

OPEN JOINT STOCK COMPANY BANK OF BAKU

Financial Statements

For the Year Ended 31 December 2008

OPEN JOINT STOCK COMPANY BANK OF BAKU

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OPEN JOINT STOCK COMPANY BANK OF BAKU

STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditors' report set out on pages 2-3, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the financial statements of Open Joint Stock Company Bank of Baku (the "Bank").

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Bank as at 31 December 2008, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

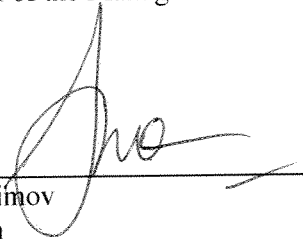
- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Preparing the financial statements on a going concern basis, unless it is inappropriate to presume that the Bank will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Bank;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Bank, and which enable them to ensure that the financial statements of the Bank comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Bank; and
- Detecting and preventing fraud, errors and other irregularities.

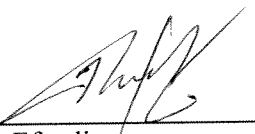
The financial statements for the year ended 31 December 2008 were authorized for issue on 26 May 2009 by the Management Board.

On behalf of the Management Board



Jalal Gasimov
Chairman

26 May 2009
Baku, Azerbaijan



Rena Efendiyeva
Chief Accountant

26 May 2009
Baku, Azerbaijan

INDEPENDENT AUDITORS' REPORT

To the Shareholders and the Board of Directors of the Open Joint Stock Company Bank of Baku:

Report on the financial statements

We have audited the accompanying financial statements of Open Joint Stock Company Bank of Baku, which comprise the balance sheet as at 31 December 2008, and the income statement, statements of changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the financial statements

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

Auditors' responsibility

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

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

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



Opinion

In our opinion, the financial statements present fairly, in all material respects the financial position of Open Joint Stock Company Bank of Baku as at 31 December 2008, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte & Touche.

26 May 2009
Baku, the Republic of Azerbaijan

OPEN JOINT STOCK COMPANY BANK OF BAKU

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats and in thousands)

| | Notes | Year ended 31 December 2008 | Year ended 31 December 2007 |
|--|-------|-----------------------------------|-----------------------------------|
| Interest income | 4, 25 | 35,711 | 17,842 |
| Interest expense | 4, 25 | (15,471) | (7,925) |
| NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS | | 20,240 | 9,917 |
| Provision for impairment losses on interest bearing assets | 5, 25 | (1,138) | (2,537) |
| NET INTEREST INCOME | | 19,102 | 7,380 |
| Net gain on foreign exchange operations | 6 | 889 | 462 |
| Fee and commission income | 7, 25 | 2,824 | 3,616 |
| Fee and commission expense | 7 | (1,285) | (1,353) |
| Dividends income | | 20 | 29 |
| Recovery of provision/(provision) for impairment losses on other transactions | 5 | 32 | (15) |
| Other income | 8 | 700 | 227 |
| NET NON-INTEREST INCOME | | 3,180 | 2,966 |
| OPERATING INCOME | | 22,282 | 10,346 |
| OPERATING EXPENSES | 9, 25 | (12,536) | (6,686) |
| PROFIT BEFORE INCOME TAX | | 9,746 | 3,660 |
| Income tax expense | 10 | (2,253) | (852) |
| NET PROFIT | | 7,493 | 2,808 |
| EARNINGS PER SHARE <i>Basic and diluted (AZN)</i> | 11 | 2.20 | 0.83 |

On behalf of the Management Board

Jalal Gasimov
Chairman

26 May 2009
Baku, Azerbaijan

Rena Efendiyeva
Chief Accountant

26 May 2009
Baku, Azerbaijan

The notes on pages 9 to 55 form an integral part of these financial statements.

OPEN JOINT STOCK COMPANY BANK OF BAKU

BALANCE SHEET

AS AT 31 DECEMBER 2008

(in Azerbaijan Manats and in thousands)

| | Notes | 31 December 2008 | 31 December 2007 |
|--|--------|---------------------|---------------------|
| ASSETS: | | | |
| Cash and balances with the National Bank of the Republic of Azerbaijan | 12 | 11,307 | 12,721 |
| Due from banks | 13 | 7,743 | 5,125 |
| Loans to customers | 14, 25 | 132,624 | 118,992 |
| Investments available-for-sale | 15 | 15,756 | 2,160 |
| Property and equipment | 16 | 11,918 | 12,079 |
| Other assets | 17 | 674 | 920 |
| TOTAL ASSETS | | 180,022 | 151,997 |
| LIABILITIES AND EQUITY | | | |
| LIABILITIES: | | | |
| Due to banks and other credit institutions | 18 | 59,009 | 57,881 |
| Customer accounts | 19, 25 | 84,909 | 64,452 |
| Debt securities issued | 20 | 2,021 | 6,153 |
| Current income tax liabilities | | 2,186 | 263 |
| Deferred income tax liabilities | 10 | 1,933 | 1,945 |
| Other liabilities | 21, 25 | 2,052 | 884 |
| Total liabilities | | 152,110 | 131,578 |
| EQUITY: | | | |
| Share capital | 22 | 6,800 | 6,800 |
| Revaluation reserve | | 6,701 | 7,097 |
| Retained earnings | | 14,411 | 6,522 |
| Total equity | | 27,912 | 20,419 |
| TOTAL LIABILITIES AND EQUITY | | 180,022 | 151,997 |

On behalf of the Management Board

Jalal Gasimov
Chairman

26 May 2009
Baku, Azerbaijan

Rena Efendiyeva
Chief Accountant

26 May 2009
Baku, Azerbaijan

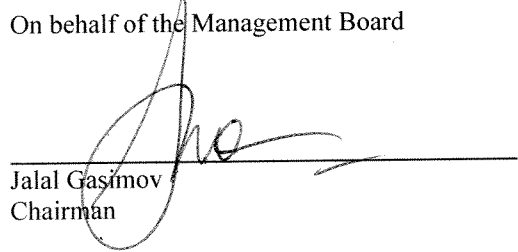
The notes on pages 9 to 55 form an integral part of these financial statements.

OPEN JOINT STOCK COMPANY BANK OF BAKU

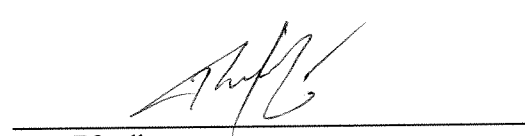
STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats and in thousands)

| | Share capital | Revaluation reserve | Retained earnings | Total equity |
|--|---------------|---------------------|-------------------|---------------|
| 31 December 2006 | 6,800 | 1,658 | 4,514 | 12,972 |
| Amortization of revaluation gain, net of deferred tax | - | (117) | 117 | - |
| Revaluation of property and equipment, net of deferred tax of AZN 1,567 thousand | - | 5,556 | - | 5,556 |
| Dividends declared | - | - | (917) | (917) |
| Net profit | - | - | 2,808 | 2,808 |
| 31 December 2007 | 6,800 | 7,097 | 6,522 | 20,419 |
| Amortization of revaluation gain, net of deferred tax | - | (396) | 396 | - |
| Net profit | - | - | 7,493 | 7,493 |
| 31 December 2008 | 6,800 | 6,701 | 14,411 | 27,912 |

On behalf of the Management Board


Jalal Gasimov
Chairman

26 May 2009
Baku, Azerbaijan


Rena Efendiyeva
Chief Accountant

26 May 2009
Baku, Azerbaijan

The notes on pages 9 to 55 form an integral part of these financial statements.

