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**The International Bank of the Republic of  
Azerbaijan**

**Consolidated Financial Statements and  
Auditors' Report**

**30 June 2006**

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## AUDITORS' REPORT

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

- 1 We have audited the accompanying consolidated balance sheet of the International Bank of the Republic of Azerbaijan and its subsidiaries (together referred to as "the Group" as defined in Note 1 to the consolidated financial statements) as at 30 June 2006, and the related consolidated statements of income, of cash flows and of changes in shareholders' equity for the six-month period then ended. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.
- 2 We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform our audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
3. In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 30 June 2006 and the consolidated results of its operations and its cash flows for the six-month period then ended in accordance with International Financial Reporting Standards.

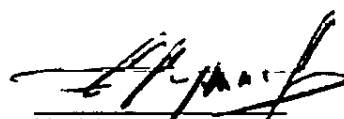
11 December 2006  
Baku, Republic of Azerbaijan


*PricewaterhouseCoopers Eastern Europe B.V.*  
*Azerbaijan Branch*

**The International Bank of the Republic of Azerbaijan**  
**Consolidated Balance Sheet**

| <i>In thousands of new Azerbaijani Manats</i>                                | Note   | 30 June<br>2006  | 31 December<br>2005 |
|--|--------|------------------|---------------------|
| <b>ASSETS</b>  |        |                  |                     |
| Cash and cash equivalents  | 6      | 142,066          | 258,370             |
| Mandatory cash balances with the National Bank of the Republic of Azerbaijan | 6      | 142,066          | 258,370             |
| Due from other banks   | 7      | 85,512           | 65,941              |
| Loans and advances to customers  | 8      | 320,609          | 54,336              |
| Investment securities available for sale                                     | 8      | 683,212          | 678,470             |
| Investment securities held to maturity                                       | 9      | 128              | 128                 |
| Investment in associates and joint ventures                                  | 10     | 10,367           | 6,550               |
| Goodwill on acquisition of a subsidiary                                      | 10     | 1,409            | 1,363               |
| Premises, equipment, intangibles and investment properties                   | 11, 12 | 1,332            | 1,460               |
| Other assets   | 13     | 82,246           | 78,455              |
| Assets of disposal groups  | 29     | 13,206           | 10,236              |
|  |        | 24,939           | -                   |
| <b>TOTAL ASSETS</b>  |        | <b>1,364,926</b> | <b>1,155,309</b>    |
| <b>LIABILITIES</b>   |        |                  |                     |
| Due to other banks   | 14     | 9,889            | 8,778               |
| Customer accounts  | 15     | 1,067,495        | 908,574             |
| Debt securities in issue   | 16     | 38,530           | 42,187              |
| Other borrowed funds   | 17     | 66,044           | 62,081              |
| Other liabilities  | 18     | 70,487           | 40,253              |
| Deferred tax liability   | 23     | 10,552           | 9,933               |
| Liabilities of disposal groups   | 29     | 1,917            | -                   |
| <b>TOTAL LIABILITIES</b>   |        | <b>1,264,914</b> | <b>1,071,806</b>    |
| <b>EQUITY</b>  |        |                  |                     |
| Share capital  | 19     | 33,154           | 24,820              |
| Revaluation reserve for premises and equipment                               | 12, 23 | 17,637           | 18,092              |
| Cumulative translation reserve   |        | 1,463            | 987                 |
| Retained earnings  |        | 47,758           | 39,604              |
| <b>TOTAL EQUITY</b>  |        | <b>100,012</b>   | <b>83,503</b>       |
| <b>TOTAL LIABILITIES AND EQUITY</b>  |        | <b>1,364,926</b> | <b>1,155,309</b>    |

Approved for issue by the Board of Directors and signed on its behalf on 11 December 2006

  
 Mr. Jahangir Hajiyev  
 Chairman of the Board of Directors

  
 Mr. (Rovshan) Ismaylov  
 Head of the Financial Management Department

**The International Bank of the Republic of Azerbaijan**  
**Consolidated Income Statement**

|   | Note | Six-Month<br>Period Ended<br>30 June 2006 | Six-Month<br>Period Ended<br>30 June 2005 |
|---|------|---|---|
| <i>In thousands of new Azerbaijani Manats</i>                           |      |   |   |
| Interest income   | 20   | 53,490                                    | 36,953                                    |
| Interest expense  | 20   | (14,895)                                  | (9,457)                                   |
| <b>Net interest income</b>  |      | <b>38,595</b>                             | <b>27,496</b>                             |
| Provision for impairment of due from other banks                        | 7    | (2,247)                                   | (762)                                     |
| Provision for impairment of loans to customers                          | 8    | (6,843)                                   | (16,451)                                  |
| <b>Net interest income after provision for impairment</b>               |      | <b>29,505</b>                             | <b>10,283</b>                             |
| Foreign currency translation gains less losses/(losses less gains)      |      | 1,331                                     | (2,777)                                   |
| Gains less losses arising from trading in foreign currencies            |      | 8,657                                     | 4,456                                     |
| Fee and commission income   | 21   | 22,247                                    | 20,233                                    |
| Fee and commission expense  | 21   | (2,576)                                   | (1,206)                                   |
| Losses on origination of assets/liabilities at rates below/above market |      | (136)                                     | -   |
| Gross insurance premiums written, net of premiums ceded                 |      | 1,914                                     | 1,548                                     |
| Increase of provision for unearned premiums, net of reinsurance         |      | (476)                                     | (177)                                     |
| Net claims incurred   |      | (559)                                     | (457)                                     |
| Other income  |      | 349                                       | 191                                       |
| <b>Operating income</b>   |      | <b>60,256</b>                             | <b>32,094</b>                             |
| Administrative and other operating expenses                             | 22   | (38,896)                                  | (19,881)                                  |
| <b>Profit from operations</b>   |      | <b>21,360</b>                             | <b>12,213</b>                             |
| Share of profit from investment in associates and joint ventures        | 10   | 56  | 4   |
| <b>Profit before taxation</b>   |      | <b>21,416</b>                             | <b>12,217</b>                             |
| Income tax charge   | 23   | (6,838)                                   | (3,869)                                   |
| <b>Net profit after tax</b>   |      | <b>14,578</b>                             | <b>8,348</b>                              |

**The International Bank of the Republic of Azerbaijan**  
**Consolidated Statement of Cash Flows**

|  | Note | Six-Month<br>Period Ended<br>30 June 2006 | Six-Month<br>Period Ended<br>30 June 2005 |
|--|------|---|---|
| <i>In thousands of new Azerbaijani Manats</i>  |      |   |   |
| <b>Cash flows from operating activities</b>  |      |   |   |
| Interest received  |      | 38,774                                    | 32,781                                    |
| Interest paid  |      | (13,355)                                  | (9,417)                                   |
| Income received from trading in foreign currencies   |      | 8,657                                     | 4,456                                     |
| Fees and commissions received  |      | 22,247                                    | 19,347                                    |
| Fees and commissions paid  |      | (2,576)                                   | (1,083)                                   |
| Insurance premiums received, net   |      | 878                                       | 1,880                                     |
| Other operating income received  |      | 303                                       | 191                                       |
| Administrative and other operating expenses paid   |      | (23,219)                                  | (15,596)                                  |
| Income tax paid  |      | (1,994)                                   | (3,334)                                   |
| <b>Cash flows from operating activities before changes in operating assets and liabilities</b> |      | <b>29,715</b>                             | <b>29,225</b>                             |
| <b>Changes in operating assets and liabilities</b>   |      |   |   |
| Net increase in mandatory cash balances with the National Bank of the Republic of Azerbaijan   |      | (19,571)                                  | (3,377)                                   |
| Net increase in due from other banks   |      | (268,012)                                 | (136,699)                                 |
| Net increase in loans and advances to customers  |      | (29,939)                                  | (32,243)                                  |
| Net (increase)/decrease in investment securities held to maturity                              |      | (3,817)                                   | 2,779                                     |
| Net (increase)/decrease in other assets  |      | (279)                                     | 2,168                                     |
| Net increase/(decrease) in due to other banks  |      | 1,111                                     | (38)                                      |
| Net increase in customer accounts  |      | 157,906                                   | 46,358                                    |
| Net increase/(decrease) in debt securities in issue  |      | (3,389)                                   | 1,608                                     |
| Net increase/(decrease) in other liabilities   |      | 24,087                                    | (284)                                     |
| <b>Net cash used in operating activities</b>   |      | <b>(112,188)</b>                          | <b>(90,503)</b>                           |
| <b>Cash flows from investing activities</b>  |      |   |   |
| Acquisition of premises and equipment  | 12   | (13,152)                                  | (8,215)                                   |
| Acquisition of intangible assets   | 12   | (2,790)                                   | (2,143)                                   |
| Proceeds from disposal of investments in associates and joint ventures                         |      | 55  | 10  |
| <b>Net cash used in investing activities</b>   |      | <b>(15,887)</b>                           | <b>(10,348)</b>                           |
| <b>Cash flows from financing activities</b>  |      |   |   |
| Proceeds from other borrowed funds   |      | 5,703                                     | 335                                       |
| Repayment of other borrowed funds  |      | (1,371)                                   | (2,566)                                   |
| Issuance of ordinary shares  |      | 8,334                                     | -   |
| Dividends paid   | 24   | (2,702)                                   | (3,347)                                   |
| <b>Net cash from/(used in) financing activities</b>  |      | <b>9,964</b>                              | <b>(5,578)</b>                            |
| <b>Effect of exchange rate changes on cash and cash equivalents</b>                            |      | <b>1,807</b>                              | <b>(3,503)</b>                            |
| <b>Net decrease in cash and cash equivalents for the period</b>                                |      | <b>(116,304)</b>                          | <b>(109,932)</b>                          |
| Cash and cash equivalents at the beginning of the period                                       |      | 258,370                                   | 222,758                                   |
| <b>Cash and cash equivalents at the end of the period</b>                                      | 6    | <b>142,066</b>                            | <b>112,826</b>                            |

**The International Bank of the Republic of Azerbaijan**  
**Consolidated Statement of Changes in Equity**

|   | Note   | Share Capital | Revaluation reserve for premises | Cumulative translation reserve | Retained earnings | Total share holders' equity |
|---|--------|---------------|----------------------------------|--------------------------------|-------------------|-----------------------------|
| <i>In thousands of new Azerbaijani Manats</i> |        |               |                                  |                                |                   |                             |
| <b>Balance as at 1 January 2005</b>           |        | <b>20,000</b> | <b>1,743</b>                     | <b>2,595</b>                   | <b>28,874</b>     | <b>53,212</b>               |
| Share issue                                   | 19     | 4,820         | -                                | -                              | -                 | 4,820                       |
| Correction on realised revaluation reserve    |        | -             | 161                              | -                              | -                 | 161                         |
| Currency translation differences              |        | -             | -                                | (1,608)                        | -                 | (1,608)                     |
| Revaluation of premises                       | 12, 23 | -             | 20,754                           | -                              | -                 | 20,754                      |
| Deferred tax liability                        | 12, 23 | -             | (4,566)                          | -                              | -                 | (4,566)                     |
| Net profit for the period                     |        | -             | -                                | -                              | 20,330            | 20,330                      |
| Dividends declared                            | 24     | -             | -                                | -                              | (9,600)           | (9,600)                     |
| <b>Balance as at 31 December 2005</b>         |        | <b>24,820</b> | <b>18,092</b>                    | <b>987</b>                     | <b>39,604</b>     | <b>83,503</b>               |
| Share issue                                   | 19     | 8,334         | -                                | -                              | -                 | 8,334                       |
| Transfer of realized revaluation reserve      |        | -             | (455)                            | -                              | 455               | -                           |
| Currency translation differences              |        | -             | -                                | 476                            | -                 | 476                         |
| Net profit for the period                     |        | -             | -                                | -                              | 14,578            | 14,578                      |
| Dividends declared                            | 24     | -             | -                                | -                              | (6,879)           | (6,879)                     |
| <b>Balance as at 30 June 2006</b>             |        | <b>33,154</b> | <b>17,637</b>                    | <b>1,463</b>                   | <b>47,758</b>     | <b>100,012</b>              |

**The International Bank of the Republic of Azerbaijan**  
**Notes To The Consolidated Financial Statements – 30 June 2006**

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**1 Introduction**

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards for the six-month period ended 30 June 2006 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 became the major shareholder with the ownership of 50.2% of the total authorized and issued share capital of the Bank. The Bank was registered in the Republic of Azerbaijan to provide commercial banking services and has been operating under a full banking license 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 privatization 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 at the open market, including international financial market.

The Bank's head office is located in Baku, Azerbaijan. The Bank has 36 branches and 114 points of service in the Republic of Azerbaijan (31 December 2005: 36 branches, 103 points of service). The Group had 1,618 employees as at 30 June 2006 (31 December 2005: 1,525 employees) where 1,294 employees are employed by the Bank, 71 – by the International Insurance Company, 41 – by Azercard Limited, 7 – by Azerleasing, 64 – by "Inter" professional football club and 141 – by the Group's fully owned banking subsidiary in Russia (31 December 2005: 1,240 by the Bank, 58 by International Insurance Company, 35 by Azercard Limited, 7 by Azerleasing, 64 by "Inter" professional football club and 121 by the Group's fully owned banking subsidiary in Russia).

A full list of subsidiaries, associates and joint ventures of the Group included within these consolidated financial statements is provided in Note 29.

On 24 January 2002 the Group registered its fully-owned subsidiary, International Bank of Azerbaijan Republic-Moscow, in Moscow, Russia ("IBAR Moscow"). The share capital of IBAR Moscow was established in the amount of EUR 10,000,000. It is a commercial bank in the form of a limited liability company. IBAR Moscow started its operations under a licence issued by the Central Bank of the Russian Federation ("the CBRF") on 25 January 2002. This licence allows IBAR Moscow to carry out banking operations with legal entities in Russian Rubles and in foreign currency. During the first two years after its registration due to the statutory requirements IBAR Moscow was restricted from attracting deposits of individuals. On 1 December 2004 IBAR Moscow received a licence from the CBRF allowing it to provide full range of banking services to individuals. IBAR Moscow's principal activity is represented by commercial banking operations. IBAR Moscow's registered office is located at the following address: Tverskaya 6, Bldg 2, Moscow, Russia. IBAR Moscow opened a branch in Saint Petersburg, Russia on 28 May 2003 and in Yekaterinburg on 25 August 2005.

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. Insurance Subsidiary operates under insurance license Number AB 029205 issued by the Ministry of Finance of the Republic of Azerbaijan on 1 April 2002 and addendum to the above license issued on 16 August 2002. Based on the decision dated 24 December 2004 of the Supervisory Council of the Group to increase the share capital of the Insurance Subsidiary the share capital of International Insurance Company was increased by AZN 4,000 thousand up to AZN 8,800 thousand during the year 2005.

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

On 7 October 2002 the Group's Insurance Subsidiary, International Insurance Company, established a captive reinsurance company, Inter Protect Re AG. It was registered in Zurich, Switzerland. Refer to Note 29.

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

Azercard Limited at present is the only provider of plastic cards operations authorization and clearing services in the Republic of Azerbaijan. The registered office address of Azercard Limited is Nizami Street, 67, AZ1001, Baku, the Republic of Azerbaijan.



