THE INTERNATIONAL BANK OF THE REPUBLIC OF AZERBAIJAN

International Financial Reporting Standards Consolidated Financial Statements and Independent Auditor's Report

31 December 2008

CONTENTS

PRICEWATERHOUSECOOPERS

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying consolidated financial statements of the International Bank of the Republic of Azerbaijan and its subsidiaries (the "Group") which comprise the consolidated balance sheet as at 31 December 2008 and the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

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

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers Audit Azerbaijan LLC

Baku, Republic of Azerbaijan
1 May 2009

The International Bank of the Republic of Azerbaijan
Consolidated Balance Sheet

In thousands of Azerbaijani Manats	Note	2008	2007
ASSETS			
Cash and cash equivalents	7	526,729	179,704
Mandatory cash balances with the National/Central banks		108,146	170,347
Due from other banks	8	127,402	173,591
Loans and advances to customers	9	2,881,520	2,035,738
Investment securities available for sale	10	-	12,679
Investment in associates	11	1,607	801
Deferred income tax asset	27	520	1,173
Premises and equipment	12	150,527	113,023
Intangible assets	12	7,073	7,685
Other financial and insurance assets	13	36,730	8,722
Other assets	14	16,103	8,949
TOTAL ASSETS		**3,856,357**	**2,712,412**
LIABILITIES			
Due to other banks	15	828,196	147,309
Customer accounts	16	2,083,995	1,850,483
Debt securities in issue	17	10,948	16,808
Other borrowed funds	18	289,863	262,621
Current income tax liability		15,188	2,199
Deferred income tax liability	27	22,735	19,094
Other financial and insurance liabilities	19	110,040	56,134
Other liabilities	20	14,483	13,006
Subordinated debt	21	96,500	102,470
TOTAL LIABILITIES		**3,471,948**	**2,470,124**
EQUITY			
Share capital	22	189,737	100,000
Retained earnings		162,083	110,383
Revaluation reserve for premises and equipment	12	32,533	27,977
Cumulative translation reserve		(1,242)	2,377
Net assets attributable to the Bank's equity holders		**383,111**	**240,737**
Minority interest		**1,298**	**1,551**
TOTAL EQUITY		**384,409**	**242,288**
TOTAL LIABILITIES AND EQUITY		**3,856,357**	**2,712,412**

Approved for issue by the Board of Directors and signed on its behalf on 1 May 2009:

Mr. Jahangir Hajiyev
Chairman of the Board of Directors

Mr. Rovshan Ismaylov
Chief Financial Officer

The notes set out on pages 5 to 72 form an integral part of these consolidated financial statements.

In thousands of Azerbaijani Manats	Note	2008	2007
Interest income	23	279,063	185,141
Interest expense	23	(100,413)	(72,825)
Net interest income		**178,650**	**112,316**
(Provision for)/Release of impairment of due from other banks	8	(306)	426
Provision for impairment of loans to customers	9	(91,279)	(28,862)
Net interest income after provision for loan impairment		**87,065**	**83,880**
Fee and commission income	24	127,346	87,260
Fee and commission expense	24	(17,723)	(7,773)
Fair value gain on derivatives	13	23,690	-
Gains less losses from trading in foreign currencies		10,670	24,743
Foreign exchange translation gains less losses/(losses less gains)		3,996	(1,821)
Loss on early settlement of assets/liabilities at rates below/above market	25	-	(8,047)
Loss on disposal of investment securities available for sale	10	(1,716)	-
Gross insurance premiums written		13,597	10,677
Premiums ceded to reinsurers		(2,230)	(2,729)
Increase of provision for unearned premiums, net of reinsurance	19	(5,330)	(2,815)
Net claims incurred		(2,923)	(1,905)
Other income		365	477
Administrative and other operating expenses	26	(104,604)	(82,767)
Share of profit (loss) of associates	11	805	(8)
Profit before tax		**133,008**	**99,172**
Income tax expense	27	(34,315)	(24,681)
Profit for the year		**98,693**	**74,491**
Profit is attributable to			
Equity holders of the Bank		98,843	74,532
Minority interest		(150)	(41)
Profit for the year		**98,693**	**74,491**
Earnings per share for profit attributable to the equity holders of the Bank, basic and diluted (expressed in AZN per share)	28	**0.17**	**0.18**

		Attributable to equity holders of the Bank					**Minority interest**	**Total equity**
In thousands of Azerbaijani Manats	**Note**	**Share capital**	**Revaluation reserve for premises**	**Cumulative translation reserve**	**Retained earnings**	**Total**		
Balance at 1 January 2007		**59,319**	**17,444**	**1,435**	**61,512**	**139,710**	**1,528**	**141,238**
Premises and equipment								
- Revaluation	12	-	16,808	-	-	16,808	-	16,808
- Realised revaluation reserve		-	(2,409)	-	2,409	-	-	-
Income tax recorded in equity	27	-	(3,866)	-	-	(3,866)	-	(3,866)
Currency translation differences		-	-	942	-	942	64	1,006
Net income recognised directly in equity		-	10,533	942	2,409	13,884	64	13,948
Profit for the year		-	-	-	74,532	74,532	(41)	74,491
Total recognised income for 2007		-	10,533	942	76,941	88,416	23	88,439
Share issue	22	40,681	-	-	-	40,681	-	40,681
Dividends declared	29	-	-	-	(28,070)	(28,070)	-	(28,070)
Balance at 31 December 2007		**100,000**	**27,977**	**2,377**	**110,383**	**240,737**	**1,551**	**242,288**
Premises and equipment								
- Revaluation increase	12	-	11,490	-	-	11,490	-	11,490
- Revaluation decrease	12	-	(3,226)	-	-	(3,226)	-	(3,226)
- Realised revaluation reserve		-	(1,794)	-	1,794	-	-	-
Income tax recorded in equity	27	-	(1,914)	-	-	(1,914)	-	(1,914)
						-		-
Currency translation differences		-	-	(3,619)	-	(3,619)	(103)	(3,722)
Net income recognised directly in equity		-	4,556	(3,619)	1,794	2,731	(103)	2,628
Profit for the year		-	-	-	98,843	98,843	(150)	98,693
Total recognised income for 2008		-	4,556	(3,619)	100,637	101,574	(253)	101,321
Share issue	22	89,737	-	-	-	89,737	-	89,737
Dividends declared	29	-	-	-	(48,937)	(48,937)	-	(48,937)
Balance at 31 December 2008		**189,737**	**32,533**	**(1,242)**	**162,083**	**383,111**	**1,298**	**384,409**

In thousands of Azerbaijani Manats	Note	2008	2007
Cash flows from operating activities			
Interest received		263,334	180,601
Interest paid		(90,787)	(66,260)
Fees and commissions received		128,351	91,547
Fees and commissions paid		(17,723)	(7,773)
Insurance premiums received		7,876	5,722
Reinsurance premiums paid		(2,230)	(2,729)
Income received from trading in foreign currencies		10,670	24,743
Other operating income received		365	477
Staff costs paid		(36,446)	(30,059)
Administrative and other operating expenses paid		(51,079)	(34,541)
Income tax paid		(18,946)	(27,423)
Cash flows from operating activities before changes in operating assets and liabilities		**193,385**	**134,305**
Changes in operating assets and liabilities			
Net decrease/(increase) in mandatory cash balances with National/Central banks		62,201	(54,893)
Cash collected on behalf of a related party		532,665	-
Cash paid on behalf of a related party		(532,665)	-
Net decrease/(increase) in due from other banks		46,642	(39,689)
Net increase in loans and advances to customers		(922,090)	(1,034,241)
Net (increase)/decrease in other financial and insurance assets		(28,008)	599
Net increase in other assets		(7,784)	(504)
Net increase/(decrease) in due to other banks		680,163	(26,175)
Net increase in customer accounts		223,269	541,291
Net increase in other financial and insurance liabilities		59,359	28,839
Net increase in other liabilities		472	3,358
Net cash provided from/(used in) operating activities		**307,609**	**(447,110)**
Cash flows from investing activities			
Acquisition of investment securities available for sale		-	(12,679)
Repayment of investment securities available for sale		10,963	-
Acquisition of premises and equipment	12	(42,820)	(34,701)
Proceeds from disposal of investments in subsidiaries	37	-	1,996
Proceeds from disposal of premises and equipment	12	-	1,480
Acquisition of intangible assets	12	(1,253)	(4,220)
Net cash used in investing activities		**(33,110)**	**(48,124)**
Cash flows from financing activities			
Repayment of debt securities in issue		(5,342)	(19,607)
Proceeds from other borrowed funds	18	151,106	163,627
Repayment of other borrowed funds	18	(123,041)	(35,925)
Proceeds from subordinated debt	21	-	102,470
Issue of ordinary shares	22	89,737	40,681
Dividends paid	29	(38,154)	(32,875)
Net cash provided from financing activities		**74,306**	**218,371**
Effect of exchange rate changes on cash and cash equivalents		**(1,780)**	**(815)**
Net increase in cash and cash equivalents		**347,025**	**(277,678)**
Cash and cash equivalents at the beginning of the year	7	179,704	457,382
Cash and cash equivalents at the end of the year	7	**526,729**	**179,704**

The notes set out on pages 5 to 72 form an integral part of these consolidated financial statements.

1 Introduction

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2008 for the International Bank of the Republic of Azerbaijan (the "Bank") and its subsidiaries (together referred to as the "Group").

Principal activity. The International Bank of the Republic of Azerbaijan was incorporated in 1991 as a fully state-owned bank and is domiciled in the Republic of Azerbaijan. On 28 October 1992, the Bank became a joint-stock commercial bank and the Ministry of Finance of the Republic of Azerbaijan ("MoF") became the major shareholder of the Bank. At 31 December 2008, the MoF held 52.92% (2007: 50.20%) of the total paid-in share capital of the Bank. Refer to Note 22.

The Bank was registered in the Republic of Azerbaijan to provide commercial banking services and has been operating under a full banking licence granted by the National Bank of the Republic of Azerbaijan ("NBAR") on 30 December 1992. On 1 March 2005, a Presidential Decree, which outlined the process for privatisation of the state shareholding in the Bank's share capital, was enacted. Based on the provisions of this Decree, the government will have to reduce gradually its share in the Bank's share capital either by selling its existing shares or by issuing additional shares in the open market, including international financial markets.

The Bank participates in the State deposit insurance scheme, which was introduced by the Azeri Law, "Deposits of individuals insurance in Azerbaijan Republic" dated 29 December 2006. The State Deposit Insurance Fund guarantees repayment of 100% of individual deposits in the following order:

- from 1 January 2008 till 1 January 2010 – up to AZN 6,000;
- 1 January 2010 and afterwards – up to AZN 8,000.

Any amounts over the respective limits are not insured.

The Bank has 36 branches (2007: 36 branches). The Group had 1,778 employees at 31 December 2008 (2007: 1,655 employees), of which 1,307 employees are employed by the Bank; 107 - by the International Insurance Company; 81 - by Azericard Limited; 254 - by the Group's fully owned banking subsidiary in the Russian Federation and 29 - by the International Bank of Azerbaijan-Georgia (2007: 1,327 - employed by the Bank; 99-by International Insurance Company; 65 - by Azericard Limited; 147 - by the Group's fully owned banking subsidiary in the Russian Federation and 17 - by the International Bank of Azerbaijan-Georgia).

On 24 January 2002, the Group registered its fully-owned subsidiary, International Bank of Azerbaijan Republic-Moscow, in Moscow, the Russian Federation ("IBAR Moscow"). The share capital of IBAR Moscow was established in the amount of EUR 10,000,000. It is a commercial bank in the form of a limited liability company. IBAR Moscow started its operations under a licence issued by the Central Bank of the Russian Federation ("the CBRF") on 25 January 2002. This licence allows IBAR Moscow to carry out banking operations with legal entities in Russian Roubles and in foreign currencies. During the first two years after its registration due to Russian statutory requirements IBAR Moscow was restricted from attracting deposits from individuals. On 1 December 2004, IBAR Moscow received a licence from the CBRF allowing it to provide a full range of banking services to individuals. IBAR Moscow's principal activity is represented by commercial banking operations. IBAR Moscow has been a member of Deposit Insurance Agency of the Russian Federation since 2 December 2004. IBAR Moscow's registered office is located at the following address: Tverskaya 6, Bldg 2, Moscow, 105,062, Russian Federation. IBAR Moscow opened a branch in Saint Petersburg, Russian Federation on 28 May 2003 and in Yekaterinburg on 25 August 2005. Based on the decision of Supervisory Board of the Group dated 30 December 2006, the share capital of IBAR Moscow was increased by EUR 4 million to EUR 14 million during the year ended 31 December 2007.

On 5 February 2002, the Group registered its fully-owned subsidiary International Insurance Company ("Insurance Subsidiary") at the Ministry of Justice of the Republic of Azerbaijan. The Insurance Subsidiary operates under an insurance licence issued by the Ministry of Finance of the Republic of Azerbaijan on 1 April 2002 and addendum to the above licence issued on 16 August 2002. The activity of the Insurance Subsidiary includes medical, auto, marine third party liability, marine hull, property, casualty, life, personal insurance, insurance of banking risks and reinsurance. During 2004, the insurance subsidiary received additional licences on mandatory fire insurance and on insurance of liability for non-performance of obligations. The official address of the Insurance Subsidiary is: J. Jabbarli Street 46, Baku, AZ 1009, the Republic of Azerbaijan.

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

On 18 July 2007, the Group sold 100% of its interest in Inter Protect Re AG to a non-resident individual in an arms-length transaction.

1 Introduction (Continued)

Azericard Limited, which is 100% owned by the Bank, was established as a limited liability company on 3 May 1996. Azericard Limited was registered with the Ministry of Justice of the Republic of Azerbaijan on 4 July 1996 and commenced its operations in 1997. Azericard Limited is a member service provider for MasterCard and Visa International and acts as a clearing and authorisation centre for plastic card transactions in the Republic of Azerbaijan.

Azericard Limited is at present one of the biggest providers of authorisation of plastic cards operations and clearing services in the Republic of Azerbaijan. The registered office address of Azericard Limited is: Nizami Street, 67, AZ1005, Baku, the Republic of Azerbaijan.

On 18 June 1999, the Group established a leasing subsidiary “Azerileasing” with the charter capital of AZN 369 thousand. On 29 July 2004, the Group increased the share capital of its leasing subsidiary by contributing an additional AZN 331 thousand.

In October 2006, the Group signed an agreement for the sale of 52.4% of its interest in the share capital of “Azerileasing” to an unrelated British based entity in an arms-length transaction. Refer to Note 37. On 14 June 2007, the new charter of “Azerileasing” was registered at Ministry of Justice of Azerbaijan Republic, where the change in shareholding structure of the company was established and the legal name of the company was changed to “Joint Leasing Company” Closed Joint-Stock Company.

On 16 November 2006, the Group registered its 75% owned subsidiary, International Bank of Azerbaijan Republic-Georgia (“IBAR Georgia”), in Tbilisi, Georgia. The share capital of IBAR Georgia was established in the amount of 12,000,000 Georgian Laris (“GL”), with the minority interest in the amount of GL 3,000,000 paid-in equally by an Azerbaijani commercial bank and a resident individual of the Republic of Georgia. IBAR Georgia started its operations under a license issued by the National Bank of Georgia (“the NBG”) on 5 February 2007. IBAR Georgia’s registered office is located at the following address: 36 Khetagurovi str., Tbilisi, Republic of Georgia. Refer to Note 37.

A full list of subsidiaries, associates and joint ventures of the Group is included within these consolidated financial statements. Refer to Note 37.

Registered address and place of business. The Bank’s registered address is:

67 Nizami Street,
AZ1005, Baku
Republic of Azerbaijan

Presentation currency. These consolidated financial statements are presented in thousands of Azerbaijani Manats ("AZN thousands"). The Azerbaijani Manat (“AZN”) is the official currency of the Republic of Azerbaijan.

At 31 December 2008, the principal rate of exchange used for translating foreign currency monetary balances was USD 1 = AZN 0.8010 (2007: USD 1 = AZN 0.8453).

2 Operating Environment of the Group

The Republic of Azerbaijan displays certain characteristics of an emerging market, including the existence of a currency that is not freely convertible in most countries outside of the Republic of Azerbaijan, restrictive currency controls, relatively high inflation and economic growth. The banking sector in the Republic of Azerbaijan is sensitive to adverse fluctuations in confidence and economic conditions. The Azerbaijani economy occasionally experiences falls in confidence in the banking sector accompanied by reductions in liquidity. Management is unable to predict economic trends and developments in the banking sector and what effect, if any, a deterioration in the liquidity of or confidence in the Azerbaijani banking system could have on the consolidated financial position of the Group.

The tax, currency and customs legislation within the Republic of Azerbaijan is subject to varying interpretations, and changes, which can occur frequently. Furthermore, the need for further developments in the bankruptcy laws, the absence of formalised procedures for the registration and enforcement of collateral, and other legal and fiscal impediments contribute to the difficulties experienced by banks currently operating in the Republic of Azerbaijan. The future economic direction of the Republic of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

2 Operating Environment of the Group (Continued)

Recent volatility in global financial markets. The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, at times much higher than normal interbank lending rates, and lower liquidity levels across the Republic of Azerbaijan banking sector resulting in a significant reduction in the number of new loans and advances made to customers, and higher funding costs where its remains possible to obtain debt finance from International Institutions or other local banks. The uncertainties in the global financial markets, has also led to bank failures and bank rescues in the United States of America, Western Europe and in Russia. Such circumstances could affect the ability of the Group to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions. The borrowers of the Group may also be affected by the lower liquidity situation which could in turn impact their ability to repay their outstanding loans. Deteriorating operating conditions for borrowers may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, management has reflected revised estimates of expected future cash flows in their impairment assessments.

Management is unable to reliably estimate the effects on the Group's future financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes that they are taking all the necessary measures to support the sustainability and development of the Group's business in the current circumstances.

3 Summary of Significant Accounting Policies

Basis of preparation. These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the revaluation of premises and certain financial instruments. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated (refer to Note 5).

Going concern. Management have prepared these consolidated financial statements on a going concern basis. In making this judgement management have considered the current macroeconomic environment for financial institutions operating in Azerbaijan, positive cash flows, the profitability of operations and access to foreign financial resources as required.

Amendments of the financial statements after issue. The Group's shareholders and management have the power to amend the consolidated financial statements after issue.

Consolidated financial statements. Subsidiaries are those companies and other entities (including special purpose entities), in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain benefits. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date, on which control is transferred to the Group (acquisition date), and are de-consolidated from the date that control ceases.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Bank and all of its subsidiaries use uniform accounting policies consistent with the Group's policies.

Minority interest is that part of the net results and of the net assets of a subsidiary attributable to interests, which are not owned, directly or indirectly, by the Bank. Minority interest forms a separate component of the Group's equity.

Associates. Associates are entities, over which the Bank has significant influence (directly or indirectly), but not control, generally accompanying a shareholding of between 20 and 50 percent of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost. The carrying amount of associates includes goodwill identified on acquisition less accumulated impairment losses, if any. The Group's share of the post-acquisition profits or losses of associates is recorded in the consolidated income statement, and its share of post-acquisition movements in reserves is recognised in reserves. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

3 Summary of Significant Accounting Policies (Continued)

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Key measurement terms. Depending on their classification financial instruments are carried at fair value, cost, or amortised cost as described below.

Fair value is the amount, for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair value is the current bid price for financial assets and current asking price for financial liabilities which are quoted in an active market. For assets and liabilities with offsetting market risks, the Group may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange or other institution and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques such as discounted cash flows models or models based on recent arms length transactions or consideration of financial data of the investees are used to fair value certain financial instruments, for which external market pricing information is not available. Valuation techniques may require assumptions not supported by observable market data. Disclosures are made in these consolidated financial statements if changing any such assumptions to a reasonably possible alternative would result in significantly different profit, income, total assets or total liabilities.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes *transaction costs*. Measurement at cost is only applicable to investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortised cost is the amount, at which the financial instrument was recognised at initial recognition, less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related balance sheet items.

The effective interest method is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate (refer to income and expense recognition policy).

Cash and cash equivalents. Cash and cash equivalents are items, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. All short-term inter-bank placements, beyond overnight placements, are included in due from other banks. Amounts, which relate to funds that are of a restricted nature, are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

Mandatory cash balances held with the NBAR, CBRF and NBG. Mandatory cash balances with the NBAR, CBRF and NBG are carried at amortised cost and represent non-interest bearing mandatory reserve deposits, which are not available to finance the Group's day to day operations and hence are not considered as part of cash and cash equivalents for the purposes of the consolidated cash flow statement.

Due from other banks. Amounts due from other banks are recorded when the Group advances money to counterparty banks with no intention of trading the resulting unquoted non-derivative receivable due on fixed or determinable dates. Amounts due from other banks are initially recognised at fair value plus transaction costs and subsequently carried at amortised cost.

3 Summary of Significant Accounting Policies (Continued)

Loans and advances to customers. Loans and advances to customers are recorded when the Group advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates and has no intention of trading the receivable. Loans and advances to customers are initially recognised at fair value plus transaction costs and subsequently carried at amortised cost.

Impairment of financial assets carried at amortised cost. Impairment losses are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Group determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Group considers whether a financial asset is impaired are its overdue status and realisability of related collateral, if any. The following other principal criteria are also used to determine that there is objective evidence that an impairment loss has occurred:

- any instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the borrower experiences a significant financial difficulty as evidenced by borrower's financial information that the bank obtains;
- the borrower considers bankruptcy or a financial reorganisation;
- there is adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrower; or
- the value of collateral significantly decreases as a result of deteriorating market conditions.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent, to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

If the terms of a financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined.

Credit related commitments. The Group enters into credit related commitments, including letters of credit and financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognised at their fair value, which is normally evidenced by the amount of fees received.

This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At each balance sheet date, the commitments are measured at the higher of (i) the remaining unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the balance sheet date.

3 Summary of Significant Accounting Policies (Continued)

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

Investment securities available for sale are carried at fair value. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit or loss. All other elements of changes in the fair value are deferred in equity until the investment is derecognised or impaired, at which time the cumulative gain or loss is removed from equity to profit or loss.

Impairment losses are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of investment securities available for sale. A significant or prolonged decline in the fair value of an equity security below its cost is an indicator that it is impaired. The cumulative impairment loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss. Impairment losses on equity instruments are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through current period's profit or loss.

Promissory notes purchased. Promissory notes purchased are included in trading securities, or in due from other banks or in loans and advances to customers, depending on their substance and are recorded, subsequently remeasured and accounted for in accordance with the accounting policies for these categories of assets.

