FC 24891

# The International Bank of the Republic of Azerbaijan

## International Financial Reporting Standards Consolidated Condensed Interim Financial Information and Auditor's Report

## 30 June 2008

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# INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying condensed consolidated interim financial information of the International Bank of the Republic of Azerbaijan and its subsidiaries (the "Group") which comprise the consolidated balance sheet as at 30 June 2008 and the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cash flows for the six-month period then ended and a summary of significant accounting policies and other explanatory notes

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of this consolidated condensed interim financial information in accordance with International Accounting Standard 34 "Interim Financial Reporting" This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error, selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances

*Auditor's Responsibility*

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

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

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

*Opinion*

In our opinion, the accompanying condensed consolidated interim financial information is prepared, in all material respects, in accordance with International Accounting Standard 34 "Interim Financial Reporting"

PricewaterhouseCoopers Audit Azerbaijan LLC

PricewaterhouseCoopers Audit Azerbaijan LLC
Baku, Azerbaijan Republic
4 February 2009

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

| *In thousands of Azerbaijani Manats* | Note | 30 June 2008 | 31 December 2007 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and cash equivalents | 6 | 361,944 | 179,704 |
| Mandatory cash balances with the National/Central banks | | 160,867 | 170,347 |
| Due from other banks | 7 | 137,942 | 173,591 |
| Loans and advances to customers | 8 | 2,345,762 | 2,035,738 |
| Investment securities available for sale | 9 | 12,174 | 12,679 |
| Investment in associates | 10 | 807 | 801 |
| Deferred income tax asset | | 1,466 | 1,173 |
| Premises and equipment | | 137,541 | 113,023 |
| Intangible assets | | 7,398 | 7,685 |
| Other financial and insurance assets | 12 | 32,327 | 8,722 |
| Other assets | 13 | 15,723 | 8,949 |
| **TOTAL ASSETS** | | **3,213,951** | **2,712,412** |
| **LIABILITIES** | | | |
| Due to other banks | 14 | 300,350 | 147,309 |
| Customer accounts | 15 | 2,066,019 | 1,850,483 |
| Debt securities in issue | 16 | 16,295 | 16,808 |
| Other borrowed funds | 17 | 346,068 | 262,621 |
| Current income tax liability | | 1,739 | 2,199 |
| Deferred income tax liability | | 23,031 | 19,094 |
| Other financial and insurance liabilities | 18 | 66,468 | 56,134 |
| Other liabilities | 19 | 15,117 | 13,006 |
| Subordinated debt | 20 | 98,342 | 102,470 |
| **TOTAL LIABILITIES** | | **2,933,429** | **2,470,124** |
| **EQUITY** | | | |
| Share capital | 21 | 100,000 | 100,000 |
| Retained earnings | | 139,777 | 110,383 |
| Revaluation reserve for premises and equipment | | 36,204 | 27,977 |
| Cumulative translation reserve | | 2,740 | 2,377 |
| **Net assets attributable to the Bank's equity holders** | | **278,721** | **240,737** |
| Minority interest | | 1,801 | 1,551 |
| **TOTAL EQUITY** | | **280,522** | **242,288** |
| **TOTAL LIABILITIES AND EQUITY** | | **3,213,951** | **2,712,412** |

Approved for issue by the Board of Directors and signed on its behalf on 4 February 2009

Mr Jahangir Hajiyev
Chairman of the Board of Directors

Mr Rovshan Ismaylov
Chief Financial Officer

The notes set out on pages 5 to 38 form an integral part of these consolidated condensed interim financial information

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

| *In thousands of Azerbaijani Manats* | Note | Six-month period ended 30 June 2008 | Six-month period ended 30 June 2007 |
|---|---|---|---|
| Interest income | 22 | 140,696 | 84,158 |
| Interest expense | 22 | (47,957) | (26,922) |
| **Net interest income** | | **92,739** | **57,236** |
| (Provision for)/release of impairment of due from other banks | 7 | (658) | 764 |
| Provision for impairment of loans to customers | 8 | (31,716) | (12,750) |
| **Net interest income after provision for loan impairment** | | **60,365** | **45,250** |
| Fee and commission income | 23 | 48,036 | 31,509 |
| Fee and commission expense | 23 | (9,168) | (4,357) |
| Gains less losses from trading in foreign currencies | | 17,652 | 10,499 |
| Foreign exchange translation losses less gains | | (2,183) | (1,044) |
| Gross insurance premiums written | | 9,304 | 3,880 |
| Reinsurance premiums ceded | | (1,008) | (806) |
| Increase of provision for unearned premiums, net of reinsurance | | (4,649) | (683) |
| Net claims incurred | | (1,073) | (882) |
| Other income | | 119 | 126 |
| Administrative and other operating expenses | 24 | (47,226) | (40,101) |
| Share of profit of associates | 10 | 6 | 13 |
| **Profit before tax** | | **70,175** | **43,404** |
| Income tax expense | | (17,551) | (11,575) |
| **Profit for the period** | | **52,624** | **31,829** |
| **Profit is attributable to** | | | |
| Equity holders of the Bank | | 52,541 | 31,860 |
| Minority interest | | 83 | (31) |
| **Profit for the period** | | **52,624** | **31,829** |
| **Earnings per share for profit attributable to the equity holders of the Bank, basic and diluted** (expressed in AZN per share) | 25 | **0 11** | **0 09** |

The notes set out on pages 5 to 38 form an integral part of these consolidated condensed interim financial information

| *In thousands of Azerbaijani Manats* | Note | Attributable to equity holders of the Bank: Share capital | Revaluation reserve for premises | Cumulative translation reserve | Retained earnings | Total | Minority interest | Total equity |
|---|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2007** | | **59,319** | **17,444** | **1,435** | **61,512** | **139,710** | **1,528** | **141,238** |
| Premises and equipment | | | | | | | | |
| - Revaluation | | - | 18,734 | - | - | 18,734 | - | 18,734 |
| - Realised revaluation reserve | | - | (205) | - | 205 | - | - | - |
| Income tax recorded in equity | | - | (4,121) | - | - | (4,121) | - | (4,121) |
| Currency translation differences | | - | - | 455 | - | 455 | 11 | 466 |
| **Net income recognised directly in equity** | | **-** | **14,408** | **455** | **205** | **15,068** | **11** | **15,079** |
| Profit for the period | | - | - | - | 31,860 | 31,860 | (31) | 31,829 |
| **Total recognised income for the period** | | **-** | **14,408** | **455** | **32,065** | **46,928** | **(20)** | **46,908** |
| Share issue | | 22,828 | - | - | - | 22,828 | - | 22,828 |
| Dividends declared | 26 | - | - | - | (7,512) | (7,512) | - | (7,512) |
| **Balance at 30 June 2007** | | **82,147** | **31,852** | **1,890** | **86,065** | **201,954** | **1,508** | **203,462** |
| Premises and equipment | | | | | | | | |
| - Realised revaluation reserve | | - | (2,204) | - | 2,204 | - | - | - |
| Income tax recorded in equity | | - | (1,671) | - | - | (1,671) | - | (1,671) |
| Currency translation differences | | - | - | 487 | - | 487 | 53 | 540 |
| **Net income recognised directly in equity** | | **-** | **(3,875)** | **487** | **2,204** | **(1,184)** | **53** | **(1,131)** |
| Profit for the period | | - | - | - | 42,672 | 42,672 | (10) | 42,662 |
| **Total recognised income for the period** | | **-** | **(3,875)** | **487** | **44,876** | **41,488** | **43** | **41,531** |
| Share issue | | 17,853 | - | - | - | 17,853 | - | 17,853 |
| Dividends declared | 26 | - | - | - | (20,558) | (20,558) | - | (20,558) |
| **Balance at 31 December 2007** | | **100,000** | **27,977** | **2,377** | **110,383** | **240,737** | **1,551** | **242,288** |
| Premises and equipment | | | | | | | | |
| - Revaluation | 11 | - | 11,537 | - | - | 11,537 | - | 11,537 |
| - Realised revaluation reserve | | - | (772) | - | 772 | - | - | - |
| Income tax recorded in equity | | | (2,538) | - | - | (2,538) | - | (2,538) |
| Currency translation differences | | - | - | 363 | - | 363 | 167 | 530 |
| **Net income recognised directly in equity** | | **-** | **8,227** | **363** | **772** | **9,362** | **167** | **9,529** |
| Profit for the period | | - | - | - | 52,541 | 52,541 | 83 | 52,624 |
| **Total recognised income for the period** | | **-** | **8,227** | **363** | **53,313** | **61,903** | **250** | **62,153** |
| Dividends declared | 26 | - | - | - | (23,919) | (23,919) | - | (23,919) |
| **Balance at 30 June 2008** | | **100,000** | **36,204** | **2,740** | **139,777** | **278,721** | **1,801** | **280,522** |

| *In thousands of Azerbaijani Manats* | Note | Six-month period ended 30 June 2008 | Six-month period ended 30 June 2007 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Interest received | | 134,861 | 79,449 |
| Interest paid | | (40,198) | (23,680) |
| Fees and commissions received | | 50,907 | 31,509 |
| Fees and commissions paid | 23 | (9,168) | (4,357) |
| Insurance premiums received | | 3,274 | 2,315 |
| Reinsurance premiums paid | | (1,008) | (806) |
| Income received from trading in foreign currencies | | 17,652 | 10,499 |
| Other operating income received | | 119 | 126 |
| Staff costs paid | | (17,330) | (13,783) |
| Administrative and other operating expenses paid | | (22,100) | (18,496) |
| Income tax paid | | (16,904) | (10,383) |
| **Cash flows provided from operating activities before changes in operating assets and liabilities** | | **100,105** | **52,393** |
| **Changes in operating assets and liabilities** | | | |
| Net decrease/(increase) increase in mandatory cash balances with National/Central banks | | 9,480 | (11,116) |
| Cash collected on behalf of a related party | | 539,714 | - |
| Cash paid on behalf of a related party | | (539,714) | - |
| Net decrease in due from other banks | | 35,099 | 25,353 |
| Net increase in loans and advances to customers | | (334,837) | (557,172) |
| Net increase in other financial and insurance assets | | (18,732) | (3,234) |
| Net (increase)/decrease in other assets | | (3,190) | 876 |
| Net increase/(decrease) in due to other banks | | 151,933 | (126,249) |
| Net increase in customer accounts | | 209,661 | 245,345 |
| Net increase in other financial and insurance liabilities | | 5,709 | 29,535 |
| Net (decrease)/increase in other liabilities | | (760) | 3,605 |
| **Net cash provided/(used in) from operating activities** | | **154,468** | **(340,664)** |
| **Cash flows from investing activities** | | | |
| Acquisition of investment securities available for sale | | - | (12,837) |
| Acquisition of premises and equipment | | (24,487) | (11,806) |
| Acquisition of intangible assets | | (644) | (448) |
| **Net cash used in investing activities** | | **(25,131)** | **(25,091)** |
| **Cash flows from financing activities** | | | |
| Repayment of debt securities in issue | | (690) | - |
| Proceeds from other borrowed funds | | 131,470 | 137,000 |
| Repayment of other borrowed funds | | (48,622) | (1,242) |
| Proceeds from subordinated debt | | - | 86,598 |
| Issue of ordinary shares | | - | 22,828 |
| Dividends paid | 26 | (23,979) | (10,087) |
| **Net cash provided from financing activities** | | **58,179** | **235,097** |
| **Effect of exchange rate changes on cash and cash equivalents** | | **(5,276)** | **(1,235)** |
| **Net increase in cash and cash equivalents** | | **182,240** | **(131,893)** |
| Cash and cash equivalents at the beginning of the period | 6 | 179,704 | 457,382 |
| **Cash and cash equivalents at the end of the period** | 6 | **361,944** | **325,489** |