OPEN JOINT STOCK COMPANY BANK OF BAKU

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats and in thousands)

| | Notes | Year ended 31 December 2008 | Year ended 31 December 2007 |
|---|-------|-----------------------------------|-----------------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Profit before income taxes | | 9,746 | 3,660 |
| Adjustments for: | | | |
| Provision for impairment losses on interest bearing assets | 5, 25 | 1,138 | 2,537 |
| (Recovery of provision)/provision for impairment losses on other transactions | 5 | (32) | 15 |
| Translation (gain)/loss on foreign exchange operations | 6 | (456) | 42 |
| Dividend income | | (20) | (29) |
| Depreciation and amortization expense | 9 | 1,328 | 663 |
| Loss on disposal of property and equipment | | 28 | 3 |
| Net change in interest accruals | | 1,186 | 1,363 |
| Cash flows from operating activities before changes in operating assets and liabilities | | 12,918 | 8,254 |
| Changes in operating assets and liabilities | | | |
| (Increase)/decrease in operating assets: | | | |
| Minimum reserve deposit with the National Bank of the Republic of Azerbaijan | | 1,434 | (1,927) |
| Due from banks | | 4,454 | (1,751) |
| Loans to customers | | (17,035) | (73,992) |
| Other assets | | 149 | (502) |
| Increase/(decrease) in operating liabilities: | | | |
| Due to banks and other credit institutions | | 1,669 | 44,548 |
| Customer accounts | | 21,782 | 21,366 |
| Other liabilities | | 1,211 | 323 |
| Cash inflow/(outflow) from operating activities before income taxes | | 26,582 | (3,681) |
| Income tax paid | | (342) | (885) |
| Net cash inflow/(outflow) from operating activities | | 26,240 | (4,566) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Purchase of property and equipment | 16 | (1,178) | (860) |
| Proceeds on sale of property and equipment | | 14 | 3 |
| Proceeds on sale of securities available-for-sale | | 143,909 | 97,389 |
| Purchase of securities available-for-sale | | (157,486) | (94,368) |
| Dividends received | | 20 | 29 |
| Net cash (outflow)/inflow from investing activities | | (14,721) | 2,193 |

OPEN JOINT STOCK COMPANY BANK OF BAKU

STATEMENT OF CASH FLOWS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008 (in Azerbaijan Manats and in thousands)

| | Notes | Year ended 31 December 2008 | Year ended 31 December 2007 |
|--|-------|-----------------------------------|-----------------------------------|
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Repayment of debt securities issued | | (4,000) | - |
| Proceeds from issue of debt securities | | - | 3,001 |
| Dividends paid | | - | (648) |
| Net cash (outflow)/inflow from financing activities | | (4,000) | 2,353 |
| <i>Effect of changes in foreign exchange rate on cash and cash equivalents</i> | | (267) | (42) |
| NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS | | 7,252 | (62) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD | 12 | 6,545 | 6,607 |
| CASH AND CASH EQUIVALENTS AT END OF THE PERIOD | 12 | 13,797 | 6,545 |

Interest paid and received by the Bank during the year ended 31 December 2008 amounted to AZN 13,824 thousand and AZN 35,250 thousand, respectively.

Interest paid and received by the Bank during the year ended 31 December 2007 amounted to AZN 5,581 thousand and AZN 16,902 thousand, respectively.

On behalf of the Management Board

Jalal Gasimov
Chairman

26 May 2009
Baku, Azerbaijan

Rena Efendiyeva
Chief Accountant

26 May 2009
Baku, Azerbaijan

The notes on pages 9 to 55 form an integral part of these financial statements.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

1. ORGANISATION

On 18 February 2005 Open Joint Stock Commercial Bank "Bank of Baku" (Bank of Baku) and Closed Joint Stock Commercial Bank Ilkbank ("Ilkbank") combined and formed a new bank under the name Open Joint Stock Commercial Bank "Bank of Baku" ("the Bank"). The Bank received from the National Bank of the Republic of Azerbaijan (the "NBA") a new banking license number 247. The share capital of the Bank was formed in equal amounts by both Bank of Baku and Ilkbank. The Bank is a legal successor of both banks. The address of the Bank's registered office is 42 Ataturk Avenue, Baku, AZ1069, the Republic of Azerbaijan. The Bank changed its name from Open Joint Stock Commercial Bank "Bank of Baku" to Open Joint Stock Company Bank of Baku on 15 May 2006. The Bank is regulated by the NBA. The Bank's principal business activities are commercial and retail banking operations.

The Head Office of the Bank provides a full range of commercial and retail banking operations. As at 31 December 2008 the Bank had 14 branches and 3 service divisions in Azerbaijan (2007: 14 branches and 3 service divisions).

As at 31 December 2008 and 2007 the shareholding structure of the Bank was as follows:

| | 31 December 2008, % | 31 December 2007, % |
|----------------------------|------------------------|------------------------|
| NAB Holding | 40.00 | 40.00 |
| Azpetrol Neft Shirketi LLC | 28.89 | 28.89 |
| Mr. R. Aliyev | 11.22 | 11.22 |
| Mr. E. Isayev | 10.00 | 10.00 |
| Azinvest LLC | 9.89 | 9.89 |
| Total | 100.00 | 100.00 |

The ultimate shareholders of NAB Holding are Nader Mohaghegh Oromi, Bahram Mohaghegh Oromi, Shahram Mohaghegh Oromi; of Azpetrol Neft Shirketi LLC is Mammadov Ibrahim; of Azinvest LLC is Rafiq Aliyev.

On 19 October 2005, Mr. Rafiq Aliyev, one of the shareholders of the Bank, had been detained by the Government authorities and a legal case was launched against him subsequently. Mr. Aliyev's detention does not relate to his ownership in or dealings with the Bank. Consequently, the Ministry of Taxes of the Republic of Azerbaijan and the National Bank of the Republic of Azerbaijan had conducted independent audits of the Bank's operations. These audits completed in February of 2006 and did not reveal any instances of unlawful conduct in the Bank's operations. During the course of these events the Bank, without disruptions, had maintained its normal course of business.

Mr. R. Aliyev owns 21.11% (11.22% of direct ownership and 9.89% through Azinvest LLC) of the share capital of the Bank.

As at 31 December 2008 and 2007 the Bank has a subsidiary – Bob Broker Ltd. The subsidiary was formed as a limited liability company under the laws of the Republic of Azerbaijan on 28 February 2007. The company's principal activity is operations with securities on the stock market of the Republic of Azerbaijan. The company possesses a license for operations with securities from the State Securities Committee of the Republic of Azerbaijan dated 15 May 2007. The Bank's management decided not to consolidate the company, because effect of such consolidation would be immaterial for the financial statements as a whole.

These financial statements were authorized for issue by the Management Board on 26 May 2009.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

2. BASIS OF PRESENTATION

Accounting basis

These financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

These financial statements are presented in thousands of Azerbaijan Manats ("AZN"), unless otherwise indicated. These financial statements have been prepared under the historical cost convention, except for the measurement at fair value of certain financial instruments and measurement of buildings at revalued amounts according to International Accounting Standard ("IAS") No. 16 "Property, Plant and Equipment".

The Bank maintains its accounting records in accordance with Azerbaijan law, which in majority complies with IFRS. These financial statements have been prepared from the Azerbaijan statutory accounting records and have been adjusted to conform with IFRS. Adjustments include certain reclassifications to reflect the economic substance of underlying transactions including reclassifications of certain assets and liabilities, income and expenses to appropriate financial statement captions.

Functional currency

Items included in the financial statements of the Bank are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to the Bank (the "functional currency"). The functional currency of the financial statements is the Azerbaijan Manat ("AZN").

3. SIGNIFICANT ACCOUNTING POLICIES

Recognition and measurement of financial instruments

The Bank recognizes financial assets and liabilities on its balance sheet when it becomes a party to the contractual obligations of the instrument. Regular way purchases and sales of financial assets and liabilities are recognized using settlement date accounting. Regular way purchases of financial instruments that will be subsequently measured at fair value between trade date and settlement date are accounted for in the same way as for acquired instruments.

