depository market was developing fastest as a segment of the banking service market.

Individuals' term deposits increased by 56.2% and reached AZM2 trillion.

The same indicators for juridical persons' deposits were 55.8% and AZM3 trillion respectively.

As a result of people's increasing trust in the banking system, long-term deposits increased faster than short-term ones, so the percentage of long-term deposits increased from 50 to 52.

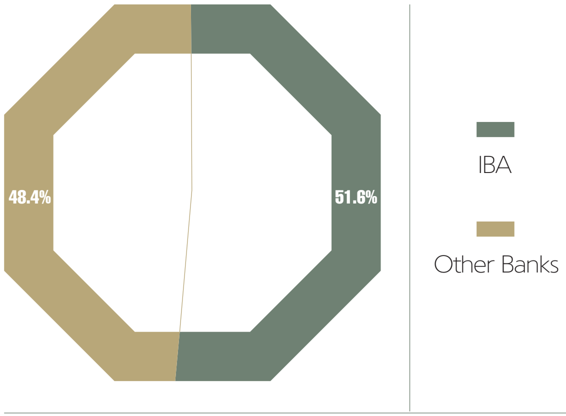
The capacity and number of banking activities also increased.

The number of client payments increased by 30% and reached 907 thousands, and the amount did by 34% to AZM54 trillion respectively.

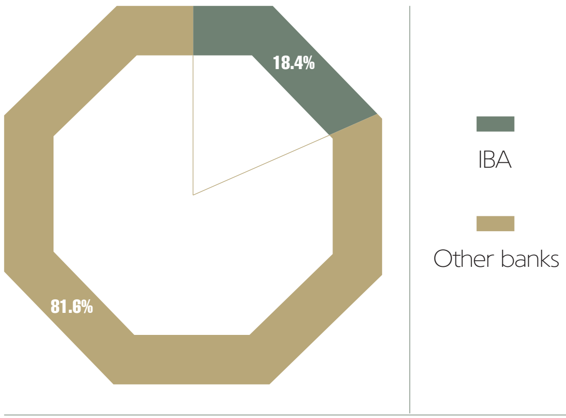
In the financial period, the growth of the main indicators for the development of banking exceeded the whole economic growth.

As a result, bank assets ratio to GDP had grown from 14.6% to 20%, with that of bank credits from 8.3% to 10.8%.

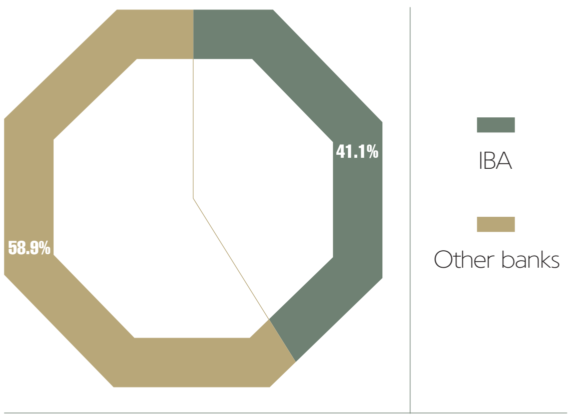
Share of the IBA in the total bank's assets of the country(%)



Share of the IBA in the aggregate share capital of the banking system (%)



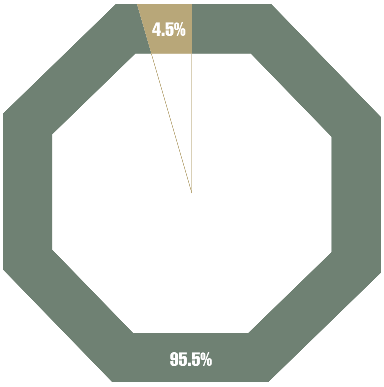
Share of the IBA in the total volume of credit investments in the national economy (%)



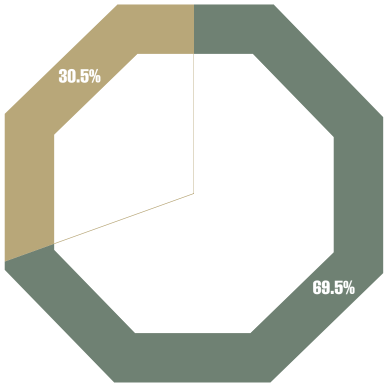
IBA

Other banks

Share of the IBA in the total volume of deposits made by legal persons (%)



Share of the IBA in the total volume of the transactions made with plactic cards (%)



IBA's Position in Main Areas of Banking Market

By the main financial indicators, the Bank's positions in the market (by total assets, liabilities, capital etc.) were as the following:

	In the whole sector *(billion AZM)*	**IBA's share**	
		billion AZM	**%**
Assets	8 374.1	4 323.1	51.6%
Shareholders' Equity	1 444.3	266.0	18.4%
Individuals' savings	2 033.5	901.5	44.3%
Deposits	3 028.8	2 892.5	95.5%
Credits	4 947.3	2 032.6	41.1%

Save the Past...

Ancient architectural traditions of the country consider climate conditions, local construction materials etc. Some of these traditions had influenced entire of the Oriental world. Great Ajami's Nakhchivan school of architecture can be named as example. Built by Ajami mausoleum of Momina-khatun is so beautiful that amazes viewers during 800 years. Decorated with blue and cyan tiles, it turned to be a model for architects and a symbol of eternal love of two lovers...

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...build the Future!

Modern building technologies allow to erect constructions which are not just beautiful, but reliable and qualitative as well – houses of various assignment, including dwellings, sportive halls for thousands of spectators, hotels, etc.

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IBA'S MISSION AND STRATEGIC PURPOSES

Mission

The IBA is the leading financial institution of the Azerbaijan Republic and an important factor to develop the national economy, to integrate it into the world economy and to revive the banking sector.

The IBA can be called the National Bank of Development, which has declared shareholders' concern and care for clientele its most precious values.

Strategic Purposes

1. To create a complete system of corporate administration, including risk managing and control systems providing concern of shareholders and clients and the Bank's safety, and a modern marketing information system meeting the Bank's business strategy and development.

2. To permanently strengthen and widen the branch network; to increase the proportion of the branches in the Bank's general indicators through their wider sales of high-quality and competitive financial service.

3. Together with widening the assortment of the Bank's production and raising the level of service for the clientele, to provide more intensive developing the retail bank business.

4. To continue the development of staff able to successfully provide the Bank's business strategy; as an important part of this work, to apply the system of motivation and evaluation of labor.

5. To maintain the leading position in the financial market and to continuously develop the Bank's image in the international market.

MAIN OUTCOMES of 2004

2004 was the second year of the Bank's concept as "The National Development Bank". As compared to 2003, the Bank developed more intensively in all strategic directions.

- *In 2004, the Bank's assets increased by 72.2%, reaching AZM4.32 trillion.*

- *Individuals' term deposits in the IBA had increased by 53.9% and reached AZM901.5 billion by 31st December 2004. Long-term resources increased 1.4 times, and their proportion in deposit made up 62.8%.*

- *Corporates' term deposits in the IBA by 90.3% and reached AZM2.9 trillion by 31st December 2004.*

- *By the end of the financial year, the Bank's crediting the national economy had increased by 79.2% relative to 2003 and totaled AZM2.03 trillion.*

- *Crediting individuals quickly increased as well. The Bank's crediting of people had increased by 52.9% since 2003 and reached AZM202.7 billion by 31st December 2004.*

- *In 2004, the Bank's collaboration with foreign financial institutions much increased. In fact, one can mention the Black Sea Trade and Development Bank, the Iran Bank of Export Development, the Islamic Bank of Development, the Islamic Development Corporation, the Deutsche Bank, Wachovia Bank, Commerzbank, US Eximbank, Turkeksimbank, the AKA Consortium of German Banks, the RaiffeisenBank and other famous financial institutions among the Bank's partners.*

- *In 2004, up to 90,000 plastic cards were produced. The Bank has the widest network of ATMs in the country.*

- *In the financial year, the Fitch International Rating Agency raised the Bank's rating to the "BB-" level. At the same time, the Bank's short-term and individual ratings were reaffirmed as "B" and "D/E" respectively.*

- *In 2004, the Bank was awarded "Best Bank in Azerbaijan" (by Euromoney), "Bank of the Year in Azerbaijan" (by The Banker) and "The Best Bank of the World's Developing Markets" (Over the Central Caucasus) (by Global Finance).*

DYNAMICS OF 2004'S MAIN FINANCIAL INDICATORS

The financial outcomes of the Bank's activities in 2004, as compared to the previous years, are proving higher increase dynamics. Backed by the strengthening competition in the banking sector, the IBA was able to hold its leading position in Azerbaijan's banking market, which was reflected in the Bank's main financial and economical indicators.

	2003		2004		Increase
	mln. AZM	*mln. USD*	*mln. AZM*	*mln. USD*	%
Assets	**2 510 956**	**510,1**	**4 323 107**	**881,7**	**72,2**
including:					
Loans to Customers	1 134 460	230,4	2 032 617	414,6	79,2
Liabilities	**2 332 207**	**437,7**	**4 057 046**	**827,5**	**74,0**
including:					
Customers accounts	2 060 786	418,6	3 720 575	758,8	80,5
Shareholders Equity	**178 749**	**36,3**	**266 061**	**54,3**	**48,8**
including:					
Share Capital	50 000	10,2	100 000	20,4	100
Income	**333 506**	**67,7**	**481 484**	**98,2**	**44,4**
including:					
Interests	140 241	28,5	236 532	48,2	68,7
Commission	166 877	33,9	214 253	43,7	28,4
Expenses	**262 934**	**53,0**	**385 633**	**78,7**	**46,7**
Profit	**70 572**	**14,3**	**95 851**	**19,5**	**35,8**
including:					
Net Profit	47 653	9,7	69 470	14,2	45,8

Structure of Assets and Liabilities. In 2004, the main achievements of the Bank were intensive crediting its individual and corporate clientele and keeping on high-tempo increase of obtaining funds to long-term financial instruments, which, in turn, resulted in positive substantial changes of the Bank's asset and liability structure. In fact, the Bank's assets increased by 72.2% (including by 79.2% for those on crediting the clientele), and liabilities did by 74.0% (including by 80.5% for those on clientele's deposits) having come to AZM4.32 trillion (AZM2.03 trillion on crediting) and AZM4.05 trillion (AZM3.72 trillion on clientele's deposits) respectively.

In 2004, the Bank's activities in the financial market enabled brining its total assets up to AZM4.32 trillion that is 72.2% more than before. In the financial year, the Bank paid special attention to obtaining long-term funds to reach optimal term ratio between assets and liabilities. As a result, by the end of the year individuals term deposits had increased more than 1.4 times and reached AZM822.0 billion. Year-longer deposits increased 1.4 times, which must be considered a positive tendency. The Bank's active obtaining of time deposits enabled better liquidity indicators and the better yield of the clientele's temporary spare cash.

A financially stable institution, the IBA continued obtaining funds from foreign banks within new limits. There are the Black Sea Trade and Development Bank, the Iran Bank of Export Development, the Islamic Bank of Development, the AKA Corporation of German Banks and others among the IBA's partners. The construction of an accumulator plant in Baku, glass dish production, building the Business Centre and other projects were financed from the back-up lines opened for the Bank.

Like in the previous years, crediting was the main direction of fund distribution and totaled AZM2289.4 billion (52.5% of the assets).

Though the IBA's fund allocation for purchasing securities was not big (AZM177.8 billion), it had increased by 5 times as compared to 2003.

Thus, the Bank spent USD26.8 million and 8 million Euros to buy bills of credit by issuers like Vneshtorgbank, Alfabank and Glavmosstroy and got the income of AZM2.2 billion.

In the domestic stock market, the Bank basically participated in the sector of fixed income securities and, for the first time, bought corporate fixed income securities. The investment came to AZM3 billion and USD300000. Decrease of investing into state short-term fixed income securities (as compared to 2003) was mainly caused by the satisfactory state budget and low issuing and yield of state short-term fixed income securities caused by lack of urgent needing debt funds.

Structure of income and expense. In 2004, the whole income increased by 44.4% as compared to 2003 and totaled AZM481.5 billion. In the income structure, interest income ratio was 49.1% (AZM236.5 billion) and non-interest income was 50.9% (AZM245 billion).

The main source of the Bank's income, crediting is an important factor of the high level of breakeven. Crediting income increased by 73.3% (AZM90.7 billion) and reached AZM214.4 billion, which was 44.5% of the whole income. Net interest income increased by AZM68.8 billion (85.5%), and net commission and other income did by AZM84.6 billion (63%), so reaching AZM 149.4 billion and AZM 218.9 billion respectively.

Interest income on due from other banks and correspondent accounts increased to a certain extent (AZM14.9 billion). Due to low development of the domestic market of securities, rate of exchange stability and the low level of secondary financing the National Bank of Azerbaijan, the ratio of interest income from investment securities to the whole income was slight (3%).

In 2004, the Bank's commission income from clientele's proliferation, settlement-cash service, widening product and service spectrum and documentary business development increased by 28.4% and came to AZM214.2 billion, and its ratio to the whole income reached 44,5%. About a half of commission income was provided by cash (19.8%), settlement (15.3%) and plastic cards (15.6%) operations. Documentary and credit line service provided 12.8% of commission income. Commission from foreign currency and securities increased by 24.2% and totaled AZM74.7 billion, which was 34.8% from the whole commission income. This indicator is proving the Bank's productivity in the currency market, a high number of its clients actively working in this part of the financial market, and the increasing influence of state of the currency market on the Bank's financial outcomes.

Interest payments for obtained funds continue to be an important item of the IBA's expense. Expense on this item increased by AZM27.4 billion (46%), having reached from AZM59.7 billion to AZM87.1 billion. This was determined by more intensive increase of capacity of obtained funds. It must be mentioned that the most part of expense belongs to interest payments on corporate and individuals' deposits (AZM73.5 billion). In 2004, its ratio to the Bank's whole expense was 19.1%. In the situation, this tendency can be considered normal, and it has been taken into account by the IBA's strategic plan for 2004-2006.

The absolute value of expense to provide the Bank's activity increased by AZM48.2 billion (44%) as compared to 2003. This was due to wider scale of the Bank's activity, substantial increase of its branch network and a higher number of the IBA's staff. In its turn, the staff's increase was accompanied by increase of expenses including higher expenditures on salaries and bonuses as a result of applying the new labor assessment system.

Capital. In 2004, the Bank's share capital increased twice and reached AZM100 billion.

Increase of the IBA's liabilities was accompanied by the adequate increase of the shareholders equity. By the late 2004, the Bank's shareholders equity had increased 1.5 times and reached AZM266 billion due to increase of the Bank's inseparable profit and share capital. The ratio of shareholders equity to the whole liabilities was 6.5%.

Increase of the capital together with increase of assets (72.2% and 48.8%) enabled better capital adequacy and crediting increase.

One of the Bank's crucial competition advantages, better capitalization became an important factor of the Bank's financial stability. The potential of the Bank's wider activity in this field increased.

As a conclusion of the report, the increase tendency related to the Bank's yield and profitability became more prominent. The IBA finished the year with high balance sheet profit (AZM95.8 billion) that exceeded the previous year's relevant indicator by 1.35 times. After-tax net profit came to AZM69.5 billion (AZM48.5 billion in 2003). Positive dynamics is seen on other indicators as well. For instance, net interest income increased by more than AZM68.9 billion (85.5%), thus, net commission income increased by AZM40.2 billion (25.6%).

The level of CAMEL indicators is proving productive managing the bank's liquidity and assets. So, the ratio of the first-grade capital to whole assets measured on risk is 8% instead of 5%, and that of the whole capital to assets is actually at the limit of 12%.

MANAGEMENT SYSTEM

The main purpose of the IBA's management system development was to obtain competition advantages through strengthening the Bank's leading position in the market, improving management quality, quick response and efficiency.

Strategic management was basically done by the IBA's Administration and consisted of defining the head principles of the Bank's activity, determining and approving its development plans and different working aspects (corporate management, developing the institutional structure and information technologies, tariff policy, on-management information system etc.).

Risk management was directed towards the optimal reconciliation of the strictly centralized policy on controlling financial risks, which was carried out with limit mechanisms and interest rates, in the way of liberating the Bank's sectors to a necessary extent. Measures on protecting information and checking computer systems were also done through the prism of efficient activity in the risk aspect.

Managing human resources was created on comprehending the crucial role of the human factor in carrying out the IBA's strategic tasks.

Developing the staff's professionalism and motivation, elaborating corporate culture meeting the modern requirements are given substantial importance.

Imaging management was based on the most possible information transparency, active promoting the IBA's brand in the market, strengthening PR-impact on target groups, and traditional good attitude to every customer. Maintaining the high level of clientele's loyalty and consolidating the Bank's positive influence on the public opinion are the main premises of this field.

Logistics was carried out through measures on improving the staff's working conditions, automatizing the Bank's processes, developing the Bank's telecommunication infrastructure, applying client-oriented advanced information technologies and providing clientele's maximum convenience at the service time. Taking into consideration these premises, developing the IBA's structure and a productive system for adopting and implementing decisions were under consistent efforts in 2004.

Within this framework, new structural segments (the Bank's office for managing bodies, the Department for Managing Human Resources, the Department for Branches and Subsidiaries, and, on the basis of the Department for Strategy Planning and Marketing, the Marketing Department and the Department for Strategic Development) were created at the end of the financial year. Since the beginning of 2004, the Department for Clientele Service has started working as the Bank's Central Branch. In 2004, the profile committees, which played an important role in providing the Bank's effective work, became an inseparable part of the Bank's harmonious management system.

The Asset and Liability Management Committee's activity was directed towards balanced managing the Bank's resources to provide stable income with minimized risk. Formed at the Bank's certain stage, the Committee is the main working body to analyze financial situations and define short-term indicator numbers. The Committee is responsible for analysis of all information directly or indirectly affecting the Bank's activity, profit, and product and service value.

The Credit Committee carries out forming the Bank's credit portfolio and adopts decisions on distribution of assets due to breakeven of credit allocation, crediting risk and rate of liquidity. The Committee defines credit limits on terms and basic directions and also analyzes different related projects and suggestions and presents relevant statements.

The Committee for Information Technologies was responsible for the items connected to developing information technologies, automatizing banking operations and working out the IBA's business support program means and implemented relevant measures to advance the Bank's activity.

As a result of developing the management structure and improving the profile committees' activity, an integral interest policy, a centralized system to control, register and manage cash flow, risk and liquidity, and modern technology facilities were provided.

Save the Past...

The country's ancient name of Adar-Bad-Agan means "The country under protection of Fire". Fire (Adur, Atar) was worshipped by Zoroastrians an Earth incarnation of one of the cosmic elements. It was time when entire of Azerbaijan's Caspian seacoast was lightened with natural res – natural gas coming from under the ground. Fires could be seen even in the sea, not far from the shore. When religion of Zoroastrians was replaced here with Islam, protesting Zoroastrians leaved to far lands of India.

THE INTERNATIONAL
BANK OF AZERBAIJAN

Annual Report 2004

...build the Future!

Only fires of natural gas coming from under the ground were lightening the area in past. Nowadays arriving to this place by a night aircraft flight one can enjoy a bird-eye view with plenty of other fires – lights of cities and settlements.

THE INTERNATIONAL BANK OF AZERBAIJAN

Annual Report 2004

MAIN DIRECTIONS OF IBA'S ACTIVITY IN 2004

Corporate Customers Service

Corporate business is the traditional basis of the IBA's activity. In the financial year, the IBA tried to consolidate its position in this segment of the banking market.

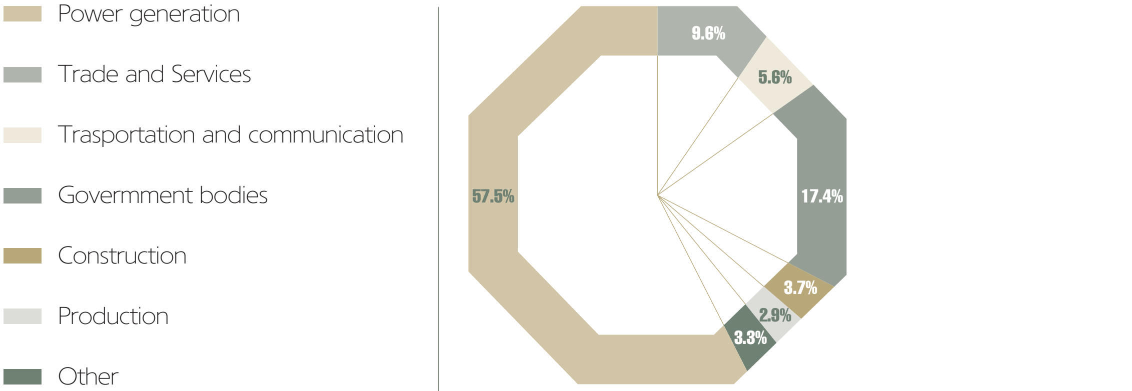
The IBA is currently offering to its corporate clientele up to 140 banking products and services, and numerous financial schemes including cash-settlement services, cheque settlement, plastic card operations, crediting and investment, documentary instruments, accepting deposits, Internet Banking etc. On the other hand, favorable conditions to have the wide branch network, to broaden scope of activities by subsidiaries in the Russian banking market and the representative network protecting the Bank's positions and concern in the world's financial markets, and to provide the IBA's business multiplicity (insurance, leasing and processing) and complex servicing the corporate customers.

The Bank declared strategic cooperation with the customers, full using the potential of reliable partnership, convenient serving and information transparency its basic principles for working with the clientele.

2004 was a year of substantial growth of corporate business for the IBA. The IBA obtained 95.5% of funds obtained from corporate clientele all over the Republic. The number of corporate clients had increased by 14.9% and reached 22,300 by the end of the year. The Bank is serving fuel and energy, industrial, and construction businesses. These are basically actively developing and profitable entities with positive business reputation. Azerneftyanajag, Azerenergy, the SOCAR, Azercell Telecom, Ground Handling Company, Lukoil-Azerbaijan, the State Oil Fund, Caspian Geophysical and others can be mentioned herein. Each of them is considered of leading ones in a relevant field, which requires an appropriate level of banking service. In this case, the Bank acts as a professional consultant helping to find optimal decisions for financial management. Operations with large-scale customers provide the main part of the Bank's profit. At the same time, the Bank is broadening its partnership with small and medium businesses.

Corporate clients are offered competitive tariff, term- and value-differing variants to provide every product. Applying service to allocate temporarily spare funds, settlement-cash service, documentary instruments which more improve credit and currency operations, corporate bank cards, project financing, collection-of-payment service, and Internet Banking was expanded. Engaging the corporate clientele into the

Deposits by sectors of economy (%)



IBA's Salary Cards Projects was going on. To make it more convenient for the customers, cash dispensers were installed in their biggest office buildings and the whole cash dispenser network was substantially enlarged.

The quantitative and qualitative development of the IBA's clientele is evident. By the late 2004, juridical persons' depository remains had reached AZM2.9 trillion (90.4% as compared to 2003), which is 71.4% from the Bank's liabilities. Long-term partnership of mutual understanding with the clientele, an individual approach to a client considering all requirements of clients and using the advanced experience of financial service compose the core of this success.

The Bank is continuously increasing the capacity of crediting its corporate customers. In fact, crediting increased by 79.2% as compared to 2003.

