CONTENTS

WHAT ARE WE UNITED BY?

Azerbaijan

We all are united by our Motherland - Azerbaijan, its mountains and valleys, rivers and lakes, towns and villages, gardens and fields, our antiquity monuments and nature reserves. But our ultimate value is our people, regardless age, sex, ethnic identity. Our people, who work and create on this land generation by generation; our people, who are able to care about and defend this land, who esteem their ancestry, keep their culture and traditions. Our people - tied to each other by thousand links, - you, me, he, she. All together we make up our common home - Azerbaijan.

General Information on the Bank

Full Name:

Joint Stock Commercial Bank «The International Bank of Azerbaijan Republic»

WHAT ARE WE UNITED BY?

INTERNATIONAL BANK OF AZERBAIJAN

Abbreviated Name:	IBA
Date of Establishment:	January 10, 1992
Head Office's Address:	Azerbaijan, Baku, AZ1005, Nizami street, 67
IN:	9900000213
Code:	805250
SWIFT:	IBAZ AZ 2X
Correspondent Account:	0137010002031

Contacts

Telephone:	(99412) 930091, 984159, 989127, 987593
Fax:	(99412) 934091, 989128
Telex:	142159 DOST AI / 142370 IBAZ AI
Reuters Dealing:	AZBB
E-mail:	ibar@ibar.az
Web:	www.ibar.az

License

- General license of the National Bank of Azerbaijan to carry out banking activities of December 30, 1992
- License of the professional participant of the securities market provided by the State Committee on Securities under the President of Azerbaijan Republic for implementation of:
  – dealer operations, the license dated April 02, 2002;
  – broking operations, the license dated May 06, 2002
- Permission of the State Customs Department of the Republic of Azerbaijan on the right to act as a guarantor before the customs departments dated March 05, 2002

Membership in proffessional associations, exchanges and payment systems

- Azerbaijan Banks Association (ABA)
- Baku Interbank Currency Exchange (BICEX)
- Baku Stock Exchange (BSE)
- International payment system MasterCard International
- International payment system VISA International
- Society for Worldwide Interbank Financial Telecommunications (SWIFT)
- International information-dealing system Reuters
- International payment system MoneyGram

Main financial indicators

by 31.12.2002,	million AZM
Assets	2 413 693
Owner's capital	132 330
Net profit	30 544

Additional information

Shareholders	23 legal entities and 1400 individuals
Employees number	968
Branch network	34 branches, 4 mini-offices, 104 service points
Subsidiary bank	«The International Bank of Azerbaijan - Moscow»
Representative office	1 (London)
Correspondent banks	64
Clients	16 148 corporate customers and 57 570 individuals
Auditor	«PriseWaterhouseCoopers» (since 1995)

Shareholders and Authorized capital stock

Shareholders	Authorized share capital	
	Amount (million AZM)	*Share (%)*
Ministry of Finance	23 500	68,9
Other legal persons (23)	7 523	22,1
Bank staff (192 people)	1 677	4,9
Other physical persons (1208 people)	1 410	4,1
Authorized share capital – total	**34 110**	**100.0**

Governing bodies of IBA

General Meeting of shareholders
Supervisory Council
Chairman of the Board
Board

Supervisory Council

Chairman	ASADOV, HEYDAR KHANISH Deputy Minister of Finance of Azerbaijan Republic, Director General of the Central National Treasury
Council Members	HASANOV, KARAM AVAZ Director of the Department of the administration of the state property and privatization, the Ministry of Economic Development of Azerbaijan Republic
	IBRAHIMOV, HEYDAR RZA Chairman of the Board, «Kovsar Bank»
	ALEKPEROV, FIZULI HASAN President of «Improtex Group»
	MAMMADOV, YASHAR ZEYNALABDIN Head of the internal borrowing Department, Ministry of Finance of Azerbaijan Republic
	MUSTAFAYEV, FIKRET AHMED Director of «Bazis Ltd.» company
	MAHARRAMOV, VIDADI MAMED Representative of minority shareholders

Board

Chairman	HAJIYEV, JAHANGIR FEVZI
Board Members	RZAYEV, RAUF VAFADAR First deputy Chairman of the Board
	AKBAROV, VAGIF YAHYA Deputy chairman of the Board
	MAMEDOV, ASKER NURMAMED Deputy chairman of the Board
	MUSTAFAYEV, EMIL MUSTAFA Deputy chairman of the Board
	ABDULLAYEV, FUAD RAHIM Chairman of the Board of «IBA-Moscow»
	ALIYEV, AKIF AKHMEDIYA Credit Department Director, Chairman of the Credit Committee
	IBRAHIMOV, NAZIM ASABALI Central Administration Department Director
	ISMAYILOV, ROVSHAN ISMAYIL Central Treasury Department Director

Statement of the Chairman of the Board

Dear shareholders, customers and partners, friends and colleagues,

The previous year was one of the most successful in the history of the Bank and excellent results were achieved practically on all directions of our activities. Furthermore, it should be taken into account that the consolidated balance for the reported period reflected the outcomes of our two newly created, and hence not fully stable in financial terms, subsidiaries «IBA – Moscow» bank and International Insurance Company, along with other enterprises in whose share capital we have a significant stake.

The main results of the IBA for the year 2002 speak for themselves. Assets increased by 24.8% to AZM 2414 billion, representing 8.2% of Azerbaijan's GDP and 57.1% of total assets of the national banking system comprising 46 commercial banks. Equity capital reached AZM 132.3 billion (a 56.8% increase). We have also achieved a considerable customer base growth (by 44.6%), which had reached by the end of reported year 74 thousands clients. Consistent evolvement characterizes the branch network covering practically all regions of the country. Operational income stood at AZM 139.5 billion, or 23.8% more than in the previous year. Net profit of the IBA was more than AZM 30.5 billion.

I don't want to bore you with numbers and details - they are extensively covered in the report. The main thing is that implementing the undertaken tasks the Bank was able to increase by the end of 2002 its resource, technological and human potential and developed a thoroughly thought-out business model strengthening thereby Bank's leading positions on the main segments of the domestic financial market. I am glad to point out that in the past year the IBA not only confirmed and reinforced its won by team efforts status of the strongest, systematic national credit institution unequivocally recognized in domestic as well as international business circles, but also made an important step on the path of establishing itself as universal bank of nation-wide significance - a Bank of National Development, which fully comprehending its responsibilities before the society contributes to Azerbaijan's rapid and effective progress through market reforms and wholesome integration in the world economy.

Striving to strengthen its positions on the corporate banking market, the IBA has been consistently increasing the quality and expanding the spectrum of the offered services and broadening the assortment of banking products offered to individuals. The offered types of deposits target customer groups' with different income and social security characteristics.

It is an undisputed fact that more and more people prefer to keep their savings in the IBA. By the total value of deposits of the population we have outrun other commercial banks of the country. This is an evidence of the increasing confidence in the IBA and success of promotional efforts for its services.

A similar situation is observed on banking cards of the international payment systems. The range of card products and services provided through them has widened. Our network as well as other elements of «plastic money» servicing infrastructure develop rapidly. All of these results determined a considerable growth in plastic card business's profitability.

Also increased the number of electronic transaction system users. Progress in the sphere of high-tech products is especially noteworthy, since it reflects economic technological and professional development of the Bank. Here is vividly manifested our readiness to meet and, sometimes, get ahead of our customers' requirements. In doing this, the Bank also pursues an object of public significance, since the introduction of such products helps to broaden the sphere of electronic settlements, makes more transparent financial reporting and cash flows of business.

Modern banking techniques and informational technologies also benefit traditional activities of the IBA. Among the latter, crediting has continued to evolve encompassing such new activities as participation along with leading international banking institutions in syndicated credits, a development that undoubtedly enhances the IBA's reputation abroad. On the whole, the Bank has been the leading «player» on Azerbaijan's credit market, being actively involved in financing projects of nation-wide economic significance.

International operations are a part and parcel of IBA's activities. They include servicing participants of foreign economic activities, contacts and relations with foreign financial institutions, correspondent relations and work with foreign companies doing business in Azerbaijan. On the backdrop of growing interest of foreign investors in the Azerbaijani economy the IBA has developed steady long-term relations with some biggest international financial institutions. Considerably increased the limits extended by them to the IBA as well as the term of discounts, which indicates a qualitatively new level of those relations.

Speaking about international dimension of the IBA business one should particularly indicate the creation of IBA's two big subsidiaries - a bank in Moscow and insurance company in Baku. €10 million constituting the share capital of the «IBA Moscow» is the largest national investments abroad. Beside purely economic benefits, the operations of this bank contribute to better ties with Azerbaijani diaspora in Russia. As regards the International Insurance Company with the share capital of $5 million, which makes 43% of aggregate capital of the national insurance institutions, it has managed in a short span of time to achieve and secure good position on the domestic market. In the time of Azerbaijan's independence, there have been no commensurate investments made by domestic companies from their own funds.

Another noteworthy event was the opening of representative office in London. It is intended to promote active cooperation with European business entities and the IBA's image as an advanced Azerbaijani financial institution - a «pioneer» in business of integrating national banking institutions in the Western capital markets.

Another evidence of recognition of the IBA's reliability and effectiveness was its receiving once again in 2002 the awards of such world-known business publications as «Euromoney», The Banker, Global Finance, and for the first time «The Golden Medallion» of Geneva Higher Institute of Business and Management, and Swiss Business-Club.

On this background, it seems logical that in August 2002 Fitch IBCA an international rating agency raised the rating of the Bank's long-term operations from a stable level of «B» up to a «B+ positive», one step short of Azerbaijan's sovereign rating («BB-»).

These priorities will retain their significance in the future, shaping the parameters and thrust of the IBA strategic plan for 2003-2005. That programme document defines the strategic goals and mission of the Bank and contains forecasts by the main indicators for the stated period.

In the framework of the approved strategy, project (modules) are specified which were approved in terms of operation plans for 2003 and are necessary for meeting the accepted objectives.

The strategic and tactical tasks undertaken by the IBA are expected to make the prospective activities of the Bank rich and responsible. I would like to assure you of our commitment to further maintaining an exemplary efficient and dependable performance of the International Bank of Azerbaijan.

In the end, I would like to express my sincere gratitude to our Customers for their invariable trust, loyalty and willingness to cooperate, to Shareholders - for their support and commitment to our common course, to Partners - for their understanding, support and reliability, to our Colleagues and all of our Staff for conscientious and professional work.

I wish you successes, and well-being. Let our joint efforts be in the future as fruitful as they have been to date, being a guarantee of new successes and enabling us to reach new horizons.

Jahangir Hajiyev
The Chairman of the Board

The Management of the International Bank of Azerbaijan

MAMMADOV ASGAR NURMAMMAD
Deputy Chairman of the Board

RZAYEV RAUF VAFADAR
First Deputy Chairman of the Board

AKBAROV VAGIF YAHYA
Deputy Chairman of the Board

MUSTAFAYEV EMIL MUSTAFA
Deputy Chairman of the Board

MAZAHIR DADASHOV
Head of Intra-Bank Audit

ELMAR SADIGOV
Informational Technologies
Department Director

FUAD MOURSHOUDLI
Strategy Planning and Marketing
Department Director

GUBAD HUSEYNOV
Bank Security Department Director

ANAR SULTANOV
Customer Service
Department Director

AYDIN SALIMOV
Cash Management
Department Director

ABDULLAYEV FUAD RAHIM
Chairman of the Board of «IBA - Moscow»,
Member of the Board of IBA

IBRAHIMOV NAZIM ASABALI
Central Administration Department Director

ALIYEV AKIF AHMADIYA
Credit Department Director

ISMAYILOV ROVSHAN ISMAYIL
Central Treasury Department Director

SAYAD YOLCHUYEV
Advisor to the Chairman of the Board

ZUMRUD AGHAYEVA
Correspondent Accounts
and Settlements Department Director

RAUF KHALILOV
Legal Department Director

ROVSHAN KARIMOV
Bank Cards Department Director

Economy and banking system of Azerbaijan in 2002

Overview of macroeconomic situation

In 2002 the International Bank of Azerbaijan carried out its activities on the background of positive changes in the economy and social spheres of the country. The goverment's course on creation of a balanced market economy contributes to the harmonious integration of independent Azerbaijan into "Global Community" and enhances its international image.
As a result of reforms, stable basis was established for the development of economy.

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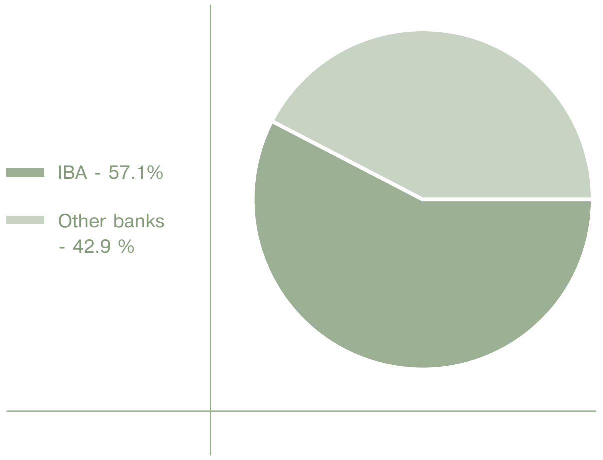
A number of legislative acts have been adopted, and the programmes have been worked out for the development of different sectors of economy, the measures have been undertaken on privatization of the state property or on its transfer under long-term management.

In 2002, GDP exceeded AZM 29,6 trillion or $6.1 billion, which was 10.6% more than in the previous year. This indicator per capita increased by 9.8%, comprising AZM 3676.0 thousand or $756.3. The composition of GDP by origin was 34.9% in the industry, 14.2% – agriculture, 10.8% – construction, 7.8% – transport, 2.0% – communication, social and unofficial services – 30.3% accordingly. About $^3/_4$ GDP (73%) was produced by private sector.

Total volume of the industrial production increased by 4,5% compared with 2001 and reached AZM 17,7 trillion. Public sector accounted for 48% of industry including 59% in processing. In 2002 the volume of petroleum output was 15.2 million tons (an increase of 291 thousand tons), gas recovery – 5,2 billion m^3, power generation – 18,4 billion kw/hour. The processing industry was demonstrates a tendency of sustained growth.

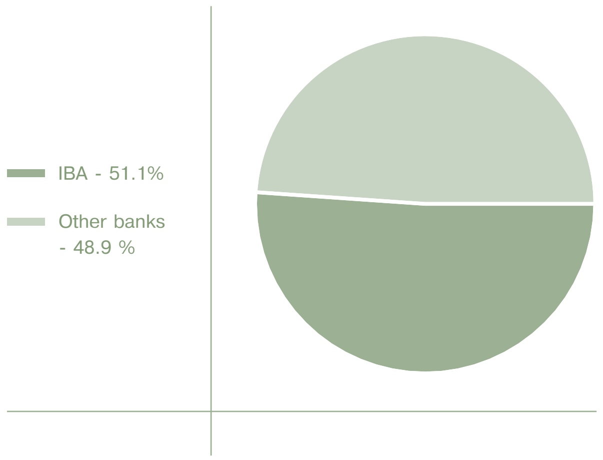
Share of IBA in total banks' assets of the country (%)



One of the main factors, determining the development of Azerbaijan, was the growth of investments first of all, in connection with the implementation of long-term projects on the development and exploitation of new oil and gas fields. In 2002 $2596,6 million worth of investments were made in the economy of the country, which 1,7 times exceeds the respective indicator for 2001. On the whole, in terms of investments per capita, Azerbaijan occupies one of the first places among the CIS and Eastern European countries.

Development of economy is reflected in the increase of welfare and living standards of the population. In 2002 the nominal incomes of the population increased by 11.4% and made up AZM 21.2 trillion, while the expenditures – respectively 10,1% and AZM 20,7 trillion, nominal average salary – 21.2% and AZM 312.9 thousand, including that in public sector – AZM 215.3 thousand, and in private sector – AZM 610.8 thousand. Growing consumer demand contributed to the increase of retail trade turnover by 9.6% and services by 7.1%. Meanwhile, the Consumer Price Index was just 2.8%.

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



Foreign trade in goods and services in 2002 was $4128.2 million, including export – $2304.9 million, import – $1823.3 million. Trade balance was positive in the amount of $481.6 million.

2002 was also successful for public finances. Budget revenues increased by 16.1% within a year and constituted AZM 4551.2 billion, and the expenditures – 15.5% and AZM 4658.6 billion respectively. The budget deficit in 2002 was on the level of AZM 107.4 billion, less than 0.4% of GDP. By January 1, 2003 the external debt stood at $1270 million or 22 percent of GDP, but per capita – $156, which was one of the lowest indicators among developing countries.

International rating agency Fitch IBCA in its report dated July 25, 2002, noted the positive tendency of growth of independent rating of Azerbaijan Republic from «Stable progressive» to «Positive progressive» and confirmed it for long term loans in foreign and local currency on the level of «BB-», and for short term loans – on the level of «B».

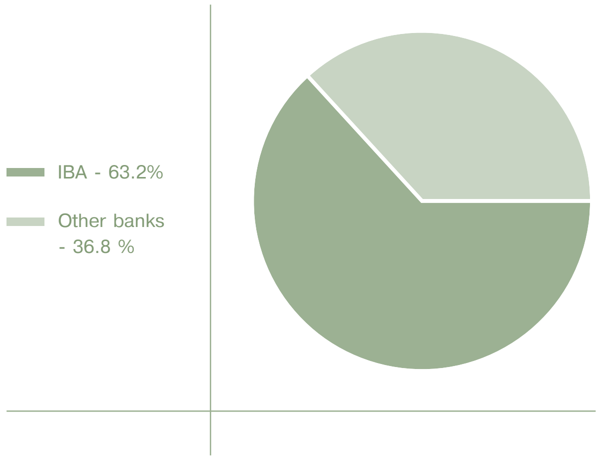
One of the key factors of Azerbaijan economy's revival has been a balanced monetary policy aimed at financial stabilization, stability of the national

currency and keeping inflation at the optimal level.

Development of banking sector

Dynamic development of the national economy in 2002 enhanced positive trends in the banking sphere: total assets of banks constituted 14.2% of GDP as against 13.7% for the previous year, credit investments – 7.6% as against 7,4% and attracted funds – 7.7% as against 7.4%.

Share of IBA in the total volume of term deposits made by companies with the banks of the country (%)



As of the end of 2002, 46 commercial banks were registered in Azerbaijan, including 15 banks with foreign capital. Their actual authorized share capital increased by 16.4% over the year and reached AZM 629.0 billion. The number of bank branches has increased from 191 to 220, while that of non-bank credit organizations – to 47.

The qualitative indicators of banks' performance (liquidity, profitability, safety of the transactions) have improved. Greater attention has been paid to the use of modern technologies and application of modern information-controlling systems. Because of the increase of capitalization and liabilities, total assets of banks increased from the beginning of the year by 15.8% and made up AZM 4224.8 billion. Structure and the quality of the assets have improved, the volume of loans granted to the real sector of economy has grown up: for the beginning of 2003 their ratio to the total assets of the banking sector was 53.4%.

In 2002 total volume of credit investments of commercial banks in real sector constituted AZM 2254.0 billion, which was 14% more than in the

previous year. Interest rates on loans also decreased.

The ratio of customer funds to the total liabilities of banks increased from 60.4% to 62.2% over the year. Total value of the deposits of population during this period increased by 31.1% and reached AZM 767.3 billion. Growth by this indicator is related to considerable extent to the increase in their real incomes. The deposits of organizations and institutions increased by AZM 115.8 billion. At the same time, there has been a tendency of lengthening terms of deposits.

Despite a certain improvement of the situation, the condition of the banking sector cannot be considered very good. Assets of banks make up only 15% of GDP. The bank risks are still high, which is explained by the narrowness of financial markets, low solvency and transparency of the majority of enterprises.

Strategic task for the development of banking sector is the establishment of conditions for the strengthening of banks' stability and their greater activity. The main prerequisites of its implementation are: increasing owner's equity; attraction of stable and long term liabilities; provision of credit support to the domestic producers and their business activities; widening the range of provided services; introduction and development of modern banking technologies; higher quality of management and professional training of the personnel; establishment of effective system of guaranteeing the deposits of citizens; development of infrastructure of securities market.

Share of IBA in the total volume of people's savings (%)

Position of IBA in main segments of the banking market

Analysis of market positions, achieved by the International Bank of Azerbaijan according to the results of 2002, clearly demonstrates its dominant role in the banking market of the country, which has been stable for several years. IBA accounts for 57.1% of total assets and over 15.8% of consolidated capital of domestic banking system fall. The share of the Bank in the market of private deposits is 38.0%. Amounts from legal persons have increased, enabling IBA to occupy 82.4% of that market. 47.5% of all credits of commercial banks are provided by the International Bank of Azerbaijan. IBA`s share in the market of bank cards was considerable - 75.8%.

Stages of IBA's development: ten years in the banking market of Azerbaijan

1992-1995. Starting to operate in 1990 as the Azerbaijan branch of the USSR «Vneshekonombank», the IBA was transformed into a joint-stock commercial bank with the decree of the President of Azerbaijan Republic

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№ 545 dated January 10, 1992, with control stock belonging to the government, and in December 1992 received the license to provide banking services. In difficult political, social and economic conditions, the International Bank of Azerbaijan made its first steps in establishing itself on the domestic market as a **specialized bank:** the system of correspondent relations was established; share issue was made; initial, although imperfect, types of branches were setup. In 1993, IBA played an active role in the establishment of Baku Interbank Currency Exchange, became a member of the Society for Worldwide Interbank Financial Telecommunications (SWIFT). At the end of 1994 and in the beginning of 1995 the Bank became the member of well-known international systems: information-dealing - Reuters and payment - Europay International.

1996-2000. Market reforms at the beginning of the second half of 90s required substantial changes in IBA activity and a prompt response to the changing situation. The Bank's main tasks were to maintain its integrity, to overcome the limits of narrow specialization, to develop bank services, to attract deposits, to establish material and technical basis and regional network of branches, providing necessary conditions for the customer service on the whole territory of the country.

As for the economy of the country on the whole, 1996 was a turning point for IBA, when a new strategy of its development was approved, aimed at following model of **full-service bank.** The following period was marked by a

complete restructuring of the operational spheres of the Bank and their orientation on the broad customer basis, with further widening of the spectrum of bank products and services, covering of considerable segment of corporate clients, introduction of automated banking technologies, entering new sectors of financial market, and improvement of management organization.

Retail banking became one of the priorities of IBA activity. Significant advances took place in the bank cards business. In 1997 IBA became a full - fledged member of international payment system Visa International. Since then the Bank has started to issue plastic cards Eurocard and MasterCard, and starting from 1998 – Visa International. At the same time IBA started to implement salary projects, widened branch networks being able to attract new clients and stepped into the international capital markets. In 1999, the International Bank became a founder and member of Baku Stock Exchange, and established a leasing company. By the end of 2000 IBA developed its own resource, technological and staff potential, achieved efficient management of retail business, strengthening thereby leading position of the Bank in the main segments of the financial market of Azerbaijan. The Bank became the winner in nominations of influential magazines: «Euromoney» (from 1997) and «The Banker» (from 2000).

2001 – 2002. Positive tendencies in social-economic life of the country and fundamental renewal of main guidelines of development on the eve of the XXI century required from the IBA, which transformed by that time into a modern full-service bank, to develop principally new approaches to corporate management and conduct of banking business, and establish more substantial opportunities for increasing their efficiency. That's why the Bank management made a decision to carry out necessary structural reforms.

Reorganization of the management system of IBA began. First of all,

duplicating sub-units were merged, new departments were established, the staff was reinforced with able people with systematic thinking and advanced professional skills capable of putting and deciding on challenging tasks, the elements of innovative management and advanced information technologies were consistently introduced. In 2002 the subsidiary bank «IBA-Moscow» was established, the representative office was opened in London, and the International Insurance Company was founded.

All these allowed the Bank to firmly strengthen its positions in the market, to create a sound basis for a qualitatively new level of service, to form the image of the **most outstanding, reliable, progressive and developed bank in the Caucasus region.** The international rating agency Fitch IBCA awarded IBA with the «B+ positive» rating in August 2002. Geneva High School of Business and Management and Swiss Business Club awarded IBA with «Gold Medallion», reputable American publication «Global Finance» awarded IBA as well.