Financial assets and liabilities are initially recognized at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to acquisition or issue of the financial asset or financial liability. The accounting policies for subsequent re-measurement of these items are disclosed in the respective accounting policies set out below.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Cash and cash equivalents

Cash and cash equivalents include cash on hand, unrestricted balances on correspondent and time deposit accounts with the National Bank of the Republic of Azerbaijan with original maturity within 90 days, advances to banks in countries included in the Organization for Economic Co-operation and Development ("OECD"), except for margin deposits for operations with plastic cards, and government securities denominated in AZN carried at fair value through profit or loss, which may be converted to cash within a short period of time. For the purposes of determining cash flows, the minimum reserve deposit required by the National Bank of the Republic of Azerbaijan is not included as a cash equivalent due to restrictions on its availability.

Due from banks

In the normal course of business, the Bank maintains advances and deposits for various periods of time with other banks. Due from banks are initially recognized at fair value. Due from banks with a fixed maturity term are subsequently measured at amortized cost using the effective interest method, and are carried net of any allowance for impairment losses. Those that do not have fixed maturities are carried at amortized cost based on expected maturities. Amounts due from credit institutions are carried net of any allowance for impairment losses.

Loans to customers

Loans to customers are non-derivative assets with fixed or determinable payments that are not quoted in an active market, other than those classified in other categories of financial assets.

Loans to customers granted by the Bank are initially recognized at fair value plus related transaction costs. Where the fair value of consideration given does not equal the fair value of the loan, for example where the loan is issued at lower than market rates, the difference between the fair value of consideration given and the fair value of the loan is recognized as a loss on initial recognition of the loan and included in the income statement according to the nature of the losses. Subsequently, loans are carried at amortized cost using the effective interest method. Loans to customers are carried net of any allowance for impairment losses.

Write off of loans and advances

Loans and advances are written off against allowance for impairment losses in case of uncollectibility of loans and advances, including through repossession of collateral. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Bank and after the Bank has sold all available collateral. In accordance with the statutory legislation, loans may only be written off with the approval of the Supervisory Board and, in certain cases, with the respective decision of the Court.

Allowance for impairment losses

Assets carried at amortized cost

The Bank accounts for impairment losses of financial assets when there is objective evidence that a financial asset or group of financial assets is impaired. Impairment losses are measured as the difference between carrying amounts and the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted at the financial asset's original effective interest rate.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Such impairment losses are not reversed, unless if in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, such as recoveries, in which case the previously recognized impairment loss is reversed by adjustment of an allowance account.

For financial assets carried at cost, impairment losses are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows, discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in the income statement, is transferred from equity to the income statement. Reversals of impairment losses in respect of equity instruments classified as available-for-sale are not recognized in the income statement. Reversals of impairment losses on debt instruments are reversed through the income statement if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment losses were recognized in the income statement.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized where:

- the rights to receive cash flows from the asset have expired;
- the Bank has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- the Bank either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial asset is derecognized when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Bank either: (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Bank reassesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. If substantially all the risks and rewards have been retained, the asset remains on the balance sheet. If substantially all of the risks and rewards have been transferred, the asset is derecognized. If substantially all the risks and rewards have been neither retained nor transferred, the Bank assesses whether or not it has retained control of the asset. If it has not retained control, the asset is derecognized. Where the Bank has retained control of the asset, it continues to recognize the asset to the extent of its continuing involvement.

Financial liabilities

A financial liability is derecognized when the obligation is discharged, cancelled, or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a de-recognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the income statement.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Finance leases

Finance leases are leases that transfer substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. The lease is classified as a finance lease if:

- The lease transfers ownership of the asset to the lessee by the end of the lease term;
- The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;
- The lease term is for the major part of the economic life of the asset even if title is not transferred;
- At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
- The leased assets are of a specialized nature such that only the lessee can use them without major modifications being made.

The Bank as a lessor

The Bank as a lessor presents finance leases as loans and initially measures them at an amount equal to the net investment in the lease. Subsequently, the recognition of finance income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Bank's net investment in the finance lease.

Before commencement date equipment purchased for future transfer to finance lease is recognized in the financial statements as property and equipment purchased to transfer to finance lease at cost.

Investments available-for-sale

Investments available-for-sale represent debt and equity investments that are intended to be held for an indefinite period of time. Investments available-for-sale are initially recorded at fair value and subsequently measured at fair value, with such re-measurement recognized directly in equity, except for impairment losses, foreign exchange gains or losses and interest income accrued using the effective interest method, which are recognized directly in the income statement. When sold, the gain/loss previously recorded in equity is recycled through the income statement. The Bank uses quoted market prices to determine the fair value for the Bank's investments available-for-sale. If the market for investments is not active, the Bank establishes fair value by using valuation techniques. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the Bank uses that technique.

Dividends received on investments available-for-sale are included in dividend income in the income statement.

Non-marketable equity securities are stated at amortized cost and cost, respectively, less impairment losses, if any, unless fair value can be reliably measured.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

When there is objective evidence that such securities have been impaired, the cumulative loss previously recognized in equity is removed from equity and recognized in the income statement for the period. Reversals of such impairment losses on debt instruments, which are objectively related to events occurring after the impairment, are recognized in the income statement for the period. Reversals of such impairment losses on equity instruments are not recognized in the income statement.

Property, equipment and intangible assets

Property, equipment and intangible assets are stated at cost (except for buildings, which are stated at revalued amounts) less accumulated depreciation and accumulated impairment losses.

Depreciation and amortization is charged on the carrying value of property, equipment and intangible assets and is designed to write off assets over their useful economic lives. Depreciation and amortization is calculated on a straight line basis at the following annual prescribed rates:

| | |
|---------------------------------------|-----|
| Buildings and other real estate | 5% |
| Furniture and equipment | 20% |
| Computers and communication equipment | 25% |
| Vehicles | 20% |
| Other fixed assets | 20% |
| Intangible assets | 10% |

The carrying amounts of property, equipment and intangible assets are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts. The recoverable amount is the higher of fair value less costs to sell and value in use. Where carrying values exceed the estimated recoverable amount, assets are written down to their recoverable amount, an impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation or amortization charge for property, equipment and intangible assets is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

Buildings held for use in supply of services, or for administrative purposes, are stated in the balance sheet at their revalued amounts, being the fair value at the date of revaluation, determined from market-based evidence by appraisal undertaken by professional independent appraisers, less any subsequent accumulated depreciation on buildings and subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date.

Any revaluation increase arising on the revaluation of such land and buildings is credited to the property and equipment revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognized as an expense, in which case the increase is credited to the income statement to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of such land and buildings is charged as an expense to the extent that it exceeds the balance, if any, held in the property and equipment revaluation reserve relating to a previous revaluation of that asset.

Depreciation on revalued buildings is charged to the income statement. The surplus transferred directly to retained earnings as the asset is used by the Bank. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Transfers from revaluation surplus to retained earnings are not made through the income statement.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Market value of property is assessed using two methods:

- The comparable sales method which involves analysis of market sales prices for similar real estate property;
- The income-based method which assumes a direct relationship between revenues generated by the property and its market value.

Taxation

Income tax expense represents the sum of the current and deferred tax expense.

The current tax expense is based on taxable profit for the year. Taxable profit differs from net profit before tax as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Bank's current tax expense is calculated using tax rates that have been enacted during the reporting period.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the balance sheet if:

- The Bank has a legally enforceable right to set off current income tax assets against current income tax liabilities; and
- Deferred income tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

Azerbaijan has various other taxes, which are assessed on the Bank's activities. These taxes are included as a component of operating expenses in the income statement.

Due to banks and other credit institutions, customer accounts and debt securities issued

Due to banks and other credit institutions, customer accounts and debt securities issued are initially recognized at fair value. Subsequently, amounts due are stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the income statement over the period of the borrowings, using the effective interest method.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Provisions

Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the obligation can be made.

Financial guarantee contracts issued and letters of credit

Financial guarantee contracts and letters of credit issued by the Bank provide for specified payments to be made in order to reimburse the holder for a loss incurred such that payments are made when a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. Such financial guarantee contracts and letters of credit issued are initially recognized at fair value. Subsequently they are measured at the higher of (a) the amount recognized as a provision in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets"; and (b) the amount initially recognized less, where appropriate, cumulative amortization of initial premium revenue received over the financial guarantee contracts or letter of credit issued.