The notes set out on pages 5 to 38 form an integral part of these consolidated condensed interim financial information

## 1 Introduction

This consolidated condensed interim financial information for the six-month period ended 30 June 2008 for the International Bank of the Republic of Azerbaijan (the "Bank") and its subsidiaries (together referred to as the "Group"), have been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting"

***Principal activity.*** The International Bank of the Republic of Azerbaijan was incorporated in 1991 as a fully state-owned bank and is domiciled in the Republic of Azerbaijan On 28 October 1992, the Bank became a joint-stock commercial bank and the Ministry of Finance of the Republic of Azerbaijan ("MoF") became the major shareholder of the Bank At 30 June 2008, the MoF held 50 20% (31 December 2007 50 20%) of the total paid-in share capital of the Bank Refer to Note 21

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

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

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

Any amounts over the respective limits are not insured by the State of the Republic of Azerbaijan

The Bank has 36 branches (31 December 2007 36 branches) The Group had 1,665 employees at 30 June 2008 (31 December 2007 1,655 employees), of which 1,306 employees are employed by the Bank, 119 - by the International Insurance Company, 72 - by Azericard Limited, 150 -by the Group's fully owned banking subsidiary in the Russian Federation and 18 - by the International Bank of Azerbaijan-Georgia (31 December 2007 1,327 - employed by the Bank, 99-by International Insurance Company, 65 - by Azericard Limited, 147- by the Group's fully owned banking subsidiary in the Russian Federation and 17 - by the International Bank of Azerbaijan-Georgia)

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

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

**1 Introduction (Continued)**

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

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

On 18 June 1999, the Group established a leasing subsidiary "Azerileasing" with the charter capital of AZN 369 thousand On 29 July 2004, the Group increased the share capital of its leasing subsidiary by contributing an additional AZN 331 thousand As a result, the share capital of the leasing company was AZN 700 thousand at 30 June 2008 (31 December 2007 AZN 700 thousand)

In October 2006, the Group signed an agreement for the sale of 52 4% of its interest in the share capital of "Azerileasing" to an unrelated British based entity in an arms-length transaction Refer to Note 32 On 14 June 2007, the new charter of "Azerileasing" was registered at Ministry of Justice of Azerbaijan Republic, where the change in shareholding structure of the company was established and the legal name of the company was changed to "Joint Leasing Company" Closed Joint-Stock Company

On 16 November 2006, the Group registered its 75% owned subsidiary, International Bank of Azerbaijan Republic-Georgia ("IBAR Georgia"), in Tbilisi, Georgia The share capital of IBAR Georgia was established in the amount of 12,000,000 Georgian Laris ("GL"), with the minority interest in the amount of GL 3,000,000 paid-in equally by an Azerbaijani commercial bank and a resident individual of the Republic of Georgia IBAR Georgia started its operations under a license issued by the National Bank of Georgia ("the NBG") on 5 February 2007 IBAR Georgia's registered office is located at the following address 36 Khetagurovi str , Tbilisi, Republic of Georgia Refer to Note 32

A full list of subsidiaries, associates and joint ventures of the Group is included within this consolidated condensed interim financial information Refer to Note 32

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

67 Nizami Street,
AZ1005, Baku
Republic of Azerbaijan

***Presentation currency.*** These consolidated condensed interim financial information are presented in thousands of Azerbaijani Manats ("AZN thousands") The Azerbaijani Manat ("AZN") is the official currency of the Republic of Azerbaijan

At 30 June 2008, the principal rate of exchange used for translating foreign currency monetary balances was USD 1 = AZN 0 8116 (31 December 2007 USD 1 = AZN 0 8453)

**2 Operating Environment of the Group**

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

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

## 2 Operating Environment of the Group (Continued)

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

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

## 3 Basis of Preparation

This condensed consolidated interim financial information has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting" The principal accounting policies applied in the preparation of this consolidated condensed interim financial information are set out below These policies have been consistently applied to all the periods presented, unless otherwise stated (refer to Note 5)

This consolidated condensed interim financial information includes comparative consolidated income statement information for the six-month period ended 30 June 2007 and comparative consolidated balance sheet information as at 31 December 2007

***Going concern.*** Management have prepared this consolidated condensed interim financial information on a going concern basis In making this judgement, management have considered current intentions, the profitability of operations and access to financial resources

As set out in Note 28, the Group had a negative cumulative liquidity gap in the period up to 12 months of AZN 1,099,504 thousand (31 December 2007 a liquidity gap in the period over 12 months of AZN 506,441 thousand) While recent global events have had a significant impact on the ability to obtain new or extended term borrowings from International Financial Institutions, and where available, the cost of funding has typically increased, management are actively managing this position and as a result of the following actions believe that the Group will have access to sufficient resources in order to continue to meet all liabilities as they fall due

(i) as explained in Note 28, management have used a conservative basis in performing the maturity analysis of customer accounts and borrowing arrangements Despite of this, management does not expect that the withdrawal of the customer accounts and repayment of the borrowing facilities to be accelerated in comparison with the timing of payments as recorded in Note 28,

(ii) management have analysed the level of customer accounts including term deposits during the past years and consider that this is evidence that such amounts provide a stable funding source for the Group As such, while the liquidity position in Note 28 records the expected maturity dates when the amounts are repayable, management are confident that a substantial portion of the existing amounts will remain with the Group, and new customer accounts and term deposits will continue to be attracted, and

(iii) the Group is continuing negotiations with International Financial Institutions, both current lenders to the Bank and with other parties, with an understanding that new or amended borrowing agreements will be agreed and funding in place during the next twelve months

## 4 Accounting Policies and Critical Accounting Estimates and Judgments

The accounting policies and methods of computation applied in the presentation of this consolidated condensed interim financial information are consistent with those disclosed in the annual consolidated financial statements of the Group for the year ended 31 December 2007

Judgements made by management in the process of applying the accounting policies were consistent with the judgements disclosed in the annual consolidated financial statements for the year ended 31 December 2007 In addition to the judgements disclosed in the annual consolidated financial statements for the year ended 31 December 2007, management has considered whether gains or losses should arise on initial recognition of loans from governmental and international financial institutions and related lending The Group obtains long term financing from international financial institutions at interest rates at which such institutions ordinarily lend in emerging markets and which may be lower than rates at which the Group could source the funds from local lenders As a result of such financing, the Group is able to advance funds to specific customers at advantageous rates As the transactions are with unrelated parties, management's judgement is that these funds and the related lending are at the market interest rates and no initial recognition gains or losses should arise In making this judgement management also considered that these instruments are a separate market segment

Management has not identified any other new areas of judgement Critical estimates, as disclosed in the most recent consolidated condensed interim financial information, have not resulted in a material adjustment to the Group's assets, income or profit during the six-month period ended 30 June 2008

***Interim period measurement*** Income tax expense is recognised in this consolidated condensed interim financial information based on management's best estimate of the effective annual income tax rate expected for the full financial year Costs that occur unevenly during the financial year are anticipated or deferred in the interim period only if it would also be appropriate to anticipate or defer such costs at the end of the financial year

Certain new IFRIC interpretations became effective for the Group from 1 January 2008 as follows

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

The above IFRIC interpretations did not significantly affect the Group's consolidated condensed interim financial information

## 5 New Accounting Pronouncements

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2008 or later periods and which the Group has not early adopted

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

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

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

**5 New accounting pronouncement (Continued)**

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

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

***IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009).*** The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed Instead, goodwill will be measured as the difference at acquisition date between the fair value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired Acquisition-related costs will be accounted for separately from the business combination and, therefore, recognised as expenses rather than included in goodwill An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone The Group is currently assessing the impact of the amended standard on its consolidated financial statements

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

***IFRIC 13, Customer Loyalty Programmes (issued in June 2007; effective for annual periods beginning on or after 1 July 2008).*** IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values

***IFRIC 15, Agreements for the Construction of Real Estate (effective for annual periods beginning on or after 1 January 2009).*** The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18 It also provides criteria for determining when entities should recognise revenue on such transactions

***IFRIC 16, Hedges of a Net Investment in a Foreign Operation (effective for annual periods beginning on or after 1 October 2008).*** The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied The IFRIC allows the hedging instrument to be held by any entity or entities within a group except the foreign operation that itself is being hedged The interpretation also clarifies how the gain or loss recycled from the currency translation reserve to profit or loss is calculated on disposal of the hedged foreign operation Reporting entities will apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16

**5 New accounting pronouncement (Continued)**

***Improvements to International Financial Reporting Standards (issued in May 2008).*** In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS The amendments issued in May 2008 consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards The substantive changes relate to the following areas classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary, possibility of presentation of financial instruments held for trading as non-current under IAS 1, accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities, clarification of definition of a curtailment under IAS 19, accounting for below market interest rate government loans in accordance with IAS 20, making the definition of borrowing costs in IAS 23 consistent with the effective interest method, clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5, reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31, enhancement of disclosures required by IAS 36, clarification of accounting for advertising costs under IAS 38, amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39, introduction of accounting for investment properties under construction in accordance with IAS 40, and reduction in restrictions over manner of determining fair value of biological assets under IAS 41

Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting The Group does not expect the amendments to have any material effect on its consolidated financial statements

- ***IAS 16, Property, Plant and Equipment (and consequential amendments to IAS 7).*** Under the amended standard, entities that routinely sell assets previously held for rental are required to classify such assets as inventories from the point that the assets cease to be leased and become held for sale, while the proceeds from sale are to be recognised as revenue The rent and proceeds from sale will have to be classified as cash flows from operating activities The Group will amend its accounting policies accordingly when the amendment becomes effective on 1 January 2009
- ***IAS 20, Accounting for Government Grants and Disclosure of Government Assistance.*** The amendment requires benefits arising from government loans at below-market interest rates to be accounted for as government grants, with the benefit calculated as the difference between the proceeds and the initial fair value of the loan, net of transaction costs The amendment applies prospectively to government loans received in periods beginning on or after 1 January 2009
- ***IAS 40, Investment Property (and consequential amendments to IAS 16).*** Property that is under construction or development for future use as investment property is brought within the scope of the revised IAS 40 Where the fair value model is applied, such property is measured at fair value Where the fair value of investment property under construction is not reliably measurable, the property is measured at cost until the earlier of the date construction is completed or the date at which the fair value becomes reliably measurable The Group will amend its accounting policies accordingly and will apply the amendment prospectively from 1 January 2009

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

***Eligible Hedged Items—Amendment to IAS 39, Financial Instruments: Recognition and Measurement (effective with retrospective application for annual periods beginning on or after 1 July 2009, with earlier application permitted).*** The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations

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

**5 New accounting pronouncement (Continued)**

***IFRIC 17, Distribution of Non-Cash Assets to Owners*** (effective for annual periods beginning on or after 1 July 2009, with earlier application permitted) The amendment clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss when the entity settles the dividend payable The Group is currently assessing the impact of the new interpretation on its consolidated financial statements

***IFRS 1, First-time Adoption of International Financial Reporting Standards*** (effective from 1 July 2009 following an amendment in December 2008) The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes The Group concluded that the revised standard does not have any effect on its consolidated financial statements

## 6 Cash and Cash Equivalents

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Cash on hand | 79,804 | 73,437 |
| Cash balances with the National/Central banks (other than mandatory reserve deposits) | 30,233 | 89,668 |
| Correspondent accounts and overnight placements with other banks | | |
| - The Republic of Azerbaijan | 2,533 | 761 |
| - Other countries | 249,374 | 15,838 |
| **Total cash and cash equivalents** | **361,944** | **179,704** |