Having gone, together with the banking system of the independant Azerbaijan, through the difficult process of development, the International Bank of Azerbaijan has transmuted from a narrowly specialized bank – through universalization – into the **Bank of National Development.**

2002: In what ways it was special for IBA

Last year was the 10-year anniversary of the International Bank of Azerbaijan. IBA's contribution to the development of national economy, its participation in realization of the social tasks, consistent integration of Azerbaijan into the world community, stability and efficiency of the work of personnel are highly appreciated by the partners, the clients of the Bank, and the population of the country.

Last year was the year of adoption of the «Strategic Development plan of IBA for 2003-2005 years». The results for 2002 prove the readiness and capability of the Bank to systematically move towards the solution of strategic tasks, and allow to appraise the feasibility of the main conditions of the Strategy as a reliable guideline for of the IBA development in the medium term.

Last year was the year of expansion of IBA activities beyond Azerbaijan. The

significant events of the year were the opening of our subsidiary bank in Moscow and the representative office in London. More close has become the collaboration with foreign financial institutions who show interests in Azerbaijan in terms of financing long-term projects. The issues of integration with Georgian banking structures have come under consideration as well as the ways of forming the Caucasian financial center.

Last year was the year of strengthening the financial corporation headed by IBA. As a big corporate structure, IBA widens its activities in the financial sector, being guided by the principle of reasonable diversification of business as a guarantee of stable development. For the first time, the PriceWaterhouse-Coopers auditing company gave its opinion on the consolidated accounts of IBA Group for 2002, where along with the Bank includes its subsidiary structures – «IBA-Moscow», «International Insurance Company» and processing company «AzeriCard».

Last year was the first year of positioning the IBA as the Bank of National Development. The International Bank of Azerbaijan is the only national credit institution in the financial market of the country that has received the general recognition as a bank of a national scale.

The main outcomes of IBA activities in 2002

Dynamics of main indicators

The financial results of the Bank in 2002 demonstrated higher dynamics of growth than in previous years. On the background of intensifying competition in the banking sector and decreasing profitability on a number of segments, the IBA has not weaken, but substantially consolidated its leading position in the financial market of Azerbaijan, which was reflected in the main financial-economic indicators of the Bank.

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	2001		2002		2003 (1st half year)	
Indicators/years	*Million AZM*	*Mln.$*	*Million AZM*	*Mln.$*	*Million AZM*	*Mln.$*
Assets,	1 934 290	405,7	2 413 693	493,3	2 419 660	492,1
including:						
Credits provided to Clients	966 171	202,6	1 070 210	218,7	1 211 467	246,4
Liabilities	1 849 899	387,9	2 277 980	465.5	2 253 106	458,2
including:						
Term and saving deposits	650 139	136,4	1 236 160	252,6	960 297	195,3
Capital	84 391	17,7	132 330	27,0	162 373	33,0
including:						
Statutory capital	11 466	2,4	34 110	7,0	50 000	10,2
Income	189 526	39,7	249 728	51,0	146 769	29,9
including:						
Interest income	88 034	18,5	107 279	21,9	63 316	12,9
Commission charges	53 872	11,3	77 011	15,7	69 611	14,2
Expenses	140 767	29,5	202 935	41,5	110 512	22,5
Profit	48 759	10,2	46 793	9,6	36 257	7,4
including:						
Net profit	35 139	7,4	30 544	6,2	21 049	4,3

The Bank has paid great attention to the balance of assets and liabilities, as well as increasing the capitalization level. Management of the assets and liabilities of the Bank for the last year was based on complex system of analysis and risk management. When faced with a choice between profitability and risk during making decision on allocation of funds, the preference has been given to transactions with lower risk.

Active and thoughtout policy of the Bank for the reporting year allowed to increase the total assets to AZM 2.4 trillion or by 24.8%. As in previous years the main direction of the allocation of funds was loans. Loans (AZM 1070.2 billion), the principal asset, constitute less than the half (44.3%) of the total assets.

The second major asset – «Cash and short term funds» include mandatory reserves in central banks of Azerbaijan and Russia (as a subsidiary bank of «IBA-Moscow») – AZM 172,4 billion (the growth against 2001 was by 30% or AZM 39.8 billion) and funds on correspondent accounts and overnight deposits at foreign banks were AZM 641.1 billion (the growth of - 41.2% or AZM 187.1 billion accordingly).

IBA investments in securities within the country in 2002 were insignificant because of underdevelopment of the stock market and in compliance with the selection of other priorities in the investment policy of the Bank. At the same time, the entry of the Bank into the equity market of Russia should also be noted, where «Gasprombank»'s promissory notes were acquired.

During 2002 the liabilities of IBA increased by 23.1%, and that was connected, first of all, with the growth of customers' and partners' trust in the Bank, the quality and variety of the proposed savings and services, flexible tariff policy of the Bank. The best indicator of the confidence of the clients in Bank and the high level of the service provided to them is the data on the attracted funds. Dynamics of this figure in 2002 continued to be high: in comparison with 2001 it grew more than 1.3 times and exceeded AZM 1.9 trillion (without the funds of correspondent banks)

In order to achieve an optimum ratio of assets and liabilities by periods, the Bank focused mainly on attracting long-term resources. Consequently, during the year the amount of the term deposits doubled (first of all, on the account of funds of corporate clients) and reached AZM 1.24 trillion, while their share in aggregated amounts on the accounts of the clients rose from 44.6% to 64.8%. The share of the term deposits in the structure of liabilities rose from 35.2% to 54.2%. The growth of deposits with the term of over 1 year (7.4 times) was a positive trend. Noteworthy attraction of the term deposits allowed the Bank to improve liquidity position, and its clients to increase the profitability of their temporarily free funds.

In the reported period the share of funds on customer accounts in AZM grew from 7.1% to 13.4%, and their total amount made up AZM 255.2 billion. The amount of the funds on dollar accounts (AZM 1.65 trillion), even though their share has diminished, exceeds the corresponding figure in local currency by almost 6.5 times. Comparied with the previous year, the volume of the long term funds obtained with the certificates of deposit increased by 29.2% or AZM 6.3 billion: by the end of 2002 their amount totalled about AZM 28.0 billion.

As a result of lower interest rates in the Western countries, as well as of its stable financial condition, the Bank continued attracting the funds by having obtained new financing limits from foreign banks. European Bank for Reconstruction and Development, Bayerische Landesbank, National

Westminster Bank Plc, Nichimen Europe Plc, Black Sea Bank of Trade and Development and other banks are among the partners of IBA. On the whole, the size of the borrowings from international financial institutions exceeded AZM 304.3 billion.

In the reporting year the size of the attracted means, consisting of the funds on the correspondent accounts and interbank deposits, increased by 23.7% and made up AZM 17.2 billion. Considerable part is the means on the correspondent LORO accounts of the banks operating in Azerbaijan, for the majority of which IBA is a clearing agent.

Increase of the IBA liabilities was accompanied by the adequate capital growth. On the account of the growth of the retained profit of the Bank and increase in share capital in 2002, the shareholders' equity increased about 1.6 times and reached AZM 132.3 billion by the end of the year. Its share in the structure of the total liabilities constituted 5.5% (against 4.4% in 2001).

Higher growth rate of the shareholders' equity compared with that of assets (56.8% against 24.8%) allowed the Bank to increase the coverage of risk assets

with its own funds, to improve the capital adequacy ratio and considerably increase the possibilities for the development of credit operations.

After the full formation of the previously announced authorized capital and bringing it up to AZM 20.0 billion, extraordinary meeting of the shareholders in June 2002 made a decision on the increase of the authorized capital by AZM 30 billion. By the end of the reporting year, shareholders paid AZM 14.1 billion out of that amount and thereby the size of the fund reached AZM 34.1 billion. Such a significant increase of the capital - AZM 22.6 billion or three times compared with the beginning of 2002 – is undoubtedly a good basis for expansion of the Bank's activities. (For information: after the reporting year, i.e. already in May 2003, the shareholders paid in full the remaining part of their share in the capital and the authorized capital at present is AZM 50 billion). More tangible growth of the internal funds was provided on the account of financial results of the Bank activity – retained profit, which increased by AZM 45.8 billion or 1.9 times.

Increased capitalization of IBA, which can be regarded as one of the critical competitive advantages of the Bank, appeared to be the major factor effectively impacting its financial viability. That ensures the Bank's capability for the expansion of the scope of active operations.

Qualitative changes in the dynamics and structure of the assets directly influenced the formation of profits and expenditures. According to the results of 2002, the total income increased by 31.8% over 2001 and made up AZM 249,7 billion. In terms of its composition interest income accounted for 43.0% (AZM 107.3 billion), and the non-interest income for 57.0% (AZM 142.4 billion). One of the main sources of the Bank's profit determining its high level of profitability is credit operations. Total amount of interest income from lending increased by about 1.4 times and made up AZM 89.1 billion, while its share in the total revenue increased to 35.7% (by 1.9 percent point).

Some growth of profits is observed from the transactions with the securities (of AZM 2.0 billion). In the conditions of underdevelopment of the securities market of the country, stable exchange rate and low refinancing rates of NBA, the said indicators should be considered optimal. Interest income on interbank crediting and correspondent accounts have decreased, and their share in the Bank's total revenues was insignificant (3.9%).

The growth of customer base, development of accounting-teller service and documentary business, widening of range of products and services contributed to the increase of the commission revenues of the Bank by 43.0% to AZM 77.0 billion, and their share in the revenues to 30.8% in 2002. About $^3/_4$ of the total amount of the commission revenues was obtained on the account of commissions received from the cash (34.7%) and clearing (25.5%) transactions and also the transactions with plastic cards (14.4%). Commissions from the documentary transactions and servicing loans were 23.7% of total commission revenues. Revenues from the foreign currency transactions increased by 30.3% and reached AZM 49.3 billion. This indicator reflects the efficiency of the Bank's performance on the currency market, significant number of customers that operate in this segment and increasing impact of foreign exchange market on the financial outcomes of the Bank.

Total costs of the Bank in the reported year were AZM 202.9 billion, an increase of 44.2% over 2001. Interest expense on the attracted resources remains a critical item of total expenses: they increased by AZM 17.2 billion or 53.6% (from AZM 32.1 billion to AZM 49.4 billion), which was explained by more intensive growth of the physical volume of the attracted funds. A predominant share of the expences falls on the payment of interests on deposits of corporate customers and individuals (AZM 46.3 billion). In 2002 those costs accounted for 22.8% of the

total costs of the Bank. In the current situation, the present tendency may be accepted as normal and it was envisaged in IBA`s business plan for 2001-2003.

The share of non-interest expenses on the whole increased by 1.5% as against the previous year. The share of the expenses for the provision of the Bank activities in the total expenses decreased by 2% over the reported year. At the same time, their nominal value has increased, which is linked with the considerable widening of the Bank's activity and branch network, as well as the increase of staff. The latter in turn, resulted in the increase of the staff expense including their salaries and bonuses. Increased expenses on creation of provisions for possible losses on NOSTRO accounts, impairment of due from other banks and loans (by 26.2%) can be explained by the desire to secure the Bank's further financial stability.

The main result, evidenced by the financial report of 2002 is the Bank's sucsess in ensuring profitability. The International Bank of Azerbaijan ended year 2002 with high balance profit – AZM 46.8 billion. Net profit after taxes was AZM 30.5 billion. Other figures show the positive dynamics as well. Thus, the net interest income increased by more than AZM 2 billion or by 3.6%; net commission income - AZM 22.0 billion and 45.7% respectively.

Such indicators as return on assets (ROA – 1.4%) and return on equity (ROE – 28.2%) confirm the efficiency of the Bank operations.

WHAT ARE WE UNITED BY?

INTERNATIONAL BANK OF AZERBAIJAN

The principal activities of IBA in 2002

Corporate customers service

Corporate business has traditionally been the core of IBA activities. In the reported period IBA tried to strengthen its position in that segment. Its efforts to meet this end included attracting as much customers as possible, establishing long-term partnership relations with financially sound enterprises as well as increasing their share in the composition of attracted funds.

Today, IBA`s corporate business is the universal system of financial services comprising about 140 banking products, and many financial schemes, which allows to meet demands of all categories of customers. The Bank is working hard to improve its infrastructure, to create resource and informational base in order to conduct the business of the customers successfully, based on accurate understanding of their individual demands and offering the same quality service both for large companies and for the medium and small entreprises. One should also take into account extensive branch network, establishment of a subsidiary bank in the Russian banking market, business diversification of IBA (insurance, leasing, processing), and in this connection favorable conditions for the complex services to the enterprises and organizations.

In its customer policy in the corporate segment the Bank has been following such main principles as constructive dialogue and establishment of strategic cooperation with clients, constant attention to their problems, development of business environment allowing full realization of the potential of dependable partnership, comfortable service, prompt decision making and information transparency.

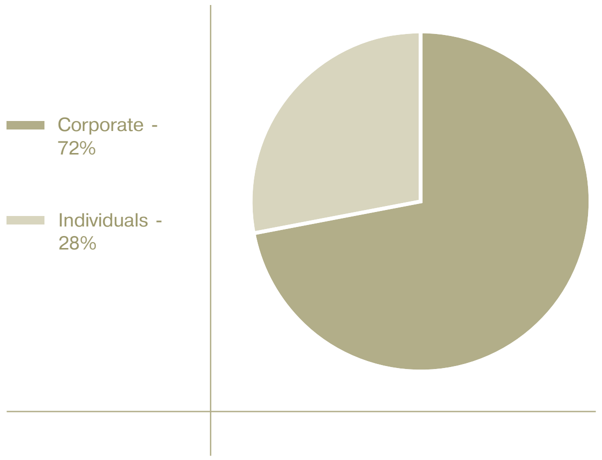
2002 became the year of a considerable growth of IBA`s customer base. Bank's share in the domestic market of corporate deposits increased to 82.4% and the total number of corporate customers has increased 1.7 time over the year reaching 16.2 thousand. The clients are offered various options of realization of each product, as well as competitive price conditions differentiated by terms and value. The greatest development have acquired the services on placement of temporary free cash, cash-account services, loan and currency transactions. Use of l/c instruments, corporate plastic cards, project finance, collection services and a system of «Bank-Client» remote service have expanded.

The geography of servicing customers` financial flows embraces Europe, America and Asia.

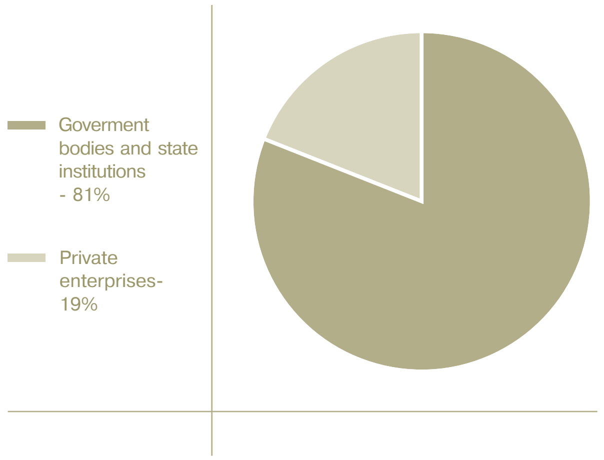
The same culture of relations with customers - atmosphere of benevolent cooperation - is maintained in all the structures of the Bank, ensuring convenience of work for both sides and expediting the process of service rendering.

The objective quantitative growth of IBA`s customer base is accompanied by the

Deposits by individuals and companies (%)



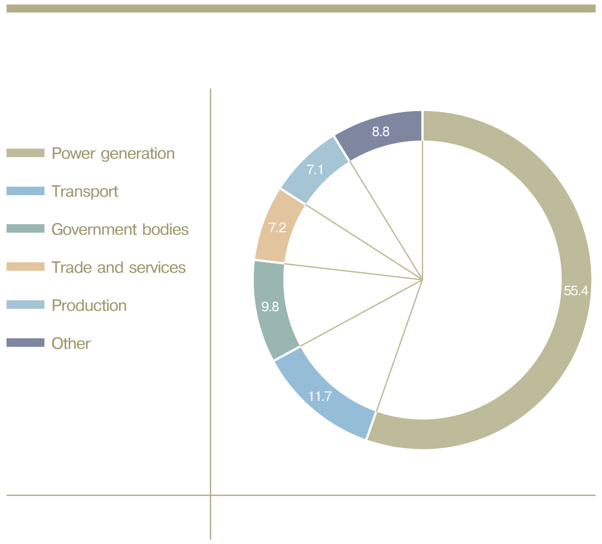
Deposits by public and private sectors (%)



improvement of its qualitative characteristics. As of the end of 2002 balances in the accounts of legal entities exceeded AZM 1.5 trillion, i.e. a growth of 21.2%. This indicator makes up 67.3% of liability amounts of the Bank. That was the result of successful implementation of the Bank's customer policy, the essence of which is the long term relations with clients on the basis of mutual understanding, trust and partnership, combination of standard technology and individual approach to every client, taking into account his or her personal demands.

Analysis of the industry composition of customers - legal entities shows that growth in the number of new clients was 2.7 times in industrial enterprises, in construction – 2.3, transportation - 1.7 times. The tendency of decreasing share of state enterprises in the customer base of the Bank still remains. Meanwhile, the share of private enterprises in the total number of clients continues to grow.

Deposits diversification by sectors of economy (%)

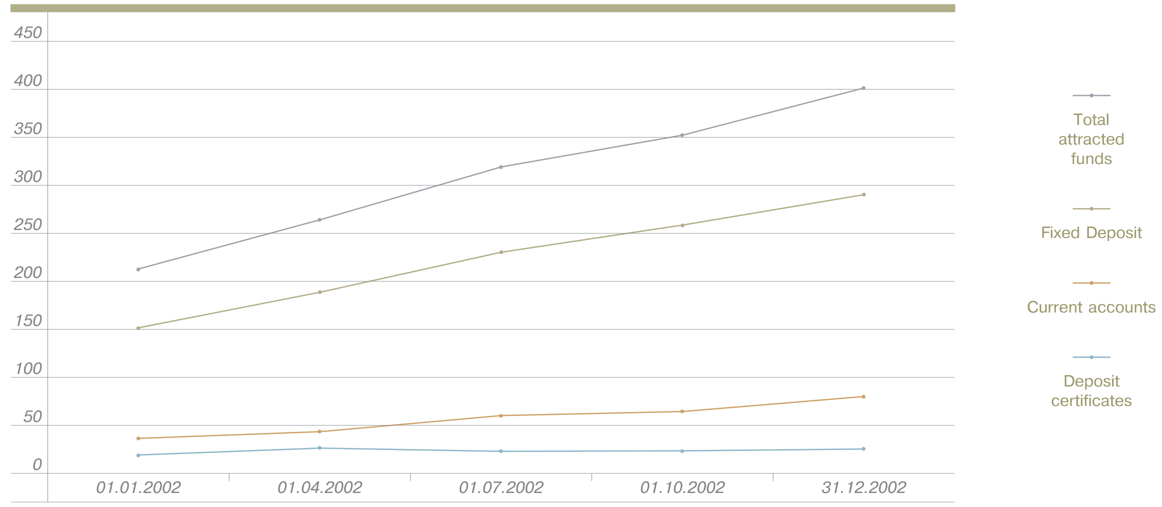


In the sphere of corporate business in 2003 the Bank intends to maintain the strategic line on developing and offering new banking products and services directed to the optimization of customer accounts, supporting and extending their businesses. Cooperation with enterprises of real sector of the economy will continue to be the main direction of the Bank's customer base broadening strategy.

Servicing individuals

Retail service market is one of the priorities of IBA activities. Practically, all large domestic banks have declared the development of this business as their priority objective, which has lead to the intensification of the competition. Last year the Bank increased number of services to physical persons and strengthened its position in this market.

Individuals funds' growth tendency (bln. AZM)



Working out the strategy of work with individuals, the Bank, first of all, focused on the active development of product range, oriented to the interests of population, provision of high quality financial service, long term trust relations, trying thereby best to meet the growing demands of clients.

Nowadays, all groups of the population use the Bank's services. Only in 2002 the number of customers-individuals increased 2.1 times. Offered types of deposits (altogether 8) «Purpose deposit for children», «Youth deposit», «Pension deposit», «Universal deposit», «Capital deposit», etc cover special groups of clients of various income and social protection levels. Taking into account its social mission as well as established behaviour stereotypes and saving motives of these population groups, the Bank carries out balanced approach to the determination of interest rates on deposits trying thereby to stimulate the activeness of depositors.

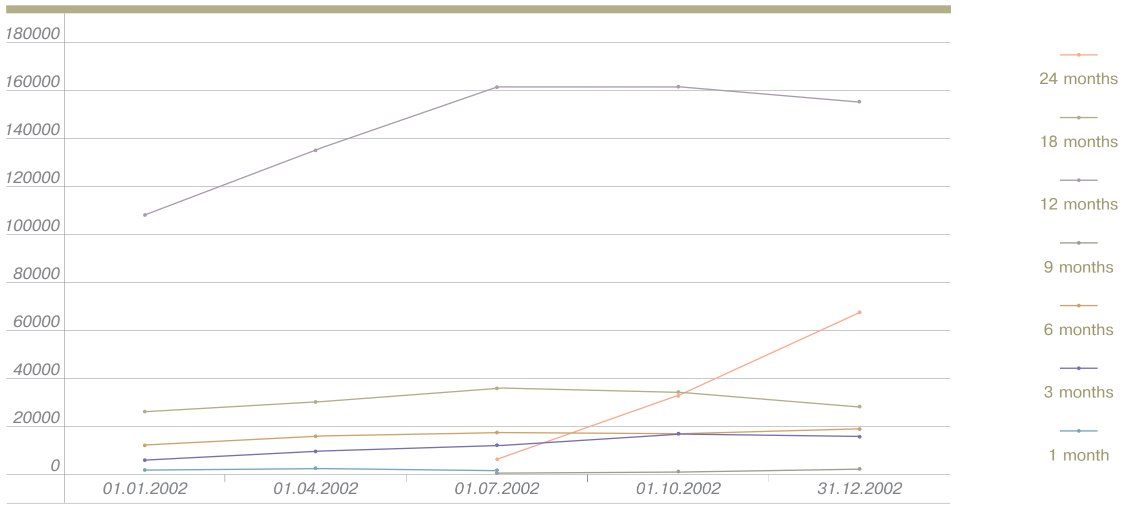
As a result only in 2002 the total number of IBA depositors increased more than 2.8 times and reached 13.1 thousands. At the end of 2002 balance on current and deposit accounts of physical persons amounted to AZM 373.6 billion (94% growth). By the volume of private deposits IBA holds the first place among Azerbaijani commercial banks. Demand deposits increased more than 2.1 times to AZM 82.4 billion, and term deposits 1.9 times and to AZM 291.3 billion respectively. The most rapid growth was observed on the deposits with more than one year duration. Their share in the deposit portfolio of physical persons was 87.7% including 24 months period - 23.5%, 18 months – 9.7% and 12 months - 54.5%. It should be noted that these indicators have been achieved on the backdrop of 2% reduction of all interest rates. In 2002, deposit certificates in the amount of AZM 6.4 billion were sold, while total volume of their realization to date has reached AZM 28.0 billion.

The customers have been offered new types of services, including deposits like «Savings for children» and «Summer savings». To improve servicing to Customer Support customers informational service has been set up, which gives information about all kinds of banking products and services presented by the IBA, location of branches and ATMs, existing prices and commissions, fees on opening accounts in the bank.

In the framework of Private Banking project service to individuals from VIP category is provided. According to the results of the year, aggregated balances for VIP customer accounts exceeded AZM 144.3 billion, which makes up 38.6% of total amounts on the accounts of clients. As for today the Bank offers them first class banking service using the most state of the art banking technologies, and based on such principles as complexity, strict confidentiality and maximum attention to the client's desires.