Contingencies

Contingent liabilities are not recognized in the balance sheet but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognized in the balance sheet but disclosed when an inflow of economic benefits is probable.

Share capital

Share capital is recognized at cost.

Dividends on ordinary shares are recognized in equity as a reduction in the period in which they are declared. Dividends that are declared after the balance sheet date are treated as a subsequent event under International Accounting Standard 10 "Events after the Balance Sheet Date" (IAS 10) and disclosed accordingly.

Retirement and other benefit obligations

In accordance with the requirements of the Azerbaijan legislation, certain percentages of pension payments are withheld from total disbursement to staff to be transferred to pension funds, such that a portion of salary expense is withheld from the employee and instead paid to a pension fund on behalf of the employee. This expense is charged in the period the related salaries are earned. Upon retirement all retirement benefit payments are made by pension funds as selected by employees. The Bank does not have any pension arrangements separate from the state pension system of Azerbaijan. In addition, the Bank has no post-retirement benefits or other significant compensated benefits requiring accrual.

Recognition of income and expense

Recognition of interest income and expense

Interest income and expense are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Once a financial asset or a group of similar financial assets has been written down (partly written down) as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest earned on assets at fair value is classified within interest income.

Recognition of fee and commission income and expense

Loan origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in the income statement over the remaining period of the loan commitment. Where a loan commitment expires without resulting in a loan, the loan commitment fee is recognized in the income statement on expiry. Loan servicing fees are recognized as revenue as the services are provided. All other commissions are recognized when services are provided.

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Azerbaijan Manats at the appropriate spot rates of exchange ruling at the balance sheet date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Profits and losses arising from these translations are included in net gain on foreign exchange operations.

Rates of exchange

The exchange rates at year-end used by the Bank in the preparation of the financial statements are as follows:

| | 31 December 2008 | 31 December 2007 |
|-----------------|---------------------|---------------------|
| 1 US Dollar/AZN | 0.8010 | 0.8453 |
| 1 Euro/AZN | 1.1292 | 1.2450 |

Offset of financial assets and liabilities

Financial assets and liabilities are offset and reported net on the balance sheet when the Bank has a legally enforceable right to set off the recognized amounts and the Bank intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. In accounting for a transfer of a financial asset that does not qualify for de-recognition, the Bank does not offset the transferred asset and the associated liability

Segment reporting

A segment is a distinguishable component of the Bank that is engaged either in providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segments with a majority of revenue earned from sales to external customers and whose revenue, result or assets are ten per cent or more of all the segments are reported separately. The Bank's primary format for reporting segment information is based on business segments.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Areas of significant management judgment and sources of estimation uncertainty

The preparation of the Bank's financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the balance sheet date and the reported amount of income and expenses during the period ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The following estimates and judgments are considered important to the portrayal of the Bank's financial condition.

Allowance for impairment of loans

The Bank regularly reviews its loans to assess for impairment. The Bank's loan impairment provisions are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Bank considers accounting estimates related to allowance for impairment of loans and receivables a key source of estimation uncertainty because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and receivables are based on recent performance experience, and (ii) any significant difference between the Bank's estimated losses and actual losses would require the Bank to record provisions which could have a material impact on its financial statements in future periods.

The Bank uses management's judgment to estimate the amount of any impairment loss in cases where a borrower has financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on past performance, past customer behavior, observable data indicating an adverse change in the payment status of borrowers in a group, and national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans. The Bank uses management's judgment to adjust observable data for a group of loans to reflect current circumstances not reflected in historical data.

The allowances for impairment of financial assets in the financial statements have been determined on the basis of existing economic and political conditions. The Bank is not in a position to predict what changes in conditions will take place in country and what effect such changes might have on the adequacy of the allowances for impairment of financial assets in future periods.

The carrying amount of the allowance for impairment of loans to customers is AZN 4,857 thousand and AZN 3,847 thousand as at 31 December 2008 and 2007, respectively.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Valuation of Financial Instruments

Financial instruments that are classified as available for sale are stated at fair value. The fair value of such financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. If a quoted market price is available for an instrument, the fair value is calculated based on the market price. When valuation parameters are not observable in the market or cannot be derived from observable market prices, the fair value is derived through analysis of other observable market data appropriate for each product and pricing models which use a mathematical methodology based on accepted financial theories. Pricing models take into account the contract terms of the securities as well as market-based valuation parameters, such as interest rates, volatility, exchange rates and the credit rating of the counterparty. Where market-based valuation parameters are not directly observable, management will make a judgment as to its best estimate of that parameter in order to determine a reasonable reflection of how the market would be expected to price the instrument. In exercising this judgment, a variety of tools are used including proxy observable data, historical data, and extrapolation techniques. The best evidence of fair value of a financial instrument at initial recognition is the transaction price unless the instrument is evidenced by comparison with data from observable markets. Any difference between the transaction price and the value based on a valuation technique is not recognized in the income statement on initial recognition. Subsequent gains or losses are only recognized to the extent that it arises from a change in a factor that market participants would consider in setting a price.

The Bank considers that the accounting estimate related to valuation of financial instruments where quoted markets prices are not available is a key source of estimation uncertainty because: (i) it is highly susceptible to change from period to period because it requires management to make assumptions about interest rates, volatility, exchange rates, the credit rating of the counterparty, valuation adjustments and specific feature of the transactions and (ii) the impact that recognizing a change in the valuations would have on the assets reported on its balance sheet as well as its profit/(loss) could be material.

Had management used different assumptions regarding the interest rates, volatility, exchange rates, the credit rating of the counterparty and valuation adjustments, a larger or smaller change in the valuation of financial instruments where quoted market prices are not available would have resulted that could have had a material impact on the Bank's reported net income.

The carrying amount of the financial instruments at fair value is as follows as at 31 December 2008 and 2007:

| | 31 December 2008 | 31 December 2007 |
|--------------------------------|------------------|------------------|
| Investments available-for-sale | 15,756 | 2,160 |

Adoption of new and revised standards

In the current year, the Bank has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the "IASB") and the International Financial Reporting Interpretations Committee (the "IFRIC") of the IASB that are relevant to its operations and effective for annual reporting periods ending on 31 December 2008. The adoption of these new and revised Standards and Interpretations has not resulted in significant changes to the Bank's accounting policies that have affected the amounts reported for the current or prior years.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Amendments to IAS 1 “Capital Disclosures” (“IAS 1”) – On 18 August 2005, the IASB issued an amendments to IAS 1 which requires certain disclosures to be made regarding the entity’s objectives, policies and processes for managing capital. Additional information was disclosed in the financial statements for the current and comparative reporting periods as required by amended IAS 1.

Amendments to IAS 39, “Financial Instruments: Recognition and Measurement”, and IFRS 7, “Financial Instruments: Disclosures”, titled “Reclassification of Financial Assets” – On 13 October 2008 IASB issued amendments to IAS 39 and IFRS 7 which permits certain reclassifications of non-derivative financial assets (other than those designated as at fair value through profit or loss at initial recognition under the fair value option) out of the fair value through profit or loss category and also allow reclassification of financial assets from the available for sale category to the loans and receivables category in particular circumstances. The amendments to IFRS 7 introduce additional disclosure requirements if an entity has reclassified financial assets in accordance with the amendments to IAS 39. The amendments are effective as of 13 October 2008 and in certain circumstances can be applied retrospectively from 1 July 2008. The Bank has elected not to apply the amendments to IAS 39 and IFRS 7 retrospectively.

Standards and interpretations issued and not yet adopted

At the date of authorization of these financial statements, other than the Standards and Interpretations adopted by the Bank in advance of their effective dates, the following Interpretations were in issue but not yet effective.

IFRIC 9 “Reassessment of Embedded Derivatives” which requires that there should be no reassessment of whether an embedded derivative should be separated from the host contract after initial recognition, unless there have been changes to the contract. The adoption of IFRIC 9 had no impact on the Bank’s profit or loss or financial position.