## **1 Introduction (Continued)**

On 20 June 2004 "Inter" professional football club was established by the Bank and Azericard Limited and registered with the Ministry of Justice of the Republic of Azerbaijan. In accordance with the foundation agreements signed between the Bank and Azericard Limited, the charter capital of the professional football club was set at AZN 402 thousand, of which AZN 300 thousand were contributed by the Bank and the remaining AZN 102 thousand by Azericard Limited. This club is a member of the Azerbaijan Football Federations Association and is one of the leading professional football clubs in the country.

On 25 July 2006 the Group sold 100% of its interest in "Inter" professional football club to a local company in an arms-length transaction. Refer to Note 29.

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. As a result, the share capital of the leasing subsidiary was AZN 700 thousand as at 30 June 2006 (31 December 2005: AZN 700 thousand).

On 19 September 2006 the Group signed an agreement with a British leasing company on the sale of 52.4% of its interest in "Azerileasing". The management of the Group believes that terms and references of this contract constitute with those of an ordinary arms-length contract with unrelated parties. Refer to Note 29.

**Registered address and place of business** The Bank's registered address is

67 Nizami Street,  
AZ1001, Baku  
Republic of Azerbaijan

**Presentation currency.** These consolidated financial statements are presented in thousands of new Azerbaijani Manats ("AZN thousands").

## **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 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.

## **3 Basis of Preparation and 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 equipment and available-for-sale financial assets. 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.*

**Consolidated financial statements** Subsidiaries are those companies and other entities in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to 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.

Inter-company 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 its subsidiary use uniform accounting policies consistent with the Group's policies.

**3 Basis of Preparation and Significant Accounting Policies (Continued)**

**Associates** Associates are entities, over which the Group has significant influence, 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.

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 cost, fair value, or amortised cost as described below.

**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*. *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.

**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.

In other than active markets, the most recent arms length transactions are the basis of current fair values. Recent transaction prices are appropriately adjusted if they do not reflect current fair values, for example because the transaction was a distress sale. Fair value is not the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale.

Valuation techniques such as discounted cash flows models and 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.

**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, 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 re-pricing 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 and points 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).

**Initial recognition of financial instruments** Trading securities, derivatives and other financial instruments at fair value through profit or loss are initially recorded at fair value. All other financial instruments are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price, which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique, whose inputs include only data from observable markets.

**3 Basis of Preparation and Significant Accounting Policies (Continued)**

All purchases and sales of financial instruments that require delivery within the period established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date that the Group commits to deliver a financial instrument. All other purchases and sales are recognised on the settlement date with the change in value between the commitment date and settlement date not recognised for assets carried at cost or amortised cost, recognised in profit or loss for trading securities, derivatives and other financial assets at fair value through profit or loss, and recognised in equity for assets classified as available for sale.

**Cash and cash equivalents** Cash and cash equivalents are items, which can be converted into cash within a day, including mandatory cash balances in Azerbaijani Manat held with the NBAR. 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 in foreign currency held with the NBAR** Mandatory cash balances in foreign currency held with the NBAR 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 carried at amortised cost.

**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 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.

For the purposes of a collective evaluation of impairment, financial assets are grouped based on 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.

Impairment losses are 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 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.

**Investment securities available for sale** This classification includes investment securities, which the Group intends to hold for an indefinite period and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

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. Dividends on available-for-sale equity instruments are recognised in profit or loss when the Group's right to receive payment is established. 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.

### **3 Basis of Preparation and Significant Accounting Policies (Continued)**

Impairment losses are recognised in profit or loss when incurred because 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.

**Investment securities held to maturity** This classification includes quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has both the intention and ability to hold to maturity. Management determines the classification of investment securities held to maturity at their initial recognition and reassesses the appropriateness of that classification at each balance sheet date. Investment securities held to maturity are carried at amortised cost.

**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 re-measured and accounted for in accordance with the accounting policies for these categories of assets.

**Investment properties.** Investment property is property held by the Group to earn rental income or for capital appreciation and which is not occupied by the Group.

Investment properties are stated at cost, less accumulated depreciation and provision for impairment, where required. If any indication exists, that investment properties may be impaired, the Group estimates the recoverable amount as the higher of value in use and fair value less costs to sell. The carrying amount of an investment property is written down to its recoverable amount through profit or loss. An impairment loss recognised in prior years is reversed if there has been a subsequent change in the estimates used to determine the asset's recoverable amount.

**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 acquirer's 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 and equipment are stated at cost or revalued amounts, less accumulated depreciation and provision for impairment, where required. The revaluation was performed to restate the net book value of the assets to a level, which reflected their market value. In addition, an independent real estate firm appraised the value of the Group's building in prior years and the resulting difference was included in the revaluation reserve for premises and equipment. The revaluation reserve included in shareholders' equity is transferred directly to retained earnings over the estimated useful life of re-valued asset. Cost of premises and equipment of acquired subsidiaries is the estimated fair value at the date of acquisition.

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.

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.

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. 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.

**3 Basis of Preparation and Significant Accounting Policies (Continued)**

**Depreciation** Land is not depreciated. Depreciation on other items of premises and equipment is calculated, using the straight-line method to allocate their cost to their residual values over their estimated useful lives at the following annual rates:

|  | 2006    | 2005    |
|--|---------|---------|
| Premises   | 5%      | 5%      |
| Leasehold improvements                                   | 10%-15% | 10%-15% |
| Computers and other communication equipment              | 25%     | 25%     |
| Plastic cards operations equipment                       | 33%     | 33%     |
| Furniture, fixtures, automated teller machines and other | 25%     | 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 licenses are capitalised based on 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 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, eg its maintenance, are expensed when incurred. Capitalised computer software is amortised on a straight-line basis over expected useful lives of 4 to 5 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, including those on expected termination, are charged to profit or loss on a straight-line basis over the period of the lease.

**Finance leases** Where the Group is a lessor in a lease, which transfers substantially all the risks and rewards incidental to ownership to the lessee, the assets leased out are presented as a finance lease receivable and carried at the present value of the future lease payments. Finance lease receivables are initially recognised at commencement date (when the lease term begins), using a discount rate determined at inception (the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease).

The difference between the gross receivable and the present value represents unearned finance income. This income is recognised over the term of the lease, using the net investment method (before tax), which reflects a constant periodic rate of return. Incremental costs directly attributable to negotiating and arranging the lease are included in the initial measurement of the finance lease receivable and reduce the amount of income recognised over the lease term unless the Group acts as a manufacturer or dealer lessor, in which case such costs are expensed as part of the selling profit similarly to outright sales. Finance income from leases is recorded within in the consolidated income statement.

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 finance lease receivables. Impairment losses are recognised through an allowance account to write down the receivables' net carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the interest rates implicit in the finance leases. The estimated future cash flows reflect the cash flows that may result from obtaining and selling the assets subject to the lease.

**Non-current assets classified as held for sale** Non-current assets and disposal groups (which may include both non-current and current assets) are classified in the balance sheet as 'Non-current assets held for sale' if their carrying amount will be recovered principally through a sale transaction within twelve months after the balance sheet date. Both financial and non-financial assets are reclassified when all of the following conditions are met: (a) the assets are available for immediate sale in their present condition, (b) the Group's management approved and initiated an active programme to locate a buyer, (c) the assets are actively marketed for a sale at a reasonable price, (d) the sale is expected within one year and (e) it is unlikely that significant changes to the plan to sell will be made or that the plan will be withdrawn. Non-current assets or disposal groups classified as held for sale in the current period's balance sheet are not reclassified or re-presented in the comparative balance sheet to reflect the classification at the end of the current period.

**3 Basis of Preparation and Significant Accounting Policies (Continued)**

A disposal group are assets (current or non-current) to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. Goodwill is included if the disposal group includes an operation within a cash-generating unit to which goodwill has been allocated on acquisition. Non-current assets are assets that include amounts expected to be recovered or collected more than twelve months after the balance sheet date. If reclassification is required, both the current and non-current portions of an asset are reclassified.

Held for sale premises and equipment, investment properties, intangible assets, or disposal groups as a whole are measured at the lower of their carrying amount and fair value less costs to sell. Held for sale premises, equipment, and intangible assets are not depreciated or amortised. Reclassified non-current financial instruments, deferred taxes and investment properties held at fair value are not subject to the write down to the lower of their carrying amount and fair value less costs to sell.

Liabilities directly associated with disposal group that will be transferred in the disposal transaction are reclassified and presented separately in the balance sheet.

**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 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.

**Other borrowed funds** Other borrowed funds are non-derivative liabilities to international financial institutions and are carried at amortised cost.

**Income taxes.** Income taxes have been provided for in the consolidated financial statements in accordance with Azerbaijani 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 of consolidated financial statements of each entity included in the Group 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.

**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.

**Credit related commitments** In the normal course of business, the Group enters into credit related commitments, including letters of credit and guarantees. Commitments to provide loans at a below-market interest rate are initially recognised at fair value, and subsequently measured at the higher of (i) the unamortized balance of the related fees received and deferred and (ii) the expenditure required to settle the commitment at the balance sheet date. Specific provisions are recorded against other credit related commitments when losses are considered more likely than not.

**3 Basis of Preparation and Significant Accounting Policies (Continued)**

**Share premium** Share premium represents the excess of contributions over the nominal value of the shares issued

**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. Azerbaijani legislation identifies the basis of distribution as the current period 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. 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 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.

**Foreign currency translation** 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 denominated in foreign currencies 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 the transactions and from the translation of monetary assets and liabilities into each entity's functional currency at period-end official exchange rates of the NBAR are recognised in profit or loss. Translation at period-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.

At 30 June 2006 the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 0.8956 (2005 USD 1 = AZN 0.9186). Exchange restrictions and controls exist relating to converting Azerbaijani Manats into other currencies. At present, the Azerbaijani Manat is not a freely convertible currency in most countries outside of the Republic of Azerbaijan.

**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 social insurance fund, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the period, in which the associated services are rendered by the employees of the Group.

#### **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 consolidated 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.

**Finance leases and de-recognition 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 tax, currency and customs legislation is subject to varying interpretations. Refer to Note 23.

**Related party transactions** In the normal course of business, the Group enters into transactions with its related parties. These transactions are priced predominantly at market rates. 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.

#### **5 Adoption of New or Revised Standards and Interpretations**

**Effect of Adoption of New or Revised Standards.** The effect of adoption of the above new or revised standards and interpretations on the Group's consolidated financial position at 30 June and on the consolidated results of its operations for the periods then ended was not significant.

#### **6 Cash and Cash Equivalents**

| <i>In thousands of new Azerbaijani Manats</i>   | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|---|-------------------------|-----------------------------|
| Cash on hand  | 66,182                  | 46,552                      |
| Cash balances with the National / Central banks (other than mandatory reserve deposits) | 62,325                  | 159,744                     |
| Correspondent accounts and overnight placements with other banks                        |                         |                             |
| - The Republic of Azerbaijan  | 739                     | 907                         |
| - Other countries   | 12,820                  | 51,167                      |
| <b>Total cash and cash equivalents</b>  | <b>142,066</b>          | <b>258,370</b>              |

Included in cash balances with National / Central banks (other than mandatory reserve deposits) are the balances on correspondent accounts of the Bank and its subsidiary, IBAR Moscow, with the NBAR and CBRF amounting to AZN 59,165 thousand (31 December 2005: AZN 155,683 thousand) and AZN 3,160 thousand (31 December 2005: AZN 4,060 thousand), respectively.

Overnight placements with non-resident banks include AZN 9,672 thousand (31 December 2005: AZN 10,129 thousand) placed with foreign banks at an annual interest rate of 3.54% to 3.85% per annum with maturities in July 2006 (31 December 2005: 3.10% to 3.45% per annum, with maturities in January 2006).

Geographical, currency, maturity and interest rate analyses of cash and cash equivalents are disclosed in Note 25. The information on related party balances is provided in Note 28.



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**7 Due from Other Banks**

| <i>In thousands of new Azerbaijani Manats</i>         | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|---|-------------------------|-----------------------------|
| Current term placements with other banks              | 305,769                 | 47,521                      |
| Notes of the National Bank of Azerbaijan              | 15,769                  | 5,875                       |
| Overdue placements with other banks                   | 4,681                   | 4,781                       |
| Debentures of resident banks                          | 1,320                   | 2,199                       |
| Accrued interest income                               | 1,415                   | 158                         |
|   |                         | -                           |
| Less Provision for impairment of due from other banks | (8,445)                 | (6,198)                     |
| <b>Total due from other banks</b>                     | <b>320,509</b>          | <b>54,336</b>               |

Current term placements with other banks include short-term placements with non-resident banks, which amounted to AZN 229,497 thousand as at 30 June 2006 with annual interest rates of 2.82% - 5.26% with maturity in July 2006 (31 December 2005 short term USD denominated placements in the amount of AZM 56,596 million and EUR denominated placements in the amount of AZM 32,653 million with several European banks, with maturities from January to October 2006 and interest rates ranging from 2.0% to 4.3% per annum)

Notes of the NBAR represent short-term government securities issued by the NBAR through the Baku Stock Exchange purchased by the Group at a discount. The notes outstanding as at 30 June 2006 had an average interest rate of 9 -13 % per annum and matured in July 2006 (31 December 2005 average interest rate of 11.93% per annum and matured in January-March 2006)

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

| <i>In thousands of new Azerbaijani Manats</i>                                | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|--|-------------------------|-----------------------------|
| <b>Provision for impairment of due from other banks at 1 January</b>         | <b>6,198</b>            | <b>5,632</b>                |
| Provision for impairment of due from other banks during the year             | 2,247                   | 816                         |
| Due from other banks written off during the year as uncollectible            | -                       | (250)                       |
| <b>Provision for impairment of due from other banks as at reporting date</b> | <b>8,445</b>            | <b>6,198</b>                |

As at 30 June 2006 the estimated fair value of due from other banks was AZN 320,509 thousand (31 December 2005 AZN 54,336 thousand). Refer to Note 27

Geographical, currency, maturity and interest rate analyses of due from other banks are disclosed in Note 25. The information on related party balances is provided in Note 28

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**8 Loans and Advances to Customers**

| <i>In thousands of new Azerbaijani Manats</i>                            | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|--|-------------------------|-----------------------------|
| Current loans  | 731,608                 | 703,787                     |
| Overdue loans  | 38,895                  | 44,375                      |
| Net investment in finance lease  | -                       | 11,961                      |
| <b>Total loans and advances to customers, gross</b>                      | <b>770,503</b>          | <b>760,123</b>              |
| Less provision for loan impairment                                       | (87,291)                | (80,845)                    |
| Less provision for uncollectible finance lease receivables               | -                       | (808)                       |
| <b>Total provision for impairment to loans and advances to customers</b> | <b>(87,291)</b>         | <b>(81,653)</b>             |
| <b>Total loans and advances to customers, net</b>                        | <b>683,212</b>          | <b>678,470</b>              |

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

| <i>In thousands of new Azerbaijani Manats</i>                                      | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|--|-------------------------|-----------------------------|
| <b>Provision for loan impairment at 1 January</b>                                  | <b>81,653</b>           | <b>51,376</b>               |
| Provision for loan impairment during the period                                    | 6,843                   | 35,576                      |
| Provision for uncollectible finance lease receivables for the period               | -                       | 552                         |
| Loans and advances to customers written off during the period                      | -                       | (5,915)                     |
| Provision on loans(leases) of subsidiary reclassified as assets available for sale | (1,205)                 | -                           |
| Effect of changes in exchange rates  | -                       | 64                          |
| <b>Provision for loan impairment at 30 June</b>                                    | <b>87,291</b>           | <b>81,653</b>               |

During the six-month period ended 30 June 2006 no decision was made by the Group to write-off bad loans issued to customers in previous years (year ended 31 December 2005 AZN 5,915 thousand)

Included in gross amount of total loans and advances to customers as at 30 June 2006, are the loans granted to twenty companies amounting to AZN 415,620 thousand (31 December 2005 eighteen companies amounting to AZN 427,608 thousand) and representing 56.6% (31 December 2005 57.4%) of the total loan portfolio of the Group

Included in gross amount of total loans and advances to customers as at 30 June 2006, are the loans granted to government institutions and state enterprises of the Republic of Azerbaijan amounting to AZN 166,057 thousand (31 December 2005 AZN 257,662 thousand) and representing 22.6% (31 December 2005 26.7%) of the total loan portfolio of the Group

Included in total gross amount of loans and advances granted to government institutions and state enterprises of the Republic of Azerbaijan outstanding at 30 June 2006, are the loans to state-owned companies in the amount of AZN 2,238 thousand (31 December 2005 AZN 131,220 thousand) guaranteed by the government of the Republic of Azerbaijan. Included in overdue loans as at 30 June 2006 is the loan in the total amount of AZN 2,236 thousand (31 December 2005 AZN 4,123 thousand) due from the Azerbaijan State Airlines covered by the letter of guarantee of the Ministry of Finance of the Republic of Azerbaijan on which no provision was recorded in the consolidated financial statements of the Group. No repayment for this loan was made during the six-month period ended 30 June 2006

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**8 Loans and Advances to Customers (Continued)**

In February 2005, in accordance with the protocol signed in December 2004 between the Group and the Ministry of Finance of the Republic of Azerbaijan, the Group offset bad loans and related accrued interest receivable in the amount of AZN 1,981 thousand and AZN 547 thousand respectively, issued to the state enterprises that have been privatized, against dividends payable to the Ministry of Finance of the Republic of Azerbaijan. Refer to Note 24.