The Bank's service on the utility and mobile communication payments has widened as well. IBA has become more active in this area in response to the decree of the President of Azerbaijan Republic «On Implementation of state budget of AR for 2002» where concrete tasks have been put before IBA on ensuring the banking service of the aforementioned payments. With this end the specialists of the Bank and «AzeriKard» processing center has developed an appropriate system, on the basis of which today more than 100 service points receive payments from the population.

Term deposits growth tendency (individuals) (mln. AZM)



IBA offers the customers services on travelers' cheques American Express, Thomas Cook or Visa. The customers of the Bank have appreciated the advantages of this service as the safest way of transporting and keeping money during travels and visits. They have been offered IBA's cheques to owner's name denominated in USD and British pounds and issued by such renowned international banks as Bankers Trust or Barclays Bank. The Bank also renders services on collection, i.e. cashing these cheques.

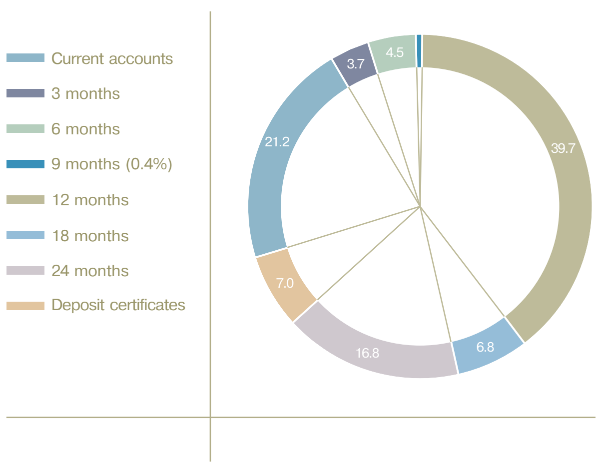
Providing to the customers additional services on more convenient ways of international payments the Bank increased in 2002 the volume of transactions on the prompt money transfer system MoneyGramm by more than 1.5 times, which made up more than $14.8 million. Cooperation with MoneyGramm allows the Bank's customers to execute transfers in hard currency in the real-time operation mode. The main criteria of transfers on this system are promptness, reliability and convenience.

A new prompt money transfer system has been established between IBA-Moscow and Baku head office, which allows to carry out money transfers to Azerbaijan actually from any corner of Russia, as well from Azerbaijan to Russia without opening account and with minimum charges.

The Bank offers people currency exchange operations through a wide net of exchange points and operational cash stations the number of which reached 70 by the end of 2002.

The IBA consistently improves work with physical persons, continues to introduce modern banking products and master new directions of work with private clients trying to anticipate their demands. The result of systematic and coordinated work in the sphere of retail business, study of the demand and timely response to the needs of clients has been a significant inflow of new depositors to the Bank. Such approach to the development of retail business, will allow to return to the banking circulation a significant portion of money being in the hands of population.

Structure of the attracted funds (%)



The Bank is going to extend in 2003 the range of services provided to individuals, first of all, by increasing the effectiveness and quality of services.

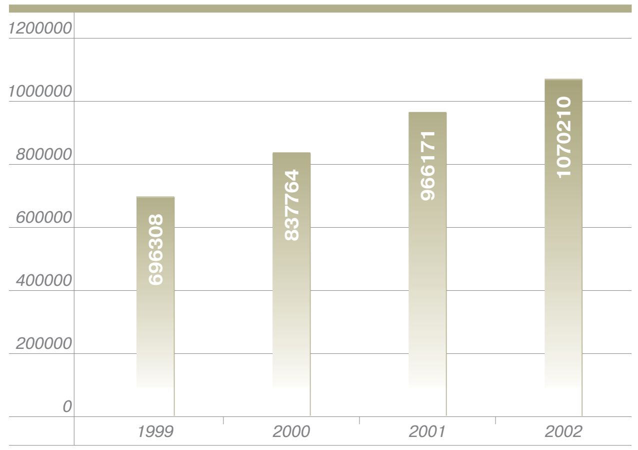
Development of a new marketing strategy allowing to take into account the requirements and needs of various categories of customers most adequately remains a key task in the development of business with retail clients.

Credit operations

Credit policy of IBA in 2002 was directed at ensuring profitability while meeting the conditions of acceptable risk of investment and full satisfaction of clients' demands in financing of their projects. In the condition of rising demand on credit resources, the key priority of this policy was to form qualitative and diversified loan portfolio.

Using its experience in crediting, the Bank has increased the number of reliable borrowers, expanded lending programmes both for corporate customers and physical persons. On the volume of credit investments in the national economy IBA holds the leading position in the banking system of the country: its share in the credit market of the country exceeds 47%. By the end of 2002 the loan portfolio of the Bank was more than AZM 1.23 trillion.

IBA's credit portfolio (mln. AZM)



Compared to 2001 this indicator has increased by 11.3%.

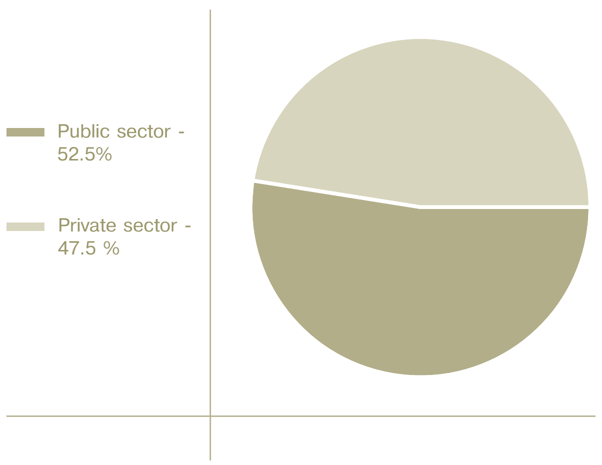
By term, the loans granted for 1 to 12 month make up 50.9% (up to 6 month-31.3%; over 6 month-19.6%). The growth was most pronounced on the loans with the payment maturity up to 6 month (62.8%). On the whole, there was a tendency of increasing the share of operations with corporate clients (taking into account the highest stable profit from them). Loans to enterprises and organizations grew by 8.5% or by AZM 92.4 billion (from AZM 1087.6 billion to AZM 1180,0 billion). Their share in the assets was 48.9%. The volume of crediting the physical persons in the reported year increased almost 2,4 times and amounted to AZM 58.8 billion. In the structure of credit portfolio corporate clients make up 95.3%, and individuals – 4.7%.

Interest income on granted loans has grown by AZM 25.0 billion or by 38.9% (from AZM 64.1 billion to AZM 89.1 billion). Interbank loans decreased by AZM 4.4 billion or by 5.1%.

IBA has been carrying out the process of granting loans in conformance with crediting rules and risk management requirements. This has been achieved thanks to establishment of crediting limits, careful analysis and selection of loan applications, system of sanctioning the loan granting that is used by the Bank, continuous monitoring on the changes of financial conditions of borrowers during whole period of crediting, determining in early stages the cases of bad loans and working on their repayments, and the Bank's system of control over the risks on each stage of crediting.

Loans to the public sector amounted to AZM 650.4 billion or 52.5% of the total volume of loan portfolio, which is 5.5% higher than in 2001. This tendency is linked with the growth of crediting the oil sector and state concerns «Azerkimya», «Azerenerji», «Azal» and Ministry of Culture of Azerbaijan. The share of loans to the private sector made up 47.5% (AZM 588.4 billion).

Allocation of the credit investments by public and private sectors of the economy (%)



Growing customer base allowed the Bank to distribute risks of credit portfolio to different sectors of economy. On the whole, in terms of diversification of risks, the credit portfolio of IBA is well balanced both by amounts and term of crediting, and by the sectors of national economy.

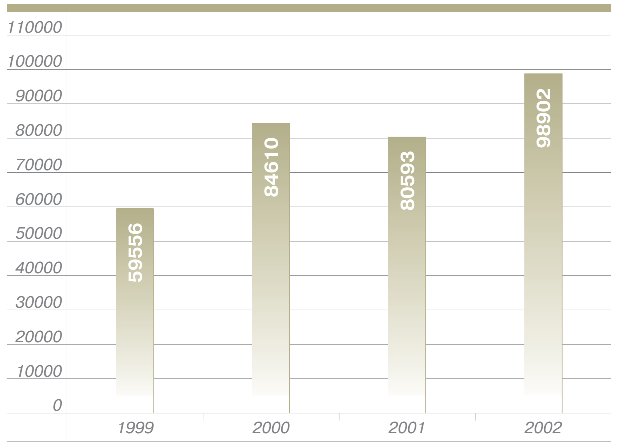
The Bank has sustained tendency of increasing investment in the real sector. The following sectors accounted for the major share of the total volume of credit: manufacturing – AZM 558.8 billion (22.9% growth), or 45.1% of credit portfolio (growth by 4.2 percent point); air transport - AZM 214.2 billion (25.3% growth) or 17.3% (by 1.9%), construction – AZM 62.0 billion (1.9 times), or 5.0% (by 2.0%). The operations on interbank crediting have been limited, mainly, by short-term placement of resources for the purposes of regulating liquidity, and their share in the loan portfolio decreased to 3.6%.

Beside big borrowers, the Bank increases support to small and medium size enterprises. Working with them the Bank monitors the development of their business, moving clients to more qualitative level of performance.

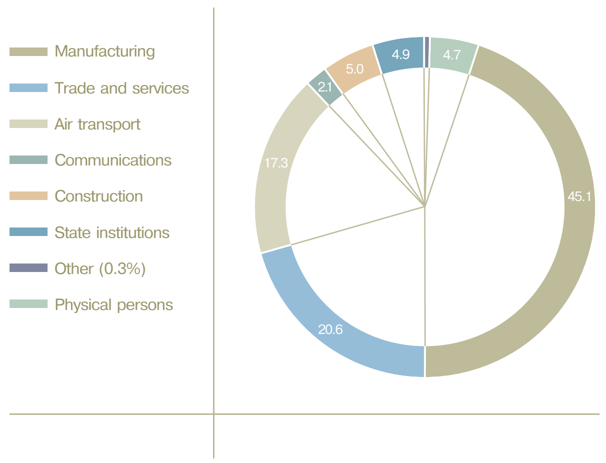
A balanced policy in forming liabilities carried out by the IBA allows to attract comparatively cheap resources within the country and consistently to reduce interest rates on loans. Although the monetary resources of foreign counterparts are still needed, one should note such recent trend as demand in funds being satisfied at the expense of internal sources. This is one more convincing example indicative of positive developments in the national economy and the International Bank plays a significant role in this process.

Another positive event was accelerated development of crediting the physical persons for whom the Bank offers various types of consumer crediting programmes, capable to a significant degree to become an instrument of stimulating and satisfying the demands of people for the goods of long term use (cars, furniture, audio-visual devices, etc) and other important needs (education, tourism, etc). During 2002 people were granted for these purposes loans totalling over AZM 58 billion (growth of almost 2.4 times), and their share in the loan portfolio rose to 4.7% (against 2.2% in 2001).

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



Allocation of credit portfolio by the sectors (%)



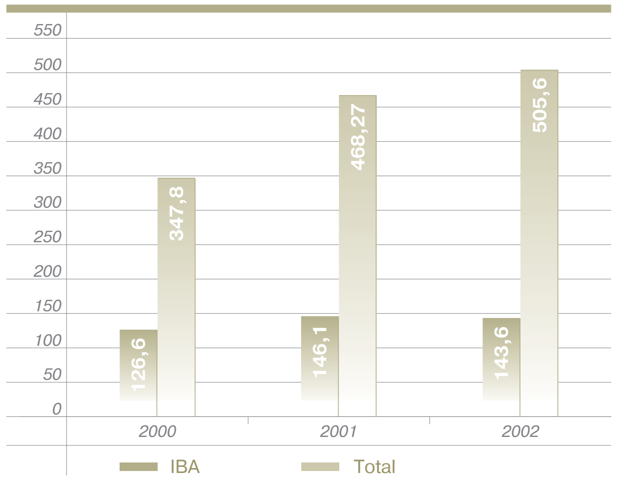
An important aspect of crediting activity is the analysis of acceptability and sufficiency of collateral on the credit offered by the borrower and its proper registration. The valuation of the mortgaged property is carried out based on its market price taking into account appropriate costs of the Bank, changes in the market, and time needed for the realization of property.

In order to make up for possible losses on the loans the Bank formed in 2002 reserve fund fully covering bad loans. Its volume was AZM 168.6 billion or 13.6% of the total volume of loan portfolio of IBA (13.2% in 2001).

Credit operations of IBA played a critical role in forming its income. In 2002 the amount of interest income from credit activity was over AZM 98.9 billion, which was 22.7% more than the corresponding indicator for the last year.

Their share in the aggregate income of the Bank was 39.6%.

Share of IBA in market of the State Short-term Treasury bills (bln. AZM)



The extensive branch network of the Bank contributes, to a large extent, to the development the credit business of IBA. By the end of 2002, the total amount of loans granted by the IBA branches was AZM 300.2 billion or 24.2% of all loans of IBA. This is 3 times more than in 2001.

In 2003 credit policy will be built on the basis of studying most promissing directions of investment. The main stress will be made on forming quality credit portfolio, diversified by the industry origins of borrowers as well as terms and types of loans.

Investments and securities

The main source of income from transactions with securities in 2002 was the operations with treasury bills (TBs) and securities of Russian corporate issuers, as well as the brokerage service.

In 2002, AZM 143.6 billion was invested in TBs, which made up 28.4% of the total issue of those securities. Income on these transactions was AZM 7.2 billion, which was AZM 2.0 bln more than in the previous year.

Along with this, IBA provided out brokering service for the clients for AZM 21.7 billion. Some decrease of this indicator as against 2001 is explained by the decrease in the number of the auctions in connection with the favorable condition of the state budget and lack of exigent need in borrowed funds.

The IBA's on-going activity in Russian securities market should be viewed as a positive fact. For the purpose of restructuring the portfolio and preparing the appropriate shares for sale, a professional participant of the Russian stock market was selected.

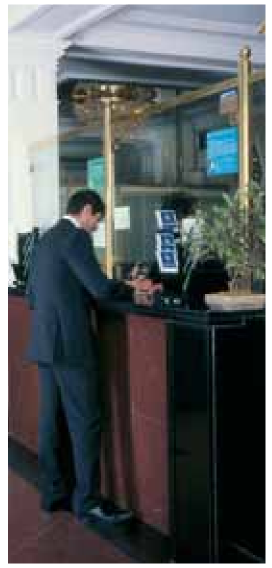
IBA operations in the Russian market was not limited only by the stock: at the end of the expired year, the Bank together with its subsidiary bank «IBA-Moscow» purchased at discount Euro-denominated promissory notes of the Russian issuers – «Gasprom» and «Vneshtorgbank» – for $8 million and $4 million respectively.

One of the main tasks of the Bank in 2003 is to further strengthen its positions on the market of securities. In perspective, it is planned to expand the spectrum of services in this market, including extending the arsenal of the financial tools, and developing the network of services for retail investors, (also with use of Internet-technology). IBA intends to promote its own promissory notes programme, giving thereby an impulse to the creation of organized promissory note market in the country.

IBA expands the sphere of its activity in the financial sector, following the principle of reasonable business diversification as a guarantee of the sustainable development. The main task in this connection is the search for the favourable opportunities for investment. During the reporting period IBA made investments in the authorized capital of enterprises formed with the Bank's participation. The amount of those investments was AZM 67.3 billion. Those investments were directed to the creation of two new institutions – International Insurance Company and a subsidiary bank «IBA-Moscow» (their authorized capital is fully owned by IBA), and increase of the share of the Bank in leasing company «Azerleasing». Last year, control over the activities of subsidiary and joint institutions was notably strengthened.

Hereinbelow is presented a brief description of the group of companies, established by the International Bank of Azerbaijan.

Subsidiary Bank of IBA «The International Bank of Azerbaijan – Moscow» («IBA-Moscow») – resident bank with 100% of foreign capital founded on January 24, 2002. Authorized share capital of the Bank was €10 million. Already over 100 enterprises, corporations, companies, etc. are serviced by it here. Correspondent accounts have been opened in many Russian banks, which allows to transfer funds to Azerbaijan practically from any point in Russia and respectively from Azerbaijan to Russia. «IBA-Moscow» performed as a participant of the market of interbank crediting and as a bank-creditor joined a syndicate on financing one of the big banks of Russia – «Ak Bars» (Republic of Tatarstan) – together with the leading banks of Europe and America (Raiffeisenbank, Dresdner Bank, Bankgesellschaft Berlin, American Express Bank, Union Bank of California, International Moscow Bank, Guarantee-bank). The share of the Bank was $1 million.



International Insurance Company, the shares of which fully belong to IBA, was founded in April 2002. Its authorized share capital is AZM 24 billion, or about 43% of the total capital of Azerbaijan insurance companies. It provides services on all types of insurance. IIC also renders services to other insurance companies of Azerbaijan on reinsurance, which until now was considered a prerogative of the foreign reinsurance companies because of the lack of such strong insurer.

Cooperation of IBA with IIC has produced a unique for our market system making possible risk management for the clients, joint (cross) sales, lead to the reduction of the cost of bank and insurance products and services, and development of new products meeting the demands of our clients. Such collaboration creates conditions for the organization of complex insurance protection of the Bank, credit and leasing operations.

Processing company «AzeriKard» was founded by IBA together with «Most-Bank Azerbaijan». This processing center is certified with the international payment systems VISA, MasterCard and American Express and serves 26 banks in Azerbaijan and abroad. It exercises the functions of a clearing and approving center for plastic cards. Advanced system has been installed here for the servicing of card operations, which contributes to the increase of the share of electronic payments in the money turnover.

In the mid-2001, PriceWaterhouse-Coopers assessed the market value of «Azericard» at $4.7 million, which means almost triple growth of the value of the investments of IBA in share capital of that enterprise.

Leasing Company «Azerileasing» was more active in 2002. It was planned that 2003 would be critical from the point of view of its further development. It is a sure opportunity for reducing bank risks, reaching a new level of business relations with the customers, ensuring strong control over the provision of funds and effectively expanding the sphere of the Bank's influence. IBA views leasing as a highly promising aspect of its business and intends to intensify the work in this direction.

«Trans-service» JV – the enterprise, managing the largest underground parking lot of Baku city.

«A-Visual» and «Business-Rabita» are respectively advertising company and communication enterprise. The main assignment of each of them is servicing of activities of IBA.

Insurance Company «Bashak-Inam» is a joint Azerbaijan-Turkish enterprise, 10% of the authorized share capital of which belongs to IBA. Due to the establishment of its own insurance company, Bank is planning to abandon the company in 2003.

Baku Interbank Currency Exchange was founded in 1994 with the participation of the National Bank of Azerbaijan and 4 other banks operating at the time, including IBA. IBA controls 20% of the capital of BICE. As of the end of 2002, its share capital was AZM 19.2 billion, which means multiple growth in the value of the IBA investment in the share capital of the Exchange.

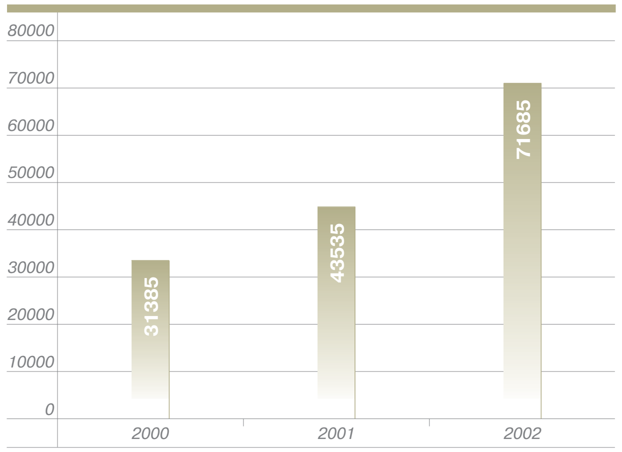
Baku Stock Exchange was founded in 2000. IBA is both a shareholder and member of BSE.

Plastic cards

In 2002 the Bank paid much attention to the business of bank cards, that considerably developed over the last years. The programme of development of electronic settlements with the use of plastic cards, has a general economic significance, and is considered one of the priorities of the IBA activities.

Being a full member of the international payment systems VISA International and MasterCard International, IBA renders wide range of services in the sphere of issuing and servicing of plastic cards. Share of IBA in the «card» market of the country exceeded 75%.

SCA turnover's growth in volume (thous. USD)

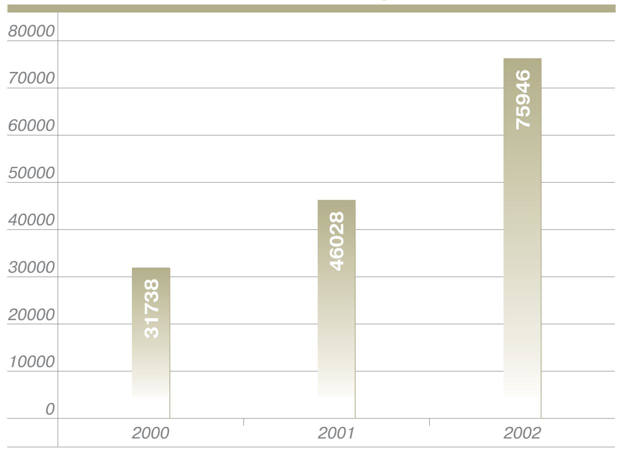


Compared to 2001, the total number of the issued cards increased 2.4 times and reached 28 thousands. The value of transactions on the card accounts was more than $71.6 million (the growth over the year was 64.7%). By the volume of issue and total turnover of card transactions, IBA is the undisputable leader in the country. The existence of its own processing company allowed the Bank to considerably reduce costs, increase the quality of service for the holders of international plastic cards and create new banking products. By the end of 2002 the balances in the card accounts increased to 40 billion AZM, the growth during the year being over 70%.

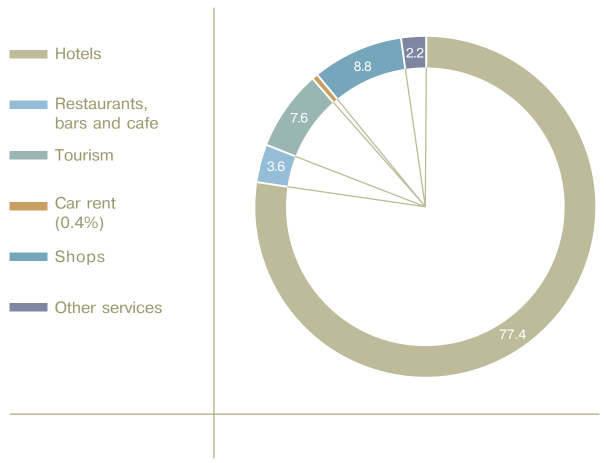
High rates of progress on the market of the card products and the efforts of the Bank to provide the plastic cards holders with the maximum volume of services required the development of the infrastructure of their servicing. The network of cash dispensers (ATM) of the International Bank of Azerbaijan covers the cities of Baku, Sumgait, Ganja and Mingechevir. During a year it doubled, and the volume of the transactions made through ATM was AZM 127.5 billion and $39.3 million. The network of cash delivery points through plastic cards has increased. The branches of the Bank have also been engaged in the card business: in any of them the clients are able to register and obtain the issued IBA cards.

IBA improves the acquiring network as well: by the present time, 140 trade-service points have been involved in the servicing of bank cards, conditions have been created for their use in larger stores, popular boutiques, restaurants, hotels and etc., in some of them the clients of the Bank have an opportunity to obtain discounts during the payment. Organization of the network of acquiring terminals makes the «card» settlements much more comfortable and attractive for the clients.