Preparatory work over applying Client Service Management system within the framework of the pilot project, which is designed to develop the Bank-clientele partnership, to bring it to the level of international standards and to raise the efficiency of sale channels was finished. According to the world experience, this system meets clientele's increasing requirements as much as possible and its application is going to promote a larger clientele basis, the Bank's product and service spectrum, and prominent developing breakeven of the Bank's activity. In 2005, the pilot project is going to be carried out over the branches.

Protecting and further consolidating the leading position in corporate banking service market is declared of the IBA's main tasks in 2005. In corporate business, the Bank will continue its strategic line towards optimizing clientele's accounts and working out, preparing and offering new banking products and services directed to support and broaden business. Partnership with businesses belonging to the real sector of the economy will remain the main direction of developing the Bank's corporate clientele basis. Attention is going to be paid to maximum obtaining large customers to the Bank, long-term partnership with them, and increasing such customers' proportion within the structure of obtained funds and credit resources.

Individual Customers Service

The National Bank of Development, the IBA continued to further expand individuals' service spectrum and provide different services and products meeting the requirements of all social groups as one of the directions of its activity in the financial year.

All layers of the society are currently using the Bank's service. They are offered settlement-cash service, accepting deposits, domestic and international money transfer, plastic cards, road and name cheques, Internet Banking, leasing depository safes and other products and services.

Considering its social mission and behavior stereotypes formed among different groups of people, the Bank tries to meet their requirements in a balanced manner and inspire their activeness.

As a result, the number of individual customers increased by almost 62% and reached 165,400 in 2004. 17,800 of those are depositors. By the end of 2004, remains of individual customers current and depository accounts had made up AZM901.5 billion and reached by 53.9%. The IBA is at the first place among Azerbaijan's credit banks in terms of capacity of individual customers' deposits. It should be mentioned that these indicators were reached with interest rate decrease by the IBA. In 2005, the Bank is going to maintain its leadership in this field and has prognosticated its minimal 52% ratio to the domestic commercial banks' whole funds obtained from people.

The Bank is also going to increase the capacity of its credit service for natural persons. Thus, since August 2004 the Bank has been giving consumer credits via Express Credit bank cards, having assessed its capacity of paying clients with Scoring. By the end of the year, almost 600 clients had used this service, and given credits had reached AZM470 million.

VIP-rated natural persons are served by the Private Banking project. At the moment, the IBA is offering its clientele excellent banking service with using new bank technologies. The main principles of this service are complexity, strict confidentiality and maximum considering clientele's concern.

The Bank expanded its participation in utility service and cell phone payments. Therefore, all service delivery points of the Bank are accepting these kinds of payments from people on the basis of a relevant system prepared by the Bank's and AzeriCard's staff. So, holders of the IBA's plastic cards are given opportunities to cover their utility and cell phone expenses.

The IBA offers its clientele services over Euro- and USD-counted American Express, Thomas Cook and Visa road cheques. Customers were offered USD- and pound-counted cheques issued by large banks like Barclay's or by Bankers Trust.

In 2004, the Bank increased MoneyGram urgent transfer by 39.2% bringing the capacity up to USD20.6 million (42,000 transfers). The main specificities of transferring by this system – urgency, reliability and convenience.

Urgent money transfer between the IBA and its subsidiary – the IBA–Moscow – significantly increased. Paying minimum commission, our clientele may transfer money from any Russian region to Azerbaijan and vice-versa without an account. In the same way, the Bank created a non-account money transfer system for natural persons, with one of the largest Ukrainian banks, Ukrsotsbank.

The Bank offers individuals currency exchange operations through its numerous currency exchange points and operation cash-desks.

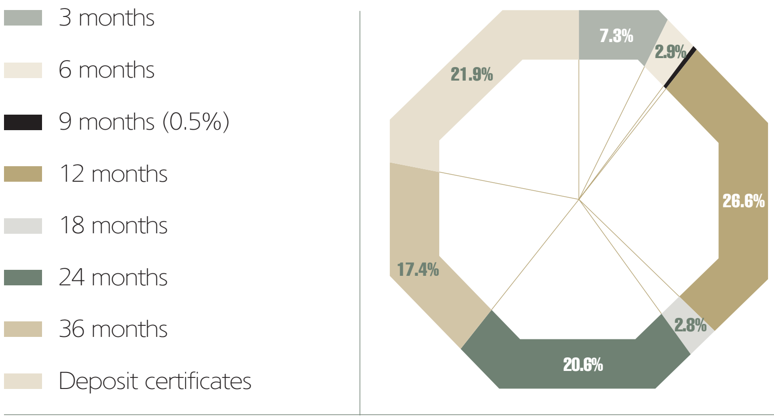
The IBA permanently develops working with individual customers and tries to anticipate customers' demands. As a result of systematic and integral activities in retail business, and that of learning customers' demand and in-time meeting their needs, the Bank obtained a substantial increase of new depositors.

Working with individual customers will remain of the Bank's main activity directions in 2005. The Bank, first of all, is planning to expand the spectrum of the mentioned service for individuals. The IBA is stressing on unconditional fulfilling its liabilities to the clientele, competitive interest rates, positive experience in the retail banking service market, deposits as one of the Bank's stable sources.

Credit Operations

In 2004, the Bank's credit portfolio substantially increased. So, while as compared to 2002, the 2003 increase had been approximately 36%, the 2004 increase reached 79.2%. This was determined by, as connected to the positive processes of the national economy, increasing credit demand, and, in particular, the on-going increase of the Bank's credit potential and efficient partnership with foreign financial institutions.

Structure of the attracted funds (%)



In 2004, the Bank's credit policy was directed towards providing necessary yield of clientele's demands assuming fuller paying and with acceptable risk of crediting. The main direction of this policy was to form a high-qualified and many-sided credit portfolio.

With its crediting experience, the Bank increased the number of reliable debtors and widened crediting both corporate customers and natural persons. In the financial year, the Bank implemented various kinds of credits for entities and organizations from all fields of economy. In terms of proportion of crediting domestic economy (41.1%), the IBA is holding the leading position in the banking system. By the end of 2004, the Bank's credit portfolio reached AZM2289.5 billion.

12-month credits total 54.8%, those for 6 months do 21.4% and 33.3% is made by more-than-6-month credits. 34.7% of credits are given for more than a year. As compared to 2003, the highest increase (2 times) was made by year-longer crediting. Crediting for terms from 6 month up to 1 year increased 1.5 times. As a positive trend, the proportion of overdue credits decreased from 25.3% to 15.9%.

Crediting corporate clientele increased by 79.2% (or by AZM898.2 billion) and reached AZM2086.8 billion (as compared to the previous year's AZM 1199.8 billion). For the financial year, crediting natural persons increased by about 52.9% and totaled AZM202.7 billion. Within the credit portfolio, corporate crediting was 91.1%, and that of natural persons did 8.9%. Interest income from given credits increased by AZM90.7 billion, or by 73.3%, from AZM123.7 billion to 214.4 billion.

Crediting state institutions made up to 39% of the credit portfolio, and individual crediting was up to 61%.

Increasing the number of clientele enabled the Bank to divide its credit portfolio risks between different economy sectors. From this point of view, the IBA's credit portfolio was well balanced both for terms and capacity of credits, and for economic diversity. Credits were distributed between manufacturing (AZM779.3 billion, or 34%), railroad, air and other transportation (AZM667.2 billion, or 29.1%), trade and services (AZM357.6 billion, or 15.6%), construction (AZM173.2 billion, 7.6%) etc. Crediting state institutions significantly decreased and made up only AZM70.8 billion, which is 3.1% of the credit portfolio.

The Bank more and more helps not only large debtors, but also small and medium businesses.

On liabilities, the IBA's policy enables obtaining relatively cheap domestic resources and consistent decreasing interest rates. Regardless foreign-originated credits remain needed, financial demand is increasingly met by inner sources.

Crediting natural persons is fast developing. The Bank offers them different programs on consumer crediting that is an instrument to stimulate and provide people's demanding long-term consumer goods (cars, furniture, home devices etc.) and other important and needed products (education, tourism etc.). Consumer credits given through Express-Credit bank cards on the basis of the Scoring system made up AZM467.4 million in the structure of crediting natural-person clientele. This product was being offered to natural persons within the framework of the 3-month pilot project since the financial year's August by the Central and Narimanov branches, acting in Baku, in Bacond and Panasonic shops. During this term, the results were analyzed, and large applying the product was made expedient. Customers are now offered Express-credit from USD250 to 2000, of two kinds: Exclusive (for holders of the Bank's salary cards) and Classic (for other customers). Up to 400 persons had used this product by the end of the financial year.

To pay supposed losses from debts, in 2004 the Bank created the foundation covering bad credits. This foundation is totaling AZM256.8 billion, which is 11.2% of the IBA's credit portfolio (14.8% in 2003).

Crediting played an important role in the IBA's income structure. In 2004, interest income from crediting exceeded AZM214.4 billion. The IBA's branch network is increasingly participating in credit operations. By the late 2004, crediting by the IBA's branch network had reached AZM1.4 billion (2.1 times as much as in 2003) which is 68.9% of all credits by the Bank.

In the conditions of increasing need of credit resources, the main direction of this policy is going to minimize and diversify credit risks, to increase the clientele by new reliable debtors, and to form a high-qualified and high-income credit portfolio. In 2005, the credit policy will be made on the basis of learning more promising directions, and the main attention will be paid to debtors' field identity and to forming a credit portfolio for many terms and types of crediting.

The Bank will expand crediting both corporate clients and natural persons. Due to growing activity of small and medium business, special attention will be paid to crediting owners. Micro-crediting, factoring, hypothec, consumption, bill crediting and other programs are planned for implementation.

Securities

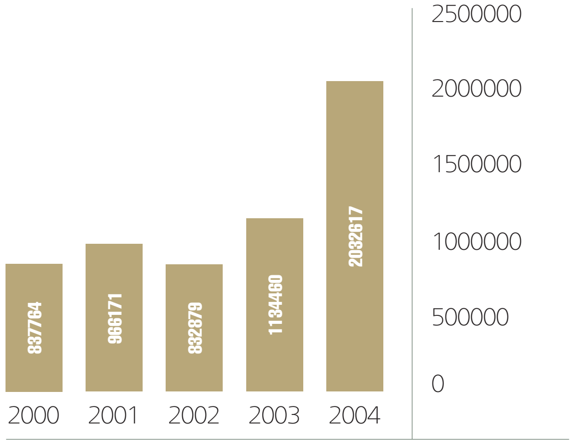
In 2004, the IBA's participation in the market of securities consisted of purchasing state short-term fixed income securities, corporate fixed income securities, and securities by Russian issuers.

Investing corporate fixed income securities was AZM3 billion and USD 300000, and these fixed income securities brought AZM220.7 million income.

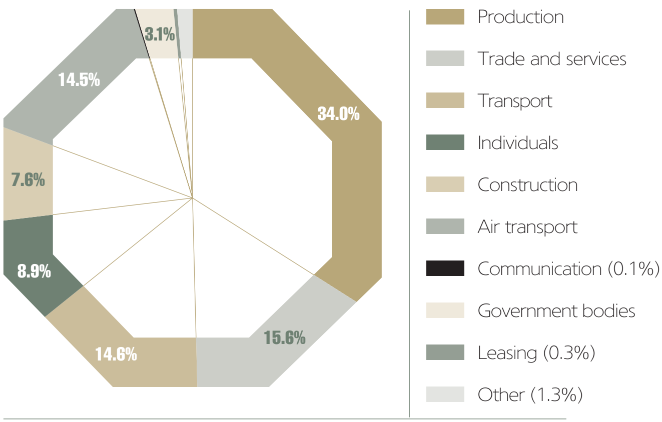
Like in the previous years, the Bank was an active participant of the state market of securities.

In 2004, AZM4.8 billion was allocated to purchase state short-term fixed income securities (6.1% of the whole issue). From this investment, the Bank's income in 2004 was AZM 132.3 million. According to 2003's results, these indicators made AZM91.5 billion and AZM2.15 billion

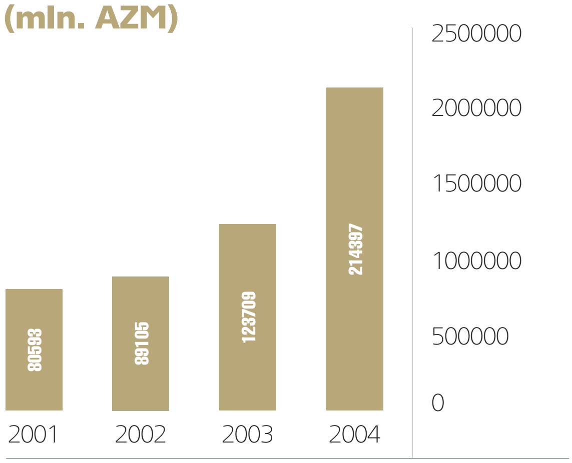
IBA's credit portfolio (mln. AZM)



Allocation of credit portfolio by sectors (%)



Interest revenue growth by the credit operations (mln. AZM)



respectively. This was caused by issue decline from AZM446.6 to 79.1 billion due to the satisfactory situation with the state budget and lack of urgent needing debt funds. So, state short-term fixed securities income also decreased.

In 2004, the Bank allocated AZM89.6 billion to purchase the National Bank's short-term notes (48.7% of the whole issue). From this investment, the IBA's issue in 2004 was AZM474.5 million.

In 2004, the Bank extended its activity in the Russian market of securities. So in 2004, investing bills of credit by such issuers like Vneshtorgbank, Alfabank and Glavmosstroy was brought to USD26.8 million and Euro 8 million, and the income was AZM2.2 billion.

Besides, shares by a number of Russian fuel-energetic and communication companies, which had been bought in 1998, were sold at the end of the financial year.

Plastic Cards

In 2004, the Bank highlighted plastic card business as it had done before. An issue of overall economic significance, developing cashless settlements via plastic cards is one of the main directions of the IBA's activity.

A full member of VISA International and MasterCard International, the IBA presents a large spectrum of plastic cards and card service. As compared to 2003, in the financial year the whole number of issued cards increased 1.6 times and made up 85,900. Card transactions increased twice and exceeded AZM1385 billion. The IBA is a doubtless leader among Azerbaijan's banks in terms of issue capacity and card transaction turnover. Having its own processing company enabled the Bank to reduce its expenses, to raise the quality of servicing the holders of international plastic cards and to create new bank products.

Like in the previous years, the Bank tried to provide high-quality service for holders of plastic cards and paid special attention to developing a relevant infrastructure. The IBA's network of cash dispensers covers 25 cities. During the financial year, the network expanded, and almost 170 cash dispensers were installed. ATM operations increased from USD60.2 million to USD263.2 million (4.4-time increase) since 2003. Contribution by the IBA's regional branches into developing the Bank's card business should be particularly mentioned.

The IBA consistently develops its acquiring network: in 2004 this network approximately increased by 20%, and nearly 200 commerce-service points have been engaged by the Bank's cards into the service so far. In the current year, turnover through POS-terminals installed in commercial and service entities has made up AZM125.4 billion. Using the Bank's plastic cards has been enabled at big stores, famous boutiques, restaurants, hotels etc. At some of these places customers are given discounts when paying by card. Acquiring terminals network made Card counts even more appropriate and attractive.

Turnover for Cash advance operations (cash payments at the IBA's branches via POS-terminals) reached AZM 101.8 billion, or had increased 7.4 times by the end of the year.

Further increasing yield of the IBA's card business is evident: plastic card commission increased by73.7%, and total amount reached AZM19.3 billion, while profit increased by 68.7% and reached AZM26.3billion.

In 2004, the Bank continued to increase the number of card products: our customers have been enabled to own VISA Platinum cards, which are of the highest status in society and symbolize prosperity and financial stability. To raise both attractiveness of the Bank's plastic cards and individual clients' loyalty, in the current year new tariffs were applied, which are more appropriate for clientele, and card validity was prolonged from 1 year to 3.

Capacity of operations on cell phone and utility payments by owners of the Bank's plastic cards via free Internet Banking and cash dispensers intensively increased. This promotes to increase ratio of cashless settlement to the turnover and to treat the whole system of turnover. Since 2003, AzeriCard has been playing a crucial role in carrying out such a socially significant state project as via-card paying pensions. So, in 2004 more than 272,000 Pensioner's cards were given to people by the IBA in about 10 cities of Azerbaijan including Baku, Sumgayit, Ganja, Aghdash, Shaki, Shamakhi and others. AzeriCard is widely participating in the IBA's consumer crediting program. Increasing in terms of corporate clientele cards of the Bank was achieved.

Keeping on developing this direction, the IBA paid special attention to Salary projects together with corporate cards. Those provide 81.5% of the card issue. In the financial year, the IBA applied above mentioned projects in nearly 150 entities and organizations. In comparison to 2003, Salary card issue increased twice, and more than 100,000 workers from nearly 460 entities and organizations are enjoying the efficiency of this system.

In the nearest future, activity range will significantly grow in all the directions of the card business including participation in social projects, and card products will be developed at the level of international standards. In 2005, the Bank is planning to pass to microprocessor Chip cards. This experiment is first of all intended for pensioners and other citizens getting various social allowances, all-kind utility payments, and underground fare. Chip cards will implement the functions of tickets, medical insurance, short-term crediting and, first of all, enable to substantially decrease possible forgery losses.

In future, importance of the card business infrastructure is going to significantly widen: in 2005, 250 ATM and 400 POS-terminals will be installed (those will also accept chip cards). To enlarge the circle of credit card owners and activities on implementation of Salary projects and co-branding (joint card service in partnership with the most famous companies) programs, and to apply Internet-Acquiring for commercial and service entities and joint stimulating programs in partnership with VISA International and MasterCard International in order to increase the clientele's loyalty to the Bank, are planned.

Relations with Foreign Financial Institutions and Project Financing

In 2004, the IBA more strengthened its relations with foreign financial institutions and acted as an agent-bank between them and the government and also as a debtor on credit lines by other foreign banks.

Efforts in developing the Bank's relations with foreign partners were oriented to widen the capacity of their crediting the Bank and to more consolidate mutually beneficial partnership. As a result, relations with foreign financial institutions rose to an essentially new level. This more enabled meeting present and prospective customers' growing demand of cheap and long-term funds.

Within Credit and Crediting Medium Properties program, using USD4-million credit line was continued according to the credit agreement signed by the IBA and the European Bank of Reconstruction and Development. Under this credit line, expert analysis of 14 projects was done, and financing the most promising of them started. Projects considered during the financial year covered producing electric devices, furniture, textiles, agriculture goods and construction materials, transport, service and tourism.

A USD6.5 million revolver credit line was opened for the Bank by the Black Sea Trade and Development Bank to finance export-import operations with the member-states. In the past year, USD4.3 million under this credit line was used for projects by our Republic's producing and reprocessing industry.

In the financial year, a number of projects were considered within the framework of an agreement for opening a Euro 10-million credit line by the Iran Bank of Export Development to finance export-import operations with Iranian companies.

The IBA convened about conditions of opening a USD4.5-million credit line to finance small and medium businesses and signed an according agreement with the Islamic Bank of Development and the Islamic Development Corporation, which is within the IBD's structure. An up-to-7-year term for each project financed under this credit line has been identified.

Within the limits of the above mentioned credit line, in September 2004 a project on constructing the Nurchin entity's accumulator plant was financed USD2 million for 4 years. Besides, the Islamic Development Corporation was offered several projects in construction, transport and glass production. As a result of implementing the projects, it is planned to bring benefit to the national economy, to develop the industry and to make new jobs.

In 2004, a USD11-million project by the Caspian Management Systems Ltd on establishing glass-dish production was considered, and expanded technical and economic analysis of the project was fulfilled. Proposals to take part in financing the project were sent to a number of well-known financial institutions, and, as a result, suggestions by the Islamic Development Bank and the Black Sea Bank of Commerce and Development were recognized the most appropriate.

In 2004, the General Construction's project to build the Business Centre in Baku was one of the largest. In 2004, a USD19.2-million-worth and 10-year-long credit agreement to finance this project was signed by Eximbank and, under the IBA's guarantee, Commerzbank and the General Construction.

In 2004, as concerning the construction of the passenger terminal at the Baku Airport, a nearly USD3.9-million debt for Turkeksimbank's credit and a USD3-million basic debt for the Exported Credit Guarantee Department's credit and counted interests, a USD11.4–million basic debt and USD1.3-million interests on the credit spent to purchase 2 Boeing 757-200 for the Azerbaijan Airlines, a Euro 2.1-million basic debt and Euro 112,700 interests on Euro 10.4 million obtained from the AKA Consortium of German Banks to finance the reconstruction of the Central Clinic were paid.

The last Yen 330.2-million part of the basic debt and Yen 6.3-million interests on the credit spent for the project on reconstructing the EP-300 steam generator at the Sumgayit Ethylene – Polyethylene Plant with the IBA as an authorized bank were paid.

As it is known, in 2003 the IBA took part with a USD1-million share in a USD13-million syndicated credit organized by the Raiffeizenbank for the Ukrsotsbank, Ukraine. This credit line was prolonged in 2004 for 6 more months and completely paid in September. Participating in this operation together with large and well-known European banks was one of the factors positively affecting our bank's image. As a result, in 2004 the IBA was invited by different foreign banks to participate in syndicated crediting advanced banks of Russia, Kazakhstan and Ukraine.

Further activities on organizing syndicated credits and financing promising projects are among the Bank's nearest plans. Opening direct credit lines and expanding the IBA's partnership with leading foreign financial institutions are important parts of business development and trusting the Bank.

Correspondent Relations and International Settlements

Like in the previous years, in 2004 the IBA was lead by the following principles of correspondent relations: constant attention to and many-sided learning demands appearing in domestic and foreign settlements by the Bank and clientele, providing efficiency and reliability of international settlements and creating the most favorable term and commission expense conditions for the clientele's payments and the Bank's operations. The main principle of developing the correspondent bank network is to create a network enabling domestic and international settlements with the least risk and financial and time wins advantages.

In the financial year, inter-bank relations with business partners developed towards the following goals:

- *Developing service technology and high-grade automatization of operation processes with decreasing the risks;*
- *With consideration of the banks' specificities and regional market peculiarities, creating individual schemes for interbank activities;*
- *Attracting new contractors and correspondents on the basis of mutually beneficial and long-term partnership.*

Upon the situation of the late 2004, the total sum of funds and short-term deposits on NOSTRO accounts at the foreign banks constituting the IBA's foreign correspondent network was equivalent to AZM323.4 billion.

Transfers through foreign correspondent banks increased about 1.5 times and reached a sum equivalent to AZM29.9 trillion including 74.1% increase and total AZM 16.1 trillion of domestic, and 34.4% increase and total AZM13.8 trillion of foreign ones.

In the financial year, special attention was given to implementing a set of measures against money-wash and financing international terrorism. The existing system of inner control was improved according to accepted international standards, the capacity and spectrum of partnership with each correspondent bank were individually defined. As a result, such approaching to the issue promoted to apply the Bank's efficient monitoring and control over money transfers, and this enabled revealing suspicious operations.

In 2005, the IBA will try to consolidate its positions in the interbank market with the purpose to raise the quality and capacity of settlements.