No such protocols were signed between the Group and the Ministry of Finance of the Republic of Azerbaijan during the six-month period ended 30 June 2006.

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

|  | 30 June 2006   |              | 31 December 2005 |              |
|--|----------------|--------------|------------------|--------------|
| <i>In thousands of new Azerbaijani Manats</i>                    | <b>Amount</b>  | <b>%</b>     | <b>Amount</b>    | <b>%</b>     |
| Manufacturing  | 176,578        | 22.9         | 211,098          | 27.8         |
| Trade  | 129,959        | 16.9         | 109,974          | 14.5         |
| Construction   | 125,670        | 16.3         | 72,577           | 9.5          |
| Individuals  | 97,053         | 12.6         | 63,853           | 8.4          |
| Railroad and other transportation                                | 96,466         | 12.5         | 103,755          | 13.6         |
| State and public organisations*                                  | 76,087         | 9.9          | 84,030           | 11.1         |
| Air transportation   | 39,386         | 5.1          | 96,039           | 12.6         |
| Communication  | 13,499         | 1.8          | 1,576            | 0.2          |
| Power production and distribution                                | 8,500          | 1.1          | 2,270            | 0.3          |
| Net investment in finance lease                                  | -              | -            | 11,962           | 1.6          |
| Other  | 7,305          | 0.9          | 2,989            | 0.4          |
| <b>Total loans and advances to customers (before impairment)</b> | <b>770,503</b> | <b>100.0</b> | <b>760,123</b>   | <b>100.0</b> |

(\*) State and public organisations include Ministries, Treasury and other state bodies of the Republic of Azerbaijan.

As at 30 June 2006, included in loans issued to government bodies is an amount of AZN 7,375 thousand (31 December 2005: AZN 8,131 thousand), which represents non-interest bearing one-day overdrafts on current accounts of the State Budget of the Republic of Azerbaijan with the Group.

Included in the total amount of loans to individuals as at 30 June 2006 are the outstanding balances drawn on credit cards in the amount of AZN 7,844 thousand (31 December 2005: AZN 7,155 thousand).

As at 30 June 2006 the estimated fair value of loans and advances to customers was AZN 683,212 thousand (31 December 2005: AZN 678,470 thousand). Refer to Note 27.

Geographical, currency, maturity and interest rate analyses of loans and advances to customers are disclosed in Note 25. The information on related party balances is provided in Note 28.

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**9 Investment Securities Held to Maturity**

| <i>In thousands of new Azerbaijani Manats</i>       | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|---|-------------------------|-----------------------------|
| Promissory notes of Russian companies and banks     | 10,367                  | 6,550                       |
| <b>Total investment securities held to maturity</b> | <b>10,367</b>           | <b>6,550</b>                |

As at 30 June 2006 promissory notes represent debt securities of a Russian bank and a private company (31 December 2005 a Russian bank) with the purchase price of AZN 10,198 in total (31 December 2005 AZN 6,445 thousand). Promissory notes of these organizations are quoted and traded at the Russian Trade System Stock Exchange in Moscow, Russian Federation. The promissory notes outstanding as at 30 June 2006 bear interest rate of 3.94% and 5.22% per annum (31 December 2005 4.28% per annum). Accrued interest on promissory notes outstanding as at 31 December 2005 amounted to AZN 169 thousand (31 December 2005 AZN 105 thousand). All promissory notes and accrued interest outstanding as at 30 June 2006 and 31 December 2005 were subsequently redeemed at maturity.

As at 30 June 2006 the estimated fair value of investment securities held to maturity was AZN 10,367 thousand (31 December 2005 AZN 6,550 thousand). Refer to Note 27.

Geographical, currency, maturity and interest rate analyses of investment securities held to maturity are disclosed in Note 25.

**10 Investment in Associates and Joint Ventures**

| <i>In thousands of new Azerbaijani Manats</i>             | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|---|-------------------------|-----------------------------|
| Investment in Baku Inter-Bank Currency Exchange (BICE)    | 842                     | 794                         |
| Investment in Trans-service                               | 567                     | 569                         |
| <b>Total investments in associates and joint ventures</b> | <b>1,409</b>            | <b>1,363</b>                |

The table below summarises the movements in the carrying amount of the Group's investment in associates and joint ventures.

|  | <b>30 June 2006</b> |                           | <b>31 December 2005</b> |                           |
|--|---------------------|---------------------------|-------------------------|---------------------------|
|  | <b>BICE</b>         | <b>Trans-<br/>service</b> | <b>BICE</b>             | <b>Trans-<br/>service</b> |
| <b>Carrying amount as at 1 January</b>                                   | <b>794</b>          | <b>569</b>                | <b>864</b>              | <b>611</b>                |
| Net share of results of associate/joint venture after tax for the period | 48                  | 8                         | (70)                    | 8                         |
| Decrease of the share capital  | -                   | (10)                      | -                       | (50)                      |
| <b>Carrying amount as at 30 June</b>                                     | <b>842</b>          | <b>567</b>                | <b>794</b>              | <b>569</b>                |

As at 30 June 2006, the Group held 20% interest in BICE and 50% interest in Trans-service. Trans-service is a joint venture with another Azerbaijani company established to operate parking facilities for the purpose of profit-making. It was included in the Group's consolidated financial statements as investment in joint venture, using equity accounting method for the first time as of 31 December 2003.

As at 30 June 2006 share capital of Trans-service decreased by AZN 10 thousand compared with the prior year-end (31 December 2005 AZN 50 thousand) due to distributions of capital to existing shareholders in accordance with foundation agreement signed between the Group and another shareholder of Trans-Service.

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**11 Investment Properties**

| <i>In thousands of new Azerbaijani Manats</i>     |    | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|---|----|-------------------------|-----------------------------|
| Investment properties as of 1 January             |    | <b>1,132</b>            | <b>1,814</b>                |
| Depreciation                                      |    | (230)                   | (443)                       |
| Transfer from/(to) owner occupied premises        | 14 | -                       | (1,125)                     |
| <b>Investment properties as at reporting date</b> |    | <b>902</b>              | <b>1,132</b>                |

Included in the opening balance of investment properties as of 1 January 2005 are the three properties with the net book value of AZN 1,814 thousand, the ownership of which was obtained by the Group based on court decision as compensation for loans granted by the Group to domestic banks and legal entities in prior years. The management of the Group has changed its intentions with respect to leasing out one of these properties and has decided to use the property to accommodate offices of several of the Group's companies and Bank's departments. Therefore, this property with a net book value amounting to AZM 1,125 was reclassified from "investment properties" category to "buildings" category during the year ended 31 December 2005.

Investment property as at 30 June 2006 includes land in Baku in the amount of AZN 688 thousand acquired by the Group in August 2002 from one of its borrowers as a partial compensation of the loans previously issued to this borrower by the Group and property in the amount of AZN 214 thousand representing warehouse and furniture production facility. The Group intends to hold this land for capital appreciation purposes.

The Group did not classify any operating leases as investment properties. The investment properties are recognised at cost less accumulated depreciation as at 30 June 2006.

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**12 Premises, Equipment and Intangible Assets**

|  | Note | Premises<br>and lease-<br>hold<br>improve-<br>ments | Office and<br>computer<br>equipment | Banking<br>equipment,<br>furniture,<br>fixtures,<br>vehicles &<br>other | Intangible<br>assets | Constru-<br>ction in<br>progress | Total         |
|--|------|---|-------------------------------------|---|----------------------|----------------------------------|---------------|
| <i>In thousands of new Azerbaijani Manats</i>  |      |   |                                     |   |                      |                                  |               |
| Cost at 1 January 2005                         |      | 25,207  | 17,158                              | 23,160  | 2,229                | 480                              | 68,234        |
| Accumulated depreciation                       |      | (5,575)   | (5,692)                             | (5,885)   | (1,206)              | -                                | (18,358)      |
| <b>Carrying amount at 1 January 2005</b>       |      | <b>19,632</b>                                       | <b>11,466</b>                       | <b>17,275</b>   | <b>1,023</b>         | <b>480</b>                       | <b>49,876</b> |
| Additions                                      |      | 691   | 5,705                               | 4,843   | 5,032                | 1,666                            | 17,937        |
| Transfers                                      |      | 1,125   | (5,094)                             | (1,355)   | -                    | 6,449                            | 1,125         |
| Disposals                                      |      | (162)   | (74)                                | (33)  | -                    | -                                | (269)         |
| Depreciation charge                            |      | (1,215)   | (3,701)                             | (5,116)   | (1,450)              | -                                | (11,482)      |
| Revaluation                                    |      | 20,754  | -                                   | -   | -                    | -                                | 20,754        |
| Effect of translation to presentation currency |      | (531)   | (77)                                | (6)   | -                    | (4)                              | (618)         |
| Cost at 31 December 2005                       |      | 50,658  | 17,587                              | 26,576  | 7,261                | 8,592                            | 110,674       |
| Accumulated depreciation                       |      | (10,364)  | (9,362)                             | (10,968)  | (2,657)              | -                                | (33,351)      |
| <b>Carrying amount at 31 December 2005</b>     |      | <b>40,294</b>                                       | <b>8,225</b>                        | <b>15,608</b>   | <b>4,604</b>         | <b>8,592</b>                     | <b>77,323</b> |
| Additions                                      |      | 88  | 2,400                               | 3,253   | 2,790                | 7,411                            | 15,942        |
| Transfers                                      |      | -   | -                                   | (495)   | -                    | 495                              | -             |
| Disposals                                      |      | (31)  | 379                                 | (1,683)   | (1,738)              | (5)                              | (3,078)       |
| Depreciation charge                            | 22   | (955)   | (1,896)                             | (3,284)   | (2,996)              | -                                | (9,131)       |
| Revaluation                                    |      | (26)  | -                                   | -   | -                    | -                                | (26)          |
| Effect of translation to presentation currency |      | 280   | 29                                  | 4   | -                    | 1                                | 314           |
| Cost at 30 June 2006                           |      | 55,640  | 23,761                              | 29,379  | 4,889                | 16,494                           | 130,163       |
| Accumulated depreciation                       |      | (15,990)  | (14,624)                            | (15,976)  | (2,229)              | -                                | (48,819)      |
| <b>Carrying amount at 30 June 2006</b>         |      | <b>39,650</b>                                       | <b>9,137</b>                        | <b>13,403</b>   | <b>2,660</b>         | <b>16,494</b>                    | <b>81,344</b> |

Additions to premises and equipment in 2006 primarily consist of 2,027 kiosk bank service terminals acquired for the purposes of provision of banking services in the amount of AZN 2,343 thousand, 35 automated teller machines in the amount of AZN 1,168 thousand (2005 20 ATMs, 100 kiosks bank service terminals), bank's accounting software in the amount of AZN 1,985 thousand and vehicles of AZN 497 thousand

Included in additions to construction in progress are advance payments in the amount of AZN 7,000 thousand (2005 AZN 1,651 thousand) made by the Group to contractors for the purposes of construction of its new office building on the residential area purchased by the Group in the centre of Baku

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

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**13 Other Assets**

| <i>In thousands of new Azerbaijani Manats</i>                | <b>Note</b> | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|--|-------------|-------------------------|-----------------------------|
| Plastic cards receivables                                    |             | 4,680                   | 304                         |
| Prepaid expenses   |             | 3,255                   | 708                         |
| Policyholder receivables                                     |             | 1,336                   | 1,127                       |
| Foreclosed buildings   |             | 902                     | 472                         |
| Restricted cash  |             | 657                     | 615                         |
| Advances for purchase of intangible assets and equipment     |             | 409                     | 755                         |
| Deferred tax asset   | 23          | 332                     | 420                         |
| Amounts in the course of settlement                          |             | 399                     | 629                         |
| Deferred acquisition costs on insurance premiums written     |             | 323                     | 163                         |
| Prepaid insurance  |             | 138                     | 615                         |
| Advances for equipment purchased for the purposes of leasing |             | -                       | 3,917                       |
| Other  |             | 775                     | 510                         |
| <b>Total other assets</b>                                    |             | <b>13,206</b>           | <b>10,235</b>               |

Plastic card receivables balance includes, AZN 1,914 thousand receivable from Pension Fund of the Republic of Azerbaijan representing fees receivable from Pension Fund for plastic card issued to pensioners by the Bank and AZN 1,848 thousand receivable of the Group's card processing subsidiary

Advances for equipment purchased for purposes of leasing as at 31 December 2005 represented equipment purchased for leasing purposes for which specific leasing contracts had not yet been identified as at the reporting date. As the net assets of the leasing subsidiary of the Group is reclassified as held for sale as at 30 June 2006, associated advances for equipment purchased for the purposes of leasing is shown under total assets of disposal groups in Note 29

Assets held for sale recorded under the "Foreclosed buildings" represent premises, which were previously rented out to earn rentals, and, therefore, classified as investment properties in previous accounting periods. However, since 2005 the management discontinued its rental arrangements with the tenants and has started to actively seek the buyers of the building

Geographical, currency, maturity and interest rate analyses of other assets are disclosed in Note 25. The relevant information on related party balances is disclosed in Note 28