Derecognition of financial assets. The Group derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

Goodwill. Goodwill represents the excess of the cost of an acquisition over the fair value of the acquirer's share of the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of exchange. Goodwill on acquisitions of subsidiaries is presented separately in the consolidated balance sheet. Goodwill on acquisitions of associates is included in the investment in associates. Goodwill is carried at cost less accumulated impairment losses, if any.

The Group tests goodwill for impairment at least annually and whenever there are indications that goodwill may be impaired. Goodwill is allocated to the cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the business combination. Such units or group of units represent the lowest level, at which the Group monitors goodwill and are not larger than a segment. Gains or losses on disposal of an operation within a cash generating unit, to which goodwill has been allocated, include the carrying amount of goodwill associated with the operation disposed of, generally measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit, which is retained.

Premises and equipment. Premises are stated at revalued amounts. Equipment is stated at cost less accumulated depreciation and impairment losses, where required.

Premises of the Group are subject to revaluation on a regular basis. The frequency of revaluation depends upon the movements in the fair values of the premises being revalued. The revaluation reserve for premises included in equity is transferred directly to retained earnings when the surplus is realised, ie either on the retirement or disposal of the asset, or as the asset is used by the Group; in the latter case, the amount of the surplus realised is the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost.

Construction in progress is carried at cost less provision for impairment where required. Cost includes borrowing costs incurred on specific or general funds borrowed to finance construction of qualifying assets. Upon completion, assets are transferred to premises and equipment at their carrying amount. Construction in progress is not depreciated until the asset is available for use

All other items of premises and equipment are stated at cost less accumulated depreciation and impairment losses, if any.

Costs of minor repairs and maintenance are expensed when incurred. Cost of replacing major parts or components of premises and equipment items are capitalised and the replaced part is retired.

3 Summary of Significant Accounting Policies (Continued)

If impaired, premises and equipment are written down to the higher of their value in use and fair value less costs to sell. The decrease in carrying amount is charged to profit or loss to the extent it exceeds the previous revaluation surplus in equity. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss.

Depreciation. Land is not depreciated. Depreciation on other items of premises and equipment is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives as follows:

	2008	2007
Premises	2.5%-5%	2.5%-5%
Leasehold improvements	10%	10%
Computers and other communication equipment	25%	25%
Plastic cards operations equipment	33%	33%
Furniture, fixtures, automated teller machines and other	20%-25%	20%-25%
Motor vehicles	25%	25%

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Intangible assets. All of the Group's intangible assets have definite useful life and primarily include capitalised computer software.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Development costs that are directly associated with identifiable and unique software controlled by the Group are recorded as intangible assets if the inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, for example its maintenance, are expensed when incurred. Capitalised computer software is amortised on a straight line basis over expected useful lives of one to four years.

Operating leases. Where the Group is a lessee in a lease, which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit or loss on a straight-line basis over the period of the lease.

Leases embedded in other agreements are separated if (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets and (b) the arrangement conveys a right to use the asset.

Due to other banks. Amounts due to other banks are recorded when money or other assets are advanced to the Group by counterparty banks. The non-derivative liability is carried at amortised cost. If the Group purchases its own debt, it is removed from the consolidated balance sheet and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from early retirement of debt.

Customer accounts. Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at amortised cost.

***Debt securities in issue**.* Debt securities in issue include promissory notes, bonds, certificates of deposit and debentures issued by the Group. Debt securities are stated at amortised cost. 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 arising from retirement of debt.

3 Summary of Significant Accounting Policies (Continued)

Subordinated debt. Subordinated debt includes long-term non-derivative liabilities to international financial institutions and is carried at amortised cost. Debt is classified as subordinated debt when its repayment ranks after all other creditors in case of liquidation. Subordinated debt is included in "tier 2 capital" of the Group.

Income taxes. Income taxes have been provided for in the consolidated financial statements in accordance with relevant legislation enacted or substantively enacted by the balance sheet date. The income tax charge comprises current tax and deferred tax and is recognised in the consolidated income statement except if it is recognised directly in equity because it relates to transactions that are also recognised, in the same or a different period, directly in equity.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if financial statements are authorised prior to filing relevant tax returns. Taxes, other than on income, are recorded within administrative and other operating expenses. Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date, which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available, against which the deductions can be utilised.

Deferred income tax is provided on post acquisition retained earnings of subsidiaries, except where the Group controls the subsidiary's dividend policy and it is probable that the difference will not reverse through dividends or otherwise in the foreseeable future.

Uncertain tax positions. The Group's uncertain tax positions are reassessed by management at every balance sheet date. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the balance sheet date and any known Court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognised based on management's best estimate of the expenditure required to settle the obligations at the balance sheet date.

Provisions for liabilities and charges. Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued 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.

Trade and other payables. Trade payables are accrued when the counterparty has performed its obligations under the contract and are carried at amortised cost.

Share premium. When shares are issued, the excess of contributions received, net of transaction costs, over the nominal value of the shares issued is recorded as share premium in equity.

Dividends. Dividends are recorded in equity in the period, in which they are declared. Dividends declared after the balance sheet date and before the consolidated financial statements are authorised for issue are disclosed in the subsequent events note. The statutory accounting reports of the Bank are the basis for profit distribution and other appropriations of the Bank. Azerbaijani legislation identifies the basis of distribution as the current year net profit.

Income and expense recognition. Interest income and expense are recorded in the consolidated income statement for all debt instruments on an accrual basis, using the effective interest method. This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents.

3 Summary of Significant Accounting Policies (Continued)

Commitment fees received by the Group to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Group does not designate loan commitments as financial liabilities at fair value through profit or loss.

When loans and other debt instruments become doubtful of collection, they are written down to present value of expected cash inflows and interest income is thereafter recorded for the unwinding of the present value discount based on the asset's effective interest rate, which was used to measure the impairment loss.

All other fees, commissions, including fees and commissions on plastic cards, and other income and expense items are generally recorded on an accrual basis by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided. Loan syndication fees are recognised as income when the syndication has been completed and the Group retained no part of the loan package for itself or retained a part at the same effective interest rate for the other participants.

Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, which are earned on execution of the underlying transaction are recorded on its completion. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-proportion basis. Asset management fees related to investment funds are recorded rateably over the period the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time.

Foreign currency translation. The functional currency of each of the Group's consolidated entities is the currency of the primary economic environment, in which the entity operates. The Bank's functional currency and the Group's presentation currency is the national currency of the Republic of Azerbaijan, Azerbaijani Manat ("AZN").

Monetary assets and liabilities are translated into each entity's functional currency at the official exchange rate of the NBAR at the respective balance sheet dates. Foreign exchange gains and losses resulting from the settlement of transactions and from the translation of monetary assets and liabilities into each entity's functional currency at year-end official exchange rates of the NBAR are recognised in profit or loss. Translation at year-end rates does not apply to non-monetary items, including equity investments. Effects of exchange rate changes on the fair value of equity securities are recorded as part of the fair value gain or loss.

The results and financial position of each group entity (the functional currency of none of which is a currency of a hyperinflationary economy) are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognised as a separate component of equity.

When a subsidiary is disposed of through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity, the exchange differences deferred in equity are reclassified to profit or loss.

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.

Staff costs and related contributions. Wages, salaries, contributions to the Republic of Azerbaijan state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Group.

Segment reporting. A segment is a distinguishable component of the Group that is engaged in providing products or services (business segment), which is subject to risks and rewards that are different from those of other segments. Segments with a majority of revenue earned from services to external customers and whose revenue, result or assets are ten percent or more of all the segments are reported separately. Geographical segments of the Group have not been reported separately within these consolidated financial statements, on the basis that, a significant majority of the Group's operations are carried out in the Republic of Azerbaijan and other segments are not more than ten percent of the Group.

3 Summary of Significant Accounting Policies (Continued)

Insurance operations

- ***Insurance contracts – classification.*** The Group issues contracts that transfer insurance risks. Insurance contracts are those that transfer significant insurance risk. As a general guideline, the Group defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event that are at least 10% more than the benefits payable if the insured event did not occur.

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

- ***Losses.*** Losses including loss adjustment expenses are charged to the statement of income as incurred. Reserves for losses represent the accumulation of estimates for incurred losses and include two types of reserves: reserve for reported but not settled losses ("RBNS") and reserve for incurred but not reported losses ("IBNR"). RBNS reserve is calculated for each unsettled claim. The estimation is made on the basis of information received by the Group during investigation of insurance cases to be settled after the balance sheet date. If the amount of loss is not determined, the maximum possible amount of losses not exceeding the insurance limit, stated in the insurance policy, is accepted as RBNS. IBNR is established based on actuarial methods used to determine loss development patterns based on historic information, implied expected ultimate loss ratios and implied reported claims development factors.IBNR is calculated by the Group for each line of business; the calculation includes assumptions based on prior years' claims and claims handling experience. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. The methods of determining such estimates and establishing the resulting provisions are continually reviewed and updated. Resulting adjustments are reflected in the statement of income as they arise. Loss provision reserve is estimated on an undiscounted basis due to the relatively quick pattern of claims notification and payment.

- ***Reinsurance.*** The Group assumes and cedes reinsurance in the normal course of business. Ceded reinsurance contracts do not relieve the Group from its obligations to policyholders. Reinsurance receivables include balances due from reinsurance companies for paid claims, including claims handling expenses and premiums receivable ceded to the Group. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance payables are obligations of the Group for the transfer of reinsurance premiums to reinsurers.

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Impairment losses on loans and advances. The Group regularly reviews its loan portfolios to assess impairment. In determining whether an impairment loss should be recorded in the consolidated income statement, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. To the extent that the assessed delay in repayment of principal on 5% of the total loans and advances to customers differs by +/- one month, the provision would be approximately AZN 11,483 thousand (2007: AZN 6,919 thousand) higher or lower.

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

Revaluation of premises. Management uses judgement to determine when factors dictate that a revaluation of the Bank's premises is appropriate in order for the balance sheet to reflect fair value at each balance sheet date and how the assessment of the fair value of premises is performed. The fair value of premises is usually determined from market-based evidence by an appraisal that is undertaken by professionally qualified valuers. The evidence used by the valuers includes estimates of prevailing market prices per square metre of properties with characteristics similar to those of the Bank's properties. These estimates are based on the valuer's experience using comparable sale information and represent a benchmark of the current situation and trends in the market. The valuer also calculates valuations using an income capitalisation approach taking into account possible future rental incomes and other factors before confirming an overall valuation for each of the Bank's properties. The most significant estimate made in performing the valuations is the sale price per square metre for comparable buildings. To the extent that the estimate for the sale price per square metre used in the independent valuation differed by 5%, the revalued amounts of premises as at 31 December 2008 would differ by +/- AZN 590 thousand (2007: revalued amounts of premises would differ by +/- AZN 840 thousand).

Other borrowed funds. Management has considered whether gains or losses should arise on initial recognition of loans from governmental and international financial institutions in the amount of AZN 289,863 thousand as at 31 December 2008 (2007: AZN 262,621 thousand) and related lending. The Bank obtains long term financing from international financial institutions at interest rates, at which such institutions ordinarily lend in emerging markets and which may be lower than rates, at which the Bank could source the funds from local lenders. The amount of such borrowings at 31 December 2008 was AZN 230,495 thousand (2007: AZN 128,325 thousand). As a result of such financing, the Bank is able to advance funds to specific customers at advantageous rates. As the transactions are with unrelated parties, management's judgement is that these funds and the related lending are at the market interest rates and no initial recognition of gains or losses should arise. In making this judgement management also considered that these instruments are a separate market segment.

Loans at low interest rates. Management have considered the appropriate market interest rate for certain loans and advances where the contractual interest rate is eight per cent or lower. As disclosed in Note 9 and Note 36, management have assessed that the contractual interest rates for these loans are equivalent to the alternative highest and best use of the funds provided under these loans, the majority of which are with Government bodies and state-owned entities. Had management concluded that the interest rates for these borrowings were different to the highest and best use of the funds provided, then the carrying amounts in respect of these loans in the consolidated financial statements, and the amounts recorded within interest income and losses on the origination of loans, would have been different.

Finance leases and derecognition of financial assets. Management applies judgement to determine if substantially all the significant risks and rewards of ownership of financial assets and lease assets are transferred to counterparties, in particular which risks and rewards are the most significant and what constitutes substantially all risks and rewards.

Tax legislation. Azerbaijani, Russian and Georgian tax, currency and customs legislation is subject to varying interpretations. Refer to Note 33.

Initial recognition of related party transactions. In the normal course of business the Group enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

Capital Adequacy ratio. Capital Adequacy Ratio is calculated in accordance with the International Convergence of Capital Measurement and Capital Standards (July 1988, updated to November 2005) (or Basel Capital Accord) requirements. Such requirements are subject to interpretation and accordingly the appropriateness of the inclusion, exclusion, and/or classification of amounts included in the calculation of the Capital Adequacy Ratio requires management judgment, for example, whether the off-balance sheet commitments covered by blocked customer accounts would carry 0% risk for the purposes of calculating total risk-weighted assets. Currently, management believes that such off-balance sheet commitments carry 0% risk for the capital adequacy calculation purposes.

Deferred Taxation. On 14 November 2008, a new Law on "Stimulation of Increasing the Capitalization of Banks, Insurance and Reinsurance Companies" ("the Law") was enacted. According to the Law the profit tax rate for banks, insurance and reinsurance companies is reduced to 0% for three fiscal years starting from 1 January 2009, for the portion of the profit which is transferred to share capital. Management of the Bank considered the impact of the enactment of the Law on the Group's deferred tax calculation. As the Management is not expecting to transfer any portion of the current year profit to share capital in the next 3 years period covered by the Law, the Bank will not be able to utilise the benefits of this Law. Therefore, the Bank recognised deferred taxes for all temporary taxable and deductible differences as at 31 December 2008.

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

Liquidity mismatch. As disclosed in Note 31 to these consolidated financial statements, the Group has a cumulative negative liquidity gap up to twelve months as at 31 December 2008 and as at 31 December 2007. Management is confident that the Group will be able to obtain required funds in order to replace attracted liabilities with duration of up to twelve months. In particular, management believe that the continued support of its shareholders and access to borrowings from international financial institutions means that the Group would be able to obtain appropriate resources should all liabilities require settlement as disclosed in Note 31. Management's ongoing discussions with its current lenders have reaffirmed management's view that the borrowings subjected to covenants as detailed in Notes 18 and 33 will not in practice require repayment prior to the contractual dates.

5 Adoption of New or Revised Standards and Interpretations

Certain new interpretations became effective for the Group from 1 January 2008:

- ***IFRIC 11, IFRS 2—Group and Treasury Share Transactions*** (effective for annual periods beginning on or after 1 March 2007);
- ***IFRIC 12, Service Concession Arrangements*** (effective for annual periods beginning on or after 1 January 2008); and
- ***IFRIC 14, IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*** (effective for annual periods beginning on or after 1 January 2008).

These interpretations did not have any significant effect on the Group's consolidated financial statements.

Reclassification of Financial Assets—Amendments to IAS 39, Financial Instruments: Recognition and Measurement, and IFRS 7, Financial Instruments: Disclosures* and a subsequent amendment, *Reclassification of Financial Assets: Effective Date and Transition. The amendments allow entities the options (a) to reclassify a financial asset out of the held to trading category if, in rare circumstances, the asset is no longer held for the purpose of selling or repurchasing it in the near term; and (b) to reclassify an available-for-sale asset or an asset held for trading to the loans and receivables category, if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity (subject to the asset otherwise meeting the definition of loans and receivables). The amendments may be applied with retrospective effect from 1 July 2008 for any reclassifications made before 1 November 2008; the reclassifications allowed by the amendments may not be applied before 1 July 2008 and retrospective reclassifications are only allowed if made prior to 1 November 2008. Any reclassification of a financial asset made on or after 1 November 2008 takes effect only from the date when the reclassification is made. The Group has not elected to make any of the optional reclassifications during the period.

6 New Accounting Pronouncements

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2009 or later periods and which the Group has not early adopted:

IFRS 8, Operating Segments (effective for annual periods beginning on or after 1 January 2009). The standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments and specifies how an entity should report such information. The Group is currently assessing what impact the standard will have on segment disclosures in the consolidated financial statements.

Puttable financial instruments and obligations arising on liquidation — IAS 32 and IAS 1 Amendment (effective from 1 January 2009). The amendment requires classification as equity of some financial instruments that meet the definition of a financial liability. The Group is currently assessing the impact of the amendment on its consolidated financial statements.

IAS 23, Borrowing Costs (revised March 2007; effective for annual periods beginning on or after 1 January 2009). The revised IAS 23 was issued in March 2007. The main change to IAS 23 is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalise such borrowing costs as part of the cost of the asset. The revised standard applies prospectively to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

6 New Accounting Pronouncements (Continued)

IAS 1, Presentation of Financial Statements (revised September 2007; effective for annual periods beginning on or after 1 January 2009). The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities will be allowed to present two statements: a separate income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The Group expects the revised IAS 1 to affect the presentation of its consolidated financial statements but to have no impact on the recognition or measurement of specific transactions and balances.

IAS 27, Consolidated and Separate Financial Statements (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

Vesting Conditions and Cancellations—Amendment to IFRS 2, Share-based Payment (issued in January 2008; effective for annual periods beginning on or after 1 January 2009). The amendment clarifies that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer will have to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. The Group is currently assessing the impact of the amended standard on its consolidated financial statements. IFRS 3 is not relevant to the Group as it does not expect a business combination to occur.

IFRIC 13, Customer Loyalty Programmes (effective for annual periods beginning on or after 1 July 2008). IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. The Group is currently assessing the impact of the Interpretation on its consolidated financial statements. The Group does not operate any loyalty programmes.

IFRIC 15, Agreements for the Construction of Real Estate (effective for annual periods beginning on or after 1 January 2009). The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions. The Group is currently assessing the impact of the interpretation on its consolidated financial statements. IFRIC 15 is not relevant to the Group's operations because it does not have any agreements for the construction of real estate.

IFRIC 16, Hedges of a Net Investment in a Foreign Operation (effective for annual periods beginning on or after 1 October 2008). The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied. The IFRIC allows the hedging instrument to be held by any entity or entities within a group except the foreign operation that itself is being hedged. The interpretation also clarifies how the gain or loss recycled from the currency translation reserve to profit or loss is calculated on disposal of the hedged foreign operation.

6 New Accounting Pronouncements (Continued)

Reporting entities will apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16. IFRIC 16 does not have an impact on these consolidated financial statements as the Group does not apply hedge accounting.

Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate—IFRS 1 and IAS 27 Amendment (revised May 2008; effective for annual periods beginning on or after 1 January 2009). The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying value as deemed cost in the separate financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss rather than as a recovery of the investment. The amendments will not have an impact on the Group's consolidated financial statements.

Eligible Hedged Items—Amendment to IAS 39, Financial Instruments: Recognition and Measurement (effective with retrospective application for annual periods beginning on or after 1 July 2009, with earlier application permitted). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment is not expected to have an impact on the Group's consolidated financial statements as the Group does not apply hedge accounting.

Improvements to International Financial Reporting Standards (issued in May 2008). In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments issued in May 2008 consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The Group does not expect the amendments to have any material effect on its consolidated financial statements.

IFRIC 17, Distribution of Non-Cash Assets to Owners (effective for annual periods beginning on or after 1 July 2009, with earlier application permitted). The amendment clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss when the entity settles the dividend payable. IFRIC 17 is not relevant to the Group's operations because it does not distribute non-cash assets to owners.

IFRS 1, First-time Adoption of International Financial Reporting Standards (effective for the first IFRS financial statements for a period beginning on or after 1 July 2009). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The Group concluded that the revised standard does not have any effect on its consolidated financial statements.

IFRIC 18, Transfers of Assets from Customers (effective for annual periods beginning on or after 1 July 2009; not yet adopted by the EU). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers. IFRIC 18 is not relevant to the Group's operations because it does not transfer assets from customers.

Embedded Derivatives - Amendments to IFRIC 9 and IAS 39 (effective for annual periods ending on or after 30 June 2009). The amendments clarify that on reclassification of a financial asset out of the 'at fair value through profit or loss' category, all embedded derivatives have to be assessed and, if necessary, separately accounted for.

6 New Accounting Pronouncements (Continued)

Improvements to International Financial Reporting Standards (issued in April 2009; amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on the cash flow hedging instruments from equity to profit or loss and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. The Group does not expect the amendments to have any material effect on its consolidated financial statements.

7 Cash and Cash Equivalents

In thousands of Azerbaijani Manats	**2008**	**2007**
Cash on hand	158,957	73,437
Cash balances with the National/Central banks (other than mandatory reserve deposits)	118,478	89,668
Correspondent accounts and overnight placements with other banks		
- The Republic of Azerbaijan	40,964	761
- Other countries	208,330	15,838
Total cash and cash equivalents	**526,729**	**179,704**

Included in cash balances with the National/Central banks (other than mandatory reserve deposits) are the balances on correspondent accounts of the Bank and its subsidiaries, IBAR Moscow and IBAR Georgia, with the NBAR, CBRF and NBG amounting to AZN 111,691 thousand, AZN 6,593 thousand and AZN 194 thousand as at 31 December 2008 (2007: AZN 78,618 thousand, AZN 8,564 thousand and AZN 2,486 thousand), respectively.

Overnight placements with other banks include AZN 118,731 thousand as at 31 December 2008 (2007: AZN 1,519 thousand) placed with a foreign bank at annual interest rate ranging between 0.75% and 1.65% per annum that matured in January 2009 (2007: 5.0% per annum, that matured in January 2008).

7 Cash and Cash Equivalents (Continued)

The analysis by credit quality of the cash and cash equivalents at 31 December 2008 is as follows:

In thousands of Azerbaijani Manats	**Cash on hand**	**Cash balances with the National/Central banks**	**Correspondent accounts and overnight placements with other banks**	**Total**
Current and not impaired				
- Cash on hand	158,957	-	-	158,957
- National Bank of the Republic of Azerbaijan	-	111,691	-	111,691
- Central Bank of the Russian Federation	-	6,593	-	6,593
- National Bank of the Republic of Georgia	-	194	-	194
- Top 15 Azerbaijani banks	-	-	125	125
- Other Azerbaijani banks	-	-	1,962	1,962
- OECD banks	-	-	243,066	243,066
- Non-OECD banks	-	-	4,141	4,141
Total cash and cash equivalents	**158,957**	**118,478**	**249,294**	**526,729**

The published international rating for the Republic of Azerbaijan is Ba1/Stable (Moody's- issued on 7 January 2009), for the Russian Federation is BA3/Stable (Moody's- issued on 21 April 2009) and for the Republic of Georgia is BB-/Stable (Fitch Ratings- issued on 7 April 2009) as at 31 December 2008.