Documentary Operations

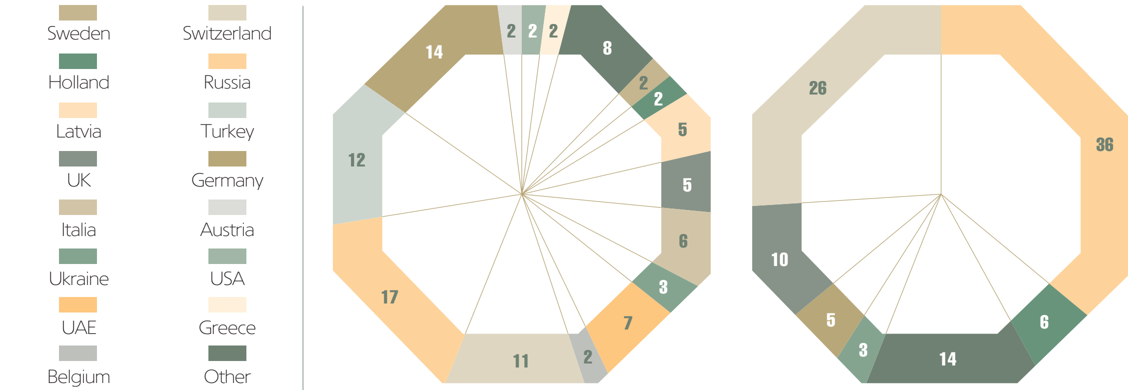
The Bank is taking the leading position among the Republic's banks for servicing its clientele's export-import activities through documentary operations. In the field of documentary business, the Bank gained excellent knowledge and work experience as a result of many-year activities. The Bank's advantage as of a financial partner in the field of documentary operations, which are a beneficial method to finance foreign economic entities and decrease the risk of nonfeasance of agreements with contractors, is based on its high international prestige, the staff's professionalism, a wide network of correspondent banks, and stable relations with numerous clientele and foreign partner banks. The IBA also provided its customers with regular consulting service on different fields of documentary business, structurizing conditions of payment under complicated deals and contracts and projecting letters of credit and cover funds.

Stable demanding of the relevant service by participants of foreign economic activity and expansion of the clientele are of the main factors of developing the Bank's documentary business. In 2004, 522 letter-of-credit operations were done with the turnover more than USD1.69 billion (in 2003, USD1.21 billion). Though the number of operations decreased by 5% in comparison to the previous year, the capacity, on the contrary, increased by 40%.

In the financial year, 100 export letters of credit totaling USD1.3 billion (by-31.6% increase as compared to 2003) were advised, and 422 import letters of credit totaling USD392.9 million (by-75.6% increase as compared to 2003) were opened. Documentary letters of credit were basically used to finance oil and oil product export (73%) and importing industrial equipment (36%), various raw materials and equipment for the tobacco industry (29%) and food (8%). Russia (36%), Switzerland (26%), the United Kingdom (10%), on the one hand, and Russia (16%), Germany (13%), Turkey (12%), Switzerland (11%), the United Arab Emirates (7%) and Italy (6%), on the other hand, were the Bank's main commercial partner in export and import respectively.

Imports letters of credit by countries (%)

Export letters of credit by countries, (%)



Letters of credit were basically approved by Citibank, Credit Suisse, Commerzbank AG, UBS AG, the HSBC, Bank Austria Creditanstalt AG, Bayerische Hypo und Vereinsbank, JP Morgan Chase, Calyon, the American Express Bank Ltd, Societe General and other well-known financial structures. For these purposes, credit lines of more than USD 200 million were created by international financial institutions.

The number and capacity of bank guarantees given to foreign commercial entities increased as well. In 2004, the Bank gave 955 guarantees to its clientele for USD134.3 million.

Income from documentary settlements was more than 1.3 times as much as 2003's indicators and approximately reached USD5 million.

Save the Past...

Ancient Baku was surrounded with double fortress wall protecting the city from enemies. Great part of the inner wall remains preserved (2/3). Thickness of this wall in its different fragments varies from 2,5m. to 4m. Then, a system of ancient towers, located in the entire area from Darband to Absheron, served for signaling about enemy attack danger. They used to burn a fire on the top of the tower under attack. As soon as the fire-signal was seen from the next tower, the fire was burned on its top as well, then, as the second fire was seen from the third tower, the danger signal was sent further on, etc...

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...build the Future!

Today new roads and dwellings are being built in Azerbaijan; economic conditions of regions come gradually revived, same as metallurgy, energy industry. The country is directed onto development of telecommunication and newer information technologies. Progressive intentions in both local and international tourism businesses are obvious as well. There grows number of modern tourist bases and refreshment zones at the seacoast; walking and riding tours to fortresses hidden in far mountains become available; new program on development of the winter tourism, including construction of lines for alpine skiers, has been worked out...

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IBA'S GROUP OF COMPANIES

Subsidiaries entering the IBA's Group of Companies play a year-by-year increasing role in strengthening the IBA's positions.

The Bank's subsidiaries and share-held institutions (stock and currency exchanges) on 31st December, 2004 are shown in the table below.

Institution Name	IBA's share of Shared Capital (%)
IBA-Moscow	100
International Insurance Company (IIC)	100
- Inter-Protect Re AG	100 (IIC)
AzeriCard Ltd	100
Business-Rabita Ltd	100
Azerileasing Closed Corporation	97,14
Inter-Baku PFC	74,6
A-Visual Production	60
Trans-Service Ltd	50
Baku Interbank Currency Exchange	20
Baku Stock Exchange	5,55

Below, the short information on the IBA-established group of companies is given.

The International Bank of Azerbaijan - Moscow
The first Azerbaijani bank abroad, the IBA-Moscow has been acting since 2002. The Bank's authorized capital stock totals Euro 10 million, and the IBA is the Bank's only constitutor.

On 6th June, 2003, the IBA-Moscow's branch opened in another Russian city, Saint-Petersburgh. Two operation offices of the IBA-Moscow are currently acting in Moscow.The IBA-Moscow's main directions include interbank operations and servicing corporate and natural clientele.

In 2004, having increasedby 17.4%, the Bank's assets reached 954.8 million roubles. Having increased by 46.6.% as compared to 2003, the Bank' credits had reached 509.3 million roubles by the end of the financial year. The capital amount had reached 325.7 million roubles by the end of the finanial year, and the increase was 0.6%.

International Insurance Company Ltd

The International Insurance Company Ltd was created in 2002. The IBA's subsidiary, the company's authorized capital stock is AZM 24 billion.

Currently one of the country's largest insurance companies, the IIC is serving for all kinds of insurance, but accumulating life insurance, and providing to cover risks on these kinds of insurance. By the end of the financial year, the company's market share had totaled 11.8%.

In the IIC's portfolio, car, personal responsibility, property, life and medical, accident and other-type insurance totaled 15.3, 12.6, 11.6, 6, 3.6, and 50%%, respectively.
By 2004's results, the ICC's income, expenses and profit had been AZM 30.4 billion, 29.6 billion and 833.5 million, respectively.

Inter Protect Re AG

This is the IIC's subsidiary located in Zurich, Switzerland. It serves on re-insuring risks by other insurance companies in the local market and significantly increases the IIC's competitiveness to foreign companies.

AzeriCard Ltd

The main activities by AzeriCard Ltd are to prepare and issue bank cards, use them in the domestic and international cashless payment-settlement network, and implement services connected to related settlements.

The Company's authorized capital stock is completely the IBA's.

In 2004, the number of banks served by AzeriCard reached 27, the number of issued cards did 500,000, and the number of ATM's was brought up to 475. Acquiring turnover was USD 400 million. In the financial year the card reception spectrum expanded to include Afghanistan, China and Turkey upon installing the terminals. In future, it is planned to include 10 more countries into the list.

By the end of 2004, the institution's net profit was AZM 7.2 billion.
The increase of operation income up to AZM 8.4-billion is prognosticated for 2005 due to the number of ATM, issued cards and POS-terminals reaching 800, 800000 and 2000 respectively.

Azerileasing Company CC

Though still created in 1999, this institution started actively working only since the second half of 2003.

By the related resolution of the IBA's Supervisory Board, in 2004, the authorized capital stock of the Azerileasing Company CC was brought up to AZM 3.5 billion with the IBA's 97.14% share.

The Azerileasing Company significantly intensified its activity in 2004 and implemented USD5.6-million projects under 77 leasing contracts. This positive tendency is developing day by day and undoubtedly going to develop.

This confidence is based on the purposes declared in the Bank's strategic plan for 2005-2007 and, along with the IBA's leadership in the banking sector, ambitions for undoubted leadership by all subsidiary institutions in their fields of action. In 2005, based on these plans, it is assumed to implement USD6.5-7-million leasing operations by the Azerileasing Company and diversify them by the numerous clients belonging to the different fields of economy.

Trans-service Ltd

Trans-service Ltd has been acting since 1998. The Company's main activity is to provide transport services (underground parking).

The constitutors of the Company are the IBA and the ISR Dish Tijaret ve Mumessillik Ltd. The IBA has 50% of the authorized capital stock.

A'Visual Production

The enterprise has been working since 1997. The IBA's share of the authorized capital stock is 60%.

The Company's main activity consists of inventing, producing and installing different advertisement products.

In 2004, 62 contracts on advertisement were signed between the Company and different organizations, and purchasing the production (work and service) brought an AZM2.0 billion income.

Business-Rabita Ltd

The Company has been acting since 1996. The only constitutor and shareholder of Business-Rabita is the IBA.

The main activity of Business Rabita Ltd consists of the following: developing different kinds of domestic and international communication; selling modems and modem accessories, ground equipment, communication equipment, telephone and radiotelephone stations and equipment, computers and other office facilities, managing information technologies and systems, computer equipment resources, maintaining service etc.

The IBA realizes importance of business multiplicity for stable development, intensifies and widens its activity in this direction. The Bank-established subsidiaries are keeping leading positions in their fields of activity and, together with the Bank, trying to keep these positions.

DEVELOPING BRANCH NETWORK

The IBA's branch network is an important and strategic resource of the Bank's dynamic and stable development. The Bank's regional policy provided its activity in Azerbaijan's most regions. At the end of 2004, the Department for Network and Subsidiaries was established.

The Department's main duties are, upon considering local specifics, peculiarities and strategic development directions of regional economies, to identify current and prospective duties on branch development, to quickly solve problems connected to branches' activity, to optimize the current management system of the branch network etc.

For the Bank, to expand regional activities means to decentralize the service, to maintain the IBA's status as of a national large and universal bank, to increase the regional clientele and branches' share in the Bank's total indicators, and to gain the regional competition advantage by service quality, a flexible tariff policy and new services.

2004's results give us the reasons to affirm the branches' role in the Bank's activity growing. Besides, developing regional economies will determine urgently growing demand of banking service that is giving an impulse for developing the branches.

The IBA's branch network had consisted of 35 branches by the late 2004. So, more than 20 sub-brunches were created in different regional branches, most of them will start working after obtaining relevant licenses in the 1st half of 2005. These sections will serve both juridical and natural persons. Sections will be also engaged into the state program of pension plastic card payments.

Many-sided developing the branch network isn't presented only by regional expansion and increasing the number of territorial sectors, but also by improving the efficiency of current structures. In the financial year, majority of the branches offered both juridical and natural persons individual approaches and a portfolio of the most competitive bank operations. Strict controlling each branch's budget implementation, a flexible organization structure, a system of management of risks let define the optimal level of expenses.

The IBA's branch network convincingly increases its potential and permanently improves quantity and quality parameters of its activity. The branch network share in the Bank's all indicators grows: for instance, up to 2/3 of the income is made up by the branches.

The Baku branches: Naqliyyat, Central, Nasimi, Sabail, Narimanov, Nizami and Qaradag, and Sumgayit, Ganja, Ali Bayramli, Yevlakh, Kurdamir, Devechi, Guba, and Saatli regional branches are especially distinguishable among successfully working branches.

In 2005, the Bank's branch network will be led by the following principles:

- *starting new service structures and optimizing expenses concerning the existing structures;*

- *economical expediency of new structures and providing efficiency of invested funds*

- *expanding the spectrum of service and product offered by the branches to the clientele;*

- *wider participation of the branches in socio-economical regional programs including implementation of projects with local entities etc.*

INFORMATION TECHNOLOGIES. SAFETY SYSTEMS.

Quality specificities of the Bank's services, its competition advantages and work efficiency, first of all, depend on information technologies (IT) used. In 2004, developing an automatized system which is to support and improve functional activities by the Bank's branches, making and applying new IT's were going on. In this process, growing dependence of modern bank business on IT, basic changes in e-commerce and existing and future demands of the Bank's customers are considered.

The leader of the country's bank sector, the IBA has done important work towards applying a new high-quality automatized system to bring its activity into accordance with the world standards, to provide high-level service for more clients and to present them new bank products.

A new program set was chosen with PriceWaterhouseCoopers' advice. As a result, an agreement was signed to buy the Flexcube program produced by I-flex (one of the leaders in the world production of automatized banking systems), which is successfully applied at more than 100 banks of the world including Western and Eastern Europe. Computer facility parameters for the new banking system were agreed, 4 new P670 servers and one P615 server were bought, and the new operation system was installed in the servers.

The Bank's pass to the new system is planned for January, 2006.

Optimizing the location of plastic card and acquiring cash network points to raise the quality and speed of the Bank's servicing card owners was kept on. 162 ATMs and 178 POS-terminals were installed in Baku and separate regions of the Republic.

Thus, the Bank's ATM and POS-terminal system consists of 309 ATMs and almost 400 POS-terminals. ATMs installed in Azerbaijan's regions have been connected to the processing center in Baku.

Systems of real-time distant servicing customers were improved. Within working to solve this problem, the Internet-banking Program was tested and given for usage by juridical and natural persons in 2004. This creates opportunities to decrease the Bank's operation expenses, pass to non-paper technology in servicing customers and let them quickly and comfortably implement their different payments.

In 2004, expanding technological allowances of currency and interbank dealing continued. The Bank's dealing section uses the real-time regime of the Reuters Messaging interbank record system and the Reuters Insertlink program, which gives the IBA's dealers possibility to work on the Reuters Information Systems platforms. Methods of technical and fundamental analysis are actively used in forecasting exchange and interest rates and other economic indicators.

In the previous year, special attention was given to providing the Bank's branches with new technologies. Thus, the Bank's all branches, mini-offices and service points were connected to the bank system for financial transactions, and the communication systems of the IBA's all regional branches were connected to the new IP-protocol system.

The Bank's all branches have been completely computerized and modern local settlement network work there, which use the system architecture of the Client server.

The number of service points accepting cell phone and utility payments in Baku and the regions increased, and the software was renewed. Utility, electricity and Azercell cell phones payments have been moved to the new software. Accepting the ULTEL Company's service payments was tested and given for usage.

Old facilities and operation systems in the IBA's branches, sections and utility payment points were replaced. The planned renewal and modernization of computer engineering equipment and facilities was done. The YTRAN customer service software was worked out, tested and submitted for use.

To provide safety measures, creating and applying of modulated and standardized opening schemes of relevant profiles of the MIDAS system were finished, and standardizing of installation of AS/400 computers and terminals used for access into this system was done. At the same time, measures to equip the IBA's entities with the newest fire-alarm and video monitoring continued.

STAFF POLICY

Like in the previous years, the IBA's successes of 2004, were, first of all, caused by the staff's professionalism and efficient managing the human resources. The Bank considers its personnel the intellectual capital which warranties the future success. In 2004, a complex project to manage human resources according to advanced experience started to be implemented at the Bank. The main directions of the project were:

- *To work out and apply a new salary system*
- *To create a system of effective stimuli providing a high level of the staff's working motivation*
- *To form and develop the corporate culture*
- *To create a planning system for the staff's professional career development*
- *To improve the staff's selection criteria*

Measures towards preparing the above mentioned new salary system were finished at the end of 2004. The new system has been working since the beginning of this year. Applying this system, which enables evaluating the staff's work upon considering their professional knowledge, attitude to work, planning and organizing abilities, initiative, problem-solving ability, working experience etc., and, on this basis, provides elimination of wage-leveling, will support to form manpower potential able to reach the Bank's strategic purposes.

In 2005, working out and probable 3-step applying a new system of staff motivation will also start. This system will consider both bonuses and career development perspectives for the staff. As a result of the IBA administration's attention to the above mentioned issues, a special relevant sector (the Department for Human Resources) in the Bank's structure was created and started at the end of the year.

This year, the Bank's Code of Corporate Ethics was adopted. The Code defines the standards to raise the efficiency of the Bank's activity and the staff's rules of behavior, different models of behavior, common standards of relations and cooperation, strengthens corporate values, and provides the staff's comprehension of their role in implementation of the Bank's mission etc.

In 2004, the Bank's staff increased by 5.8% and reached 1,170. About 400 workers were trained, and training expenses were AZM2.2 billion.

The IBA's administration tried to improve the staff's social package and to create favorable conditions for raising business activity and developing stimulation. A program of social protection which lets all the staff use the best medical service under medical insurance and improve their health at sport centers was applied.
The staff's complex evaluation and working out the motivation system have created opportunities to intensify forming professional manpower potential able to reach the Bank's strategic purposes, to check the workers' professionalism and to keep it on a necessarily high level, to increase working efficiency and responsibility, to define the staff's eligibility and provide their development. 606 workers have passed through certification tests, and 93% of them succeeded. The new salary system has been applied since January, 2005.

As a result of the logic of managing human resources, the IBA has the most experienced and motivated, initiative and professional team able to carry out the IBA's general principles in a high-quality and quick manner.

Realizing that management of human resources is one of the main factors of successful activities, the Bank's administration will continue developing it in 2005.

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Save the Past,
Build the Future!

Same as during the ancient times, the ships entering the capital's Caspian bay today are met by the Maiden Tower. This unique historical tower has no architectural analogue all over the world. Why did it get the name of Maiden? Some people say that the tower was a defensive construction being unassailable and inaccessible like a high-morality girl. Others prefer the story of a beauty, who being forced to marry to unloved khan (king), had dropped her from the tower top down into the sea. Some others consider the tower to be related to ancient Zoroastrian magicians – fire worshippers and astrologists, who observed the skies from here... Legends are weaved to each-other like a colorful carpet of dream and reality. A signal fire no more can be seen on the top of the tower. Only on the day of Novruz holiday, March 21, annually, there can be seen a fire of joy, saying everybody that the new Spring has come.

CONSOLIDATED FINANCIAL STATEMENTS AND AUDITORS' REPORT

31 December 2004

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Notes to the Consolidated Financial Statements:

PRICEWATERHOUSECOOPERS

AUDITORS' REPORT

To the Board of Directors and the Shareholders of the International Bank of Azerbaijan

1. We have audited the accompanying consolidated balance sheet of the International Bank of Azerbaijan and its subsidiaries (together referred to as "the Group" as defined in Note 1 to the consolidated financial statements) as at 31 December 2004, and the related consolidated statements of income, of cash flows and of changes in shareholders' equity for the year then ended. These consolidated financial statements are the responsibility of the Group's Management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

3. In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2004 and the consolidated results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

4 May 2005
Baku, the Republic of Azerbaijan

Consolidated Balance Sheet as at 31 December 2004
(in millions of Azerbaijani Manats)

	Note	2004	2003
Assets			
Cash and cash equivalents	5	1,113,792	757,776
Mandatory cash balances with central banks		346,623	171,138
Due from other banks	6	327,822	139,866
Loans and advances to customers	7	2,032,617	1,134,460
Investment securities	8	177,776	35,097
Investments in associates and joint ventures	9	7,377	7,504
Goodwill on acquisition of a subsidiary	32	7,300	8,112
Other assets	10	51,352	56,778
Premises and equipment and investment property	11	258,448	200,225
Total assets		**4,323,107**	**2,510,956**
Liabilities			
Due to other banks	12	18,672	16,394
Customer accounts	13	3,720,575	2,060,786
Debt securities in issue	14	212,314	182,793
Other borrowed funds	15	31,670	30,475
Other liabilities	16	51,921	28,705
Deferred tax liability	25	21,894	13,054
Total liabilities		**4,057,046**	**2,332,207**
Shareholders' equity			
Share capital	18	100,000	50,000
Revaluation reserve for premises and equipment	11	8,713	9,261
Cumulative translation reserve	19	12,977	9,109
Fair value reserve for investment securities available for sale	8	-	(4,145)
Retained earnings	20	144,371	114,524
Total shareholders' equity		**266,061**	**178,749**
Total liabilities and shareholders' equity		**4,323,107**	**2,510,956**

Approved for issue by the Board of Directors and signed on its behalf on 4 May 2005:

Mr. Jahangir Hajiyev
Chairman of the Board of Directors

Mr. Rovshan Ismaylov
Head of the Financial Management Department

Consolidated Statement of Income for the Year Ended 31 December 2004
(in millions of Azerbaijani Manats)

	Note	2004	2003
Interest income	21	236,532	140,241
Interest expense	21	(87,141)	(59,700)
Net interest income		**149,391**	**80,541**
Provision for impairment of loans to customers	7	(111,892)	(32,399)
Provision for impairment of due from other banks	6	(2,798)	(2,067)
Net interest income after provision for impairment		**34,701**	**46,075**
Foreign currency translation (losses less gains)/gains less losses		(1,687)	6,013
Gains less losses arising from trading in foreign currencies		17,739	12,367
Losses arising from trading in investment securities	8	(2,158)	-
Fee and commission income	22	214,253	166,877
Fee and commission expense	22	(16,621)	(9,472)
Losses on origination of assets/liabilities at rates below/above market	6, 14	(1,404)	(44,307)
Gross insurance premiums written, net of premiums ceded		11,485	7,245
Increase of provision for unearned premiums, net of reinsurance	16	(1,967)	(2,251)
Net claims incurred	16	(2,217)	(2,937)
Other income		1,437	763
Operating income		**253,561**	**180,373**
Staff costs	23	(55,039)	(46,366)
General, administrative and other operating expenses	24	(102,709)	(63,167)
Profit from operations		**95,813**	**70,840**
Income/(losses) from investment in associates and joint ventures	9	38	(268)
Profit before taxation		**95,851**	**70,572**
Income tax charge	25	(26,381)	(22,121)
Profit after tax		**69,470**	**48,451**
Minority interest	17	-	(798)
Net profit for the year		**69,470**	**47,653**

Consolidated Statement of Cash Flows for the Year Ended 31 December 2004
(in millions of Azerbaijani Manats)

	Note	2004	2003
Interest received		222,890	134,411
Interest paid		(85,321)	(58,933)
Income received from trading in foreign currencies		17,738	12,367
Fees and commissions received		217,455	166,943
Fees and commissions paid		(15,041)	(9,413)
Insurance premiums received, net		7,343	7,138
Other operating income received		1,316	658
Operating expenses paid		(113,907)	(91,827)
Income tax paid		(16,676)	(11,563)
Cash flows provided from operating activities before changes in operating assets and liabilities		**235,797**	**149,781**
Changes in operating assets and liabilities			
Net increase in mandatory cash balances with central banks		(175,485)	(22,375)
Net increase in due from other banks		(187,879)	(69,133)
Net increase in loans and advances to customers		(1,002,799)	(327,628)
Net (increase)/decrease in investment securities held to maturity		(148,434)	36,764
Net decrease in other assets		18,291	45,488
Net increase/(decrease) in due to other banks		2,278	(836)
Net increase in customer accounts		1,655,020	152,404
Net increase in certificates of deposit		33,050	18,452
Net increase/(decrease) in other liabilities		1,582	(258)
Net cash provided from/(used in) operating activities		**431,421**	**(17,341)**
Cash flows from investing activities:			
Acquisition of premises and equipment	11	(107,062)	(59,044)
Proceeds from disposal of premises and equipment		5,950	-
Acquisition of intangible assets		(3,955)	(3,025)
Acquisition of investment securities available for sale		-	(1,000)
Proceeds from disposal of investment securities available for sale	8	10,990	300
Proceeds from disposal of investments in associates and joint ventures	9	165	180
Dividend income received		120	5
Acquisition of subsidiary, net of cash acquired		-	(12,293)
Net cash used in investing activities		**(93,792)**	**(74,877)**
Cash flows from financing activities:			
Issuance of ordinary shares	17	50,000	15,890
Proceeds from other borrowed funds		18,214	13,975
Proceeds from issuance of debentures		-	98,460
Repayments of other borrowed funds		(17,199)	(26,178)
Dividends paid	26	(33,061)	(17,205)
Net cash provided from financing activities		**17,954**	**84,942**
Effect of exchange rate changes on cash and cash equivalents		**433**	**9,878**
Net increase in cash and cash equivalents for the year		**356,016**	**2,602**
Cash and cash equivalents at the beginning of the year	5	757,776	755,174
Cash and cash equivalents at the end of the year	**5**	**1,113,792**	**757,776**

Consolidated Statement of Changes in Shareholders' Equity for the Year Ended 31 December 2004

(in millions of Azerbaijani Manats)

	Share Capital	Revaluation reserve for premises and equipment	Cumulative translation reserve	Fair value loss reserve for investment securities available for sale	Retained earnings	Total shareholders' equity
Balance as at 1 January 2003	**34,110**	**9,626**	**4,159**	**(5,803)**	**90,238**	**132,330**
Share issue (Note 18)	15,890	-	-	-	-	15,890
Currency translation differences (Note 19)	-	-	4,950	-	-	4,950
Net fair value gain on investment securities available for sale, net of taxation (Note 8)	-	-	-	1,658	-	1,658
Other movements (Notes 9, 25, 31)	-	114	-	-	(2,056)	(1,942)
Transfer of realized revaluation of premises and equipment, net of deferred taxation	-	(479)	-	-	479	-
Net profit for the year	-	-	-	-	47,653	47,653
Dividends declared (Note 26)	-	-	-	-	(21,790)	(21,790)
Balance as at 31 December 2003	**50,000**	**9,261**	**9,109**	**(4,145)**	**114,524**	**178,749**
Share issue (Note 18)	50,000	-	-	-	-	50,000
Currency translation differences (Note 19)	-	-	3,868	-	-	3,868
Net fair value gain on investment securities available for sale, net of taxation (Note 8)	-	-	-	2,125	-	2,125
Transfer of the remaining balance of fair value loss to the consolidated statement of income (Note 8)	-	-	-	2,020	-	2,020
Distribution to shareholders other than dividends (Notes 11 and 30)	-	-	-	-	(886)	(886)
Other movements	-	(548)	-	-	(206)	(754)
Net profit for the year	-	-	-	-	69,470	69,470
Dividends declared (Note 26)	-	-	-	-	(38,531)	(38,531)
Balance as at 31 December 2004	**100,000**	**8,713**	**12,977**	**-**	**144,371**	**266,061**

Notes To The Consolidated Financial Statements – 31 December 2004
(in millions of Azerbaijani Manats)

1. Principal Activities

The consolidated financial statements include the financial statements of the International Bank of the Republic of Azerbaijan ("the Bank") and its subsidiaries. The Bank and its subsidiaries are hereinafter collectively referred to as "the Group". The principal subsidiaries of the Group are represented by the Russian commercial bank, Azerbaijani and foreign companies, and other entities, in which the Group, directly or indirectly, has the power to exercise control over financial and operating policies. Refer to Note 30.