Included in cash balances with National/Central banks (other than mandatory reserve deposits) are the balances on correspondent accounts of the Bank and its subsidiaries, IBAR Moscow and IBAR Georgia, with the NBAR, CBRF and NBG amounting to AZN 21,833 thousand, AZN 7,348 thousand and AZN 1,052 thousand as at 30 June 2008 (2007 AZN 78,618 thousand, AZN 8,564 thousand and AZN 2,486 thousand), respectively

As at 30 June 2008, overnight placements with other banks include AZN 240,560 thousand placed with five foreign banks at interest rates of 2 2% to 4 7% per annum that matured in July 2008

A liquidity risk analysis of cash and cash equivalents is disclosed in Note 28 The information on related party balances is disclosed in Note 31

## 7 Due from Other Banks

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Term placements with other banks | 126,245 | 105,606 |
| Notes of the NBAR | - | 53,411 |
| Promissory notes of Russian banks | 18,408 | 20,631 |
| Debentures of resident banks | 299 | 295 |
| Less Provision for impairment | (7,010) | (6,352) |
| **Total due from other banks** | **137,942** | **173,591** |

At 30 June 2008, term placements with other banks include three short-term foreign currency denominated placements with two non-resident banks in the total amount equivalent to AZN 69,886 thousand at annual interest rates ranging between 2 75% and 4 35% and with maturities in July and October 2008 (31 December 2007 short-term foreign currency denominated placements with two non-resident banks, which amounted to equivalent of AZN 39,447 thousand with annual interest rate of 3 13% and 5 25% and with maturities in January and April 2008) Subsequent to the balance sheet date, two placements in the total amount of AZN 57,636 thousand have been repaid on initial maturity being in July 2008 and the third one amounting to AZN 12,250 thousand has been prolonged till April 2009

## 7 Due from Other Banks (Continued)

Promissory notes of Russian banks represent short-term promissory notes of commercial banks in Russia purchased by IBAR Moscow These promissory notes are denominated in Russian Roubles, bear an average interest rate of 8 22% per annum with maturities between July and August 2008 Subsequent to the balance sheet date AZN 13,928 thousand of these promissory notes were redeemed

Movement in the provision for impairment of due from other banks during the six-month period ended 30 June 2008 is as follows

| *In thousands of Azerbaijani Manats* | Provision for impairment at 1 January 2008 | Provision for impairment during the period | Provision for impairment at 30 June 2008 |
|---|---|---|---|
| Term placements with other banks | 6,352 | 658 | 7,010 |
| **Total** | **6,352** | **658** | **7,010** |

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

| *In thousands of Azerbaijani Manats* | Provision for impairment at 1 January 2007 | Recovery of provision for impairment between 1 January 2007 and 30 June 2007 | Provision for impairment between 1 July 2007 and 31 December 2007 | Provision for impairment at 31 December 2007 |
|---|---|---|---|---|
| Term placements with other banks | 6,778 | (764) | 338 | 6,352 |
| **Total** | **6,778** | **(764)** | **338** | **6,352** |

The carrying value of each class of amounts due from other banks approximates fair value at 30 June 2008 and 31 December 2007 At 30 June 2008, the estimated fair value of due from other banks was AZN 137,942 thousand (31 December 2007 AZN 173,591 thousand)

The liquidity analysis of due from other banks is disclosed in Note 28 The information on related party balances is disclosed in Note 31

## 8 Loans and Advances to Customers

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Corporate loans | 2,159,674 | 1,844,536 |
| State and public organisations | 39,367 | 73,180 |
| Loans to individuals – consumer loans | 166,990 | 130,918 |
| Loans to individuals – purchase of motor vehicles | 27,406 | 30,121 |
| Loans to individuals – employees | 17,307 | 17,639 |
| Loans to individuals – mortgage loans | 23,092 | 14,630 |
| Loans to individuals – other purposes | 82,031 | 63,103 |
| Less Provision for loan impairment | (170,105) | (138,389) |
| **Total loans and advances to customers** | **2,345,762** | **2,035,738** |

Movements in the provision for loan impairment during the six-month period ended 30 June 2008 are as follows

| *In thousands of Azerbaijani Manats* | Provision for loan impairment at 1 January 2008 | Increase in/(Recovery of) provision for impairment during the period | Provision for loan impairment at 30 June 2008 |
|---|---|---|---|
| Corporate loans | 126,208 | 27,292 | 153,500 |
| State and public organisations | 4,108 | 641 | 4,749 |
| Loans to individuals – consumer loans | 3,430 | 3,326 | 6,756 |
| Loans to individuals – purchase of motor vehicles | 1,235 | (119) | 1,116 |
| Loans to individuals – employees | 391 | (13) | 378 |
| Loans to individuals – mortgage loans | 444 | 452 | 896 |
| Loans to individuals – other purposes | 2,573 | 137 | 2,710 |
| **Total** | **138,389** | **31,716** | **170,105** |

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

| *In thousands of Azerbaijani Manats* | Provision for loan impairment at 1 January 2007 | Increase in/(Recovery of) provision for impairment during the period between 1 January 2007 and 30 June 2007 | Increase in/(Recovery of) provision for impairment during the period between 1 July 2007 and 31 December 2007 | Provision for loan impairment at 31 December 2007 |
|---|---|---|---|---|
| Corporate loans | 101,721 | 12,836 | 11,651 | 126,208 |
| State and public organisations | 2,989 | (2,727) | 3,846 | 4,108 |
| Loans to individuals – consumer loans | 2,139 | 2,464 | (1,173) | 3,430 |
| Loans to individuals – purchase of motor vehicles | 1,237 | 562 | (564) | 1,235 |
| Loans to individuals – employees | 594 | (316) | 113 | 391 |
| Loans to individuals – mortgage loans | 388 | (181) | 237 | 444 |
| Loans to individuals – other purposes | 459 | 112 | 2,002 | 2,573 |
| **Total** | **109,527** | **12,750** | **16,112** | **138,389** |

## 8 Loans and Advances to Customers (Continued)

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

| *In thousands of Azerbaijani Manats* | 30 June 2008 Amount | % | 31 December 2007 Amount | % |
|---|---|---|---|---|
| Trade and service | 586,066 | 23.3 | 383,473 | 17.6 |
| Construction | 533,295 | 21.2 | 407,394 | 18.7 |
| Manufacturing | 411,986 | 16.4 | 331,643 | 15.3 |
| Individuals | 316,041 | 12.6 | 256,411 | 11.8 |
| Power production and distribution | 180,814 | 7.2 | 116,200 | 5.3 |
| Oil and gas sector | 169,818 | 6.7 | 124,628 | 5.7 |
| Railroad and other transportation | 160,327 | 6.4 | 322,451 | 14.8 |
| Leasing companies | 67,927 | 2.7 | 68,683 | 3.2 |
| Air transportation | 30,575 | 1.2 | 38,257 | 1.8 |
| Communication | 17,660 | 0.7 | 23,770 | 1.1 |
| State and public organisations* | 11,526 | 0.5 | 73,180 | 3.4 |
| Other | 29,832 | 1.1 | 28,037 | 1.3 |
| **Total loans and advances to customers (before impairment)** | **2,515,867** | **100** | **2,174,127** | **100** |

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

Included in the gross amount of total loans and advances to customers as at 30 June 2008, are the loans granted to twenty companies amounting to AZN 1,025,150 thousand (31 December 2007 twenty companies amounting to AZN 1,025,082 thousand) and representing a significant concentration of 40.7% (31 December 2007 47.1%) of the total gross loan portfolio of the Group

Included in the gross amount of total loans and advances to customers as at 30 June 2008, are the loans granted to government institutions and state enterprises of the Republic of Azerbaijan amounting to AZN 533,458 thousand (31 December 2007 AZN 661,626 thousand) and representing 21.2% (31 December 2007 30.4%) of the total gross loan portfolio of the Group

Included in the gross amount of total loans and advances to customers as at 30 June 2008, are the loans granted to fifteen borrowers amounting to AZN 317,841 thousand (31 December 2007 fifteen borrowers, AZN 501,302 thousand) with interest rates being less than or equal to eight per cent and representing a significant concentration of 12% (31 December 2007 24%) of the total gross loan portfolio of the Group The majority of these loans are transactions with related parties and as such disclosed in Note 31 No adjustments have been made to the contractual interest rates in relation to these amounts on initial recognition at fair value as the interest rates applicable are considered to represent the highest and best use of the funds provided given the alternative uses by the Bank of the funds extended under those loan agreements

Included in the total amount of loans to individuals as at 30 June 2008 are outstanding balances drawn on credit cards of AZN 15,531 thousand (31 December 2007 AZN 11,338 thousand)

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

The carrying value of each class of loans and advances to customers approximates fair value at 30 June 2008 and 31 December 2007 At 30 June 2008, the estimated fair value of loans and advances to customers was AZN 2,345,762 thousand (31 December 2007 AZN 2,035,738 thousand)

The liquidity risk analysis of loans and advances to customers is disclosed in Note 28 The information on related party balances is disclosed in Note 31

## 9 Investment Securities Available for Sale

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Promissory notes | 12,174 | 12,679 |
| **Total investment securities available for sale** | **12,174** | **12,679** |

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

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

The carrying value of each investment securities available for sale approximates fair value at 30 June 2008 At 30 June 2008, the fair value of investment securities available for sale was AZN 12,174 thousand (31 December 2007 AZN 12,679)

The liquidity risk analysis of investment securities available for sale is disclosed in Note 28

## 10 Investment in Associates

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Investment in Baku Inter-Bank Currency Exchange (BICE) | 807 | 801 |
| Joint Leasing Company (formerly Azerileasing) | - | - |
| **Total investments in associates** | **807** | **801** |

In October 2006, the Group signed an agreement for the sale of 52 4% of its interest in the share capital of "Azerileasing" As a result of this transaction, Azerileasing became an associate of the Group On 14 June 2007, the new charter of "Azerileasing" was registered at Ministry of Justice of Azerbaijan Republic, where the change in shareholding structure of the company was stipulated and the legal name of the company was changed to "Joint Leasing Company" Closed Joint-Stock Company The carrying value of the Group's interest in Joint Leasing Company was nil on the date of recognition as an associate and at 30 June 2008

The table below summarises the movements in the carrying amount of the Group's investment in associates as at 30 June 2008

| *In thousands of Azerbaijani Manats* | Carrying amount at 1 January 2008 | Share of profit of associates | Carrying amount at 30 June 2008 |
|---|---|---|---|
| Total investments in associates and joint ventures | 801 | 6 | 807 |
| **Total** | **801** | **6** | **807** |

## 10 Investment in Associates (Continued)

The table below summarises the movements in the carrying amount of the Group's investment in associates as at 31 December 2007

| *In thousands of Azerbaijani Manats* | Carrying amount at 1 January 2007 | Share of profit of associate between 1 January 2007 and 30 June 2007 | Share of loss of associate between 1 July 2007 and 31 December 2007 | Carrying amount at 31 December 2007 |
|---|---|---|---|---|
| Total investments in associates and joint ventures | 809 | 13 | (21) | 801 |
| **Total** | **809** | **13** | **(21)** | **801** |

The net share of the profit of associate after tax for the six-month period ended 30 June 2008 of AZN 6 thousand (six-month period ended 30 June 2007 loss of AZN 8 thousand) has been recorded in the statement of income as the share of profit of associate after tax