The analysis by credit quality of the cash and cash equivalents at 31 December 2007 is as follows:

In thousands of Azerbaijani Manats	**Cash on hand**	**Cash balances with the National/Central banks**	**Correspondent accounts and overnight placements with other banks**	**Total**
Current and not impaired				
- Cash on hand	73,437	-	-	73,437
- National Bank of the Republic of Azerbaijan	-	78,618	-	78,618
- Central Bank of the Russian Federation	-	8,564	-	8,564
- National Bank of the Republic of Georgia	-	2,486	-	2,486
- Top 15 Azerbaijani banks	-	-	661	661
- Other Azerbaijani banks	-	-	100	100
- OECD banks	-	-	13,844	13,844
- Non-OECD banks	-	-	1,994	1,994
Total cash and cash equivalents	**73,437**	**89,668**	**16,599**	**179,704**

Geographical, currency and interest rate analyses of cash and cash equivalents are disclosed in Note 31. The information on related party balances is disclosed in Note 36.

8 Due from Other Banks

In thousands of Azerbaijani Manats	**2008**	**2007**
Term placements with other banks	128,560	105,606
Notes of the NBAR	-	53,411
Promissory notes of Russian banks	5,246	20,631
Debentures of resident banks	254	295
Less: Provision for impairment	(6,658)	(6,352)
Total due from other banks	**127,402**	**173,591**

At 31 December 2008, term placements with other banks include two short-term foreign currency denominated placements with non-resident banks in the total amount equivalent to AZN 96,705 thousand at annual interest rates of 4.5% and 8.0%, respectively. Term placements of AZN 12,015 thousand matured and were repaid to the Group in January 2009 with the remaining portion maturing in May, 2009. (2007: short-term foreign currency denominated placements with non-resident banks, which amounted to equivalent of AZN 39,447 thousand with annual interest rates of 3.13% and 5.25% with maturities in January and April 2008).

Promissory notes of Russian banks represent short-term promissory notes of commercial banks in Russia purchased by IBAR Moscow. These promissory notes are denominated in Russian Roubles, bear an average interest rate of 13.0% per annum with maturities in January - May 2009.

Subsequent to 31 December 2008, AZN 2,878 thousand of these promissory notes was redeemed.

Notes of the NBAR as at 31 December 2007 represented short-term government securities issued by the NBAR at Baku Stock Exchange and purchased by the Group at a discount. These notes had an average effective interest rate of 11.1 % per annum and matured and were redeemed in January 2008.

Amounts due from other banks are not collateralised. The analysis by credit quality of amounts due from other banks outstanding at 31 December 2008 is as follows:

In thousands of Azerbaijani Manats	**Term placements with other banks**	**Promissory notes of Russian banks**	**Debentures of resident banks**	**Total**
Current and not impaired				
- Top 20 Azerbaijani banks	8,724	-	254	8,978
- OECD banks	28,475	-	-	28,475
- Non – OECD banks	84,693	-	-	84,693
Credit ratings of Russian banks:				
- Baa3/Stable (Moody's)	-	551	-	551
- Baa2/Stable (Moody's)	-	1,186	-	1,186
- Ba3/Stable (Moody's)	-	1,981	-	1,981
- Ba1/Stable (Moody's)	-	871	-	871
- B2 /(Moody's)	-	657	-	657
Total current and not impaired	**121,892**	**5,246**	**254**	**127,392**
Balances individually determined to be impaired (gross)				
- over 360 days overdue	6,668	-	-	6,668
Total individually impaired (gross)	**6,668**	**-**	**-**	**6,668**
Less provision for impairment	**(6,658)**	-	-	**(6,658)**
Total due from other banks	**121,902**	**5,246**	**254**	**127,402**

8 Due from Other Banks (Continued)

The analysis by credit quality of amounts due from other banks outstanding at 31 December 2007 is as follows:

In thousands of Azerbaijani Manats	Term placements with other banks	Notes of the NBAR	Promissory notes of Russian banks	Debentures of resident banks	Total
Current and not impaired					
- Top 20 Azerbaijani banks	59,788	-	-	295	60,083
- National Bank of the Republic of Azerbaijan	-	53,411	-	-	53,411
- OECD banks	39,447	-	-	-	39,447
Credit ratings of Russian banks:					
- Baa3/Stable (Moody's)	-	-	2,167	-	2,167
- Baa2/Stable (Moody's)	-	-	4,663	-	4,663
- Ba3/Stable (Moody's)	-	-	7,791	-	7,791
- Ba1/Stable (Moody's)	-	-	3,425	-	3,425
- B2 /(Moody's)	-	-	1,292	-	1,292
- B1/Stable (Moody's)	-	-	1,293	-	1,293
Total current and not impaired	**99,235**	**53,411**	**20,631**	**295**	**173,572**
Balances individually determined to be impaired (gross)					
- over 360 days overdue	6,371	-	-	-	6,371
Total individually impaired (gross)	**6,371**	**-**	**-**	**-**	**6,371**
Less provision for impairment	**(6,352)**	**-**	**-**	**-**	**(6,352)**
Total due from other banks	**99,254**	**53,411**	**20,631**	**295**	**173,591**

The primary factor that the Group considers whether a deposit is impaired is its overdue status. As a result, the Group presented the above ageing analysis of deposits that are individually determined to be impaired.

Movements in the provision for impairment of due from other banks in 2008 are as follows:

In thousands of Azerbaijani Manats	Provision for impairment at 1 January 2008	Provision for impairment during the year	Amounts written off during the year as uncollectible	Provision for impairment at 31 December 2008
Term placements with other banks	6,352	306	-	6,658
Total	**6,352**	**306**	**-**	**6,658**

Movements in the provision for impairment of due from other banks in 2007 are as follows:

In thousands of Azerbaijani Manats	Provision for impairment at 1 January 2007	Recovery of impairment during the year	Amounts written off during the year as uncollectible	Provision for impairment at 31 December 2007
Term placements with other banks	6,778	(426)	-	6,352
Total	**6,778**	**(426)**	**-**	**6,352**

8 Due from Other Banks (Continued)

The carrying value of each class of amounts due from other banks approximates fair value at 31 December 2008 and 31 December 2007. At 31 December 2008, the estimated fair value of due from other banks was AZN 127,402 thousand (2007: AZN 173,591 thousand). Refer to Note 34.

The interest rate analysis of due from other banks is disclosed in Note 31. The information on related party balances is disclosed in Note 36.

9 Loans and Advances to Customers

In thousands of Azerbaijani Manats	**2008**	**2007**
Corporate loans	2,725,947	1,844,536
State and public organisations	12,540	73,180
Loans to individuals – consumer loans	131,186	130,918
Loans to individuals – employees	45,811	17,639
Loans to individuals – purchase of motor vehicles	31,421	30,121
Loans to individuals – mortgage loans	18,861	14,630
Loans to individuals – other purposes	145,422	63,103
Less: Provision for loan impairment	(229,668)	(138,389)
Total loans and advances to customers	**2,881,520**	**2,035,738**

Movements in the provision for loan impairment during 2008 are as follows:

In thousands of Azerbaijani Manats	**Provision for loan impairment at 1 January 2008**	**Increase in/ (Recovery of) provision for impairment during the year**	**Provision for loan impairment at 31 December 2008**
Corporate loans	126,208	76,781	202,989
State and public organisations	4,108	(43)	4,065
Loans to individuals – consumer loans	3,430	4,446	7,876
Loans to individuals – employees	391	557	948
Loans to individuals – purchase of motor vehicles	1,235	1,337	2,572
Loans to individuals – mortgage loans	444	70	514
Loans to individuals – other purposes	2,573	8,131	10,704
Total	**138,389**	**91,279**	**229,668**

Movements in the provision for loan impairment during 2007 are as follows:

In thousands of Azerbaijani Manats	**Provision for loan impairment at 1 January 2007**	**Increase in/ (Recovery of) provision for impairment during the year**	**Provision for loan impairment at 31 December 2007**
Corporate loans	101,721	24,487	126,208
State and public organisations	2,989	1,119	4,108
Loans to individuals – consumer loans	2,139	1,291	3,430
Loans to individuals – employees	594	(203)	391
Loans to individuals – purchase of motor vehicles	1,237	(2)	1,235
Loans to individuals – mortgage loans	388	56	444
Loans to individuals – other purposes	459	2,114	2,573
Total	**109,527**	**28,862**	**138,389**

9 Loans and Advances to Customers (Continued)

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

	2008		2007	
In thousands of Azerbaijani Manats	Amount	%	Amount	%
Trade and service	873,814	28.1	383,473	17.6
Manufacturing	563,277	18.1	331,643	15.3
Construction	502,245	16.1	407,394	18.7
Railroad and other transportation	444,607	14.3	322,451	14.8
Individuals	372,701	12	256,411	11.8
Power production and distribution	239,589	7.7	116,200	5.3
Air transportation	39,829	1.3	38,257	1.8
Leasing companies	31,557	1	68,683	3.2
Communication	21,392	0.6	23,770	1.1
State and public organisations*	12,540	0.4	73,180	3.4
Oil and gas sector	1,752	0.1	124,628	5.7
Other	7,885	0.3	28,037	1.3
Total loans and advances to customers (before impairment)	**3,111,188**	**100.0**	**2,174,127**	**100.0**

(*) State and public organisations include ministries, the Treasury and other state bodies of the Republic of Azerbaijan, excluding profit making state and public organisations that are included in the respective categories.

Included in the gross amount of total loans and advances to customers as at 31 December 2008, are the loans granted to twenty companies amounting to AZN 1,143,353 thousand (2007: twenty companies amounting to AZN 1,025,082 thousand) and representing a concentration of 36.7% (2007: 47.1%) of the total loan portfolio of the Group.

Included in the gross amount of total loans and advances to customers as at 31 December 2008, are the loans granted to government institutions and state enterprises of the Republic of Azerbaijan amounting to AZN 678,026 thousand (2007: AZN 661,626 thousand) and representing 21.8% (2007: 30.4%) of the total loan portfolio of the Group.

As at 31 December 2008, included in loans issued to state and public organisations is the amount of AZN 170 thousand (2007: AZN 30,195 thousand), which represents non-interest bearing on demand overdrafts on current accounts of the State Budget of the Republic of Azerbaijan with the Group.

Included in the gross amount of total loans and advances to customers as at 31 December 2008, are the loans granted to fifteen borrowers amounting to AZN 316,676 thousand (2007: fifteen borrowers, AZN 501,302 thousand) with interest rates being less than or equal to eight per cent and representing 10% (2007: 24%) of the total gross loan portfolio of the Group. The majority of these loans are transactions with related parties and as such disclosed in Note 36. No adjustments have been made to the contractual interest rates in relation to these amounts on initial recognition at fair value as the interest rates applicable are considered to represent the highest and best use of the funds provided given the alternative uses by the Bank of the funds extended under these agreements.

Included in the total amount of loans to individuals as at 31 December 2008 are outstanding balances drawn on credit cards of AZN 43,618 thousand (2007: AZN 11,338 thousand).

9 Loans and Advances to Customers (Continued)

Information about collateral at 31 December 2008 is as follows:

In thousands of Azerbaijani Manats	**Corporate loans**	**State and public organisations**	**Loans to individuals - consumer loans**	**Loans to individuals - employees**	**Loans to individuals - purchase of motor vehicles**	**Loans to individuals - mortgage loans**	**Loans to individuals - other purposes**	**Total**
Unsecured loans	1,700,421	12,427	26,416	44,045	3,726	7,421	101,076	1,895,532
Loans collateralised by:								
- real estate	443,543	113	44,861	1,512	-	11,440	37,573	539,042
- state guarantee	237,854	-	-	-	-	-	-	237,854
- corporate guarantee	183,916	-	3,451	-	-	-	-	187,367
- cash deposits	58,602	-	953	53	-	-	2,854	62,462
- movable property and equipment	76,314	-	2,483	-	-	-	578	79,375
- motor vehicles	883	-	883	57	27,695	-	2,987	32,505
- other	24,414	-	52,139	144	-	-	354	77,051
Total loans and advances to customers	**2,725,947**	**12,540**	**131,186**	**45,811**	**31,421**	**18,861**	**145,422**	**3,111,188**

Information about collateral at 31 December 2007 is as follows:

In thousands of Azerbaijani Manats	**Corporate loans**	**State and public organisations**	**Loans to individuals - consumer loans**	**Loans to individuals - employees**	**Loans to individuals - purchase of motor vehicles**	**Loans to individuals - mortgage loans**	**Loans to individuals - other purposes**	**Total**
Unsecured loans	964,320	8,515	38,808	-	588	6,647	19,321	1,038,199
Loans collateralised by:								
- real estate	283,840	52	65,398	224	-	7,905	26,831	384,250
- state guarantee	241,606	30,195	-	-	-	-	-	271,801
- corporate guarantee	195,857	386	-	-	-	-	-	196,243
- cash deposits	86,100	34,007	18,491	91	-	78	1,591	140,358
- movable property and equipment	56,514	25	1,469	101	-	-	894	59,003
- motor vehicles	270	-	436	-	29,533	-	125	30,364
- other	16,029	-	6,316	17,223	-	-	14,341	53,909
Total loans and advances to customers	**1,844,536**	**73,180**	**130,918**	**17,639**	**30,121**	**14,630**	**63,103**	**2,174,127**

9 Loans and Advances to Customers (Continued)

The analysis by credit quality of loans outstanding at 31 December 2008 is as follows:

In thousands of Azerbaijani Manats	Corporate loans	State and public organisations	Loans to individuals - consumer loans	Loans to individuals - employees	Loans to individuals - purchase of motor vehicles	Loans to individuals - mortgage loans	Loans to individuals - other purposes	Total
Current and not impaired								
Loans collateralised by:								
- real estate	217,620	-	27,532	1,416	-	9,259	31,492	287,319
- state guarantee	-	-	-	-	-	-	-	-
- corporate guarantee	62,341	-	3,451	-	-	-	-	65,792
- cash deposits	58,602	-	953	53	-	-	2,854	62,462
- movable property and equipment	68,431	-	2,153	-	-	-	450	71,034
- motor vehicles	833	-	844	57	24,833	-	2,756	29,323
- other	23,280	-	6,799	62	-	-	336	30,477
Unsecured loans	1,363,805	4,217	25,752	43,940	3,505	3,676	87,570	1,532,465
Loans renegotiated in 2008	5,479	-	9	127	40	3,407	190	9,252
Total current and not impaired	**1,800,391**	**4,217**	**67,493**	**45,655**	**28,378**	**16,342**	**125,648**	**2,088,124**
Past due but not impaired								
- less than 30 days overdue	5,550	-	175	11	13	148	3,126	9,023
- 30 to 90 days overdue	525,290	4,932	60,481	36	8	1,509	11,696	603,952
- 90 to 180 days overdue	262,573	-	1,047	-	12	573	2,061	266,266
- 180 to 360 days overdue	3	-	-	18	1	117	178	317
- over 360 days overdue	1,358	-	-	-	6	-	118	1,482
Total past due but not impaired	**794,774**	**4,932**	**61,703**	**65**	**40**	**2,347**	**17,179**	**881,040**
Loans individually determined to be impaired								
- 90 to 180 days overdue	73,004	-	-	7	15	27	172	73,225
- 180 to 360 days overdue	33,395	3,294	1,234	84	983	123	1,183	40,296
- over 360 days overdue	24,383	97	756	-	2,005	22	1,240	28,503
Total individually impaired loans (gross)	**130,782**	**3,391**	**1,990**	**91**	**3,003**	**172**	**2,595**	**142,024**
Less impairment provisions	**(202,989)**	**(4,065)**	**(7,876)**	**(948)**	**(2,572)**	**(514)**	**(10,704)**	**(229,668)**
Total loans and advances to customers	**2,522,958**	**8,475**	**123,310**	**44,863**	**28,849**	**18,347**	**134,718**	**2,881,520**

9 Loans and Advances to Customers (Continued)

The analysis by credit quality of loans outstanding at 31 December 2007 is as follows:

In thousands of Azerbaijani Manats	**Corporate loans**	**State and public organisations**	**Loans to individuals - consumer loans**	**Loans to individuals - employees**	**Loans to individuals - purchase of motor vehicles**	**Loans to individuals - mortgage loans**	**Loans to individuals - other purposes**	**Total**
Current and not impaired								
Loans collateralised by:								
- real estate	215,470	2	59,511	224	-	7,033	11,957	294,197
- state guarantee	239,493	30,195	-	-	-	-	-	269,688
- corporate guarantee	163,199	385	-	-	-	-	-	163,584
- cash deposits	86,100	34,009	18,307	91	-	78	1,591	140,176
- movable property and equipment	43,283	25	1,158	98	-	-	479	45,043
- motor vehicles	183	-	419	-	27,423	-	125	28,150
- other	33,068	-	5,813	16,929	-	-	14,306	70,116
Unsecured loans	426,478	219	34,327	-	115	6,451	18,109	485,699
Loans renegotiated in 2007	48,614	117	3,584	5	3	241	26	52,590
Total current and not impaired	**1,255,888**	**64,952**	**123,119**	**17,347**	**27,541**	**13,803**	**46,593**	**1,549,243**
Past due but not impaired								
- less than 30 days overdue	3,551	-	1,268	42	273	43	45	5,222
- 30 to 90 days overdue	337,168	4,803	4,744	142	173	437	15,545	363,012
- 90 to 180 days overdue	167,989	-	836	-	261	166	269	169,521
- 180 to 360 days overdue	2	-	72	70	21	34	-	199
- over 360 days overdue	827	-	48	-	139	-	-	1,014
Total past due but not impaired	**509,537**	**4,803**	**6,968**	**254**	**867**	**680**	**15,859**	**538,968**
Loans individually determined to be impaired								
- 90 to 180 days overdue	43,187	-	55	3	7	23	-	43,275
- 180 to 360 days overdue	20,763	3,327	379	35	473	105	404	25,486
- over 360 days overdue	15,161	98	397	-	1,233	19	247	17,155
Total individually impaired loans (gross)	**79,111**	**3,425**	**831**	**38**	**1,713**	**147**	**651**	**85,916**
Less impairment provisions	**(126,208)**	**(4,108)**	**(3,430)**	**(391)**	**(1,235)**	**(444)**	**(2,573)**	**(138,389)**
Total loans and advances to customers	**1,718,328**	**69,072**	**127,488**	**17,248**	**28,886**	**14,186**	**60,530**	**2,035,738**

9 Loans and Advances to Customers (Continued)

The Group applied the portfolio provisioning methodology prescribed by IAS 39, *Financial Instruments: Recognition and Measurement*, and created portfolio provisions for impairment losses that were incurred, but have not been specifically identified with any individual loan by the balance sheet date. The Group's policy is to classify each loan as "current and not impaired" until a specific objective evidence of impairment of the loan is identified. The impairment provisions exceed the total gross amount of individually impaired loans as a result of this policy and the portfolio impairment methodology.

The primary factors that the Group considers whether a loan is impaired are its overdue status and realisability of related collateral, if any. As a result, the Group presented the above ageing analysis of loans that are individually determined to be impaired.

Current and not impaired, but renegotiated loans represent the carrying amount of loans that would otherwise be past due or impaired whose terms have been renegotiated. Past due, but not impaired loans represent collateralised loans where the fair value of collateral covers the overdue interest and principal repayments. The amount reported as past due, but not impaired is the whole balance of such loans, not only the individual instalments that are past due.

As at 31 December 2008, total estimated value of collateral was AZN 595,469 thousand (2007: AZN 488,951 thousand) for past due and individually impaired corporate loans and AZN 8,858 thousand (2007: AZN 14,951 thousand) for past due and individually impaired loans to state and public organisations. These amounts comprise (a) collateral which was fair valued by external independent appraisers as at 31 December 2008 and (b) collateral which has been assessed by independent appraisers or the Group's internal valuation procedures as at the date of origination of the loan and for which it was impractical to update the valuations as of 31 December 2008, as follows:

(a) Collateral which was fair valued by external independent appraisers as at 31 December 2008 and 2007 comprises:

	2008		**2007**	
In thousands of Azerbaijani Manats	**Corporate loans**	**State and public organisations**	**Corporate loans**	**State and public organisations**
Fair value of collateral for past due but not impaired loans				
- real estate	251,503	3,053	175,876	2,135
- movable property	177,366	2,478	124,032	1,733
- securities	1,343	-	939	-
- other assets	63,084	-	44,115	-
Fair value of collateral for individually impaired loans				
- real estate	26,418	2,587	18,474	1,809
- movable property	1,529	-	1,069	-
- securities	1,171	-	819	-
- other assets	250	-	175	-
Total	**522,664**	**8,118**	**365,499**	**5,677**

(b) Collateral, which has been assessed by independent appraisers or the Group's internal valuation procedures as at the date of origination of the loan, comprises:

- Corporate loans - collateral for past due but not impaired loans was AZN 64,795 thousand (2007: AZN 109,869 thousand) and for individually impaired loans was AZN 8,010 thousand (2007: AZN 13,583 thousand); and
- State and public organisations - collateral for past due but not impaired loans was AZN 522 thousand (2007: AZN 6,028 thousand) and for individually impaired loans was AZN 218 thousand (2007: AZN 3,246 thousand).

The carrying value of each class of loans and advances to customers approximates fair value at 31 December 2008 and 31 December 2007. At 31 December 2008, the estimated fair value of loans and advances to customers was AZN 2,881,520 thousand (2007: AZN 2,035,738 thousand). Refer to Note 34. The interest rate analysis of loans and advances to customers is disclosed in Note 31. The information on related party balances is disclosed in Note 36.

10 Investment Securities Available for Sale

In thousands of Azerbaijani Manats	**2008**	**2007**
Promissory notes	-	12,679
Total investment securities available for sale	**-**	**12,679**

On 13 June 2007, the Bank signed an agreement with SGA Societe Generale Acceptance N.V, registered in Netherlands Antilles, on purchasing fifty products under the name "Emerald Dual Income" with the nominal amount of AZN 4,226 thousand (USD 5,000,000) with an original maturity date of 19 June 2012. At maturity, the investor was guaranteed to receive 100% of the capital initially invested. In addition to that, the Group was entitled to receive an annual coupon interest linked to a defined "Emerald Basket Performance". On 25 November 2008, the Group redeemed these products before the original maturity in return for USD 4,355,000 and the resulting loss of USD 645 thousand (AZN 521 thousand) was recorded in the income statement of the Group for the year ended 31 December 2008.