Plastic cards cash transactions volumes growth (thous. USD)



Turnover by trade outlets accepting plastic cards (%)

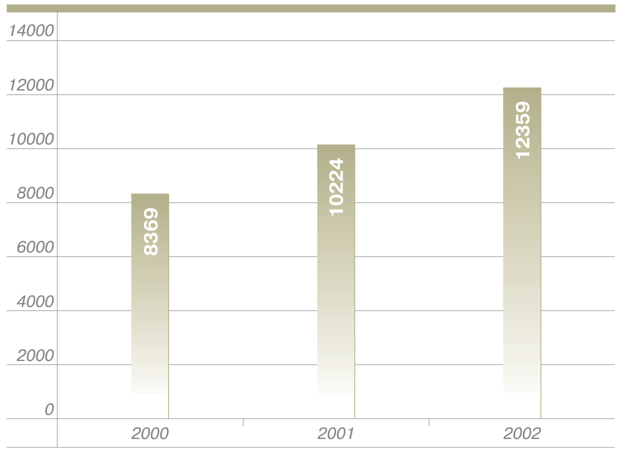


On the whole, total volume of «Cash» type transactions (taking into account the servicing of the cards of other banks) increased by 65% and amounted to about $76.0 million. Turnovers on «Cash advance» operations (i.e. cash dispensing with the use of POS terminals in the branches of IBA) increased to AZM 4.8 billion and $8.2 million, growth per year – respectively 2,5 times and 1.5 times. Total turnover on POS terminals installed on the territory of trade and services enterprises grew to $10.5 million or almost 21%. The profitability of the card business of IBA is expected to grow further: sum of commission obtained from the operations with plastic cards grew 3.5 times during the year – AZM 11.1 billion against AZM 3.2 billion, and the profit – by 48%, reaching AZM 4.7 billion.

In 2002 the Bank continued to broaden its product range issuing the cards of the highest category - MasterCard Platinum.

Their owners can have the credit limits in the range of 20-30% of the sum of the term deposit and are provided with a number of additional services and discounts, including the insurance. Another new product, introduced in the last year was gift card Cirrus Maestro Prepaid Card, being the «plastic» analogue of the traveller cheques. The network of points adopting the American Express cards for payment has expanded.

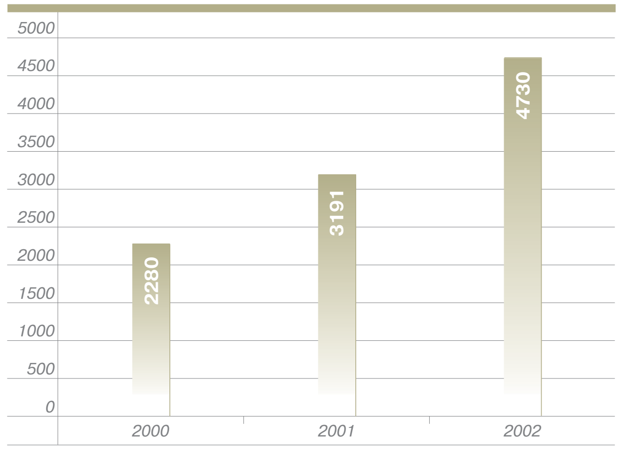
Payments' turnover growth in the receiving points of plastic cards (thous. USD)



Notably grew the popularity of the cards designed for the settlement via Internet - VISA InterCard and MasterCard WebCard. In 2002 IBA together with the company «Azeronline», first in the Eurasian region within the framework of the project «Co-branded Card», started the issue of joint cards «Netcard» on the base of the card of the MasterCard International system, and on the base of Maestro cards joint cards hade been issued together with one of the biggest customer of the Bank – «Azercell» Company. One should note an intensive growth of transactions with the payment for utilities and mobile phone services by the means of the plastic cards.

Corporate bank cards have been also actively promoted in the market. Evolving its activities in this direction, IBA carried out the «salary» projects in 78 enterprises and organizations during the reporting period.

Card business profitability growth tendency (thous. USD)



Efficiency of that system is verified during the process of servicing over 24 thousand employees of 209 organizations and enterprises of the country.

Highly attractive, particularly from the point of view of the social profile, is the new project of IBA – multifunctional plastic card «Bakuvian's Card». This experiment is first of all oriented on the pensioners and other recipients of different types of social welfare, on payments for all types of utilities, and metro transport payment. «Bakuvian's Card» at the same time will carry out the functions of savings book and pension card, season tickets, medical insurance, short-term crediting and etc, along with being used as a full - fledged bank card.

In connection with the implementation of the project «Bakuvian's Card», the Bank plans to move to a new type of card – microprocessor («chip-based»), the size of the memory and the number of the functions of which are greatly bigger than those of the magnetic cards. The infrastructure of the card business will considerably expand: 250 cash dispensers and 600 POS terminals of modern types have already been purchased (compatible also with «Chip» cards), and will be placed all over the country.

Relations with international financial institutions and project financing

In 2002 IBA continued the close cooperation with foreign financial organizations, acting as the agent bank between them and the government, and also as borrower on the credit lines of other foreign banks.

Efforts on the development of relations with the foreign partners were aimed at increasing of the volume of credit lines, opened by them for IBA, provision of most advantageous conditions for the mutual cooperation. Consequently, today we can certainly talk about the qualitatively new level of relations with them.

Credit line of the European Bank for

Reconstruction and Development (EBRD) on the programme of «crediting of small and medium enterprises» in amount of $2,35 million was fully used. In this connection, in November 2002, the agreement was signed between IBA and EBRD on the increase of the credit line to $5 million. At the present time, 11 projects with the value of $3.1 million have been financed through that credit line. Expertise has been carried out for over 30 projects, financing of which will start in 2003. Along with this, the syndicated credit ($10 million) provided by the consortium of the banks headed by Raiffeisenbank was entirely used in the reporting year.

On January 2002, an agreement was reached with Black Sea Bank of Trade and Development (BSBTD) on the granting of credit facility in the amount of $4 million for the period of 4 years for the financing of export-import operations with the Bank's member-countries. In November 2002 the amendments were made to the original agreement on the increase of the credit line to $6.5 million.

In June 2002 agreement was signed with the German bank Bayerishe Landesbank Girozentrale for the credit facility of 4.105 million swiss francs for the financing of the commodities imported to Azerbaijan from Germany and other countries of the Western Europe. These funds were fully used.

During the reporting period the negotiations were held with the Export Development Bank of Iran on the short-term financing of export and with the Islamic Development Bank on the crediting of large projects of the clients of our Bank. In the present conditions, the problem of search for new effective projects that could be financed by the funds attracted from abroad is brought to the forefront. With this view, special information directory was prepared for potential investors, containing the overview of two sectors – «Foodstuffs» and «Silk, wool and cotton».

With purpose of better satisfying the needs of the customers in the financing of the projects on favorable conditions, the Bank will continue the collaboration with foreign financial institutions. To this end, the negotiations will be continued with the Islamic Development Bank and Islamic Financial Corporation on the opening of credit line. Signing of the respective agreement is expected in 2003.

The contacts will be established with the Asian Development Bank. For the financing of the construction of the «Business-center in Baku the negotiations have been planned with a number of foreign banks on the provision of credit in the value of $20 million. The Bank intends to continue the activity on the arrangement of the syndicated credits. Opening of straight credit lines and development of partnership relations of IBA with the leading international financial institutions is an important component of the Bank's business development, and also a manifestation of confidence of the partners in it.

Correspondent relations

Efficiency, reliability and cost-effectiveness of the international settlements and creation of most favorable conditions for the Bank's customers continued to be the key principles of the correspondent relations of IBA in 2002.

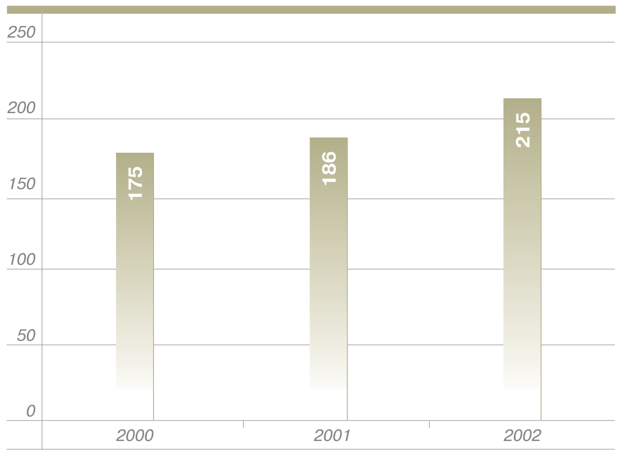
During the reporting period IBA developed the interbank relations with the partners in national as well as in international markets. In this regard, the following objectives were put forward: increase of the quality of the provided services; improvement of the technology of services and high level of automation of the transaction process with the accompanying reduction of risks; development of individual schemes of interaction with the banks taking into account their particularities and specific character of the regional markets; engagement of new contractors and correspondents on the basis of mutually beneficial and long-term collaboration.

The structure of the foreign correspondent network of IBA covers some largest banks of the countries of the Western Europe, Asia, North America and other regions and allows to realize in the regime of real time all types of international settlements. IBA has had direct correspondent relations with 64 banks from 24 countries of the world.

The majority of the banks-correspondents render IBA the services not by the standard prices, but by special rates, taking into account the volume of settlements and other aspects of cooperation. Introduction of all-European currency required the optimization of the correspondent network in the countries of European Union. Consequently, the number of the accounts decreased, but the financial flows were focused on the reliable banks-partners. As of the end of 2002, the balances on the correspondent accounts and short term deposits of IBA in the foreign banks made up the amount equivalent to AZM 641.1 billion, which is 41.2% more than in 2001.

Correspondent network of IBA on the territory of Azerbaijan covers the majority of banks of the country and 15 foreign banks. The total number of the correspondent accounts LORO in the Bank reached 178 (including 25 – non-residents). Only over the last year 19 such accounts were opened, 4 of them - by the non-residents. By the end of the last year AZM 15.3 billion was accumulated in those accounts, which was AZM 1,9 billion more than as of December 31, 2001.

Correspondent accounts growth in numbers



During the reporting period particular attention was paid to the establishment of a reliable system against the legalization of the illegally obtained revenues, and arrangements were made on the counteraction of the financing of the international terrorism. Taking into account improved standards of the international practice, that was the target of internal control systems and new approaches for the cooperation with the bank-correspondents were aimed to that. An effective monitoring and control on the transfer of the money are carried out in the Bank, which allows to discover suspicious transactions. Speed, reliability and safety of the implementation of the payment operations are provided by the international interbank system SWIFT.

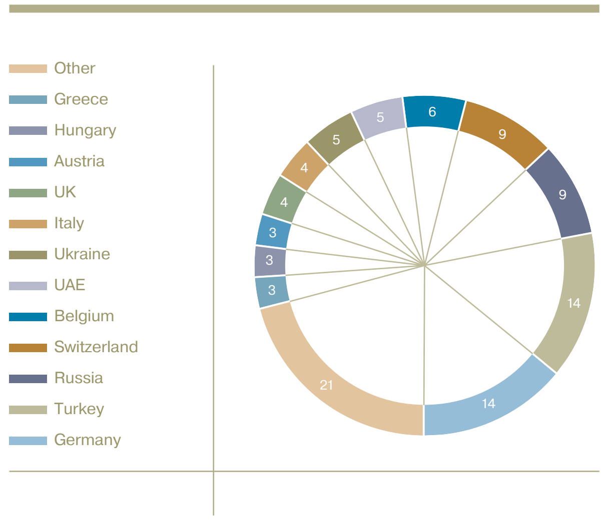
In 2003 IBA will seek to strength of its positions in the interbank market and further develop the correspondent relations with the purpose of increasing reliability, speed and the quality of settlements.

Documentary operations

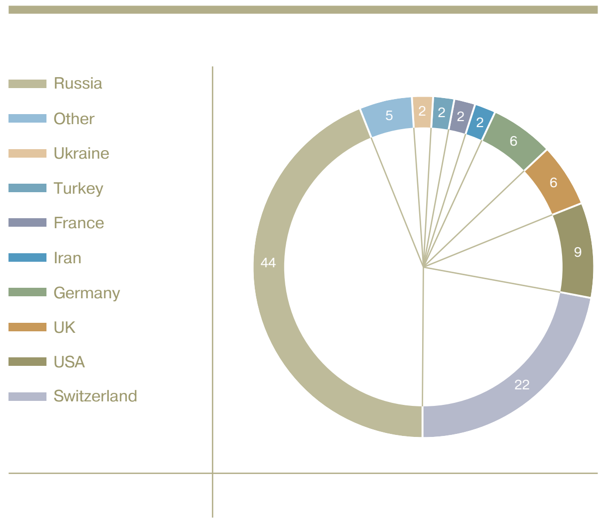
Long term history of active work in the segment of documentary business allowed the Bank to acquire good knowledge and work experience with various types of documentary instruments, as convenient tools lowering the risk of failure in implementing the agreements with counteragents, and also as a useful way of financing participants of foreign economic activities.

The Bank's advantage in this area is based on its high international reputation as a financial partner, professionalism of the specialists, branch correspondent network, sustainable relations with large number of clients and foreign banks-partners, high quality information consulting service, wide ranging opportunities of the modern banking communications. IBA also regularly provided the clients with the consulting services on different aspects of the documentary business, support in the structuring of difficult deals and payment conditions of contracts, preparation of the drafts of letters of credits and guarantees.

Import letters of credit by countries (%)



Export letters of credit by countries (%)

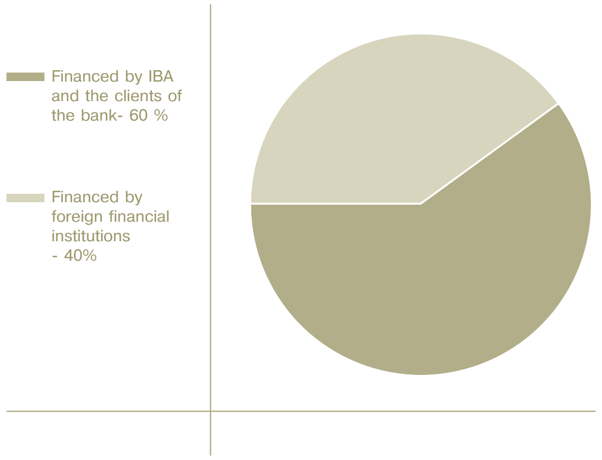


Stable demand from the participants of foreign-economic activities and the growth of the customer base became the key factors of the development of the documentary business of IBA. In 2002, 508 letter of credit operations were carried out with the total turnover of over $1.1 billion. In comparison with the preceding year, those indicators have increased respectively by 1.8 times and 6%.

During the reporting period, 123 export

letters of credit were advised for the value of $793.8 million and 385 import letters of credit were advanced for the value of $308.6 million. Documentary letters of credit were used mainly in the export of oil and oil products (96%) and for the financing of the industrial imports (46%) and trade (18%), import of telecommunications equipment and technology (8%), oil products (7%) and transport vehicles (6%). Over 60% of import letters of credit were financed by IBA or its clients, and about 40% - by internetional financial organizations. The main trade partners of the Bank are: on export – Russia (44%), Switzerland (22%), USA (9%); on import – Turkey and Germany (14%), Russia and Switzerland (9%).

Import letters of credit by the source of financing (%)



Confirmation of the letters of credit was carried out mainly by such reputed financial institutions as Citibank, Credit Suisse, UBS AG, ING Bank, JP Morgan Chase, Banque de Commerce et de Placements, Credit Lyonnais, Raiffeizen Zentralbank, American Express Bank Ltd and etc. With this end, the international financial institutions opened the credit lines in the value of about $100 million.

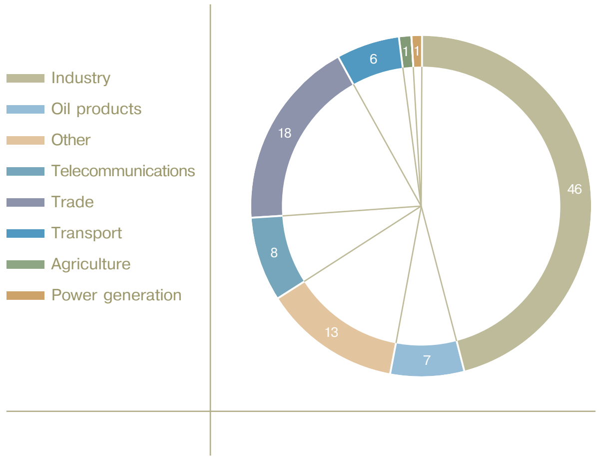
In servicing the operations of export trading companies, IBA widely uses the bank guarantees. In 2002, 1296 guarantees (i.e. 3.9 times more than in 2001) were given with the total value of $79.6 million (the growth in comparison with the previous year – by 27.2%), out of those 636 fell on the share of tender guarantees ($10.8 million).

Total income obtained on account of use of documentary settlements exceeded the corresponding indicator of 2001 more than 3.1 times and reached about $3.2 million.

In 2003, the Bank will seek to increase its share in the documentary settlements of the clients related, first of all, those engaged in export-import operations. Winning new customers in the field of documentary

business, increasing the volume of operations and strengthening the mutually beneficial collaboration with foreign banks – those tasks are among the main issues for the development of documentary business in the Bank.

Import letters of credit by the sectors of economy (%)



WHAT ARE WE UNITED BY?

INTERNATIONAL BANK OF AZERBAIJAN

Development of branch network

The important source of the dynamic development of IBA is the branch network. The regional policy of the Bank ensured its presence in the majority of the regions of Azerbaijan. The main tasks of IBA in this sphere are strengthening of the leading positions in the regions on all products and services, entry to new financial markets, increase of the volumes of operations with customers by the means of bringing closer the services of the Bank to the customers and optimization of the management system of existing branch network.

Expansion of the regional presence of the Bank means on one hand the decentralization of the services and maintaining the status of IBA as a big universal bank, and on the other hand, such opportunities as enhancing of the investment attractiveness of the Bank; attraction of new regional customers complex service to the big concerns and holdings having numerous counterparts (customers and suppliers) in the regions, optimization of cash flows and operational reallocation of the resources; reduction of the operating costs; greater promteness and higher quality of the banking operations for the corporate clients via technologies of inter-branch settlements streamlined by the Bank; participation in the programmes requiring the obligatory existence of the branch network; obtaining competitive advantages in the regions thanks to the quality of service, flexible price policy and new types of services.

The results of 2002 allow to state that more active performance on account of the branch network has a tendency to grow. Besides, further development of the economy of the regions entails the increase in the demand for the banking services, which in its turn gives a push to the development of the branches themselves. Extensive and successfully functioning regional network of IBA comprised 34 branches as of the end of 2002. During the last year branches have been opened in Baku and Zagatala, as well as a mini-office in the Landmark business center for the servicing foreign companies. The sphere of servicing the customers of the Bank also broadened due to establishment of the service outlets, the total number of which reached 104.

Multifacet development of the branch network requires not only the regional expansion and the increase of the number of territorial divisions of the Bank, but also the increase of the efficiency of the operating structures. Almost all the branches have offered the legal and physical persons a portfolio of bank operations with an individual approach to each client. Tight internal control on the implementation by each branch of its budget, flexible organizational structure and risk management system allowed to outline the limits of the optimum level of fixed costs enabling the achievement of positive financial result. Branch network of IBA confidently increases its potential, steadily improving quantity and quality parameters of its activities. Its share in the total indicators of the Bank has considerably increased: for instance, they form 1/3 of all revenues. Among the successfully functioning regional departments are the branches of

Garadagh, Nasimi, Nizami, Sabunchu, «Sahil», Khatai (Baku city), Ali Bayramly, Ganja and Yevlakh are notable.

Development of branch network as the channel of sale of the bank products and services was also one of the objectives of the Bank in 2002. The branches of IBA actively introduce the modern banking technologies and new methods of work with the clients, which provides permanent increase of the number of the clients, expansion of the resource basis and allows to offer enterprises and organizations of the regions a universal set of bank products and services.

Given the necessity for the improvement of the management system of the branch network, at the end of 2002 the division was established under the Department of Strategic planning and marketing, to coordinate work with the branches. Furthemore, with the purpose of improving the work in that direction, IBA Board approved a new scheme of management of the structural departments of Bank, where the coordination of the branches is distributed between the deputies Chairman of the Board of IBA. Those arrangements resulted in the improvement of the work with branches.

The Bank is interested in further expansion and reallocation of the financial flows from the center to the regions for the development of their financial and economic infrastructure, job creation, social protection of the population, strengthening of the participation of the branches in regional programmes of socio-economic character and in different projects of local enterprises. At the same time, the branches will be involved in servicing the members of well-known international energy (Baku-Jeyhan oil pipeline and Baku-Erzurum gas pipeline) and transport (TRACECA) projects taking into account their routes. Also more active will be the process of offering the products and services of IBA subsidiary structures dealing with the insurance and leasing through the branches of the Bank, which will considerably increase the level of comprehensiveness of services.

Branches

Absheron
AZ 1065, Baku, Izmir Street, 1033
Tel: (994 12) 907 557 Fax: 907 556

Binagadi
AZ 1108, Baku, Z.Bunyadov Ave, 11
Tel.: (994 12) 629 337 Fax: 981 158

Garadagh
AZ 1003, Baku, Khanlar Street, 52
Tel.: (994 12) 974 008 Fax: 974 007

Khatayi
AZ 1025, Baku, U.Safarov Street, 20
Tel.: (994 12) 902 015 Fax: 902 434

Narimanov
AZ 1072, Baku, K.Rahimov str, 22
Tel.: (994 12) 656 562 Fax: 656 558

Nasimi
AZ 1010, Baku, Azadlyg Avenue, 18
Tel.: (994 12) 939 744 Fax: 936 157

Nizami
AZ 1149, Baku, M.Hadi Str, 23/24
Tel.: (994 12) 275 040 Fax: 275 030

Sabayil
AZ 1095, Baku, Nizami Street, 68
Tel.: (994 12) 985 634 Fax: 935 623

Sabunchu
AZ 1034, Baku, Moscow Ave, 119A
Tel.: (994 12) 965 555 Fax: 474 849

«Sanaye»
AZ 1033, Baku, A.Aliyev Street, 13
Tel.: (994 12) 966 142 Fax: 938 458

«Sahil»
AZ 1001, Baku, Nizami Street, 54
Tel.: (994 12) 980 876 Fax: 980 875

Surakhany
AZ 1049, Amirjan, I.Mammadov Str, 3
Tel.: (994 12) 528 500 Fax: 528 800

Yasamal
AZ 1073, Baku, A.Alekperov Str, 528/E
Tel.: (994 12) 316 398 Fax: 397 208

Aghdash
AZ 0300, Aghdash, Azadlyg Str, 1A
Tel.: (994 193) 52 331 Fax: 51 400

Ali-Bayramly
AZ 1800, Ali-Bayramly, M.A.Rasulzadeh Street, 11
Tel.: (994 197) 47 190 Fax: 48 040

Davachi
AZ 1700, Davachi, Azadlygh Street, 101
Tel. (994 115) 32 433 Fax: 32 660

Ganja
AZ 2000, Ganja, Zardabi Street, 210
Tel.: (994 822) 560 288 Fax: 560 288

Gazakh
AZ 3500, Gazakh, S.Vurgun Street, 6/1
Tel.: (994 279) 51 275 Fax: 51 275

Goychay
AZ 2300, Geychay, Azerbaijan Avenue, 38
Tel.: (994 167) 52 180 Fax: 52 180

Guba
AZ 4000, Guba, Fatali-khan Street, 41
Tel.: (994 169) 53 204 Fax: 52 953

Imishly
AZ 3000, Imishly, 20-th January Street, 1
Tel.: (994 154) 55 693 Fax: 55 693

Jalilabad
AZ 1500, Jalilabad, Azerbaijan Street, 103
Tel.: (994 114) 31 693 Fax: 32 639

Khachmaz
AZ 2700, Khachmaz, Rasulbekov Street, 1
Tel.: (994 172) 33 389 Fax: 34 849

Kurdamir
AZ 3300, Kurdamir, Azadlyg Avenue, 14
Tel.: (994 145) 66 489 Fax: 66 489

Lankaran
AZ 4200, Lankaran, Sh. Akhundov Street, 18
Tel.: (994 171) 54 793 Fax: 54 793

Nakhchivan
AZ 7006, Nakhchivan, Istiglal Street, 87
Tel.: (994 136) 50 527 Fax: 50 527

Saatly
AZ 4900, Saatly, Azerbaijan Alley, 150
Tel.: (994 168) 52 030 Fax: 54 151

Shamakhy
AZ 5600, Shamakhy, M.A.Rasulzadeh Street, 85
Tel.: (994 176) 94 550 Fax: 94 550

Shamkir
AZ 5700, Shamkir, S. Vurgun Street, 129
Tel.: (994 241) 27 911 Fax: 24 926

Shaki
AZ 5500, Shaki, S. Rahman Street, 121
Tel.: (994 177) 42 758 Fax: 42 060

Sumgayit
AZ 5000, Sumgayit, S.Vurgun Street, 112/14
Tel.: (994 12) 971 940 Fax: (994 164) 29 555

Yevlakh
AZ 6600, Yevlakh, S.Aliyev Street, 10
Tel.: (994 166) 63 421 Fax: 65 590

Zagatala
AZ 6200, Zagatala, Khatai Avenue, 11
Tel.: (994 174) 54 513 Fax: 54 513

Mini–offices

AZ 1010, Baku, Nizami Str., 96, Landmark Plaza,
2nd floor. Tel.: (994 12) 982 487 Fax: 982 488

International Airport «Bina», Ground floor,
Southern Terminal, Tel.: (994 12) 972 500

AZ 1003, Baku, Neftchilar Avenue, 2, «Villa Petrolia»
Tel.: (994 12) 979 000 (6890)

SC «AZAL» AZ 1000, Baku, Azadlyg Avenue, 11
Tel.: (994 12) 930 091 (1801)

Representative Office

One Hyde Park Gate, London SW7 5EW
Tel: (44 207) 581 18 19 Fax: (44 207) 581 11 16

WHAT ARE WE UNITED BY?