The International Bank of the Republic of Azerbaijan was established in 1991 as a fully state-owned bank. On 28 October 1992, the Bank became a joint-stock commercial bank and the Ministry of Finance of the Republic of Azerbaijan became the major shareholder with the ownership of 50.2% of the total authorized and issued share capital of the Bank. The Bank was registered in the Republic of Azerbaijan to provide commercial banking services and has been operating under a full banking licence granted by the National Bank of the Republic of Azerbaijan ("NBA") on 30 December 1992. The Bank's head office is located in Baku. The Group has 35 branches and 105 points of service in the Republic of Azerbaijan and 1,352 employees as at 31 December 2004 (31 December 2003: 34 branches, 85 points of service and 1,250 employees). 1,140 employees are employed by the Bank, 45 – by the International Insurance Company, 30 – by Azericard Limited, 5 – by Azerileasing, 54 - by "Inter" professional football club and 78– by the Bank's fully owned banking subsidiary in Russia. The registered address of the Bank is 67 Nizami Street, AZ-1005, Baku, Republic of Azerbaijan.

A full list of subsidiaries, associates and joint ventures of the Bank included within these consolidated financial statements is provided in Note 31. On 24 January 2002 the Bank registered its fully-owned subsidiary, International Bank of Azerbaijan Republic-Moscow, in Moscow, Russia ("IBAR Moscow"). The share capital of IBAR Moscow was established in the amount of EUR 10,000,000. It is a commercial bank in the form of a limited liability company. IBAR Moscow started its operations under a licence issued by the Central Bank of the Russian Federation ("the CBRF") on 25 January 2002. This licence allows IBAR Moscow to carry out banking operations with legal entities in Russian Rubles and in foreign currency. During the first two years after its registration due to the statutory requirements IBAR Moscow was restricted from attracting deposits of individuals. On 1 December 2004 IBAR Moscow received a licence from the CBRF allowing it to provide full range of banking services to individuals. IBAR Moscow's principal activity is represented by commercial banking operations. IBAR Moscow's registered office is located at the following address: Tverskaya 6, Bldg 2, Moscow, Russia. IBAR Moscow opened a branch in Saint Petersburg, Russia on 28 May 2003.

On 5 February 2002 the Group registered its fully-owned subsidiary, International Insurance Company ("Insurance Subsidiary") at the Ministry of Justice of the Republic of Azerbaijan. The share capital of Insurance Subsidiary is AZM 24,000 million. Insurance Subsidiary operates under insurance licence Number AB 029205 issued by the Ministry of Finance of the Republic of Azerbaijan on 1 April 2002 and addendum to the above licence issued on 16 August 2002. On 24 December 2004 the Supervisory Council of the Bank made a decision to increase the share capital of the Insurance Subsidiary by AZM 20,00 million to AZM 44,000 million.

The activity of the Insurance Subsidiary includes medical, marine third party liability, marine hull, property, casualty, life, personal insurance, insurance of banking risks and reinsurance. During 2004 the insurance subsidiary received additional licenses on mandatory fire insurance and on insurance of liability for non-performance of obligations. The official address of the Insurance Subsidiary is: C. Cabbarli street 46, Baku, the Republic of Azerbaijan.

Azericard Limited, which is 100% owned by the Group, was established as a limited liability company on 3 May 1996 in accordance with the joint venture agreement between the Bank and Bank Standard (former Most Bank Azerbaijan). Azericard Limited was registered with the Ministry of Justice of the Republic of Azerbaijan on 4 July 1996 and commenced its operations in 1997. Azericard Limited is a member service provider for MasterCard and Visa International and acts as a clearing and authorization center for plastic card transactions in the Republic of Azerbaijan.

Azericard Limited so far has monopolistic position of providing plastic cards operations authorization and clearing services in the Republic of Azerbaijan. The registered office address of Azericard Limited is: Nizami Street, 67, AZ10-05, Baku, the Republic of Azerbaijan. Prior to 26 July 2003 the Group owned 50% of Azericard Limited, but exercised control over financial and operational decisions of the company. On 26 July 2003, the Bank purchased the remaining 50% stake in Azericard Limited. Refer to Notes 30 and 31.

1. Principal Activities (continued)

On 7 October 2002 the Group's Insurance Subsidiary, International Insurance Company, established a captive reinsurance company, Inter Protect Re AG. It was registered in Zurich, Switzerland. Refer to Note 31.

On 20 June 2004 "Inter" professional football club was established and registered with the Ministry of Justice of the Republic of Azerbaijan. In accordance with the foundation agreements signed between the Bank and Azericard Limited, the charter capital of the professional football club was set at AZM 2,011 million, of which AZM 1,500 million were contributed by the Bank and the remaining AZM 511 million by Azericard Limited. This club is a member of the Azerbaijan Football Federations Association and is one of the leading professional football clubs in the country.

On 18 June 1999 the Bank established a leasing subsidiary "Azerileazing" with the charter capital of AZM 1,845 million. On 29 July 2004 the Bank increased the share capital of its leasing subsidiary by contributing an additional AZM 1,655 million. As a result, the share capital of the leasing subsidiary was AZM 3,500 million as at 31 December 2004.

2. Operating Environment of the Group

The Azerbaijani economy has shown progress in achieving a lower rate of inflation, stable exchange rates and sustainable growth in recent years. The ongoing political stabilisation has been a positive contributing factor for the further development of the political and legal environment.

However, the economy is largely dependent on oil prices and all sectors of the economy, including the banking sector, could be affected by fluctuations in oil prices. The banking and financial sectors in the Republic of Azerbaijan are particularly sensitive to adverse currency fluctuations and economic conditions. Furthermore, the need for further developments in the bankruptcy regulations, formalized procedures for the registration and enforcement of collateral, and other legal and fiscal impediments contribute to the difficulties experienced by banks currently operating in the Republic of Azerbaijan.

The prospects for future economic stability in the Republic of Azerbaijan are largely dependent upon the effectiveness of economic measures undertaken by the Government, together with legal, regulatory and political developments, which are beyond the Group's control.

In addition, economic conditions continue to limit the volume of activity in the financial markets. Market quotations may not be reflective of the values for financial instruments, which would be determined in an efficient active market involving willing buyers and willing sellers. Management has therefore used the best available information to adjust market quotations to reflect their best estimate of fair values, where considered necessary.

3.Basis of Preparation

The consolidated financial statements of the Group are prepared in accordance with the International Financial Reporting Standards ("IFRS"), including International Accounting Standards ("IAS") and Interpretations issued by the International Accounting Standards Board. The Bank and its subsidiaries maintain their accounting records in accordance with applicable regulations in the countries of their registration, respectively. These consolidated financial statements have been prepared from those accounting records and adjusted as necessary in order to comply with IFRS.

The accounting policies, used in preparing these consolidated financial statements are consistent with those used in the consolidated financial statements for the year ended 31 December 2003. These consolidated financial statements are measured and presented in the national currency of the Republic of Azerbaijan, the Azerbaijani Manat ("AZM"). The preparation of consolidated financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of consolidated financial statements, and the reported amounts of revenues and expenses during the reported period. Although these estimates are based on Management's best knowledge of current events and actions, actual results ultimately may differ from those estimates. Where necessary, corresponding figures have been adjusted to conform to changes in presentation in the current period.

4. Significant Accounting Policies

Consolidated financial statements. Subsidiaries are those companies and other entities (including special purpose entities) in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to exercise control over financial and operating policies. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group and are removed from consolidation from the date that control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured at the fair value of the assets given up, equity instruments issued or liabilities undertaken at the date of acquisition, plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net assets of the subsidiary acquired is recorded as goodwill. Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless cost cannot be recovered. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

The line "Other movements" in the consolidated statement of changes in shareholders' equity includes the translation effect on equity, which arises for those subsidiaries whose operating currency differs from the reporting currency of the Group (Azerbaijani Manat), and other movements due to the acquisition and consolidation of certain subsidiaries.

Minority interest is that part of the net results and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly, by the Group. Minority interest in the consolidated balance sheet is recorded separate from liabilities and shareholders' equity and is affected by the foreign currency translation adjustment applicable to the minority shareholders' interest in the subsidiary. Minority interest related to net results of the current year is recorded in the consolidated statement of income.

Associates and joint ventures. Associates are entities, over which the Group has between 20% and 50% of the voting rights, or over which the Group has significant influence, but which it does not control. Investments in joint ventures are contractual arrangements whereby two or more parties exercise joint control over an entity. Investments in associates and joint ventures are accounted for using the equity method of accounting. Under this method, the Group's share of the post-acquisition profits or losses of associates and joint ventures is recorded in the consolidated statement of income, and its share of post-acquisition movements in reserves is recorded in consolidated statement of changes in shareholders' equity.

The cumulative post-acquisition movements are adjusted against the cost of the investments. Unrealized gains on transactions between the Group and its associates/joint ventures are eliminated to the extent of the Group's interest in the associates/joint ventures; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The Group's investment in associates/joint ventures includes goodwill (net of accumulated amortization) on acquisition. When the Group's share of losses in an associate/joint venture equals or exceeds its interest in the associate/joint venture, the Group does not recognize further losses unless the Group has incurred obligations or made payments on behalf of the associate/joint venture.

Cash and cash equivalents. Cash and cash equivalents are items, which can be converted into cash within a day. All short-term inter-bank placements, beyond overnight placements, are included in due from other banks. Amounts, which relate to funds that are of a restricted nature, are excluded from cash and cash equivalents.

Mandatory cash balances with central banks. Mandatory cash balances with central banks comprise mandatory cash balances with the National Bank of the Republic of Azerbaijan (the NBA) and the Central Bank of the Russian Federation (the CBRF). Mandatory cash balances with the NBA represent regulatory reserve deposits, which are calculated by using daily average balances and deposited at the NBA twice a month. Mandatory cash balances with the NBA and the CBRF represent mandatory reserve deposits, which are not available to finance the Group's day-to-day operations and hence are not considered as part of cash and cash equivalents for the purposes of the consolidated cash flow statement.

4. Significant Accounting Policies (continued)

Originated loans and advances and provision for loan impairment. Loans originated by the Group by providing money directly to the borrower or to a sub-participation agent at draw down, other than those that are originated with the intent of being sold immediately or in the short-term, which are recorded as trading assets, are categorised as originated loans.

Originated loans and advances are recorded when cash is advanced to borrowers. Initially, originated loans and advances are recorded at cost, which is the fair value of the consideration given, and subsequently are carried at amortised cost less provision for loan impairment. Amortised cost is based on the fair value of cash consideration given to originate those loans determinable by reference to market prices at origination date. Third party expenses, such as legal fees incurred in securing a loan are treated as part of the cost of the transaction.

Loans originated at interest rates different from market rates are re-measured at origination to their fair value, being future interest payments and principal repayment(s) discounted at market interest rates for similar loans. The difference between the fair value and the nominal value at origination is credited or charged to the consolidated statement of income as gains on origination of assets at rates above market or losses on origination of assets at rates below market. Subsequently, the carrying amount of such loans is adjusted for amortization of the gains/losses on origination and the related income is recorded as interest income within the consolidated statement of income, using the effective yield method.

A credit risk provision for loan impairment is established if there is objective evidence that the Group will not be able to collect the amounts due according to original contractual terms. The amount of the provision is the difference between the carrying amount and estimated recoverable amount, calculated as the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted at the instrument's original effective interest rate.

The provision for loan impairment also covers losses where there is objective evidence that probable losses are present in components of the loan portfolio at the balance sheet date. These have been estimated based upon historical patterns of losses in each component, the credit ratings assigned to the borrowers and reflect the current economic environment, in which the borrowers operate.

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of provision for loan impairment for the year in the consolidated statement of income.

If the amount of the provision for loan impairment subsequently decreases due to an event occurring after the write-down, the release of the provision is credited to the provision for loan impairment in the consolidated statement of income.

The Group does not enter into transactions for purchases of loans with third parties.

Other credit related commitments. In the normal course of business, the Group enters into other credit related commitments, including letters of credit and guarantees. Specific provisions are recorded against other credit related commitments when losses are considered probable.

Investment securities available for sale. This classification includes investment securities which Management intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Management determines the appropriate classification of its investment securities at the time of purchase.

4. Significant Accounting Policies (continued)

Investment securities available for sale are initially recorded at cost (which includes transaction costs) and subsequently remeasured to fair value based on quoted bid prices. Certain investment securities available for sale for which there is no available external independent quotation have been fair valued by Management on the basis of results of recent sales of equity interests in the investees between unrelated third parties, consideration of other relevant information such as discounted cash flows and financial data of the investees and application of other valuation methodologies. Unrealised gains and losses arising from changes in the fair value of investment securities available for sale are recorded in the consolidated statement of changes in shareholders' equity. When the investment securities available for sale are disposed of, the related accumulated fair value adjustments are included in the consolidated statement of income as gains less losses arising from investment securities available for sale. Impairment and reversal of impairment of investment securities available for sale is recorded through the consolidated statement of income. An investment security available for sale is impaired if its carrying amount is greater than its estimated recoverable amount. The recoverable amount is the present value of expected future cash flows discounted at the current market rate of interest for a similar financial asset. Interest earned on investment securities available for sale is reflected in the consolidated statement of income as interest income on investment securities available for sale. Dividends received are included in dividend income within the consolidated statement of income.

All regular way purchases and sales of investment securities available for sale are recorded at trade date, which is the date that the Group commits to purchase or sell the asset. All other purchases and sales are recorded as derivative forward transactions until settlement.

Investment securities held-to-maturity. This classification includes investment securities with fixed maturity, which Management has both the intent and the ability to hold to maturity. Management determines the appropriate classification of its investment securities at the time of the purchase.

Investment securities held to maturity are initially recorded at cost (which includes transaction costs) and subsequently are carried at amortised cost using the effective yield method, less any provision for impairment, calculated as the difference between the carrying amount and the present value of expected future cash flows discounted at the instrument's original effective interest rate.

Interest earned whilst holding investment securities held to maturity is recorded in the consolidated statement of income as interest income on investment securities held to maturity.

All regular way purchases of investment securities held to maturity are recorded at trade date, which is the date that the Group commits to purchase the asset. All other purchases are recorded as derivative forward transactions until settlement.

Goodwill. Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable assets and liabilities of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of subsidiaries and associates is reported in the consolidated balance sheet as an intangible asset and is amortised using the straight-line method over its estimated useful life. Management determines the estimated useful life of goodwill based on its evaluation of the respective companies at the time of the acquisition, considering factors such as existing market share, potential growth and other factors inherent in the acquired companies. Goodwill is amortised over ten years.

At each balance sheet date the Group assesses whether there is any indication of impairment of goodwill. If such indications exist an analysis is performed to assess whether the carrying amount of goodwill is fully recoverable. A write down is made if the carrying amount exceeds the recoverable amount.

The gain or loss on disposal of an entity includes the related unamortised balance of goodwill relating to the entity disposed of.

Premises and equipment. All premises and equipment are stated at cost or revalued amounts, less accumulated depreciation and impairment, where required. The revaluation was performed to restate the net book value of the asset to a level, which reflected their market value. In addition, an independent real estate firm appraised the value of the Bank's building in prior years and the resulting difference was included in the revaluation reserve for premises and equipment. Revaluation of premises and equipment is performed every 2-3 years. The revaluation reserve included in shareholders' equity is transferred directly to retained earnings over the estimated useful life of revalued asset.

4. Significant Accounting Policies (continued)

Repair and maintenance costs of premises and equipment, including refurbishment of buildings or leased office premises, are capitalized if they result in an enlargement or substantial improvement of the respective asset and depreciated on a straight-line basis over the estimated economic life of the asset or over the term of the lease contract, whichever is the shortest. Other repair and maintenance costs are charged to the consolidated statement of income when expenditure is incurred.

Construction in progress is carried at cost. Upon completion, assets are transferred to the respective "Premises and equipment" category at their carrying value. Construction in progress is not depreciated until the asset is available for use.

At each reporting date the Group assesses whether there is any indication of impairment of premises and equipment. If any such indication exists, the Group estimates the recoverable amount, which is determined as the higher of an asset's net selling price or its value in use. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down to its recoverable amount and the difference is charged to the consolidated statement of income, unless it has previously been revalued, in which case the revaluation surplus is eliminated first and any additional loss is charged in the income statement. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the assets recoverable amount. Gains and losses on disposal of premises and equipment are determined by reference to the carrying amount and are taken into account in determining profit/(loss).

Investment property. Property held for long-term rental yields, which is not occupied by the Group, is classified as investment property. Investment property comprises land and premises. Investment property is measured at cost less any accumulated depreciation and any accumulated impairment losses. Depreciation rates applied for investment property are same as those applied for similar fixed assets occupied by the Group. Investment property items are shown together with premises and equipment on the face of the consolidated balance sheet.

Depreciation: Depreciation is applied on a straight-line basis over the estimated useful lives of the assets. In 2004 the Bank has changed depreciation rates applied to some of its property, plant and equipment. This change was a consequence of change in accounting estimates and was accounted for prospectively in these consolidated financial statements. The depreciation rates applied by the Group as at 31 December 2004 and 2003, respectively, are as follows:

	2004	2003
Premises	5%	3%-4%
Leasehold improvements	12%-15%	12%-15%
Computers and other communication equipment	25%	20%
Plastic cards operations equipment	33%	33%
Furniture, fixtures, automated teller machines and other	25%	25%
Motor vehicles	25%	25%

Computer software development costs. Costs associated with maintaining computer software programs are recorded as an expense as incurred. Costs that are directly associated with identifiable and unique software products controlled by the Group and will probably generate economic benefits exceeding costs beyond one year, are recorded as intangible assets. Direct costs include staff costs of the software development team and an appropriate portion of relevant overheads. Expenditure, which enhances or extends the performance of computer software programs beyond their original specifications, is recorded as a capital improvement and added to the original cost of the software. Computer software development costs recorded as intangible assets are amortised using the straight-line method over their useful lives not exceeding four years.

Operating leases. Where the Group is the lessee, the total lease payments, including those on expected termination, are charged by the lessee to the consolidated statement of income on a straight-line basis over the period of the lease.

Finance leases. Where the Group is the lessor, upon inception of a finance lease, the present value of the lease payments ("net investment in leases") is recorded within loans and advances to customers. Lease income is recorded over the term of the lease using the net effective yield method.

4. Significant Accounting Policies (continued)

The inception of a lease is considered to be the date of the lease agreement, or commitment if earlier. For purposes of this definition, a commitment should be in writing, signed by the parties with an interest in the transaction, and should specifically set forth the principal terms of the transaction. Any advance payments made by the lessee prior to commencement of the lease reduces the net investment in the leases.
Finance income from leases is recorded within other operating income in the consolidated statement of income.

When impaired, provisions against net investment in leases are created. A financial lease is impaired if its carrying amount is greater than its estimated recoverable amount. The amount of the impairment loss is calculated as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the original effective interest rate of the financial lease receivable.

Borrowings. Borrowings are recorded initially at "cost", being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Subsequently, borrowings are stated at amortised cost and any difference between net proceeds and the redemption value is recorded in the consolidated statement of income over the period of the borrowings, using the effective yield method.

Borrowings originated at interest rates different from market rates are re-measured at origination to their fair value, being future interest payments and principal repayment(s) discounted at market interest rates for similar borrowings. The difference between the fair value and the nominal value at origination is credited or charged to the consolidated statement of income as gains on origination of liabilities at rates below market or losses on origination of liabilities at rates above market. Subsequently, the carrying amount of such borrowings is adjusted for amortization of the gains/losses on origination and the related income/expense is recorded as interest income/expense within the consolidated statement of income, using the effective yield method.

If the Group purchases its own debt, it is removed from the consolidated balance sheet and the difference between the carrying amount of a liability and the consideration paid is included in gains arising from [early] retirement of debt.