## 11 Premises, Equipment and Intangible Assets

Premises were independently valued at 30 June 2008 The valuation was carried out by an independent firm of valuers, DTZ Debenham Tie Leung The basis used for the appraisal was market value Fair values were estimated, using appropriate valuation techniques under the assumption that observable prices in an active market for the premises of characteristics and locations similar to those of the Group's premises do not differ significantly from, and, therefore, are a good indication of the fair value of the Group's premises As a result of the valuation, the net carrying amount of buildings increased by AZN 11,942 thousand Revaluation surplus of AZN 8,999 thousand relating to revaluation of buildings, net of deferred tax of AZN 2,538 thousand, was recorded in the "Revaluation reserve" for premises in the consolidated statement of changes in equity for the year ended 30 June 2008

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

Included in the property, plant and equipments as at 30 June 2008 are office, computer equipments and furniture, vehicles and other assets amounted to AZN 29,052 thousand (31 December 2007 AZN 21,953 thousand) that have been fully depreciated and still are used by the Bank The Bank's management believe that the depreciation rates used for these items were in compliance with the normative to express their useful lives

Included in additions to construction in progress are payments of AZN 16,513 thousand (31 December 2007 AZN 17,338 thousand) made by the Group to contractors for the purposes of construction of its new office building on land purchased by the Group in the centre of Baku

## 12 Other Financial and Insurance Assets

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Receivables for plastic cards transactions | 15,671 | 2,302 |
| Policyholder receivables | 9,674 | 4,801 |
| Amounts in the course of settlement | 6,982 | 1,619 |
| **Total other financial and insurance assets** | **32,327** | **8,722** |

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

The carrying value of each class of other financial and insurance assets approximates fair value at 30 June 2008 and 31 December 2007 At 30 June 2008, the estimated fair value of other financial and insurance assets was AZN 32,327 thousand (31 December 2007 AZN 8,722 thousand)

## 13 Other Assets

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Prepaid expenses | 3,729 | 3,018 |
| Advances for purchases of intangible assets and equipment | 3,581 | - |
| Deferred acquisition costs on insurance premiums written | 2,817 | 1,530 |
| Deferred expenses for plastic cards | 1,462 | 1,692 |
| Other | 4,134 | 2,709 |
| **Total other assets** | **15,723** | **8,949** |
| Current | 13,506 | 7,451 |
| Non-current | 2,217 | 1,498 |

Prepaid expenses balances as at 30 June 2008 include prepaid rentals and other administrative expenses of AZN 954 thousand for operation of representative offices of the Group in Dubai, London and New York and advance payment of AZN 1,434 thousand for the construction of the administrative branch by the Bank (31 December 2007 prepaid expenses balances included AZN 2,221 thousand of advance payments for the purchase of plastic cards)

## 14 Due to Other Banks

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Short-term placements of other banks | 294,775 | 110,012 |
| Correspondent accounts and overnight placements of other banks | 5,378 | 37,100 |
| Blocked accounts of resident banks in relation to plastic cards operations | 197 | 197 |
| **Total due to other banks** | **300,350** | **147,309** |

Included in the short-term placements of other banks as at 30 June 2008 are four short-term placements of a non-resident bank with the Bank amounting to USD 110,000 thousand or AZN 89,276 thousand (31 December 2007 nil) These placements bear interest rates of 9-9 25% per annum with maturities in August 2008 - December 2008 Subsequent to the balance sheet date, three placements in total amount of USD 85,000 thousand or AZN 68,986 thousand have been repaid on initial maturity and the fourth one amounting to USD 25,000 thousand or AZN 20,290 thousand has been prolonged till February 2009

Included in the short-term placements of other banks as at 30 June 2008 is a short-term placement of a non-resident bank with the Bank amounting to USD 80,000 thousand or AZN 64,928 thousand The placement bear interest rate of 4 32% per annum and had maturity in August 2008 (31 December 2007 two short-term placements of a non-resident bank with the Bank amounting to USD 40,000 thousand or AZN 33,812 thousand each and interest rates of 6 4% and 6 5% per annum with maturities in May 2008)

Included in the short-term placements of other banks as at 30 June 2008 are short-term placements of three non-resident banks with the Bank amounting to USD 74,750 thousand or AZN 60,667 thousand The placements bear interest rates ranging between 3 2% and 4 65% per annum and had maturities in July and December 2008 (31 December 2007 nil)

Also included in short-term placements of other banks are a deposit of USD 50,000 thousand or AZN 40,580 thousand by a foreign bank with an interest rate of 6 6% per annum, and two placements of USD 30,000 thousand or AZN 24,348 thousand of another foreign bank with interest rates ranging between 4 90% and 6 16% per annum placed with IBAR Moscow and with maturity in August and December 2008 (31 December 2007 a deposit of USD 50,000 thousand or AZN 42,265 thousand and a deposit of USD 15,000 thousand or AZN 12,174 thousand at an interest rate of 6 6% and 6 16% per annum, respectively and with maturity in August 2008)

The carrying value of each class of due to other banks approximates fair value at 30 June 2008 and 31 December 2007 At 30 June 2008, the estimated fair value of due to other banks was AZN 300,350 thousand (31 December 2007 AZN 147,309 thousand)

The liquidity risk analysis of due to other banks is disclosed in Note 28 The information on related party balances is disclosed in Note 31

## 15 Customer Accounts

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| **State and public organisations** | | |
| - Current/settlement accounts | 550,087 | 411,654 |
| - Term deposits | 636,717 | 607,582 |
| - Restricted customer deposits | 83 | 86 |
| **Other legal entities** | | |
| - Current/settlement accounts | 210,720 | 234,363 |
| - Term deposits | 52,354 | 42,114 |
| - Restricted customer deposits | 156,218 | 164,933 |
| **Individuals** | | |
| - Current/demand accounts | 136,866 | 114,428 |
| - Term deposits | 322,974 | 275,323 |
| **Total customer accounts** | **2,066,019** | **1,850,483** |

As at 30 June 2008, the Group had significant concentration of customer accounts attracted from one customer – a state organisation involved in the oil industry - of AZN 506,812 thousand and from a government body of AZN 281,965 thousand or 38 2% of total customer accounts in aggregate (31 December 2007 AZN 547,467 thousand and AZN 233,130 thousand, respectively or 42 2% in aggregate)

Included in term deposits of state and public organisations are two deposits of a state organisation involved in the oil industry sector of the Republic of Azerbaijan in the total amount equivalent to AZN 422,610 thousand The average interest rate on these deposits is 1 8% per annum (31 December 2007 deposits of a state organisation involved in the oil industry sector of the Republic of Azerbaijan of AZN 455,573 thousand with interest rate of 1 8% per annum on this deposit )

Included in the current and settlement accounts of state and public organisations as at 30 June 2008 are balances on current interest bearing accounts of state-owned enterprises and government bodies of AZN 29,736 thousand (31 December 2007 AZN 72,899 thousand) Interest rates on these accounts vary from 0 5% to 3 5% per annum (31 December 2007 0 5% to 3 5% per annum)

Also included in term deposits of state and public organisations are two short-term deposits of the Ministry of Finance of the Republic of Azerbaijan amounted to USD 150,000 thousand or AZN 121,740 thousand and USD 100,000 thousand or AZN 81,160 thousand (31 December 2007 a deposit amounted to USD 150,000 thousand or AZN 126,795) that are being continuously prolonged each month The interest rates on these deposits are 5% per annum (31 December 2007 5 25% p a)

Restricted customer deposits amounting to AZN 156,301 thousand as at 30 June 2008 (31 December 2007 AZN 165,019 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 2008 and 31 December 2007 is disclosed in Note 30

Economic sector concentrations within customer accounts are as follows

| | 30 June 2008 | | 31 December 2007 | |
|---|---|---|---|---|
| *In thousands of Azerbaijani Manats* | Amount | % | Amount | % |
| Energy | 708,214 | 34 3 | 725,318 | 39 2 |
| State and public organisations, except energy sector* | 502,595 | 24 3 | 316,694 | 17 1 |
| Individuals | 459,840 | 22 3 | 389,751 | 21 1 |
| Trade and services | 137,936 | 6 7 | 105,620 | 5 7 |
| Construction | 78,965 | 3 8 | 52,568 | 2 8 |
| Manufacturing | 33,013 | 1 6 | 98,257 | 5 3 |
| Transportation and communication | 20,459 | 1 0 | 48,711 | 2 6 |
| Other | 124,997 | 6 1 | 113,564 | 6 1 |
| **Total customer accounts** | **2,066,019** | **100.0** | **1,850,483** | **100.0** |

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

## 15 Customer Accounts (Continued)

The carrying value of each class of customer accounts approximates fair value at 30 June 2008 and 31 December 2007 At 30 June 2008, the estimated fair value of customer accounts was AZN 2,066,019 thousand (31 December 2007 AZN 1,850,483 thousand)

The liquidity risk analysis of customer accounts is disclosed in Note 28 The information on related party balances is disclosed in Note 31

## 16 Debt Securities in Issue

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Deposit certificates | 12,208 | 12,581 |
| Debentures | 4,087 | 4,227 |
| **Total debt securities in issue** | **16,295** | **16,808** |

Deposit certificates denominated in USD bear an interest rate of 9 0% per annum and have maturity of three years and deposit certificates denominated in AZN bear an interest rate of 25 0% per annum and have maturity of ten years (31 December 2007 USD denominated deposit certificate of at 9 0% per annum and with maturity of three years, AZN denominated deposit certificate of at 25 0 % per annum and with maturity of ten years) These certificates of deposit state as a condition that interest is paid each year only if certificates are held for the full period of that calendar year

The liquidity risk analysis of debt securities in issue is disclosed in Note 28

## 17 Other Borrowed Funds

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Term borrowings from government organisations | | |
| - National Fund for Support of Entrepreneurship (the Republic of Azerbaijan) | 10,940 | 7,951 |
| Syndicated borrowings | | |
| - Syndicated borrowing agreement signed on 10 November 2006 | 74,667 | 77,768 |
| - Syndicated borrowing agreement signed on 13 June 2007 | - | 118,342 |
| - Syndicated borrowing agreement signed on 23 April 2008 | 40,580 | - |
| - Syndicated borrowing agreement signed on 5 June 2008 | 140,813 | - |
| Societe Generale | 22,624 | 23,239 |
| Export-Import Bank of Korea | 20,913 | 8,330 |
| Rabobank | 9,623 | 9,459 |
| Black Sea Trade and Development Bank (BSTDB) | 7,662 | 9,099 |
| BNP Paribas | 3,997 | - |
| Landesbank Berlin AG | 2,710 | - |
| DZ Bank | 2,475 | 995 |
| Islamic Development Corporation (IDC) | 2,096 | 2,833 |
| Dresdner Bank AG | 1,925 | - |
| Nova Ljubljanska Banka | 1,623 | 2,536 |
| Export Development Bank of Iran | 725 | - |
| Accrued interest payable | 2,695 | 2,069 |
| **Total other borrowed funds** | **346,068** | **262,621** |

The balance of funds attracted under syndicated borrowings as at 30 June 2008 include the funds attracted under a syndicated borrowing agreement signed on 10 November 2006 with foreign banks led by one of major German banks in the total amount of USD 130,000,000 for general corporate lending purposes The borrowing facility bears a market interest rate The initial maturity of the borrowing was 10 November 2007, but it was extended until 7 November 2008 according to the Supplemental Deed between the parties dated 2 November 2007 As at 30 June 2008, outstanding debt of the Bank under the above syndicated borrowing agreement comprised USD 92,000 thousand or AZN 74,667 thousand (31 December 2007 USD 92,000 thousand or AZN 77,768 thousand) The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement As at 30 June 2008, existence of the some breaches automatically makes valid the cross default clauses included in the agreement with the above mentioned institution, balance of which in the amount of AZN 74,667 thousand was classified as being on demand in the liquidity analysis table disclosed in the Note 28 of this consolidated condensed interim financial information The breaches that have occurred are detailed in Note 30