INTERNATIONAL BANK OF AZERBAIJAN

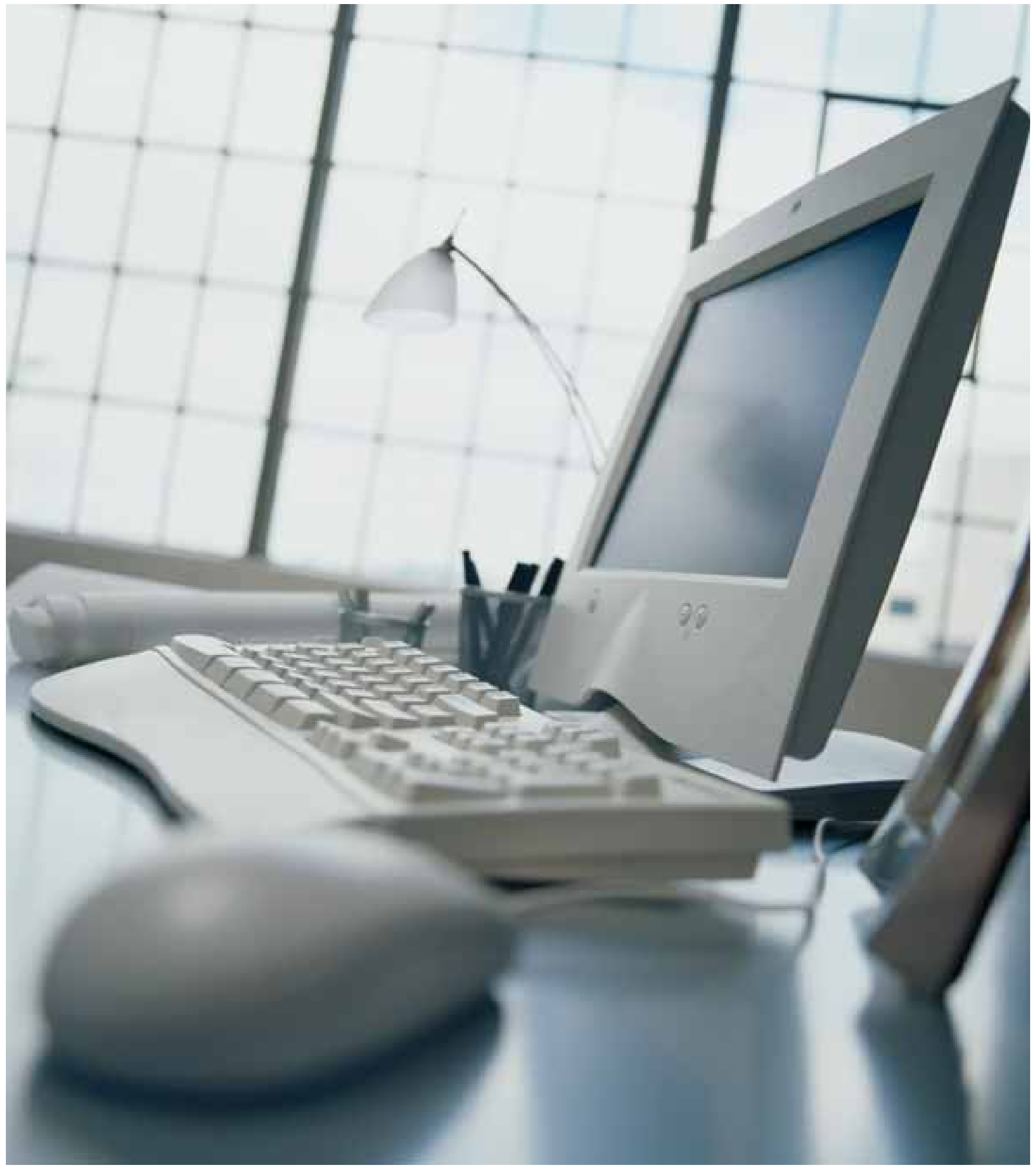
Information Technologies. Security systems

In 2002 IBA continued to work on upgrading automated systems, developing and applying new IT to maintain and improve functional activity of the Bank's divisions. Thereby, «challenges to new economy» have been taken into consideration and emphasis has been made on fundamental principles of banking IT development: productivity, reliability, quality and safety. Being oriented on the current and prospective demands of its clients, the Bank combined in an optimal way the most advanced technologies, software of well-known companies and that developed by the Bank's specialists.

In the condition of qualitative growth of IBA in 2002 the accent was made on three main directions - development of software for the support of retail business; further development of automated system of the Bank; increasing the level of safety and reliability of the Bank's information system. In the light of intensive development of retail in the reporting year, automation process acquires a special significance. In order to increase the quality and speed of servicing the Bank's card holders, the Bank continued to extend the number of points of cash dispensation on plastic cards and acquiring net: 40 ATMs and 100 POS terminals have been installed in Baku and other districts of the Republic.

The system of remote service to customers has been improved. To meet this task, the Bank-Client system, designed for corporate customers, has undergone qualitative development. This system provides full banking services to remote customers in the mode of real time. As a result, operating costs and overhead expenses have been reduced, and the transition to paperless technology-based servicing to clients has been initiated. During 2002 the number of corporate clients using the electronic ways of dealing with the Bank increased by 40%.

In the reported year IBA, for the first time among the banks of Azerbaijan Republic, started to develop the system of Internet-banking. This system, protected by several security levels gives opportunity to the Bank's customers to make through computers the payments for utility and mobile communication services, manage the



account of his own payment cards, freeze it and distribute amounts on additional cards, and to make payments from his account to any other accounts without leaving home or office.

Another area of business characterized by information technology intensity is operations on the currency markets. In 2002 technological opportunities of currency and interbank dealings continued to augment.

In 2002, the preparatory work for the introduction of the system of E-commerce, GSM-banking, chip cards and system of monitoring movement of money collecting vehicles was carried out. All the newly created branches, mini-offices and service outlets have been provided with state of the art technology and connected with the Bank's net for carrying out financial transactions. Aggregated expenditures for the purchase of new equipment rose to AZM 19.2 billion.

The bank was two central computers using AS/400 processors equipped with MIDAS programme; this system comprises accounting, dealing, credit modules, modules for carrying out operations with securities and money transfers, SWIFT and telex modules and allows to automatize the most part of payments, settlements and other operations of the Bank. During the reporting year the work was carried out on improving programme security of servers and operational systems being used. Reorganized territorial structures of the Bank have been connected to common system as well.

The number of banks that joined the system developed by the IBA for receiving payments for the use of mobile telephony, electric power, water and gas in Baku, their processing in the IBA central computer and forwarding them to corresponding addresses in the mode of on-line increased to 25 last year. The number of IBA service outlets receiving payments for mobile telephony and communal services has increased in Baku and districts of the country as well.

The use of SWIFT-Alliance facility provides for the settlements with correspondent banks within this payment system. Work on the installation of new, more powerful UPS in the head office has been carried out and, new UPSs have been installed in all of the branches. Local network was introduced (Ethernet) in the head office of IBA and Customer Service department, and all of computers were connected to it. The capacity of Telephone Station Meridian has been increased and the number of subscribers and functions of ATS has increased as well.

Planned renewal and modernization of equipment and computer technology was implemented. By the end of 2002, the number of personal computers of the Bank reached 17 thousand units. All the branches of the bank have been fully computerized and they comprise modern local networks using «client-server» system architecture.

A great attention was paid to providing maximum security and reliable functioning of software and hardware. For these purposes, the Bank operates special systems for security protection of information from unsanctioned interference, meeting the most stringent requirements. The automatic testing of computers against viruses with antivirus programs being renewed every hour was also introduced.

Taking into account the prospects for development for 2003 measures the Bank envisaged establishing and applying the Retail-teller system for automation and speeding-up the transactions with individuals and MIS, electronic system of identification of client signatures and systems of Telephone- and-SMS banking.

WHAT ARE WE UNITED BY?

INTERNATIONAL BANK OF AZERBAIJAN

Management system and human resources policy

In 2002 the emphasis was made on the improvement of the structure of the Bank, and formation of an effective system of decision making and implementation. A new composition of the IBA Board was formed, the functions, the rights and responsibilities of the current specialized bank committees – the Committee on the management of assets and liabilities, the Credit Committee and the Committee on information technologies - were made more specific; the Department of strategic planning and marketing was created.

The new Board and the above mentioned committees undoubtedly played an important role in ensuring effective work of Bank in 2002.

Realizing that the capabilities, knowledge and skills of the staff are the exclusive capital, and investments in the development of personnel's potential are the basis for the long-term success, the Bank paid close attention to the formation of consolidated professional and innovative team, united by common objectives and tasks, capable of providing their quality and prompt accomplishment. The human resources policy of the Bank remained unchanged: the candidates were carefully selected, those who passed the selection process were provided with the necessary training and with the opportunity to express themselves in a team based environment, efforts were directed at combining financial and moral forms of motivation of labor, the conditions were created for their professional growth and corporate culture continued to develop.

Having a reputation of exacting employer, the Bank as before, remained committed to the policy of employing the people able to organically join already formed team of professionals. In 2002 the system of recruitment requiring the pass of the special tests was developed and submitted for approval. The system should be the major factor of maintaining of high qualification of IBA's personnel.

Along with the «fine-tuning» of the rules of selection of bank specialists, the human resources policy of IBA during the reporting period was focused on steady increase of the professionalism of the personnel. It is clearly illustrated with the following figures: in 2002 the total number of the specialists of the Bank, who had improved their qualification, was around 400 (over 41% of the Bank's employees), while the cost of training was $121 thousand.

The logical result of the done work on the personnel management is the fact that the team of specialists of IBA is justifiably reckoned as one of the most competent and motivated in the national market.

Taking into account the global trends in banking business, IBA will continue to improve the organizational structure of the Bank in 2003 too. It is planned to create services dealing with the issues of personnel management and methodological back-up of banking

activities. Reengineering of the management will allow considerably to optimize the functional system of the Bank and increase the efficiency of the operations.

It is planned to introduce the techniques of personnel audit, appraisal of the personnel and their work and foster motivation of the employees. Such human resources policies as the career planning and preparation of staff reserve will be widely used. It is expected to introduce a new programme of social security, allowing all employees to use the services of the best healthcare institutions under the programme of medical insurance.

On the whole, in accordance with the adopted Strategy of IBA up to 2005, the system of personnel management will be oriented on the further development of balanced in number, highly motivated professional personnel, understanding and sharing the operational objectives and principles of corporate culture of the Bank, loyal to its policy and strategy.

Consolidated financial statements and Auditors' report for 31 december 2002

Contents

PRICEWATERHOUSECOOPERS

Auditors' Report

To the Board of Directors
of the International Bank of the Republic of Azerbaijan

1. We have audited the accompanying consolidated balance sheet of the International Bank of the Republic of Azerbaijan Group («the Group» as defined in Note 1 to the consolidated financial statements) as at 31 December 2002, 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 2002 and the consolidated results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

4. Without qualifying our opinion, we draw attention to Note 2 to the consolidated financial statements. The economy of the Republic of Azerbaijan has shown progress in achieving a lower rate of inflation, stable exchange rates and sustainable growth in recent years. However, the Azeri economy is largely dependent on oil prices and all sectors of the economy, including the banking sector, could be adversely affected in the future by fluctuations in oil prices.

23 July 2003
Baku, Azerbaijan

Consolidated Balance Sheet as at 31 December 2002
(Amounts are expressed in millions of Azerbaijani Manats unless otherwise indicated.)

	Notes	2002	2001
Assets			
Cash and short-term funds	5	904,176	651,793
Due from other banks	6	80,930	85,290
Loans and advances to customers	7	1,070,210	966,171
Investment securities			
- held-to-maturity	8	65,097	50,166
- available-for-sale	8	11,325	17,758
Investment in associate	9	4,333	1
Accrued interest income	10	21,974	17,830
Other assets	11	99,118	39,375
Premises and equipment	12	154,027	105,298
Intangible assets		2,503	608
Total assets		2,413,693	1,934,290
Liabilities			
Due to other banks	13	17,230	13,928
Customer accounts	14	1,907,132	1,457,669
Debt securities in issue	15	27,985	21,653
Other borrowed funds	16	304,265	344,525
Accrued interest expense	17	4,435	3,304
Other liabilities	18	10,924	3,739
Deferred tax liability	26	6,009	5,081
Total liabilities		2,277,980	1,849,899
Minority interest	19	3,383	-
Shareholders' equity			
Share capital	20	34,110	11,466
Revaluation reserve for premises and equipment	12	9,626	28,380
Fair value reserve for investment securities available for sale	8	(5,803)	(4,036)
Retained earnings	21	94,397	48,581
Total shareholders' equity		132,330	84,391
Total liabilities, minority interest and shareholders' equity		2,413,693	1,934,290

Approved for issue by the Board of Directors and signed on its behalf on 23 July 2003.

Mr. Jahangir Hajiyev
Chief Executive Officer

Mr. Rovshan Ismailov
Chief Accountant

The notes set out on pages 92 to 142 form an integral part of these consolidated financial statements.

Consolidated Statement of Income For the Year Ended 31 December 2002

(Amounts are expressed in millions of Azerbaijani Manats unless otherwise indicated.)

	Notes	2002	2001
Interest income	22	107,279	88,034
Interest expense	22	(49,377)	(32,141)
Net interest income		57,902	55,893
Provision for impairment of nostro accounts	5	(7,739)	-
Provision for impairment of due from other banks	6,10	(12,931)	(12,116)
Provision for impairment of loans to customers	7,10	(28,598)	(26,923)
Net interest income after provision for impairment		8,634	16,854
Foreign currency translation gains less losses		12,445	9,656
Gains less losses arising from trading in foreign currencies		49,324	37,867
Fee and commission income	23	77,011	53,872
Fee and commission expense	23	(6,740)	(5,646)
Losses on origination of assets at rates below market	7	(4,124)	-
Losses on origination of liabilities at rates above market	14	(266)	-
Gross insurance premiums written net of premiums ceded		1,316	-
Other income		1,908	97
Operating income		139,508	112,700
Staff costs	24	(40,832)	(27,141)
General, administrative and other operating expenses	25	(47,208)	(36,800)
Monetary loss		(5,120)	-
Profit from operations		46,348	48,759
Income from investment in associate	9	445	-
Profit before taxation		46,793	48,759
Income tax charge	26	(15,562)	(13,620)
Profit after tax		31,231	35,139
Minority interest	19	(687)	-
Net profit for the year		30,544	35,139

The notes set out on pages 92 to 142 form an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows For the Year Ended 31 December 2002

(Amounts are expressed in millions of Azerbaijani Manats unless otherwise indicated.)

	Notes	2002	2001
Interest received		87,133	76,190
Interest paid		(48,246)	(31,865)
Income received from securities held to maturity		7,163	7,150
Income received from trading in foreign currencies		49,324	37,868
Fees and commissions received		76,799	53,872
Fees and commissions paid		(6,714)	(5,646)
Insurance premiums, net		968	-
Other operating income received		969	89
Operating expenses paid		(74,635)	(50,018)
Income tax paid		(8,300)	(17,097)
Cash flows provided from operating activities before changes in operating assets and liabilities		84,461	70,543
Changes in operating assets and liabilities			
Net (increase)/decrease in mandatory cash balances with central banks		(33,879)	34,426
Net increase in restricted cash		(55,627)	(2,045)
Net (increase)/decrease in due from other banks		(49,192)	316,128
Net increase in loans and advances to customers		(188,823)	(447,622)
Net increase in other assets		(4,907)	(11,166)
Net increase/(decrease) in due to other banks		3,302	(307,036)
Net increase/(decrease) in customer accounts		449,196	(489,145)
Net increase in debt securities in issue		6,332	5,066
Net increase in other borrowed funds		8,367	30,531
Net decrease in other liabilities		(106)	(4,528)
Net cash from/(used in) operating activities		219,124	(804,848)
Cash flows from investing activities:			
Acquisition of premises and equipment	12	(50,668)	(18,638)
Acquisition of intangible assets		(1,334)	(93)
Proceeds from redemption of investment securities available for sale		150	85
Acquisition of investment securities available for sale		-	(444)
Proceeds from redemption of investment securities held to maturity		-	750
Cash balances of subsidiary at 1 January 2002		2,238	-
Dividend income received		59	8

The notes set out on pages 92 to 142 form an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows For the Year Ended 31 December 2002

(Amounts are expressed in millions of Azerbaijani Manats unless otherwise indicated.)

	Notes	2002	2001
Net cash used in investing activities		(49,555)	(18,332)
Cash flows from financing activities:			
Issuance of ordinary shares		22,644	9
Dividends paid	27	(5,327)	(8,059)
Dividends paid to government	21	-	(23,000)
Net cash from/(used in) financing activities		17,317	(31,050)
Effect of exchange rate changes on cash and cash equivalents		16,312	9,124
Effect of inflation on cash and cash equivalents		(5,120)	-
Net increase in cash and cash equivalents		198,078	(845,106)
Cash and cash equivalents at the beginning of the year	5	704,579	1,549,685
Cash and cash equivalents at the end of the year	5	902,657	704,579

* Acquisition of premises plant and equipment exclude the non-cash acquisition of a building in the amount of AZM 9,065 million and furniture, fixtures and others in the amount of AZM 779 million acquired by the IIC, one of the wholly owned subsidiaries of the Group. Refer to Note 12.

The notes set out on pages 92 to 142 form an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity For the Year Ended 31 December 2002

(Amounts are expressed in millions of Azerbaijani Manats unless otherwise indicated.)

	Share capital	Revaluation reserve for premises and equipment	Fair value reserve for investment securities available for sale	Retained earnings	Total shareholders equity
Balance at 1 January 2001	11,457	28,380	(4,734)	43,688	78,791
Share issue (Note 20)	9	-	-	-	9
Fair value gain on available for sale securities, net of taxation (Note 8)	-	-	698	-	698
Dividends declared (Note 27)	-	-	-	(7,246)	(7,246)
Dividend paid to government (Note 21)	-	-	-	(23,000)	(23,000)
Net profit for the year	-	-	-	35,139	35,139
Balance at 31 December 2001	11,466	28,380	(4,036)	48,581	84,391
Share issue (Note 20)	22,644	-	-	-	22,644
Fair value loss on available for sale securities, net of taxation (Note 8)	-	-	(1,767)	-	(1,767)
Other movements (Notes 9,12, 26,32)	-	798	-	6,988	7,786
Depreciation of revaluation reserve for premises and equipment	-	(19,552)	-	19,552	-
Dividends declared (Note 27)	-	-	-	(11,268)	(11,268)
Net profit for the year	-	-	-	30,544	30,544
Balance at 31 December 2002	34,110	9,626	(5,803)	94,397	132,330

The notes set out on pages 92 to 142 form an integral part of these consolidated financial statements.

Notes To The Consolidated Financial Statements at 31 December 2002

(Amounts are expressed in millions of Azerbaijani Manat unless otherwise indicated)

Note 1: Principal Activities

The International Bank of Azerbaijan Republic and its subsidiaries and associate («the Group») comprise Azerbaijani and foreign commercial banks, companies and other entities, in which the Group, directly or indirectly, has the power to exercise control over financial and operating policies.

The International Bank of the Azerbaijan Republic 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 its 50.2% of the total authorised 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 license granted by the National Bank of the Azerbaijan Republic («NBAR») on 30 December 1992. The Bank's head office is located in Baku.

The Group has 34 (2001: 32) branches in Azerbaijan and 1,057 employees as at 31 December 2002 (2001: 857). 968 employees are employed by the Bank, 43 – by International Insurance Company, 20 – by Azericard and 26 – by IBAR Moscow. The registered address of the Bank is 67 Nizami Street, 370005, Baku, Azerbaijan.

A full list of subsidiaries and associate included within these consolidated financial statements is provided in Note 32.

According to the Presidential Decree dated 23 November 1998, the Bank is included in the privatisation program of the Government of the Azerbaijan Republic. In accordance with the latest Presidential Decree dated 17 April 2003, the Ministry of Economic Development of the Republic of Azerbaijan was authorised to conduct negotiations with the European Bank for Reconstruction and Development («the EBRD») regarding the potential sale of 20% of the share capital of the Bank and sign a relevant memorandum of understanding by 30 May 2003 as well as to present to the President of the Republic of Azerbaijan a price offer from the EBRD for the purchase of 20% of the share capital of the Bank by 30 August 2003. In addition, in accordance with the Decree dated 17 April 2003, all remaining shares of the Bank owned by the state are to be sold via auctions by the end of 2004.

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 partnership. IBAR Moscow started its operations under a license issued by the Central Bank of the Russian Federation («the CBRF») on 25 January 2002. This license allows IBAR Moscow to carry out banking operations with legal entities in Russian Roubles and in foreign currency. The IBAR Moscow's principal activity is represented by commercial banking operations. The IBAR Moscow's registered office is located at the following address: Tverskaya 6, Bld 2, Moscow, Russia.

On 5 February 2002 the Group registered a fully-owned subsidiary, Azerbaijan International Insurance Company («the Insurance Subsidiary») with the Ministry of Justice of the Republic of Azerbaijan. The share capital of the Insurance Subsidiary is AZM 24,000 million. The Insurance Subsidiary operates under an insurance license No. AB 029205 issued by the Ministry of Finance of the Republic of Azerbaijan on 1 April 2002 and addendum issued on 16 August 2002. The activity of the Insurance Subsidiary includes medical, property, casualty, life, personal insurance, insurance of banking risks and reinsurance. The official address of the insurance subsidiary is C. Chabbarli street 46, Baku, Azerbaijan.

Azericard Ltd., which is 50% 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 Most Bank Azerbaijan. Azericard was registered with the Ministry of Justice of the Republic of Azerbaijan on 4 July 1996 and commenced its operations starting from the third quarter of 1997. Azericard 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. In the beginning of 2003 Azericard had contracts signed with 26 local banks on provision of plastic cards related services. Azericard so far has a unique monopolistic position in the Republic of Azerbaijan as a plastic card operations authorization and clearing center. The registered office address of Azericard is Nizami street, 67, 370005, Baku, Azerbaijan. Azericard has not been previously consolidated with the Group, as its financial results were insignificant.

Note 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 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 Azerbaijan.

The prospects for future economic stability in 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.

Note 3:
Basis of Presentation

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 (except IBAR Moscow) and associate maintain their accounting records in accordance with Azerbaijani banking and accounting regulations. IBAR Moscow maintains its accounting records in accordance with Russian banking regulations. These consolidated financial statements have been prepared from those accounting records and adjusted as necessary in order to comply with IFRS.