**14 Due to Other Banks**

| <i>In thousands of new Azerbaijani Manats</i>                              | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|--|-------------------------|-----------------------------|
| Correspondent accounts and overnight placements of other banks             | 9,647                   | 8,516                       |
| Blocked accounts of resident banks in relation to plastic cards operations | 242                     | 262                         |
| <b>Total due to other banks</b>  | <b>9,889</b>            | <b>8,778</b>                |

Included in the closing balances of correspondent accounts of other banks as at 30 June 2006 is foreign bank deposit placed with IBA at an annual interest rate of 3.95% and with maturity in September, 2006 amounting to AZN 5,690 thousand (31 December 2005 Nil)

As at 30 June 2006 the estimated fair value of due to other banks was AZN 9,889 thousand (31 December 2005 AZN 8,778 thousand). Refer to Note 27

Geographical, currency, maturity and interest rate analyses of due to other banks are disclosed in Note 25. The relevant information on related party balances is disclosed in Note 28

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**15 Customer Accounts**

| <i>In thousands of new Azerbaijani Manats</i> | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|---|-------------------------|-----------------------------|
| <b>State and public organisations</b>         |                         |                             |
| - Current/settlement accounts                 | 397,502                 | 241,151                     |
| - Term deposits                               | 298,364                 | 320,629                     |
| - Restricted customer deposits                | 72,370                  | 52,199                      |
| <b>Other legal entities</b>                   |                         |                             |
| - Current/settlement accounts                 | 86,948                  | 107,264                     |
| - Term deposits                               | 4,085                   | 6,914                       |
| - Restricted customer deposits                | 9,752                   | 16,287                      |
| <b>Individuals</b>                            |                         |                             |
| - Current/demand accounts                     | 62,027                  | 47,383                      |
| - Term deposits                               | 136,447                 | 116,747                     |
| <b>Total customer accounts</b>                | <b>1,067,495</b>        | <b>908,574</b>              |

Included in the current and settlement accounts of state and public organizations as at 30 June 2006 are balances on current interest bearing accounts of state-owned enterprises and government bodies in the amount of AZN 58,467 thousand (31 December 2005 AZN 11,649 thousand) Interest rates on these accounts vary from 0.5% to 2.5% per annum (31 December 2005 0.5% to 2.5% per annum)

Included in term deposits of state and public organizations are call deposits of a state organization involved in the oil industry sector of the Republic of Azerbaijan in the amount of AZN 295,548 thousand (31 December 2005 AZN 312,256 thousand) and of government bodies in the amount of AZN 1,147 thousand (31 December 2005 AZN 1,089 thousand) The average interest rates on these call deposits were 0.5% and 1.5% per annum respectively (31 December 2005 0.5% and 2.0% per annum)

As at 30 June 2006 the Group had significant concentration of customer accounts attracted from a state organization involved in the oil industry sector in the total amount of AZN 486,209 thousand or 45.5% of total customer accounts (31 December 2005 AZN 423,444 thousand or 46.6%, respectively)

Restricted customer deposits amounting to AZN 82,122 thousand as at 30 June 2006 (31 December 2005 AZN 68,486 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 30 June 2006 and 2005 is disclosed in Note 26

Economic sector concentrations within customer accounts are, as follows

| <i>In thousands of new Azerbaijani Manats</i>        | <b>30 June<br/>2006</b> | <b>%</b>     | <b>31 December<br/>2005</b> | <b>%</b>     |
|--|-------------------------|--------------|-----------------------------|--------------|
| Energy   | 587,499                 | 55.0         | 502,581                     | 55.3         |
| Individuals  | 197,942                 | 18.5         | 164,131                     | 18.0         |
| State and public organisations, except energy sector | 102,970                 | 9.6          | 38,883                      | 4.3          |
| Trade and services                                   | 51,858                  | 4.9          | 48,816                      | 5.4          |
| Manufacturing  | 33,562                  | 3.1          | 69,922                      | 7.7          |
| Transportation and communication                     | 33,080                  | 3.1          | 7,371                       | 0.8          |
| Construction   | 19,887                  | 1.9          | 23,303                      | 2.6          |
| Other  | 40,697                  | 3.9          | 53,567                      | 5.9          |
| <b>Total customer accounts</b>                       | <b>1,067,495</b>        | <b>100.0</b> | <b>908,574</b>              | <b>100.0</b> |

(\*) State and public organisations comprise Ministries, Treasury, municipalities and other state bodies of the Republic of Azerbaijan

As at 30 June 2006 the estimated fair value of customer accounts was AZN 1,067,495 thousand (31 December 2005 AZN 908,574 thousand) Refer to Note 27

Geographical, currency, maturity and interest rate analyses of customer accounts are disclosed in Note 25 The information on related party balances is disclosed in Note 28



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**16 Debt Securities in Issue**

| <i>In thousands of new Azerbaijani Manats</i> | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|---|-------------------------|-----------------------------|
| Debentures                                    | 24,251                  | 24,897                      |
| Deposit certificates                          | 14,279                  | 17,290                      |
| <b>Total debt securities in issue</b>         | <b>38,530</b>           | <b>42,187</b>               |

During the six-month period ended 30 June 2006 the Group incurred interest expense on the above debentures in the amount of AZN 1,362 thousand (six-month period ended 30 June 2005 AZN 1,181 thousand) recorded in the consolidated statement of income of the Group. Refer to Note 20.

Certificates of deposit bear interest rate of 9.0% per annum (2005 9.0%) and have maturity of 3 years. These certificates of deposit bear a condition that interest is paid only if certificates are claimed for repayment after 365 calendar days from their respective issue dates.

As at 30 June 2006 the estimated fair value of debt securities in issue was AZN 38,530 thousand (31 December 2005 AZN 42,187 thousand). Refer to Note 27.

Geographical, currency, maturity and interest rate analyses of debt securities in issue are disclosed in Note 25.

**17 Other Borrowed Funds**

| <i>In thousands of new Azerbaijani Manats</i> | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|---|-------------------------|-----------------------------|
| Syndicated borrowing                          | 51,919                  | 52,414                      |
| Black Sea Trade and Development Bank (BSTDB)  | 9,885                   | 7,535                       |
| Islamic Development Corporation (IDC)         | 4,039                   | 2,132                       |
| Societe Generale                              | 201                     | -                           |
| <b>Total other borrowed funds</b>             | <b>66,044</b>           | <b>62,081</b>               |

Funds attracted under syndicated borrowing as at 31 December 2005 represent the balance of funds attracted under syndicated borrowing agreement signed 19 August 2005 with foreign banks led by one of major German banks in the total amount of USD 56,000,000 for the Group's financing of large government projects. The borrowing facility bears annual interest rate of LIBOR plus 2% and matures on 19 August 2006. Outstanding principal amount and accrued interest payable on this borrowing were fully repaid on 18 August 2006.

On 21 January 2002 the Group signed an 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 4,000 thousand. The amount drawn on this revolving facility net of repayments as at 30 June 2006 amounted to AZN 3,997 thousand or USD 4,463 thousand (31 December 2005 AZN 2,008 thousand or USD 2,187 thousand) and is used for financing of various projects related to manufacturing and transportation sectors of the Republic of Azerbaijan. The borrowing facility bears annual interest rate of LIBOR plus 5%.

On 22 November 2002 the Bank obtained additional credit facility in the amount of USD 2,500 thousand from the Black Sea Trade and Development Bank for the purposes of financing of various Azerbaijani projects in electricity distribution and manufacturing sectors. Each disbursement of the facility is repayable in 6 equal semi-annual installments commencing six months after the value date of the disbursement. The interest rate for the loan is LIBOR plus 4% per annum. Amounts drawn down on this credit line net of repayments as at 30 June 2006 account for nil (31 December 2005 nil).

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**17 Other Borrowed Funds (Continued)**

On 21 June 2005 the Group signed a Loan Agreement with the Black Sea Trade and Development Bank for the purpose of funding construction of glass factory in Azerbaijan at the amount of AZN 5,442 thousand or EUR 5,000 thousand. The interest rate for the loan is LIBOR plus 5% per annum. Loan will be repaid in semi-annual instalments, commencing 18 months after the date of first disbursement and ending on the expiry of 60 months after the date of first disbursement.

On 12 April 2004 the Group signed up for a Line of Financing Agreement with the Islamic Development Corporation (a member of Islamic Development Bank Group, an international financial institution with head-quarters in Jeddah, Saudi Arabia) for the credit line of USD 4,500 thousand for the period of 7 years at SWAP plus 5% per annum for financing of various investment projects in the Republic of Azerbaijan. As at 30 June 2006 the amount drawn down on this credit line comprised AZN 3,988 thousand or USD 4,453 thousand (31 December 2005: AZN 2,088 thousand or USD 2,274 thousand) and was used for the purposes of financing of a project in manufacturing sector of Azerbaijan.

As 30 June 2006 the estimated fair value of other borrowed funds was AZN 66,044 thousand (31 December 2005: AZN 62,081 thousand). Refer to Note 27. Geographical, currency, maturity and interest rate analysis of other borrowed funds are disclosed in Note 25.

**18 Other Liabilities**

| <i>In thousands of new Azerbaijani Manats</i>       | <b>Note</b> | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|---|-------------|-------------------------|-----------------------------|
| Items in course of settlement                       |             | 43,091                  | 26,071                      |
| Provision for letters of guarantee                  | 22, 26      | 7,051                   | 879                         |
| Dividends payable to shareholders                   | 24          | 6,577                   | 2,400                       |
| Taxes payable                                       |             | 4,913                   | 2,825                       |
| Deferred revenue on plastic cards operations        |             | 3,785                   | 1,515                       |
| Insurance reserves                                  |             | 2,285                   | 1,876                       |
| Plastic cards creditors                             |             | 1,138                   | -                           |
| Insurance premiums and broker commissions payable   |             | 1,063                   | 513                         |
| Deferred ceding commissions on insurance operations |             | 75                      | 74                          |
| Trade creditors                                     |             | 42                      | 1,997                       |
| Payable for software                                |             | -                       | 1,080                       |
| Payable on intangibles of Inter Club                |             | -                       | 269                         |
| Other liabilities                                   |             | 467                     | 754                         |
| <b>Total other liabilities</b>                      |             | <b>70,487</b>           | <b>40,253</b>               |

Items in course of settlement include payable to Central Treasury ("Central Treasury") Department of the Ministry of Finance of the Republic of Azerbaijan amounting to AZN 22,848 thousand representing the funds collected by the Bank on behalf of Central Treasury which are subsequently transferred to Central Treasury's bank accounts (31 December 2005: AZN 25,773). This balance was debited from the current accounts of Bank customers at the last day of the period and transferred to the account of Central Treasury in NBAR.

Taxes payable comprised income tax payables by the companies of the Group as at 30 June 2006 in the amount of AZN 4,913 thousand.

Deferred revenue on plastic cards operations represents unearned portion of revenue related to fees charged for annual maintenance of plastic cards. The above fee is charged upon issuance of cards and amortized over their respective term. Included in deferred revenue on plastic cards operations as at 30 June 2006 is AZN 3,785 thousand (31 December 2005: AZN 628 thousand) representing deferral of revenue arising from servicing of plastic cards issued by the Bank to Azerbaijani pensioners in accordance with the contract signed by the Bank with the State Social Security Funds of the Republic of Azerbaijan on 23 January 2004 and salary card as well. Refer to Notes 13 and 21.

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**19 Share Capital**

Authorised, issued and paid-in share capital of the Group as at 30 June 2006 and as at 31 December 2005 is, as follows

| <i>In thousands of new Azerbaijani Manats</i> | <b>Number of outstanding shares<br/>[in thousands]</b> | <b>Ordinary<br/>shares</b> |
|---|--|----------------------------|
| <b>At 1 January 2005</b>                      | <b>100,000</b>   | <b>100,000</b>             |
| New shares issued                             | 24,100   | 24,100                     |
| <b>At 31 December 2005</b>                    | <b>124,100</b>   | <b>124,100</b>             |
| New shares issued                             | 41,670   | 41,670                     |
| <b>At 30 June 2006</b>                        | <b>165,770</b>   | <b>165,770</b>             |

The par value of the Bank's issued registered share capital is AZN 33,154 thousand (31 December 2005 AZN 24,800 thousand) At 30 June 2006, all of the Bank's outstanding shares were authorised, issued and fully paid in

All ordinary shares have a nominal value of AZN 0.2 per share (2005 AZN 0.2 per share) and rank equally. Each share carries one vote.

As at 30 June 2006 the Group's employees hold 5.74% of the total share capital of the Group, which amounts to AZN 2,298 thousand (31 December 2005 4.71% and AZN 1,169 thousand respectively). Refer to Note 28.

**20 Interest Income and Expense**

| <i>In thousands of new Azerbaijani Manats</i>            | <b>Six-Month<br/>Period Ended<br/>30 June 2006</b> | <b>Six-Month<br/>Period Ended<br/>30 June 2005</b> |
|--|--|--|
| <b>Interest income</b>                                   |  |  |
| Loans and advances to customers                          | 44,441   | 33,086   |
| Due from other banks and correspondent accounts          | 8,435  | 3,343  |
| Interest income on investment securities                 | 614  | 524  |
| <b>Total interest income</b>                             | <b>53,490</b>                                      | <b>36,953</b>                                      |
| <b>Interest expense</b>                                  |  |  |
| Savings deposits of individuals and deposit certificates | (6,515)  | (5,715)  |
| Term deposits of legal entities                          | (4,434)  | (2,294)  |
| Deposits from banks and other borrowed funds             | (2,584)  | (267)  |
| Debentures   | (1,362)  | (1,181)  |
| <b>Total interest expense</b>                            | <b>(14,895)</b>                                    | <b>(9,457)</b>                                     |
| <b>Net interest income</b>                               | <b>38,595</b>                                      | <b>27,496</b>                                      |

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**21 Fee and Commission Income and Expense**

|   | <b>Six-Month<br/>Period Ended<br/>30 June 2006</b> | <b>Six-Month<br/>Period Ended<br/>30 June 2005</b> |
|---|--|--|
| <i>In thousands of new Azerbaijani Manats</i>         |  |  |
| <b>Fee and commission income</b>                      |  |  |
| - Plastic cards operations                            | 7,077  | 4,764  |
| - Transactions with foreign currencies and securities | 5,393  | 6,499  |
| - Cash transactions                                   | 4,656  | 3,847  |
| - Settlement transactions                             | 3,344  | 3,214  |
| - Letters of credit issued                            | 874  | 924  |
| - Guarantees issued                                   | 236  | 371  |
| - Servicing intermediary loans                        | 84   | 212  |
| - Other   | 583  | 402  |
| <b>Total fee and commission income</b>                | <b>22,247</b>                                      | <b>20,233</b>                                      |
| <b>Fee and commission expense</b>                     |  |  |
| - Cash transactions                                   | (886)  | (76)   |
| - Plastic cards operations                            | (868)  | (524)  |
| - Settlement transactions                             | (596)  | (370)  |
| - Policy acquisition costs on insurance operations    | (210)  | (174)  |
| - Transactions with foreign currencies and securities | -  | (37)   |
| - Other   | (16)   | (25)   |
| <b>Total fee and commission expense</b>               | <b>(2,576)</b>                                     | <b>(1,206)</b>                                     |
| <b>Net fee and commission income</b>                  | <b>19,671</b>                                      | <b>19,027</b>                                      |

Included in fees and commission income on plastic cards operations is AZN 649 thousand (six-month period ended 30 June 2005 AZN 1,503 thousand) representing commission income arising from servicing plastic cards issued by the Group to Azerbaijani pensioners in accordance with the contract signed on 23 January 2004 with the State Social Security Fund of the Republic of Azerbaijan. These plastic cards were issued in the context of the project for implementation of the retirement benefits payment system through plastic cards in the biggest local cities arranged by the Group under the abovementioned contract with the State Social Security Fund of the Republic of Azerbaijan. Refer to Note 18.