On 23 April 2008, Bank signed term loan facility agreement with foreign banks led by one of the major German banks in the amount of USD 50,000,000 The borrowing facility bears a market interest rate and is repayable in one full instalment to be made on 23 April 2011 Bank will utilize amounts borrowed under this agreement for its general corporate lending purposes The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement As at 30 June 2008, management of the Bank believes that the Bank was in compliance with those covenants with the exception of a cross-default clause related to breaches of covenants stipulated by borrowing agreements between the Bank and other third parties Because of this the Bank has formally breached this covenant and, therefore, outstanding balance of term loan facility agreement in the amount of AZN 40,580 thousand was classified as being on demand in the liquidity analysis table disclosed in the Note 28 of this consolidated condensed interim financial information

On 5 June 2008, Bank signed the third syndicated borrowing agreement with foreign banks led by one of the major German banks in the amount of USD 173,500 thousand or AZN 140,813 thousand (Facility A and B commitment amounted to USD 107,500,000 and USD 66,000,000 respectively) The borrowing facilities bear a market interest rate and are repayable in two full instalments each to be made on 12 June 2009 and 12 December 2009 Bank will utilise amounts borrowed under this agreement for its general corporate lending purposes and financing of trade As at 30 June 2008, the Bank had fully drawn down the facility available under the above borrowing agreement The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement As at 30 June 2008, management of the Bank believes that the Bank was in compliance with those covenants with the exception of a cross-default clause related to breaches of covenants stipulated by borrowing agreements between the Bank and other third parties Because of this the Bank has formally breached this covenant and, therefore, outstanding balance of syndicated borrowing agreement in the amount of AZN 140,813 thousand was classified as being on demand in the liquidity analysis table disclosed in the Note 28 of this consolidated condensed interim financial information The breaches that have occurred are detailed in Note 30

**17 Other Borrowed Funds (Continued)**

On 22 June 2005, the Bank signed a General Buyer Credit Agreement with Societe Generale, legal entity registered in France for obtaining funds not exceeding EUR 45,000 thousand at a market interest rate for the financing of commercial contracts entered into by local companies The agreement was in force for a period of two years with an option of automatic renewal for one additional year This option was used by the Bank to extend the term of this agreement for another one year in 2007 Each draw down made under the agreement is repayable in eight equal semi-annual instalments, starting from the date of the respective draw down This credit line is designated to finance Azerbaijani companies, which purchase the goods and services of French and German origin As at 30 June 2008, the amount drawn down on this credit line was EUR 11,735 thousand or AZN 15,030 thousand (31 December 2007 EUR 11,735 thousand or AZN 14,607 thousand)

On 19 July 2007, the Bank signed a second General Buyer Credit Agreement with Societe Generale for obtaining funds not exceeding USD 50,000 thousand at a market interest rate for the financing of commercial contracts entered into by local companies The agreement will be in force for a period of two years with an option of automatic renewal for one additional year Each draw down made under the agreement is repayable in twelve equal semi-annual instalments, starting from the date of the respective draw down This credit line is designated to finance Azerbaijani companies, which purchase the goods and services of Korean origin As at 30 June 2008, the amount drawn down on this credit line was USD 9,358 thousand or AZN 7,595 thousand (31 December 2007 USD 10,208 thousand or AZN 8,629 thousand)

There are no financial covenants with regard to the above borrowing agreements of the Bank with Societe Generale

On 23 April 2007, the Bank signed the Comprehensive Interbank Export Credit Agreement with Export-Import Bank of Korea, legal entity registered in Korea for a credit line of USD 10,000 thousand for a period of two years at a market interest rate for financing the import of the goods of Korean origin As at 30 June 2008, the amount drawn down under this credit line was AZN 4,681 thousand or USD 5,768 thousand (31 December 2007 AZN 8,330 thousand or USD 9,855 thousand)

In addition to that, on 4 February 2008, the Bank signed the second Agreement for a credit line of USD 20,000 thousand for a period of two years at a market interest rate for financing the import of the goods of Korean origin As at 30 June 2008, the amount drawn down under this credit line was USD 20,000 thousand or AZN 16,232 thousand (31 December 2007 nil) Each drawdown under these agreements is repayable on a semi-annual basis On 22 April 2008, the Bank signed the second Amendment to the Credit Agreement for a credit line of USD 10,000 thousand untied two-step loan facility for a period of two years at a market interest rate

There are no financial covenants with regard to this borrowing from Export-Import Bank of Korea that the Bank should comply with

On 11 August 2006, the Bank signed an agreement with the Cooperative Centrale Raiffeisen-Boerenleenbank B A ("Rabobank"), registered in Netherlands, for the initial credit line of EUR 5,330 thousand for the period of five years at a market interest rate for financing of the construction of a dairy plant in the Republic of Azerbaijan Limit of the credit line has been gradually increased since the date of the agreement and comprised EUR 7,513 thousand or AZN 9,623 thousand, which was fully drawn down by the Bank as at 30 June 2008 (31 December 2007 EUR 7,597 thousand or AZN 9,459 thousand) The loan will be repaid in ten equal semi-annual instalments There are no financial covenants with regard to this borrowing from Rabobank that the Bank should comply with

On 21 January 2002, the Bank 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 6,500 thousand The amount drawn down on this revolving facility net of repayments as at 30 June 2008 amounted to USD 4,181 thousand or AZN 3,393 thousand (31 December 2007 USD 4,627 thousand or AZN 3,911 thousand) and is used for the financing of various projects related to the manufacturing and transportation sectors of the Republic of Azerbaijan The borrowing facility bears a market interest rate The revolving facility is for three years to be payable in six semi-annual instalments

On 21 June 2005, the Bank signed a Loan Agreement with the Black Sea Trade and Development Bank for the purpose of funding the construction of a glass factory in Azerbaijan of EUR 3,333 thousand or AZN 4,269 thousand (31 December 2007 EUR 4,167 thousand or AZN 5,188 thousand) The borrowing facility bears a market interest rate The loan is repayable in semi-annual instalments within three years, commencing 18 months after the date of first disbursement and ending on the expiry of 60 months after the date of first disbursement

The Bank is obliged to comply with certain financial covenants stipulated by the borrowing agreements signed with the Black Sea Trade and Development Bank At 30 June 2008, management believes that the Bank was in compliance with those covenants

## 17 Other Borrowed Funds (Continued)

On 6 June 2006, the Bank signed a Multisource Framework Agreement with BNP Paribas, legal entity registered in France, for the initial credit line of EUR 3,121 thousand with the maturity period of five years at a market interest rate for the purposes general trade As at 30 June 2008, amount drawn down under this credit line was EUR 3,121 thousand or AZN 3,997 thousand (31 December 2007 nil) The loan will be repaid in ten equal semi-annual instalments with maturity date of 21 January 2013 There are no financial covenants with regard to this borrowing from BNP Paribas that the Bank should comply with

On 5 July 2005, the Bank signed a borrowing agreement with Landesbank Berlin AG, registered in Germany for the purposes of delivery of laundry equipment and services rendered A credit line of EUR 2,116 thousand under this agreement have been granted to the Bank for the period of five years The borrowing bore a market interest rate Total amount drawn down as at 30 June 2008 amounted to EUR 2,116 thousand or AZN 2,710 thousand (31 December 2007 nil) The loan will be repaid in ten equal semi-annual instalments with maturity date of 22 March 2013 There are no financial covenants with regard to this borrowing from Landesbank Berlin AG that the Bank should comply with

On 17 September 2007, the Bank signed the Master agreement with respect to short term trade finance with DZ Bank AG, legal entity registered in Frankfurt am Main, Germany for a credit line of EUR 10,000 thousand for a period of two years at a market interest rate for financing of trade As at 30 June 2008, the amount drawn down under this credit line was EUR 1,932 thousand or AZN 2,475 thousand (31 December 2007 EUR 799 thousand or AZN 955 thousand) There are no financial covenants with regard to this borrowing from DZ Bank AG that the Bank should comply with

On 12 April 2004, the Group signed a Line of Financing Agreement with the Islamic Development Corporation (a member of Islamic Development Bank Group, an international financial institution with headquarters registered in Jeddah, Saudi Arabia) for a credit line of USD 4,500 thousand for a period of seven years at a market interest rate for financing of various investment projects in the Republic of Azerbaijan As at 30 June 2008, the amount drawn down under this credit line net of repayments was USD 2,582 thousand or AZN 2,096 thousand (31 December 2007 USD 3,351 thousand or AZN 2,833 thousand) and was used for the purposes of financing a project in the manufacturing sector of Azerbaijan The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement

As at 30 June 2008, management of the Bank believes that the Bank was in compliance with those covenants with the exception of a cross-default clause related to breaches of covenants stipulated by borrowing agreements between the Bank and other third parties Because of this the Bank formally breached this covenant and, therefore, outstanding balance of this borrowing in the amount of USD 2,582 thousand or AZN 2,096 thousand was classified as being on demand in the liquidity analysis table disclosed in the Note 28 of this condensed consolidated financial information The breaches that have occurred are detailed in Note 30

On 26 September 2006, the Bank signed a Basic Agreement with Dresdner Bank AG, legal entity registered in Germany at a market interest rate for the supply of woodworking equipment as well as short-cycle throughfeed press line for laminating chipboards including supervision, installation and training A credit line of EUR 2,255 thousand have been granted to the Bank under this agreement for the period of five years Total amount drawn down as at 30 June 2008 amounted to EUR 1,503 thousand or AZN 1,925 thousand (31 December 2007 nil) The loan will be repaid in ten equal semi-annual instalments with last repayment date of 15 September 2013 There are no financial covenants with regard to this borrowing from Dresdner Bank AG that the Bank should comply with

On 29 November 2006, the Bank signed Loan Agreement with Nova Ljubljanska Banka, registered in Slovenia, for export of goods and services, not exceeding USD 3,000 thousand for a period of 36 months at a market interest rate The amount drawn down under this credit line net of repayments was USD 2,000 thousand or AZN 1,623 thousand (31 December 2007 USD 3,000 thousand or AZN 2,536 thousand) The Bank is obliged to comply with certain financial covenants stipulated by this borrowing agreement At 30 June 2008, management believes that the Bank was in compliance with those covenants

On 20 October 2007, the Bank signed a Credit Facility Agreement with Export Development Bank of Iran, registered office in Iran at a market interest rate for of purpose of trading goods and services of Iranian origin A credit line of not exceeding EUR 10,000 thousand under this agreement have been extended to be granted to the Bank for the period of two years Total amount draw down as at 30 June 2008 amounted to EUR 566 thousand or AZN 725 thousand (31 December 2007 nil) The loan will be repaid in four semi-annual instalments with last repayment date of 17 May 2010 There are no financial covenants with regard to this borrowing from Export Development Bank of Iran that the Bank should comply with

Market interest rates for the borrowings range between 5% and 10% per annum for the six-month period ended 30 June 2008 (5% and 10% per annum for the year ended 31 December 2007)

## 17 Other Borrowed Funds (Continued)

The carrying value of each class of other borrowed funds approximates fair value at 30 June 2008 and 31 December 2007 At 30 June 2008, the estimated fair value of other borrowed funds was AZN 346,068 thousand (31 December 2007 AZN 262,621 thousand)

The liquidity analysis of other borrowed funds is disclosed in Note 28 The information on related party balances is disclosed in Note 31

## 18 Other Financial and Insurance Liabilities

Other financial and insurance liabilities comprise the following

| *In thousands of Azerbaijani Manats* | Note | 30 June 2008 | 31 December 2007 |
|---|---|---|---|
| Items in course of settlement | | 51,031 | 48,043 |
| Insurance reserves | | 10,812 | 6,247 |
| Insurance premiums and broker commissions payable | | 4,625 | 1,784 |
| Dividends payable | 26 | - | 60 |
| **Total other financial and insurance liabilities** | | **66,468** | **56,134** |