On 5 March 2007, the Group signed a contract to purchase 5 Year Structured Product Investment ("SPI") Notes from Forsyth Multi-Strategy Fund under the guarantee of JP Morgan Chase Bank N.A. Forsyth Multi-Strategy Fund is an open-ended hedge fund, listed in Dublin, which provides an actively managed portfolio of highly diversified hedge strategies. The total amount of SPI notes was AZN 8,453 thousand (USD 10,000,000, each note has a nominal value of USD 100,000) with an original maturity of 5 years. At maturity the Group would have received guaranteed 100% of the initial outlaid capital. In addition to that, the Group was entitled to receive an annual interest, which was linked to the performance of Forsyth Multi-Strategy Fund. On 1 December 2008, the Group redeemed SPI notes before the original maturity in return for USD 8,523,000 and the resulting loss of USD 1,477 thousand (AZN 1,195 thousand) was recorded in the income statement of the Group for the year ended 31 December 2008.

The analysis by credit quality of debt securities classified as available for sale at 31 December 2007 was as follows:

In thousands of Azerbaijani Manats	**Total**
Current and not impaired	
- AA- rated, long term (Fitch Ratings), (SGA Societe Generale Acceptance N.V)	4,226
- Unrated* (Forsyth Multi-Strategy Fund)	8,453
Total investment securities available for sale	**12,679**

***** *JP Morgan Chase Bank N.A. which acted as a guarantor for the notes purchased from Forsyth Multi-Strategy Fund is rated as long term issuer default rating of AA- by Fitch Ratings.*

At 31 December 2008, the fair value of investment securities available for sale was nil (2007: AZN 12,679 thousand). Refer to Note 34.

The interest rate analysis of investment securities available for sale is disclosed in Note 31.

11 Investment in Associates

In thousands of Azerbaijani Manats	2008	2007
Investment in Baku Inter-Bank Currency Exchange (BICE)	755	801
Joint Leasing Company (formerly Azerileasing)	852	-
Total investments in associates	**1,607**	**801**

The table below summarises the movements in the carrying amount of the Group's investment in associates:

In thousands of Azerbaijani Manats	2008	2007
Carrying amount at 1 January	**801**	**809**
Share of loss	(47)	(8)
Share of profit of Joint Leasing Company	852	-
Carrying amount at 31 December	**1,607**	**801**

At 31 December 2008, the Group's interests in its principal associates and their summarised financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Total assets	Total liabilities	Revenue	(Loss)/Profit	% interest held	Country of Incorporation
BICE	3,785	10	325	(230)	20.0	The Republic of Azerbaijan
Joint Leasing Company (former Azerileasing)	24,695	22,905	9,571	3,675	47.6	The Republic of Azerbaijan
Total	**28,480**	**22,915**	**9,896**	**3,445**		

At 31 December 2007, the Group's interests in its principal associates and their summarised financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Total assets	Total liabilities	Revenue	Loss	% interest held	Country of Incorporation
BICE	4,201	198	413	(41)	20.0	The Republic of Azerbaijan
Joint Leasing Company (formerly Azerileasing)	50,892	52,777	3,467	(1,028)	47.6	The Republic of Azerbaijan
Total	**55,093**	**52,975**	**3,880**	**(1,069)**		

As at 31 December 2008, the net assets of Azerileasing amounted to AZN 1,790 thousand (2007: net liabilities of AZN 1,885 thousand). The carrying value of the Group's interest in Azerileasing was AZN 852 thousand at 31 December 2008 (2007: nil).

12 Premises, Equipment and Intangible Assets

In thousands of Azerbaijani Manats	Note	Premises	Leasehold improvements	Office and computer equipment	Banking equipment, furniture, fixtures, vehicles & other	Construction in progress	Total premises and equipment	Intangible assets	Total
Cost or valluation at 1 January 2007		54,977	1,147	27,267	34,325	13,173	130,889	5,187	136,076
Accumulated depreciation		(16,580)	(255)	(16,681)	(18,477)	-	(51,993)	(2,485)	(54,478)
Carrying amount at 1 January 2007		**38,397**	**892**	**10,586**	**15,848**	**13,173**	**78,896**	**2,702**	**81,598**
Additions		4,040	215	4,309	2,580	22,479	33,623	5,811	39,434
Transfers		26	-	840	(610)	(256)	-	-	-
Disposals		(1,763)	(41)	-	(42)	-	(1,846)	-	(1,846)
Depreciation charge	26	(2,673)	(104)	(4,804)	(6,877)	-	(14,458)	(828)	(15,286)
Revaluation		16,808	-	-	-	-	16,808	-	16,808
Carrying amount at 31 December 2007		**54,835**	**962**	**10,931**	**10,899**	**35,396**	**113,023**	**7,685**	**120,708**
Cost or valuation at 31 December 2007		80,446	1,322	31,974	35,792	35,396	184,930	11,255	196,185
Accumulated depreciation		(25,611)	(360)	(21,043)	(24,893)	-	(71,907)	(3,570)	(75,477)
Carrying amount at 31 December 2007		**54,835**	**962**	**10,931**	**10,899**	**35,396**	**113,023**	**7,685**	**120,708**
Additions		3,203	1,748	2,670	2,781	32,418	42,820	1,253	44,073
Depreciation charge	26	(3,184)	(138)	(4,520)	(5,738)	-	(13,580)	(1,865)	(15,445)
Revaluation		8,264	-	-	-	-	8,264	-	8,264
Carrying amount at 31 December 2008		**63,118**	**2,572**	**9,081**	**7,942**	**67,814**	**150,527**	**7,073**	**157,600**
Cost or valuation at 31 December 2008		100,123	3,070	34,644	38,573	67,814	244,224	12,508	256,732
Accumulated depreciation		(37,005)	(498)	(25,563)	(30,631)	-	(93,697)	(5,435)	(99,132)
Carrying amount at 31 December 2008		**63,118**	**2,572**	**9,081**	**7,942**	**67,814**	**150,527**	**7,073**	**157,600**

12 Premises, Equipment and Intangible Assets (Continued)

Premises were independently valued at 30 June 2008. The valuation was carried out by an independent firm of valuers, DTZ Debenham Tie Leung. The basis used for the appraisal was market value. Fair values were estimated, using appropriate valuation techniques under the assumption that observable prices in an active market for the premises of characteristics and locations similar to those of the Group's premises do not differ significantly from, and, therefore, are a good indication of the fair value of the Group's premises. As a result of the valuation, the net carrying amount of buildings increased by AZN 8,264 thousand, representing a revaluation increase of AZN 11,490 thousand and a revaluation decrease of AZN 3,226 thousand. Revaluation surplus of AZN 11,490 thousand relating to revaluation of buildings, net of deferred tax of AZN 2,538 thousand, was recorded as an increase in the "Revaluation reserve" for premises in the consolidated statement of changes in equity for the year ended 31 December 2008. Revaluation decrease of AZN 3,226 thousand relating to revaluation of buildings was recorded as a decrease in "Revaluation reserve" for premises in the consolidated statement of changes in equity for the year ended 31 December 2008, which resulted in a decrease of AZN 774 thousand in previously recognized deferred tax liability. This related decrease in deferred tax liability was recorded in the consolidated statement of changes in equity for the year ended 31 December 2008. Refer to Note 27.

At 31 December 2008, the carrying amount of premises would have been AZN 21,926 thousand (2007: AZN 18,524 thousand) had the assets been carried at cost less depreciation.

Included in the property, plant and equipments as at 31 December 2008 are office, computer equipments and furniture, vehicles and other assets with a cost of AZN 32,162 thousand (2007: AZN 21,953 thousand) which have been fully depreciated but were still in use by the Bank as at 31 December 2008.

Construction in progress consists mainly of construction and refurbishment of branch premises. Upon completion, assets are transferred to premises and equipment.

Included in additions to construction in progress are payments of AZN 23,487 thousand (2007: AZN 17,338 thousand) made by the Group to contractors for the purposes of construction of its new office building on land purchased by the Group in the centre of Baku.

13 Other Financial and Insurance Assets

In thousands of Azerbaijani Manats	**2008**	**2007**
Receivables under currency swap agreement	23,690	-
Receivables from insurance policyholders	7,599	4,801
Amounts in the course of settlement	3,830	1,619
Receivables for plastic cards transactions	1,611	2,302
Total other financial and insurance assets	**36,730**	**8,722**

Receivables for plastic cards transactions represent receivables from other local banks for cards produced, issued and serviced for them by Azericard, the card processing subsidiary, as well as net funds receivable from other local banks for cash withdrawn from the Bank's ATMs by customers of other banks.

The analysis by credit quality of other financial and insurance receivables outstanding at 31 December 2008 is as follows:

In thousands of Azerbaijani Manats	**Receivables under currency swap agreement**	**Amounts in the course of settlement**	**Receivables for plastic cards transactions**	**Total**
Current and not impaired				
- Medium sized companies	-	-	1,611	1,611
- Resident banks	-	3,830	-	3,830
- Top ranked OECD banks	23,690	-	-	23,690
Total other financial and insurance receivables	**23,690**	**3,830**	**1,611**	**29,131**

13 Other Financial and Insurance Assets (Continued)

The analysis by credit quality of other financial and insurance receivables outstanding at 31 December 2007 is as follows:

In thousands of Azerbaijani Manats	**Receivables under currency swap agreement**	**Amounts in the course of settlement**	**Receivables for plastic cards transactions**	**Total**
Current and not impaired				
- Medium sized companies	-	-	2,302	2,302
- Resident banks	-	1,619	-	1,619
Total other financial and insurance receivables	**-**	**1,619**	**2,302**	**3,921**

During the year ended 31 December 2008, the Group entered into currency swap agreements with non-resident banks, whereby the Group sold EUR and bought USD using the predetermined foreign exchange rate at the transaction date and agreed to buy back the initially sold amount of EUR at a predetermined future date by paying USD at the predetermined foreign exchange rate. As at 31 December 2008, the Group had 11 outstanding currency swap agreements representing derivative financial instruments (2007: nil). The fair value of these derivative financial instruments was AZN 23,690 thousand at 31 December 2008 (2007: nil). Refer to Note 31.

The carrying value of each class of other financial assets approximates fair value at 31 December 2008 and 31 December 2007. At 31 December 2008, the estimated fair value of other financial assets was AZN 29,131 thousand (2007: AZN 3,921 thousand). Refer to Note 34.

14 Other Assets

In thousands of Azerbaijani Manats	**2008**	**2007**
Prepaid expenses	5,101	3,293
Advances for purchase of intangible assets and equipment	3,428	-
Deferred acquisition costs on insurance premiums written	2,814	1,530
Deferred expenses for plastic cards	1,504	1,692
Prepaid insurance	275	203
Other	2,981	2,231
Total other assets	**16,103**	**8,949**
Current	12,550	7,451
Non-current	3,553	1,498

Prepaid expenses balances as at 31 December 2008 include prepaid rentals and other administrative expenses of AZN 852 thousand for operation of representative offices of the Group in Dubai, London and New York and advance payment of AZN 3,148 thousand for the purchase of plastic cards by the Bank from local and foreign suppliers (2007: prepaid expenses balances included AZN 2,221 thousand of advance payments for the purchase of plastic cards).

15 Due to Other Banks

In thousands of Azerbaijani Manats	2008	2007
Short-term placements of other banks	685,773	110,012
Correspondent accounts and overnight placements of other banks	142,423	37,100
Blocked accounts of resident banks in relation to plastic cards operations	-	197
Total due to other banks	**828,196**	**147,309**

Included in the short-term placements of other banks as at 31 December 2008 are six short-term placements of a non-resident bank amounting to EUR 500,000 thousand or AZN 564,600 thousand (2007: nil). These placements bear interest rates of 4.3-6.5% per annum with maturities in March 2009 - November 2009.

Included in the short-term placements of other banks as at 31 December 2008 is one short-term placement of a non-resident bank with the Bank amounting to USD 25,000 thousand or AZN 20,025 thousand (2007: nil). This placement bears interest rate 11.5% per annum and had maturities in 2009 year.

Included in the short-term placements of other banks as at 31 December 2008 is a short-term placement of a non-resident bank amounting to USD 30,000 thousand or AZN 24,030 thousand (2007: two short-term placements of a non-resident bank with the Bank amounting to USD 40,000 thousand or AZN 33,812 thousand each and interest rates of 6.4% and 6.5% per annum with maturities in May 2008). This placement bears an interest rate of 6.5% per annum and matures in 2009.

Included in the short-term placements of other banks as at 31 December 2008 are two short-term placements of a non-resident and one short-term placement of a resident bank amounting to USD 33,000 thousand or AZN 26,433 thousand (2007: nil). The placements bear interest rates ranging between 3.8% and 14% per annum and had maturities in the first quarter of 2009.

Also included in short-term placements of other banks is a deposit of USD 55,000 thousand or AZN 44,055 thousand by a foreign bank with an interest rate of 4.35% per annum placed with IBAR Moscow and with maturity in August 2009 (2007: a deposit of USD 50,000 thousand or AZN 42,265 thousand and a deposit of USD 15,000 thousand or AZN 12,174 thousand at an interest rate of 6.60% and 6.16% per annum, respectively and with maturity in August 2008).

The carrying value of each class of due to other banks approximates fair value at 31 December 2008 and 31 December 2007. At 31 December 2008, the estimated fair value of due to other banks was AZN 828,196 thousand (2007: AZN 147,309 thousand). Refer to Note 34.

The interest rate analysis of due to other banks is disclosed in Note 31. The information on related party balances is disclosed in Note 36.

16 Customer Accounts

In thousands of Azerbaijani Manats	2008	2007
State and public organisations		
- Current/settlement accounts	551,690	411,654
- Term deposits	661,187	607,582
- Restricted customer deposits	-	86
Other legal entities		
- Current/settlement accounts	180,450	234,363
- Term deposits	41,790	42,114
- Restricted customer deposits	122,292	164,933
Individuals		
- Current/demand accounts	164,128	114,428
- Term deposits	362,458	275,323
Total customer accounts	**2,083,995**	**1,850,483**

16 Customer Accounts (Continued)

As at 31 December 2008, the Group had significant concentration of customer accounts attracted from one customer - a state organisation involved in the oil industry - totalling to AZN 426,611 thousand and from a government body of AZN 304,698 thousand, respectively or 35.1% of total customer accounts in aggregate (2007: AZN 547,467 thousand and AZN 233,130 thousand, respectively or 42.2% in aggregate).

Included in term deposits of state and public organisations is a deposit of a state organisation involved in the oil industry sector of the Republic of Azerbaijan of AZN 532,665 thousand. The interest rate on this deposit is 1.8% per annum (2007: deposits of a state organisation involved in the oil industry sector of the Republic of Azerbaijan of AZN 455,573 thousand with interest rate on this deposit 1.8% per annum).

Included in the current and settlement accounts of state and public organisations as at 31 December 2008 are balances on current interest bearing accounts of state-owned enterprises and government bodies of AZN 17,815 thousand (2007: AZN 72,899 thousand). Interest rates on these accounts vary from 0.5% to 3.0% per annum (2007: 0.5% to 3.5% per annum).

Also included in term deposits of state and public organisations are four short-term deposits of the Ministry of Finance of the Republic of Azerbaijan amounting to USD 150,000 thousand or AZN 120,150 thousand, USD 100,000 thousand or AZN 80,100 thousand and USD 100,000 thousand or AZN 80,100 thousand and EUR 62,600 thousand or AZN 70,688 thousand (2007: a deposit amounting to USD 150,000 thousand or AZN 126,795 thousand) that are being continuously prolonged each month. The interest rates on these deposits range between 1.5% and 5.0% per annum (2007: 5.25% per annum).

Restricted customer deposits amounting to AZN 122,292 thousand as at 31 December 2008 (2007: AZN 164,933 thousand) represent balances on customer accounts held by the Group as collateral for irrevocable commitments under import letters of credit and guarantees issued by the Group on behalf of its customers. The information on letters of credit and guarantees outstanding as at 31 December 2008 and 31 December 2007 is disclosed in Note 33.

Economic sector concentrations within customer accounts are as follows:

	2008		**2007**	
In thousands of Azerbaijani Manats	**Amount**	**%**	**Amount**	**%**
State and public organisations*	783,418	37.6	316,694	17.1
Energy	542,794	26.0	725,318	39.2
Individuals	526,586	25.3	389,751	21.1
Trade and services	93,713	4.5	105,620	5.7
Construction	23,916	1.1	52,568	2.8
Transportation and communication	21,865	1.0	48,711	2.7
Manufacturing	14,031	0.7	98,257	5.3
Other	77,672	3.8	113,564	6.2
Total customer accounts	**2,083,995**	**100.0**	**1,850,483**	**100.0**

(*) State and public organisations comprise ministries, Treasury, municipalities and other state bodies of the Republic of Azerbaijan, excluding profit making state and public organisations that are included in the respective categories

The carrying value of each class of customer accounts approximates fair value at 31 December 2008 and 31 December 2007. At 31 December 2008, the estimated fair value of customer accounts was AZN 2,083,995 thousand (2007: AZN 1,850,483 thousand). Refer to Note 34.

The interest rate analysis of customer accounts is disclosed in Note 31. The information on related party balances is disclosed in Note 36.

17 Debt Securities in Issue

In thousands of Azerbaijani Manats	2008	2007
Deposit certificates	10,948	12,581
Debentures	-	4,227
Total debt securities in issue	**10,948**	**16,808**

At 31 December 2008, deposit certificates denominated in USD in the amount of AZN 10,753 thousand bear interest rates ranging between 9.0%-10.0% per annum and have maturities of two, three, four and ten years and deposit certificates denominated in AZN in the amount of AZN 195 thousand bear an interest rate of 25.0% per annum and have maturities of ten years (2007: USD denominated deposit certificates of AZN 12,496 thousand at 9.0-10.0% per annum and with maturities of two, three, four and ten years, AZN denominated deposit certificates of AZN 85 thousand at 25.0% per annum and with maturity of ten years). These certificates of deposit state as a condition that interest is paid each year only if certificates are held for the full period of that calendar year.

The interest rate analysis of debt securities in issue is disclosed in Note 31.

18 Other Borrowed Funds

In thousands of Azerbaijani Manats	2008	2007
Term borrowings from government organisations:		
- National Fund for Support of Entrepreneurship (the Republic of Azerbaijan)	14,700	7,951
Syndicated borrowings:		
- Syndicated borrowing agreement signed on 10 November 2006	-	77,768
- Syndicated borrowing agreement signed on 13 June 2007	-	118,342
- Syndicated borrowing agreement signed on 5 June 2008	138,974	-
Commerzbank	52,960	-
Societe Generale	25,638	23,239
Export-Import Bank of Korea	12,028	8,330
Rabobank	6,826	9,459
Black Sea Trade and Development Bank (BSTDB)	5,916	9,099
AKA Ausfuhrkredit Gesellscaft mbH	4,409	-
Bayerische Landesbank	3,610	
DZ Bank	3,554	995
BNP Paribas	3,171	-
Credit Suisse	3,032	-
Landesbank Berlin AG	2,150	-
Dresdner Bank AG	1,935	-
Others	8,788	5,369
Accrued interest payable	2,172	2,069
Total other borrowed funds	**289,863**	**262,621**

Syndicated borrowings

On 5 June 2008, Bank signed a syndicated borrowing agreement with foreign banks led by one of the major German banks in the amount of USD 173,500 thousand or AZN 138,974 thousand (Facility A and B: commitment amounted to USD 107,500,000 and USD 66,000,000, respectively). The borrowing facilities bear a market interest rate and are repayable in two full instalments each to be made on 12 June 2009 and 12 December 2009. The Bank is obliged to comply with certain financial covenants stipulated by the borrowing agreements signed with the bank. At 31 December 2008, management believes that the Bank was in compliance with those covenants.

Commerzbank

On 27 May 2005, Bank signed basic loan agreement with Commerzbank in the amount of EUR 25,000 thousand. The borrowing facility bears a market interest rate and is repayable within five years. Bank will utilize amounts borrowed under this agreement for its export financing purposes. At 31 December 2008, the amount drawn down under this credit line net of repayments was EUR 352 thousand or AZN 398 thousand (2007: nil). The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement.

18 Other Borrowed Funds (Continued)

On 23 April 2008, the Bank signed term loan facility agreement with the same bank in the amount of USD 50,000 thousand or AZN 40,050 thousand. The borrowing facility bears a market interest rate and is repayable in one full instalment to be made on 23 April 2011. The Bank will utilize amounts borrowed under this agreement for its general corporate lending purposes. At 31 December 2008, the Bank had fully drawn down the facility available under the above borrowing agreement. The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement.

In addition, on 30 October 2008, the Bank signed amended basic agreement with the same bank in the amount of USD 16,569 thousand. The borrowing facility bears a market interest rate and is repayable within 5 years in five instalments. The Bank will utilize amounts borrowed under this agreement for export financing purposes. As at 31 December 2008, the amount drawn down on this credit line was USD 15,621 thousand or AZN 12,512 thousand (2007: nil). The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement.

Bayerische Landesbank

On 2 July 2008, the Bank signed amended and restated basic agreement with Bayerische Landesbank in the amount of USD 25,000 thousand. The borrowing facility bears a market interest rate and is in force for a period of two years. The Bank will utilise amounts borrowed under this agreement for its export financing purposes. At 31 December 2008, the amount drawn down on this credit line was USD 4,507 thousand or AZN 3,610 thousands (2007: nil). The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement.

As at 31 December 2008, management of the Bank believes that the Bank was in compliance with those covenants with the exception of a cross-default clause related to breaches of covenants stipulated by borrowing agreements between the Bank and other third parties. Because of this the Bank has formally breached the loan agreement and, therefore, the total outstanding balance of borrowing agreements disclosed above in the total amount of AZN 195,544 thousand was classified as being on demand in the liquidity analysis table disclosed in the Note 31 of these consolidated financial statements. The breaches that have occurred are detailed in Note 33.

Societe Generale

On 22 June 2005, the Bank signed a General Buyer Credit Agreement with Societe Generale, legal entity registered in France for obtaining funds not exceeding EUR 45,000 thousand at a market interest rate for the financing of commercial contracts entered into by local companies. The agreement was in force for a period of two years with an option of automatic renewal for two additional years. This option was used by the Bank to extend the term of this agreement for other two years in 2007. In 2008, the agreement was extended for another year. Each draw down made under the agreement is repayable in eight equal semi-annual instalments, starting from the date of the respective draw down. This credit line is designated to finance Azerbaijani companies, which purchase the goods and services of French and German origin. At 31 December 2008, the remaining balance on this credit line net of repayments was EUR 10,268 thousand or AZN 11,594 thousand (2007: EUR 11,735 thousand or AZN 14,607 thousand).