The relevant information on related party balances is disclosed in Note 28.

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**Notes To The Consolidated Financial Statements – 30 June 2006**

**22 Administrative and Other Operating Expenses**

| <i>In thousands of new Azerbaijani Manats</i>  | <b>Note</b> | <b>Six-Month<br/>Period Ended<br/>30 June 2006</b> | <b>Six-Month<br/>Period Ended<br/>30 June 2005</b> |
|--|-------------|--|--|
| Staff costs  |             | 10,796   | 7,309  |
| Provision for letters of credit and guarantee  |             | 6,239  | 91   |
| Depreciation of premises and equipment   | 12          | 6,135  | 4,707  |
| Amortisation of software and other intangible assets                                     | 12          | 2,996  | 381  |
| Advertising and marketing services   |             | 1,784  | 482  |
| Rent   |             | 1,359  | 1,006  |
| Customs duties and other taxes other than on income                                      |             | 1,020  | 529  |
| Transportation of valuables  |             | 976  | 686  |
| Communication  |             | 799  | 671  |
| Charity and financial aid  |             | 699  | 206  |
| Training   |             | 591  | -  |
| Premises, equipment and investment property maintenance                                  |             | 529  | 652  |
| Stationery, books, printing and other supplies   |             | 509  | 355  |
| External labor and guarding  |             | 442  | 393  |
| Software maintenance   |             | 337  | -  |
| Business trip  |             | 232  | 252  |
| Property insurance   |             | 196  | -  |
| Sport inventory and football field maintenance for "Inter"<br>professional football club |             | 140  | 230  |
| Other  |             | 3,117  | 1,931  |
| <b>Total administrative and other operating expenses</b>                                 |             | <b>38,896</b>                                      | <b>19,881</b>                                      |

Included in staff costs are obligatory payments to the Social Security Fund and other funds of the Republic of Azerbaijan, bonuses and other benefits provided by the Group to its employees

Staff costs include payroll and other employee benefits of the Bank in the amount of AZN 8,750 thousand (six-month period ended 30 June 2005 AZN 6,235 thousand), IBAR Moscow of AZN 990 thousand (six-month period ended 30 June 2005 AZN 364 thousand), insurance subsidiary of AZN 379 thousand (six-month period ended 30 June 2005 234 thousand), Azercard Limited of AZN 290 thousand (six-month period ended 30 June 2005 AZN 205 thousand), leasing subsidiary of AZN 33 thousand (six-month period ended 30 June 2005 AZN 25 thousand) and "Inter" professional football club of AZN 354 thousand (six-month period ended 30 June 2005 AZN 46 thousand)

Rental expenses are related to operating lease of the Group's branch buildings in Baku and in the regions of the Republic of Azerbaijan, exchange offices and costs associated with ATMs installed in department stores, hotels, etc

The relevant information on related party balances is disclosed in Note 28

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**23 Income Taxes**

Income tax expense comprises the following

| <i>In thousands of new Azerbaijani Manats</i> | <b>Six-Month<br/>Period Ended<br/>30 June 2006</b> | <b>Year Ended<br/>31 December 2005</b> | <b>Six-Month<br/>Period Ended<br/>30 June 2005</b> |
|---|--|--|--|
| Current tax                                   | (6,547)  | (7,747)                                | (3,788)  |
| Deferred tax                                  | (291)  | (981)                                  | (81)   |
| <b>Income tax expense for the period</b>      | <b>(6,838)</b>                                     | <b>(8,728)</b>                         | <b>(3,869)</b>                                     |

The income tax rate applicable to the majority of the Group's income is 22% as at 30 June 2006 (31 December 2005 24%) Effective from 1 January 2004, the statutory tax rate of the Republic of Azerbaijan was reduced from 25% to 24% Starting from 1 January 2006, the statutory tax rate was further reduced from 24% to 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, effectively applicable from 1 January 2002

A reconciliation between the expected and the actual taxation charge is provided below

| <i>In thousands of new Azerbaijani Manats</i>                                    | <b>Six-Month<br/>Period Ended<br/>30 June 2006</b> | <b>Year Ended<br/>31 December<br/>2005</b> | <b>Six-Month<br/>Period Ended<br/>30 June 2005</b> |
|--|--|--|--|
| <b>IFRS profit before tax</b>  | <b>21,416</b>                                      | <b>29,058</b>                              | <b>12,217</b>                                      |
| Theoretical tax charge at statutory rate (2006 22%, 2005 24%)                    | (4,712)  | (6,974)                                    | (2,932)  |
| Tax effect of items which are not deductible or assessable for taxation purposes |  |  |  |
| - Non deductible expenses  | (1,046)  | (1,056)                                    | (424)  |
| - Unrecognized tax loss carry forwards   | (1,101)  | (1,050)                                    | (523)  |
| - Effect of change in tax rates  |  | 439  | -  |
| Other non-temporary differences  | 2  | (87)                                       | 10   |
| <b>Income tax expense for the period</b>   | <b>(6,838)</b>                                     | <b>(8,728)</b>                             | <b>(3,869)</b>                                     |

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

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**23 Income Taxes (Continued)**

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% (2005: 24%)

|   |             | 31 December<br>2005 | Reclassified<br>as DTA/DTL<br>of disposal<br>groups | Charged/<br>(credited)<br>to profit or<br>loss | 30 June<br>2006 |
|---|-------------|---------------------|---|--|-----------------|
| <i>In thousands of new Azerbaijani Manats</i>                                     |             |                     |   |  |                 |
|   | <b>Note</b> |                     |   |  |                 |
| <b>Tax effect of deductible temporary differences</b>                             |             |                     |   |  |                 |
| Losses on assets and liabilities at non-market rates                              |             | 1,621               | -   | (124)  | 1,497           |
| Deferred revenue recognition  |             | 577                 | -   | 189  | 766             |
| Provision for letters of credit and guarantees                                    |             | 168                 | -   | (37)   | 131             |
| Loan impairment in subsidiaries   |             | 84                  | -   | -  | 84              |
| Tax loss carry forward for subsidiaries   |             | 84                  | -   | -  | 84              |
| Difference in depreciation rate of premises and equipment and investment property |             | 190                 | -   | 48   | 238             |
| Recognition of expenses incurred, but recorded as other assets                    |             | 57                  | -   | 203  | 260             |
| Difference in amortization rates of intangibles                                   |             | 55                  | -   | 33   | 88              |
| Accruals and other  |             | 97                  | -   | 34   | 131             |
| <b>Gross deferred tax asset</b>   |             | <b>2,933</b>        | <b>-</b>  | <b>346</b>                                     | <b>3,279</b>    |
| <b>Deferred tax asset of disposal groups reclassified</b>                         | <b>29</b>   | <b>-</b>            | <b>(455)</b>  | <b>-</b>                                       | <b>(455)</b>    |
| <b>Tax effect of taxable temporary differences</b>                                |             |                     |   |  |                 |
| Loan impairment provision   |             | (5,535)             | -   | (773)  | (6,308)         |
| Difference in depreciation rates of fixed assets                                  |             | (1,446)             | -   | -  | (1,446)         |
| Movement of the revaluation of premises   |             | (5,103)             | -   | -  | (5,103)         |
| Revenue accruals  |             | (82)                | -   | (41)   | (123)           |
| Effect of consolidation of associates   |             | (136)               | -   | -  | (136)           |
| Difference in amortization rates  |             | (47)                | -   | -  | (47)            |
| Deferral of prepaid expenses  |             | (46)                | -   | (19)   | (65)            |
| Other   |             | (51)                | -   | 196  | 145             |
| <b>Gross deferred tax liability</b>   |             | <b>(12,446)</b>     | <b>-</b>  | <b>(637)</b>                                   | <b>(13,083)</b> |
| <b>Deferred tax liability of disposal groups reclassified</b>                     | <b>29</b>   | <b>-</b>            | <b>39</b>   | <b>-</b>                                       | <b>39</b>       |
| <b>Total net deferred tax liability</b>   |             | <b>(9,513)</b>      | <b>(416)</b>  | <b>(291)</b>                                   | <b>(10,220)</b> |

In the context of the Group's current structure, 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.

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**23 Income Taxes (Continued)**

As at 31 December 2005 the temporary differences giving rise to the deferred tax assets and liabilities are, as follows

| <i>In thousands of new Azerbaijani Manats</i>                  | <b>31 December<br/>2004</b> | <b>Movement</b> | <b>30 June<br/>2005</b> | <b>Movement</b> | <b>31 December<br/>2005</b> |
|--|-----------------------------|-----------------|-------------------------|-----------------|-----------------------------|
| <b>Tax effect of deductible temporary differences</b>          |                             |                 |                         |                 |                             |
| Losses on assets and liabilities at non-market rates           | 1,869                       | (163)           | 1,706                   | (85)            | 1,621                       |
| Deferred revenue recognition                                   | 236                         | 452             | 688                     | (111)           | 577                         |
| Tax loss carry forward for "Inter" professional football club  | 209                         | 523             | 732                     | 365             | 1,097                       |
| Provision for letters of credit and guarantees                 | 185                         | 22              | 207                     | (39)            | 168                         |
| Loan impairment in subsidiaries                                | 92                          | 49              | 141                     | (57)            | 84                          |
| Tax loss carry forward for Azerleasing                         | 92                          | 48              | 140                     | (56)            | 84                          |
| Difference in depreciation rate of fixed assets                | 209                         | 20              | 229                     | (39)            | 190                         |
| Recognition of expenses incurred, but recorded as other assets | 63                          | -               | 63                      | (6)             | 57                          |
| Difference in amortization rates of intangibles                | 60                          | 23              | 83                      | (28)            | 55                          |
| Accruals and other   | 107                         | 138             | 245                     | (148)           | 97                          |
| <b>Gross deferred tax asset</b>                                | <b>3,122</b>                | <b>1,112</b>    | <b>4,234</b>            | <b>(204)</b>    | <b>4,030</b>                |
| Less non-recorded deferred tax asset                           | (209)                       | (523)           | (732)                   | (365)           | (1,097)                     |
| <b>Net deferred tax asset</b>                                  | <b>2,913</b>                | <b>589</b>      | <b>3,502</b>            | <b>(569)</b>    | <b>2,933</b>                |
| <b>Tax effect of taxable temporary differences</b>             |                             |                 |                         |                 |                             |
| Provision for impairment of loans                              | (4,176)                     | (166)           | (4,342)                 | (1,193)         | (5,535)                     |
| Difference in depreciation rates of fixed assets               | (1,590)                     | -               | (1,590)                 | 144             | (1,446)                     |
| Recognition of intangible assets recorded as expenses          | -                           | (342)           | (342)                   | 342             | -                           |
| Movement of the revaluation of premises                        | (698)                       | 218             | (480)                   | (4,623)         | (5,103)                     |
| Revenue accruals   | (92)                        | (160)           | (252)                   | 170             | (82)                        |
| Effect of consolidation of associates                          | (164)                       | (2)             | (166)                   | 30              | (136)                       |
| Difference in amortization rates                               | (52)                        | -               | (52)                    | 5               | (47)                        |
| Deferral of prepaid expenses                                   | (50)                        | -               | (50)                    | 4               | (46)                        |
| Other  | (56)                        | -               | (56)                    | 5               | (51)                        |
| <b>Gross deferred tax liability</b>                            | <b>(6,878)</b>              | <b>(452)</b>    | <b>(7,330)</b>          | <b>(5,116)</b>  | <b>(12,446)</b>             |
| <b>Total net deferred tax liability</b>                        | <b>(3,965)</b>              | <b>137</b>      | <b>(3,828)</b>          | <b>(5,685)</b>  | <b>(9,513)</b>              |



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**23 Income Taxes (Continued)**

The increase in net deferred tax liability for the year ended 31 December 2005 in the amount of AZN 5,548 thousand (for 6-month period ended 30 June 2005 decrease in the amount of AZN 137 thousand) includes AZN 4,567 thousand charge (for 6-month period ended 30 June 2005 AZN 218 thousand credit) to revaluation surplus on premises and AZN 981 thousand charge (for 6-month period ended 30 June 2005 AZN 81 thousand charge) to consolidated income tax expense

In the table above deferred tax assets and liabilities of the Group are shown on a net basis. Where, in the context of the Group's current structure, deferred tax liabilities and tax assets of different companies may not be offset against each other, they are shown separately. The composition of the total net deferred tax liability of the Group is, as follows

| <i>In thousands of new Azerbaijani Manats</i>           | <b>30 June 2006</b> | <b>31 December 2005</b> | <b>30 June 2005</b> |
|---|---------------------|-------------------------|---------------------|
| Total net deferred tax assets of subsidiaries (Note 13) | 332                 | 420                     | 685                 |
| Total net deferred tax liability of the parent Bank     | (10,552)            | (9,933)                 | (4,517)             |
| <b>Total net deferred tax liability of the Group</b>    | <b>(10,220)</b>     | <b>(9,513)</b>          | <b>(3,828)</b>      |

The net deferred tax asset of the subsidiaries represents income taxes recoverable through future revenues and is recorded within other assets in the consolidated balance sheet. Deferred income tax assets are recorded for tax loss carry forwards only to the extent that realisation of the related tax benefit is probable.

**24 Dividends**

| <i>In thousands of new Azerbaijani Manats</i> | <b>Six-month<br/>period ended<br/>30 June 2006</b> | <b>Six-month<br/>period ended<br/>30 June 2005</b> |
|---|--|--|
| <b>Dividends payable at 1 January</b>         | 2,400  | 3,474  |
| Dividends declared during the period          | 6,879  | 4,800  |
| Dividends paid during the period              | (2,702)  | (5,874)  |
| <b>Dividends payable at 30 June</b>           | <b>6,577</b>                                       | <b>2,400</b>                                       |

Dividends are declared at quarter-ends and paid in the following 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. Included in dividends declared as at 30 June 2006 are dividends declared for the first and second quarters of 2006 in the amount of AZN 3,104 and AZN 3,775, respectively.

## **25 Financial Risk Management**

The risk management function within the Group is carried out in respect of financial risks (credit, market, geographical, currency, liquidity and interest rate), operational risks and legal risks. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimise operational and legal risks.

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

The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed, in part, by obtaining collateral and corporate and personal guarantees.