Items in the course of settlement include AZN 48,563 thousand (31 December 2007 43,440 thousand), which include the fund transfers in the course of processing These amounts were settled two to three days after the balance sheet date

The carrying value of each class of other financial and insurance liabilities approximates fair value at 30 June 2008 and 31 December 2007

## 19 Other Liabilities

Other liabilities comprise the following

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Deferred revenue on plastic cards operations | 11,015 | 8,144 |
| Other | 4,102 | 4,862 |
| **Total other liabilities** | **15,117** | **13,006** |
| Current | 7,497 | 4,918 |
| Non-current | 7,620 | 8,088 |

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

## 20 Subordinated Debt

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 |
|---|---|---|
| Credit Linked Notes issued by Rubrika Finance Company Limited | 81,160 | 84,530 |
| Subordinated debt from Asian Development Bank | 16,232 | 16,906 |
| Accrued interest payable | 950 | 1,034 |
| **Total other borrowed funds** | **98,342** | **102,470** |

## 20 Subordinated Debt (Continued)

On 10 May 2007, the Bank signed Subordinated Facility Agreement with Rubrika Finance Company Limited, legal entity registered in Dublin, for an issue of Credit Linked Notes on the Cayman Islands Stock Exchange to institutional investors from Europe and the United States of America for a total amount of USD 100,000,000 for general corporate purposes The Credit Linked Notes bear a market interest rate and mature on 10 May 2017 The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement As at 30 June 2008, management of the Bank believes that the Bank was in compliance with those covenants

On 14 December 2007, the Bank signed Subordinated Debt Agreement with the Asian Development Fund, registered in Manila, the Philippines, for obtaining funds in the amount not exceeding USD 20 million to be used in further lending activities of the Bank The borrowing bears a market interest rate and is repayable in six equal semi-annual instalments with a first instalment due on 14 June 2012 As at 30 June 2008, the balance of this subordinated debt was USD 20,000 thousand or AZN 16,232 thousand (31 December 2007 AZN 16,906 thousand) and was used for the purposes of strengthening the Bank's funding base The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement As the Bank formally breached this covenant, outstanding balance of this borrowing in the amount of USD 16,232 thousand was classified as being on demand in the liquidity analysis table disclosed in the Note 28 of this consolidated condensed financial information The breaches that have occurred are detailed in Note 30

Market interest rates for these subordinated debts range between 7% and 8% per annum The repayment of Bank's subordinated debt ranks after all other creditors in case of liquidation of the Bank

At 30 June 2008, the estimated fair value of subordinated debt was AZN 98,342 thousand (31 December 2007 AZN 102,470 thousand)

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

## 21 Share Capital

The authorised, issued and paid-in capital of the Bank as at 30 June 2008 and 31 December 2007 is as follows

| *In thousands of AZN except for number of shares* | Number of paid-in shares (in thousands) | Ordinary shares | Total |
|---|---|---|---|
| **At 1 January 2007** | **296,595** | **59,319** | **59,319** |
| New shares paid-in | 203,405 | 40,681 | 40,681 |
| **At 31 December 2007** | **500,000** | **100,000** | **100,000** |
| New shares paid-in | - | - | - |
| **At 30 June 2008** | **500,000** | **100,000** | **100,000** |

All ordinary shares have a nominal value of AZN 0 2 per share (31 December 2007 AZN 0 2 per share) and rank equally Each share carries one vote

The weighted average number of ordinary shares outstanding during the six-month period ended 30 June 2008 was 500,000 thousand (30 June and 31 December 2007 355,519 and 424,444 thousand respectively)

As at 30 June 2008, the Ministry of Finance of the Republic of Azerbaijan ("MoF") held 50 20% of the total paid-in share capital of the Bank (31 December 2007 50 20% of the total paid-in share capital of the Bank)

As at 30 June 2008, the Group's employees held 6 30% of the total share capital of the Bank, or 31,518 ordinary shares with a par value of AZN 6,304 thousand (31 December 2007 6 30%, or 31,518 ordinary shares with a par value of AZN 6,304 thousand) Refer to Note 31

## 22 Interest Income and Expense

| *In thousands of Azerbaijani Manats* | Six-month period ended 30 June 2008 | Six-month period ended 30 June 2007 |
|---|---|---|
| **Interest income** | | |
| Loans and advances to customers | 132,958 | 79,530 |
| Due from other banks and correspondent accounts | 7,738 | 4,628 |
| **Total interest income** | **140,696** | **84,158** |
| **Interest expense** | | |
| Savings deposits of individuals and deposit certificates | 18,231 | 10,769 |
| Deposits from banks and other borrowed funds | 12,644 | 4,868 |
| Term deposits of legal entities | 12,544 | 6,426 |
| Subordinated debt | 4,187 | 3,464 |
| Debentures | 351 | 1,395 |
| **Total interest expense** | **47,957** | **26,922** |
| **Net interest income** | **92,739** | **57,236** |

For information on related party transactions, see Note 31

## 23 Fee and Commission Income and Expense

| *In thousands of Azerbaijani Manats* | Six-month period ended 30 June 2008 | Six-month period ended 30 June 2007 |
|---|---|---|
| **Fee and commission income** | | |
| - Transactions with foreign currencies and securities | 16,428 | 9,098 |
| - Plastic cards operations | 15,210 | 9,659 |
| - Settlement transactions | 7,436 | 4,689 |
| - Cash transactions | 6,822 | 5,408 |
| - Letters of credit issued | 1,161 | 1,586 |
| - Guarantees issued | 337 | 417 |
| - Servicing intermediary Loans | 196 | 140 |
| - Other | 446 | 512 |
| **Total fee and commission income** | **48,036** | **31,509** |
| **Fee and commission expense** | | |
| - Cash transactions | 3,721 | 2,325 |
| - Settlement transactions | 1,400 | 609 |
| - Plastic cards operations | 1,281 | 714 |
| - Policy acquisition costs on insurance operations | 1,174 | 543 |
| - Other | 1,592 | 166 |
| **Total fee and commission expense** | **9,168** | **4,357** |
| **Net fee and commission income** | **38,868** | **27,152** |

For information on related party transactions, see Note 31

## 24 Administrative and Other Operating Expenses

| *In thousands of Azerbaijani Manats* | Six-month period ended 30 June 2008 | Six-month period ended 30 June 2007 |
|---|---|---|
| Staff costs | 17,330 | 13,783 |
| Depreciation of premises and equipment | 6,858 | 7,369 |
| Charity and financial aid | 3,566 | 2,588 |
| Advertising and marketing services | 3,254 | 2,165 |
| Customs duties and other taxes other than on income | 2,446 | 1,434 |
| Rent | 2,112 | 1,399 |
| Premises, equipment and investment property maintenance | 1,784 | 1,623 |
| Purchase of plastic cards | 1,365 | 2,211 |
| External labour and guarding | 1,214 | 776 |
| Communication | 961 | 836 |
| Amortisation of software and other intangible assets | 938 | 453 |
| Stationery, books, printing and other supplies | 527 | 685 |
| Property insurance | 499 | 301 |
| Business trip | 435 | 610 |
| Transportation of valuables | 306 | 1,110 |
| Training | 173 | 134 |
| Software maintenance | 136 | 122 |
| Other | 3,322 | 2,502 |
| **Total administrative and other operating expenses** | **47,226** | **40,101** |

Included in staff costs are obligatory payments to the Social Security Fund and other funds of the Republic of Azerbaijan of AZN 2,866 thousand (six-month period ended 30 June 2007 AZN 2,374 thousand) In addition, AZN 266 thousand was collected by the Group as a deduction to employee salaries and paid to the State Pension Fund on their behalf (six-month period ended 30 June 2007 AZN 218 thousand)

Included in charity and financial aid expenses incurred during the six-month period ended 30 June 2008 are AZN 3,133 thousand paid to "Inter" professional football club (six-month period ended 30 June 2007 AZN 1,500 thousand)

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

## 25 Earnings per Share

Basic earnings per share are calculated by dividing the profit or loss attributable to equity holders of the Bank by the weighted average number of ordinary shares in issue during the year, excluding treasury shares

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

| *In thousands of Azerbaijani Manats* | Note | Six-month period ended 30 June 2008 | Six-month period ended 30 June 2007 |
|---|---|---|---|
| Profit for the period attributable to ordinary shareholders | | 52,541 | 31,860 |
| Weighted average number of ordinary shares in issue (thousands) | 21 | 500,000 | 355,519 |
| **Basic and diluted earnings per ordinary share (expressed in AZN per share)** | | **0 11** | **0.09** |

## 26 Dividends

| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 | 30 June 2007 |
|---|---|---|---|
| **Dividends payable at the beginning of the period** | **60** | **4,865** | **4,865** |
| Dividends declared during the period | 23,919 | 28,070 | 7,512 |
| Dividends paid during the period | (23,979) | (32,875) | (10,087) |
| **Dividends payable at the end of the period** | **-** | **60** | **2,290** |
| **Dividends per share declared during the period** | **0.048** | **0.072** | **0.021** |

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

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

## 27 Segment Analysis

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

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

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

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

Segment information for the main reportable business segments of the Group for the six-month periods ended 30 June 2008 and 2007 is set out below

| | Retail banking | | Corporate banking | | Total | |
|---|---|---|---|---|---|---|
| *In thousands of Azerbaijani Manats* | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| External revenues | 37,148 | 23,829 | 169,236 | 102,337 | 206,384 | 126,166 |
| Revenues from other segments | 1,675 | 734 | 7,629 | 3,146 | 9,304 | 3,880 |
| **Total revenues** | **38,823** | **24,563** | **176,865** | **105,483** | **215,688** | **130,046** |
| **Total revenues comprise** | | | | | | |
| - Interest income | 25,325 | 15,037 | 115,371 | 69,121 | 140,696 | 84,158 |
| - Fee and commission income | 8,646 | 6,809 | 39,390 | 24,700 | 48,036 | 31,509 |
| - Gains less losses from trading in foreign currencies | 3,177 | 1,983 | 14,475 | 8,516 | 17,652 | 10,499 |
| - Gross insurance premiums written | 1,675 | 734 | 7,629 | 3,146 | 9,304 | 3,880 |
| **Total revenues** | **38,823** | **24,563** | **176,865** | **105,483** | **215,688** | **130,046** |
| **Segment result** | **18,436** | **8,965** | **51,733** | **34,426** | **70,169** | **43,391** |
| Share of after tax results of associates | | | | | 6 | 13 |
| **Profit before tax** | | | | | **70,175** | **43,404** |
| Income tax expense | | | | | (17,551) | (11,575) |
| **Profit for the period** | | | | | **52,624** | **31,829** |
| **Other segment items** | | | | | | |
| Capital expenditure | 3,809 | 2,154 | 17,352 | 9,250 | 21,161 | 11,404 |
| Depreciation and amortisation expense | 1,403 | 1,477 | 6,393 | 6,345 | 7,796 | 7,822 |
| Other non-cash expenses | 7,056 | 2,590 | 32,144 | 11,123 | 39,200 | 13,713 |