IFRS 8 – The IASB issued IFRS 8 “Operating Segments” in December 2006. This will replace IAS 14 “Segment Reporting” for accounting periods beginning on or after 1 January 2009. IFRS 8 requires segmental analysis reported by an entity to be based on information used by management. Management is currently assessing the impact of the adoption of IFRS 8.

IAS 1 – On 6 September 2006, the IASB issued an amendment to IAS 1 which changes the way in which non-owner changes in equity are required to be presented to in IFRS but does not require that these be renamed in an entity’s financial statements. The amendment to IAS 1 is effective for periods beginning on or after 1 January 2009.

IAS 23 – On March 2007 the IASB issued a revised IAS 23 “Borrowing Costs”. The main change 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 borrowing costs as part of the cost of such asset. The Standard applies to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

IAS 27 - In 2008 the Standard was amended as part of the second phase of the business combinations project. That phase of the project was undertaken jointly with the US Financial Accounting Standards Board (FASB). The amendments related, primarily, to accounting for non-controlling interests and the loss of control of a subsidiary. The boards concluded the second phase of the project by the IASB issuing the amended IAS 27 and the FASB issuing FASB Statement No. 160 Noncontrolling Interests in Financial Statements, along with, respectively, a revised IFRS 3 Business Combinations and FASB Statement No. 141 (revised 2007) Business Combinations. The amended Standard must be applied for annual periods beginning on or after 1 July 2009. Earlier application is permitted. However, an entity must not apply the amendments for annual periods beginning before 1 July 2009 unless it also applies IFRS 3 (as revised in 2008).

4. NET INTEREST INCOME

| | Year ended 31 December 2008 | Year ended 31 December 2007 |
|--|-----------------------------------|-----------------------------------|
| Interest income comprises: | | |
| Interest income on financial assets recorded at amortized cost: | | |
| - interest income on impaired financial assets | 32,395 | 10,729 |
| - interest income on unimpaired financial assets | 2,481 | 6,477 |
| Interest income on investments available-for-sale | 696 | 623 |
| Interest income on guarantees | 139 | 13 |
| Total interest income | 35,711 | 17,842 |
| Interest income on financial assets recorded at amortized cost comprises: | | |
| Interest on loans to customers | 34,769 | 16,977 |
| Interest on due from banks | 107 | 229 |
| Total interest income on financial assets recorded at amortized cost | 34,876 | 17,206 |
| Interest income on investments available-for-sale | 696 | 623 |
| Interest income on guarantees | 139 | 13 |
| Total interest income | 35,711 | 17,842 |
| Interest expense comprises: | | |
| Interest expense on financial liabilities recorded at amortized cost comprise | | |
| Interest on customer accounts | (8,194) | (5,782) |
| Interest on due to banks and other credit institutions | (6,644) | (1,518) |
| Interest on debt securities issued | (633) | (625) |
| Total interest expense on financial liabilities recorded at amortized cost | (15,471) | (7,925) |
| Net interest income before provision for impairment losses on interest bearing assets | 20,240 | 9,917 |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

5. ALLOWANCE FOR IMPAIRMENT LOSSES, OTHER PROVISIONS

The movements in allowance for impairment losses on interest bearing assets were as follows:

| | Loans to customers | Due from banks | Investments available-for- sale | Total |
|---------------------------------|-----------------------|-------------------|---------------------------------------|--------------|
| 31 December 2006 | 1,327 | 9 | 5 | 1,341 |
| Additional provision recognized | 2,547 | - | - | 2,547 |
| Write-off of assets | (27) | - | - | (27) |
| Recovery of provision | - | (8) | (2) | (10) |
| 31 December 2007 | 3,847 | 1 | 3 | 3,851 |
| Additional provision recognized | 1,139 | - | - | 1,139 |
| Write-off of assets | (129) | - | - | (129) |
| Recovery of provision | - | (1) | - | (1) |
| 31 December 2008 | 4,857 | - | 3 | 4,860 |

The movements in allowances for impairment losses on other transactions were as follows:

| | Guarantees and other commitments | Other assets | Total |
|---------------------------------|--|-----------------|-----------|
| 31 December 2006 | - | 17 | 17 |
| Additional provision recognized | 32 | - | 32 |
| Recovery of provision | - | (17) | (17) |
| 31 December 2007 | 32 | - | 32 |
| Recovery of provision | (32) | - | (32) |
| 31 December 2008 | - | - | - |

6. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprises:

| | Year ended 31 December 2008 | Year ended 31 December 2007 |
|--|-----------------------------------|-----------------------------------|
| Translation differences, net | 456 | (42) |
| Dealing, net | 433 | 504 |
| Total net gain on foreign exchange operations | 889 | 462 |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

7. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

| | Year ended 31 December 2008 | Year ended 31 December 2007 |
|---|-----------------------------------|-----------------------------------|
| Fee and commission income: | | |
| Cash operations | 1,313 | 955 |
| Plastic cards operations | 544 | 941 |
| Settlements | 528 | 1,258 |
| Foreign exchange operations | 360 | 391 |
| Documentary operations | 7 | 55 |
| Other | 72 | 16 |
| Total fee and commission income | 2,824 | 3,616 |
| Fee and commission expense: | | |
| Plastic cards operations | (438) | (480) |
| Settlements | (393) | (308) |
| Cash operations | (330) | (386) |
| Securities operations | (78) | (48) |
| Documentary operations | (18) | (19) |
| Foreign exchange operations | (2) | (3) |
| Other | (26) | (109) |
| Total fee and commission expense | (1,285) | (1,353) |

8. OTHER INCOME

Other income comprises:

| | Year ended 31 December 2008 | Year ended 31 December 2007 |
|------------------------------|-----------------------------------|-----------------------------------|
| Fines and penalties received | 692 | 225 |
| Other | 8 | 2 |
| Total other income | 700 | 227 |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

9. OPERATING EXPENSES

Operating expenses comprise:

| | Year ended 31 December 2008 | Year ended 31 December 2007 |
|--|-----------------------------------|-----------------------------------|
| Staff costs (including bonuses) | 8,416 | 3,948 |
| Depreciation and amortization | 1,328 | 663 |
| Operating lease | 759 | 526 |
| Advertising | 516 | 325 |
| Payments to Deposit Insurance Fund | 317 | 126 |
| Stationery | 206 | 204 |
| Security expenses | 195 | 95 |
| Professional service fees | 162 | 91 |
| Communications | 125 | 86 |
| Property and equipment maintenance | 93 | 302 |
| Taxes, other than income tax | 73 | 48 |
| Occupancy costs | 69 | 48 |
| Business trip expenses | 37 | 30 |
| Vehicle running costs | 30 | 24 |
| Losses from disposal of property and equipment | 28 | 3 |
| Membership fees | 21 | 22 |
| Legal fees | 18 | 69 |
| Representative expenses | 10 | 3 |
| Insurance cost | 10 | 6 |
| Other expenses | 123 | 67 |
| Total operating expenses | 12,536 | 6,686 |

10. INCOME TAXES

The Bank provides for taxes based on the statutory tax accounts maintained and prepared in accordance with the Azerbaijan statutory tax regulations that differ from International Financial Reporting Standards.