Debt securities in issue. Debt securities in issue include promissory notes, certificates of deposit and debentures issued by the Group. Debt securities in issue are recorded initially at cost, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Subsequently, debt securities in issue are stated at amortised cost and any difference between net proceeds and the redemption value is recorded in the consolidated statement of income over the period of the security issue using the effective yield method. Debt securities originated at interest rates different from market rates are re-measured at origination to their fair value, being future interest payments and principal repayment(s) discounted at market interest rates for similar debt securities. The difference between the fair value and the nominal value at origination is credited or charged to the consolidated statement of income as gains on origination of liabilities at rates below market or losses on origination of liabilities at rates above market. Subsequently, the carrying amount of such debt securities is adjusted for amortization of the gains/losses on origination and the related income/expense is recorded as interest income/expense within the consolidated statement of income, using the effective yield method.

If the Group purchases its own debt securities in issue, they are removed from the consolidated balance sheet and the difference between the carrying amount of the liability and the consideration paid is included in gains/losses arising from retirement of debt.

Accrued interest income and accrued interest expense. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount, are included in the carrying values of related balance sheet items.

Dividends. Dividends are recorded as the movement in equity in the period, in which they are declared. Dividends declared after the balance sheet date, are disclosed in the subsequent events note. The statutory accounting reports of the members of the Group serve as the basis for profit allocation and other appropriations. Azerbaijani legislation identifies the basis of distribution as the current year net profit.

4. Significant Accounting Policies (continued)

Income taxes. Taxation has been provided for in the consolidated financial statements in accordance with Azerbaijani legislation currently in force. The income tax charge/[credit] in the consolidated statement of income for the year comprises current tax and changes in deferred tax. Current tax is calculated on the basis of the expected taxable profit for the year, using the tax rates enacted at the balance sheet date. Taxes, other than on income, are recorded within operating expenses.

Deferred income tax is provided, using the liability method, for all temporary differences arising between the tax basis of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets are recorded to the extent that it is probable that future taxable profit will be available against which the 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 balance sheet date. Deferred tax assets and liabilities are netted only within the individual companies of the Group.

Deferred income tax relating to the fair value remeasurement of investment securities available for sale, which is charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recorded in the consolidated statement of income when the gain or loss on the securities is realised. Deferred income tax is provided on temporary differences arising from investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future. The principal temporary differences arise from different rates of depreciation, differences in the amounts of provisions for loan impairment, accrued interest income and expenses, and accrued expenses for the purposes of statutory income tax calculation and for the purposes of these consolidated financial statements. Refer to Note 25.

Income and expense recognition. Interest income and expense are recorded in the consolidated statement of income for all interest bearing instruments on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. When loans become doubtful of collection, they are written down to their recoverable amounts and interest income is thereafter recorded based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

Fees, commissions and other income and expense items are generally recorded on an accrual basis when the service has been provided. Loan commitment fees for loans which are probable of being drawn down, are deferred (together with related direct costs) and recorded as an adjustment to the effective interest on the loan. Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, are recorded on completion of the underlying transaction. Portfolio and other management advisory and service fees are recorded based on the applicable service contracts. Asset management fees related to investment funds are recorded ratably over the period the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time.

Foreign currency translation and cumulative translation reserve. Transactions denominated in foreign currency are recorded at the exchange rate ruling as at the transaction date. Exchange differences resulting from the settlement of transactions denominated in foreign currency are included in the consolidated statement of income, using the exchange rate ruling on that date.

Monetary assets and liabilities denominated in foreign currency are translated into AZM at the official exchange rate of the NBA at the balance sheet date. Translation differences on debt securities and other monetary financial assets measured at fair value are included in foreign exchange translation gains and losses. Translation differences on non-monetary items such as equity securities available for sale are recorded as part of the fair value gain or loss. Thus, underlying translation differences on equity investment securities available for sale are recorded through the fair value reserve for investment securities available for sale in the consolidated statement of changes in shareholders' equity.

4. Significant Accounting Policies (continued)

The Group determines the appropriate measurement currency for each subsidiary. The statements of income and of cash flows of foreign entities are translated into AZM using average exchange rates for the year calculated on the basis of official exchange rates of the NBA, and their balance sheets are translated into AZM using the official exchange rate of the NBA as at the balance sheet date. Exchange differences arising from the translation of the net investment in foreign entities are recorded as the movement of cumulative translation reserve in the consolidated statement of changes in shareholders' equity. When a foreign entity is sold, such exchange differences are recorded in the consolidated statement of income as part of the gain or loss on sale. Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at AZM using the official exchange rate of the NBA at the balance sheet date.

As at 31 December 2004 the principal rate of exchange used for translating foreign currency balances was USD 1 = 4,903 Azerbaijani Manats and EUR 1 = 6,681.81 Azerbaijani Manats, 1 RR = 176.69 Azerbaijani Manats and 1 CHF = 4,329.17 Azerbaijani Manats (31 December 2003: USD 1 = 4,923 Azerbaijani Manats; EUR 1 = 6,151.53 Azerbaijani Manats, 1 RR = 167.14 Azerbaijani Manats and 1 CHF = 3,971.76 Azerbaijani Manats). Exchange restrictions and controls exist relating to converting AZM into other currencies. At present, the AZM is not a freely convertible currency in countries outside of the Republic of Azerbaijan.

Fiduciary assets. Assets and liabilities held by the Group in its own name, but on the account of third parties, are not reported on the consolidated balance sheet. Commissions received from such business are shown in fee and commission income within the consolidated statement of income.

Offsetting. Financial assets and liabilities are offset and the net amount reported in the consolidated balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

Provisions. Provisions are recorded when the Group has a present legal or constructive obligation as a result of past events, 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 the obligation can be made.

Staff costs and related contributions. The Group's contributions to the State Funds of the Republic of Azerbaijan in respect of the salary of its employees are expensed as incurred and included into staff costs.

Basis of accounting for insurance activities:

Premiums. Upon inception of the contract, premiums are recorded as written and are earned primarily on a pro-rata basis over the term of the related policy coverage. Provision for unearned premiums represents the proportion of premiums written in the period that relate to unexpired terms of policies in force at the balance sheet date, calculated on time apportionment basis.

Acquisition costs. Acquisition costs represent commission and other related underwriting expenses, which vary with and are directly related to the production of business and are deferred and amortised over the period, in which the related written premiums are earned. Deferred acquisition costs (DAC) are reviewed by category of business at the time of the policy issue and at the end of each accounting period to ensure they are recoverable based on future estimates.

Losses. Losses including loss adjustment expenses (LAE) are charged to the consolidated statement of income as incurred. Provision for losses represents the accumulation of estimates for ultimate losses and includes outstanding claims reserve (OCR), provision for losses incurred, but not yet reported (IBNR), and additional unexpired risk reserve (AURR). OCR is provided in respect of material claims reported, but not settled as at the balance sheet date. The estimation is made on the basis of information received by the Group during investigation of the insurance case after the balance sheet date.

IBNR is determined by the Group for each line of business, based on the assessment of the independent actuary and includes assumptions based on prior years' claims and loss adjustment experience. The methods of determining such estimates and establishing the resulting reserves are continually reviewed and updated by the Management of the Bank.

4. Significant Accounting Policies (continued)

Resulting adjustments are reflected in the consolidated statement of income as they arise. AURR is recorded when unearned premiums are insufficient to meet claims and expenses, which may be incurred after the end of the reporting period. To estimate the additional unexpired risk reserve the Group uses historical experience and forward looking assumptions of ultimate loss ratios (including loss adjustment expenses) and the level of existing portfolio maintenance expenses. The loss reserves are estimated on undiscounted basis.

Ceding commissions. Ceding commissions relate to commissions received from reinsurers for reinsurance of premiums written, and are deferred over the period, in which the related premiums are earned.

Claims incurred. Claims incurred comprise claims and related expenses paid during the reporting period.

Reinsurance. The Group assumes and/or cedes reinsurance in the normal course of business. Reinsurance assets include the balances due from both insurance and reinsurance companies for paid and unpaid losses, including loss adjustment expenses and ceded unearned premiums. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy.

Basis of accounting for leasing activities:

Inception of the lease. The inception of the lease is considered to be the date of the lease agreement, or the date of commitment, if earlier. For purposes of this definition, a commitment shall be in writing, signed by the parties involved in the transaction, and shall specifically set forth the principal terms of the transaction.

Commencement of the lease. The commencement of the lease is considered to be the date, when the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease.

Finance lease receivables / Revenue recognition. The Group records the finance lease receivables in the amount equal to the net investment in the lease. At the commencement of the lease the net investment in the lease equal the lower of the fair value of the assets or present value of the minimum lease payments at a commercial rate of interest. Net investment in the lease is calculated as the aggregate of the minimum lease payments, representing the amounts guaranteed by the lessee and any un-guaranteed residual value (together gross investment in the lease), discounted at the interest rate implicit in the lease. The interest rate implicit in the lease is the discount rate that, at the commencement of the lease, causes the present value of the gross investment in the lease to be equal to the fair value of the leased asset.

The difference between the gross investment in the lease and the net investment in the lease is recorded as unearned finance income at the commencement of the lease. The unearned finance income is amortised over the life of the finance lease, using the discount rate implicit in the lease.

Initial direct costs incurred by lessors include amounts such as commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging a lease. They exclude general overheads such as those incurred by sales and marketing team. For finance leases other than those involving manufacturer or dealer lessors, initial direct costs are included in the initial measurement of the finance lease receivable and reduce the amount of income recognized over the lease term.

Finance lease receivables are reduced by any advance payments received by the Group from the lessee in the amount attributable to recovery of the finance lease receivables. The difference between the fair value of the leased asset and finance lease receivable, i.e. the amount outstanding from the Group to the supplier, represents a commitment and is disclosed within contingencies and commitments.

Equipment for leasing. Equipment for leasing represents equipment purchased for the purposes of leasing and is stated at cost. At the date of lease agreement inception the Group recognizes profit or loss on transfer of equipment into lease, based upon the prevalent market prices at that moment.

5.Cash and Cash Equivalents

	2004	2003
Cash on hand	187,342	115,682
Cash balances with central banks (other than mandatory reserve deposits)	867,079	101,782
Correspondent accounts and overnight placements with other banks		
- Republic of Azerbaijan	77	176
- Other countries	59,294	540,136
Total cash and cash equivalents	**1,113,792**	**757,776**

Included in cash balances with central banks are the balances on correspondent accounts of the Bank and its subsidiary, IBAR Moscow, with the NBA and CBRF amounting to AZM 853,197 million (31 December 2003: AZM 98,218 million) and AZM 13,882 million (31 December 2003: AZM 3,564 million), respectively.

On 30 December 2004 the Bank transferred AZM 578,554 million from its account with an OECD bank to its correspondent account with the NBA. On 3 January 2005, the above funds were transferred back from the Bank's correspondent account with the NBA to its account with the OECD bank.

Overnight placements with other banks represent AZM 26,476 million (31 December 2003: AZM 87,443 million) placed with foreign banks with maturities in January 2005 and interest rates ranging from 1.25% to 1.99% per annum (31 December 2003: 1.8% to 2.3% per annum).

6.Due from Other Banks

	2004	2003
Current term placements with foreign banks	264,053	115,772
Current term placements with resident banks	60,191	11,077
Syndicated loans	-	9,847
Overdue placements with resident banks	30,407	71,642
Accrued interest income	1,330	437
Less: provision for impairment of due from other banks	(28,159)	(68,909)
Total due from other banks	**327,822**	**139,866**

A loss on origination of due from other banks at rates below market in the amount of AZM 1,404 million (31 December 2003: AZM 10,075 million) was recorded in the consolidated statement of income for the year ended 31 December 2004 in relation to a current term placement with a foreign bank in the amount of AZM 49,030 million (31 December 2003: current term placements with two foreign banks in the total amount of AZM 98,460 million).

Current term placements with resident banks include a deposit with a state owned resident bank in the amount of AZM 37,000 million with interest rate at 7.0% per annum and maturity in December 2005.

Current term placements with foreign banks include AZM 49,661 million with Russian banks (31 December 2003: AZM 49,439 million).

Syndicated loans represented two loans in the amount of USD 1,000 thousand each provided by the Group to two separate syndicated credit facilities led by European banks and granted to a Ukrainian bank and a Russian bank, respectively. These loans were repaid at maturity in 2004.

6. Due from Other Banks (continued)

Movements in the provision for loan impairment of due from other banks are, as follows:

	2004	2003
Provision for impairment of due from other banks as at 1 January	68,909	67,177
Provision for impairment of due from other banks for the year	2,798	2,067
Due from other banks written off during the year as uncollectible	(43,548)	(340)
Effect of change in exchange rates	-	5
Provision for impairment of due from other banks as at 31 December	**28,159**	**68,909**

On 21 September 2004 the Supervisory Council of the Bank approved a decision to write-off bad loans issued to resident banks in previous years, whose banking licenses were withdrawn by the NBA, in the total amount of AZM 43,548 million or USD 8,874 thousand.

As at 31 December 2004 the estimated fair value of due from other banks was AZM 327,822 million (31 December 2003: AZM 139,866 million). Refer to Note 29.

Geographical, currency, maturity and interest rate analyses of due from other banks are disclosed in Note 27. The information on related party balances is provided in Note 30.

7. Loans and Advances to Customers

	2004	2003
Current loans	1,876,549	964,408
Net investment in finance lease	17,937	6,370
Overdue loans	364,077	337,286
Accrued interest income	30,936	24,239
Total loans and advances to customers, gross amount	**2,289,499**	**1,332,303**
Less: provision for loan impairment	(255,603)	(197,053)
Less: provision for uncollectible finance lease receivables	(1,279)	(790)
Total loans and advances to customers, net	**2,032,617**	**1,134,460**

Finance lease receivables can be further analysed, as follows:

	2004	2003
Gross investment in finance leases	**20,525**	**7,717**
Less: Unearned future finance income on finance leases	(2,588)	(1,347)
Net investment in finance leases	**17,937**	**6,370**
Less: Provision for uncollectible finance lease receivables	(1,279)	(790)
Total finance lease receivables	**16,658**	**5,580**

7.Loans and Advances to Customers (continued)

Movements in the provision for impairment of loans and advances to customers and for uncollectible lease receivables are, as follows:

	2004	2003
Provision for loan impairment as at 1 January	197,843	171,342
Provision for loan impairment for the year	111,403	31,609
Provision for uncollectible finance lease receivables for the year	489	790
Loans and advances to customers written off during the year	(53,028)	(5,964)
Effect of changes in exchange rates	175	66
Provision for loan impairment as at 31 December	**256,882**	**197,843**

On 21 September 2004 the Supervisory Council of the Bank approved a decision to write-off bad loans issued to customers in previous years in the total amount of AZM 53,028 million represented by AZM 39,412 million or USD 8,033 thousand of principal amounts and AZM 13,616 million of interest accrued in previous years on impaired loans and written off as uncollectible in 2004 (2003: AZM 5,964 million of accrued interest income).

Included in gross amount of total loans and advances to customers as at 31 December 2004, are the loans granted to thirteen companies amounting to AZM 1,303,152 million (31 December 2003: twelve companies amounting to AZM 673,230 million) and representing 56.9% (31 December 2003: 50.5%) of the total loan portfolio of the Group.

Included in gross amount of total loans and advances to customers as at 31 December 2004, are the loans granted to government institutions and state enterprises of the Republic of Azerbaijan amounting to AZM 888,709 million (31 December 2003: AZM 448,437 million) and representing 38.8% (31 December 2003: 33.6%) of the total loan portfolio of the Group.

Included in total gross amount of loans and loans granted to government institutions and state enterprises of the Republic of Azerbaijan outstanding at 31 December 2004, are the loans to state-owned companies in the amount of AZM 105,363 million (31 December 2003: AZM 22,102 million) and guaranteed by the government of the Republic of Azerbaijan. These balances include overdue loans in the amount of AZM 22,012 million (31 December 2003: AZM 22,112 million), on which no provision was recorded in the consolidated financial statements of the Group. Furthermore, included in current loans as at 31 December 2004 is the loan and the related accrued interest in the total amount of AZM 210,829 million issued to the Azerbaijan State Airlines with maturity in January 2005 covered by the deposit of the Ministry of Finance of the Republic of Azerbaijan in the same amount and with the same maturity date.

During 2004 in accordance with the protocols signed between the Bank and the Ministry of Finance of the Republic of Azerbaijan, the Bank has offset overdue loans issued to several state-owned enterprises in previous years in the amount of AZM 6,251 million, which were fully provided against in previous years, and related accrued interest in the amount of AZM 5,087 million, which was written off in previous years. Recovery of principal amount decreased the amount of provision for loans impairment for 2004, while recovery of accrued interest income was recoded in interest income in the consolidated statement of income for the year ended 31 December 2004. The above amounts were offset against AZM 2,670 million of income tax payable to the budget and AZM 8,668 million against dividends payable to the Ministry of Finance. Refer to Notes 16 and 26.

In February 2005, in accordance with similar protocol signed in December 2004 between the Bank and the Ministry of Finance of the Republic of Azerbaijan, the Bank has additionally recovered bad loans and related accrued interest in the amount of AZM 9,906 million and AZM 2,732 million, respectively, by offsetting these amounts against dividends payable to the Ministry of Finance of the Republic of Azerbaijan. Refer to Notes 16 and 33. Provision for loan impairment as at 31 December 2004 has been adjusted to reflect the offsetting of bad loans and related accrued interest income against the dividends payable.

7. Loans and Advances to Customers (continued)

Economic sector risk concentrations within the customer loan portfolio are, as follows:

	2004	%	2003	%
Manufacturing	779,254	34.0	524,291	39.4
Trade and services	357,552	15.6	235,669	17.7
Railroad and other transportation	335,095	14.6	171,491	12.9
Air transportation	332,103	14.5	75,058	5.6
Individuals	202,671	8.9	132,512	9.9
Construction	173,157	7.6	117,257	8.8
Government bodies (*)	70,778	3.1	21,691	1.6
Net investment in finance lease	17,937	0.8	6,370	0.5
Leasing companies	7,509	0.3	8,089	0.6
Communication	2,838	0.1	31,203	2.3
Other	10,605	0.5	8,672	0.7
Total loans and advances to customers (aggregate amount)	**2,289,499**	**100.0**	**1,332,303**	**100.0**

(*) Government bodies include Ministries, Treasury and other state bodies of the Republic of Azerbaijan.

As at 31 December 2004, included in loans issued to government bodies is an amount of AZM 70,778 million (31 December 2003: AZM 21,677 million), which represents non-interest bearing one-day overdrafts on current accounts of the State Budget of the Republic of Azerbaijan with the Bank.

Included in the total amount of loans to individuals as at 31 December 2004 are the outstanding balances drawn on credit cards in the amount of AZM 17,324 million (31 December 2003: AZM 8,870 million).

Geographical, currency, maturity and interest rate analyses of loans and advances to customers are disclosed in Note 27. The relevant information on related party balances is disclosed in Note 30.

As at 31 December 2004 the estimated fair value of loans and advances to customers was AZM 2,032,617 million (31 December 2003: AZM 1,134,460 million). Refer to Note 29.

8. Investment Securities

	2004	2003
Investment securities available for sale		
Listed equity securities	-	6,693
Unlisted equity securities	642	1,642
Subtotal	**642**	**8,335**
Investment securities held-to-maturity		
Promissory notes of Russian companies and banks	124,979	20,347
State short-term notes of the National Bank of Azerbaijan	48,572	-
Debentures of resident banks	3,583	-
Treasury bills	-	6,415
Subtotal	**177,134**	**26,762**
Total investment securities	**177,776**	**35,097**

8.Investment Securities (continued)

Listed equity securities represent shares in Russian companies operating in oil and gas, utilities and other related sectors, which are traded at the Russian Trade System Stock Exchange in Moscow, Russia. Listed equity securities are recorded at market value. The movements in listed investment securities available for sale are, as follows:

	2004	2003
Carrying amount as at 1 January	**6,693**	**4,336**
Movement in fair value reserve for investment securities available for		
sale during the year	2,797	2,283
Disposal of investment securities available from sale	(9,490)	-
Foreign exchange differences	-	74
Carrying amount as at 31 December	**-**	**6,693**

In December 2004 listed equity securities were fully disposed for gross proceeds of AZM 9,490 million. Gain arising from change in the fair value of listed securities in 2004 amounted to AZM 2,797 million and was recorded in "Fair value loss reserve for investment securities available for sale" column in the consolidated statement of changes in shareholders' equity for the year ended 31 December 2004 in the amount of AZM 2,125 million net of deferred tax liability in the amount of AZM 672 million (31 December 2003: gain amounted to AZM 2,283 million and was recorded in the consolidated statement of changes in shareholders' equity in the amount of AZM 1,658 net of deferred tax liability in the amount of AZM 625 million).

The remaining fair value loss balance on investment securities available for sale as at the date of disposal amounted to AZM 2,020 million and was recorded in losses less gains arising from trading in investment securities in the consolidated statement of income for the year ended 31 December 2004. As at 31 December 2003 accumulated fair value loss balance, which was recorded in the consolidated statement of shareholders' equity amounted to AZM 4,145 million net of deferred tax asset of AZM 1,310 million. The accumulated deferred tax asset amounting to AZM 1,310 million was fully reversed in 2004. Refer to Note 25.

As at 31 December 2004 the principal unlisted equity investment securities available for sale are:

Name	Nature of business	Country of registration	Fair value	
			2004	*2003*
Baku Stock Exchange	Stock exchange	Azerbaijan	300	300
A-Visual	Advertising	Azerbaijan	263	263
Business Rabita	Communication	Azerbaijan	79	79
Azal Sigorta	Insurance	Azerbaijan	-	1,000
Total			**642**	**1,642**

External independent market quotations were not available for unlisted equity securities available for sale. The fair value of these assets was determined by Management on the basis of results of recent sales of equity interests in the investees between unrelated third parties, consideration of other relevant information such as discounted cash flows and financial data of the investees and application of other valuation methodologies.

In November 2004, the Group sold shares in Azal Sigorta with the total carrying value of AZM 1,000 million to a third party for gross proceeds of AZM 1,500 million. The related gain of AZM 500 million was included within losses less gains arising from trading in investment securities in the consolidated statement of income for the year ended 31 December 2004.

Promissory notes represent debt securities of two Russian banks with the cost of AZM 108,637 million and of a Russian state owned company with the cost of AZM 14,532 million. Promissory notes of these organizations are quoted and traded at the Russian Trade System Stock Exchange in Moscow, Russia. The promissory notes outstanding as at 31 December 2004 bear interest rates ranging between 3.2%-4.6% per annum (31 December 2003: 4.1% per annum) with maturities in January-May 2005. Accrued interest on promissory notes outstanding as at

8. Investment Securities (continued)

31 December 2004 amounted to AZM 1,810 million (31 December 2003: AZM 163 million). All promissory notes and accrued interest outstanding as at 31 December 2004 and 31 December 2003 were redeemed at maturity.

State short-term notes of the NBA represent short-term government securities issued by the NBA through the Baku Stock Exchange purchased by the Group at a discount. The notes outstanding as at 31 December 2004 bear average interest rate of 4.7% per annum and mature in January-March 2005. All of the notes outstanding as at 31 December 2004 were redeemed at maturity.

Debentures of resident banks consist of AZM denominated coupon debt securities purchased by the Group at Baku Stock Exchange and issued by an Azerbaijani bank in the amount of AZM 2,000 million with interest rate of 6.0% per annum and maturity in April 2005, and USD denominated coupon debt securities issued by another Azerbaijani bank in the amount of AZM 1,472 million with maturity in March 2009 and interest rate of 7.0% per annum. Accrued interest on coupon debt securities of resident banks outstanding as at 31 December 2004 amounted to AZM 112 million.