**27 Segment Analysis (Continued)**

Information about segment assets and liabilities of the Group at 30 June 2008 and 31 December 2007 is given in the following table

| | Retail banking | | Corporate banking | | Total | |
|---|---|---|---|---|---|---|
| *In thousands of Azerbaijani Manats* | 30 June 2008 | 31 December 2007 | 30 June 2008 | 31 December 2007 | 30 June 2008 | 31 December 2007 |
| **Total segment assets** | **453,503** | **328,823** | **2,565,186** | **2,243,236** | **3,018,689** | **2,572,059** |
| Investments in associates | | | | | 807 | 801 |
| Current and deferred tax assets | | | | | 1,466 | 1,173 |
| Other unallocated assets | | | | | | |
| - Other financial and insurance assets | | | | | 32,327 | 8,722 |
| - Other assets | | | | | 15,723 | 8,949 |
| - Premises and equipment | | | | | 137,541 | 113,023 |
| - Intangible assets | | | | | 7,398 | 7,685 |
| **Total assets** | | | | | **3,213,951** | **2,712,412** |
| **Total segment liabilities** | **596,830** | **479,717** | **2,230,244** | **1,899,974** | **2,827,074** | **2,379,691** |
| Current and deferred tax liability | | | | | 24,770 | 21,293 |
| Other unallocated liabilities | | | | | | |
| - Other financial and insurance liabilities | | | | | 66,468 | 56,134 |
| - Other liabilities | | | | | 15,117 | 13,006 |
| **Total liabilities** | | | | | **2,933,429** | **2,470,124** |

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

## 28 Financial Risk Management

The following table shows the carrying amounts of assets and liabilities of the Group as at 30 June 2008 on the basis of the remaining period from the balance sheet date to their expected maturity date

| *In thousands of Azerbaijani Manats* | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | Over 12 months | Total |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and cash equivalents | 361,944 | - | - | - | 361,944 |
| Mandatory cash balances with the National/Central banks | 103,502 | 41,310 | 5,998 | 10,057 | 160,867 |
| Due from other banks | 49,742 | 60,930 | 20,962 | 6,308 | 137,942 |
| Loans and advances to customers | 83,956 | 368,180 | 379,956 | 1,513,670 | 2,345,762 |
| Investment securities available for sale | - | 12,174 | - | - | 12,174 |
| Other financial and insurance assets | 32,327 | - | - | - | 32,327 |
| **Total financial assets** | **631,471** | **482,594** | **406,916** | **1,530,035** | **3,051,016** |
| **Liabilities** | | | | | |
| Due to other banks | 17,169 | 283,181 | - | - | 300,350 |
| Customer accounts | 1,329,276 | 530,544 | 77,036 | 129,163 | 2,066,019 |
| Debt securities in issue | 5,458 | 121 | 52 | 10,664 | 16,295 |
| Other borrowed funds | 261,958 | 24,662 | 7,468 | 51,980 | 346,068 |
| Other financial and insurance liabilities | 55,656 | - | 10,812 | - | 66,468 |
| Subordinated debt | 17,182 | - | - | 81,160 | 98,342 |
| **Total financial liabilities** | **1,686,699** | **838,508** | **95,368** | **272,967** | **2,893,542** |
| **Net liquidity gap at 30 June 2008** | **(1,055,228)** | **(355,914)** | **311,548** | **1,257,068** | **157,474** |
| **Cumulative liquidity gap at 30 June 2008** | **(1,055,228)** | **(1,411,142)** | **(1,099,594)** | **157,474** | |

For loans and advances to customers, as a result of more detailed information not being readily available within the Group's accounting system, management have used a conservative basis in classifying the maturity of loan principal balances on the date of the final loan repayment In practice, repayments during the term of a loan are typically made on a monthly basis and include interest payments and the part repayment of the principal amount

Management believes that in spite of a substantial portion of customers accounts being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Group would indicate that these customer accounts provide a long-term and stable source of funding for the Group Customer accounts are classified in the above analysis based on contractual maturities However, in accordance with the Civil Code of the Republic of Azerbaijan, individuals have a right to withdraw their deposits prior to maturity if they forfeit their right to a certain portion of accrued interest

As set out in Note 30, included in the above analysis of maturities, total borrowings consisting of other borrowed funds and subordinated debt of AZN 274,387 thousand are included as "on demand" due to breaches and cross default cases of certain covenants imposed in those borrowing agreements Subsequent to the six-month period ended 30 June 2008, management have or are in the progress of obtaining waivers in respect of the breaches that have occurred and believe that all such waivers will be forthcoming such that there is no reason to believe that these borrowings will be required to be repaid prior to the contractual maturity dates are set out in the relevant loan agreements The contractual maturity dates are set out in Notes 17 and 20 for the individual term borrowings and subordinated debt of the Group, respectively

## 29 Management of Capital

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

Under the current capital requirements set by the NBAR banks have to (a) hold the minimum level of total statutory capital of AZN 10,000 thousand (31 December 2007 AZN 10,000 thousand), (b) maintain a ratio of regulatory capital to risk weighted assets ("statutory capital ratio") at or above a prescribed minimum of 12% (31 December 2007 12%) and (c) maintain a ratio of tier-1 capital to the risk-weighted assets (the 'Tier-1 capital ratio') at or above the prescribed minimum of 6% (31 December 2007 6%)

The capital that the Bank manages is consistent with that amount required by the NBAR statutory capital adequacy purposes The amount of the cumulative statutory capital that the Bank manages as at 30 June 2008 is AZN 270,645 thousand (31 December 2007 AZN 245,542 thousand)

Management consider that the Bank, except for certain times, was in compliance with the statutory capital ratios during the six-month period ended 30 June 2008 and the year ended 31 December 2007 Refer to Note 30

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

| *In thousands of Azerbaijani Manats* | **30 June 2008** | **31 December 2007** |
|---|---|---|
| **Tier 1 capital** | | |
| Share capital | 100,000 | 100,000 |
| Retained earnings | 139,777 | 110,383 |
| Minority interest | 1,801 | 1,551 |
| **Total qualifying Tier 1 capital** | **241,578** | **211,934** |
| **Tier 2 capital** | | |
| Reserves | 30,549 | 22,381 |
| Revaluation reserve for premises | 36,204 | 27,977 |
| Subordinated debt | 98,342 | 102,470 |
| **Total qualifying Tier 2 capital** | **165,095** | **152,828** |
| Less Investments in equity shares | (807) | (801) |
| **Total regulatory capital** | **405,866** | **363,961** |
| **Risk-weighted assets** | | |
| On-balance sheet | 2,443,920 | 1,790,504 |
| Off-balance sheet | 865,648 | 702,324 |
| **Total risk-weighted assets** | **3,309,568** | **2,492,828** |
| **Basel ratio** | **12.3%** | **14 6%** |

## 30 Contingencies and Commitments

***Legal proceedings*** From time to time and in the normal course of business, claims against the Group are received On the basis of its own estimates and internal professional advice the Group's management is of the opinion that no material losses will be incurred in respect of claims and, accordingly, no provision has been made in this condensed consolidated interim financial information (31 December 2007 no provision)

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

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

Management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained Accordingly, at 30 June 2008 no provision for potential tax liabilities was recorded (31 December 2007 no provision)

In accordance with Article 18 of the Tax Code of the Republic of Azerbaijan effective from 1 January 2002, tax authorities can make transfer-pricing adjustments and impose additional tax liabilities in respect of transactions between inter-related entities, which are carried out at non-market prices, and all transactions, where the price differs from the market price by more than 30% Management believes that, the Group is not exposed to any possible transfer-pricing tax adjustments to be made by the tax authorities as at 30 June 2008 and 31 December 2007

***Capital expenditure commitments.*** At 30 June 2008, the Group has contractual capital expenditure commitments towards a local construction company in respect of the Bank's new administrative building and operational branches totalling AZN 16,577 thousand (31 December 2007 AZN 5,589 thousand)

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

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

| *In thousands of Azerbaijani Manats* | **30 June 2008** | **31 December 2007** |
|---|---|---|
| Not later than 1 year | 2,782 | 1,247 |
| Later than 1 year and not later than 5 years | 2,468 | 916 |
| Later than 5 years | 1,120 | 989 |
| **Total operating lease commitments** | **6,370** | **3,152** |

***Compliance with covenants*** The Bank is subject to certain covenants related primarily to its borrowings Non-compliance with such covenants may result in negative consequences for the Group including, growth in the cost of borrowings and declaration of default As at 30 June 2008 and at certain times during the six-month period then ended the Bank was in breach of the restrictions that limit the maximum exposure of the Bank to (i) to parties that are connected parties to the Bank to twenty five per cent of the Bank's equity and (ii) tier-1 capital adequacy ratio

As at 30 June 2008, as disclosed in this consolidated condensed interim financial information, the aggregate exposure of the Group to parties that are related parties to the Group's equity was 87% (31 December 2007 79%) and tier-1 capital adequacy ratio comprised 7 3% (31 December 2007 8 5%) As a result, the Group was not in compliance with this covenant as at 30 June 2008, and at certain other times during the six-month period then ended As a result of cross-default clauses being included in the Group's certain other borrowing agreements, the agreements provide for these other lenders to have the right to declare some or all of their loans repayable on demand

The total borrowings affected by the breach of these covenants comprised AZN 274,387 thousand as at 30 June 2008 (31 December 2007 AZN 208,041 thousand) In accordance with those agreements, where covenants are breached or are affected by cross-default clauses, provision is made for the borrowings to become due and/or repayable on demand Accordingly, the borrowings impacted have been reclassified to being on demand within this consolidated condensed interim financial information

**30 Contingencies and Commitments (Continued)**

In addition, the Bank was not in compliance with certain statutory ratios stipulated by the National Bank of Azerbaijan's regulations during the period ended 30 June 2008 and 31 December 2007 Management considered that the Bank had obtained formal agreement with the National Bank of Azerbaijan through the development of an action plan aimed at enabling the Bank to comply with all statutory requirements by 31 December 2008 Management believed that this agreement represented a waiver from these requirements in the years prior to 31 December 2008 and as a result there would be no adverse consequences for the Bank prior 31 December 2008 with regard the potential areas of non-compliance Management considered that the Bank is on schedule with the action plan agreed in 2005 and would be in a position to fully comply with all requirements by 31 December 2008

The Bank did not achieve full compliance with all statutory ratios by 31 December 2008 There is no guarantee that the NBAR will extend the waiver which was in place prior to 31 December 2008 and as such the Bank may be exposed to penalties including the ultimate withdrawal of the Bank's license However, management is confident that the Bank will not be subject to any potential sanctions by the NBAR Non-compliance with statutory ratios may also trigger non-compliance with covenants imposed by counterparties of the Bank with regard to other borrowed funds which in its turn may lead to immediate withdrawal of these other borrowed funds

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

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

| *In thousands of Azerbaijani Manats* | **30 June 2008** | **31 December 2007** |
|---|---|---|
| Import letters of credit | 888,637 | 870,701 |
| Guarantees issued | 577,630 | 431,992 |
| Commitments to extend credit and undrawn credit lines | 82,571 | 77,684 |
| **Total credit related commitments** | **1,548,838** | **1,380,377** |

At 30 June 2008, the fair value of credit related commitments was AZN 1,035 thousand (31 December 2007 AZN 948 thousand)

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 36,785 thousand at 30 June 2008 (31 December 2007 AZN 24,657 thousand) Credit related commitments are denominated in currencies as follows

| *In thousands of Azerbaijani Manats* | **30 June 2008** | **31 December 2007** |
|---|---|---|
| Azerbaijani Manats | 173,441 | 160,719 |
| US Dollars | 653,514 | 746,018 |
| Euro | 614,112 | 454,924 |
| Other | 107,771 | 18,716 |
| **Total** | **1,548,838** | **1,380,377** |

**30 Contingencies and Commitments (Continued)**

As at 30 June 2008, the Group had a significant concentration of import letters of credit of AZN 718,977 thousand issued to 20 entities or 80 9% of total import letters of credit (31 December 2007 import letters of credit of AZN 701,161 thousand issued to 20 entities or 80 5% of total import letters of credit) As at 30 June 2008, the Group also had a significant concentration of guarantees of AZN 436,697 thousand issued to 20 entities or 84 9% of total guarantees issued (31 December 2007 guarantees of AZN 360,098 thousand issued to 8 entities or 83 9% of total guarantees)