On 19 July 2007, the Bank signed a second General Buyer Credit Agreement with Societe Generale for obtaining funds not exceeding USD 50,000 thousand at a market interest rate for the financing of commercial contracts entered into by local companies. The agreement will be in force for a period of two years with an option of automatic renewal for two additional years. Each draw down made under the agreement is repayable in twelve equal semi-annual instalments, starting from the date of the respective draw down. This credit line is designated to finance Azerbaijani companies, which purchase the goods and services of Korean origin. At 31 December 2008, the amount drawn down on this credit line net of repayments was USD 17,533 thousand or AZN 14,044 thousand (2007: USD 10,208 thousand or AZN 8,629 thousand). There are no financial covenants with regard to the above borrowing agreements of the Bank with Societe Generale.

Export-Import Bank of Korea

On 23 April 2007, the Bank signed Comprehensive Interbank Export Credit Agreement with Export-Import Bank of Korea, the Republic of Korea for obtaining funds not exceeding USD 10,000 thousand at a market interest rate for a period of two years for financing the import of goods and services with Korean origin on the revolving facility basis to be repayable on a semi-annual instalments. The agreement was signed for two years validity period with an option of automatic renewal for the next two years.

On 4 February 2008, the Bank signed the Amendment Agreement with Export-Import Bank of Korea, the Republic of Korea, for a credit line of USD 20,000 thousand for a period of two years validity period with an option of automatic renewal for the next two years at a market interest rate for financing the import of the goods of Korean origin. At 31 December 2008, the amount drawn down under this credit line net of repayments was USD 8,677 thousand or AZN 6,950 thousand (2007: nil).

18 Other Borrowed Funds (Continued)

In addition, on 22 April 2008, the Bank signed the second Amendment Agreement with Export-Import Bank of Korea for a credit line of USD 10,000 thousand for a period of two years at a market interest rate for financing the import of the goods of Korean origin. At 31 December 2008, the amount drawn down under this credit line net of repayments was USD 6,339 thousand or AZN 5,078 thousand (2007: nil). Each drawdown under these agreements is repayable in seven equal semi-annual instalments, starting from the date of the respective draw down. There are no financial covenants with regard to this borrowing from Export-Import Bank of Korea that the Bank should comply with.

Rabobank

On 11 August 2006, the Bank signed an agreement with the Cooperative Centrale Raiffeisen-Boerenleenbank B.A. ("Rabobank"), registered in Netherlands, for the initial credit line of EUR 5,330 thousand for the period of five years at a market interest rate for financing of the construction of a dairy plant in the Republic of Azerbaijan. Limit of the credit line has been gradually increased since the date of the agreement and comprised EUR 10,000 thousand. As at 31 December 2008, the amount drawn down under this credit line net of repayments was EUR 6,045 thousand or AZN 6,826 thousand (2007: EUR 7,597 thousand or AZN 9,459 thousand). The loan will be repaid in ten equal semi-annual instalments. There are no financial covenants with regard to this borrowing from Rabobank that the Bank should comply with.

Black Sea Trade and Development Bank (BSTDB)

On 21 January 2002, the Bank signed a Loan Agreement with the Black Sea Trade and Development Bank, registered in Thessaloniki, Greece for a Multiple Buyer Revolving Credit Facility in the amount of USD 6,500 thousand. The amount drawn down on this revolving facility net of repayments as at 31 December 2008 amounted to USD 3,861 thousand or AZN 3,093 thousand (2007: USD 4,627 thousand or AZN 3,911 thousand) and is used for the financing of various projects related to the manufacturing and transportation sectors of the Republic of Azerbaijan. The borrowing facility bears a market interest rate. The revolving facility is for seven years. Each drawdown under these agreements is repayable in equal semi-annual instalments, starting from the date of the respective draw down.

On 21 June 2005, the Bank signed the second Loan Agreement with the Black Sea Trade and Development Bank for the purpose of funding the construction of a glass factory in Azerbaijan of EUR 5,000 thousand. The amount drawn down on this credit facility agreement as at 31 December 2008 amounted to EUR 2,500 thousand or AZN 2,823 thousand (2007: EUR 4,167 thousand or AZN 5,188 thousand). The borrowing facility bears a market interest rate.

The loan is repayable in a ten equal semi-annual instalments within seven years two of which are considered to serve as a grace ones.

The Bank is obliged to comply with certain financial covenants stipulated by the borrowing agreements signed with the Black Sea Trade and Development Bank. At 31 December 2008, management had a waiver against all potential breaches of covenants existing at the reporting date.

AKA Ausfuhrkredit Gesellschaft mbH

On 3 July 1996, the Bank signed Loan Agreement with AKA Ausfuhrkredit Gesellschaft mbH, legal entity registered in Germany for a credit line of EUR 10,000 thousand for exports of goods and services of German origin. The borrowing facility bears a market interest rate and is repayable within five years in ten equal semi-annual instalments. At 31 December 2008, the amount drawn down under this credit line was EUR 3,905 thousand or AZN 4,409 thousand (2007: nil). There are no financial covenants with regard to this borrowing from AKA Ausfuhrkredit Gesellschaft mbH that the Bank should comply with.

DZ Bank

On 17 September 2007, the Bank signed the Master agreement with respect to short term trade finance with DZ Bank AG, legal entity registered in Frankfurt am Main, Germany for a credit line of EUR 10,000 thousand for a period of two years at a market interest rate for financing of trade. At 31 December 2008, the amount drawn down under this credit line was EUR 3,148 thousand or AZN 3,554 thousand (2007: EUR 799 thousand or AZN 955 thousand). There are no financial covenants with regard to this borrowing from DZ Bank AG that the Bank should comply with.

BNP Paribas

On 6 June 2006, the Bank signed a Multisource Framework Agreement with BNP Paribas, legal entity registered in France, for the initial credit line of EUR 3,121 thousand with the maturity period of five years at a market interest rate for the purposes of general trade financing. Limit of the credit line has been gradually increased since the date of the agreement and comprised USD 50,000 thousand. At 31 December 2008, amount drawn down under this credit line net of repayments was EUR 2,808 thousand or AZN 3,171 thousand (2007: nil). The loan will be repaid in ten equal semi-annual instalments with maturity date of 21 January 2013. There are no financial covenants with regard to this borrowing from BNP Paribas that the Bank should comply with.

18 Other Borrowed Funds (Continued)

Credit Suisse

On 5 September 2005, the Bank signed Export Frame Loan Agreement with Credit Suisse, registered in Switzerland, for financing export of goods and services. A credit line of EUR 20,000 thousand under this agreement has been granted to the Bank for the period of five years at a market interest rate. At 31 December 2008, the amount drawn down under this credit line net of repayments was EUR 2,685 thousand or AZN 3,032 thousand (2007: nil). There are no financial covenants with regard to this borrowing from Credit Suisse that the Bank should comply with.

Landesbank Berlin AG

On 5 July 2005, the Bank signed a borrowing agreement with Landesbank Berlin AG, registered in Germany for the purposes of financing delivery of laundry equipment and services rendered. A credit line of EUR 2,116 thousand under this agreement have been granted to the Bank for the period of five years. The borrowing bore a market interest rate. Total amount drawn down at 31 December 2008 amounted to EUR 1,904 thousand or AZN 2,150 thousand (2007: nil). The loan will be repaid in ten equal semi-annual instalments with maturity date of 22 March 2013. There are no financial covenants with regard to this borrowing from Landesbank Berlin AG that the Bank should comply with.

Dresdner Bank AG

On 26 September 2006, the Bank signed a Basic Agreement with Dresdner Bank AG, legal entity registered in Germany at a market interest rate for the financing of goods and services of German origin. A credit line of EUR 2,255 thousand have been granted to the Bank under this agreement for the supply of woodworking equipment as well as short-cycle through feed press line for laminating chipboards. Total amount drawn down at 31 December 2008 amounted to EUR 1,714 thousand or AZN 1,935 thousand (2007: nil). The loan will be repaid in ten equal semi-annual instalments within five years. There are no financial covenants with regard to this borrowing from Dresdner Bank AG that the Bank should comply with.

Others

Included in other category are funds attracted from Islamic Development Corporation (a member of Islamic Development Bank Group, an international financial institution with headquarters registered in Jeddah, Saudi Arabia), Nova Ljubljanska Banka, registered in Slovenia, Export Development Bank of Iran, registered office in Iran, Export Development Bank of Canada, registered in Canada, Japan Bank for International Cooperation, registered in Japan.

On 12 April 2004, the Bank signed a Line of Financing Agreement with the Islamic Development Corporation for the development of private sector with the amount of USD 4,500 thousand for a period of six years including two years of grace period at a market interest rate for financing of various investment projects in the Republic of Azerbaijan. At 31 December 2008, the amount drawn down under this credit line net of repayments was USD 1,763 thousand or AZN 1,412 thousand (2007: USD 3,351 thousand or AZN 2,833 thousand) and was used for the purposes of financing a project in the manufacturing sector of Azerbaijan. The loan will be repaid in an eight semi-annual instalments. The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement.

At 31 December 2008, management of the Bank believes that the Bank was in compliance with those covenants with the exception of a cross-default clause related to breaches of covenants stipulated by borrowing agreements between the Bank and other third parties. Because of this the Bank formally breached this covenant and, therefore, outstanding balance of this borrowing from the Islamic Development Corporation in the amount of USD 1,763 thousand or AZN 1,412 thousand was classified as being on demand in the liquidity analysis table disclosed in the Note 31 of these consolidated financial statements. The breaches that have occurred are detailed in Note 33.

On 29 November 2006, the Bank signed Loan Agreement with Nova Ljubljanska Banka for export of goods and services, in the amount of USD 3,000 thousand for a period of 36 months at a market interest rate. The amount drawn down under this credit line net of repayments was USD 1,500 thousand or AZN 1,202 thousand (2007: USD 3,000 thousand or AZN 2,536 thousand). The loan will be repaid in a six equal semi-annual instalments. The Bank is obliged to comply with certain financial covenants stipulated by this borrowing agreement. At 31 December 2008, management believes that the Bank was in compliance with those covenants.

On 20 October 2007, the Bank signed a Credit Facility Agreement with Export Development Bank of Iran at a market interest rate for the purpose of financing of trading goods and services of Iranian origin. A credit line of not exceeding EUR 10,000 thousand under this agreement has been extended to the Bank for the period of two years. At 31 December 2008 total amount draw down under this credit line net of repayments was EUR 424 thousand or AZN 479 thousand (2007: nil). The loan will be repaid in four semi-annual instalments with last repayment date of 17 May 2010. There are no financial covenants with regard to this borrowing from Export Development Bank of Iran that the Bank should comply with.

18 Other Borrowed Funds (Continued)

On 23 October 2008, the Bank signed Loan Agreement with Export Development Bank of Canada for financing of export of goods and services. A credit line of USD 3,037 thousand under this agreement have been granted to the Bank for the period of five years at a market interest rate (2007: nil). The amount draw down under this credit line at 31 December 2008 was USD 1,301 thousand or AZN 1,042 thousand (2007: nil).There are no financial covenants with regard to this borrowing from Export Development Bank of Canada that the Bank should comply with.

On 13 June 2007, the Bank signed Loan Agreement with Japan Bank for International Cooperation and the Participating Financial Institution namely with Sumitomo Mitsui Banking Corporation for financing export of goods and services. A credit line of USD 20,000 thousand under this agreement has been granted to the Bank for the period of three years at a market interest rate. The amount drawn down under this credit line at 31 December 2008 net of repayments was USD 225 thousand or AZN 180 thousand (2007: nil). There are no financial covenants with regard to this borrowing from Japan Bank for International Cooperation and Sumitomo Mitsui Banking Corporation that the Bank should comply with.

Market interest rates for the borrowings range between 5% and 10% per annum for the year ended 31 December 2008 (5% and 10% per annum for the year ended 31 December 2007).

The carrying value of each class of other borrowed funds approximates fair value at 31 December 2008 and 31 December 2007. At 31 December 2008, the estimated fair value of other borrowed funds was AZN 289,863 thousand (2007: AZN 262,621 thousand).

The liquidity analysis of other borrowed funds is disclosed in Note 31. The information on related party balances is disclosed in Note 36.

19 Other Financial and Insurance Liabilities

Other financial and insurance liabilities comprise the following:

In thousands of Azerbaijani Manats	**Note**	**2008**	**2007**
Items in course of settlement		83,855	48,043
Insurance reserves		11,577	6,247
Dividends payable	29	10,843	60
Insurance premiums and broker commissions payable		3,765	1,784
Total other financial and insurance liabilities		**110,040**	**56,134**

Items in the course of settlement include AZN 14,343 thousand (2007: AZN 43,440 thousand), which include the fund transfers in the course of processing. These amounts were settled two to three days after the balance sheet date.

Movements in insurance reserves during the years ended 31 December 2008 and 2007 were as follows:

	1 January 2007	**Increase/(decrease) during the year**	**31 December 2007**	**Increase/(decrease) during the year**	**31 December 2008**
IBNR					
Gross	158	351	509	1,056	1,565
Reinsurer's share	(34)	(69)	(103)	66	(37)
Net	**124**	**282**	**406**	**1,122**	**1,528**
UPR					
Gross	3,669	3,482	7,151	4,305	11,456
Reinsurer's share	(682)	(986)	(1,668)	55	(1,613)
Net	**2,987**	**2,496**	**5,483**	**4,360**	**9,843**
RBNS					
Gross	366	85	451	(244)	207
Reinsurer's share	(45)	(48)	(93)	92	(1)
Net	**321**	**37**	**358**	**(152)**	**206**
Total	**3,432**	**2,815**	**6,247**	**5,330**	**11,577**

19 Other Financial and Insurance Liabilities (Continued)

The carrying value of each class of other financial liabilities approximates fair value at 31 December 2008 and 31 December 2007. Refer to Note 19.

20 Other Liabilities

Other liabilities comprise the following:

In thousands of Azerbaijani Manats	2008	2007
Deferred revenue on plastic cards operations	9,148	8,144
Sundry creditors	2,745	2,039
Deferred ceding commissions on insurance operations	75	75
Other	2,515	2,748
Total other liabilities	**14,483**	**13,006**
Current	4,448	4,918
Non-current	10,035	8,088

Deferred revenue on plastic cards operations represents the unearned portion of revenue related to fees charged for the annual maintenance of plastic card accounts. This fee is charged upon the issuance of cards and amortised over their respective term.

21 Subordinated Debt

In thousands of Azerbaijani Manats	2008	2007
Credit Linked Notes issued by Rubrika Finance Company Limited	80,100	84,530
Subordinated debt from Asian Development Bank	16,020	16,906
Accrued interest payable	380	1,034
Total subordinated debt	**96,500**	**102,470**

On 8 May 2007, the Bank signed Subordinated Facility Agreement with Rubrika Finance Company Limited, legal entity registered in Dublin, for an issue of Credit Linked Notes on the Cayman Islands Stock Exchange to institutional investors from Europe and the United States of America for a total amount of USD 100,000 thousand or AZN 80,100 thousand for general corporate purposes. The Credit Linked Notes bear a market interest rate and mature on 10 May 2017. The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement. As at 31 December 2008, management of the Bank believes that the Bank was in compliance with those covenants.

On 14 December 2007, the Bank signed subordinated debt agreement with the Asian Development Bank, registered in Manila, the Philippines, for obtaining funds in the amount not exceeding USD 20,000 thousand to be used in further lending activities of the Bank. The borrowing bears a market interest rate and is repayable on 14 December 2015. As at 31 December 2008, the balance of this subordinated debt was USD 20,000 thousand or AZN 16,020 thousand (2007: AZN 16,906 thousand) and was used for the purposes of strengthening the Bank's funding base. The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement. As the Bank formally breached some of these covenants, outstanding balance of this borrowing in the amount of USD 16,020 thousand was classified as being on demand in the liquidity analysis table disclosed in the Note 31 of these consolidated financial statements. The breaches that have occurred are detailed in Note 33.

Market interest rates for these subordinated debts range between 5.68% and 8.40% per annum. The repayment of Bank's subordinated debt ranks after all other creditors in case of liquidation of the Bank.

At 31 December 2008, the estimated fair value of subordinated debt was AZN 96,500 thousand (2007: AZN 102,470 thousand).

The liquidity risk analysis of subordinated debt is disclosed in Note 28.

22 Share Capital

The authorised, issued and paid-in capital of the Bank as at 31 December 2008 and 31 December 2007 is as follows:

In thousands of AZN except for number of shares	Number of paid-in shares (in thousands)	Ordinary shares	Total
At 1 January 2007	**296,595**	**59,319**	**59,319**
New shares paid-in	203,405	40,681	40,681
At 31 December 2007	**500,000**	**100,000**	**100,000**
New shares paid-in	448,685	89,737	89,737
At 31 December 2008	**948,685**	**189,737**	**189,737**

All ordinary shares have a nominal value of AZN 0.2 per share (2007: AZN 0.2 per share) and rank equally. Each share carries one vote.

The weighted average number of ordinary shares outstanding during the year ended 31 December 2008 was AZN 578,152 thousand (2007: 424,444 thousand)

As at 31 December 2008, the Ministry of Finance of the Republic of Azerbaijan (“MoF”) paid all subscribed shares and held 52.92% of the total paid-in share capital of the Bank (2007: 50.20% of the total paid-in share capital of the Bank). After all subscribed shares are paid by the remaining shareholders, the MoF will have held 50.20% of the total paid-in share capital of the Bank.

As at 31 December 2008, the Bank had 51,315 thousand ordinary shares in issue that have not been paid-in (2007: nil).

As at 31 December 2008, the Group’s employees held 6.85% of the total share capital of the Bank, or 64,984 thousand ordinary shares with a par value of AZN 12,997 thousand (2007: 6.30%, or 31,518 thousand ordinary shares with a par value of AZN 6,304 thousand). Refer to Note 36. The Group’s employees are entitled to purchase the Bank’s shares at the market price available for all other shareholders and potential investors. After all subscribed shares are paid, the Group’s employees will have held 7.98% of the total paid-in share capital of the Bank.

23 Interest Income and Expense

In thousands of Azerbaijani Manats	2008	2007
Interest income		
Loans and advances to customers	221,945	154,347
Due from other banks and correspondent accounts	57,118	30,794
Total interest income	**279,063**	**185,141**
Interest expense		
Deposits from banks and other borrowed funds	41,139	24,644
Savings deposits of individuals and deposit certificates	33,039	25,019
Term deposits of legal entities	17,026	16,418
Subordinated debt	8,505	4,623
Debentures	704	2,121
Total interest expense	**100,413**	**72,825**
Net interest income	**178,650**	**112,316**

For information on related party transactions, see Note 36.

24 Fee and Commission Income and Expense

In thousands of Azerbaijani Manats	2008	2007
Fee and commission income		
- Plastic cards operations	38,139	21,757
- Transactions with foreign currencies	31,662	23,845
- Cash transactions	19,621	13,157
- Settlement transactions	13,891	11,443
- Letters of credit issued	12,301	8,711
- Guarantees issued	9,761	7,409
- Servicing intermediary loans	848	266
- Other	1,123	672
Total fee and commission income	**127,346**	**87,260**
Fee and commission expense		
- Plastic cards operations	6,435	2,508
- Cash transactions	3,782	1,022
- Settlement transactions	2,685	1,528
- Policy acquisition costs on insurance operations	2,130	1,192
- Other	2,691	1,523
Total fee and commission expense	**17,723**	**7,773**
Net fee and commission income	**109,623**	**79,487**

For information on related party transactions, see Note 36.

25 Loss on the Early Settlement of Assets/Liabilities at Rates Below/Above Market

During the year ended 31 December 2007 as part of a single negotiation, the Bank agreed to the termination of a number of assets and liabilities that were entered into during earlier periods at non-market rates. As a result of these early terminations, and the loss on the acquisition of a loan acquired by the Bank during the year, the Bank recorded a net loss of AZN 8,047 thousand in the consolidated income statement for the year ended 31 December 2007.

A breakdown of losses on origination of asset/liabilities at rates below/above market is as follows:

In thousands of Azerbaijani Manats	2008	2007
Loss on acquisition of loan	-	(13,009)
Gain on the early termination of certificates of deposits issued at rates above market	-	4,962
Total losses on the early settlement of assets/liabilities at rates below/above market	**-**	**(8,047)**

The amounts presented as a loss on acquisition of loan and gains on the early termination of certificates of deposits issued at rates above market represent gains/(losses) on assets classified as loans and receivables and on financial liabilities carried at amortised cost, respectively, in accordance with *IAS 39 – Financial Instruments: Recognition and Measurement*.

26 Administrative and Other Operating Expenses

In thousands of Azerbaijani Manats	Note	2008	2007
Staff costs		36,446	30,059
Depreciation of premises and equipment	12	13,580	14,458
Charity and financial aid		8,878	4,203
Advertising and marketing services		7,358	5,553
Customs duties and other taxes other than on income		7,115	4,363
Rent		4,176	3,159
Maintenance of premises and equipment		3,918	3,791
Purchase of plastic cards		2,829	3,936
Communication		2,794	1,833
Security		2,388	1,742
Amortisation of software and other intangible assets	12	1,865	828
Stationery, books, printing and other supplies		1,849	1,250
Transportation of valuables		923	2,010
Property insurance		859	892
Business trip expenses		829	596
Software related expenses		720	393
Training		432	332
Other		7,645	3,369
Total administrative and other operating expenses		**104,604**	**82,767**

Included in staff costs are obligatory payments to the Social Security Fund and other funds of the Republic of Azerbaijan of AZN 5,972 thousand (2007: AZN 4,814 thousand). In addition, AZN 385 thousand was collected by the Group as a deduction to employee salaries and paid to the State Pension Fund on their behalf (2007: AZN 387 thousand).

Included in charity and financial aid expenses incurred during the year are AZN 5,958 thousand paid to “Inter” professional football club (2007: AZN 3,300 thousand).

Rental expenses are related to the lease of the Group’s branch buildings in Baku and in the regions of the Republic of Azerbaijan, exchange offices and rental costs associated with ATMs installed, for example, in department stores and hotels.

27 Income Taxes

Income tax expense comprises the following:

In thousands of Azerbaijani Manats	2008	2007
Current tax	(31,935)	(22,661)
Deferred tax	(2,380)	(2,020)
Income tax expense for the year	**(34,315)**	**(24,681)**

The income tax rate applicable to the majority of the Group's income is 22% at 31 December 2008 (2007: 22%). The income tax rate applicable to the operations of IBAR Moscow is 24%. A 24% statutory income tax rate for IBAR Moscow was enacted in August 2001, and applicable from 1 January 2002. On 26 November 2008, the Russian Federation reduced the standard corporate income tax rate from 24% to 20% with effect from 1 January 2009. The impact of the change in tax rate presented above represents the effect of applying the reduced 20% tax rate to deferred tax balances at 31 December 2008.