These consolidated financial statements are measured and presented in the national currency of the Azerbaijan Republic, the Azeri 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.
In 2001, the Group adopted IAS 39 «Financial Instruments: Recognition and Measurement.» The financial effects of adopting IAS 39 were reported in the previous year's financial statements.
Note 3: Basis of Presentation (continued)
Where necessary, corresponding figures have been adjusted to conform to changes in presentation in the current year.

Note 4:
Significant Accounting Policies

Consolidated financial statements. Subsidiaries are those companies and other 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 effective 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, shares 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. Minority interest is that part of the net results of operations 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 separately from liabilities and shareholders' equity. Minority interest related to operational results of the current year is recorded in the consolidated statement of income.

Associates. 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 associates 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 is recognized in the consolidated statement of income, and its share of post-acquisition movements in reserves is recognized 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 are eliminated to the extent of the Group's interest in the associates; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The Group's investment in associates includes goodwill (net of accumulated amortization) on acquisition. When the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognize further losses unless the Group has incurred obligations or made payments on behalf of the associate.

Note 4: Significant Accounting Policies (continued)

Cash and short-term funds. Cash and short-term funds comprise cash, balances with the NBAR and CBRF, blocked accounts with non-resident banks with contractual maturities of less than 3 months and correspondent accounts with resident and non-resident banks including overnight deposits.

Cash and cash equivalents. For the purpose of the consolidated cash flow statement, petty cash and cash equivalents comprise cash in hand, balances with the NBAR (excluding some part of mandatory reserves), correspondent accounts including overnight deposits and short-term (up to three months) placements with other banks, and investment securities with original maturity of less than 3 months (Note 5).

Mandatory reserve deposits with the NBAR. Starting from 2000 the Group is allowed by the NBAR to utilize 50% of the total calculated amount of mandatory reserves for purchase of short-term treasury bills. The remaining 50% of the total calculated amount of mandatory reserves are not available to finance day-to day operations of the Group, therefore, they are excluded from cash and cash equivalents for the purposes of consolidated cash flow statement.

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 recognised 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.

Loans originated at interest rates different from market rates are remeasured 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 uncollectable, 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 are credited to the provision for loan impairment 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 held-to-maturity. Held-to-maturity investments are financial assets with fixed or determinable payments and a fixed maturity that Management has both the intent and the ability to hold to maturity other than loans and receivables originated by the Group. Management determines the appropriate classification of its investments at the time of the purchase. Held-to-maturity investments are carried at amortized cost, using the effective yield method, less any provision for impairment.

Note 4: Significant Accounting Policies (continued)

Interest earned whilst holding investment securities is reported as interest income. All regular way purchases and sales of investment securities are recognised at trade date, which is the date the Group commits to purchase or sell the asset.

Investment securities available for sale. This classification includes investment securities, which Management intends to hold for an indefinite period of time, that 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.

Investment securities available for sale are initially recognised at cost (which includes transaction costs) and subsequently remeasured to fair value based on quoted bid prices. Certain investments 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 recognised 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. Unrealised gains and losses arising from changes in the fair value of investment securities available for sale are recorded directly in the consolidated statement of changes in shareholders' equity as a fair value reserve, net of deferred taxation, in the period in which they arise, and are recycled through consolidated statement of income upon disposal of these securities when gains and losses are realized.

Interest earned on investment securities available for sale is recorded 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 recognized at trade date, which is the date that the Group commits to purchase or sell the asset.

Premises and equipment. All premises and equipment are stated at cost or revalued amounts, less accumulated depreciation and impairment. The revaluation was performed to restate the net book value of the asset to a level, which reflected their market value. The indices vary according to asset type and acquisition date. Additionally, an independent real estate firm reassessed the value of a branch building in prior years and the resulting difference was included in the revaluation reserve for premises and equipment.

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 amount. Construction in progress is not depreciated until the asset is available for use.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount and the difference is charged to the consolidated statement of income. The estimated recoverable amount is the higher of an asset's net selling price or its value in use.

Gains and losses on disposal of premises and equipment are determined by reference to their carrying amount and are taken into account in determining profit/(loss).

Intangible assets. Costs associated with maintaining computer software programmes are recognised 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 recognised 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 programmes beyond their original specifications, is recognised as a capital improvement and added to the original cost of the software. Computer software development costs recognised as intangible assets are amortised using the straight-line method over their useful lives, which range from 3 to 4 years.

Investment property: Property held for long-term rental yields, which is not occupied by the Group, is classified as investment property. Investment property comprises buildings and a furniture production facility leased out to a small furniture production company. 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 included into premises and equipment on the face of the consolidated balance sheet.

Depreciation: Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Premises	2-5%
Leasehold improvements	12-15%
Computers and other office equipment	20-25%
Plastic card operations related equipment	33%
Motor vehicles	25%
Furniture, fixtures and other	25%

Note 4:
Significant Accounting Policies (continued)

Debt securities in issue. Debt securities in issue include promissory notes, certificates of deposit and debentures. Debt securities in issue are recognised 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 recognised in the consolidated statement of income over the period of the security issue 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.

Dividends. Dividends are recorded 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 allocation as the current year net profit.

Income taxes. Taxation has been provided for in the consolidated financial statements in accordance with appropriate legislation currently in force. The income tax charge 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 balance sheet 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 recognised 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 recognised in the consolidated statement of income when the gain or loss on the securities is realised.

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 26.

Interest income and expense recognition. Interest income and expense are recognised in the consolidated statement of income for all interest bearing instruments on an accrual basis, using the effective yield method based on the actual purchase price.

Interest income includes coupons earned on fixed income securities and accrued discount and premium on promissory notes and other discounted instruments.

When loans become doubtful of collection, they are written down to their recoverable amounts and interest income is thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

Fee and commission income and expense. Fee and commission income and expense on banking services are recorded on an accrual basis when the service has been provided.

Foreign currency translation. Monetary assets and liabilities originally denominated in AZM are stated at their original AZM amounts. Monetary assets and liabilities in other currencies have been translated into AZM using the exchange rate ruling at the balance sheet date. Non-monetary assets and liabilities, which are denominated in currencies other than AZM, have been translated into AZM at the exchange rates in effect at the date of the transaction. Income and expenses, which were earned and incurred in currencies other than AZM, have been translated into AZM using a basis that approximates the rate of exchange ruling at the date of the transaction.

Gains and losses arising from the translation of assets and liabilities into AZM are reflected in the consolidated statement of income as foreign exchange translation gains less losses.

As certain members of the Group located outside the Republic of Azerbaijan operate independently of the Group, in accordance with IAS 21 «The Effects of Changes in Foreign Exchange Rates» («IAS 21»), these entities are considered to be foreign entities (operations not integral to those of the parent) with respect to the Group. Thus, the financial statements of these foreign entities have been translated into AZM as follows: balance sheets and the statements of income are translated at the applicable period end exchange rate.

As at 31 December 2002 the principal rate of exchange used for translating foreign currency balances was USD 1 = 4,893 Azerbaijani Manats and EUR 1 = 5,080 Azerbaijani Manats, 1 RR = 153.94 Azerbaijani Manats (2001: USD 1 = 4,775 Azerbaijani Manats and EUR 1 = 4,230 Azerbaijani Manats). At present, the AZM is not a freely convertible currency in most countries outside of the Azerbaijan Republic.

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.

Pension and other salary related costs. The Group's contributions to the social insurance and other funds in respect of the salary of its employees are expensed as incurred and included into staff costs in the consolidated statement of income.

Note 5:
Cash and Short-term Funds

	2002	2001
Cash on hand	97,576	64,475
Mandatory reserve deposits with central banks	148,763	64,925
Settlement accounts with central banks	23,607	67,604
Correspondent accounts and overnight deposits with other banks		
- Azerbaijan Republic	1,024	974
- Other countries	641,103	453,973
Less: Provision for impairment of nostro accounts	(7,897)	(158)
Total cash and short-term funds	904,176	651,793
Less: Mandatory reserves with NBAR not allowed to be utilised for purchase of treasury bills	(90,473)	(56,713)
Less: Mandatory reserves with CBRF	(119)	-
Add: Treasury bills and short term promissory notes (Note 8)	65,097	50,166
Add: Due from other banks with maturity of less than 3 months	23,976	59,333
Total cash and cash equivalents	902,657	704,579

Mandatory reserve deposits with central banks consist of mandatory deposits of the Bank and its subsidiary, IBAR Moscow, placed with the NBAR and the CBRF in the amounts of AZM 148,644 million and AZM 119 million, respectively. According to the regulations of the NBAR, the Bank is required to maintain reserve deposits equal to 10% of the statutory balances of its customer accounts, due to other banks and other borrowed funds. These mandatory reserves are calculated by using daily average balances and deposited at the NBAR twice a month.

According to the regulations of the NBAR the Bank is allowed to utilise 50% of the total calculated amount of mandatory reserves for purchase of treasury bills (Refer to Note 8). As of 31 December 2002 mandatory reserve deposits with central banks in the amount of AZM 148,763 represented the difference between the total calculated amount of mandatory reserve deposits amounting to AZM 181,066 million (2001: AZM 113,427 million) and AZM 32,303 million (2001: AZM 48,502 million) used for purchase of treasury bills. Accordingly, mandatory reserve deposits in the central banks in the amount of AZM 148,763 include the amount of AZM 58,170 million (2001: AZM 8,212 million), which represents the resources available, but not used, for purchase of treasury bills as of 31 December 2002.

Included in settlement accounts with central banks are the balances on correspondent accounts of the Bank and its subsidiary, IBAR Moscow, with the NBAR and CBRF amounting to AZM 22,721 million and AZM 886 million, respectively.

Overnight deposits in the amount of AZM 84,491 represent funds placed with foreign banks with maturities in January and February 2003 and interest rates from 1.38% to 3.40% p.a.

Treasury bills and short-term promissory notes outstanding are included in cash and cash equivalents due to their high liquidity and original maturity of less than three months (Note 8).

Note 6:
Due from Other Banks

	2002	2001
Current term placements with other banks	75,155	84,565
Overdue placements with other banks	72,952	57,446
Less: provision for impairment of due from other banks	(67,177)	(56,721)
Total due from other banks	80,930	85,290

Included in current term placements with other banks as at 31 December 2002 are deposits in the amount of AZM 36,698 million (2001: AZM 58,775 million) with OECD (Organisation for Economic Cooperation and Development) banks. Current term placements with other banks include AZM 18,833 million (2001: AZM 25,790 million) of placements with local banks.

Included in overdue placements with other banks is the amount of AZM 50,054 million (2001: AZM 46,196 million) representing placements with Azerbaijani banks, which are either bankrupt or had their license withdrawn by the NBAR, against which a 100% provision was created by the Group.

Movements in the provision for loan impairment are as follows

	2002	2001
Provision for impairment of due from other banks at 1 January	56,721	45,427
Provision for impairment of due from other banks during the year	10,456	11,294
Provision for impairment of due from other banks at 31 December	67,177	56,721

As at 31 December 2002 the estimated fair value of due from other banks was AZM 80,930 million (2001: AZM 85,290 million). Refer to Note 30.

Geographical, currency, maturity and interest rate analyses of due from other banks are disclosed in Note 28.

Note 7:
Loans and Advances to Customers

	2002	2001
Loans originated:		
Current loans	661,518	481,810
Overdue loans	315,207	320,061
Less: provision for impairment of loans and advances to customers	(168,564)	(146,376)
Total loans originated, net	808,161	655,495
Intermediary loans:		
Current loans	134,258	185,967
Overdue loans	127,791	124,709
Total intermediary loans	262,049	310,676
Total loans and advances to customers	1,070,210	966,171

During 2002 a loss on origination of loans at the rates below market in amount of AZM 4,124 million (2001: nil) has been recorded in the consolidated statement of income.

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

	2002	2001
Provision for impairment of loans and advances to customers at 1 January	146,376	121,809
Provision for impairment of loans and advances to customers during the year	22,188	24,567
Provision for loan impairment at 31 December	168,564	146,376

As of 31 December 2002, loans granted to government institutions and state enterprises amounted to AZM 650,412 million (2001: AZM 671,629 million), representing 52.5% (2001: 60.0%) of the total loan portfolio.

As of 31 December 2002, loans amounting to AZM 3,120 million (2001: AZM 4,223 million) were granted to state-owned companies, which are included in the privatisation program of the Republic of Azerbaijan. These loans will be offset against the Group's future payables to the state budget in accordance with the law of the Republic of Azerbaijan No. 937-IG dated 24 October 2000. In addition, according to the decision of the Cabinet of Ministers, the Ministry of Finance of the Republic of Azerbaijan is authorised to issue guarantee letters for loans granted to government institutions and state enterprises. As of 31 December 2002, the aggregate amount of loans guaranteed by the Ministry of Finance, excluding intermediary loans, described below, is AZM 94,858 million (2001: AZM 89,564 million), of which loans in the amount of AZM 21,980 million (2001: AZM 78,781 million) are included in overdue loans.

Intermediary loans represent loans granted through various banks and financial institutions to state owned enterprises and government bodies, and are guaranteed by the Ministry of Finance. The Group acts as an intermediary and does not bear any credit risk related to these loans. These loans do not bring any interest income, except for service fees amounting to AZM 4,755 million (2001: AZM 4,449 million) for 2002 (Note 23). The Group charges service fees of 0.75% on each disbursement of sub-loans granted at the expense of the credit facilities of Eximbank, Nichimen Europe Plc. and National Westminster Bank and Bayerische Landesbank (Note 16).

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

	2002	%	2001	%
Manufacturing	558,801	45.1	454,654	40.9
Trade and services	255,554	20.6	305,001	27.4
Air transportation	214,168	17.3	170,895	15.4
Construction	62,003	5.0	33,126	3.0
Government bodies (*)	60,328	4.9	53,348	4.8
Individuals	58,803	4.7	24,958	2.2
Communication	26,181	2.1	52,694	4.7
Other	2,936	0.3	17,871	1.6
Total loans and advances to customers	1,238,774	100.0	1,112,547	100.0

(*) Government bodies include Ministries, Treasury and other state bodies of the Republic of Azerbaijan. As of 31 December 2002, included in loans to government bodies is the amount of AZM 59,887 million (2001: AZM 22,196 million), which represents non-interest bearing overdrafts on current accounts of the State Budget of the Republic of Azerbaijan.

Included in loans to individuals as at 31 December 2002 are the balances drawn on credit cards in the amount of AZM 7,282 million (2001: AZM 4,155 million).

Geographical, currency, maturity and interest rate analyses of loans and advances to customers are disclosed in Note 28. The Group has several balances outstanding from related parties. The relevant information on related party balances is disclosed in Note 31.

As at 31 December 2002 the estimated fair value of loans and advances to customers was AZM 1,070,210 million (2001: AZM 966,171 million). Refer to Note 30.

Note 8:
Investment Securities

	2002	2001
Investment securities held-to-maturity		
Treasury bills	35,331	50,166
Gasprombank promissory notes	29,766	-
Total investment securities held-to-maturity	65,097	50,166
Investment securities available for sale		
Listed equity securities	4,336	7,746
Unlisted equity securities	6,989	10,012
Total investment securities available for sale	11,325	17,758
Total investment securities	76,422	67,924

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 2002 bear an average yield of 13.1% p.a. (2001: 16.6 %. p.a.) and have maturity dates between February and March 2003.

Treasury bills are recorded at amortized cost and include interest accrued amounting to AZM 1,709 million as of 31 December 2002 (2001: AZM 1,665 million). All treasury bills outstanding as at 31 December 2002 were paid at maturity.

On 31 December 2002 the Bank purchased at discount four promissory notes from Gasprombank, of which one promissory note was purchased for USD 1,043,818 and the remaining three promissory notes for the total amount of USD 2,956,182. The Group expected to receive USD 4,069,808 upon redemption of promissory notes on 31 March 2003. The yield on the above promissory notes was 6.9% p.a. In addition, IBAR Moscow purchased at discount eight promissory notes on 31 December 2002 in the total amount of EUR 2,000,000 and expected to receive EUR 2,032,055 upon redemption on 31 March 2003. The yield on the promissory notes was 6.4%. All promissory notes and accrued interest were redeemed at maturity.

Investment securities held-to-maturity are treated as cash and cash equivalents for the purposes of the consolidated cash flow statement due to their high liquidity and maturity of less than three months (Note 5).

Listed equity securities represent shares of the Russian companies operating in oil and gas, utilities and other related sectors, which are traded at the RTS Stock Exchange in Moscow, Russia. Listed equity securities are recorded at market value, which approximates their fair value.

Movements in fair value reserve for listed equity securities available for sale before taxation was as follows:

	2002	2001
Opening balance	4,036	4,735
Movement in fair value during the year	3,702	(699)
Closing balance	7,738	4,036

The Group recorded a deferred tax asset in amount of AZM 1,935 million with respect to the movement of the fair value reserve on available for sale investment securities in the consolidated statement of changes in shareholders' equity. Refer to Note 26.

At 31 December 2002 the estimated fair value of investment securities held-to-maturity was AZM 65,097 million (2001: AZM 50,166 million).

Geographical, currency, maturity and interest rate analyses of investment securities are disclosed in Note 28.

Note 9:
Investment in Associate

The table below summarizes the movements in the carrying value of the Group's investment in associate representing a 20% investment in Baku Inter-Bank Currency Exchange.

	2002	2001
Carrying amount at 1 January	1	1
Net share of reserves of associate accumulated prior to 1 January 2002	3,887	-
Net share of profit of associate after tax for the year	445	-
Carrying amount at 31 December	4,333	1

Net share of reserves of associate accumulated prior to 1 January 2002 has been recorded as part of other movement of reserves in the consolidated statement of shareholders' equity in 2002 due to the fact that the Group has prepared its consolidated financial statements as of 31 December 2002 for the first time.

Net share of profit of associate after tax for the year ended 31 December 2002 in amount of AZM 445 million has been recorded in the consolidated statement of income as income from investment in associate.

Note 10:
Accrued Interest Income

	Note	2002	2001
Accrued interest income on loans and advances to customers	7	24,121	17,269
Accrued interest income on overnight placements and due from other banks	6	631	3,739
		24,752	21,008
Less: provision for impairment of accrued interest on loans to customers		(2,778)	(2,356)
Less: provision for impairment of accrued interest on due from other banks		-	(822)
Total accrued interest income (net)		**21,974**	**17,830**

Accrued interest income on intermediary loans granted to state owned enterprises from funds borrowed on behalf of the Government of Azerbaijan, amounted to AZM 111,712 million (2001: AZM 97,161 million) and is accounted for by the Bank off balance sheet as the Bank acts as intermediary on these loans and does not earn any interest income on them. Refer to Note 17.

Movements in the provision for impairment of accrued interest income are as follows:

	2002	2001
Provision for accrued interest income at 1 January	3,178	-
Provision for accrued interest income on loans to customers during the year	6,410	2,356
Provision for accrued interest income on due from other banks during the year	2,475	822
Accrued interest income written off during the year	(9,285)	-
Provision for accrued interest income at 31 December	**2,778**	**3,178**

During 2002 the Group wrote off overdue interest income accrued and recognized in prior years in the amount of AZM 3,297 million related to due from other banks. The Group also wrote off overdue interest income accrued and recognized in prior years in the amount of AZM 5,988 million related to loans and advances to customers.

Note 11:
Other Assets

	2002	2001
Restricted cash	57,672	2,045
Amounts in the course of settlement	30,869	20,708
Prepaid profit and other taxes	5,692	11,024
Prepaid insurance and amounts due from policyholders	1,678	-
Advances paid for purchase of equipment	1,172	566
Plastic cards debtors	979	761
Prepaid expenses	882	4,053
Receivables from employees	51	-
Other	123	218
Total other assets	**99,118**	**39,375**

Restricted cash as at 31 December 2002 represents cash blocked under two letters of credit with maturities in June 2003 in the total amount of AZM 53,993 million and cash blocked with two European banks in the total amount of AZM 3,679 million (2001: AZM 2,045 million) as a cover for the court proceeding raised by DHT Inshaat, a construction company, against the Group in Stockholm, Sweden (Note 29). Blocked accounts with foreign banks are non-interest bearing.

Cash blocked with two European banks was subsequently unblocked following an out-of-court settlement of the lawsuit. Refer to Note 29 and Note 33. Included in the restricted cash related to letters of credit outstanding at the year-end, the first letter of credit in the amount of AZM 3,299 million was rolled over until May 2004, the second letter of credit in the amount of AZM 50,694, million had a partial payment made in relation to it in May 2003 with the remaining payment in the amount of AZM 26,911 million further rolled over until July 2003.

Amounts in the course of settlement include a transit account of a state owned organisation in the amount of AZM 29,272 million (2001: AZM 17,006 million). This account is used to record taxes transferred to the state budget by the Group on behalf of this organization, which are cleared within first few days of January of the next financial year. The remaining amounts in the course of settlement represent transactions via Moneygram clearing center.

Prepaid insurance and amounts due from policyholders as at 31 December 2002 represent insurance premium receivables from policyholders by the Group's Insurance Subsidiary in the amount of AZM 594 million and insurance premiums prepaid by the Bank in the amount of AZM 1,084 million.

Note 12: Premises and Equipment

	Land, buildings and leasehold improvements	Computers and office equipment	Furniture, fixtures and other	Motor vehicles	Investment property	CIP	Total
Net book amount at 1 January 2002	**68,782**	**14,911**	**2,682**	**1,307**	**12,883**	**4,733**	**105,298**
Cost or valuation							
Opening balance	82,748	25,807	5,962	4,074	13,327	4,733	136,651
Transfer from Azericard	2,031	2,323	20	55	-	-	4,429
Additions	26,446	21,138	4,354	1,093	369	7,112	60,512
Disposals	-	(3,765)	(1,978)	(2,282)	-	(242)	(8,267)
Transfers between accounts	4,655	-	-	-	3,414	(8,069)	-
Closing balance	**115,880**	**45,503**	**8,358**	**2,940**	**17,110**	**3,534**	**193,325**
Accumulated depreciation							
Opening balance	(13,966)	(10,896)	(3,280)	(2,767)	(444)	-	(31,353)
Transfer from Azericard	(1,472)	(1,986)	(14)	(24)	-	-	(3,496)
Depreciation charge	(3,272)	(5,396)	(1,085)	(852)	(1,852)	-	(12,457)
Disposals	-	3,749	1,977	2,282	-	-	8,008
Closing balance	**(18,710)**	**(14,529)**	**(2,402)**	**(1,361)**	**(2,296)**	**-**	**(39,298)**
Net book amount **at 31 December 2002**	**97,170**	**30,974**	**5,956**	**1,579**	**14,814**	**3,534**	**154,027**

Included in opening and closing balances of computers and office equipment are fully depreciated assets in the amount of AZM 1,921 million (2001: AZM 1,874 million). These assets are used by the Group's plastic cards subsidiary in carrying out its operational activities.

Of the total additions and transfers from CIP to land, buildings and leasehold improvements amounting to AZM 33,132 million - AZM 9,065 million represents an office building of the Group's Insurance Subsidiary acquired through an auction held at the Republican Commodity and Raw Materials Exchange.

Also, included in additions and transfers from Construction in progress (CIP) to land, buildings and leasehold improvements category is the cost of constructing two additional floors of the Bank's head office in Baku in the amount of AZM 4,724 million, leasehold improvement of rented premises for the Bank's branches in the regions in the amount of AZM 1,093 million and two office premises in Moscow and one in St. Petersburg purchased for IBAR Moscow in the total amount of AZM 13,107 million. Capital commitments in relation to improvement and reconstruction of the buildings purchased for IBAR Moscow amount to AZM 938 million and are further disclosed in Note 29.

Additions to computers and office equipment primarily consist of 60 automated teller machines and related modem equipment purchased by the Bank in 2002 in the amount of AZM 10,371 million. Other additions represent the investment of the Bank into the full upgrade of the Bank's information technology infrastructure in its branches, including the purchase of new computers, printers, internet routers and other equipment for branches, new high capacity server, antennas for satellite connection of branches' accounting electronic data processing systems with the head office's system and other relevant equipment purchased for the Bank's branches in the Republic of Azerbaijan and for IBAR Moscow.