Treasury bills are short-term government securities issued by the Ministry of Finance of the Republic of Azerbaijan and were purchased by the Group at a discount. Treasury bills outstanding as at 31 December 2003 carried interest rate of 6.3% per annum and were redeemed at maturity in March 2004.

As at 31 December 2004 the estimated fair value of investment securities was AZM 177,776 million (31 December 2003: AZM 35,097 million). Refer to Note 29.

Geographical, currency, maturity and interest rate analyses of investment securities are disclosed in Note 27.

9. Investments in Associates and Joint Ventures

	2004	2003
Investment in Baku Inter-Bank Currency Exchange (BICE)	4,321	4,211
Investment in Trans-service	3,056	3,293
Total investments in associates and joint ventures	**7,377**	**7,504**

Movements in investments in associates and joint ventures are, as follows:

	2004		2003	
	BICE	*Trans-service*	*BICE*	*Trans-service*
Carrying amount as at 1 January	4,211	3,293	4,333	4,302
Net share of net accumulated deficit resulting from first time inclusion into consolidation	-	-	-	(683)
Net share of results of associate/joint venture after tax for the year	110	(72)	(122)	(146)
Other	-	(165)	-	(180)
Carrying amount as at 31 December	**4,321**	**3,056**	**4,211**	**3,293**

9.Investments in Associates and Joint Ventures (continued)

As at 31 December 2004 the Group held 20% interest in BICE and 50% interest in Trans-service. Trans-service is a joint venture with another Azerbaijani company established to operate parking facilities on a commercial basis. It was included in the Group's consolidated financial statements as investment in joint venture, using equity accounting method for the first time as of 31 December 2003 due to its materiality for the consolidated financial results of the Group for 2003.

Net share of accumulated deficit of Trans-service accumulated prior to 1 January 2003 in the amount of AZM 683 million was recorded as part of other movements in the consolidated statement of shareholders equity for the year ended 31 December 2003. Refer to Note 31.

Net total share of profits of associates and joint ventures after tax for the year ended 31 December 2004 in the amount of AZM 38 million (net share of losses for the year ended 31 December 2003: in the amount of AZM 268 million) has been recorded in the consolidated statement of income as income/(losses) from investment in associates and joint ventures.

10.Other Assets

	2004	2003
Advances for purchase of equipment and intangible assets	17,761	321
Policyholder receivables	7,850	4,219
Assets held for sale (Refer to Note 11)	4,579	-
Restricted cash	3,582	45,339
Prepaid expenses	3,811	2,414
Amounts in the course of settlement	3,395	1,908
Advances on equipment purchased for leasing purposes	2,807	-
Plastic cards receivables	2,173	749
Deferred tax assets of subsidiaries (Note 25)	2,065	729
Equipment for leasing	1,746	-
Deferred acquisition costs on insurance premiums written	713	215
Other	870	884
Total other assets	**51,352**	**56,778**

Advances for the purchase of equipment and intangible assets represent prepayments for the purchase of 100 kiosk information terminals (bank service points) acquired for the purposes of provision of banking services.

Policyholder receivables as at 31 December 2004 and 31 December 2003 represent insurance premium receivables from policyholders by the Group's Insurance Subsidiary.

Assets held for sale represent warehouse facilities with the net book value of AZM 3,795 million and furniture production facility with the net book value of AZM 784 million, which were previously rented out to earn rentals, and, therefore, recorded within investment property as at 31 December 2003. However, during 2004 these facilities were vacated by their tenants. The Management of the Bank intends to sell the above facilities during 2005 for at least the carrying value outstanding at 31 December 2004. Refer to Note 11.

Restricted cash as at 31 December 2004 includes cash deposits blocked under letters of credit issued by the Bank on behalf of its customers in the amount of AZM 3,345 million (31 December 2003: AZM 45,339 million) with maturity in June 2005.

The amounts in the course of settlement as at 31 December 2004 and 31 December 2003 represent transactions via Moneygram clearing center and settlements with plastic cards, which were not completed as of the reporting dates and cleared subsequent to year end.

10.Other Assets (continued)

Advances on equipment purchased for leasing purposes represent advances made by the Group's leasing subsidiary to suppliers of equipment to be subsequently leased.

Equipment for leasing represents equipment purchased for leasing purposes, but for which specific leasing contracts have not yet been negotiated. Equipment for leasing is usually held by the Group's leasing subsidiary for the period of 1 to 6 months, until the inception of new lease agreements.

11.Premises and Equipment and Investment Property

	Premises and lease-hold improvements	Computers & other of-fice equipment	Investment property	Banking equipment, furniture, fixtures, ve-hicles & other	Intangible assets	Construc-tion in Prog-ress	Total
Net book amount as at 31 December 2003	**103,207**	**64,286**	**14,231**	**10,468**	**4,375**	**3,658**	**200,225**
Cost or valuation							
Opening balance	126,391	83,757	17,110	16,588	6,918	3,658	254,422
Additions	3,437	42,646	-	58,966	3,955	2,013	111,017
Disposals	(4,944)	(200)	-	(351)	(4)	(3,279)	(8,778)
Transfers (Refer to Note 10)	-	(40,596)	(6,832)	40,596	-	-	(6,832)
Translation differences	1,151	183	-	-	274	10	1,618
Closing balance	**126,035**	**85,790**	**10,278**	**115,799**	**11,143**	**2,402**	**351,447**
Accumulated depreciation							
Opening balance	(23,184)	(19,471)	(2,879)	(6,120)	(2,543)	-	(54,197)
Depreciation charge (Note 24)	(5,529)	(14,861)	(584)	(17,550)	(3,471)	-	(41,995)
Disposals	879	31	-	120	4	-	1,034
Transfers (Refer to Note 10)	-	5,875	2,253	(5,875)	-	-	2,253
Translation differences	(40)	(36)	-	-	(18)	-	(94)
Closing balance	**(27,874)**	**(28,462)**	**(1,210)**	**(29,425)**	**(6,028)**	**-**	**(92,999)**
Net book amount as at 31 December 2004	**98,161**	**57,328**	**9,068**	**86,374**	**5,115**	**2,402**	**258,448**

Included in the closing and opening balances of computers and other office equipment are fully depreciated items in the amount of AZM 3,440 million and AZM 1,984 million, respectively. These fixed assets continue to be used by the Group for the purposes of carrying out its operational activities.

11. Premises and Equipment and Investment Property (continued)

Additions to premises and equipment primarily consist of 223 automated teller machines (2003: 149 ATMs) and related accessories and equipment in the amount of AZM 45,610 million, modem equipment, routers and point of sale terminals of AZM 9,295 million, high capacity servers of AZM 17,589 million and vehicles of AZM 4,541 million.

Other additions to premises and equipment represent the continuing investment of the Group into the upgrade of the Bank's information technology infrastructure in its branches and IBAR-Moscow, including purchase of new information technologies equipment as well as purchase of high capacity servers for the Bank's plastic cards operations processing subsidiary.

Included in disposals of premises and leasehold improvements are premises of one of the Bank's branches located in the centre of Baku with the net book value of AZM 2,586 million sold for net cash proceeds of AZM 1,700 million on 18 November 2004 to one of the shareholders of the Bank. Loss on disposal of the office premises in the amount of AZM 886 million is included in transfers to shareholders other than dividends in the consolidated statement of changes in shareholders' equity. Refer to Note 30 for related party disclosures.

Disposals of construction in progress represent sale of a building under construction owned by the Bank to a trade union established by the Bank's employees for net cash proceeds of AZM 3,279 million, which equaled to the net book value at the date of disposal. Refer to Note 30 for related party disclosures.

Additions to construction in progress represent compensation payments made by the Bank to former dwellers of the residential area purchased by the Bank in the centre of Baku for the purposes of construction of its new office building.

Included in the opening cost balance of investment property are three properties with the opening net book value of AZM 10,790 million the ownership of which was obtained by the Group based on court decision as compensation of loans granted by the Bank to domestic banks and legal entities in prior years. These properties used to be leased out for rentals. All of these properties are located in the Republic of Azerbaijan. Two of these properties representing warehouse facilities with the net book value as at 31 December 2004 of AZM 3,795 million and furniture production facility with the net book value of AZM 784 million were vacated by their tenants. The intention of the management is to sell these properties during 2005 and therefore they were reclassified from investment property to assets held for sale and recorded within other assets in the consolidated balance sheet of the Group as at 31 December 2004. Refer to Note 10.

Investment property as at 31 December 2004 includes a land in Baku in the amount of AZM 3,442 million acquired by the Group in August 2002 from one of its borrowers as a partial compensation of the loans previously issued to this borrower by the Bank. The Group intends to hold this land for capital appreciation purposes. The carrying value of the investment property approximates its fair value as at 31 December 2004.

The rental income generated from leasing out of investment property for the year ended 31 December 2004 in the amount of AZM 492 million (year ended 31 December 2003: AZM 327 million) was included in other operating income in the consolidated statement of income.

Premises and equipment were revalued in 1996 and 1998 and 2001, using independent appraisers on the basis of market prices, which approximate their fair value. The resulting revaluation surplus was recorded in the consolidated statement of shareholders' equity as revaluation reserve for premises and equipment. The management of the Group intends to perform revaluation of premises and equipment during 2005.

12. Due to Other Banks

	2004	2003
Correspondent accounts of commercial banks	17,618	15,017
Current term placements of the banks	-	491
Blocked accounts of resident banks in relation to plastic cards operations	1,054	886
Total due to other banks	**18,672**	**16,394**

Current term placements of the banks as at 31 December 2003 were represented by a deposit of an Azerbaijani bank bearing an interest rate of 3.5% per annum, which was repaid on 9 June 2004.

As at 31 December 2004 the estimated fair value of due to other banks was AZM 18,672 million (31 December 2003: AZM 16,394 million). Geographical, currency, maturity and interest rate analyses of due to other banks are disclosed in Note 27. The Group had several balances outstanding on transactions with related parties. The relevant information on related party balances is disclosed in Note 30.

13. Customer Accounts

	2004	2003
State and public organizations		
- Current/settlement accounts	1,068,716	479,922
- Term deposits	1,251,222	571,830
- Restricted customer deposits	47,917	72,900
Accrued interest	2,009	386
Subtotal	**2,369,864**	**1,125,038**
Other legal entities		
- Current/settlement accounts	478,853	332,570
- Term deposits	31,205	47,973
- Restricted customer deposits	14,599	14,838
Accrued interest	1,102	-
Subtotal	**525,759**	**395,381**
Individuals		
- Current/demand accounts	190,102	124,870
- Term deposits	631,942	414,633
Accrued interest	2,908	864
Subtotal	**824,952**	**540,367**
Total customer accounts	**3,720,575**	**2,060,786**

Included in the current and settlement accounts of state and public organizations as at 31 December 2004 are balances on current interest bearing accounts of state-owned enterprises and government bodies in the amount of AZM 142,877 million (31 December 2003: AZM 135,981 million). Interest rates on these accounts vary from 0.5% to 1.5% per annum (31 December 2003: 0.5% to 3.0% per annum).

Included in term deposits of state and public organizations are call deposits of a state organisation involved in the oil industry sector of the Republic of Azerbaijan in the amount of AZM 970,794 million (31 December 2003: AZM 295,380 million) and of government bodies in the amount of AZM 17,664 million (31 December 2003: AZM 49,552 million). The average interest rates on these call deposits were 0.5% and 1.5% per annum respectively (31 December 2003: 0.59% and 1.5% per annum).

13. Customer Accounts (continued)

As at 31 December 2004 the Bank had significant concentration of customer accounts attracted from a state organization involved in the oil industry sector in the total amount of AZM 1,478,786 million or 39.7% of total customer accounts (31 December 2003: AZM 560,572 million or 27.2%, respectively).

Restricted deposits represent balances on customer accounts held by the Group as collateral for irrevocable commitments under import letters of credit and guarantees issued by the Group on behalf of its customers. The information on letters of credit and guarantees outstanding as at 31 December 2004 and 31 December 2003 is disclosed in Note 28.

Economic sector concentration of customer accounts is, as follows:

	2004	%	31 December 2003	%
Energy	1,669,185	44.9	864,419	41.9
Individuals	817,910	22.0	540,367	26.2
Government bodies (*)	506,343	13.6	89,959	4.4
Trade and services	279,935	7.5	163,996	8.0
Transportation and communication	162,325	4.4	138,202	6.7
Construction	105,958	2.8	89,896	4.4
Manufacturing	83,582	2.2	65,069	3.2
Others	95,337	2.6	108,878	5.2
Total customer accounts	**3,720,575**	**100.0**	**2,060,786**	**100.0**

(*) Government bodies comprise Ministries, Treasury, municipalities and other state bodies of the Republic of Azerbaijan.

As at 31 December 2004 the estimated fair value of customer accounts was AZM 3,720,575 million (31 December 2003: AZM 2,060,786 million). Refer to Note 29.

Geographical, currency, maturity and interest rate analyses of customer accounts are disclosed in Note 27. The Group has several balances outstanding on transactions with related parties. The relevant information on related party balances is disclosed in Note 30.

14. Debt Securities in Issue

	2004	2003
Debentures	129,164	132,107
Certificates of deposit	79,487	46,437
Accrued interest expense	3,663	4,249
Total debt securities in issue	**212,314**	**182,793**

On 12 August 2003 the Group issued 200 debentures with par value of USD 50,000 each in the total amount of USD 10 million for a period of ten years with an effective interest rate of 9.0% per annum. On 28 October 2003 the Group issued additional 200 debentures with the same par value totaling USD 10 million with the same maturity and interest rate as those applicable to the first issue.

14. Debt Securities in Issue (continued)

A loss on origination of debentures at rates above market in the amount of AZM 34,232 million was recorded in the consolidated statement of income for 2003.

During 2004 the Group incurred interest expense on the above debentures in the amount of AZM 12,197 million (2003: AZM 3,571 million) recorded in the consolidated statement of income of the Group. Refer to Note 21.

Certificates of deposit bear interest rate of 10.0% p. a. and have maturity of 3 years. These certificates of deposit bear a condition that interest is paid only if certificates are claimed for repayment after 365 calendar days from their respective issue dates.

As at 31 December 2004 the estimated fair value of debt securities in issue was AZM 212,314 million (31 December 2003: AZM 182,793 million). Refer to Note 29.

Geographical, currency, maturity analyses and effective interest rates of debt securities in issue are disclosed in Note 27.

15. Other Borrowed Funds

	2004	2003
Black Sea Trade and Development Bank (BSTDB)	16,090	18,210
Islamic Development Corporation (IDC)	9,806	-
European Bank for Reconstruction and Development (EBRD)	5,308	11,749
Export Development Bank of Iran	-	230
Accrued interest expense	466	286
Total other borrowed funds	**31,670**	**30,475**

On 21 January 2002 the Bank signed an agreement with the Black Sea Trade and Development Bank for a multiple buyer revolving credit facility in the amount of USD 4,000 thousand. The amount drawn on this revolving facility net of repayments as at 31 December 2004 amounted to AZM 6,952 million (31 December 2003: AZM 9,846 million) or USD 1,418 thousand (31 December 2003: USD 2,000 thousand) and is used for financing of various projects related to manufacturing and transportation sectors of the Republic of Azerbaijan.

On 22 November 2002 additional credit facility in the amount of USD 2,500 thousand was approved by the Black Sea Trade and Development Bank for the purposes of financing of various Azerbaijani projects in electricity distribution and manufacturing sectors. Each disbursement of the facility is repayable in 6 equal semi-annual installments commencing six months after the value date of the disbursement. The interest rate for the loan is LIBOR plus 4% per annum. The amount of AZM 9,138 million (31 December 2003: AZM 8,364 million) or USD 1,864 thousand (31 December 2003: USD 1,699 thousand) net of repayments was drawn down on this credit line as at 31 December 2004.

On 12 April 2004 the Bank signed a Line of Financing Agreement with the Islamic Development Corporation (a member Islamic Development Bank Group, an international financial institution with head-quarters in Jeddah, Saudi Arabia) for the credit line of USD 4,500 thousand for the period of 7 years at LIBOR plus 5% per annum for financing of various investment projects in the Republic of Azerbaijan. As at 31 December the amount drawn down on this credit line comprised USD 2,000 thousand or AZM 9,806 million and was used for financing of a project in manufacturing sector of Azerbaijan.

The Bank signed a loan agreement with the European Bank for Reconstruction and Development on 21 July 1998 for provision of a credit line in the amount of USD 2,350 thousand for the period of 5 years for financing of domestic and medium size enterprises. A separate Amendment Agreement was signed on 4 November 2002 increasing the total amount of the credit line up to USD 5,000 thousand and breaking down the total amount of the credit line into two parts: initial credit line of USD 2,546 thousand and additional credit line of USD 2,454 thousand. The interest rate on

15. Other Borrowed Funds (continued)

the balance drawn down on the credit line is set at LIBOR+4.5% per annum. The amount drawn down on initial credit line is repayable in semi-annual installments and matures in November 2005. The amount drawn down on additional credit line is repayable in four equal semi-annual installments with the first payment due on 6 May 2004 and matures in November 2005.

As at 31 December 2004 the amount drawn down on initial credit line amounted to AZM 3,054 million or USD 623 thousand (31 December 2003: USD 7,220 thousand or AZM 1,466 million) while the amount drawn down on additional credit line amounted to AZM 2,254 million or USD 460 thousand (31 December 2003: USD 920 thousand or AZM 4,529 million). On 6 January 2005 the Bank fully repaid outstanding draw down and accrued interest with regard to this credit line to EBRD ahead of schedule and decided not to utilize the above credit facility any further.

On 27 April 2003 the Bank signed a credit agreement with Export Development Bank of Iran for a credit line amounting to EUR 10 million to finance import/export transactions of domestic companies with Iranian enterprises. The amounts drawn under this facility in 2003 carried interest rate of 12-months EURIBOR plus 2% per annum and were fully repaid during 2004.

As at 31 December 2004 the estimated fair value of other borrowed funds was AZM 31,670 million (31 December 2003: AZM 30,475 million). Refer to Note 29. Geographical, currency, maturity and interest rate analysis of other borrowed funds are disclosed in Note 27.

16. Other Liabilities

	2004	2003
Dividends payable to shareholders (Note 26)	17,372	11,902
Taxes payable	10,546	5,731
Insurance reserves	5,920	4,295
Deferred revenue on plastic cards operations	4,560	-
Provision for letters of guarantee (Notes 24 and 28)	3,857	-
Insurance premiums and broker commissions payable	3,782	4,063
Plastic cards creditors	2,236	158
Trade creditors	1,681	1,686
Amounts in the course of settlement	709	-
Deferred ceding commissions on insurance operations	451	385
Other liabilities	807	485
Total other liabilities	**51,921**	**28,705**

The majority of the balance of taxes payable comprised income tax payable by the Bank as at 31 December 2004 in the amount of AZM 7,073 million and income tax payable by Azericard Limited of AZM 2,355 million. In September 2004 in accordance with the protocol signed between the Bank and the Ministry of Finance of the Republic of Azerbaijan the Bank with entitled to compensation of the overdue loans issued in previous years to state-owned enterprises and related accrued interest in the total amount of AZM 2,670 million by offseting these amounts against income tax payable due to the budget for 2004. Refer to Notes 7, 25 and 33.

Deferred revenue on plastic cards operations represents unearned portion of revenue related to fees charged for annual maintenance of plastic cards. The above fee is charged upon issuance of cards and amortized over their respective term.

Insurance reserves, insurance premiums and broker commission payable; and deferred ceding commissions on insurance operations relate to the activities of the Insurance Subsidiary of the Group. Insurance reserves include the following:

16. Other Liabilities (continued)

	2004	2003
Provision for unearned premiums, net of reinsurer's share	4,812	2,845
Loss provision, net of reinsurance	1,108	1,450
Total insurance reserves	**5,920**	**4,295**

Movements in the provision for unearned premiums, net of reinsurer's share, are as follows:

	2004	2003
Provision for unearned premiums, net of reinsurance as at 1 January	2,845	594
Increase in gross provision	5,234	3,980
Increase in reinsurer's share of provision	(3,267)	(1,729)
Net increase of provision	1,967	2,251
Provision for unearned premiums, net of reinsurance as at year end	**4,812**	**2,845**

The structure of loss provision, net of reinsurance, as at 31 December 2004 and 31 December 2003, respectively is provided below:

	2004			2003		
	OCR	*IBNR*	*Total*	*OCR*	*IBNR*	*Total*
Gross provision	866	884	1,750	657	3,397	4,054
Reinsurer's share in provision	-	(642)	(642)	-	(2,604)	(2,604)
Loss provision, net of reinsurance	**866**	**242**	**1,108**	**657**	**793**	**1,450**

Movements in loss provision, net of reinsurance, are as follows:

	2004			2003		
	OCR	*IBNR*	*Total*	*OCR*	*IBNR*	*Total*
Balance as at 1 January	657	793	1,450	54	111	165
Increase/(decrease) in provision, gross	209	(2,512)	(2,303)	603	2,921	3,524
Increase in reinsurer's share of provision	-	1,961	1,961	-	(2,239)	(2,239)
Net increase in loss provision	209	(551)	(342)	603	682	1,285
Balance as at year end	**866**	**242**	**1,108**	**657**	**793**	**1,450**

Claims paid during the year ended 31 December 2004 amounted to AZM 2,560 million (2003: AZM 1,652 million).

17. Minority Interest

As at 31 December 2004 and 2003, the balance of minority interest equals to nil. However, the balance of minority interest as 1 January 2003 was equal to AZM 3,383 million.

The table below represents movements in minority interest of the Group in relation to the 50% holding in Azericard Limited for the period through to 26 July 2003 when it was wholly acquired by the Group:

	Note	2004	2003
Minority interest as at 1 January		-	3,383
Share of net profit after tax for the period from 1 January 2003 to 26 July 2003		-	798
Less: consideration paid for acquisition of additional 50% interest	32	-	(4,181)
Minority interest as at 31 December		**-**	**-**

On 26 July 2003 the Group acquired the remaining 50% of the share capital of Azericard Limited from Bank Standard (formerly Most Bank Azerbaijan) for AZM 4,181 million. The Group's share of net profit after tax amounting to AZM 798 million was recorded in the consolidated statement of income for the year ended 31 December 2003.

18. Share Capital

Authorised, issued and paid-in share capital of the Bank as at 31 December 2004 is, as follows:

	Authorised			Issued and paid-in		
	Number of ordinary shares	*Nominal amount*	%	*Number of ordinary shares*	*Nominal amount*	%
Individuals	16,870,100	16,870	16.9	16,870,100	16,870	16.9
Ministry of Finance of the Republic of Azerbaijan	50,200,000	50,200	50.2	50,200,000	50,200	50.2
Other legal entities	32,929,900	32,930	32.9	32,929,900	32,930	32.9
Total share capital	**100,000,000**	**100,000**	**100.0**	**100,000,000**	**100,000**	**100.0**

Authorised, issued and paid-in share capital of the Bank as at 31 December 2003 is, as follows:

	Authorised			Issued and paid-in		
	Number of ordinary shares	*Nominal amount*	%	*Number of ordinary shares*	*Nominal amount*	%
Individuals	7,633,625	7,634	15.3	7,633,625	7,634	15.3
Ministry of Finance of the Republic of Azerbaijan	25,100,000	25,100	50.2	25,100,000	25,100	50.2
Other legal entities	17,266,375	17,266	34.5	17,266,375	17,266	34.5
Total share capital	**50,000,000**	**50,000**	**100.0**	**50,000,000**	**50,000**	**100.0**

All shares have par value of AZM 1,000, rank equally and carry one vote. As at 31 December 2004 the Bank's employees hold 7.9% of the total share capital of the Bank, which amounts to AZM 7,859 million (31 December 2003: 7.4% and AZM 3,679 million respectively).