The Bank is subject to certain permanent tax differences due to the non-tax deductibility of certain expenses and a tax free regime for certain income.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at 31 December 2008 and 2007 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Temporary differences as at 31 December 2008 and 2007 comprise:

| | 31 December 2008 | 31 December 2007 |
|---|---------------------|---------------------|
| Deductible temporary differences: | | |
| Loans to customers | 794 | 435 |
| Property and equipment | 20 | 368 |
| Total deductible temporary differences | 814 | 803 |
| Taxable temporary differences: | | |
| Property and equipment | (8,838) | (9,088) |
| Loans from banks | (93) | - |
| Finance lease receivable | - | (51) |
| Provisions for credit lines and guarantees | (670) | (505) |
| Total taxable temporary differences | (9,601) | (9,644) |
| Net taxable temporary differences | (8,787) | (8,841) |
| Net deferred tax liability at the statutory tax rate (22%) | (1,933) | (1,945) |

Relationships between tax expenses and accounting profit for the year ended 31 December 2008 and 2007 are explained as follows:

| | Year ended 31 December 2008 | Year ended 31 December 2007 |
|--|-----------------------------------|-----------------------------------|
| Profit before income taxes | 9,746 | 3,660 |
| Tax at the statutory tax rate (22%) | 2,144 | 805 |
| Tax effect of permanent differences | 109 | 47 |
| Income tax expense | 2,253 | 852 |
| Current income tax expense | 2,265 | 878 |
| Change in the deferred tax liabilities | (12) | (26) |
| Income tax expense | 2,253 | 852 |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

| | 31 December 2008 | 31 December 2007 |
|---|---------------------|---------------------|
| Deferred income tax liabilities | | |
| Beginning of the period | 1,945 | 404 |
| Change in the income tax liability for the period charged to profit | (12) | (26) |
| Tax effect of changes in property and equipment revaluation reserve | - | 1,567 |
| End of the period | 1,933 | 1,945 |

11. EARNINGS PER SHARE

| | Year ended 31 December 2008 | Year ended 31 December 2007 |
|---|-----------------------------------|-----------------------------------|
| Profit: | | |
| Net profit for the year | 7,493 | 2,808 |
| Weighted average number of ordinary shares for basic and diluted earnings per share | 3,400,000 | 3,400,000 |
| Earnings per share – basic and diluted (AZN) | 2.20 | 0.83 |

12. CASH AND BALANCES WITH THE NATIONAL BANK OF THE REPUBLIC OF AZERBAIJAN

| | 31 December 2008 | 31 December 2007 |
|---|---------------------|---------------------|
| Cash | 4,671 | 3,845 |
| Balances with the National Bank of the Republic of Azerbaijan | 6,636 | 8,876 |
| Total cash and balances with the NBA | 11,307 | 12,721 |

The balances with the National Bank of the Republic of Azerbaijan as at 31 December 2008 and 2007 include AZN 5,054 thousand and AZN 6,488 thousand, respectively, which represents the obligatory minimum reserve deposits with the National Bank of the Republic of Azerbaijan. The Bank is entitled to use all funds on its correspondent account with the National Bank of the Republic of Azerbaijan provided that average daily balance for 15 days period will be eventually higher than required reserve mandatory balance.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Cash and cash equivalents for the purposes of the statement of cash flows comprise the following:

| | 31 December 2008 | 31 December 2007 |
|--|---------------------|---------------------|
| Cash and balances with the National Bank of the Republic of Azerbaijan | 11,307 | 12,721 |
| Due from banks in OECD countries | 7,544 | 312 |
| | 18,851 | 13,033 |
| Less minimum reserve deposits and foreign currency deposits with the National Bank of the Republic of Azerbaijan | (5,054) | (6,488) |
| Total cash and cash equivalents | 13,797 | 6,545 |

13. DUE FROM BANKS

Due from banks comprise:

| | 31 December 2008 | 31 December 2007 |
|--|---------------------|---------------------|
| Correspondent accounts with other banks | 7,639 | 2,910 |
| Loans and time deposits with other banks | 104 | 2,216 |
| | 7,743 | 5,126 |
| Less allowance for impairment losses | - | (1) |
| Total due from banks | 7,743 | 5,125 |

Movements in allowances for impairment losses on balances due from banks for the years ended 31 December 2008 and 2007 are disclosed in Note 5.

As at 31 December 2008 and 2007 accrued interest income included in due from banks amounted to AZN 6 thousand and AZN 3 thousand, respectively.

As at 31 December 2007 included in above is cash collateral with Dresdner Bank AG, Germany totaling AZN 2,121 thousand, which the Bank is obliged to maintain the credit facility provided by the counterparty.

As at 31 December 2008 and 2007 the Bank had loans and advances to 1 and 2 banks, which individually exceeded 10% of the Bank's equity.

As at 31 December 2008 and 2007 maximum credit risk exposure of due from banks amounted to AZN 7,743 thousand and AZN 5,125 thousand, respectively.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

14. LOANS TO CUSTOMERS

Loans to customers comprise:

| | 31 December 2008 | 31 December 2007 |
|--------------------------------------|-----------------------|-----------------------|
| Loans to customers | 133,636 | 120,285 |
| Net investment in finance lease | 3,845 | 2,554 |
| | <u>137,481</u> | <u>122,839</u> |
| Less allowance for impairment losses | (4,857) | (3,847) |
| Total loans to customers | <u>132,624</u> | <u>118,992</u> |

Movements in allowances for impairment losses for the years ended 31 December 2008 and 2007 are disclosed in Note 5.

The table below summarizes the amount of loans secured by collateral, rather than the fair value of the collateral itself:

| | 31 December 2008 | 31 December 2007 |
|--|-----------------------|-----------------------|
| Loans collateralized by vehicles | 51,403 | 34,634 |
| Loans collateralized by real estate | 35,712 | 34,918 |
| Loans collateralized by equipment | 27,795 | 26,617 |
| Loans collateralized by third party guarantees | 13,222 | 14,074 |
| Loans collateralized by inventories | 5,469 | 1,492 |
| Loans collateralized by other collateral | 1,752 | 2,694 |
| Loans collateralized by deposits and precious metals | 1,745 | 2,999 |
| Loans collateralized by insurance policies | 98 | 1,168 |
| Loans collateralized by corporate guarantees | - | 4,207 |
| Unsecured loans | 285 | 36 |
| | <u>137,481</u> | <u>122,839</u> |
| Less allowance for impairment losses | (4,857) | (3,847) |
| Total loans to customers | <u>132,624</u> | <u>118,992</u> |

| | 31 December 2008 | 31 December 2007 |
|--------------------------------------|-----------------------|-----------------------|
| Analysis by sector: | | |
| Individuals | 99,127 | 84,105 |
| Trade and services | 26,110 | 21,382 |
| Manufacturing | 5,350 | 9,280 |
| Construction | 3,081 | 3,192 |
| Energy | 1,762 | 2,014 |
| Agriculture | 1,401 | 2,065 |
| Other | 650 | 801 |
| | <u>137,481</u> | <u>122,839</u> |
| Less allowance for impairment losses | (4,857) | (3,847) |
| Total loans to customers | <u>132,624</u> | <u>118,992</u> |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Loans to individuals comprise the following products:

| | 31 December 2008 | 31 December 2007 |
|--------------------------------------|---------------------|---------------------|
| Car loans | 50,567 | 31,794 |
| Consumer loans | 45,281 | 49,733 |
| Mortgage loans | 1,980 | 2,063 |
| Other | 1,299 | 515 |
| | 99,127 | 84,105 |
| Less allowance for impairment losses | (3,941) | (2,634) |
| Total loans to individuals | 95,186 | 81,471 |

As at 31 December 2008 and 2007 all loans (100% of total portfolio) is granted to companies operating in the Republic of Azerbaijan, which represents a significant geographical concentration in one region.

As at 31 December 2008 and 2007 maximum credit risk exposure of loans to customers amounted to AZN 132,624 thousand and AZN 118,992 thousand, respectively. As at 31 December 2008 and 2007 a maximum credit risk exposure on loan commitments and overdrafts extended by the Bank to its customers amounted to AZN 7,202 thousand and AZN 8,036 thousand, respectively.

As at 31 December 2008 and 2007 accrued interest income included in loans to customers amounted to AZN 1,933 thousand and AZN 1,494 thousand, respectively.

As at 31 December 2008 and 2007 loans to customers included loans in amount of AZN 633 thousand and nil, respectively whose terms have been renegotiated. Otherwise these loans would be past due or impaired.