In thousands of Azerbaijani Manats	2008	2007
IFRS profit before tax	**133,008**	**99,171**
Theoretical tax charge at statutory rate (2008: 22%; 2007: 22%)	(29,262)	(21,818)
Tax effect of items which are not deductible or assessable for taxation purposes:		
-Non deductible expenses	(5,028)	(3,401)
-Other non-temporary differences	112	538
-Effect of changes in income tax rate related to IBAR Moscow	(137)	-
Income tax expense for the year	**(34,315)**	**(24,681)**

Differences between IFRS and Azerbaijani and Russian (for IBAR Moscow) statutory taxation regulations give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below and is recorded at the rate of 22% (2007: 22%) except for IBAR Moscow being at the rate of 20% (2007: 24%):

In thousands of Azerbaijani Manats	**31 December 2007**	**(Charged)/ credited to profit or loss**	**Charged directly to equity**	**31 December 2008**
Tax effect of deductible/(taxable) temporary differences				
Losses on assets and liabilities at non-market rates	155	-	-	155
Deferred revenue recognition	987	(277)	-	710
Provision for letters of credit and guarantees	168	-	-	168
Accruals and other	17	-	-	17
Loan impairment provision	(9,947)	(410)	-	(10,357)
Premises, equipment and intangible assets	(9,513)	(529)	(1,914)	(11,956)
Revenue accruals	(204)	-	-	(204)
Tax effect of share of profits of associates	(136)	-	-	(136)
Tax effect of fair value gain of derivatives	-	(893)		(893)
Other	552	(271)	-	281
Recognised deferred tax liability	**(17,921)**	**(2,380)**	**(1,914)**	**(22,215)**

27 Income Taxes (Continued)

In the context of the Group's current structure and applicable tax legislation, tax losses and current tax assets of different group companies may not be offset against current tax liabilities and taxable profits of other group companies and, accordingly, taxes may accrue even where there is a consolidated tax loss. Therefore, deferred tax assets and liabilities are offset only when they relate to the same taxable entity and the same taxation authority.

In thousands of Azerbaijani Manats	**31 December 2006**	**(Charged)/ credited to profit or loss**	**(Charged) / credited directly to equity**	**Disposals of subsidiaries**	**31 December 2007**
Tax effect of deductible/(taxable) temporary differences					
Losses on assets and liabilities at non-market rates	1,483	(1,328)	-	-	155
Deferred revenue recognition	461	526	-	-	987
Provision for letters of credit and guarantees	168	-	-	-	168
Accruals and other	33	(16)	-	-	17
Loan impairment provision	(7,610)	(2,337)	-	-	(9,947)
Premises, equipment and intangible assets	(6,135)	488	(3,866)	-	(9,513)
Revenue accruals	(204)	-	-	-	(204)
Tax effect of share of profits of associates	(136)	-	-	-	(136)
Deferral of prepaid expenses	(46)	46	-	-	-
Other	(153)	601	-	104	552
Recognised deferred tax asset/(liability)	**(12,139)**	**(2,020)**	**(3,866)**	**104**	**(17,921)**

The composition of the total net deferred tax liability of the Group after offsetting within the individual entities comprising the Group is, as follows:

In thousands of Azerbaijani Manats	**2008**	**2007**
Total net deferred tax asset	520	1,173
Total net deferred tax liability	(22,735)	(19,094)
Total net deferred tax liability of the Group	**(22,215)**	**(17,921)**

28 Earnings per Share

Basic earnings per share are calculated by dividing the profit or loss attributable to equity holders of the Bank by the weighted average number of ordinary shares in issue during the year, excluding treasury shares. There were no treasury shares outstanding as at 31 December 2008 (2007: no treasury shares outstanding).

The Group has no dilutive potential ordinary shares; therefore, the diluted earnings per share equal the basic earnings per share.

In thousands of Azerbaijani Manats	**Note**	**2008**	**2007**
Profit for the year attributable to ordinary shareholders		98,843	74,532
Weighted average number of ordinary shares in issue (thousands)	22	578,152	424,444
Basic and diluted earnings per ordinary share (expressed in AZN per share)		**0.17**	**0.18**

29 Dividends

In thousands of Azerbaijani Manats	**Note**	**2008**	**2007**
Dividends payable at 1 January		**60**	**4,865**
Dividends declared during the year		48,937	28,070
Dividends paid during the year		(38,154)	(32,875)
Dividends payable at 31 December	19	**10,843**	**60**
Dividends per share declared during the year		**0.072**	**0.072**

All dividends are declared in respect of ordinary shares and paid in Azerbaijani Manats by the Bank.

Dividends are declared on a quarterly basis and paid in the subsequent quarter to the shareholders of the Bank in accordance with their shareholding percentage in the issued and paid share capital as at the end of the quarter.

30 Segment Analysis

The Group is organised on a basis of two main business segments:

- Retail banking – representing private banking services, private customer current accounts, savings, deposits, investment savings products, custody, credit and debit cards, insurance services, consumer loans and mortgages; and

- Corporate banking – representing direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, insurance services and foreign currency products.

There are no material items of income or expenses between the business segments. Segment assets and liabilities comprise operating assets and liabilities, being the majority of the consolidated balances sheet, but excluding taxation.

Segment information for the main reportable business segments of the Group for the years ended 31 December 2008 and 2007 is set out below:

	Retail banking		**Corporate banking**		**Total**	
In thousands of Azerbaijani Manats	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**
External revenues	83,416	50,514	357,353	246,630	440,769	297,144
Revenues from other segments	2,719	1,815	10,878	8,862	13,597	10,677
Total revenues	**86,135**	**52,329**	**368,231**	**255,492**	**454,366**	**307,821**
Total revenues comprise:						
- Interest income	55,813	31,474	223,250	153,667	279,063	185,141
- Fee and commission income	25,469	14,834	101,877	72,426	127,346	87,260
- Gains less losses from trading in foreign currencies	2,134	4,206	8,536	20,537	10,670	24,743
- Gross insurance premiums written	2,719	1,815	10,878	8,862	13,597	10,677
- FV of gain on derivatives			23,690		23,690	
Total revenues	**86,135**	**52,329**	**368,231**	**255,492**	**454,366**	**307,821**
Segment result	**40,285**	**19,725**	**91,918**	**79,455**	**132,203**	**99,180**
Share of after tax results of associates					805	(8)
Profit before tax					**133,008**	**99,172**
Income tax expense					(34,315)	(24,681)
Profit for the year					**98,693**	**74,491**
Other segment items						
Capital expenditure	7,492	6,704	40,009	32,730	47,501	39,434
Depreciation and amortisation expense	2,626	2,599	12,819	12,687	15,445	15,286
Other non-cash expenses	11,868	5,624	85,047	27,456	96,915	33,080

Capital expenditures in the year ended 31 December 2008 consisted of AZN 44,073 thousand of additions to premises, equipment and intangible assets (Note 12) and AZN 3,428 thousand of advances for purchase of intangible assets and equipment (Note 14).

30 Segment Analysis (Continued)

Information about segment assets and liabilities of the Group at 31 December 2008 and 31 December 2007 is given in the following table:

	Retail banking		Corporate banking		Total	
In thousands of Azerbaijani Manats	2008	2007	2008	2007	2008	2007
Total segment assets	**538,641**	**328,823**	**3,105,156**	**2,243,236**	**3,643,797**	**2,572,059**
Investments in associates					1607	801
Current and deferred tax assets					520	1,173
Other unallocated assets:						
- Other financial and insurance assets					36,730	8,722
- Other assets					16,103	8,949
- Premises and equipment					150,527	113,023
- Intangible assets					7,073	7,685
Total assets					**3,856,357**	**2,712,412**
Total segment liabilities	**667,156**	**479,717**	**2,642,346**	**1,899,974**	**3,309,502**	**2,379,691**
Current and deferred tax liability					37,923	21,293
Other unallocated liabilities:						
- Other financial and insurance liabilities					110,040	56,134
- Other liabilities					14,483	13,006
Total liabilities					**3,471,948**	**2,470,124**

Geographical segments. The Group's operations outside of Republic of Azerbaijan are not considered significant and do not meet the definition of separately reportable segments.

31 Financial Risk Management

The Group has exposure to financial risks which include credit, liquidity, market and operational risks. The taking of risk is integral to the Group's business. The Group's risk management function's aim is to achieve an appropriate balance between risk and return and to minimise potential adverse effects on the Group's financial performance.

The risk management framework. The risk management function is an integral part of the Group's internal control system and is centralised. The Group's risk management policies and approaches aim to identify, analyse, mitigate and manage the risks faced by the Group. This is accomplished through setting appropriate risk limits and controls, continuously monitoring risk levels and the adherence to limits and procedures and ensuring that business processes are correctly formulated and maintained.

Risk Management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and to ensure that "best practices" are implemented. The Group, as part of its risk culture, emphasises integrity, management and employee standards in order to maintain and continuously improve upon a conservative control environment.

Risk management bodies and governance. Risk management policy, assessment, approval, monitoring and controls are conducted by a number of specialised bodies within the Group. These bodies also oversee the risk management policies and controls at the Group's subsidiaries. The Group has established executive bodies, committees and departments, which conform to Azerbaijani law, the NBAR regulations and the best industry practices.

The Supervisory Board of the Group has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing and approving risk management policies as well as several key risk limit approval authorities, including significantly large exposures, economic and product sector limits. It also delegates certain authority levels to the Executive Board and the Credit Committee.

Established by, appointed by and reporting directly to the Supervisory Board are the Executive Board, the Risk Management Committee, the Audit Committee ("AC"), the Internal Audit Department, the Credit Committee and the Asset and Liability Committee ("ALCO").

The Executive Board is responsible for the implementation and monitoring of risk mitigation measures and ensuring that the Group operates within the established risk parameters. The Member of the Executive Board responsible for risk management along with the Risk Management Department, which reports to this Director, are responsible for the overall risk management functions, ensuring the implementation of common principles and methods for identifying, measuring, mitigating, managing and reporting both financial and non-financial risks.

The Risk Management Committee is chaired by the Member of the Executive Board responsible for risk management. This Committee is responsible for establishing risk management methodologies and ensuring that the risk appetite of the Group is correctly reflected in the strategic and business plans of the Group. It is the main forum for discussing and recommending changes in all risk approaches and procedures to the Executive and Supervisory Boards. It ensures that the Risk Management Department, the Credit Committee and ALCO, as well as the Executive Board, address all potential risks facing the Group and reports on these issues to the Supervisory Board.

The Audit Committee is responsible for overseeing and monitoring the internal control framework of the Group and for assessing the adequacy of risk management policies and procedures, as an integral part of the internal control system of the Group. The Chairman of the AC, an independent professional auditor, and the other two Committee members are representatives of two of the shareholders. The AC members cannot be employees or part of the management structure of the Group. They provide recommendations to the Executive Board, the Risk Management Committee and the Supervisory Board on development of the framework, as well as their views on, the quality of risk management and compliance with established policies, procedures and limits. The AC supervises the work of the Internal Audit, which reports directly to the AC. The Internal Audit's working plans, schedule of audits and its reports, including non-planned audits, are closely reviewed and approved by the AC. Implementation plans based on Internal Audit's and the AC's recommendations, including status reports, are approved by the Executive Board and reported to the Executive Board, the Supervisory Board and the General Meeting of the Shareholders.

The Credit Committee consists of five members. They are nominated by the Risk Management Committee and the Executive Board and elected by the Supervisory Board. The Credit Committee manages and approves, or recommends for approval, corporate, retail and financial organisations' counterparty credit risk exposures within its credit approval authority. It also continuously reviews and makes recommendations as to analysis methodology and portfolio quality, including overall structure, diversification and pricing. The Credit Committee is one of the bodies which ensures adherence to all approval and authority limits and high standards for risk analysis and assessments.

31 Financial Risk Management (Continued)

ALCO is responsible for the management and optimisation of the Group's asset and liability structure. It is an integral part of the risk management process that focuses on various market risks, including liquidity, foreign currency and interest rate risks. ALCO's functions include making recommendations for approval of strategies, policies and limits associated with the aforementioned risks. It is responsible for providing timely and reliable information and reports regarding these risk areas. ALCO assists in setting pricing policies and funding strategies. It is also responsible, along with other risk management and controlling units of the Group, for ensuring that Treasury and other relevant units work with the parameters set by ALCO, the Risk Management Committee, the Executive Board and the Supervisory Board.

Credit risk. Credit risk is the risk of financial loss to the Group if a customer or counterparty fails to meet its contractual obligations when due. The major portion of credit risk arises from the Groups' loans and advances to customers and banks and other on and off balance sheet credit exposures. For risk reporting purposes, the Group considers and consolidates all elements of credit risk exposures such as individual customer and counterparty default risk and industry risk. At present, the credit risk arising from securities markets operations is Azerbaijani government bonds, the notes issued by the NBAR, and held-to-maturity investment securities purchased from foreign financial institutions. These securities are used exclusively to help manage the liquidity position of the Group.

The general credit risk approval structure, for corporate legal entities, private individuals and financial organisations, is as follows:

Supervisory Board	The Supervisory Board reviews and approves limits above AZN 16 million and meets on a regular basis
Executive Board	The Executive Board reviews and approves limits above AZN 8 million up to a maximum limit of AZN 16 million and meets on a regular basis
Big Credit Committee	The Big Credit Committee reviews and approves limits above AZN 2.4 million up to a maximum limit of AZN 8 million and meets on a regular basis
Credit Committee	The Credit Committee reviews and approves limits above AZN 0.8 million up to a maximum limit of AZN 2.4 million and meets on a regular basis
Small Credit Committee	The Small Credit Committee reviews and approves limits up to AZN 0.8 and meets on a regular basis

The Supervisory Board also approves general limits so as to control and manage risk diversification:

- Portfolio limits: Corporate loans, retail loans and interbank exposures as percentages of the total portfolio;
- Portfolio limits: Secured facilities and unsecured facilities as percentages of the total portfolios and as a percentage of the retail portfolio; and
- Economic sector and product exposures: as a percentage of the corporate and retail portfolios.

The Executive Board also approves limits and authority levels for exposures, as follows:

- By branch;
- By collateral type and loan to value ratios; and
- By individual authority.

As of 31 December 2008, the breakdown of the loan portfolio by economic and product sectors is provided in Note 9.

Credit risk management. Credit risk policy is developed by the Credit Department and Executive Board in line with the risk profile and strategic plans of the Group. It is approved by the Supervisory Board.

This policy establishes:

- Procedures for generating, analysing, reviewing and approving counterparty risk exposures;
- The methodology for the credit assessment of counterparties;
- The methodology for the credit rating of counterparties;
- The methodology for the evaluation and control of collateral;
- Credit documentation requirements;
- Loan administration procedures;
- Procedures for the ongoing monitoring of credit exposures;
- Loan loss provisioning policy.

31 Financial Risk Management (Continued)

Loan/credit requests are originated and generated by client managers and credit inspectors. Credit applications within approved authority limits are approved by the branches or relevant business generating units. Then copies of these approved requests are submitted to the Credit Department for post-control, including being assigned a rating and input into a monitoring schedule. Risk exposure requests above these limits are sent to the Credit Committee. The Credit Committee performs a secondary analysis and issues a report, rating and opinion. If the credit request is below a certain authorised limit and receives a positive opinion from the Credit Committee, and is signed off by the appropriate individuals, then the request is considered approved. If the opinion of risk management is negative then the request is sent to the Credit Committee for adjudication. If approved and the transaction is in an amount higher than the competence of the Credit Committee then it is sent to the Executive Board for approval. Large transactions, as defined above, have to be submitted to the Supervisory Board for approval.

The Group uses a rating system based on an analysis of four basic criteria: creditworthiness, financial performance, credit history and other risks. The Group uses this system for decision-making purposes to lend to new borrowers. For the quality of its existing loan portfolio, the Group uses the classification as disclosed in Note 9 to these consolidated financial statements.

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

For certain retail loan products, a credit scoring system is used, plus the Group uses its internal database and that of the NBAR to identify potentially risky customers. Credit assessments are done on a portfolio basis concentrating on amount and term limits, approval procedures, target groups, types of product, default statistics, loan/value ratios (if applicable), and pricing.

Collateral and other credit enhancements. Exposure to credit risk is also assessed and managed, in part, by obtaining, controlling and monitoring collateral in the form of mortgage interests over property, pledge of assets and securities and other collateral including deposits, corporate and personal guarantees.

While collateral is an important mitigating factor in assessing the credit risk, it is the Group's policy to establish that loans are within the customer's capacity to repay rather than to rely solely on security. Collateral is considered as a secondary source of repayment. In limited cases, depending on the customer's standing or on the type of product or amounts, the facilities may be unsecured. The Group has in place various limits on the unsecured portions of its risk portfolio.

The principal types of collateral accepted by the Group are as follows:

- Commercial real estate
- Residential real estate
- Corporate capital assets
- Corporate liquid assets
- Transport vehicles
- Term deposits
- Other including precious metals.

Strict appraisal, documentation and, where applicable, registration procedures are in place for all forms of collaterals. Loan to value ratios are approved by the Executive Board and controlled by the Credit Department. The loan to value limits as of 31 December 2008 are as follows:

Type of collateral	Ratio of loan amount to liquid value of collateral
Real estate	up to 60%
Precious metals	up to 80%
Machinery, equipment	up to 50%
Inventory	up to 60%
Vehicles, transport	up to 70%
Term deposit	up to 90%

However, management notes that the above limits may at certain times be overridden based on commercial considerations.

31 Financial Risk Management (Continued)

The Credit Department is responsible for establishing a schedule of monitoring events, fulfilling this plan and notifying the appropriate parties if the monitoring results are unsatisfactory and recommending a plan of action. The Credit Department physically monitors all transactions above an established amount plus does selected checks of transactions below this amount. All transactions above a certain amount are first monitored either before or at least within one month of disbursement. Following this, risk exposures are monitored according to a schedule.

The Credit Department is charged with compiling and reporting on all counterparty credit risk issues, including compliance with all limits, risk concentrations, portfolio trends, past due and default statistics, loan loss reserves and collateral statistics. Besides regular monthly reporting, they also compile reports on adherence to selected credit procedures.

Related party lending. The NBAR has strict definitions regarding the category of "related parties". Mainly, these are corporate entities owned/controlled by the Shareholders or the private individual shareholders themselves or immediate family members. Also included are individuals with senior management/authority positions in the Group. The largest loan per related party private individual may not be more than 3% of the consolidated capital of the Group. Per related corporate entity, the limit is 10%. The overall limit for related party risk exposure is 20%. Pricing and other terms and conditions must be done on an arms-length basis. The Bank may at times be in breach of certain statutory covenants set out by the NBAR on related party balances. For information on potential consequences of those breaches refer to Note 33.

Past due, non-performing loans. The Group has in place procedures for reporting and dealing with past-due and non-performing loans from the first day past-due. Up to 60-day past-dues are all handled by the relevant business units unless obvious problems are identified earlier. Unsecured retail loans over 60-days past-due are automatically transferred to the Problematic Loans Department. Corporate loans over 90-days past-due are also transferred to this department. All loans are placed on non-accrual after 90 days past due for its statutory financial statements as per required by the Central Bank. If the Problematic Loans Department is unsuccessful in collecting on these obligations, then legal proceedings are instituted. When a loan is deemed uncollectible, recommendations to write-off these amounts are presented to the Credit Committee and the Executive Board. Final decisions regarding write-offs are taken by the Supervisory Board.

All past-dues statistics are reported to the Credit Committee on at least a monthly basis. All corporate loan past-due issues are individually reported to the Credit Committee.

Allowance for loan losses – reserve policy. The Group establishes an allowance for loan losses that represents its estimate of losses incurred in its risk exposures.

The NBAR also has a reserve policy, which is a minimum standard for banks. The categories with reserve requirements are as follows:

Standard assets	2%
Controllable assets	10%
Unsatisfactory assets	30%
Assets-at-risk	60%
Hopeless assets	100%

These categories are strictly defined.

In its IFRS reporting, the Group utilises the methodology contained in *IAS 39 – Financial Instruments: Recognition and Measurement*.

Maximum exposure to credit risk. The Group's maximum exposure to on balance sheet credit risk is generally 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.

The maximum credit risk for off-balance items, mainly letters of credit and guarantees, represents the gross amount of the commitment. The Group's maximum exposure to off-balance credit risk is disclosed in Note 33, "Contingencies and Commitments".

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.

31 Financial Risk Management (Continued)

Management of insurance risks

- ***Insurance risk.*** The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and, therefore, unpredictable for each individual insurance contract.

  For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Group faces under its insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits may be greater than estimated. Insured events are random and the actual number and amount of claims and benefits will vary from year to year from the level established using statistical techniques.

  The Group manages its insurance risk by means of established internal procedures which include underwriting authority levels, pricing policy, approved reinsurers list and ongoing monitoring.

- ***Estimation of insurance loss reserves***. Loss provisions are calculated based on the Group's historical data. In calculating the estimated cost of unpaid claims (both reported and not), the Group's estimation techniques include a combination of loss ratio-based estimates (where the loss ratio is defined as the ratio between the ultimate cost of insurance claims and insurance premiums earned in a particular financial year in relation to such claims) and an estimate based upon actual claims experience using predetermined formulae where a greater weight is given to actual claims experience as time passes.

  The initial loss ratio estimate is an important assumption in the estimation technique and is based on previous years' experience, adjusted for factors such as premium rate changes, anticipated market experience and historical claims inflation. The initial estimate of the loss ratios used for the current year (before reinsurance) are analysed by type of risk for current and prior year premiums earned.

- ***Sources of uncertainty in the estimation of future claim payments.*** Claims on insurance contracts are payable on a claims-occurrence basis. The Group is liable for all insured events that occurred during the term of the contract, if the loss is discovered before the end of the contract term. As a result, liability claims are settled within a short period of time, which historically has not exceeded 3 months from the end of the contract term. There are several variables that affect the amount and timing of cash flows from insurance contracts. These mainly relate to the inherent risks of the activities carried out by both corporate and individual contract holders and the risk management procedures they adopted. The compensation paid on insurance contracts in the Group's portfolio primarily consists of monetary awards granted for:

  - medical insurance;
  - physical damage to motor vehicles (for motor vehicle insurance covers); and
  - financial loss, bodily injury and physical damage suffered by the third parties (caused by the vehicle owners).

  Such awards are lump-sum payments that are calculated by the Group's in-house underwriters as the present value of the lost earnings and rehabilitation expenses that the injured party will incur as a result of the accident.

- ***Reinsurance policy.*** An element of the Group's motor, property, third party liability, employer liability and cargo portfolios is reinsured with local and foreign insurance companies under reinsurance agreements that reduce the potential maximum exposure that the Group is subject to.