18. Share Capital (continued)

In 2002 the Shareholder's Meeting of the Bank authorized the issue of ordinary shares in the amount of AZM 30,000 million, of which ordinary shares of AZM 14,110 million were fully paid in as at 31 December 2002; and the remaining ordinary shares of AZM 15,890 million were fully paid in as at 31 December 2003.

On 4 June 2004 the Bank registered further increase of its share capital in the amount of AZM 50,000 million at the Ministry of Justice of the Republic of Azerbaijan. On 9 November 2004 the entire amount of the capital increase was fully paid-in by the shareholders.

19. Cumulative Translation Reserve

Cumulative translation reserve results from translating the financial statements of foreign subsidiaries whose operations are not integral to those of the parent into AZM, the reporting currency of the Group, in accordance with IAS 21 "Effect of Changes in Foreign Exchange Rates". It is shown as part of consolidated shareholders' equity of the Group.

20. Retained Earnings

In accordance with the Azeri Law on Banks and Banking Activity, the Group allocates profits as dividends or transfers them to reserves (fund accounts) on the basis of statutory financial statements prepared in accordance with Azerbaijani accounting rules. The Bank's standalone reserves calculated in accordance with Azerbaijani accounting rules as at 31 December 2004 are AZM 128,903 million (31 December 2003: AZM 92,194 million). Statutory profits and retained earnings are allocated on annual basis in accordance with statutory legislation.

21. Interest Income and Expense

	2004	2003
Interest income		
Interest income on loans and advances to customers	214,397	123,709
Interest income on due from other banks and correspondent accounts	14,909	13,219
Interest income on investment securities	7,226	3,313
Total interest income	**236,532**	**140,241**
Interest expense		
Interest expenses on savings deposits of individuals and deposit certificates	(54,740)	(38,508)
Interest expense on accounts of legal entities	(18,787)	(15,864)
Interest expense on debentures (Note 14)	(12,197)	(3,571)
Interest expenses on deposits from banks and other borrowed funds	(1,417)	(1,757)
Total interest expense	**(87,141)**	**(59,700)**
Net interest income	**149,391**	**80,541**

22.Fee and Commission Income and Expense

	2004	2003
Commission on transactions with foreign currencies and securities	74,701	60,127
Commission on cash transactions	42,518	36,701
Commission on plastic cards operations	33,562	19,325
Commission on settlement transactions	32,822	26,593
Commission on letters of credit issued	14,419	10,350
Commission on guarantees issued	10,321	8,580
Commission on servicing intermediary loans	2,769	3,621
Other	3,141	1,580
Total fee and commission income	**214,253**	**166,877**
Fees paid for plastic cards operations	(7,306)	(3,764)
Commission on settlement transactions	(4,761)	(3,811)
Fees and commissions paid on cash transactions	(2,482)	(1,008)
Policy acquisition costs on insurance operations	(1,221)	(296)
Commissions paid on transactions with foreign currencies and securities	(714)	(195)
Other	(137)	(398)
Total fee and commission expenses	**(16,621)**	**(9,472)**
Net fee and commission income	**197,632**	**157,405**

Included in commission income on plastic cards operations is commission income from the Social Protection Fund of the Republic of Azerbaijan in the amount of AZM 5,151 million for the issuance of 308,366 plastic cards for Azerbaijani pensioners. These plastic cards were issued in the context of the project for implementation of the retirement benefits payment system through plastic cards in Baku and Sumgait cities arranged by the Bank based on the contract with the State Social Protection Fund of the Republic of Azerbaijan signed as a result of a tender won by the Bank.

23.Staff Costs

Staff costs consist of wages, including obligatory payments to the Social Insurance Fund and other funds of the Republic of Azerbaijan, bonuses and other benefits provided by the Group to its employees.

Staff costs include payroll and other employee benefits of the parent Bank in the amount of AZM 44,645 million (2003: AZM 40,051 million), IBAR Moscow of AZM 4,644 million (2003: 2,979 million), insurance subsidiary of AZM 2,180 million (2003: AZM 2,450 million), Azericard Limited of AZM 1,179 million (2003: AZM 756 million), leasing subsidiary of AZM 185 million (2003: AZM 130 million) and “Inter” professional football club of AZM 2,206 million.

24. General, Administrative and Other Operating Expenses

	2004	2003
Depreciation of premises, equipment and investment property	38,524	18,283
Communication	6,310	5,976
Rent	5,979	4,028
Advertising and marketing	5,484	4,960
Professional fees	5,143	3,344
Stationery, books, printing and other supplies	4,828	2,204
Customs duties and other taxes other than on income	4,687	6,653
Provision for letters of credit and guarantee (Notes 16, 28)	3,857	-
Amortization of intangible assets	3,471	1,353
Software maintenance	3,651	1,057
External labor and guarding	3,196	1,661
Transportation of valuables	2,895	3,268
Premises, equipment and investment property maintenance	2,380	3,370
Training	2,183	1,126
Business trip	1,809	899
Charity and financial aid	1,448	699
Property insurance	1,013	1,551
Sport inventory and football field maintenance for "Inter" professional football club	1,097	-
Amortization of goodwill (Note 32)	812	-
Other	3,942	2,735
Total general, administrative and other operating expenses	**102,709**	**63,167**

Depreciation of premises, equipment and investment property and amortization of intangible assets amounts to AZM 41,995 million in total for the year ended 31 December 2004 (31 December 2003: AZM 19,636 million).

Rent expense is related to operating lease of the Bank's branch buildings in Baku and in the regions of the Republic of Azerbaijan, exchange offices and costs associated with ATMs installed in department stores, hotels, etc.

25. Income Taxes

	2004	2003
Current tax charge	(20,941)	(16,303)
Deferred taxation movements due to:		
- Origination and reversal of temporary differences	(7,504)	(6,784)
- Effect of reduction in tax rates	-	468
Less: Reversal of deferred tax asset related to the movement of fair value reserve on securities available for sale recorded directly to equity (Note 8)	1,310	625
Add: Recognition of deferred tax liability related to the revaluation on premises and equipment prior to 31 December 2002	754	(114)
Add: Change in exchange translation rates for IBAR Moscow	-	(13)
Income tax expense for the year	**(26,381)**	**(22,121)**

25. Income Taxes (continued)

The income tax rate applicable to the majority of the Group's income is 24% as at 31 December 2004 (31 December 2003: 25%). Effective from 1 January 2003, the statutory tax rate of the Republic of Azerbaijan was reduced from 27% to 25%. Furthermore, effective from 1 January 2004, the statutory tax rate of the Republic of Azerbaijan was reduced from 25% to 24%. The income tax rate applicable to the operations of IBAR Moscow is 24%. A 24% statutory income tax rate for IBAR Moscow was enacted in August 2001, effectively applicable from 1 January 2002.

Reconciliation between the expected and the actual taxation charge is provided below.

	2004	2003
IFRS profit before taxation	95,851	70,572
Theoretical tax charge at the applicable statutory rate (2004: 24%; 2003: 25%)	(23,004)	(17,643)
Tax effect of items, which are not deductible or assessable for taxation purposes:		
- Non-deductible expenses	(4,324)	(4,872)
- Income which is exempt from taxation	1,133	-
- Non-recorded deferred tax asset movement of Azerileasing	605	(263)
- Non recognized tax losses of "Inter" professional football club	(1,046)	-
- Difference on investments in subsidiaries	134	634
- Share of results of operations of associates	-	(912)
- Change in tax rates	-	468
Other non temporary differences	121	467
Income tax charge for the year	**(26,381)**	**(22,121)**

Starting from the financial year ended 31 December 2001 fiscal periods remains open to review by the authorities in respect of taxes for three calendar years preceding the year of review. This clause of the Tax Code of the Republic of Azerbaijan is applied prospectively, i.e. does not apply to the financial years prior to 2001. Under certain legislative circumstances reviews may cover longer periods.

Deferred taxes. Differences between IFRS, Azerbaijani and Russian (for IBAR Moscow) statutory taxation regulations give rise to certain temporary differences between the carrying amount of certain assets and liabilities for financial reporting purposes and for income tax calculation purposes. The tax effect of the movement on these temporary differences is recorded at the rate of 24%, except for income on state securities for IBAR Moscow, which is taxed at 15%. As at 31 December 2004 the temporary differences giving rise to the deferred tax assets and liabilities are, as follows:

25. Income Taxes (continued)

	2003	Movement	2004
Tax effect of deductible temporary differences			
Losses on assets and liabilities at non-market rates	10,606	(1,261)	9,345
Deferred revenue recognition	248	932	1,180
Tax loss carry forward for "Inter" professional football club	-	1,046	1,046
Provision for letters of credit and guarantees	-	926	926
Depreciation of investment property	584	140	724
Loan impairment in subsidiaries	446	16	462
Tax loss carry forward for Azerileasing	460	(2)	458
Difference in depreciation rate of premises and equipment	322	(5)	317
Recognition of expenses incurred, but recorded as other assets	239	75	314
Difference in amortization rates of intangibles	66	234	300
Fair value loss on investments securities available for sale	1,310	(1,310)	-
Accrual of commission expense on insurance operations	188	(188)	-
Recognition of insurance related reserves	181	(181)	-
Accruals and other	40	496	536
Gross deferred tax asset	**14,690**	**918**	**15,608**
Less: non-recorded deferred tax asset	(605)	(441)	(1,046)
Net deferred tax asset	**14,085**	**477**	**14,562**
Tax effect of taxable temporary differences			
Provision for impairment of loans	(16,569)	(4,309)	(20,878)
Difference in depreciation rates of fixed assets	(5,817)	(2,133)	(7,950)
Movement of the revaluation of premises	(2,735)	(754)	(3,489)
Revenue accruals	-	(460)	(460)
Effect of consolidation of associates	(812)	(9)	(821)
Difference in amortization rates	(307)	42	(265)
Deferral of prepaid expenses	-	(252)	(252)
Other	(170)	(106)	(276)
Gross deferred tax liability	**(26,410)**	**(7,981)**	**(34,391)**
Total net deferred tax liability, net	**(12,325)**	**(7,504)**	**(19,829)**

25. Income Taxes (continued)

	2003	Movement	2004
Tax effect of deductible temporary differences			
Losses on assets and liabilities at non-market rates	556	10,050	10,606
Impairment provision on correspondent accounts	4,628	(183)	4,445
Fair valuation of investment securities available for sale	1,935	(625)	1,310
Depreciation of investment property	463	121	584
Tax loss carry forward for Azerileasing	-	460	460
Loan impairment in subsidiaries	-	446	446
Difference in depreciation rate of premises and equipment	322	-	322
Deferred revenue recognition	-	248	248
Recognition of expenses recorded as other assets	324	(85)	239
Accrual of commission expense on insurance operations	-	188	188
Recognition of insurance related reserves	-	181	181
Difference in amortization rates of intangibles	-	66	66
Tax loss carry forward for IIC	71	(71)	-
Accruals and other	165	(125)	40
Gross deferred tax asset	**8,464**	**10,671**	**19,135**
Less: non-recorded deferred tax asset	-	(605)	(605)
Net deferred tax asset	**8,464**	**10,066**	**18,530**
Tax effect of taxable temporary differences			
Provision for impairment of loans	(8,113)	(12,901)	(21,014)
Difference in depreciation rates of fixed assets	(3,188)	(2,583)	(5,771)
Movement of the revaluation of premises	(2,849)	114	(2,735)
Effect of consolidation of associates	-	(812)	(812)
Difference in amortization rates	(160)	(147)	(307)
Accruals and other	(163)	(53)	(216)
Gross deferred tax liability	**(14,473)**	**(16,382)**	**(30,855)**
Total net deferred tax liability	**(6,009)**	**(6,316)**	**(12,325)**

In the table above deferred tax assets and liabilities of the Group are shown on a net basis. However, since in the context of the Group's current structure, deferred tax liabilities and tax assets of different companies may not be offset against each other in the consolidated balance sheet deferred tax assets of subsidiaries are shown separately from the deferred tax liabilities of the parent Bank. The composition of the total net deferred tax liability of the Group as at 31 December 2004 and 31 December 2003 respectively is, as follows:

	2004	2003
Total net deferred tax assets of subsidiaries (Note 10)	2,065	729
Total net deferred tax liability of the parent Bank	(21,894)	(13,054)
Total net deferred tax liability of the Group	**(19,829)**	**(12,325)**

25. Income Taxes (continued)

Deferred tax asset on tax loss carry forward for Insurance Subsidiary in the amount of AZM 71 million was reversed during the year ended 31 December 2003 due to the fact the company has fully utilized the related tax losses in the amount of AZM 285 million, incurred in prior years, for the purposes of calculation of statutory profits for 2003.

The net deferred tax asset of the subsidiaries represents income taxes recoverable through future revenues and is recorded within other assets in the consolidated balance sheet. Deferred income tax assets are recorded for tax loss carry forwards only to the extent that realisation of the related tax benefit is probable. As at 31 December 2004, a net deferred tax asset in the amount of AZM 1,046 million with respect to tax losses for 2004 of "Inter" professional football club has not been recognised, as it is not probable that sufficient taxable profit will be available to allow the benefit of that deferred tax asset to be utilized. A net deferred tax asset in the amount of AZM 605 million of the Group's leasing subsidiary, Azerileasing, for net deductible temporary differences, not recognised as at 31 December 2003, has been recorded as at 31 December 2004 due to the fact that the company made statutory profit in 2004 and started utilizing tax losses carried forward.

A deferred tax asset of AZM 1,310 million (31 December 2003: AZM 1,310 million) related to the fair value loss of investment securities available for sale recorded directly in the consolidated statement of changes in shareholders equity was fully reversed due to the sale of these securities. Refer to Note 8.

26. Dividends

	2004	2003
Ordinary dividends		
Dividends payable as at 1 January	11,902	7,317
Dividends declared during the year	38,531	21,790
Dividends paid during the year	(33,061)	(17,205)
Dividends payable as at 31 December (Note 16)	**17,372**	**11,902**

Dividends are declared at quarter-ends and paid in the following quarter to the shareholders in accordance with their shareholding percentage in the issued and paid share capital as at the end of the quarter. Included in dividends payable as at 31 December 2004 are dividends declared for the fourth quarter of 2004 in the amount of AZM 11,950 million (31 December 2003: AZM 6,000 million) and dividends payable to the Ministry of Finance of the Republic of Azerbaijan in the amount of AZM 5,422 million (31 December 2003: AZM 5,902 million).

In September 2004 in accordance with the protocol signed between the Bank and the Ministry of Finance of the Republic of Azerbaijan overdue loans issued in previous years to state owned enterprises and related accrued interest in the total amount of AZM 8,669 million were offset against dividends payable to the budget. Additional AZM 12,638 million of bad loans and related accrued interest is due to be offset against dividends in 2005. Refer to Notes 7 and 16. In February 2005, in accordance with the similar protocol signed in December 2004 between the Bank and the Ministry of Finance of the Republic of Azerbaijan, the Bank has further offset bad loans and related accrued interest in the amount of AZM 9,906 million and AZM 2,732 million, respectively, against the dividends payable to the Ministry of Finance of the Republic of Azerbaijan. Refer to Notes 7 and 33.

27. Financial Risk Management

The risk management function within the Group is carried out in respect of financial risks (credit, market, geographical, currency, liquidity and interest rate), operational risks and legal risks. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. Risk assessment also forms the basis for optimal risk-adjusted capital allocation, transaction pricing and performance assessment. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimize operational and legal risks.

Credit risk. The Group takes on exposure to credit risk, which is the risk that counter-party will be unable to pay amounts in full when due. The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Limits on the level of credit risk by product, borrower and industry sector are approved regularly by the Board of Directors and Credit Committee.

The exposure to any one borrower, including banks and brokers, is further restricted by sub-limits covering on and off-balance sheet exposures and daily delivery risk limits in relation to trading items. Actual exposures against limits are monitored daily. Exposure to credit risk is managed through regular analysis of the ability of the borrowers to meet interest and principal repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed, in part, by obtaining collateral and corporate and personal guarantees. The Group's maximum exposure to credit risk is primarily reflected in the carrying amounts of financial assets on the consolidated balance sheet. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrumen*t failing to perform in accordance with the terms of the contract. The Group uses the same credit policies in making conditional obligations as it does for on-balance sheet financial instruments through established credit approvals, risk control limits and monitoring procedures.

Market risk. The Group takes on exposure to market risks. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The Board of Directors sets limits on the value of risk that may be accepted, which is monitored on a daily basis. However, the use of this approach does not prevent losses outside of these limits in the event of more significant market movements.

27. Financial Risk Management (continued)

Geographical risk. The geographical concentration of the Group's consolidated assets and liabilities as at 31 December 2004 is set out below:

	Republic of Azerbaijan	OECD*	Non OECD	Total
Assets				
Cash and cash equivalents	1,034,810	58,367	20,615	1,113,792
Mandatory cash balances with central banks	344,236	-	2,387	346,623
Due from other banks	63,404	171,490	92,928	327,822
Loans and advances to customers	1,947,979	-	84,638	2,032,617
Investment securities				
- available-for-sale	642	-	-	642
- held-to-maturity	52,155	-	124,979	177,134
Investments in associates and joint ventures	7,377	-	-	7,377
Goodwill on acquisition of a subsidiary	7,300	-	-	7,300
Other assets	43,931	5,915	1,506	51,352
Premises and equipment and investment property	258,448	-	-	258,448
Total assets	**3,760,282**	**235,772**	**327,053**	**4,323,107**
Liabilities				
Due to other banks	16,067	-	2,605	18,672
Customer accounts	3,717,109	-	3,466	3,720,575
Debt securities in issue	212,314	-	-	212,314
Other borrowed funds	-	21,666	10,004	31,670
Other liabilities	46,163	2,862	2,896	51,921
Deferred tax liability	21,894	-	-	21,894
Total liabilities	**4,013,547**	**24,528**	**18,971**	**4,057,046**
Net balance sheet position	**(253,265)**	**211,244**	**308,082**	**266,061**
Credit related commitments (Note 28)	**(2,458,361)**	**(147,283)**	**(25,535)**	**(2,631,179)**

* OECD – Organisation for Economic Cooperation and Development.

Assets, liabilities and credit related commitments have generally been based on the country, in which counterparty is located. Balances with Azerbaijani counterparties actually outstanding to/from off-shore companies of these Azerbaijani counterparties are allocated to the caption "Republic of Azerbaijan". Cash on hand and premises and equipment have been allocated based on the country in which they are physically held. The geographical concentration of the Group's consolidated assets and liabilities as at 31 December 2003 is set out below:

27. Financial Risk Management (continued)

	Republic of Azerbaijan	OECD*	Non OECD	Total
Net balance sheet position	**(605,995)**	**531,273**	**253,471**	**178,749**
Credit related commitments (Note 28)	**(1,284,502)**	**(54,320)**	**(1,128,428)**	**(2,467,250)**

Currency risk. The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board of Directors sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily. The table below summarises the Group's exposure to foreign currency exchange rate risk as at 31 December 2004. Included in the table are the Group's assets and liabilities at carrying amounts, categorised by currency. The off-balance sheet gap represents the difference between the notional amounts of foreign currency derivative financial instruments, which are principally used to reduce the Group's exposure to currency movements, and their fair values. As at 31 December 2004, the Group has the following positions in currencies:

	USD	AZM	EUR	RR	Other	Total
Assets						
Cash and cash equivalents	729,343	330,197	25,718	20,492	8,042	1,113,792
Mandatory cash balances with central banks	281,160	63,076	-	2,387	-	346,623
Due from other banks	188,821	38,722	100,279	-	-	327,822
Loans and advances to customers	1,768,680	242,592	8,171	13,174	-	2,032,617
Investment securities:						
- available-for-sale	-	642	-	-	-	642
- held-to-maturity	72,148	50,651	54,335	-	-	177,134
Investments in associates and joint ventures	-	7,377	-	-	-	7,377
Goodwill on acquisition of a subsidiary	-	7,300	-	-	-	7,300
Other assets	17,594	32,826	80	715	137	51,352
Premises and equipment and investment property	-	233,652	-	24,796	-	258,448
Total assets	**3,057,746**	**1,007,035**	**188,583**	**61,564**	**8,179**	**4,323,107**
Liabilities						
Due to banks	17,192	312	146	1,022	-	18,672
Customer accounts	2,861,510	684,271	166,634	5,426	2,734	3,720,575
Debt securities in issue	212,310	4	-	-	-	212,314
Other borrowed funds	31,670	-	-	-	-	31,670
Other liabilities	11,464	39,549	5	888	15	51,921
Deferred tax liability	-	21,894	-	-	-	21,894
Total liabilities	**3,134,146**	**746,030**	**166,785**	**7,336**	**2,749**	**4,057,046**
Net balance sheet position	**(76,400)**	**261,005**	**21,798**	**54,228**	**5,430**	**266,061**
Credit related commitments (Note 28)	**(2,393,799)**	**(77,799)**	**(142,525)**	**(9,249)**	**(7,807)**	**(2,631,179)**

27. Financial Risk Management (continued)

As at 31 December 2003 the Group had the following positions in currencies:

	USD	AZM	EUR	RR	Other currencies	Total
Net balance sheet position	**(39,775)**	**146,405**	**40,396**	**26,883**	**4,840**	**178,749**
Credit related commitments (Note 28)	**(2,274,124)**	**(61,807)**	**(90,961)**	**(2,585)**	**(37,773)**	**(2,467,250)**

The Group has extended loans and advances denominated in foreign currencies. Depending on the revenue stream of the borrower, the appreciation of foreign currencies against the Azerbaijani Manat may adversely affect the borrowers' repayment ability and, therefore, increases the likelihood of future loan losses.

Liquidity risk. Liquidity risk is defined as the risk when the maturity of assets and liabilities does not match. The Group is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs, guarantees and from margin and other calls on cash settled derivative instruments. The Group does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. Liquidity risk is managed by the Asset/Liability Committee of the Group.

The table below shows consolidated assets and liabilities as at 31 December 2004 by their remaining contractual maturity, unless there is evidence that any of these assets are impaired and will be settled after their contractual maturity dates, in which case the expected date of settlement is used. Some of the assets, however, may be of a longer term nature; for example, loans are frequently renewed and accordingly short term loans can have a longer term duration.

27. Financial Risk Management (continued)

The liquidity position of the Group as at 31 December 2004 is set out below.