The Group's maximum exposure to credit risk is primarily reflected in the carrying amounts of financial assets on the consolidated balance sheet. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

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

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**25 Financial Risk Management (Continued)**

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

**Geographical risk** The geographical concentration of the Group's assets and liabilities at 30 June 2006 is set out below.

| <i>In thousands of new Azerbaijani Manats</i>              | <b>Republic of<br/>Azerbaijan</b> | <b>OECD</b>    | <b>Non OECD</b> | <b>Total</b>       |
|--|-----------------------------------|----------------|-----------------|--------------------|
| <b>Assets</b>  |                                   |                |                 |                    |
| Cash and cash equivalents                                  | 122,455                           | 12,489         | 7,122           | 142,066            |
| Mandatory cash balances with the NBAR                      | 84,360                            | -              | 1,152           | 85,512             |
| Due from other banks                                       | 44,297                            | 251,441        | 24,771          | 320,509            |
| Loans and advances to customers                            | 626,735                           | -              | 56,477          | 683,212            |
| Investment securities available for sale                   | 128                               | -              | -               | 128                |
| Investment securities held to maturity                     | -                                 | -              | 10,367          | 10,367             |
| Investment in associates and joint ventures                | 1,409                             | -              | -               | 1,409              |
| Goodwill on acquisition of a subsidiary                    | 1,332                             | -              | -               | 1,332              |
| Premises, equipment, intangibles and investment properties | 73,903                            | -              | 8,343           | 82,246             |
| Other assets   | 11,393                            | 786            | 1,027           | 13,206             |
| Assets of disposal groups                                  | 24,939                            | -              | -               | 24,939             |
| <b>Total assets</b>  | <b>990,951</b>                    | <b>264,716</b> | <b>109,259</b>  | <b>1,364,926</b>   |
| <b>Liabilities</b>   |                                   |                |                 |                    |
| Due to other banks   | 2,355                             | 5,691          | 1,843           | 9,889              |
| Customer accounts  | 1,052,903                         | -              | 14,592          | 1,067,495          |
| Debt securities in issue                                   | 38,530                            | -              | -               | 38,530             |
| Other borrowed funds                                       | -                                 | 62,001         | 4,043           | 66,044             |
| Other liabilities  | 68,822                            | 763            | 902             | 70,487             |
| Deferred tax liability                                     | 9,879                             | -              | 673             | 10,552             |
| Liabilities of disposal group                              | 1,917                             | -              | -               | 1,917              |
| <b>Total liabilities</b>                                   | <b>1,174,406</b>                  | <b>68,455</b>  | <b>22,053</b>   | <b>1,264,914</b>   |
| <b>Net balance sheet position</b>                          | <b>(183,455)</b>                  | <b>196,261</b> | <b>87,206</b>   | <b>100,012</b>     |
| <b>Credit related commitments</b>                          | <b>(1,068,777)</b>                | <b>-</b>       | <b>(6,818)</b>  | <b>(1,075,595)</b> |

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**Notes To The Consolidated Financial Statements – 30 June 2006**

**25 Financial Risk Management (Continued)**

The geographical concentration of the Group's assets and liabilities at 31 December 2005 is set out below

| <i>In thousands of new Azerbaijani Manats</i>              | <b>Republic of<br/>Azerbaijan</b> | <b>OECD</b>      | <b>Non OECD</b> | <b>Total</b>     |
|--|-----------------------------------|------------------|-----------------|------------------|
| <b>Assets</b>  |                                   |                  |                 |                  |
| Cash and cash equivalents                                  | 200,729                           | 49,589           | 8,052           | 258,370          |
| Mandatory cash balances with the NBAR                      | 65,096                            | -                | 845             | 65,941           |
| Due from other banks                                       | 26,068                            | 8,168            | 20,100          | 54,336           |
| Loans and advances to customers                            | 661,543                           | -                | 16,927          | 678,470          |
| Investment securities available for sale                   | 128                               | -                | -               | 128              |
| Investment securities held to maturity                     | -                                 | -                | 6,550           | 6,550            |
| Investment in associates and joint ventures                | 1,363                             | -                | -               | 1,363            |
| Goodwill on acquisition of a subsidiary                    | 1,460                             | -                | -               | 1,460            |
| Premises, equipment, intangibles and investment properties | 70,114                            | -                | 8,341           | 78,455           |
| Other assets   | 5,055                             | 3,592            | 1,589           | 10,236           |
| <b>Total assets</b>  | <b>1,031,556</b>                  | <b>61,349</b>    | <b>62,404</b>   | <b>1,155,309</b> |
| <b>Liabilities</b>   |                                   |                  |                 |                  |
| Due to other banks   | 3,372                             | -                | 5,406           | 8,778            |
| Customer accounts  | 902,435                           | -                | 6,139           | 908,574          |
| Debt securities in issue                                   | 42,187                            | -                | -               | 42,187           |
| Other borrowed funds                                       | 59,951                            | -                | 2,130           | 62,081           |
| Other liabilities  | 38,733                            | -                | 1,520           | 40,253           |
| Deferred tax liability                                     | 9,169                             | -                | 764             | 9,933            |
| <b>Total liabilities</b>                                   | <b>1,055,847</b>                  | <b>-</b>         | <b>15,959</b>   | <b>1,071,806</b> |
| <b>Net balance sheet position</b>                          | <b>(24,291)</b>                   | <b>61,349</b>    | <b>46,445</b>   | <b>83,503</b>    |
| <b>Credit related commitments</b>                          | <b>(364,934)</b>                  | <b>(209,040)</b> | <b>(87,867)</b> | <b>(661,841)</b> |

Assets, liabilities and credit related commitments have generally been based on the country, in which counterparty is located. Cash on hand and premises and equipment have been allocated based on the country, in which they are physically held.

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**25 Financial Risk Management (Continued)**

**Currency risk** The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board of Directors sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily. The table below summarises the Group's exposure to foreign currency exchange rate risk at 30 June 2006.

| <i>In thousands of new Azerbaijani Manats</i>              | <b>AZN</b>      | <b>USD</b>       | <b>Euro</b>      | <b>Other</b>   | <b>Total</b>       |
|--|-----------------|------------------|------------------|----------------|--------------------|
| <b>Assets</b>  |                 |                  |                  |                |                    |
| Cash and cash equivalents                                  | 93,791          | 40,188           | 2,154            | 5,933          | 142,066            |
| Mandatory cash balances with the NBAR                      | -               | 84,360           | -                | 1,152          | 85,512             |
| Due from other banks                                       | 8,660           | 290,283          | 19,348           | 2,218          | 320,509            |
| Loans and advances to customers                            | 140,916         | 502,911          | 31,218           | 8,167          | 683,212            |
| Investment securities available for sale                   | 128             | -                | -                | -              | 128                |
| Investment securities held to maturity                     | -               | 4,598            | 5,769            | -              | 10,367             |
| Investment in associates and joint ventures                | 1,409           | -                | -                | -              | 1,409              |
| Goodwill on acquisition of a subsidiary                    | 1,332           | -                | -                | -              | 1,332              |
| Premises, equipment, intangibles and investment properties | 73,903          | -                | -                | 8,343          | 82,246             |
| Other assets   | 6,649           | 5,379            | 574              | 604            | 13,206             |
| Assets of disposal groups                                  | 24,939          | -                | -                | -              | 24,939             |
| <b>Total assets</b>  | <b>351,727</b>  | <b>927,719</b>   | <b>59,063</b>    | <b>26,417</b>  | <b>1,364,926</b>   |
| <b>Liabilities</b>   |                 |                  |                  |                |                    |
| Due to other banks   | 1,506           | 2,364            | 5,740            | 279            | 9,889              |
| Customer accounts  | 153,126         | 861,547          | 44,243           | 8,579          | 1,067,495          |
| Debt securities in issue                                   | 4               | 38,526           | -                | -              | 38,530             |
| Other borrowed funds                                       | -               | 59,375           | 6,669            | -              | 66,044             |
| Other liabilities  | 43,075          | 24,918           | 1,880            | 614            | 70,487             |
| Deferred tax liability                                     | 9,879           | -                | -                | 673            | 10,552             |
| Liabilities of disposal groups                             | 1,917           | -                | -                | -              | 1,917              |
| <b>Total liabilities</b>                                   | <b>209,507</b>  | <b>986,730</b>   | <b>58,532</b>    | <b>10,145</b>  | <b>1,264,914</b>   |
| <b>Net balance sheet position</b>                          | <b>142,220</b>  | <b>(59,011)</b>  | <b>531</b>       | <b>16,272</b>  | <b>100,012</b>     |
| <b>Credit related commitments (Note 26)</b>                | <b>(36,832)</b> | <b>(531,839)</b> | <b>(504,816)</b> | <b>(2,108)</b> | <b>(1,075,595)</b> |

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**25 Financial Risk Management (Continued)**

At 31 December 2005, the Group had the following positions in currencies

| <i>In thousands of new Azerbaijani Manats</i>              | <b>AZN</b>      | <b>USD</b>       | <b>Euro</b>      | <b>Other</b>   | <b>Total</b>     |
|--|-----------------|------------------|------------------|----------------|------------------|
| <b>Assets</b>  |                 |                  |                  |                |                  |
| Cash and cash equivalents                                  | 63,272          | 180,630          | 6,032            | 8,436          | 258,370          |
| Mandatory cash balances with the NBAR                      | -               | 65,096           | -                | 845            | 65,941           |
| Due from other banks                                       | 5,114           | 41,160           | 6,531            | 1,531          | 54,336           |
| Loans and advances to customers                            | 155,182         | 491,020          | 28,446           | 3,822          | 678,470          |
| Investment securities available for sale                   | 128             | -                | -                | -              | 128              |
| Investment securities held to maturity                     | -               | 6,550            | -                | -              | 6,550            |
| Investment in associates and joint ventures                | 1,363           | -                | -                | -              | 1,363            |
| Goodwill on acquisition of subsidiaries                    | 1,460           | -                | -                | -              | 1,460            |
| Premises, equipment, intangibles and investment properties | 70,114          | -                | -                | 8,341          | 78,455           |
| Other assets   | 6,261           | 2,821            | 630              | 524            | 10,236           |
| <b>Total assets</b>  | <b>302,894</b>  | <b>787,277</b>   | <b>41,639</b>    | <b>23,499</b>  | <b>1,155,309</b> |
| <b>Liabilities</b>   |                 |                  |                  |                |                  |
| Due to other banks   | 58              | 4,325            | 162              | 4,233          | 8,778            |
| Customer accounts  | 135,992         | 732,805          | 34,662           | 5,115          | 908,574          |
| Debt securities in issue                                   | 19              | 42,168           | -                | -              | 42,187           |
| Other borrowed funds                                       | -               | 56,528           | 5,553            | -              | 62,081           |
| Other liabilities  | 35,830          | 2,994            | 246              | 1,183          | 40,253           |
| Deferred tax liability                                     | 9,169           | -                | -                | 764            | 9,933            |
| <b>Total liabilities</b>                                   | <b>181,068</b>  | <b>838,820</b>   | <b>40,623</b>    | <b>11,295</b>  | <b>1,071,806</b> |
| <b>Net balance sheet position</b>                          | <b>121,826</b>  | <b>(51,543)</b>  | <b>1,016</b>     | <b>12,204</b>  | <b>83,503</b>    |
| <b>Credit related commitments (Note 26)</b>                | <b>(14,636)</b> | <b>(534,187)</b> | <b>(111,087)</b> | <b>(1,931)</b> | <b>(661,841)</b> |

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

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

The table below shows assets and liabilities at 30 June 2006 by their remaining contractual maturity, unless there is evidence that any of the assets are impaired and will be settled after their contractual maturity dates, in which case the expected date of settlement of the assets is used. Some of the assets and liabilities, however, may be of a longer-term nature, for example, loans are frequently renewed and accordingly short term loans can have a longer term duration.

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**25 Financial Risk Management (Continued)**

Overdue liabilities, such as term deposits not withdrawn by the Group's customers, are classified within the "demand and less than 1 month" column. Overdue assets are allocated based on their expected maturity [The entire portfolio of trading securities is classified within demand and less than one month based on management's assessment of portfolio's realisability and their view that it is a fairer portrayal of the Group's liquidity position]. Certain assets, for example available for sale equity securities and non-current assets held for sale (or disposal groups), are assumed to mature on the expected date on which the assets will be realised. Mandatory cash balances with the NBAR are included within demand and less than one month as the requirement is to maintain as a reserve a specified percentage of certain liabilities which are also included within this category.

The liquidity position of the Group at 30 June 2006 is set out below

| <i>In thousands of new Azerbaijani Manats</i>              | <b>Demand and less than 1 month</b> | <b>From 1 to 6 months</b> | <b>From 6 to 12 months</b> | <b>Over 12 months</b> | <b>Overdue/ No stated maturity</b> | <b>Total</b>     |
|--|-------------------------------------|---------------------------|----------------------------|-----------------------|------------------------------------|------------------|
| <b>Assets</b>  |                                     |                           |                            |                       |                                    |                  |
| Cash and cash equivalents                                  | 142,066                             | -                         | -                          | -                     | -                                  | 142,066          |
| Mandatory cash balances with the NBAR                      | 85,512                              | -                         | -                          | -                     | -                                  | 85,512           |
| Due from other banks                                       | 243,298                             | 60,177                    | 10,387                     | -                     | 6,647                              | 320,509          |
| Loans and advances to customers                            | 31,654                              | 215,377                   | 199,417                    | 174,557               | 62,207                             | 683,212          |
| Investment securities available for sale                   | 128                                 | -                         | -                          | -                     | -                                  | 128              |
| Investment securities held to maturity                     | -                                   | 10,367                    | -                          | -                     | -                                  | 10,367           |
| Investment in associates and joint ventures                | -                                   | -                         | -                          | -                     | 1,409                              | 1,409            |
| Goodwill on acquisition of a subsidiary                    | -                                   | -                         | -                          | -                     | 1,332                              | 1,332            |
| Premises, equipment, intangibles and investment properties | -                                   | -                         | -                          | -                     | 82,246                             | 82,246           |
| Other assets   | 6,108                               | 1,671                     | 4,958                      | 338                   | 131                                | 13,206           |
| Assets of disposal groups                                  | -                                   | 24,939                    | -                          | -                     | -                                  | 24,939           |
| <b>Total assets</b>  | <b>508,766</b>                      | <b>312,531</b>            | <b>214,762</b>             | <b>174,895</b>        | <b>153,972</b>                     | <b>1,364,926</b> |
| <b>Liabilities</b>   |                                     |                           |                            |                       |                                    |                  |
| Due to other banks   | 3,957                               | 5,735                     | 197                        | -                     | -                                  | 9,889            |
| Customer accounts  | 645,840                             | 41,516                    | 332,762                    | 47,377                | -                                  | 1,067,495        |
| Debt securities in issue                                   | 119                                 | -                         | -                          | 38,411                | -                                  | 38,530           |
| Other borrowed funds                                       | 51,499                              | -                         | -                          | 14,545                | -                                  | 66,044           |
| Other liabilities  | 53,853                              | 12,631                    | 3,482                      | 66                    | 455                                | 70,487           |
| Deferred tax liability                                     | -                                   | -                         | -                          | 10,552                | -                                  | 10,552           |
| Liabilities of disposal groups                             | -                                   | 1,917                     | -                          | -                     | -                                  | 1,917            |
| <b>Total liabilities</b>                                   | <b>755,268</b>                      | <b>61,799</b>             | <b>336,441</b>             | <b>110,951</b>        | <b>455</b>                         | <b>1,264,914</b> |
| <b>Net liquidity gap</b>                                   | <b>(246,502)</b>                    | <b>250,732</b>            | <b>(121,679)</b>           | <b>63,944</b>         | <b>153,517</b>                     | <b>100,012</b>   |
| <b>Cumulative liquidity gap at 30 June 2006</b>            | <b>(246,502)</b>                    | <b>4,230</b>              | <b>(117,449)</b>           | <b>(53,505)</b>       | <b>100,012</b>                     |                  |