- ***Diversification.*** Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected by a change in any subset of the portfolio. The Group has developed its insurance underwriting strategy to diversify the type of insurance risks accepted and within each of these categories to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

Market risk. The Group is exposed to market risks. Market risks arise from open positions in interest rates, currency and equity products, all of which are exposed to general and specific market movements. The Group manages market risk through policies of very limited exposures to these risks and periodic estimations of the Group's positions regarding these risks.

The Group does not have any trading positions in financial instruments. Its exposure to the securities market is the investment, from time to time, in the NBAR notes, Azerbaijan Ministry of Finance obligations and securities issued by other banks in order to help manage its consolidated liquidity position. The Group does not normally trade in the derivatives market and has no exposure to this market.

31 Financial Risk Management (Continued)

Currency risk. The Group is exposed to effects of fluctuation in the prevailing local/foreign currency exchange rates on its consolidated financial position. Currency risk is the risk that movements in foreign exchange rates will affect the Group's income or the value of its portfolios of financial instruments.

The main element in the Group's risk policy regarding foreign currency risk is that there is no conscious effort to take a trading position in any currency. Limited open positions occur as a natural consequence of business operations only. The Group uses every effort to match its assets and liabilities by currency.

Exposure to foreign exchange risk faced by the Bank is also limited by the NBAR normative requirements, which place a 10% of capital limit on open positions in any single foreign currency and a 20% open limit on all foreign currencies.

The foreign exchange exposures are managed by the Financial Management Department. The reports on open currency positions prepared by the Financial Management Department are reviewed by the ALCO.

The table below summarises the Group's consolidated exposure to foreign currency exchange rate risk at the balance sheet date:

	At 31 December 2008				**At 31 December 2007**		
In thousands of Azerbaijani Manats	**Monetary financial and insurance assets**	**Monetary financial and insurance liabilities**	**Foreign currency swap agree-ments**	**Net balance sheet position**	**Monetary financial and insurance assets**	**Monetary financial and insurance liabilities**	**Net balance sheet position**
AZN	992,300	610,225	-	382,075	815,716	563,313	252,403
USD	1,972,270	1,849,684	(348,946)	(226,360)	1,570,820	1,690,818	(119,998)
EUR	627,802	874,090	372,636	126,348	107,836	117,972	(10,136)
RR	49,896	24,162	-	25,734	79,670	60,390	19,280
Other	14,569	61,381	-	(46,812)	6,739	3,332	3,407
Total	**3,656,837**	**3,419,542**	**23,690**	**260,985**	**2,580,781**	**2,435,825**	**144,956**

Foreign currency swap agreements in the amount of EUR receivable of AZN 372,636 thousand and USD payable of AZN 348,946 thousand resulted in net fair value gain on derivatives in the amount of AZN 23,690 thousand. Refer to Note 13. All foreign currency swap agreements are short-term and have been closed at their maturity in January-March 2009. The above analysis includes only monetary assets and liabilities. Investments in equities and non-monetary assets are not considered to give rise to any material currency risk.

The Group has extended loans and advances denominated in foreign currencies. Depending on the revenue stream and cost structure of the borrower, the possible appreciation of the currencies, in which loans and advances have been extended against the Azerbaijani Manat may, adversely affect the borrower's repayment ability and, therefore, increase the potential of future loan losses.

The following table presents sensitivities of consolidated profit and loss and equity to reasonably possible changes in exchange rates applied at the balance sheet date, with all other variables held constant:

	At 31 December 2008	**At 31 December 2007**
In thousands of Azerbaijani Manats	**Impact on profit or loss and equity**	**Impact on profit or loss and equity**
US Dollars strengthening by 10% (2007:5%)	38,862	(6,003)
US Dollars weakening by 10% (2007:5%)	(38,862)	6,003
Euro strengthening by 10% (2007:5%)	41,886	(1,014)
Euro weakening by 10% (2007:5%)	(41,886)	1,014
RUR strengthening by 10% (2007:5%)	2,792	964
RUR weakening by 10% (2007:5%)	(2,792)	(964)
Other strengthening by 10% (2007:5%)	646	170
Other weakening by 10% (2007:5%)	(646)	(170)

Other than as a result of any impact on the Group's consolidated profit or loss, there is no other impact on the Group's consolidated equity as a result of such changes in exchange rates. The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the respective entity of the group.

31 Financial Risk Management (Continued)

The Group's exposure to currency risk at the balance sheet date is not representative of the typical exposure during the year. The following table presents sensitivities of consolidated profit and loss and equity to reasonably possible changes in exchange rates applied to average exposure to currency risk during the year, with all other variables held constant:

In thousands of Azerbaijani Manats	**Average exposure during 2008** Impact on profit or loss and equity	**Average exposure during 2007** Impact on profit or loss and equity
US Dollars strengthening by 10% (2007:5%)	12,682	(3,177)
US Dollars weakening by 10% (2007:5%)	(12,682)	3,177
Euro strengthening by 10% (2007:5%)	8,074	(656)
Euro weakening by 10% (2007:5%)	(8,074)	656
RUR strengthening by 10% (2007:5%)	502	458
RUR weakening by 10% (2007:5%)	(502)	(458)
Other strengthening by 10% (2007:5%)	206	118
Other weakening by 10% (2007:5%)	(206)	(118)

Other than as a result of any impact on the Group's consolidated profit or loss, there is no other impact on the Group's consolidated equity as a result of changes in exchange rates.

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 consolidated 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. Management monitors on a daily basis and sets limits on the level of mismatch of interest rate repricing that may be undertaken.

At present, the Group manages its interest rate risk by matching, where possible, its maturity and/or repricing positions. In addition, the Group's monthly interest margins are continually reviewed in order to reprice its assets when deemed appropriate. Operational procedures set the acceptable interest rate margin usually at a minimum 5%. ALCO and the Financial Management Department constantly monitor the maintenance of this margin. ALCO is also responsible for preparing interest rate movement reports and forecasts. At present, through the Group's matching policies for expected repricing and relatively high interest rate margins achieved in the Group's markets, the Group does not more actively manage this risk.

ALCO and the Financial Management Department are responsible for managing interest rate risk, the Risk Management Committee is responsible for controlling the risk and the Executive Board must approve all guidelines and asset/liability repricing reports.

The table presents the aggregated amounts of the Group's consolidated financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest repricing or maturity dates.

In thousands of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 6 months**	**From 6 to 12 months**	**More than 1 year**	**Total**
31 December 2008					
Total monetary financial and insurance assets	1,245,963	1,336,479	347,546	750,539	**3,680,527**
Total monetary financial and insurance liabilities	1,603,505	910,165	292,463	613,409	**3,419,542**
Net interest sensitivity gap at 31 December 2008	**(357,542)**	**426,314**	**55,083**	**137,130**	**260,985**
31 December 2007					
Total monetary financial and insurance assets	528,961	1,107,013	297,802	647,005	**2,580,781**
Total monetary financial and insurance liabilities	1,450,895	212,697	228,727	543,506	**2,435,825**
Net interest sensitivity gap at 31 December 2007	**(921,934)**	**894,316**	**69,075**	**103,499**	**144,956**

31 Financial Risk Management (Continued)

All of the Group's debt instruments reprice within 10 years (2007: all reprice within 10 years). At 31 December 2008, if USD interest rates at that date had been 200 basis points lower with all other variables held constant, profit for the year would have been AZN 9,249 thousand (2007: AZN 3,626 thousand) higher, mainly as a result of lower interest expense on variable interest liabilities.

If USD interest rates had been 200 basis points higher, with all other variables held constant, profit would have been AZN 9,249 thousand (2007: AZN 3,626 thousand) lower, mainly as a result of higher interest expense on variable interest liabilities. The Bank's consolidated profit is not exposed to AZN market interest rate changes because the Bank does not have variable interest assets or liabilities denominated in AZN. The impact of a reasonably possible shift in market interest rates on components of equity, other than due to the effects of the change in profit on retained earnings, would not be significant.

The Group monitors interest rates for its financial instruments. The table below summarises interest rates based on reports reviewed by key management personnel:

	2008					2007				
In % p.a.	**USD**	**AZN**	**Euro**	**RUR**	**Other**	**USD**	**AZN**	**Euro**	**RUR**	**Other**
Assets										
Cash and cash equivalents	-	-	1.7	-	0.8	1.9	-	1.7	-	0.9
Due from resident banks	7.7	7.1	-	13.0	-	7.0	10.3	-	-	-
Due from non resident banks	4.5	-	3.2	-	-	5.2	-	3.1	6.2	-
Loans and advances to customers – individuals	20.6	20.5	14.0	15.9	-	17.2	15.7	18.7	15.8	-
Loans and advances to customers – corporate	14.1	15.7	11.7	18.0	-	13.9	11.9	9.9	18.0	-
Liabilities										
Customer accounts – individuals	13.5	12.1	9.7	9.1	9.7	13.2	12.1	9.5	8.9	8.8
Customer accounts – corporate	5.5	6.6	4.5	6.8	-	5.0	5.6	3.7	6.6	-
Due to other banks	7.5	-	5.9	-	-	6.5	-	-	9.3	-
Debt securities in issue	10.0	24.5	-	-	-	10.8	24.5	-	-	-
Other borrowed funds	8.0	-	8.5	-	-	7.2	1.0	5.9	-	-
Subordinated debt	8.5	-	-	-	-	8.5	-	-	-	-

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

31 Financial Risk Management (Continued)

Geographical risk concentrations. The geographical concentration of the Group's consolidated financial assets and liabilities at 31 December 2008 is set out below:

In thousands of Azerbaijani Manats	Azerbaijan	OECD	Non-OECD	Total
Assets				
Cash and cash equivalents	272,147	240,948	13,634	526,729
Mandatory cash balances with the National/Central banks	107,392	-	754	108,146
Due from other banks	24,658	98,185	4,559	127,402
Loans and advances to customers	2,678,895	10,522	192,103	2,881,520
Other financial and insurance assets	36,713	-	17	36,730
Total financial and insurance assets	**3,119,805**	**349,655**	**211,067**	**3,680,527**
Non-financial assets	**166,045**	**226**	**9,559**	**175,830**
Total assets	**3,285,850**	**349,881**	**220,626**	**3,856,357**
Liabilities				
Due to other banks	95,563	114,268	618,365	828,196
Customer accounts	1,996,655	42,531	44,809	2,083,995
Debt securities in issue	10,948	-	-	10,948
Other borrowed funds	22,618	267,245	-	289,863
Other financial and insurance liabilities	107,850	2,190	-	110,040
Subordinated debt	-	96,500	-	96,500
Total financial and insurance liabilities	**2,233,634**	**522,734**	**663,174**	**3,419,542**
Non-financial liabilities	**47,670**	**-**	**4,736**	**52,406**
Total liabilities	**2,281,304**	**522,734**	**667,910**	**3,471,948**
Net balance sheet position	**1,004,546**	**(172,853)**	**(447,284)**	**384,409**
Credit related commitments	**261,489**	**689,354**	**419,697**	**1,370,540**

Assets, liabilities and credit related commitments have generally been based on the country, in which the counterparty is located. Balances with Azerbaijani counterparties actually outstanding to/from off-shore companies of these Azerbaijani counterparties are allocated to the caption "Azerbaijan". Cash on hand and premises and equipment have been allocated based on the country, in which they are physically held.

31 Financial Risk Management (Continued)

The geographical concentration of the Group's consolidated assets and liabilities at 31 December 2007 is set out below:

In thousands of Azerbaijani Manats	**Azerbaijan**	**OECD**	**Non-OECD**	**Total**
Assets				
Cash and cash equivalents	147,255	13,844	18,605	179,704
Mandatory cash balances with the National/Central banks	166,502	-	3,845	170,347
Due from other banks	43,662	49,657	80,272	173,591
Loans and advances to customers	1,778,441	-	257,297	2,035,738
Investment securities available for sale	-	-	12,679	12,679
Other financial and insurance assets	8,722	-	-	8,722
Total financial and insurance assets	**2,144,582**	**63,501**	**372,698**	**2,580,781**
Non-financial assets	**114,960**	**1,056**	**15,615**	**131,631**
Total assets	**2,259,542**	**64,557**	**388,313**	**2,712,412**
Liabilities				
Due to other banks	8,211	137,559	1,539	147,309
Customer accounts	1,768,192	-	82,291	1,850,483
Debt securities in issue	16,808	-	-	16,808
Other borrowed funds	93,487	157,781	11,353	262,621
Other financial and insurance liabilities	56,134	-	-	56,134
Subordinated debt	-	102,470	-	102,470
Total financial liabilities	**1,942,832**	**397,810**	**95,183**	**2,435,825**
Non-financial and insurance liabilities	**31,463**	**-**	**2,836**	**34,299**
Total liabilities	**1,974,295**	**397,810**	**98,019**	**2,470,124**
Net balance sheet position	**285,247**	**(333,253)**	**290,294**	**242,288**
Credit related commitments	**66,413**	**820,740**	**493,224**	**1,380,377**

Other risk concentrations. As a part of its management of risk concentrations, management monitors concentrations of credit risk on the basis of the statutory limits set by the NBAR, as follows:

- The aggregate amount of loans, the fair value of the collateral of which is greater than the carrying amount of the loan, may not exceed 25% of the total statutory capital calculated in accordance with the NBAR's guidance;
- The aggregate amount of loans, the fair value of the collateral of which is less than the carrying amount of the loan, may not exceed 10% of the total statutory capital calculated in accordance with the NBAR's guidance; and
- The ratio of the aggregate amount of significant loans (loans with a carrying amount of AZN 1 million and above) to the statutory capital calculated in accordance with the NBAR's guidance may not be higher than 8.

For IFRS reporting purposes, the Group, monitors concentrations of credit risk by obtaining reports listing exposures to borrowers with aggregated loan balances in excess of 10% of net assets. The Group discloses any such concentrations within the respective notes in its consolidated financial statements.

31 Financial Risk Management (Continued)

Liquidity risk. Liquidity risk is the risk that the Group will encounter difficulty in settling its financial obligations. It refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments and insurance obligations as they actually fall due. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of financial institutions.

In order to manage liquidity risk, the Group performs daily monitoring of future expected cash flows on clients' and banking operations, which is part of the assets/liabilities management process. The Executive Board and Supervisory Board set limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals under both normal and stressed conditions. They also set parameters for the risk diversification of the liability base.

The NBAR has in place minimum levels of liquidity required. Loan agreements with international financial institutions also have minimum liquidity covenants in their agreements with the Group. As of 31 December, 2007, management consider that the Group was in compliance with all these covenants.

The Group's liquidity policy is comprised of the following:

- Projecting cash flows and maintaining the level of liquid assets necessary to ensure liquidity in various time-bands;
- Maintaining a funding plan commensurate with the Group's strategic goals;
- Maintaining a diverse range of funding sources thereby increasing the Group's borrowing capacity, domestically as well as from foreign sources;
- Maintaining highly liquid and high-quality assets;
- Adjusting its product base by time bands against available funding sources;
- Daily monitoring of liquidity ratios against regulatory requirements; and
- Constant monitoring of asset and liability structures by time-bands.

The Financial Management Department within the Group is charged with the following responsibilities:

- Monitoring compliance with the liquidity requirements of the NBAR as well as the liquidity requirements through covenants contained in the agreements with foreign lenders;
- Daily reports to management, including reporting to management on the forecast levels of cash flows in the main currencies (AZN, USD, EUR), cash positions, balance sheet changes;
- Constantly controlling/monitoring the level of liquid assets;
- Monitoring of deposit and other liability concentrations; and
- Maintaining a plan for the instant increase of cash to provide liquidity under stressed conditions.

ALCO is responsible for ensuring that the Financial Management Department properly manages the Group's consolidated liquidity position. Decisions on liquidity positions and management are made by the Executive Board. Funding plans are approved by the Supervisory Board.

The undiscounted maturity analysis of financial liabilities at 31 December 2008 is as follows:

In thousands of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 3 months**	**From 3 to 12 months**	**From 12 months to 5 years**	**Over 5 years**	**Total**
Liabilities						
Due to other banks	151,297	794,109	9,991	7,348	-	962,745
Customer accounts	1,444,363	64,594	210,356	496,552	29,019	2,244,884
Debt securities in issue	-	209	4,407	8,652	2,389	15,657
Other borrowed funds	199,837	22,717	10,824	66,433	-	299,811
Other financial and insurance liabilities	97,794	-	12,246	-	-	110,040
Subordinated debt	17,036	3,183	3,819	14,533	112,215	150,786
Commitments to extend credit and undrawn credit lines	65,378	-	-	-	-	65,378
Total potential future payments for financial obligations	**1,975,705**	**884,812**	**251,643**	**593,518**	**143,623**	**3,849,301**

31 Financial Risk Management (Continued)

The undiscounted maturity analysis of financial liabilities at 31 December 2007 is as follows:

In thousands of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 3 months**	**From 3 to 12 months**	**From 12 months to 5 years**	**Over 5 years**	**Total**
Liabilities						
Due to other banks	9,750	73,669	66,396	-	-	149,815
Customer accounts	1,262,331	58,605	146,894	628,742	-	2,096,572
Debt securities in issue	767	319	188	13,543	10,567	25,384
Other borrowed funds	209,528	4,695	13,923	35,792	4,446	268,384
Other financial and insurance liabilities	49,887	-	6,247	-	-	56,134
Subordinated debt	1,034	-	8,647	30,196	124,438	164,315
Commitments to extend credit and undrawn credit lines	77,684	-	-	-	-	77,684
Total potential future payments for financial obligations	**1,610,981**	**137,288**	**242,295**	**708,273**	**139,451**	**2,838,288**

The Group does not use the above undiscounted maturity analysis to manage liquidity. Instead, the Group monitors contractual maturities of carrying values of assets and liabilities.

The following two tables show carrying amounts of financial assets and financial liabilities of the Group grouped on the basis of the remaining period from the balance sheet date to their contractual maturity date with the exception of government securities, which are shown in the category "Demand and less than 1 month" based on the fact that management believes that these securities could be liquidated within one week in the normal course of business.

The analysis of carrying values of assets and liabilities by contractual maturities may be summarised as follows at 31 December 2008:

In thousands of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 6 months**	**From 6 to 12 months**	**Over 12 months**	**Total**
Assets					
Cash and cash equivalents	526,729	-	-	-	526,729
Mandatory cash balances with the National/Central banks	108,146	-	-	-	108,146
Due from other banks	13,070	25,847	27,030	61,455	127,402
Loans and advances to customers	12,751	783,850	452,744	1,632,175	2,881,520
Other financial and insurance assets	5,441	31,289	-	-	36,730
Total financial and insurance assets	**666,137**	**840,986**	**479,774**	**1,693,630**	**3,680,527**
Liabilities					
Due to other banks	148,466	611,254	61,128	7,348	828,196
Customer accounts	1,405,670	135,459	108,478	434,388	2,083,995
Debt securities in issue	64	1,607	1,949	7,328	10,948
Other borrowed funds	199,198	9,740	12,528	68,397	289,863
Other financial and insurance liabilities	100,176	885	8,979	-	110,040
Subordinated debt	16,400	-	-	80,100	96,500
Total financial and insurance liabilities	**1,869,974**	**758,945**	**193,062**	**597,561**	**3,419,542**
Net liquidity gap at 31 December 2008	**(1,203,837)**	**82,041**	**286,712**	**1,096,069**	**260,985**
Cumulative liquidity gap at 31 December 2008	**(1,203,837)**	**(1,121,796)**	**(835,084)**	**260,985**	

31 Financial Risk Management (Continued)

The analysis of carrying values of assets and liabilities by contractual maturities may be summarised as follows at 31 December 2007:

In thousands of Azerbaijani Manats	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	Over 12 months	Total
Assets					
Cash and cash equivalents	179,704	-	-	-	179,704
Mandatory cash balances with the National/Central banks	108,619	7,474	5,653	48,601	170,347
Due from other banks	117,358	27,762	4,741	23,730	173,591
Loans and advances to customers	185,521	255,557	346,674	1,247,986	2,035,738
Investment securities available for sale	-	-	-	12,679	12,679
Other financial and insurance assets	8,722	-	-	-	8,722
Total financial and insurance assets	**599,924**	**290,793**	**357,068**	**1,332,996**	**2,580,781**
Liabilities					
Due to other banks	9,750	71,974	65,585	-	147,309
Customer accounts	1,179,931	81,195	61,406	527,951	1,850,483
Debt securities in issue	766	311	176	15,555	16,808
Other borrowed funds	209,528	4,437	11,999	36,657	262,621
Other financial and insurance liabilities	49,887	-	6,247	-	56,134
Subordinated debt	1,034	-	-	101,436	102,470
Total financial and insurance liabilities	**1,450,896**	**157,917**	**145,413**	**681,599**	**2,435,825**
Net liquidity gap at 31 December 2007	**(850,972)**	**132,876**	**211,655**	**651,397**	**144,956**
Cumulative liquidity gap at 31 December 2007	**(850,972)**	**(718,096)**	**(506,441)**	**144,956**	

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

Management believes that in spite of a substantial portion of customers 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. Customer accounts are classified in the above analysis based on contractual maturities. However, in accordance with the Civil Code of the Republic of Azerbaijan, individuals have a right to withdraw their deposits prior to maturity if they forfeit their right to a certain portion of accrued interest.

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.

As set out in Note 33, included in the above analysis of maturities, total borrowings of AZN 196,956 thousand (2007: AZN 208,041 thousand) and total subordinated debt of AZN 16,020 thousand (2007: nil) are included as “on demand” due to breaches of certain covenants imposed in those borrowing agreements and subordinated debt agreements as at 31 December 2008. Subsequent to the year end, management has been in the process of obtaining waivers in respect of those breaches that have occurred. Management believes that all such waivers will be forthcoming and that these borrowings or subordinated debt will not be required to be repaid prior to the contractual maturity dates as set out in the relevant agreements. The contractual maturity dates are set out in Note 18 for the individual term borrowings and in Note 21 for the subordinated debt of the Group.

32 Management of Capital

The objectives of management when managing the Group's capital are (i) to comply with the capital requirements set by the NBAR, (ii) to safeguard the Group's ability to continue as a going concern and (iii) to maintain a sufficient capital base to achieve a capital adequacy ratio based on Basel Accord of at least 8%. Compliance with capital adequacy ratios set by the NBAR is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Finance Director, Head of Audit Committee, Chairman of the Board and Head of Internal Audit Department. The other objectives of capital management are evaluated annually.

Under the current capital requirements set by the NBAR banks have to: (a) hold the minimum level of total statutory capital of AZN 10,000 thousand (2007: AZN 10,000 thousand); (b) maintain a ratio of regulatory capital to risk weighted assets ("statutory capital ratio") at or above a prescribed minimum of 12% (2007: 12%) and (c) maintain a ratio of tier-1 capital to the risk-weighted assets (the 'Tier-1 capital ratio') at or above the prescribed minimum of 6% (2007: 6%).