Included in investment property at net book value of AZM 14,814 million, is AZM 11,372 million, which represent three facilities obtained by the Group in satisfaction of loans granted to the banks and legal entities in prior years and leased out to earn rentals. These facilities include a six-storied office building in Baku with a net book value of AZM 6,038 million leased out to a private local company, another office building with a net book value of AZM 4,089 million leased out to the Bank's local borrower, and a facility consisting of office premises with a net book value of AZM 452 million and manufacturing equipment with a net book value of AZM 793 million currently held to be leased out under operating leases. In addition, included in investment property is AZM 3,442 million, which represents a building in Baku acquired by the Group in August 2002 from one of its borrowers. Cash paid by the Group to the borrower was used to pay part of the loans issued to the borrower by the Bank. The Group intends to hold this building for capital appreciation purposes. The carrying value of investment property approximates its fair value at 31 December 2002.

The rental income generated from leasing out of the first building in the amount of AZM 28 million (2001: AZM 12 million) and of the second building in the amount of AZM 23 million (2001: AZM 23 million) were recorded in other operating income in the consolidated statement of income.

Construction-in-progress balance includes a building under construction in the amount of AZM 3,230 million (2001: AZM 3,201 million) acquired in satisfaction of a loan granted to a local bank in prior years.

Premises and equipment were revalued in 1996 and 1998 using market prices, which approximate their fair value. The resulting revaluation surplus is recorded in the consolidated statement of shareholders' equity.

Note 13: Due to Other Banks

	2002	2001
Correspondent accounts of local commercial banks	15,326	13,427
Blocked accounts on plastic cards operations	681	501
Current term placements of other banks	1,223	-
Total due to other banks	17,230	13,928

As at 31 December 2002 the estimated fair value of due to other banks was AZM 17,230 million (2001: AZM 13,928 million).

Term placements of other banks as at 31 December 2002 are represented by a deposit of an Azerbaijani bank bearing interest rate of 3% p.a. with maturity date on 20 February 2003. The deposit was fully repaid subsequent to the year-end.

Geographical, currency, maturity and interest rate analyses of due to other banks are disclosed in Note 28. The Group had several balances outstanding to related parties. The relevant information on related party balances is disclosed in Note 31.

Note 14: Customer Accounts

	2002	2001
Legal entities		
- Current/settlement accounts	588,590	768,461
- Term deposits	783,546	377,767
- Restricted customer deposits	161,363	118,820
Total legal entities	1,533,499	1,265,048
Individuals		
- Current/demand accounts	82,382	39,069
- Term deposits	291,251	153,552
Total individuals	373,633	192,621
Total customer accounts	1,907,132	1,457,669

During 2002 a loss on origination of deposits at rates above market in the amount of AZM 266 million (2001: nil) has been recorded in the consolidated statement of income.

Included in term deposits of legal entities are call deposits of a state organization related to the oil industry in the amount of AZM 419,183 million and of a government body in the amount of AZM 12,233 million. The interest rates on these call deposits range between 1.02%-1.25% and 1.75% p.a. respectively.

Included in the current and settlement accounts of legal entities as at 31 December 2002 are current accounts of state owned enterprises and government bodies in the amount of AZM 52,268 million, which are interest-bearing. Interest rates on these accounts vary from 1% to 7% p.a.

Restricted deposits represent customer accounts held by the Group against irrevocable letters of credit and guarantees issued for customers. The information on letters of credit and guarantees outstanding as at 31 December 2002 and 2001 is disclosed in Note 29.

Balances on outstanding term deposits of legal entities and applicable interest rates are represented by the following:

	2002	Interest rates, % p.a.	2001	Interest rates, % p.a.
Government bodies and state enterprises	1,242,509	5.6%	914,986	8.5%
Private enterprises	290,990	6.2%	350,062	7.5%
Total legal entities	1,533,499		1,265,048	

Note 14:
Customer Accounts (continued)

Economic sector concentration for legal entities' deposits is as follows:

	2002	%	2001	%
Energy	847,393	55.3	802,209	63.4
Transportation	179,855	11.7	70,691	5.6
Government bodies (*)	150,984	9.8	121,307	9.6
Trade and services	110,700	7.2	51,590	4.1
Manufacturing	108,919	7.1	49,423	3.9
Others	135,648	8.8	169,828	13.4
Total corporate accounts	1,533,499	100.0	1,265,048	100.0

(*) Government bodies comprise ministries, Treasury, municipalities and other state bodies of the Republic of Azerbaijan.
As at 31 December 2002 the estimated fair value of customer accounts was AZM 1,907,132 million (2001: AZM 1,457,669 million). Refer to Note 30.
Geographical, currency, maturity and interest rate analyses of customer accounts are disclosed in Note 28. The Group has several balances outstanding to related parties. The relevant information on related party balances is disclosed in Note 31.

Note 15:
Debt Securities in Issue

	2002	2001
Certificates of deposit	27,985	21,653
Total debt securities in issue	27,985	21,653

Certificates of deposit bear interest rate of 10.0% p. a. and have maturities of 3 years with interest paid only if certificates are claimed for repayment after the first year.
Note 15: Debt Securities in Issue (continued)

Geographical, currency, maturity and interest rate analyses of debt securities in issue are disclosed in Note 28.

Note 16:
Other Borrowed Funds

	2002	2001
Funds borrowed from banks and financial institutions under Government guarantee for intermediary loans:		
Export Credit Bank of Turkey (Eximbank):		
- Trade finance facility*	127,791	124,709
- Project finance facility	44,013	60,316
Nichimen Europe Plc	36,729	54,670
National Westminster Bank	21,503	34,974
Bayerische Landesbank	32,013	36,007
Total fund borrowed for the purposes of providing intermediary loans (Note 7)	262,049	310,676
Other funds borrowed without government guarantee:		
European Bank for Reconstruction and Development (EBRD)	11,579	5,199
Raiffeisen Austria	-	28,650
Bayerische Landesbank	14,327	-
Black Sea Trade and Development Bank	16,310	-
Total other borrowed funds	304,265	344,525

On 21 April 1993 the Bank signed a credit agreement with the Export Credit Bank of Turkey («Eximbank») for a total credit line of USD 250 million. This credit line comprises a trade finance facility of USD 100 million and a project finance facility of USD 150 million. As of 31 December 2002, the interest rates for the trade and project finance facilities are LIBOR plus 3.5 % and 2.5%, respectively (2001: LIBOR plus 3.5 and 2.5%, respectively).

During August 1996, the Bank rescheduled its agreement with Eximbank, which deferred the payment of the total principal of USD 74,817 thousand, including capitalized interest of USD 2,978 thousand, to commence in 1998 with full repayment by 2000. This rescheduled agreement required the Bank to issue promissory notes guaranteed by the Government of the Republic of Azerbaijan (Note 29).

During 1998, USD 48,700 thousand of the liabilities of the Bank under the Rescheduled Agreement dated 8 August 1996 was transferred to the Government of the Republic of Azerbaijan for the purposes of subsequent settlement between the governments of Turkey and Azerbaijan, based on the inter-governmental protocol signed on 8 September 1997. Outstanding funds borrowed from this facility at 31 December 2002 are USD 26,117 thousand (AZM 127,791 million). At 31 December 2002 the aggregate interest payable to Eximbank is AZM 110,633 million (2001: AZM 95,910 million) or USD 22,610 thousand (2001: USD 20,085 thousand). The accrued interest payable mentioned above is recorded by the Bank off balance sheet as the bank acts as intermediary on these loans.

Note 16:
Other Borrowed Funds (continued)

On 25 August 1998 the Bank signed a new agreement with Eximbank for a credit line of USD 20 million for financing of the construction of the International Terminal of Baku Bina Airport. At 31 December 2002 the amount utilised and granted to the borrower under this agreement totaled AZM 44,013 million (2001: AZM 60,316 million) or USD 8,995 thousand (2001: USD 12,632 thousand). The interest rate on this borrowing is LIBOR plus 2.5% at 31 December 2002.

On 7 June 1998 the Group signed a loan agreement with Nichimen Europe Plc for a credit line of JPY 1,615 million (AZM 69,031 million). This credit line is utilized by a state enterprise for the purposes of modernisation of a chemical plant. The interest rate for the loan is Japanese Inter-bank Offered Rate (JIBOR) plus 4% and it matures in 66 months after the first disbursement i.e. in March 2005.

In 1998 the Group obtained another credit facility of USD 16,113 thousand, from National Westminster Bank for the purpose of extending loans to a state enterprise for financing of the construction of International Terminal at Baku Bina Airport. At 31 December 2002 the outstanding amount of the borrowing from the National Westminster Bank totaled to AZM 21,503 million (2001: AZM 34,974 million) or USD 4,395 thousand (2001: USD 7,324 thousand).

In October 2000 the Bank obtained a credit line from Bayerische Landesbank for the purposes of financing the construction of a clinic hospital in Baku. At 31 December 2002 the outstanding amount on this loan totaled to AZM 32,013 million (2001: AZM 36,007 million) or EUR 6,302 thousand (2001: EUR 8,512 thousand). The loan carries an interest rate of EURIBOR plus 1%.

The Bank signed a loan agreement with the European Bank for Reconstruction and Development on 21 July 1998 for a USD 2,350 thousand credit line for the period of 5 years to finance sub loans to local small 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 total credit line into two parts: initial loan of USD 2,546 thousand and additional loan of USD 2,454 thousand. The interest rate on the credit line is set at LIBOR+4.5%. The initial loan is repayable in semi-annual installments and matures in November 2005. Additional loan is repayable in four equal semi-annual installments with the first payment due on 6 May 2004 and matures in November 2005.

On 3 June 2002 the Bank entered into an agreement with Bayerische Landesbank Girozentrale for a loan of CHF 4,105 thousand for the purposes of financing the project related to state electricity-producing company. The loan bears interest rate of LIBOR+1% p.a. and is repayable no later than 30 June 2003.

On 21 January 2002 the Bank signed an agreement with the Black Sea Trade and Development Bank for a multiple buyer revolving credit facility up to USD 4,000 thousand. The amount drawn on this revolving facility as at 31 December 2002 amounts to USD 3,333 thousand and is intended to be used for financing the project related to the oil transportation sector.

On 22 November 2002 additional credit facility of USD 6,500 thousand was approved by the Black Sea Trade and Development Bank for financing of electricity distribution company. Each disbursement of the facility is repayable in 6 equal semi-annual installments commencing 6 months after the value date. The interest rate for the loan is LIBOR plus 4% p.a.

As at 31 December 2002 the estimated fair value of other borrowed funds was AZM 304,265 million (2001: AZM 344,525 million). Refer to Note 30.

Geographical, currency, maturity and interest rate analysis of other borrowed funds are disclosed in Note 28.

Note 17:
Accrued Interest Expense

	2002	2001
Accrued interest expense on customer accounts	3,841	3,195
Accrued interest expense on due to banks and other borrowed funds	594	109
Total accrued interest expense	4,435	3,304

Accrued interest expense on the funds borrowed on behalf of the Government of the Republic of Azerbaijan for the purposes of granting loans to the state owned enterprises, amounted to AZM 111,712 million (2001: AZM 97,161 million) and is accounted for by the Group off balance sheet as the Bank acts as an intermediary only on these borrowed funds. Refer to Note 10.

Note 18:
Other Liabilities

	2002	2001
Amounts in course of settlement	1,199	1,495
Dividends payable to other shareholders (Note 27)	7,317	1,376
Technical provisions on insurance policyholders (Note 25)	759	-
Trade creditors	852	403
Insurance premiums and broker commissions payable	271	-
Profit taxes payable for subsidiaries	210	-
Plastic cards creditors	186	-
Other liabilities	130	465
Total other liabilities	10,924	3,739

Technical provisions on insurance policyholders and insurance premiums and broker commissions payable represent balances related to the activities of the Insurance Subsidiary of the Group. Technical provisions include provisions for unearned premiums, net of reinsurer's share, in the amount of AZM 594 million and loss provision on anticipated payments on insurance claims, net of reinsurer's share, in amount of AZM 165 million.

Note 19:
Minority Interest

The table below represents the movements in minority interest of the Group in relation to the 50% holding in Azericard:

	2002
Minority interest at 1 January	-
Share of net assets accumulated prior 1 January 2002	2,696
Share of net profit after tax for 2002	687
Minority interest at 31 December	3,383

Share of net assets accumulated prior to 1 January 2002, which belongs to minority, has been recorded as the movement in minority interest of the Group in 2002 due to the fact that the Group has prepared consolidated financial statements for the first time as of 31 December 2002. Share of net profit after tax for 2002, which belongs to minority, has been recorded as separate line in the consolidated statement of income.

Note 20:
Share Capital

The Bank's authorised share capital of AZM 20,000 million at the date of inception comprised 2,765,720 registered shares. Of these 351,720 shares had a par value of AZM 50,000 and 2,414,000 shares had a par value of AZM 1,000. In 2000 the Bank converted all of the shares in issue to par value of AZM 1,000 bringing the total number of shares outstanding at 31 December 2001 to 11,465,707.

The Ministry of Finance of the Republic of Azerbaijan has a 50.2%, or AZM 10,400 million, stake in the authorized share capital of the Bank. Of this amount it paid AZM 1,506 million and had a capital commitment for the remaining AZM 8,534 million as at 31 December 2001. During March 2002 the Ministry of Finance of the Republic of Azerbaijan paid AZM 8,534 million for 8,534,293 shares and fulfilled its capital commitment.

On 7 May 2002 the Board of Directors of the Bank approved the issue of 30 million shares in the total amount of AZM 30,000 million. The Ministry of Finance paid AZM 13,460 million out of its share of capital increase as at 31 December 2002. Other shareholders paid in AZM 650 million during 2002.

On 6 May 2003, the share issue in the amount of AZM 30,000 million was formally registered with the Securities Committee of the Republic of Azerbaijan and fully paid in by all the shareholders, bringing the total authorized and paid share capital of the Bank up to AZM 50,000 million (Note 33)
Note 20: Share Capital (continued)

As of 31 December 2002, the authorized and paid share capital of AZM 34,110 million (2001: AZM 11,466 million) belongs to the following groups of shareholders:

	2002			2001		
	Number of shares	Amount	Percent	Number of shares	Amount	Percent
Individuals	3,087,710	3,088	9.1	3,007,707	3,008	26.2
Legal entities	31,022,672	31,022	90.9	8,458,000	8,458	73.8
Total share capital authorized and paid	34,110,382	34,110	100.0	11,465,707	11,466	100.0

Note 20:
Share Capital (continue)

Further details of the shareholding structure of the Bank are as follows:

Shareholder	*Country of Registration*	**2002** *Amount*	*Share %*	*2001* *Amount*	*Share %*
The Ministry of Finance of the Republic of Azerbaijan	Azerbaijan	23,500	68.9	1,506	13.1
Bank employees	-	1,677	4.8	1,708	14.9
Physical persons	-	1,410	4.0	1,300	11.3
Caspian Investment Bank	Azerbaijan	951	2.8	-	-
Unitrans LTD.	Azerbaijan	850	2.4	850	7.4
Unicom Ltd.	Azerbaijan	650	1.9	650	5.7
Basis Ltd. Company	Azerbaijan	600	1.8	600	5.2
Arsenal MM	Azerbaijan	500	1.5	500	4.4
Rashad G. Small venture	Azerbaijan	500	1.5	500	4.4
Odjak-5 Company	Azerbaijan	500	1.5	500	4.4
Agat Company	Azerbaijan	500	1.5	500	4.4
Shams Ltd.	Azerbaijan	400	1.2	400	3.5
Miss Company	Azerbaijan	400	1.2	400	3.5
Real Company	Azerbaijan	400	1.2	400	3.5
Roleks 96	Azerbaijan	400	1.2	400	3.5
National Bank of Azerbaijan	Azerbaijan	-	-	360	3.1
Improtex	Azerbaijan	303	0.9	303	2.6
Abbas Guliyev Company	Azerbaijan	300	0.9	300	2.6
Vneshekspertservis	Azerbaijan	102	0.3	-	-
Other legal entities	Azerbaijan	167	0.5	289	2.5
Total share capital authorized and paid		34,110	100.0	11,466	100.0

Note 21:
Retained Earnings

In accordance with the Azeri Law on Banks and Banking Activity, the Group distributes profits as dividends or transfers them to reserves (fund accounts) on the basis of financial statements prepared in accordance with Azeri accounting regulations. The Bank's standalone reserves calculated in accordance with Azeri accounting regulations at 31 December 2002 are AZM 86,754 million (2001: AZM 83,717 million). Statutory profits are allocated on the annual basis.

Upon the request of the Government of the Republic of Azerbaijan during January 2001 the Group made a payment to the Ministry of Finance of the Republic of Azerbaijan in the form of a dividend amounting to AZM 23,000 million.

Note 22:
Interest Income and Expense

	2002	*2001*
Interest income		
Interest income on loans and advances to customers	89,105	64,137
Interest income on due from other banks	9,797	16,456
Interest income on investment securities	7,163	5,203
Interest income on nostro accounts	1,214	2,238
Total interest income	107,279	88,034
Interest expense		
Interest expenses on customer accounts	(46,292)	(23,338)
Interest expenses on deposits from banks and other borrowed funds	(3,085)	(8,803)
Total interest expense	(49,377)	(32,141)
Net interest income	57,902	55,893

Note 23:
Fee and Commission Income

	2002	2001
Fees from cash withdrawals	26,727	19,247
Fees from fund transfers	19,650	15,652
Fees and commissions from plastic cards operations	11,096	3,206
Commissions for issuance of letters of credit	8,863	5,277
Commissions for servicing intermediary loans (Note 7)	4,755	4,449
Commissions for issuance of letters of guarantee	4,649	2,008
Other	1,271	4,033
Total fee and commission income	77,011	53,872
Fees and commissions paid to other banks for fund transfers	(2,570)	(1,455)
Fees paid for credit card operations	(2,844)	(1,955)
Fees and commissions paid to other banks for cash withdrawals	(575)	(747)
Other	(751)	(1,489)
Total fee and commission expenses	(6,740)	(5,646)
Net fee and commission income	70,271	48,226

Note 24:
Staff Costs

Staff costs consist of wages, including payments to the Social Insurance Fund of the Republic of Azerbaijan, bonuses and other benefits in kind provided by the Group to its employees. Increase in staff costs is due to the increase of the number of employees from 857 in 2001 up to 1,057 in 2002; 2% increase in base salaries and corresponding increase in payments to the Social Insurance Fund and 15%-34% increase of bonuses.

Note 25:
General, Administrative and Other Operating Expenses

	2002	2001
Depreciation of fixed assets and amortisation of intangible assets	13,172	13,211
Transportation of valuables	2,393	2,056
Communication expenses	4,681	3,433
Fixed asset maintenance expenses	3,608	2,771
Rental expenses	3,278	2,132
Advertising and marketing expenses	2,813	1,751
Stationery, books, printing and other supplies	2,679	1,865
Professional fees	2,752	959
Software related expenses	2,057	1,452
External labour and security expenses	1,212	1,049
Business trip expenses	1,148	438
Training expenses	1,136	671
Change in technical provisions on insurance policyholders (Note 18)	759	-
Court expenses (Note 29)	658	-
Other	4,862	5,012
Total general, administrative and other operating expenses	47,208	36,800

Rental expenses are related to the operating lease of the Bank's 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.

Increase in professional fees is due to start up costs of the subsidiaries. Increase in training expenses is due to increased number of employees and additional training programs conducted by the Head Office of the Bank for its branches.

Increase in software related expenses is due to the consolidation of the Azericard's expenses related to maintenance of plastic cards operations processing software in the amount of AZM 688 million. During 2002 the Bank completed integration of all its branches operating in different parts of the Republic of Azerbaijan by connecting them to the electronic data processing system used by the Bank's head office. This resulted in increase of communication costs due to fees paid to the provider of the software, as well as increase in communication costs of branches with head office.

Technical provisions on insurance policyholders represent deferred insurance premiums and other technical provisions established by the Group's insurance subsidiary.

Court expenses represent legal fees and reimbursements of court expenses of DHT Inshaat. Refer to Note 29.

Note 26: Income Taxes

	2002	2001
Current tax expenses	(11,367)	(7,061)
Deferred taxation movements due to:		
- Origination and reversal of temporary differences	(2,140)	(6,559)
- Effect of reduction in tax rate	678	-
Less: Deferred tax asset recorded as the movement in the consolidated statement of changes in shareholders' equity (Note 8)	(1,935)	-
Less: Deferred tax asset recorded as the movement in the consolidated statement of changes in shareholders' equity (Note 12)	(798)	-
Income tax charge for the year	(15,562)	(13,620)

The income tax rate applicable to the majority of the Group's income is 27% as at 31 December 2002 (2001: 27%). Effective 1 January 2003, the statutory tax rate of the Republic of Azerbaijan will be reduced from 27% to 25%.

Reconciliation between the expected and the actual taxation charge is as follows:

	2002	2001
IFRS profit before taxation	46,793	48,759
Theoretical tax charge at the applicable statutory rate of 27%	(12,634)	(13,165)
Non-deductible expenses	(2,668)	(171)
Additional tax liability recorded in statutory books	(783)	-
Change in tax rates	678	-
Elimination of intra-group balances	489	-
Non temporary elements of monetary gains and losses	206	-
Share of results of operations in associate for 2002	120	-
Differences in tax rates with IBAR Moscow	18	-
Income exempt from taxation	3	-
Contribution to the Disability Fund of the Republic of Azerbaijan	-	(324)
Other non temporary differences	(991)	40
Income tax charge for the year	(15,562)	(13,620)

Additional tax liability recorded in statutory books represents additional tax liability calculated by the Bank in the profit tax return for 2001 and related to tax depreciation of property and equipment, which was recorded in statutory books and transferred to the budget during 2002.

Differences between IFRS and 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 profit tax purposes.

The tax effect of the movement on these temporary differences is recorded at the rate of 25% for entities operating in the Republic of Azerbaijan and at rate of 24% for IBAR Moscow, except for income on state securities for IBAR Moscow, which is taxed at 15%.

In the Republic of Azerbaijan, there is no conclusive procedure for the final agreement of tax assessments. Tax returns are filed by 1 April of the following year and the tax authorities may examine records and/or revise assessments over an indefinite future period.

Deferred taxes. Differences between IFRS and taxation regulations give rise to certain temporary differences between the carrying amount of certain assets and liabilities for financial reporting purposes and for profits tax calculation purposes. The tax effect of the movement on the majority of these temporary differences is recorded at the rate of 25%, which becomes effective in the Republic of Azerbaijan from 1 January 2003. As at 31 December 2002 and 2001, the temporary differences giving rise to the deferred tax assets and liabilities are as follows:

	2001	Movement	Opening balances of the Group's subsidiary as of 1 January 2002	2002
Tax effect of deductible temporary differences at the expected future tax rate of 25%				
Reversal of interest income on nostro accounts	-	2,109	-	2,109
Impairment provision on nostro accounts	43	1,931	-	1,974
Difference in depreciation rate of fixed assets	-	-	349	349
Fair value adjustments on loans to customers and customer accounts	-	556	-	556
Reversal of commission income	-	544	-	544
Depreciation of investment property	-	463	-	463
Transfer of expenses incurred but recorded as other assets	266	(16)	74	324
Tax loss carry forward	-	71	143	214
Difference in amortization rate of intangible assets	-	-	54	54
Accrual of other expenses	161	165	-	326
Gross deferred tax asset	470	5,823	620	6,913

Note 26: Income Taxes (continued)

	2001	Movement	Opening balances of the Group's subsidiary as of 1 January 2002	2002
Tax effect of taxable temporary differences at expected future tax rate of 25%				
Provision for impairment of loans	(1,371)	(4,806)	-	(6,177)
Difference in depreciation rate of fixed assets	(1,104)	(2,111)	-	(3,215)
Movement of the revaluation reserve for premises	(3,076)	226	-	(2,850)
Difference in amortization rate of intangibles assets	-	(215)	-	(215)
Tax loss carry forward utilization by Azericard	-	(143)	-	(143)
Accrual of other income	-	(236)	(86)	(322)
Gross deferred tax liability	**(5,551)**	**(7,285)**	**(86)**	**(12,922)**
Net deferred tax (liability)/asset	**(5,081)**	**(1,462)**	**534**	**(6,009)**

Opening balances of the Group subsidiary as of 1 January 2002 represent deferred tax assets and liabilities balances of Azericard at 1 January 2002.