	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	More than 1 year	Overdue/ No stated maturity	Total
Assets						
Cash and cash equivalents	1,113,792	-	-	-	-	1,113,792
Mandatory cash balances with central banks	346,623	-	-	-	-	346,623
Due from other banks	85,824	96,042	87,605	53,914	4,437	327,822
Loans and advances to customers	469,343	647,406	239,721	508,590	167,557	2,032,617
Investment securities:						
- available-for-sale	-	-	-	-	642	642
- held-to-maturity	84,727	90,936	-	1,471	-	177,134
Investments in associates and joint ventures	-	-	-	-	7,377	7,377
Goodwill on acquisition of a subsidiary	-	-	-	-	7,300	7,300
Other assets	10,032	30,651	5,638	2,362	2,669	51,352
Premises and equipment and investment property	-	-	-	-	258,448	258,448
Total assets	**2,110,341**	**865,035**	**332,964**	**566,337**	**448,430**	**4,323,107**
Liabilities						
Due to other banks	17,618	662	392	-	-	18,672
Customer accounts	1,890,555	477,186	1,160,580	192,254	-	3,720,575
Debt securities in issue	-	-	-	212,314	-	212,314
Other borrowed funds	5,573	2,080	7,287	16,730	-	31,670
Other liabilities	12,906	28,723	5,267	-	5,025	51,921
Deferred tax liability	-	-	-	21,894	-	21,894
Total liabilities	**1,926,652**	**508,651**	**1,173,526**	**443,192**	**5,025**	**4,057,046**
Net liquidity gap	**183,689**	**356,384**	**(840,562)**	**123,145**	**443,405**	**266,061**
Cumulative liquidity gap as at 31 December 2004	**183,689**	**540,073**	**(300,489)**	**(177,344)**	**266,061**	
Cumulative liquidity gap as at 31 December 2003	**(112,216)**	**(173,896)**	**(105,907)**	**(223,685)**	**178,749**	

27. Financial Risk Management (continued)

Mandatory cash balances with the NBA and the CBRF are included within demand and less than one month as the majority of liabilities, to which these balances relate, are also included within this category.

The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the Management of the Group. It is unusual for banks ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest and exchange rates.

Management believes that in spite of a substantial portion of customer accounts being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Group would indicate that these customer accounts provide a long-term and stable source of funding for the Group.

Liquidity requirements to support calls under guarantees and standby letters of credit are usually considerably less than the amount of the commitment, because the Group does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

Interest rate risk. The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its consolidated financial position and cash flows. Interest margins may increase as a result of such changes, but may reduce or create losses in the event that unexpected movements arise.

The Group is exposed to interest rate risk, principally as a result of lending at fixed interest rates, in amounts and for periods, which differ from those of term borrowings at fixed interest rates. In practice, interest rates are generally fixed on a short-term basis. Also, interest rates that are contractually fixed on both assets and liabilities are usually renegotiated to reflect current market conditions.

The Board of Directors sets limits on the level of mismatch of interest rate re-pricing that may be undertaken, which is monitored daily. In the absence of any available hedging instruments, the Group normally seeks to match its interest rate positions.

27. Financial Risk Management (continued)

The table below summarises the Group's exposure to interest rate risks. Included in the table are the Group's consolidated assets and liabilities as at 31 December 2004 at their carrying amounts, categorised by the earlier of contractual re-pricing or maturity dates.

	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	More than 1 year	Non-interest bearing	Total
Assets						
Cash and cash equivalents	1,113,792	-	-	-	-	1,113,792
Mandatory cash balances with central banks	346,623	-	-	-	-	346,623
Due from other banks	85,824	96,042	87,605	53,914	4,437	327,822
Loans and advances to customers	469,343	647,406	239,721	508,590	167,557	2,032,617
Investment securities:						
- available-for-sale	-	-	-	-	642	642
- held-to-maturity	84,727	90,936	-	1,471	-	177,134
Investments in associates and joint ventures	-	-	-	-	7,377	7,377
Goodwill on acquisition of a subsidiary	-	-	-	-	7,300	7,300
Other assets	-	-	-	-	51,352	51,352
Premises and equipment and investment property	-	-	-	-	258,448	258,448
Total assets	**2,100,309**	**834,384**	**327,326**	**563,975**	**497,113**	**4,323,107**
Liabilities						
Due to other banks	17,618	662	392	-	-	18,672
Customer accounts	1,890,555	477,186	1,160,580	192,254	-	3,720,575
Debt securities in issue	-	-	-	212,314	-	212,314
Other borrowed funds	5,573	2,080	7,287	16,730	-	31,670
Other liabilities	-	-	-	-	51,922	51,922
Deferred tax liability	-	-	-	-	21,894	21,894
Total liabilities	**1,913,746**	**479,928**	**1,168,259**	**421,298**	**73,815**	**4,057,046**
Net sensitivity gap	**186,563**	**354,456**	**(840,933)**	**142,677**	**423,298**	**266,061**
Cumulative sensitivity gap as at 31 December 2004	**186,563**	**541,019**	**(299,914)**	**(157,237)**	**266,061**	
Cumulative sensitivity gap as at 31 December 2003	**(112,216)**	**(195,929)**	**(120,189)**	**(211,360)**	**178,749**	

27. Financial Risk Management (continued)

The table below summarises the effective interest rates by major currencies for major monetary financial instruments. The analysis has been prepared based on year-end effective rates used for amortisation of the respective assets/liabilities as adjusted for re-measurement of the effect of non-market interest rates at origination.

	2004				2003			
	USD	AZM	EUR	RR	USD	AZM	EUR	RR
Assets								
Cash and cash equivalents	1.7	-	-	-	1.5	-	1.9	-
Due from resident banks	17.7	7.1	-	-	18.9	-	-	-
Due from non resident banks	4.5	-	2.0	-	4.8	-	-	-
Loans and advances to customers - individuals	20.2	17.5	18.0	-	20.7	17.6	-	-
Loans and advances to customers - corporate	14.4	10.9	15.9	14.7	15.1	20.8	20.9	15.0
Investment securities held to maturity	4.2	4.6	3.6	-	4.3	8.9	-	-
Liabilities								
Customer accounts – corporate	0.9	5.5	2.6	-	4.9	5.8	5.8	-
Customer accounts – individuals	8.7	10.4	8.1	-	9.7	12.1	8.4	
Due to other banks	-	-	-	-	3.5	-	-	-
Debt securities in issue	9.4	10.0	-	-	9.1	10.0	-	-
Other borrowed funds	6.8	-	-	-	4.9	-	2.3	-

The sign "-" in the table above means that the Group does not have the respective assets or liabilities in corresponding currency.

28. Contingencies and Commitments

Legal proceedings. From time to time and in the normal course of business, claims against the Group are received. On the basis of Group's own estimates, internal and external professional advice the Management of the Group is of the opinion that no material losses will be incurred, and, accordingly, no provision has been made in these consolidated financial statements as at 31 December 2004 and 31 December 2003, respectively.

Tax legislation. Tax, currency and customs legislation of the Republic of Azerbaijan 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 Group may be challenged by the relevant tax authorities. As a result, significant additional taxes, penalties and interest may be assessed. Starting from the financial year ended 31 December 2001 fiscal periods remains open to review by the authorities in respect of taxes for three calendar years preceding the year of review. This clause of the Tax Code of the Republic of Azerbaijan is applied prospectively, i.e. does not apply to the financial years prior to 2001. Under certain legislative circumstances reviews may cover longer periods.

The tax consequence of transactions for Azerbaijani taxation purposes is frequently determined by the form, in which transactions are documented, and the underlying accounting treatment prescribed by Azerbaijani Accounting Rules. Accordingly, the Bank structures certain transactions so as to take advantage of such form driven determinations to reduce the overall effective tax rate of the Bank. The statement of income as presented in these consolidated financial statements includes reclassifications to reflect the underlying economic substance of those transactions. The effect of these reclassifications was not taken into consideration for the purposes of calculation of the Bank's profit before taxation or the tax charge recorded in these financial statements.

The Group's Management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained. Accordingly, as at 31 December 2004 no provision for potential tax liabilities had been recorded (2003: no provision).

28. Commitments and Contingent Liabilities (continued)

In accordance with Article 18 of the Tax Code of the Republic of Azerbaijan effective from 1 January 2002, tax authorities can make transfer pricing adjustments and impose additional tax liabilities in respect of transactions between inter-related entities, which are carried out at non-market prices, and all transactions, where price differs from the market price by more than 30%.

Capital commitments. As at 31 December 2004 and 31 December 2003 the Group had no significant capital commitments.

Operating lease commitments. Where the Group is the lessee the future minimum lease payments under non-cancelable operating leases are, as follows:

	2004	2003
Not later than 1 year	1,973	1,284
Later than 1 year and not later than 5 years	1,153	1,997
Later than 5 years	2,221	2,303
Total operating lease commitments	**5,347**	**5,584**

Credit related commitments. The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods, to which they relate, or cash deposits and, therefore, carry less risk than a direct borrowing.

Credit related commitments comprise loan commitments, letters of credit and guarantees. The contractual amount of these commitments represents the amount of exposure should the contract be fully drawn upon, the client defaults or the value of any existing collateral becomes worthless.

Outstanding credit related commitments are, as follows:

	2004	2003
Export letters of credit	1,024,549	1,010,115
Guarantees issued	663,461	616,383
Import letters of credit	654,112	593,182
Commitments to extend credit and un-drawn credit lines	156,417	92,614
Promissory notes issued by the Bank, guaranteed by the Government of the Republic of Azerbaijan and provided to the Eximbank (Turkey) against credit facilities as collateral	136,497	154,956
Less: Provision for losses on credit related commitments (Notes 16 and 24)	(3,857)	-
Total credit related commitments	**2,631,179**	**2,467,250**

Provision for losses in relation to uncovered letters of credit and letters of guarantee issued by the Bank, in the total amount of AZM 3,857 million has been recorded in the consolidated statement of income for the year ended 31 December 2004. Refer to Notes 16 and 24.

28. Commitments and Contingent Liabilities (continued)

Of the total export letters of credit as at 31 December 2004, those in the amount of AZM 873,245 million (31 December 2003: AZM 955,077 million) were issued by foreign banks for exports by the Azerbaijani state organisations related to the oil industry. All export letters of credit are covered by guarantees of foreign banks, and the Group does not bear any credit risk in relation to these export letters of credit.

Included in the total amount of guarantees issued by the Group are the guarantees issued by IBAR Moscow amounting to AZM 1,686 million (31 December 2003: AZM 834 million).

Included in the total amount of import letters of credit issued by the Group as at 31 December 2004 are import letters of credit issued by IBAR Moscow in the amount of AZM 14,266 million (31 December 2003: AZM 8,861 million).

Included in the total amount of un-drawn credit lines of the Group as at 31 December 2004 is a balance of un-drawn credit lines for IBAR Moscow amounting to AZM 20,445 million (31 December 2003 AZM 7,983 million).

As at 31 December 2004 credit related commitments in the amount of AZM 64,006 million (31 December 2003: AZM 120,509 million) are secured by the Azerbaijan government guarantees or blocked customer deposits. For blocked customer deposits under letters of credit and guarantees please refer to Note 13.

Commitments to extend credit represent unused portions of authorizations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit related commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

The total outstanding contractual amount of undrawn credit lines, letters of credit, and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded.

On 15 June 2004 the Bank signed a credit agreement where Azerbaijani company acted as a borrower, the Bank - as a guarantor of the Azerbaijani company, Commerzbank AG - as a lender and Export-Import Bank of the United States - as a guarantor of Commerzbank AG for a credit line of USD 17,046 thousand at the rate of LIBOR plus 0.10% per annum repayable in sixteen semi-annual instalments beginning from 5 November 2006 for the construction of a business and entertainment complex in the centre of Baku. As at 31 December 2004 an import letter of credit in the amount of USD 3,000 thousand or AZM 14,709 million has been issued for the borrower under the above credit facility. No payments have been made on above letter of credit as at 31 December 2004.

Intermediary loans. As at 31 December 2004 the Bank has borrowed funds amounting to AZM 146,796 million (31 December 2003: AZM 201,820 million) on behalf of the Government of the Republic of Azerbaijan from foreign banks and financial institutions for the purposes of providing intermediary loans to state-owned enterprises and government bodies of the Republic of Azerbaijan. The loan agreements signed between the Bank and these foreign banks and financial institutions are secured by unconditional letters of guarantee of the Government of the Republic of Azerbaijan, whereby the Government acts as the primary obligor in relation to these borrowings. As a result, the Bank acts as a loan-servicing agent for the Government of the Republic of Azerbaijan by transferring collected principal and interest payments to foreign banks and financial institutions and earns no interest margin on these loans.

As the Bank does not receive the benefits and does not bear the risks of these intermediary loans, the Bank has recorded these intermediary loans amounting as at 31 December 2004 to AZM 146,796 million (31 December 2003: AZM 201,820 million) in off-balance sheet accounts. Similarly funds received by the Bank to finance these intermediary loans in the corresponding amounts have also been recorded in off balance sheet accounts.

28. Commitments and Contingent Liabilities (continued)

Funds borrowed by the Bank for the purposes of providing intermediary loans are, as follows:

	2004	2003
Export Credit Bank of Turkey (Eximbank):		
- Trade finance facility	128,052	128,574
- Project finance facility	8,445	26,382
Bayerische Landesbank	10,299	25,843
Nichimen Europe Plc	-	13,809
National Westminster Bank	-	7,212
Total funds borrowed for the purposes of providing intermediary loans and transferred to off-balance sheet accounts	**146,796**	**201,820**

Funds borrowed with respect to the trade finance facility from Export Credit Bank of Turkey (Eximbank) were overdue as at 31 December 2004 and 31 December 2003. The outstanding amounts drawn on credit facilities from National Westminster Bank and Nichimen Europe Plc. were fully repaid during the year ended 31 December 2004.

29.Fair Value of Financial Instruments

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price. The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. The Republic of Azerbaijan continues to display characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may not be reflective of the values for financial instruments, which would be determined in an efficient, active market involving willing buyers and willing sellers. While Management has used available market information in estimating the fair value of financial instruments, the market information may not be fully reflective of the value that could be realised in the current circumstances.

Financial instruments carried at fair value. Cash and cash equivalents and investment securities available for sale are carried on the consolidated balance sheet at their fair value. As set out in Note 8, external independent market quotations were not available for certain investment securities available for sale. The fair value of these assets was determined by Management on the basis of results of recent sales of equity interests in the investees between unrelated third parties, consideration of other relevant information such as discounted cash flows and financial data of the investees and application of other valuation methodologies.

Loans originated carried at amortised cost less provision for impairment. The fair value of floating rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Refer to Notes 6 and 7 for the estimated fair values of due from other banks and loans and advances to customers, respectively.

Investment securities held to maturity. Fair value for investment securities held to maturity is based on quoted market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics, or in some cases by reference to the net tangible asset backing of the investee. Refer to Note 8 for the estimated fair value of investment securities held to maturity.

Liabilities carried at amortised cost. The fair value of instruments with a quoted market price is based on quoted market prices. The estimated fair value of instruments with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest rate instruments without a quoted market price is based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Refer to Notes 12, 13, 14 and 15 for the estimated fair values of due to other banks, customer accounts, debt securities in issue and other borrowed funds, respectively.

30. Related Party Transactions

For the purposes of these consolidated financial statements, 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 as defined by IAS 24 "Related Party Disclosures". In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Banking transactions are entered into in the normal course of business with significant shareholders, directors, subsidiaries, associates, companies, with which the Group has significant shareholders in common and other related parties. These transactions include settlements, loans, deposit taking, guarantees, trade finance and foreign currency transactions. These transactions are priced predominantly at market rates.
The outstanding balances of the transactions of the Group as at 31 December 2004 and 31 December 2003 with related parties are, as follows:

	2004		2003	
	Shareholders and management	***Other****	***Shareholders and management***	***Other***
Loans and advances to customers				
Loans and advances as at the year-end (contractual interest rates: 2004: 15%-24%; 2003: 18% - 21%)	139,874	-	5,478	26,053
Provision for impairment of loans and advances to customers as at year end	68,183	-	(130)	(3,975)
Interest income for the year	2,207	-	769	-
Due from other banks				
Term placements with resident banks (contractual interest rates: 2004: 7%- 18%)	48,681	-	-	-
Provision for impairment of due from banks as at year end	(1,681)	-	-	-
Interest income on due from other banks	952	-	-	-
Due to other banks				
Corresponding accounts of other banks as at year end	8,946	-	7,944	-
Customer accounts				
Current/settlements accounts as at year end	8,431	48	4,208	-
Term deposits outstanding as at the year end (contractual interest rates: 2004: 5%; 2003: 5%)	-	25	-	25
Interest expense for the year	-	1	-	48
Credit related commitments				
Letters of guarantees as at year end	29,482	-	148	-
Fee and commission income for the year	3,257	-	2,527	46
Fee and commission expense for the year	-	(288)	(97)	(65)
Other expense			-	
Staff costs	(1,595)	-	(1,448)	-
Other operating expenses	-	(2,434)	-	(2,077)
Insurance operations				
Insurance premiums receivable	-	2,984	-	245
Insurance premiums payable	-	(38)	-	(50)
Insurance premiums written during the year	-	8,825	-	1,006
Insurance premiums ceded during the year	-	(366)	-	(421)
Insurance related commission income	-	22	-	-
Insurance related commission expense	-	(443)	-	-

*Other related parties - include balances and transactions with associates, joint ventures and other related parties.

30. Related Party Transactions (continued)

During 2004 the Bank sold a building under construction owned by the Bank to a trade union owned by the Bank's employees for net cash proceeds of AZM 3,279 million, which equaled to its net book value as at the date of disposal. Refer to Note 11.

During the year ended 31 December 2004 the total remuneration of members of the Board of Directors and key management personnel of the Group including discretionary compensation amounted to AZM 2,440 million (2003: AZM 2,607 million).

During 2004 the Bank sold a building to one of its shareholders. A loss on disposal of the office premises in the amount of AZM 886 million is included in transfers to shareholders other than dividends in the consolidated statement of changes in shareholders' equity. Refer to Note 11.

As at 31 December 2004 the Bank's employees hold 7.9% of the total share capital of the Bank, which amounts to AZM 7,859 million (31 December 2003: 7.4% and AZM 3,679 million respectively)

The Bank is controlled by the Government of the Republic of Azerbaijan. Therefore, in accordance with IAS 24 transactions with the Government, the Ministry of Finance of the Republic of Azerbaijan and state-owned companies of the Republic of Azerbaijan are not included in the above related party transactions.

31. Consolidated Subsidiaries and Associates

The subsidiaries and associates of the Bank included in these consolidated financial statements are presented in the table below:

Name	Subsidiary/ associate	Nature of business	Country of Registration	Percentage of ownership	
				2004	**2003**
Baku Inter-Bank Currency Exchange	Associate	Currency exchange	Republic of Azerbaijan	20.0%	20.0%
Trans-service	Joint venture	Parking	Republic of Azerbaijan	50.0%	50.0%
IBAR Moscow	Subsidiary	Banking	Russian Federation	100.0%	100.0%
International Insurance Company	Subsidiary	Insurance	Republic of Azerbaijan	100.0%	100.0%
Inter Protect Re AG	Subsidiary	Reinsurance	Switzerland	100.0%	100.0%
Azericard Limited	Subsidiary	Plastic cards	Republic of Azerbaijan	100.0%	100.0%
Azerileasing	Subsidiary	Leasing	Republic of Azerbaijan	100.0%	100.0%
"Inter" Professional football club	Subsidiary	Professional sports	Republic of Azerbaijan	100.0%	100.0%

The financial statements of Trans-service were included in the consolidated financial statements of the Group as investment in joint venture as at 31 December 2003 for the first time, using equity accounting method. Net share of losses of Trans-service accumulated prior to 1 January 2003 totalling AZM 683 million has been recorded as part of other movements in the consolidated statement of shareholders equity of the Group for year ended 31 December 2003. Refer to Note 9.

On 7 October 2002 the Group's Insurance Subsidiary, International Insurance Company, has established a reinsurance company, Inter Protect Re AG. It was registered in Zurich, Switzerland. The Insurance Subsidiary of the Group transferred CHF 1,450 thousand or AZM 4,635 million as contribution to the share capital and reserves of Inter Protect Re AG. Of the total amount transferred, CHF 1,200 thousand was used to pay for 1,000 shares at CHF 1,200 par value each, CHF 200 thousand as a payment for the share premium and the remaining CHF 50 thousand as contribution to capital reserves of the company.

31. Consolidated Subsidiaries and Associates (continued)

The financial statements of Azerileasing, the Group's leasing subsidiary, were included in the consolidated financial statements of the Group for the first time as at 31 December 2003. The accumulated losses of Azerileasing prior to 1 January 2003 totaling AZM 1,373 million were recorded as part of other movements in the consolidated statement of shareholders equity of the Group for the year ended 31 December 2003.

On 20 July 2004 "Inter" professional football club was established and registered with the Ministry of Justice of the Republic of Azerbaijan. In accordance with the foundation agreement signed between the Bank and Azericard Limited the charter capital of the professional football club was set at AZM 2,011 million, of which AZM 1,500 million was contributed by the Bank and the remaining AZM 511 million by Azericard Limited. This club is a member of the Azerbaijan Football Federations Association and is currently among the top five professional football clubs in the country as per the preliminary results of the national football tournament. During the year the Bank provided financial aid to "Inter" in the amount of AZM 3,000 million and Azericard Limited in the amount of AZM 1,600 million, respectively. As at 31 December 2004 financial statements of "Inter" professional football club were included in consolidated financial statements of the Group as a fully owned subsidiary of the Bank for the first time.

32. Acquisition

On 26 July 2003 the Group acquired the remaining 50% of the share capital of Azericard Limited from Bank Standard (formerly Most Bank Azerbaijan). The consideration paid to Bank Standard for the acquisition of its minority stake in the company amounted to AZM 12,293 million. The acquired subsidiary contributed operating income, after deduction of minority interest, of AZM 4,848 million to the Group for the year ended 31 December 2003. The details of the minority interest acquired and the goodwill arising are, as follows:

	26 July 2003
Cash and cash equivalents	1,524
Term placements with banks	5,015
Trade accounts receivable	1,045
Premises and equipment	528
Intangible assets	569
Other assets	825
Deferred tax assets	315
Deferred revenue	(632)
Other liabilities	(827)
Fair value of net assets of subsidiary at the date of acquisition of minority interest	**8,362**
Less: Consideration paid	(4,181)
Fair value of acquired minority interest in net assets of subsidiary in 2003	**4,181**
Goodwill arising from the acquisition of minority interest	8,112
Total purchase consideration	**12,293**
Less: fair value of payable arising on acquisition	(-)
Less: cash and cash equivalents in subsidiary acquired	(1,524)
Cash outflow on acquisition	**10,769**

Goodwill is amortized on straight line basis over the period of ten years. The amortization charge of AZM 812 million was recorded in the consolidated statement of income for the year ended 31 December 2004 with respect to the above goodwill. Refer to Note 24.

32. Acquisition (continued)

Movements in the amount of goodwill in 2004 and 2003 are, as follows:

	2004	2003
Opening balance at 1 January	**8,112**	**-**
Goodwill arising from the acquisition of minority interest	-	8,112
Amortization of goodwill (Note 24)	(812)	-
Closing balance as at 31 December	**7,300**	**8,112**

33. Subsequent Events

On 1 March 2005 a Presidential Decree was enacted outlining the process for privatization of the state shareholding in the Bank's share capital. Based on this Decree, the government will have to gradually reduce its shareholding by selling its existing shares or by issuing additional shares at open markets, including international financial markets.

On 15 April 2005, at the annual meeting of shareholders of the Bank the current chairman of the Board of Directors of the Bank Mr. Jahangir Hajiyev was re-elected for a second four year term.

In February 2005, in accordance with the protocol similar to the one signed in December 2004 between the Bank and the Ministry of Finance of the Republic of Azerbaijan, the Bank has further offset bad loans and related accrued interest in the amount of AZM 9,906 million and AZM 2,732 million, respectively, against dividends payable to the Ministry of Finance of the Republic of Azerbaijan. Refer to Notes 7 and 26.