The capital that the Bank manages is consistent with the amount required by the NBAR for statutory capital adequacy purposes. The amount of capital that the Bank manages as at 31 December 2008 is AZN 418,590 thousand (2007: AZN 245,542 thousand).

The Group and the Bank are also subject to minimum capital requirements established by covenants stated in loan agreements, including capital adequacy levels calculated in accordance with the requirements of the Basle Accord, as defined in the International Convergence of Capital Measurement and Capital Standards (updated April 1998) and Amendment to the Capital Accord to incorporate market risks (updated November 2005), commonly known as Basel I. The composition of the Group's capital calculated in accordance with Basel Accord, based on the consolidated financial statements of the Group, is as follows:

In thousands of Azerbaijani Manats	**2008**	**2007**
Tier 1 capital		
Share capital	189,737	100,000
Retained earnings	63,240	35,850
Minority interest	1,298	1,551
Less: Intangible assets	(7,073)	(7,685)
Total qualifying Tier 1 capital	**247,202**	**129,716**
Tier 2 capital		
Current year profit	98,693	74,491
Reserves (1.25% of total risk-weighted assets)	55,172	22,381
Revaluation reserve for premises	32,533	27,977
Subordinated debt	96,500	102,470
Total qualifying Tier 2 capital limited to 100% of Tier 1 capital	**247,202**	**129,716**
Less: Investments in equity shares	(1,607)	(801)
Total regulatory capital	**492,797**	**258,631**
Risk-weighted assets:		
On-balance sheet	3,094,128	1,790,504
Off-balance sheet	1,319,516	702,324
Total risk-weighted assets	**4,413,644**	**2,492,828**
Basel ratio	**11.2%**	**10.4%**

As an integral part of the Bank's capital management procedures Finance Director performs regular monitoring of compliance with the externally imposed capital requirements and the monitoring reports are reviewed and approved by Head of Audit Committee, Chairman of the Board and the Head of Internal Audit Department. The Group and the Bank have complied with all externally imposed capital requirements throughout 2008 and 2007, except as stated in Note 33.

33 Contingencies and Commitments

***Legal proceedings*.** From time to time and in the normal course of business, claims against the Group are received. On the basis of its own estimates and internal professional advice the Group's management is of the opinion that no material losses will be incurred in respect of claims and, accordingly, no provision has been made in these consolidated financial statements.

Tax legislation. The tax, currency and customs legislation applicable to the Group is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant authorities.

The tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. In Azerbaijan and in Russia, fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained. Accordingly, at 31 December 2008 no provision for potential tax liabilities was recorded (2007: no provision).

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 the price differs from the market price by more than 30%. Management believes that, the Group is not exposed to any possible transfer-pricing tax adjustments to be made by the tax authorities as at 31 December 2008 and 31 December 2007.

Capital expenditure commitments. At 31 December 2008, the Group has contractual capital expenditure commitments towards a local construction company in respect of the Bank's new administrative building totalling AZN 2,950 thousand (2007: AZN 5,589 thousand).

The Group has already allocated the necessary resources in respect of these commitments. The Group believes that future net income and funding will be sufficient to cover this and any similar such commitments.

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

In thousands of Azerbaijani Manats	**2008**	**2007**
Not later than 1 year	16,800	1,247
Later than 1 year and not later than 5 years	6,421	916
Later than 5 years	7,499	989
Total operating lease commitments	**30,720**	**3,152**

Compliance with covenants. The Bank is subject to certain covenants related primarily to its borrowings. Non-compliance with such covenants may result in negative consequences for the Group including, growth in the cost of borrowings and declaration of default. As at 31 December 2008 and at certain times during the year then ended the Bank was in breach of the restrictions that limit the maximum exposure of the Bank to (i) a ratio of the aggregate exposure to parties that are connected parties to the Bank to twenty five per cent of the Bank's equity and (ii) tier-1 capital adequacy ratio.

33 Contingencies and Commitments (Continued)

As at 31 December 2008, as disclosed in these consolidated financial statements, the ratio of aggregate exposure to parties that are related parties to the Group's equity was 67% (2007: 79%) and tier-1 capital adequacy ratio comprised 5.7% (2007: 5%). As a result, the Group was not in compliance with these covenants as at 31 December 2008 and 31 December 2007, and at certain other times during the reporting periods then ended. As a result of cross-default clauses being included in certain other of the Group's borrowing and subordinated debt agreements, the agreements provide for these other lenders to have the right to declare some or all of their loans repayable on demand.

As set out in Note 31, total borrowings of AZN 196,956 thousand (2007: AZN 208,041 thousand) and total subordinated debt of AZN 16,020 thousand (2007: nil) are included as "on demand" due to breaches of certain covenants imposed in those borrowing agreements and subordinated debt agreements as at 31 December 2008. Subsequent to the year end, management has been in the process of obtaining waivers in respect of those breaches that have occurred. Management believes that all such waivers will be forthcoming and that these borrowings or subordinated debt will not be required to be repaid prior to the contractual maturity dates as set out in the relevant agreements. The contractual maturity dates are set out in Note 18 for the individual term borrowings and in Note 21 for the subordinated debt of the Group.

In addition, the Bank was not in compliance with certain statutory ratios stipulated by the National Bank of Azerbaijan's regulations during the years ended 31 December 2008 and 31 December 2007. Management considered that the Bank had obtained formal agreement with the National Bank of Azerbaijan through the development of an action plan aimed at enabling the Bank to comply with all statutory requirements by 31 December 2008. Management believed that this agreement represents a waiver from these requirements in the years prior to 31 December 2008 and as a result there will be no adverse consequences for the Bank before 31 December 2008 with regard the potential areas of non-compliance.

The Bank did not achieve full compliance with all statutory ratios by 31 December 2008. The NBAR has a right to impose monetary penalties on the Bank and in case of repeatedly continued breaches it may ultimately withdraw the banking license of the Bank if the Bank does not achieve a full compliance with the statutory ratios. However, management expects that the NBAR will negotiate a further action plan to rectify the potential breaches. Management is confident that the Bank will have materially complied with all statutory ratios by the new deadline that will be set as a result of agreeing a further action plan and accordingly will not be subject to any penalties imposed by the NBAR.

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

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

In thousands of Azerbaijani Manats	**2008**	**2007**
Import letters of credit	740,653	870,701
Guarantees issued	563,096	431,992
Commitments to extend credit and undrawn credit lines	66,791	77,684
Total credit related commitments	**1,370,540**	**1,380,377**

At 31 December 2008, the fair value of credit related commitments was AZN 903 thousand (2007: AZN 948 thousand).

33 Contingencies and Commitments (Continued)

The total outstanding contractual amount of undrawn credit lines, letters of credit, and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded. Credit related commitments are denominated in currencies as follows:

In thousands of Azerbaijani Manats	**2008**	**2007**
Azerbaijani Manats	184,897	160,719
US Dollars	692,630	746,018
Euro	473,176	454,924
Other	19,837	18,716
Total	**1,370,540**	**1,380,377**

As at 31 December 2008, the Group had a significant concentration of import letters of credit of AZN 615,507 thousand issued to 20 entities or 83.2% of total import letters of credit (2007: import letters of credit of AZN 701,161 thousand issued to 20 entities or 80.5% of total import letters of credit). As at 31 December 2008, the Group also had a significant concentration of guarantees of AZN 454,031 thousand issued to 20 entities or 80.8% of total guarantees issued (2007: guarantees of AZN 360,098 thousand issued to 8 entities or 83.9% of total guarantees).

As at 31 December 2008, credit related commitments of AZN 122,292 thousand (2007: AZN 165,019 thousand) are secured by Azerbaijan government guarantees or blocked customer deposits. Refer to Note 16.

Intermediary loans. At 31 December 2008, the Group had borrowed funds amounting to AZN 10,261 thousand (2007: AZN 18,047 thousand) on behalf of the Government of the Republic of Azerbaijan from foreign banks and financial institutions for the purposes of providing intermediary loans to state-owned enterprises and government bodies of the Republic of Azerbaijan. The loan agreements signed between the Group and these foreign banks and financial institutions are secured by unconditional letters of guarantee of the Government of the Republic of Azerbaijan, whereby the Government acts as the primary obligor in relation to these borrowings. As a result, the Group acts as a loan-servicing agent for the Government of the Republic of Azerbaijan by transferring collected principal and interest payments to foreign banks and financial institutions and earns no interest margin on these loans.

As the Group does not receive the benefits and does not bear the risks of these intermediary loans, the Group has recorded these intermediary loans amounting as at 31 December 2008 to AZN 10,261 thousand (2007: AZN 18,047 thousand) on off-balance sheet accounts. Similarly funds received by the Group to finance these intermediary loans in the corresponding amounts have also been recorded on off balance sheet accounts.

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

In thousands of Azerbaijani Manats	**2008**	**2007**
Export Credit Bank of Turkey (Eximbank):		
- Trade finance facility	10,261	18,047
Total funds borrowed for the purposes of providing intermediary loans and transferred to off-balance sheet accounts	**10,261**	**18,047**

34 Fair Value of Financial Instruments

Fair value is the amount, at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price.

The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. The Republic of Azerbaijan continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may be outdated or reflect distress sale transactions and, therefore, not represent fair values of financial instruments. Management has used all available market information in estimating the fair value of financial instruments.

Financial instruments carried at fair value. Investment securities available for sale are carried in the consolidated balance sheet at their fair value. Fair values were determined based on quoted market prices.

Cash and cash equivalents and mandatory cash balances with central banks are carried at amortised cost, which approximates current fair value.

Loans and receivables carried at amortised cost. The fair value of floating rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on currency, maturity of the instrument and credit risk of the counterparty and were as follows:

	2008	**2007**
Due from other banks – Note 8		
Term placements with other banks	4.5% to 18% p.a.	3.1% to 18.0% p.a.
Notes of the NBAR	-	10.9% to 11.7% p.a.
Promissory notes of Russian banks	7.0% to 9.0% p.a.	7.3% to 9.2% p.a.
Debentures of resident banks	7.7% p.a.	7.0% p.a.
Loans and advances to customers – Note 9		
Corporate loans	6.0% to 30.0% p.a.	6.0% to 30.0% p.a.
State and public organisations	5.0% to 25.0% p.a.	9.0% to 25.0% p.a.
Loans to individuals – consumer loans	12.0% to 25.0% p.a.	11.0% to 25.0% p.a.
Loans to individuals – employees	12.0% to 24.0% p.a.	12.0% to 24.0% p.a.
Loans to individuals – purchase of motor vehicles	14.0% to 30.0% p.a.	15.0% to 30.0% p.a.
Loans to individuals – mortgage loans	12.0% to 24.0% p.a.	14.0% to 24.0% p.a.
Loans to individuals – other purposes	7.0% to 30.0% p.a.	10.0% to 30.0% p.a.

Refer to Notes 8 and 9 for the estimated fair values of due from other banks and loans and advances to customers, respectively.

Liabilities carried at amortised cost. The estimated fair value of fixed interest rate instruments with stated maturity, for which a quoted market price is not available, was estimated based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity. The fair value of liabilities repayable on demand or after a notice period ("demandable liabilities") is estimated as the amount payable on demand, discounted from the first date that the amount could be required to be paid. Refer to Notes 15, 16, 17, 18 and 19 for the estimated fair values of due to other banks, customer accounts, debt securities in issue, other borrowed funds and other financial and insurance liabilities, respectively. Discount rates used were consistent with the Bank's credit risk and also depend on currency and maturity of the instrument and ranged from 3% p.a. to 25% p.a. (2007: from 3% p.a. to 25% p.a.).

35 Reconciliation of Classes of Financial Instruments with Measurement Categories

For the purposes of measurement, IAS 39, *Financial Instruments: Recognition of Measurement*, classifies financial assets into the following categories: (a) loans and receivables; (b) available for sale financial assets; (c) financial assets held to maturity and (d) financial assets at fair value through profit or loss ("FVTPL"). Financial assets at fair value through profit or loss have two subcategories: (i) assets designated as such upon initial recognition, and (ii) those classified as held for trading. The following table provides a reconciliation of classes of financial assets with these measurement categories.

	2008			2007		
In thousands of Azerbaijani Manats	**Loans and receivables**	**Available -for-sale assets**	**Total**	**Loans and receivables**	**Available -for-sale assets**	**Total**
Assets						
Cash and cash equivalents	526,729	-	526,729	179,704	-	179,704
Mandatory cash balances with the National/Central banks	108,146	-	108,146	170,347	-	170,347
Due from other banks						
- Term placements with other banks	121,902	-	121,902	99,254	-	99,254
- Notes of the NBAR	-	-	-	53,411	-	53,411
- Promissory notes of Russian banks	5,246	-	5,246	20,631	-	20,631
- Debentures of resident banks	254	-	254	295	-	295
Loans and advances to customers						
- Corporate loans	2,522,958	-	2,522,958	1,718,328	-	1,718,328
- State and public organisations	8,475	-	8,475	69,072	-	69,072
- Loans to individuals – consumer loans	123,310	-	123,310	127,488	-	127,488
- Loans to individuals – employees	44,863	-	44,863	17,248	-	17,248
- Loans to individuals – purchase of motor vehicles	28,849	-	28,849	28,886	-	28,886
- Loans to individuals – mortgage loans	18,347	-	18,347	14,186	-	14,186
- Loans to individuals – other purposes	134,718	-	134,718	60,530	-	60,530
Investment securities available for sale	-	-	-	-	12,679	12,679
Other financial assets:						
Receivables under FX swap agreement	23,690	-	23,690	-	-	-
Receivables for plastic cards transactions	3,830	-	3,830	1,619		1,619
Amounts in the course of settlement	1,611	-	1,611	2,302	-	2,302
Total financial assets	**3,672,928**	**-**	**3,672,928**	**2,563,301**	**12,679**	**2,575,980**
Non-financial and insurance assets			**183,429**			**136,432**
Total assets			**3,856,357**			**2,712,412**

All of the Group's consolidated financial liabilities are carried at amortised cost.

36 Related Party Transactions

Parties are generally considered to be related if the parties are under common control or one party has the ability to control the other party or can exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Included in the "Other" column within this note are related parties falling within the definition of "other related parties" in IAS 24, *Related Party Transactions*, including transactions with entities over which the Group's key management or shareholders have control or significant influence.

At 31 December 2008, the outstanding balances with related parties were as follows:

In thousands of Azerbaijani Manats	Shareholders	Management	Government bodies and state-owned entities	Associates	Other
Cash and cash equivalents (non-interest bearing)	-	-	111,691	-	-
Mandatory cash balances with the NBAR	-	-	107,449	-	-
Gross amount of loans and advances to customers (contractual interest rate: 1 - 25% p.a.)	17,059	-	676,659	23,063	330,514
Impairment provisions for loans and advances to customers	-	-	(16,995)	(1,862)	(53,145)
Due to other banks					
Correspondent accounts of other banks	3,605	-	-	-	-
Customer accounts					
Current/settlement accounts	-	-	247,889	-	423
Term deposits (contractual interest rate: 2 - 7% p.a.)			308,348	-	-
Other borrowed funds (contractual interest rate: 1% p.a.)	-	-	14,700	-	-
Current income tax liability	-	-	15,188	-	-
Other financial liabilities – dividends payable	10,843	-	-	-	-

The income and expense items with related parties for the year 2008 were as follows:

In thousands of Azerbaijani Manats	Shareholders	Management	Government bodies and state-owned entities	Associates	Other
Interest income	2,388	-	47,188	2,089	9,781
Interest expense	-	-	28,847	-	-
Release of/(provision for) loan impairment		6	(3,946)	10,781	(5,931)
Insurance related commission expense	-	-	-	-	(2,371)
Fee and commission income	-	-	18,641	-	-
Staff costs	-	(864)	-	-	-
Current tax expense	-	-	(30,989)	-	-

36 Related Party Transactions (Continued)

At 31 December 2008, other rights and obligations with related parties were as follows:

In thousands of Azerbaijani Manats	Shareholders	Management	Government bodies and state-owned entities	Associates	Other
Guarantees issued by the Group	-	-	179,812	-	-
Import letters of credit	-	-	359,409	-	8,244

At 31 December 2007, the outstanding balances with related parties were as follows:

In thousands of Azerbaijani Manats	Shareholders	Management	Government bodies and state-owned entities	Associates	Other
Cash and cash equivalents (non-interest bearing)	-	-	78,618	-	-
Mandatory cash balances with the NBAR	-	-	166,512	-	-
Term placements with resident banks (contractual interest rate: 6% p.a.)	4,227	-	-	-	-
Notes of the NBAR (contractual interest rate: 10 - 11% p.a.)	-	-	53,411	-	-
Gross amount of loans and advances to customers (contractual interest rate: 1 - 25% p.a.)	8.945	285	659,053	59,828	330,701
Impairment provisions for loans and advances to customers	-	(6)	(13,049)	(12,643)	(47,214)
Due to other banks					
Correspondent accounts of other banks	423	-	-	-	-
Customer accounts					
Current/settlement accounts	-	10	411,740	-	564
Term deposits (contractual interest rate: 2 – 7% p.a.)	-	-	607,582	-	-
Other borrowed funds (contractual interest rate: 1% p.a.)	-	-	7,951	-	-
Current income tax liability	-	-	1,084	-	-
Other financial liabilities – dividends payable	60	-	-	-	-

The income and expense items with related parties for the year 2007 were as follows:

In thousands of Azerbaijani Manats	Shareholders	Management	Government bodies and state-owned entities	Associates	Other
Interest income	254	-	40,011	4,291	1,119
Interest expense	-	-	(14,414)	-	-
Release of/(provision for) loan impairment	(1,089)	6	8,630	10,744	(863)
Fee and commission income	-	-	12,935	-	-
Insurance related commission expenses	-	-	-	-	(1,190)
Staff costs	-	(859)	-	-	-
Current tax expense	-	-	(21,545)	-	-

36 Related Party Transactions (Continued)

At 31 December 2007, other rights and obligations with related parties were as follows:

In thousands of Azerbaijani Manats	Shareholders	Management	Government bodies and state-owned entities	Associates	Other
Guarantees issued by the Group	-	-	119,547	-	58,685
Import letters of credit	-	-	1,316,251	-	18,675

The Group is controlled by the Government of the Republic of Azerbaijan. Therefore, in accordance with revised IAS 24 transactions with the Government, the Ministry of Finance of the Republic of Azerbaijan and state-owned companies of the Republic of Azerbaijan are included in the above related party balances and transactions.

At 31 December 2008, the Group's employees held 6.80% of the total share capital of the Group, or 64,968 ordinary shares with a par value of AZN 12,994 thousand (2007: 6.30%, or 31,518 ordinary shares with a par value of AZN 6,304 thousand). Refer to Note 22.

During the year ended 31 December 2008, the total remuneration of members of the Board of Directors and key management personnel of the Group including discretionary compensation amounted to AZN 864 thousand (2007: AZN 859 thousand).

In thousands of Azerbaijani Manats	2008	2007
Short-term benefits:		
- Salaries	610	606
- Performance bonuses	254	253
Total	**864**	**859**

As disclosed in Note9, included in the gross amount of total loans and advances to customers as at 31 December 2008, are the loans granted to fifteen borrowers amounting to AZN 587,782 thousand (2007: fifteen borrowers, AZN 501,302 thousand) with interest rates being less than or equal to eight per cent and representing a significant concentration of 18% (2007: 24%) of the total gross loan portfolio of the Group. The majority of these loans are transactions with related parties and as such disclosed in Note 36. No adjustments have been made to the contractual interest rates in relation to these amounts on initial recognition at fair value as the interest rates applicable are considered to represent the highest and best use of the funds provided given the alternative uses by the Bank of the funds extended under these agreements.

On 15 June 2004, the Group signed a credit agreement where a related party, categorised as "other related parties" above, which is an Azerbaijani company acted as a borrower, the Group - as a guarantor of the Azerbaijani company, Commerzbank AG - as a lender and Export-Import Bank of the United States as a guarantor to Commerzbank AG for a credit line of USD 19,637 thousand at the rate of LIBOR plus 0.10% per annum repayable in sixteen semi-annual instalments beginning from 5 November 2006 for the purposes of construction of a business and entertainment complex in the centre of Baku. At 31 December 2008, an import letter of credit of USD 3,000 thousand or AZN 2,403 thousand (2007: USD 3,000 thousand or AZN 2,536 thousand) had been issued by the Group for this borrower under the above credit facility.

37 Principal Subsidiaries and Associates

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

Name	Nature of business	Country of registration	Percentage of ownership 2008	Percentage of ownership 2007
Subsidiaries:				
IBAR Moscow	Banking	Russian Federation	100.0	100.0
International Insurance Company	Insurance	Republic of Azerbaijan	100.0	100.0
Azericard Limited	Plastic cards	Republic of Azerbaijan	100.0	100.0
IBAR Georgia	Banking	Georgia	75.0	75.0
Associates:				
Joint Leasing	Leasing	Republic of Azerbaijan	47.6	47.6
Baku Inter-Bank Currency Exchange	Currency exchange	Republic of Azerbaijan	20.0	20.0

On 18 July 2007 the Group sold 100% of its interest in Inter Protect Re AG to a non-resident individual at an arms-length transaction with a total contractual cash consideration of CHF 2,620 thousand or AZN 1,996 thousand. No gain or loss was recorded in the consolidated income statement of the Group as a result of this transaction.

Total assets and total liabilities of Inter Protect Re AG at the date of the disposal can be summarised by major categories as follows:

In thousands of Azerbaijani Manats	
Assets	
Cash and cash equivalents	1,806
Receivable from International Insurance Company	246
Other assets	29
Total assets	**2,081**
Liabilities	
Other liabilities	85
Total liabilities	**85**
Net assets	**1,996**

38 Subsequent Events

Subsequent to the balance sheet date, the Bank switched its automated banking system from “Midas” to “Flexcube”. The new system is expected to enhance the operational effectiveness of the Bank. Currently, the Bank uses both systems simultaneously with a view to completely switch to “Flexcube” by the end of 2010.

On 3 March 2009, the Bank signed a Master Loan Agreement with LandesBank Baden Wurttemberg, registered in Germany, for obtaining funds for import financing. The amount for each credit line will be determined on an ad-hoc basis. The funds will bear a market interest rate to be used for import financing.

On 12 February 2009 the Bank repaid its short-term liability balances with Citibank in the amount of USD 25,000 thousand.

On 9 January 2009 the Bank repaid its short-term liability balances with JPMorgan in the amount of USD 30,000 thousand.

On 15 January 2009 the Bank repaid its short-term liability balances with Barclays Bank in the amount of USD 5,500 thousand.

On 4 March 2009 the Bank repaid its short-term liability balances with Kapital Bank in the amount of USD 4,500 thousand.