As at 31 December 2008 and 2007 loans to customers included loans in amount of AZN 6,668 thousand and AZN 4,856 thousand, respectively, that were individually impaired. As at 31 December 2008 and 2007 such loans were collateralized by property with a fair value of AZN 14,786 thousand and AZN 12,627 thousand, respectively.

The components of net investment in finance lease as at 31 December 2008 and 2007 are as follows:

| | 31 December 2008 | 31 December 2007 |
|---|---------------------|---------------------|
| Less than one year | 2,496 | 1,321 |
| Later than one year not later than five years | 2,183 | 2,001 |
| | 4,679 | 3,322 |
| Total minimum lease payments | (911) | (768) |
| Less: deferred finance charges | | |
| Net investment in finance lease | 3,768 | 2,554 |
| | 1,839 | 1,016 |
| Current portion | 1,929 | 1,538 |
| Long-term portion | | |
| Net investment in finance lease | 3,768 | 2,554 |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

15. INVESTMENTS AVAILABLE-FOR-SALE

Investments available-for-sale comprise:

| | 31 December 2008 | 31 December 2007 |
|---|----------------------|---------------------|
| Debt securities | 15,597 | 2,001 |
| Equity securities | <u>162</u> | <u>162</u> |
| | 15,759 | 2,163 |
| Less allowance for impairment losses | <u>(3)</u> | <u>(3)</u> |
| Total investments available-for-sale | <u>15,756</u> | <u>2,160</u> |

| | 31 December 2008 | | 31 December 2007 | |
|--|--------------------------|----------------------|--------------------------|---------------------|
| | Nominal interest rate | Fair value | Nominal interest rate | Fair value |
| Debt securities | | | | |
| <i>The National Bank of the Republic of Azerbaijan</i> | 4.18% | <u>15,597</u> | 7.67% | <u>2,001</u> |
| | | <u>15,597</u> | | <u>2,001</u> |

| | 31 December 2008 | | 31 December 2007 | |
|--|-----------------------|-------------------|-----------------------|-------------------|
| | Ownership interest | Fair value | Ownership interest | Fair value |
| Equity securities | | | | |
| <i>Bob Broker LTD</i> | 100.00% | 75 | 100.00% | 75 |
| <i>International Bank of Azerbaijan JSCB</i> | 0.04% | 47 | 0.04% | 47 |
| <i>Milli Kart LLC</i> | 1.00% | <u>40</u> | 1.00% | <u>40</u> |
| | | 162 | | 162 |
| Less allowance for impairment losses | | <u>(3)</u> | | <u>(3)</u> |
| Total investments available-for-sale | | <u>159</u> | | <u>159</u> |

Movements in allowances for impairment losses for the years ended 31 December 2008 and 2007 are disclosed in Note 5.

Bob Broker LTD is not consolidated in these financial statements, because effect of such consolidation would be immaterial for the financial statements as a whole.

As at 31 December 2008 and 2007 accrued interest income included in debt securities amounted to AZN 21 thousand and AZN 2 thousand, respectively.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

16. PROPERTY AND EQUIPMENT

Property and equipment comprise:

| | Land and buildings | Furniture and equipment | Computers and communication equipment | Vehicles | Other fixed assets | Total |
|--|-----------------------|-------------------------------|---|----------|--------------------------|--------|
| At initial/revalued cost | | | | | | |
| 31 December 2006 | 3,678 | 1,072 | 724 | 89 | 8 | 5,571 |
| Additions | 83 | 369 | 386 | 1 | 4 | 843 |
| Revaluation | 9,064 | - | - | - | - | 9,064 |
| Reclassified from held-for - sale | 804 | 34 | - | - | - | 838 |
| Transfers | - | - | (2) | - | 2 | - |
| Disposals | - | (55) | (23) | - | - | (78) |
| 31 December 2007 | 13,629 | 1,420 | 1,085 | 90 | 14 | 16,238 |
| Additions | - | 430 | 487 | 256 | 5 | 1,178 |
| Transfers | - | 13 | (13) | - | - | - |
| Disposals | (23) | (79) | (26) | (10) | (5) | (143) |
| 31 December 2008 | 13,606 | 1,784 | 1,533 | 336 | 14 | 17,273 |
| Accumulated depreciation | | | | | | |
| 31 December 2006 | 466 | 448 | 384 | 63 | 4 | 1,365 |
| Charge for the year | 249 | 223 | 160 | 11 | 3 | 646 |
| Eliminated on revaluation | 1,941 | - | - | - | - | 1,941 |
| Eliminated on reclassification as held for sale | 263 | 16 | - | - | - | 279 |
| Eliminated on disposals | - | (49) | (23) | - | - | (72) |
| Transfers | - | 8 | (8) | - | - | - |
| 31 December 2007 | 2,919 | 646 | 513 | 74 | 7 | 4,159 |
| Charge for the year | 686 | 296 | 271 | 42 | 2 | 1,297 |
| Transfers | - | 1 | (1) | - | - | - |
| Eliminated on disposals | (2) | (61) | (26) | (9) | (3) | (101) |
| 31 December 2008 | 3,603 | 882 | 757 | 107 | 6 | 5,355 |
| Net book value | | | | | | |
| 31 December 2008 | 10,003 | 902 | 776 | 229 | 8 | 11,918 |
| 31 December 2007 | 10,710 | 774 | 572 | 16 | 7 | 12,079 |

As at 31 December 2008 and 2007 included in property and equipment were fully depreciated assets of AZN 237 thousand and AZN 356 thousand, respectively.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

As at 31 December 2008 and 2007 the land and buildings owned by the Bank were revalued to market value according to the report of an independent appraiser. The following methods were used for the estimation of their fair value: discounted cash flow method (income approach) and method of sales comparison (comparative approach). For the estimation of the final value, certain weights were assigned to the results obtained using different approaches, depending on the degree to which the estimates met the following characteristics: reliability and completeness of the information, specifications of the estimated property and other.

As a result, the carrying value of the land and buildings amounted to AZN 10,003 thousand and AZN 10,710 thousand as at 31 December 2008 and 2007, respectively. If the land and buildings were accounted at historical cost less accumulated depreciation and impairment losses, its carrying value would be AZN 1,695 thousand and AZN 1,799 thousand as at 31 December 2008 and 2007, respectively.

17. OTHER ASSETS

Other assets comprise:

| | 31 December 2008 | 31 December 2007 |
|--|--|--|
| Other financial assets recorded as loans and receivables in accordance with IAS 39: | | |
| Unsettled payments on plastic cards operations and money transfers | 153 | 220 |
| Other receivables | 26 | - |
| | <u>179</u> | <u>220</u> |
| Other non-financial assets: | | |
| Intangible assets | 361 | 106 |
| Prepayments and receivables | 134 | 572 |
| Other | - | 22 |
| | <u>495</u> | <u>700</u> |
| Total other assets | <u>674</u> | <u>920</u> |
| | Year ended 31 December 2008 | Year ended 31 December 2007 |
| At cost | | |
| 1 January | 188 | 192 |
| Additions | 286 | - |
| Disposals | - | (4) |
| 31 December | <u>474</u> | <u>188</u> |
| Accumulated amortization | | |
| 1 January | 82 | 67 |
| Charge for the year | 31 | 17 |
| Eliminated on disposals | - | (2) |
| | <u>113</u> | <u>82</u> |
| Net book value 31 December | <u>361</u> | <u>106</u> |

Intangible assets include software and licenses.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

18. DUE TO BANKS AND OTHER CREDIT INSTITUTIONS

Due to banks and other credit institutions comprise:

| | 31 December 2008 | 31 December 2007 |
|---|---------------------|---------------------|
| Recorded at amortized cost: | | |
| Loans from non-banking financial institutions | 13,302 | 7,031 |
| Loans from banks | 12,172 | 12,181 |
| Loans from European Bank for Reconstruction and Development | 9,791 | 11,254 |
| Loans from the National Fund for Entrepreneurship Support | 8,008 | 6,160 |
| Loans from the Asian Development Bank | 3,721 | 5,107 |
| Demand deposits of banks | 3,622 | 4,232 |
| Deposits of non-banking financial institutions | 3,036 | 7,080 |
| Loans from the German Azerbaijan Fund | 2,835 | 2,329 |
| Loans from the Azerbaijan Mortgage Fund | 1,972 | 1,943 |
| Demand deposits of non-banking financial institutions | 550 | 564 |
| Total due to banks and other credit institutions | 59,009 | 57,881 |

As at 31 December 2008 and 2007 accrued interest expenses included in due to banks and other credit institutions amounted to AZN 1,172 thousand and AZN 1,058 thousand, respectively.