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**25 Financial Risk Management (Continued)**

The liquidity position of the Group at 31 December 2005 is set out below

| <i>In thousands of new Azerbaijani Manats</i>                 | <b>Demand<br/>and less<br/>than<br/>1 month</b> | <b>From 1 to<br/>6 months</b> | <b>From 6 to<br/>12 months</b> | <b>Over<br/>12 months</b> | <b>Overdue/<br/>No stated<br/>maturity</b> | <b>Total</b>     |
|---|---|-------------------------------|--------------------------------|---------------------------|--|------------------|
| <b>Assets</b>   |   |                               |                                |                           |  |                  |
| Cash and cash equivalents                                     | 258,370   | -                             | -                              | -                         | -  | 258,370          |
| Mandatory cash balances with the NBAR                         | 65,941  | -                             | -                              | -                         | -  | 65,941           |
| Due from other banks  | 20,484  | 6,059                         | 16,708                         | 11,085                    | -  | 54,336           |
| Loans and advances to customers                               | 75,989  | 56,652                        | 209,444                        | 263,925                   | 72,460                                     | 678,470          |
| Investment securities available for sale                      | 128   | -                             | -                              | -                         | -  | 128              |
| Investment securities held to maturity                        | -   | 6,550                         | -                              | -                         | -  | 6,550            |
| Investment in associates and joint ventures                   | -   | -                             | -                              | -                         | 1,363                                      | 1,363            |
| Goodwill on acquisition of a subsidiary                       | -   | -                             | -                              | -                         | 1,460                                      | 1,460            |
| Premises, equipment, intangibles and<br>investment properties | -   | -                             | -                              | -                         | 78,455                                     | 78,455           |
| Other assets  | 3,478   | 4,121                         | 867                            | -                         | 1,770                                      | 10,236           |
| <b>Total assets</b>   | <b>424,390</b>                                  | <b>73,382</b>                 | <b>227,019</b>                 | <b>275,010</b>            | <b>155,508</b>                             | <b>1,155,309</b> |
| <b>Liabilities</b>  |   |                               |                                |                           |  |                  |
| Due to other banks  | 8,534   | 161                           | 83                             | -                         | -  | 8,778            |
| Customer accounts   | 473,669   | 46,261                        | 30,885                         | 357,759                   | -  | 908,574          |
| Debt securities in issue                                      | 843   | -                             | -                              | 41,344                    | -  | 42,187           |
| Other borrowed funds  | 7,135   | -                             | 52,348                         | 2,598                     | -  | 62,081           |
| Other liabilities   | 31,473  | 2,113                         | 982                            | -                         | 5,685                                      | 40,253           |
| Deferred tax liability  | -   | -                             | -                              | 9,933                     | -  | 9,933            |
| <b>Total liabilities</b>                                      | <b>521,654</b>                                  | <b>48,535</b>                 | <b>84,298</b>                  | <b>411,634</b>            | <b>5,685</b>                               | <b>1,071,806</b> |
| <b>Net liquidity gap</b>                                      | <b>(97,264)</b>                                 | <b>24,847</b>                 | <b>142,721</b>                 | <b>(136,624)</b>          | <b>149,823</b>                             | <b>83,503</b>    |
| <b>Cumulative liquidity gap at<br/>31 December 2005</b>       | <b>(97,264)</b>                                 | <b>(72,417)</b>               | <b>70,304</b>                  | <b>(66,320)</b>           | <b>83,503</b>                              |                  |

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

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

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



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**25 Financial Risk Management (Continued)**

Customer accounts are classified in the above analysis based on contractual maturities. However, in accordance with Azerbaijani Civil Code, individuals have a right to withdraw their deposits prior to maturity if they forfeit their right to 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.

**Interest rate risk** The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The table below summarises the Group's exposure to interest rate risks at 30 June 2006. Included in the table are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

| <i>In thousands of new Azerbaijani Manats</i>                 | <b>Demand and<br/>less than<br/>1 month</b> | <b>From 1 to<br/>6 months</b> | <b>From 6 to<br/>12 months</b> | <b>More than<br/>1 year</b> | <b>Non-<br/>monetary</b> | <b>Total</b>     |
|---|---|-------------------------------|--------------------------------|-----------------------------|--------------------------|------------------|
| <b>Assets</b>   |   |                               |                                |                             |                          |                  |
| Cash and cash equivalents                                     | 142,066                                     | -                             | -                              | -                           | -                        | 142,066          |
| Mandatory cash balances with the NBAR                         | 85,512                                      | -                             | -                              | -                           | -                        | 85,512           |
| Due from other banks  | 241,882                                     | 60,178                        | 17,034                         | -                           | 1,415                    | 320,509          |
| Loans and advances to customers                               | 93,860                                      | 215,377                       | 199,417                        | 174,558                     | -                        | 683,212          |
| Investment securities available for sale                      | -   | -                             | -                              | -                           | 128                      | 128              |
| Investment securities held to maturity                        | -   | 10,367                        | -                              | -                           | -                        | 10,367           |
| Investment in associates and joint ventures                   | -   | -                             | -                              | -                           | 1,409                    | 1,409            |
| Goodwill on acquisition of a subsidiary                       | -   | -                             | -                              | -                           | 1,332                    | 1,332            |
| Premises, equipment, intangibles and<br>investment properties | -   | -                             | -                              | -                           | 82,246                   | 82,246           |
| Other assets  | -   | -                             | -                              | -                           | 13,206                   | 13,206           |
| Assets of disposal groups                                     | -   | -                             | -                              | -                           | 24,939                   | 24,939           |
| <b>Total assets</b>   | <b>563,320</b>                              | <b>285,922</b>                | <b>216,451</b>                 | <b>174,558</b>              | <b>124,675</b>           | <b>1,364,926</b> |
| <b>Liabilities</b>  |   |                               |                                |                             |                          |                  |
| Due to other banks  | 3,138                                       | 5,691                         | -                              | -                           | 1,060                    | 9,889            |
| Customer accounts   | 645,840                                     | 41,516                        | 332,762                        | 47,377                      | -                        | 1,067,495        |
| Debt securities in issue                                      | 119   | -                             | -                              | 38,411                      | -                        | 38,530           |
| Other borrowed funds  | 65,772                                      | -                             | -                              | 272                         | -                        | 66,044           |
| Other liabilities   | -   | -                             | -                              | -                           | 70,487                   | 70,487           |
| Deferred tax liability  | -   | -                             | -                              | -                           | 10,552                   | 10,552           |
| Liabilities of disposal groups                                | -   | -                             | -                              | -                           | 1,917                    | 1,917            |
| <b>Total liabilities</b>                                      | <b>714,869</b>                              | <b>47,207</b>                 | <b>332,762</b>                 | <b>86,060</b>               | <b>84,016</b>            | <b>1,264,914</b> |
| <b>Net sensitivity gap</b>                                    | <b>(151,549)</b>                            | <b>238,715</b>                | <b>(116,311)</b>               | <b>88,498</b>               | <b>40,659</b>            | <b>100,012</b>   |
| <b>Cumulative sensitivity gap at<br/>30 June 2006</b>         | <b>(151,549)</b>                            | <b>87,166</b>                 | <b>(29,145)</b>                | <b>59,353</b>               | <b>100,012</b>           |                  |

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**25 Financial Risk Management (Continued)**

The following table summarises the Group's exposure to interest rate risks at 31 December 2005 by showing assets and liabilities in categories based on the earlier of contractual repricing or maturity dates

|   | Demand<br>and less<br>than<br>1 month | From 1 to<br>6 months | From 6 to<br>12 months | More than<br>1 year | Non-<br>monetary | Total            |
|---|---------------------------------------|-----------------------|------------------------|---------------------|------------------|------------------|
| <i>In thousands of new Azerbaijani Manats</i>                 |                                       |                       |                        |                     |                  |                  |
| <b>Assets</b>   |                                       |                       |                        |                     |                  |                  |
| Cash and cash equivalents                                     | 258,370                               | -                     | -                      | -                   | -                | 258,370          |
| Mandatory cash balances with the<br>NBAR                      | 65,941                                | -                     | -                      | -                   | -                | 65,941           |
| Due from other banks  | 20,484                                | 6,059                 | 16,708                 | 11,085              | -                | 54,336           |
| Loans and advances to customers                               | 148,449                               | 56,652                | 209,444                | 263,925             | -                | 678,470          |
| Investment securities available for sale                      | 128                                   | -                     | -                      | -                   | -                | 128              |
| Investment securities held to maturity                        | -                                     | 6,550                 | -                      | -                   | -                | 6,550            |
| Investment in associates and joint ventures                   | -                                     | -                     | -                      | -                   | 1,363            | 1,363            |
| Goodwill on acquisition of a subsidiary                       | -                                     | -                     | -                      | -                   | 1,460            | 1,460            |
| Premises, equipment, intangibles and<br>investment properties | -                                     | -                     | -                      | -                   | 78,455           | 78,455           |
| Other assets  | -                                     | -                     | -                      | -                   | 10,236           | 10,236           |
| <b>Total assets</b>   | <b>493,372</b>                        | <b>69,261</b>         | <b>226,152</b>         | <b>275,010</b>      | <b>91,514</b>    | <b>1,155,309</b> |
| <b>Liabilities</b>  |                                       |                       |                        |                     |                  |                  |
| Due to other banks  | 2,025                                 | 2,491                 | 4,262                  | -                   | -                | 8,778            |
| Customer accounts   | 473,669                               | 46,261                | 30,885                 | 357,759             | -                | 908,574          |
| Debt securities in issue                                      | 843                                   | -                     | -                      | 41,344              | -                | 42,187           |
| Other borrowed funds  | -                                     | 62,081                | -                      | -                   | -                | 62,081           |
| Other liabilities   | -                                     | -                     | -                      | -                   | 40,253           | 40,253           |
| Deferred tax liability  | -                                     | -                     | -                      | -                   | 9,933            | 9,933            |
| <b>Total liabilities</b>                                      | <b>476,537</b>                        | <b>110,833</b>        | <b>35,147</b>          | <b>399,103</b>      | <b>50,186</b>    | <b>1,071,806</b> |
| <b>Net sensitivity gap</b>                                    | <b>16,835</b>                         | <b>(41,572)</b>       | <b>191,005</b>         | <b>(124,093)</b>    | <b>41,328</b>    | <b>83,503</b>    |
| <b>Cumulative sensitivity gap at<br/>31 December 2005</b>     | <b>16,835</b>                         | <b>(24,737)</b>       | <b>166,268</b>         | <b>42,175</b>       | <b>83,503</b>    |                  |

The Group is exposed to cash flow interest rate risk, principally through assets and liabilities for which interest rates are reset as market rates change. Such assets and liabilities are primarily presented in the above table as being re-priced in the short-term. The Group is exposed to fair value interest rate risk as a result of assets and liabilities at fixed interest rates, these are primarily presented in the above table as being re-priced in the long-term. In practice, interest rates that are contractually fixed on both assets and liabilities are usually renegotiated to reflect current market conditions.

The Board of Directors monitors on a daily basis and sets limits on the level of mismatch of interest rate repricing that may be undertaken. In the absence of any available hedging instruments, the Group normally seeks to match its interest rate positions.

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**25 Financial Risk Management (Continued)**

The table below summarises the effective interest rates by major currencies for major debt instruments. The analysis has been prepared based on period-end effective rates used for amortisation of the respective assets/liabilities.

| <i>In % p a</i>                        | 30 June 2006 |      |      |       | 31 December 2005 |      |      |       |
|--|--------------|------|------|-------|------------------|------|------|-------|
|  | USD          | AZN  | Euro | Other | USD              | AZN  | Euro | Other |
| <b>Assets</b>                          |              |      |      |       |                  |      |      |       |
| Cash and cash equivalents              | 3.6          | -    | -    | -     | 3.1              | -    | -    | -     |
| Due from resident banks                | 13.3         | 9.0  | -    | -     | 13.0             | -    | -    | -     |
| Due from non resident banks            | 2.5          | -    | 2.4  | -     | 2.2              | -    | 2.2  | -     |
| Loans and advances to customers        |              |      |      |       |                  |      |      |       |
| – individuals                          | 18.7         | 16.9 | 14.2 | -     | 20.9             | 18.7 | 18.1 | -     |
| Loans and advances to customers        |              |      |      |       |                  |      |      |       |
| – corporate                            | 14.2         | 14.2 | 8.0  | 14.0  | 15.8             | 11.1 | 16.1 | 15.2  |
| Investment securities held to maturity | 4.5          | -    | -    | -     | 4.3              | -    | -    | -     |
| <b>Liabilities</b>                     |              |      |      |       |                  |      |      |       |
| Customer accounts – corporate          | 0.6          | 5.2  | 1.6  | 6.0   | 0.6              | 5.5  | 1.9  | 6.0   |
| Customer accounts – individuals        | 10.7         | 10.2 | 8.6  | 8.0   | 8.9              | 9.4  | 8.4  | -     |
| Due to other banks                     | -            | -    | 4.0  | -     | -                | -    | -    | -     |
| Debt securities in issue               |              |      |      |       | 9.0              | 9.0  | -    | -     |
| Other borrowed funds                   | 6.0          | -    | 9.0  | -     | 6.9              | -    | 9.0  | -     |

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

**26 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 both internal and external professional advice the 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 as at 31 June 2006 and 31 December 2005 respectively.

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

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

The Group’s Management believes that its interpretation of the relevant legislation is appropriate and the Group’s tax, currency and customs positions will be sustained. Accordingly, as at 30 June 2006 no provision for potential tax liabilities had been recorded (31 December 2005: no provision).

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**26 Contingencies and Commitments (Continued)**

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

**Capital expenditure commitments.** As at 30 June 2006 and 31 December 2005 the Group had no significant capital commitments

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

| <i>In thousands of new Azerbaijani Manats</i> | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|---|-------------------------|-----------------------------|
| Not later than 1 year                         | 210                     | 150                         |
| Later than 1 year and not later than 5 years  | 116                     | 160                         |
| Later than 5 years                            | 559                     | 580                         |
| <b>Total operating lease commitments</b>      | <b>885</b>              | <b>890</b>                  |

**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

| <i>In thousands of new Azerbaijani Manats</i>  | <b>30 June<br/>2006</b> | <b>31 December<br/>2005</b> |
|--|-------------------------|-----------------------------|
| Export letters of credit   | 437,543                 | 274,043                     |
| Import letters of credit   | 433,709                 | 245,622                     |
| Guarantees issued  | 183,189                 | 120,192                     |
| Commitments to extend credit and un-drawn credit lines   | 21,154                  | 22,863                      |
| Promissory notes issued by the Group, guaranteed by the Government of the Republic of Azerbaijan and provided to the Eximbank (Turkey) against credit facilities as collateral | -                       | -                           |
| <b>Total credit related commitments</b>  | <b>1,075,595</b>        | <b>662,720</b>              |

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. Fair value of credit related commitments was AZN 1,075,595 thousand at 30 June 2006 (31 December 2005: AZN 662,720 thousand).