Included in the total amount of deferred tax liability balance of AZM 6,009 million as at 31 December 2002 are deferred tax asset balances in the amount of AZM 184 million, AZM 89 million and AZM 27 million for Azericard, IIC and IBAR Moscow, respectively. In the context of the Group's current structure, tax losses and current tax assets of different companies may not be offset against current tax liabilities and taxable profits of other companies. Therefore, a deferred tax asset of one company of the Group may not be offset against a deferred tax liability of another company.

Tax loss carry forward for Azericard was reversed in 2002 due to the fact the company has utilized tax loss incurred in prior years for the purposes of calculation of statutory profits for 2002.

The Group has statutory tax losses of its Insurance Subsidiary in the amount of AZM 263 million to carry forward against future taxable income of this subsidiary; these tax losses will expire in 2007, if not utilised. Insurance Subsidiary had a tax loss carry forward in the amount of AZM 71 million as of 31 December 2002. This has been reflected in these consolidated financial statements as an increase of deferred tax asset. Deferred income tax assets are recognised for tax loss carry forwards only to the extent that realisation of the related tax benefit is probable.

A deferred tax asset of AZM 1,935 million arises as at 31 December 2002 as a result of the fair valuation of investment securities available for sale. Deferred asset related to the fair valuation of investment securities available for sale was recorded as the movement of fair value reserve in the consolidated statement of changes in shareholders' equity and will be subsequently recognized in the consolidated statement of income when the loss on the securities is realized. Refer to Note 8.

Temporary differences on depreciation expenses arise from differences between depreciation rates per statutory tax regulations and IFRS, and mostly relate to the estimated useful life of buildings.

Note 27: Dividends

	2002	2001
Ordinary dividends		
Dividends payable at 1 January	1,376	2,189
Dividends declared during the year	11,268	7,246
Dividends paid during the year	(5,327)	(8,059)
Dividends payable at 31 December	**7,317**	**1,376**

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. Included in dividends payable as at 31 December 2002 are dividends declared for the 4th quarter of 2002 in the amount of AZM 4,017 million (2001: AZM 1,376 million) and dividends payable to the Ministry of Finance of the Republic of Azerbaijan for 2002 in the amount of AZM 3,300 million.

Note 28:
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.

Credit risk. The Group takes on exposure to credit risk, which is the risk that a 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 instrument 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.

Geographical risk. The geographical concentration of the Group's consolidated assets and liabilities as at 31 December 2002:

	Azerbaijan	*OECD*	*Non OECD*	*Total*
Assets				
Cash and short-term funds	268,388	426,594	209,194	904,176
Due from other banks	24,609	36,697	19,624	80,930
Loans and advances to customers	1,066,021	-	4,189	1,070,210
Investment securities	42,319	-	34,103	76,422
Investment in associate	4,333	-	-	4,333
Accrued interest income	21,954	-	20	21,974
Other assets	38,861	59,388	869	99,118
Premises and equipment	140,322	-	13,705	154,027
Intangible assets	2,503	-	-	2,503
Total assets	1,609,310	522,679	281,704	2,413,693
Liabilities				
Due to banks	17,160	-	70	17,230
Customer accounts	1,905,958	-	1,174	1,907,132
Debt securities in issue	27,985	-	-	27,985
Other borrowed funds	-	304,265	-	304,265
Accrued interest expense	3,841	594	-	4,435
Other liabilities	9,657	398	869	10,924
Deferred tax liability	6,009	-	-	6,009
Total liabilities	1,970,610	305,257	2,113	2,277,980
Net balance sheet position	(361,300)	217,422	279,591	135,713
Credit related commitments	1,365,270	-	5,593	1,370,863

The geographical concentration of the Group's assets and liabilities as at 31 December 2001:

	Total assets	*Total liabilities*	*Net balance sheet position*	*Credit related commitments*
As at 31 December 2001				
Azerbaijan	1,419,656	1,514,527	(94,871)	1,347,586
OECD* countries	512,589	335,372	177,217	-
Non-OECD countries	2,045	-	2,045	-
	1,934,290	1,849,899	84,391	1,347,586

*OECD – Organisation for Economic Cooperation and Development

Note 28:
Financial Risk Management (continued)

Currency risk. The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its consolidated financial position and cash flows. The Group has an Asset and Liability Committee (ALCO), which regularly monitors the foreign currency position and make decisions in line with the expected movements in foreign exchange rates in order to reduce this risk. The table below summarises the Group's exposure to foreign currency exchange rate risk as at 31 December 2002. Included in the table below are the Group's consolidated assets and liabilities at their carrying amounts, categorised by currency.

As at 31 December 2002, the Group has the following positions in major currencies:

	USD	AZM	EUR	JPY	RR	Other	Total
Assets							
Cash and short-term funds	743,432	84,774	63,024	974	1,448	10,524	904,176
Due from other banks	77,685	3,245	-	-	-	-	80,930
Loans and advances to customers	876,582	105,363	37,350	36,729	146	14,040	1,070,210
Investment securities	23,908	42,320	10,194	-	-	-	76,422
Investment in associate	-	4,333	-	-	-	-	4,333
Accrued interest income	20,795	1,075	68	-	-	36	21,974
Other assets	56,458	37,386	3,886	-	749	639	99,118
Premises and equipment	-	140,323	-	-	13,704	-	154,027
Intangible assets	-	2,503	-	-	-	-	2,503
Total assets	1,798,860	421,322	114,522	37,703	16,047	25,239	2,413,693
Liabilities							
Due to banks	17,064	38	50	-	78	-	17,230
Customer accounts	1,584,315	255,175	65,599	-	959	1,084	1,907,132
Debt securities in issue	27,983	2	-	-	-	-	27,985
Other borrowed funds	221,197	-	32,013	36,729	-	14,326	304,265
Accrued interest expense	4,301	45	43	-	-	46	4,435
Other liabilities	2,289	8,377	18	-	108	132	10,924
Deferred tax liability	-	6,009	-	-	-	-	6,009
Total liabilities	1,857,149	269,646	97,723	36,729	1,145	15,588	2,277,980
Net balance sheet position	(58,289)	151,676	16,799	974	14,902	9,651	135,713
Credit related commitments	(818,060)	(68,650)	(64,846)	(418,732)	(462)	(113)	(1,370,863)

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

As at 31 December 2001, the Group has the following positions in major currencies:

	USD	AZM	EUR	JPY	Other	Total
Assets						
Cash and short-term funds	527,928	94,424	-	-	29,441	651,793
Due from other banks	56,074	6,375	22,841	-	-	85,290
Loans and advances to customers	808,219	65,396	37,885	54,671		966,171
Investment securities	7,746	60,178	-	-	-	67,924
Investment in associate	-	1	-	-	-	1
Accrued interest income	14,667	3,092	43	28	-	17,830
Other assets		37,330	2,045	-	-	39,375
Premises and equipment	-	105,298	-	-	-	105,298
Intangible assets	-	608	-	-	-	608
Total assets	1,414,634	372,702	62,814	54,699	29,441	1,934,290
Liabilities						
Due to banks	13,832	96	-	-	-	13,928
Customer accounts	1,305,437	104,008	47,207	-	1,017	1,457,669
Debt securities in issue	21,647	6	-	-	-	21,653
Other borrowed funds	253,848	-	36,007	54,670	-	344,525
Accrued interest expense	3,228	32	44	-	-	3,304
Other liabilities	1,495	2,244	-	-	-	3,739
Deferred tax liability, net	-	5,081	-	-	-	5,081
Total liabilities	1,599,487	111,467	83,258	54,670	1,017	1,849,899
Net balance sheet position	(184,853)	261,235	(20,444)	29	28,424	84,391
Credit related commitments	(842,478)	(22,378)	(47,024)	(430,685)	(5,021)	(1,347,586)

Note 28:
Financial Risk Management (continued)

The Group both as at 31 December 2002 and 2001 had a short position in US dollar and, therefore, was exposed to foreign exchange risk should the local currency devalue against the US dollar. The Group's strategy is generally to maintain short position in local currency and long position in US dollar. However, mainly because of the short term loans extended in AZM at the year-end to various state enterprises the Group had a net short position in US dollar and long position in local currency as at both year ends.

The Bank is required to maintain its foreign currency position within the limits set up by the NBAR. Effective from 31 January 2001, the open currency position limit for each individual currency is 10% of statutory equity. As at 31 December 2002 the Bank's net currency position ratios calculated in accordance with local statutory requirements are as follows: for US dollar 3.60% long (2001: -6.59 % short), for EUR 0.28% long (2001: 2.86% long), for JPY 0.73% long (2001: 0.70% long) and for RR 0.59% long (2001: 0.74% long).

IBAR Moscow, a fully owned subsidiary of the Bank registered in Moscow, Russia, operates under a license issued by the Central Bank of the Russian Federation (CBRF) and is required to maintain its foreign currency position in compliance with the CBRF regulations. As at 31 December 2002 IBAR Moscow was in compliance with the open currency position limits set by the CBRF.

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 derivatives. The table below shows consolidated assets and liabilities as at 31 December 2002 and 2001 by their remaining contractual maturities. 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. The liquidity position of the Group as at 31 December 2002 is set out below:

The liquidity position of the Group as at 31 December 2001 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 maturity*	*Total*
Assets							
Cash and short term funds	904,176	-	-	-	-	-	904,176
Due from other banks	19,910	49,269	3,524	1,468	6,759	-	80,930
Loans and advances customers	135,364	334,442	209,856	105,601	284,947	-	1,070,210
Investment securities	4,334	65,097	-	-	-	6,991	76,422
Investment in associate		-	-	-	-	4,333	4,333
Accrued interest income	21,974	-	-	-	-	-	21,974
Other assets	38,899	58,372	1,302	545	-	-	99,118
Premises and equipment	-	-	-	-	-	154,027	154,027
Intangible assets	-	-	-	-	-	2,503	2,503
Total assets	**1,124,657**	**507,180**	**214,682**	**107,614**	**291,706**	**167,854**	**2,413,693**
Liabilities							
Due to banks	15,325	1,223	-	-	-	682	17,230
Customer accounts	1,355,376	329,351	138,981	83,424	-	-	1,907,132
Debt securities in issue	-	-	-	27,985	-	-	27,985
Other borrowed funds	-	49,808	37,635	89,030	127,792	-	304,265
Accrued interest expense	3,968	467	-	-	-	-	4,435
Other liabilities	2,536	7,872	258	258	-	-	10,924
Deferred tax liability	-	-	-	6,009	-	-	6,009
Total liabilities	**1,377,205**	**388,721**	**176,874**	**206,706**	**127,792**	**682**	**2,277,980**
Net liquidity gap	**(252,548)**	**118,459**	**37,808**	**(99,092)**	**163,914**	**167,172**	**135,713**
Cumulative liquidity gap	**(252,548)**	**(134,089)**	**(96,281)**	**(195,373)**	**(31,459)**	**135,713**	

Note 28:
Financial Risk Management (continued)

The liquidity position of the Group as at 31 December 2001 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 maturity	Total
Assets							
Cash and short term funds	651,793	-	-	-	-	-	651,793
Due from other banks	59,968	12,622	4,745	-	7,955		85,290
Loans to customers	82,159	206,322	171,540	199,283	306,867	-	966,171
Investment securities	7,746	50,166	-	-	-	10,012	67,924
Investment in associate	-	-	-	-	-	1	1
Accrued interest income	17,830	-	-	-	-	-	17,830
Other assets	39,375	-	-	-	-	-	39,375
Premises and equipment	-	-	-	-	-	105,298	105,298
Intangible assets	-	-	-	-	-	608	608
Total assets	858,871	269,110	176,285	199,283	314,822	115,919	1,934,290
Liabilities							
Due to banks	13,928	-	-	-	-	-	13,928
Customer accounts	1,095,266	38,110	313,035	11,258	-	-	1,457,669
Debt securities in issue	-	-	-	21,653	-	-	21,653
Other borrowed funds	-	-	94,150	125,666	124,709	-	344,525
Accrued interest expense	3,304	-	-	-	-	-	3,304
Other liabilities	3,739	-	-	-	-	-	3,739
Deferred tax liability, net	-	-	-	5,081	-	-	5,081
Total liabilities	1,116,237	38,110	407,185	163,658	124,709	-	1,849,899
Net liquidity gap	(257,366)	231,000	(230,900)	35,625	190,113	115,919	84,391
Cumulative liquidity gap	(257,366)	(26,366)	(257,266)	(221,641)	(31,528)	84,391	

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. The liquidity risk is managed by the ALCO.

Mandatory cash balances with the NBAR and 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 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 uncertain term and of different types. An unmatched position potentially enhances profitability, but also increases 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 Group and its exposure to changes in interest rates 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 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.

Note 28:
Financial Risk Management (continued)

The table below summarizes the Group's exposure to interest rate risks as at 31 December 2002. Included in the table below are the Group's consolidated assets and liabilities at their carrying amounts, categorized 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	Overdue/ Non interest bearing	Total
Assets						
Cash and short term funds	635,027	-	-	-	269,149	904,176
Due from other banks	20,732	49,269	3,524	1,468	5,937	80,930
Loans and advances to customers	135,364	334,442	209,857	105,601	284,946	1,070,210
Investment securities	-	65,097	-	-	11,325	76,422
Investment in associate		-	-	-	4,333	4,333
Accrued interest income	-	-	-	-	21,974	21,974
Other assets	-	53,994	-	-	45,124	99,118
Premises and equipment	-	-	-	-	154,027	154,027
Intangible assets	-	-	-	-	2,503	2,503
Total assets	791,123	502,802	213,381	107,069	799,318	2,413,693
Liabilities						
Due to banks	-	1,223	-	-	16,007	17,230
Customer accounts	575,308	329,351	138,981	83,424	780,068	1,907,132
Debt securities in issue	-	-	-	27,985	-	27,985
Other borrowed funds	-	49,808	37,635	89,030	127,792	304,265
Accrued interest expense	-	-	-	-	4,435	4,435
Other liabilities	-	-	-	-	10,924	10,924
Deferred tax liability	-	-	-	-	6,009	6,009
Total liabilities	575,308	380,382	176,616	200,439	945,235	2,277,980
Net liquidity gap	215,815	122,420	36,765	(93,370)	(145,917)	135,713
Cumulative liquidity gap	215,815	338,235	375,000	281,630	135,713	

As at 31 December 2001 the Group's interest rate sensitivity analysis based on the re-pricing of the Group's consolidated assets and liabilities did not differ significantly from the maturity analysis as of the same date.

The table below summarises the effective interest rates by major currencies for major monetary financial instruments. The analysis has been prepared using period-end effective contractual rates.

	2002				2001		
	USD	AZM	EUR	RR	USD	AZM	EUR
Assets							
Cash and cash equivalents	1.3	-	2.9	-	0.80	-	-
Due from other banks	16.3	18.0	6.5	-	15.2	18.5	-
Loans and advances to customers	16.8	16.0	20.3	25.0	16.0	17.5	4.3
Investment securities	6.9	13.1	6.4	-	-	16.1	-
Liabilities							
Customer accounts	10.0	11.9	10.1	-	10.0	10.0	-
Due to other banks	3.0	-	-	-	-	-	-
Debt securities in issue	10.0	10.0	-	-	10.0	10.0	-
Other borrowed funds	6.1	-	4.2	-	5.5	-	4.3

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

No interest rates were provided for balances denominated in RR as at 31 December 2001, as there were no outstanding interest-bearing assets and liabilities in this currency at that date.

Note 29:
Commitments and Contingent Liabilities

Legal proceedings. At 31 December 2002 the Group was engaged in litigation proceeding with DHT Inshaat, a construction company registered in Republic of Turkey, in relation to value added tax (VAT) in the amount of USD 1,704 million on the cost of construction of the Group's head office building. The VAT was to be paid by the Group to DHT Inshaat for the purposes of subsequent transfer to the budget of the Republic of Azerbaijan. However, the Group paid to DHT Inshaat for the services provided on the basis of the contract between the two parties net of the VAT.

DHT Inshaat initiated a legal proceeding against the Group with the Chamber of Commerce of the Stockholm Arbitrage Institute and won the court case. DHT Inshaat obtained enforcement of the arbitral award from Brussels and Paris courts. As a result, the Group's funds placed with two European banks in the total amount of AZM 3,679 million (EUR 724 thousand) have been blocked. Refer to Note 11. The Group has also incurred legal costs and paid court expenses of DHT Inshaat in the total amount of AZM 658 million during 2002 (Note 25). In response to the decision of the court, the Group transferred the VAT to the budget of the Republic of Azerbaijan on behalf of DHT Inshaat as follows: USD 1,252 million was transferred in June 2001 and USD 451 million in February 2002.

On 21 February 2003 a joint Settlement Agreement was signed between the Group and DHT Inshaat, whereby DHT Inshaat irrevocably acknowledged that all its claims against the Group, of whatever nature, and relating to the arbitral award and its enforcement are fully and finally settled.

The parties signed Joint Instructions authorizing the above mentioned European banks to release entirely all blocked accounts on the Bank's accounts to the Group without delay in the total amount of AZM 3,679 million (EUR 724 thousand). The funds were fully unblocked in March 2003.

No provision has been made in connection with these lawsuits, as the Group's Management believes that it is unlikely that any significant loss will eventuate.

Tax legislation. The Azerbaijani commercial and tax legislation contains provisions which sometimes imply more than one treatment for transactions. Moreover, the tax authorities may make arbitrary judgements as to business activities and transactions, including the arbitrary classification of the activities of the enterprise when the regulatory basis for this decision is deemed insufficient. Thus, management's judgement of the Group's business activities and transactions may not coincide with the interpretation of the tax authorities.

In the event that the tax authorities challenge a particular transaction treatment, the Group entities may be assessed penalties and taxes on present and past transactions. Although the actual tax due on a transaction may be minimal, penalties can be significant. Management believes that these consolidated financial statements adequately reflect the activities of the Group.

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%.

If a particular treatment was to be challenged by the tax authorities, the Group entities may be assessed additional taxes, penalties and interest, which can be significant. Tax years remain open to review by the tax authorities for three years.

Capital commitments. As at 31 December 2002 the Group has capital commitments in respect of improvement and reconstruction of the Group's subsidiary premises in Moscow, Russia totalling AZM 938 million (RR 6,094 thousand). Refer to Note 12.

Operating lease commitments. As at 31 December 2002 the Group had no significant operating lease commitments.

Credit related commitments. 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.

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 authorizing 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.

Note 29:
Commitments and Contingent Liabilities (continued)

Outstanding credit related commitments as at 31 December are as follows:

	2002	2001
Un-drawn credit lines	114,017	168,543
Promissory notes issued by the Bank and provided to the Eximbank (Turkey) against credit facilities as collateral (Notes 16)	171,804	185,025
Import letters of credit	800,653	737,181
Guarantees issued	284,389	256,837
Total credit related commitments	**1,370,863**	**1,347,586**

Included in the total amount of un-drawn credit lines of the Group of AZM 114,017 million as of 31 December 2002 is the balance of un-drawn credit lines of IBAR Moscow amounting to AZM 3,045 million. In addition, included in the total amount of import letters of credit issued by the Group of AZM 800,653 million is the balance of import letters of credit issued by IBAR Moscow in the amount of AZM 2,548 million.

As of 31 December 2002 credit related commitments in the amount of AZM 831,353 million (31 December 2001: AZM 862,576 million) are secured by the Azerbaijan government guarantees or blocked customer deposits.

As of 31 December 2002, the Group had outstanding balance of export letters of credit in amount of AZM 924,991 million (2001: 531,424 million). Of the total export letters of credit as at 31 December 2002, those in the amount of AZM 876,882 million were issued for importers of crude oil from the state organization related to the oil industry by foreign banks. 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 letters of credit.

The total outstanding contractual amount of un-drawn 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. The Group has the right to renegotiate the terms of credit line agreements.

At 31 December 2002 and 2001, the probability of losses arising in connection with these commitments was considered remote, and, accordingly, no provision has been established.

Note 30:
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 a 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.

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 available-for-sale investment securities are carried on the consolidated balance sheet at their fair value.

Due from other banks. The fair value of floating rate placements is their carrying amount. The estimated fair value of fixed interest bearing placement is based on discounted cash flows using prevailing money market interest rates for instruments with similar credit risk and remaining maturity. Refer to Note 6 for the estimated fair value of due from other banks at 31 December 2002.

Loans and advances to customers. Loans and advances are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value. Refer to Note 7 for the estimated fair value of loans and advances to customers as at 31 December 2002.

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.

Borrowings. The estimated fair value of liabilities with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest bearing placements and other borrowings without a quoted market price is based on discounted cash flows, using interest rates for new debts with similar remaining maturity. Refer to Notes 13 and 14 for the estimated values of due to other banks and customer accounts as at 31 December 2002.

Note 31: 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 at the year-end and results of transactions carried out during the years with related parties are as follows:

	2002	2001
Loans		
Loans outstanding at year end (net)	25,025	23,301
Interest collected during the year	2,468	1,487
Due to banks		
Due to banks	3,745	-
Customer accounts		
Deposits from customers and current accounts outstanding at year end	2,757	6,261
Interest expense incurred during the year	102	113
Other		
Commissions and other fees paid	116	2,986
Credit related commitments		
Un-drawn credit lines	2,135	-
Import letters of credit	205	2,080
Letters of guarantee	1,597	-

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

Note 32: Consolidated Subsidiaries and Associates

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

			Equity controlled	
Name	*Activity*	*Country of Registration*	***2002***	*2001*
Baku Inter-Bank Currency Exchange	Currency exchange	Republic of Azerbaijan	20.0%	20.0%
IBAR Moscow	Banking	Russian Federation	100.0%	-
International Insurance Company	Insurance	Republic of Azerbaijan	100.0%	-
InterProtect Re AG	Reinsurance	Switzerland	100.0%	-
Azericard Ltd.	Plastic cards	Republic of Azerbaijan	50.0%	50.0%

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 1,400 million or AZM 4,635 million as contribution to the share capital and reserves of Inter Protect Re. Of the total amount transferred, CHF 1,200 million was used to pay for 1,000 shares at CHF 120 par value each, and the remaining CHF 200 thousand as a share premium. As at 31 December 2002 the operations of Inter Protect Re were insignificant.

The financial statements of Azericard as at 31 December 2002 were consolidated with the consolidated financial statements of the Group on the grounds that the Group exercises control on financial and operational decisions of Azericard.

Net share of losses of Azericard accumulated prior to 1 January 2002 in amount of AZM 1,058 million has been recorded as part of other movements of reserves in consolidated statement of changes in shareholders' equity in 2002 due to the fact that the Group has prepared its consolidated financial statements for the first time as of 31 December 2002.

Included in other movements of reserves in the consolidated statement of changes in shareholders' equity for the year ended 31 December 2002 is AZM 4,159 million which represents a currency translation gain on the consolidation of IBAR Moscow.

Note 33:
Subsequent Events

On 6 May 2003 a share issue in the amount of AZM 30,000 million was officially registered by the Securities Committee of the Republic of Azerbaijan and fully paid in by all shareholders, bringing the total authorized and paid in share capital of the Bank up to AZM 50,000 million.

On 21 February 2003 a joint Settlement Agreement was signed between the Group and DHT Inshaat, whereby DHT Inshaat irrevocably acknowledged that all its claims against the Group, of whatever nature, and relating to the lawsuit award and its enforcement are fully and finally settled.

In accordance with the latest Presidential Decree dated 17 April 2003 the Ministry of Economic Development of the Republic of Azerbaijan was assigned to conduct negotiations with the European Bank for Reconstruction and Development («the EBRD») regarding the potential sale of 20% of the share capital of the Bank and sign a relevant memorandum of understanding by 30 May 2003 as well as to present to the President of the Republic of Azerbaijan a price offer from the EBRD for the acquisition of 20% of the share capital of the Bank by 30 August 2003. In addition, in accordance with the Decree, all remaining shares of the Bank owned by the state are to be sold via auctions by the end of 2004.