As at 30 June 2008, credit related commitments of AZN 156,301 thousand (31 December 2007 AZN 165,019 thousand) are secured by Azerbaijan government guarantees or blocked customer deposits Refer to Note 15

***Intermediary loans*** At 30 June 2008, the Group had borrowed funds amounting to AZN 13,862 thousand (31 December 2007 AZN 18,047 thousand) on behalf of the Government of the Republic of Azerbaijan from foreign banks and financial institutions for the purposes of providing intermediary loans to state-owned enterprises and government bodies of the Republic of Azerbaijan The loan agreements signed between the Group and these foreign banks and financial institutions are secured by unconditional letters of guarantee of the Government of the Republic of Azerbaijan, whereby the Government acts as the primary obligor in relation to these borrowings As a result, the Group acts as a loan-servicing agent for the Government of the Republic of Azerbaijan by transferring collected principal and interest payments to foreign banks and financial institutions and earns no interest margin on these loans

At 30 June 2008, the Group had attracted a deposit from a state owned company operating in the oil and gas sector amounting to USD 655,000 thousand or AZN 539,714 thousand (31 December 2007 nil) The fund has been transferred as loan facility to a subsidiary of the company in a foreign country with the loan agreement signed on 22 May 2008 for a period of three years 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 the subsidiary of the company and earns no interest margin on these loans

As the Group does not receive the benefits and does not bear the risks of the above mentioned intermediary loans, the Group has recorded these intermediary loans amounting to AZN 13,862 thousand and AZN 539,714 thousand respectively as at 30 June 2008 (31 December 2007 AZN 18,047 thousand) on off-balance sheet accounts Similarly funds received by the Group to finance these intermediary loans in the corresponding amounts have also been recorded on off balance sheet accounts

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

| *In thousands of Azerbaijani Manats* | **30 June 2008** | **31 December 2007** |
|---|---|---|
| Intermediary loan facility to a state owned company | 539,714 | - |
| Trade finance facility from the Export Credit Bank of Turkey (Eximbank) | 13,862 | 18,047 |
| **Total funds borrowed for the purposes of providing intermediary loans and transferred to off-balance sheet accounts** | **553,576** | **18,047** |

## 31 Related Party Transactions

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

Included in the "Other" column within this note are related parties falling within the definition of IAS 24 *Related Party Transactions*, including for example, transactions with entities that the Group has significant influence over but are not classified as being Associates or Subsidiaries

At 30 June 2008, the outstanding balances with related parties were as follows

| *In thousands of Azerbaijani Manats* | Shareholders | Management | Government bodies and state-owned entities | Associates | Other |
|---|---|---|---|---|---|
| Cash and cash equivalents (non-interest bearing) | - | - | 21,833 | - | - |
| Mandatory cash balances with the NBAR | - | - | 154,939 | - | - |
| Term placements with resident banks (contractual interest rate 6% p a ) | - | - | - | - | - |
| Gross amount of loans and advances to customers (contractual interest rate 1 - 25% p a ) | 9,089 | 647 | 533,458 | 54,026 | 354,260 |
| Impairment provisions for loans and advances to customers | (203) | (13) | (14,217) | (5,403) | (65,374) |
| **Due to other banks** | | | | | |
| Correspondent accounts of other banks | - | - | - | - | - |
| **Customer accounts** | | | | | |
| Current/settlement accounts | - | 10 | 552,680 | - | 564 |
| Term deposits (contractual interest rate 2 - 7% p a ) | - | - | 1,171,297 | - | - |
| Other borrowed funds (contractual interest rate 1% p a ) | - | - | 10,940 | - | - |
| Current income tax liability | - | - | 1,662 | - | - |
| Other liabilities | - | - | 60 | - | - |

The income and expense items with related parties for the six-month period ended 30 June 2008 were as follows

| *In thousands of Azerbaijani Manats* | Shareholders | Management | Government bodies and state-owned entities | Associates | Other |
|---|---|---|---|---|---|
| Interest income | - | - | 26,166 | 3,222 | 2,113 |
| Interest expense | - | - | 10,545 | - | - |
| (Release of)/provision for loan impairment | (203) | (7) | (1,168) | 7,240 | (18,160) |
| Fee and commission income | - | - | 8,491 | - | - |
| Insurance related commission expenses | - | - | - | - | - |
| Staff costs | - | 413 | - | - | - |
| Current tax expense | - | - | 14,139 | - | - |

**31 Related Party Transactions (Continued)**

At 30 June 2008, other rights and obligations with related parties were as follows

| *In thousands of Azerbaijani Manats* | Shareholders | Management | Government bodies and state-owned entities | Associates | Other |
|---|---|---|---|---|---|
| Guarantees issued by the Group | - | - | 198,981 | - | - |
| Import letters of credit | - | - | 453,614 | - | - |

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

| *In thousands of Azerbaijani Manats* | Shareholders | Management | Government bodies and state-owned entities | Associates | Other |
|---|---|---|---|---|---|
| Cash and cash equivalents (non-interest bearing) | - | - | 78,618 | - | - |
| Mandatory cash balances with the NBAR | - | - | 166,512 | - | - |
| Term placements with resident banks (contractual interest rate 6% p a ) | 4,227 | - | - | - | - |
| Notes of the NBAR (contractual interest rate 10 - 11% p a ) | - | - | 53,411 | - | - |
| Gross amount of loans and advances to customers (contractual interest rate 1 - 25% p a ) | 8,945 | 285 | 659,053 | 59,828 | 330,701 |
| Impairment provisions for loans and advances to customers | - | (6) | (13,049) | (12,643) | (47,214) |
| **Due to other banks** | | | | | |
| Correspondent accounts of other banks | 423 | - | - | - | - |
| **Customer accounts** | | | | | |
| Current/settlement accounts | - | 10 | 411,740 | - | 564 |
| Term deposits (contractual interest rate 2 - 7% p a ) | - | - | 607,582 | - | - |
| Other borrowed funds (contractual interest rate 1% p a ) | - | - | 7,951 | - | - |
| Current income tax liability | - | - | 1,084 | - | - |
| Other liabilities | 60 | - | - | - | - |

The income and expense items with related parties for the six-month period ended 30 June 2007 were as follows

| *In thousands of Azerbaijani Manats* | Shareholders | Management | Government bodies and state-owned entities | Associates | Other |
|---|---|---|---|---|---|
| Interest income | - | - | 19,768 | 3,414 | 1,160 |
| Interest expense | - | - | 5,619 | - | - |
| (Release of)/provision for loan impairment | (8) | - | 2,175 | (5,424) | 8,525 |
| Fee and commission income | - | - | 4,795 | - | - |
| Insurance related commission expenses | - | - | - | - | - |
| Staff costs | - | 380 | - | - | - |
| Current tax expense | - | - | 8,907 | - | - |

### 31 Related Party Transactions (Continued)

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

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

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

At 30 June 2008, the Group's employees held 6 30% of the total share capital of the Group, or 31,518 ordinary shares with a par value of AZN 6,304 thousand (31 December 2007 6 30%, or 31,518 ordinary shares with a par value of AZN 6,304 thousand) Refer to Note 21

During the six-month period ended 30 June 2008, the total remuneration of members of the Board of Directors and key management personnel of the Group including discretionary compensation amounted to AZN 413 thousand (six-month period ended 30 June 2007 AZN 380 thousand)

As disclosed in Note 8, included in the gross amount of total loans and advances to customers as at 30 June 2008, are the loans granted to fifteen companies amounting to AZN 317,841 thousand (2007 fifteen borrowers, AZN 501,302 thousand) with interest rates being less than or equal to eight per cent and representing a significant concentration of 12% (31 December 2007 24%) of the total gross loan portfolio of the Group The majority of these loans are transactions with related parties and as such disclosed in Note 8 No adjustments have been made to the contractual interest rates in relation to these amounts on initial recognition at fair value as the interest rates applicable are considered to represent the highest and best use of the funds provided given the alternative uses by the Bank of the funds extended under these agreements

On 15 June 2004, the Group signed a credit agreement where an Azerbaijani company, a related party, acted as a borrower, the Group - as a guarantor of the Azerbaijani company, Commerzbank AG - as a lender and Export-Import Bank of the United States as a guarantor to Commerzbank AG for a credit line of USD 19,637 thousand at the rate of LIBOR plus 0 10% per annum repayable in sixteen semi-annual instalments beginning from 5 November 2006 for the purposes of construction of a business and entertainment complex in the centre of Baku As at 30 June 2008, the total amount drawn down on this credit line was USD 15,583 thousand or AZN 12,647 thousand (31 December 2007 USD 16,881 thousand or AZN 13,701 thousand) An import letter of credit of USD 3,000 thousand or AZN 2,435 thousand (31 December 2007 USD 3,000 thousand or AZN 2,536 thousand) had been issued by the Group for this borrower under the above credit facility

### 32 Principal Subsidiaries and Associates

The subsidiaries and associates of the Group included in this consolidated condensed interim financial information are presented in the table below

| | | | Percentage of ownership | |
|---|---|---|---|---|
| **Name** | **Nature of Business** | **Country of registration** | **30 June 2008** | **30 December 2007** |
| **Subsidiaries** | | | | |
| IBAR Moscow | Banking | Russian Federation | 100 0 | 100 0 |
| International Insurance Company | Insurance | Republic of Azerbaijan | 100 0 | 100 0 |
| Azericard Limited | Plastic cards | Republic of Azerbaijan | 100 0 | 100 0 |
| IBAR Georgia | Banking | Georgia | 75 0 | 75 0 |
| **Associates.** | | | | |
| Jointleasing | Leasing | Republic of Azerbaijan | 47 6 | 47 6 |
| Baku Inter-Bank Currency Exchange | Currency exchange | Republic of Azerbaijan | 20 0 | 20 0 |

## 33 Subsequent Events

Subsequent to the balance sheet date, during September-December period, a foreign bank placed six short-term deposits with the Bank in total amount of EUR 500,000 thousand at market interest rates

On 14 November 2008, a new law on "Stimulation of Increasing the Capitalization of Banks, Insurance and Reinsurance Companies" was enacted According to the law the profit tax rate for banks, insurance and reinsurance companies is reduced to 0% for three fiscal years from 1 January 2009, where all profits are retained within the business Management is currently considering the impact of the enactment of this law on the Group

On 5 November 2008, the Bank arranged the repayment of funds borrowed amounted to USD 92,000 thousand, which included the funds attracted under a syndicated borrowing agreement signed on 10 November 2006 with foreign banks led by one of the major German banks in the total initial amount of USD 130,000,000 Refer to Note 17

On 15 October 2008, the Bank signed a Letter of Credit Refinancing Facility Agreement with Sumitomo Mitsui Banking Corporation (SMBC), legal entity registered in Japan According to the Agreement Credit SMBC agrees to make available a Letter of Credit Refinancing Facility from time to time at its sole discretion in an amount of USD 20,000,000 The facility will be available only for irrevocable letter of credit issued that is aimed for export of goods or services shipped from Japan has amount exceeding USD 250 thousand on its face

On 20 August 2008, the Bank signed a term loan facility agreement with foreign banks led by one of the major German banks in the amount of USD 55,000,000 at a market interest rate with a maturity of one year for general funding requirements and financing of the trade-related projects

On 8 August 2008, the State Committee for Securities registered the issue of 500,000 thousand additional rights each with a nominal value of AZN 0 20 to increase the amount of share capital of the Bank to AZN 200,000 thousand This issue granted a right to existing shareholders to purchase these shares at the nominal face value of AZN 0 2 per share