Additional provision of AZN 6,239 for losses in relation to uncovered letters of credit, letters of guarantees and undrawn credits issued by the Group has been recorded in the consolidated statement of income for the six-month period ended 30 June 2006 (six-month period ended 30 June 2005: AZN 91 thousand). Refer to Notes 18 and 22.

**26 Contingencies and Commitments (continued)**

Of the total export letters of credit as at 30 June 2006, those in the amount of AZN 422,872 thousand (31 December 2005 AZN 202,620 thousand) were issued by foreign banks for exports by the Azerbaijani state organisations related to the oil industry. All export letters of credit are covered by guarantees of foreign banks, and the Group does not bear any credit risk in relation to these export letters of credit.

As at 30 June 2006 credit related commitments in the amount of AZN 82,122 thousand (31 December 2005 AZN 68,486 thousand) are secured by the Azerbaijan government guarantees or blocked customer deposits. Refer to Note 15.

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

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

On 15 June 2004 the Group signed a credit agreement where 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 of Commerzbank AG for a credit line of USD 7,638 thousand (31 December 2005 USD 19,638) 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. As at 30 June 2006 an import letter of credit in the amount of USD 9,497 thousand or AZN 8,506 thousand (31 December 2005 USD 6,645 thousand or AZN 6,103 thousand) has been issued by the Group for this borrower under the above credit facility.

**Intermediary loans.** As at 30 June 2006 the Group has borrowed funds amounting to AZN 30,593 thousand (31 December 2005 AZN 35,294 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 30 June 2006 to AZN 30,593 thousand (31 December 2005 AZN 35,294 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:

| <i>In thousands of new Azerbaijani Manats</i>  | <b>30 June 2006</b> | <b>31 December 2005</b> |
|--|---------------------|-------------------------|
| Export Credit Bank of Turkey (Eximbank)<br>- Trade finance facility  | 30,593              | 35,294                  |
| <b>Total funds borrowed for the purposes of providing intermediary loans and transferred to off-balance sheet accounts</b> | <b>30,593</b>       | <b>35,294</b>           |

## **27 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 on the consolidated balance sheet at their fair value. Cash and cash equivalents are carried at amortised cost which approximates current fair value.

Fair values were determined based on quoted market prices except for certain investment securities available for sale for which there were no available external independent market price quotations. These securities have been fair valued by the Group on the basis of results of recent sales of equity interests in the investees between unrelated third parties, consideration of other relevant information such as discounted cash flows and financial data of the investees and application of other valuation methodologies. Valuation techniques required certain assumptions that were not supported by observable market data. Changing any such used assumptions to a reasonably possible alternative would not result in a significantly different profit, income, total assets or total liabilities.

**Investment securities held to maturity** Fair value for investment securities held to maturity is based on quoted market prices.

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

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

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

**Loans originated carried at amortised cost less provision for impairment.** The fair value of floating rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Refer to Notes 7 and 8 for the estimated fair values of due from other banks and loans and advances to customers, respectively.

**Liabilities carried at amortised cost.** The fair value of instruments with a quoted market price is based on quoted market prices. The estimated fair value of instruments with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest rate instruments without a quoted market price is based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Refer to Notes 14, 15, 16 and 17 for the estimated fair values of due to other banks, customer accounts, debt securities in issue and other borrowed funds, respectively.

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**28 Related Party Transactions**

For the purposes of these consolidated financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 "Related Party Disclosures". In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

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

The outstanding balances of the transactions of the Group as at 31 December 2005 and 31 December 2004 with related parties are, as follows:

|  | 30 June 2006                |  |        |
|--|-----------------------------|--|--------|
|  | Shareholders and management | Government bodies and state-owned entities | Other* |
| <i>In thousands of new Azerbaijani Manats</i>                                |                             |  |        |
| <b>Cash and cash equivalents</b>   | 4,478                       | 58,013                                     | -      |
| Mandatory balances with NBAR   | -                           | 85,512                                     | -      |
| <b>Loans and advances to customers</b>                                       |                             |  | -      |
| Loans and advances as at the period end                                      | -                           | 283,892                                    | -      |
| Provision for impairment of loans and advances to customers as at period end | -                           | (35,194)                                   | -      |
| Interest income for the period   | -                           | 2,802                                      | -      |
| <b>Due from other banks</b>  |                             | -  | -      |
| Term placements with resident banks  | 10,446                      | -  | -      |
| Provision for impairment of due from banks as at period end                  | (1,105)                     | -  | -      |
| Interest income on due from other banks                                      | 23                          | -  | -      |
| <b>Other Assets</b>  | -                           | -  | 88     |
| <b>Due to other banks</b>  |                             | -  | -      |
| Corresponding accounts of other banks as at period end                       | 622                         | -  | -      |
| <b>Customer accounts</b>   |                             |  |        |
| Current/settlements accounts as at period end                                | 9                           | 326,153                                    | 103    |
| Term deposits outstanding as at the period end                               | 14                          | 301,985                                    | -      |
| Interest expense for the period  | -                           | 50   | -      |
| <b>Other Liabilities</b>   | 6,577                       | 24,063                                     | -      |
| <b>Credit related commitments</b>  |                             |  |        |
| Letters of guarantees as at period end                                       | -                           | 27,646                                     | -      |
| <b>Fee and commission income for the period</b>                              | -                           | 2,675                                      | -      |
| <b>Other expense</b>   |                             |  |        |
| Staff costs  | (279)                       | -  | -      |
| Other operating expenses   | -                           | -  | (280)  |
| <b>Insurance operations</b>  |                             |  |        |
| Insurance premiums receivable  | -                           | -  | -      |
| Insurance premiums payable   | -                           | -  | -      |
| Insurance premiums written during the period                                 | -                           | -  | -      |
| Insurance premiums ceded during the period                                   | -                           | -  | -      |
| Insurance related commission income  | -                           | -  | -      |
| Insurance related commission expense   | -                           | -  | -      |

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

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**28 Related Party Transactions (Continued)**

|   | 31 December 2005            |  |         |
|---|-----------------------------|--|---------|
|   | Shareholders and management | Government bodies and state-owned entities | Other*  |
| <i>In thousands of new Azerbaijani Manats</i>                                 |                             |  |         |
| <b>Cash and cash equivalents</b>  | 299                         | 155,683                                    | -       |
| Mandatory balances with NBAR  | -                           | 65,096                                     | -       |
| <b>Loans and advances to customers</b>  |                             |  |         |
| Loans and advances as at the period-end                                       | -                           | 350,078                                    | -       |
| Provision for impairment of loans and advances to customers as at period-end  | -                           | (26,591)                                   | -       |
| Interest income for the period  | -                           | 4,723                                      | -       |
| <b>Due from other banks</b>   |                             |  |         |
| Term placements with resident banks (contractual interest rates 2004 7%- 18%) | 8,661                       | -  | -       |
| Provision for impairment of due from banks as at period-end                   | (556)                       | -  | -       |
| Interest income on due from other banks                                       | 3                           | -  | -       |
| <b>Other Assets</b>   | -                           | 1  | 71      |
| <b>Due to other banks</b>   |                             |  |         |
| Corresponding accounts of other banks as at period-end                        | 1,083                       | -  | -       |
| <b>Customer accounts</b>  |                             |  |         |
| Current/settlements accounts as at period-end                                 | 69                          | 241,317                                    | 111     |
| Term deposits outstanding as at the period-end                                | 14                          | 320,568                                    | -       |
| Interest expense for the period   | 1                           | 60   | -       |
| <b>Other Liabilities</b>  | 2,400                       | 26,285                                     | -       |
| <b>Credit related commitments</b>   |                             |  |         |
| Letters of guarantees as at period-end  | 37                          | 66,338                                     | -       |
| <b>Fee and commission income for the period</b>                               | -                           | 4,219                                      | -       |
| <b>Other expense</b>  |                             |  |         |
| Staff costs   | (351)                       | -  | -       |
| Other operating expenses  | -                           | -  | (1,230) |
| <b>Insurance operations</b>   |                             |  |         |
| Insurance premiums receivable   | 124                         | -  | -       |
| Insurance premiums payable  | -                           | -  | -       |
| Insurance premiums written during the period                                  | 356                         | -  | -       |
| Insurance premiums ceded during the period                                    | 3                           | -  | -       |
| Insurance related commission income   | -                           | -  | -       |
| Insurance related commission expense  | -                           | -  | -       |

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

During the six month period ended 30 June 2006 the total remuneration of members of the Board of Directors and key management personnel of the Group including discretionary compensation amounted to AZN 279 thousand (six months in 2005 AZN 264 thousand)

As at 30 June 2006 the Group's employees hold 5.74% of the total share capital of the Group, which amounts to AZN 2,298 thousand (31 December 2005 4.71% and AZN 1,169 thousand respectively)

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 transactions



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**29 Principal Subsidiaries, Associates and Joint Ventures**

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

| Name                               | Subsidiary/<br>associate | Nature of<br>business | Country of<br>Registration | Percentage of<br>ownership |                     |
|------------------------------------|--------------------------|-----------------------|----------------------------|----------------------------|---------------------|
|                                    |                          |                       |                            | 30 June<br>2006            | 31 December<br>2005 |
| Baku Inter-Bank Currency Exchange  | Associate                | Currency              | Republic of Azerbaijan     | 20 0                       | 20 0                |
| Trans-service                      | Joint                    | Parking               | Republic of Azerbaijan     | 50 0                       | 50 0                |
| IBAR Moscow                        | Subsidiary               | Banking               | Russian Federation         | 100 0                      | 100 0               |
| International Insurance Company    | Subsidiary               | Insurance             | Republic of Azerbaijan     | 100 0                      | 100 0               |
| Inter Protect Re AG                | Subsidiary               | Reinsurance           | Switzerland                | 100 0                      | 100 0               |
| Azercard Limited                   | Subsidiary               | Plastic cards         | Republic of Azerbaijan     | 100 0                      | 100 0               |
| Azerleasing                        | Held for sale            | Leasing               | Republic of Azerbaijan     | 100 0                      | 100 0               |
| "Inter" Professional football club | Held for sale            | Professional sports   | Republic of Azerbaijan     | 100 0                      | 100 0               |

The financial statements of Trans-service were included in the consolidated financial statements of the Group as investment in joint venture as at 31 December 2003 for the first time, using equity accounting method. Net share of losses of Trans-service accumulated prior to 1 January 2003 totalling AZN 137 thousand has been recorded as part of other movements in the consolidated statement of shareholders equity of the Group for year ended 31 December 2003. Refer to Note 10.

On 7 October 2002 the Group's Insurance Subsidiary, International Insurance Company, has established a reinsurance company, Inter Protect Re AG. It was registered in Zurich, Switzerland. The Insurance Subsidiary of the Group transferred CHF 1,450 thousand or AZN 927 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 capital reserves of the company.

The financial statements of Azerleasing, the Group's leasing subsidiary, were included in the consolidated financial statements of the Group for the first time as at 31 December 2003. The accumulated losses of Azerleasing prior to 1 January 2003 totaling AZN 275 thousand were recorded as part of other movements in the consolidated statement of shareholders equity of the Group for the year ended 31 December 2003.

On 20 July 2004 "Inter" professional football club was established and registered with the Ministry of Justice of the Republic of Azerbaijan. In accordance with the foundation agreement signed between the Bank and Azercard Limited the charter capital of the professional football club was set at AZN 402 thousand, of which AZN 300 thousand was contributed by the Bank and the remaining AZN 102 thousand by Azercard Limited. This club is a member of the Azerbaijan Football Federations Association and is currently among the top five professional football clubs in the country as per the preliminary results of the national football tournament. During the six-month period ended 30 June 2006 the Bank provided financial aid to "Inter" in the amount of AZN 4,500 thousand (2005: AZN 4,500 thousand) and Azercard Limited in the amount of AZN 320 thousand (2005: AZN 320 thousand), respectively. As at 31 December 2004 financial statements of "Inter" professional football club were included in consolidated financial statements of the Group as a fully owned subsidiary of the Bank for the first time.

During the subsequent period the Group has sold its interest in 2 of its subsidiaries including "Inter" and "Azerleasing".

On 25 July 2006 the Group sold 100% of its interest in "Inter" professional football club to a local company at an arms-length transaction with a total consideration of AZN 540 thousand.

On 19 September 2006 the Group signed an agreement with a British leasing company on the sale of 52.4% of its interest in "Azerleasing" with a total consideration of AZN 24,170 thousand. The management of the Group believes that terms and references of this contract constitute with those of an ordinary arms-length contract with unrelated parties.

The comparison between net carrying amount of disposal groups and their fair value of net assets as at 30 June 2006 is provided below:

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**29 Principal Subsidiaries, Associates and Joint Ventures (Continued)**

Carrying amount after classification as held for sale

| <i>In thousands of new Azerbaijani Manats</i> | <b>Note</b> | <b>Disposal group I<br/>Inter FC</b> | <b>Disposal group II<br/>Azerileasing</b> | <b>Total</b>   |
|---|-------------|--------------------------------------|---|----------------|
| Property, plant and equipment                 |             | 525                                  | 24  | 549            |
| Leasing receivables                           |             | -                                    | 16,304                                    | 16,304         |
| Prepayments                                   |             | 1,247                                | 6,344                                     | 7,591          |
| Deferred tax asset                            | 23          | -                                    | 455                                       | 455            |
| Other assets                                  |             | 39                                   | 1   | 40             |
| <b>Total assets of disposal groups</b>        |             | <b>1,811</b>                         | <b>23,128</b>                             | <b>24,939</b>  |
| Liabilities to third parties                  |             | (1,315)                              | (563)                                     | (1,878)        |
| Deferred tax liability                        | 23          | (39)                                 | -   | (39)           |
| <b>Total liabilities of disposal groups</b>   |             | <b>(1,354)</b>                       | <b>(563)</b>                              | <b>(1,917)</b> |
| <b>Net carrying amount of disposal groups</b> |             | <b>457</b>                           | <b>22,565</b>                             | <b>23,022</b>  |

Fair value of net assets of the disposal groups

|  | <b>Disposal group I<br/>Inter FC</b> | <b>Disposal group II<br/>Azerileasing</b> |
|--|--------------------------------------|---|
| Immediate consideration                                  | 448                                  | 367                                       |
| Deferred consideration                                   | 92                                   | 23,803                                    |
| <b>Total fair value of net assets of disposal groups</b> | <b>540</b>                           | <b>24,170</b>                             |

In both cases, net carrying amounts of disposal groups are lower than the total fair value of net assets of disposal groups. Therefore, these disposal groups are recorded at their net carrying amount yielding no impairment loss as at 30 June 2006.

**30 Subsequent Events**

During the subsequent period the Group has sold its interest in two of its subsidiaries including "Inter" and "Azerileasing".

On 25 July 2006 the Group sold 100% of its interest in "Inter" professional football club to a local company at an arms-length transaction. Refer to Note 29.

On 19 September 2006 the Group signed an agreement with a British leasing company on the sale of 52.4% of its interest in "Azerileasing". The management of the Group believes that terms and references of this contract constitute with those of an ordinary arms-length contract with unrelated parties. Refer to Note 29.