As at 31 December 2008 and 2007 the Bank received loans and advances from 9 and 3 banks and financial institutions, respectively, which individually exceeded 10% of the Bank's equity.

As at 31 December 2008 and 2007 subordinated debt included in due to banks and other credit institutions amounted to AZN 2,027 thousand and AZN 2,113 thousand, respectively. The loan bears LIBOR plus 10% per annum and to be repaid in November 2017. In the event of bankruptcy or liquidation of the Bank, repayment of this debt is subordinate to the repayments of the Bank's liabilities to all other creditors.

The Bank is obligated to comply with financial covenants in relation to due to banks disclosed above. These covenants include stipulated ratios, debt to equity ratios and various other financial performance ratios.

Maturities of amounts due to banks are included in Note 30 under liquidity risk.

These liabilities are measured at amortized cost.

19. CUSTOMER ACCOUNTS

Customer accounts comprise:

| | 31 December 2008 | 31 December 2007 |
|------------------------------------|---------------------|---------------------|
| Recorded at amortized cost: | | |
| Time deposits | 67,381 | 45,309 |
| Repayable on demand | 17,261 | 19,017 |
| Blocked accounts | 267 | 126 |
| Total customer accounts | 84,909 | 64,452 |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

As at 31 December 2008 and 2007 accrued interest expenses included in customers accounts amounted to AZN 3,223 thousand and AZN 1,558 thousand, respectively.

As at 31 December 2008 and 2007 customer accounts amounted to AZN 1,124 thousand and AZN 527 thousand, respectively, were held as security against loans to customers.

As at 31 December 2008 and 2007 included in customer accounts are accounts of 3 and 1 customers totalling AZN 17,575 thousand and AZN 5,782 thousand respectively, which individually exceed 10% of the Bank's equity.

| | 31 December 2008 | 31 December 2007 |
|--------------------------------|---------------------|---------------------|
| Analysis by sector: | | |
| Individuals | 69,505 | 49,061 |
| Trade and services | 7,674 | 7,232 |
| Energy | 5,909 | 5,965 |
| Construction | 876 | 271 |
| Manufacturing | 208 | 511 |
| Transport and communication | 118 | 320 |
| Agriculture | 10 | 15 |
| Public organizations | - | 47 |
| Other | 609 | 1,030 |
| Total customer accounts | 84,909 | 64,452 |

These liabilities are measured at amortised cost.

20. DEBT SECURITIES ISSUED

Debt securities issued comprise:

| | Maturity date | Annual coupon rate % | 31 December 2008 | 31 December 2007 |
|---|------------------|----------------------------|---------------------|---------------------|
| Recorded at amortized cost: | | | | |
| Manat-denominated bonds- AZ200400536 | 18/02/2009 | 13.5% | 1,016 | 1,013 |
| Manat-denominated bonds- AZ200500539 | 18/03/2009 | 14.0% | 1,005 | 1,005 |
| Manat-denominated bonds- AZ200100536 | 13/08/2008 | 14.0% | - | 2,035 |
| Manat-denominated bonds- AZ200300536 | 18/08/2008 | 14.0% | - | 2,100 |
| Total debt securities issued | | | 2,021 | 6,153 |

As at 31 December 2008 and 2007 accrued interest expense included in debt securities issued amounted to AZN 21 thousand and AZN 153 thousand, respectively.

On 18 February and 18 March 2009 debt securities issued for the amount AZN 2,021 thousand were fully repaid.

These liabilities are measured at amortised cost.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

21. OTHER LIABILITIES

Other liabilities comprise:

| | 31 December 2008 | 31 December 2007 |
|--|---------------------|---------------------|
| Other financial liabilities: | | |
| Accrued expenses | 1,426 | 419 |
| Payments in the course of settlement | 298 | 115 |
| Dividends payable | 269 | 269 |
| Net payables under finance lease | 59 | - |
| | <u>2,052</u> | <u>803</u> |
| Other non-financial liabilities: | | |
| Provision for guarantees and other commitments | - | 32 |
| Taxes payable, other than income tax | - | 48 |
| Other | - | 1 |
| | <u>-</u> | <u>81</u> |
| Total other liabilities | <u><u>2,052</u></u> | <u><u>884</u></u> |

Movements in provision for guarantees and other commitments for the years ended 31 December 2008 and 2007 are disclosed in Note 5.

22. SHARE CAPITAL

As of 31 December 2008 and 2007 authorized, issued and fully paid share capital amounted to AZN 6,800 thousand and consisted of 3,400,000 ordinary shares with par value of AZN 2 each. Each share entitles to the shareholder one vote.

In 2007 the Bank declared dividends of AZN 917 thousand for 2006 financial year on ordinary shares.

23. COMMITMENTS AND CONTINGENCIES

In the normal course of business the Bank is a party to financial instruments with off-balance sheet risk in order to meet the needs of its customers. These instruments, involving varying degrees of credit risk, are not reflected in the balance sheet.

The Bank's maximum exposure to credit loss under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

The Bank's uses the same credit control and management policies in undertaking off-balance sheet commitments as it does for on-balance operations.

Provision for losses on contingent liabilities amounted to AZN 32 thousand as at 31 December 2007.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

As at 31 December 2008 and 2007, the nominal or contract amounts were:

| | 31 December 2008 | 31 December 2007 |
|--|---------------------|---------------------|
| Contingent liabilities and credit commitments | | |
| Commitments on loans and unused credit lines | 7,202 | 8,036 |
| Guarantees issued and similar commitments | 3,512 | 3,545 |
| Other contingent liabilities | 248 | - |
| Total contingent liabilities and credit commitments | 10,962 | 11,581 |

As at 31 December 2008 and 2007 included in commitments on loans and unused credit lines are AZN 7,202 thousand and AZN 8,036 thousand respectively, representing the Bank's commitments to extend loans within unused credit lined limits that are conditioned on the following: a borrower has to apply to the Bank each time it wants to extend its borrowings within preliminary unused; and the Bank may approve the extension of finance based on a borrower's financial performance, debt service and other credit risk characteristics.

Capital commitments – The Bank had no material commitments for capital expenditures outstanding at 31 December 2008.

Legal proceedings – From time to time and in the normal course of business, claims against the Bank are received from customers and counterparties. As of the date of approval of these financial statements no legal cases were pending against the Bank. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these financial statements.

Taxation – Azerbaijan commercial legislation and tax legislation in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result the Bank may be assessed additional taxes, penalties and interest. The Bank believes that it has already made all tax payments, and therefore no allowance has been made in the financial statements. Tax years remain open to review by the tax authorities for three years.

Operating environment – The Bank's principal business activities are within the Republic of Azerbaijan. Laws and regulations affecting the business environment in the Republic of Azerbaijan are subject to rapid changes and the Bank's assets and operations could be at risk due to negative changes in the political and business environment.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Recent volatility in global financial markets and its effects on Azerbaijan – In recent months a number of major economies around the world have experienced volatile capital and credit markets. A number of major global financial institutions have been placed into bankruptcy, taken over by other financial institutions and/or supported by government funding. As a consequence of the recent market turmoil in capital and credit markets both globally and in the Republic of Azerbaijan, notwithstanding any potential economic stabilization measures that may be put into place by the Government of the Republic of Azerbaijan, there exists economic uncertainties surrounding the continual availability, and cost, of credit both for the Bank and its counterparties the potential for economic uncertainties to continue in the foreseeable future and, as a consequence, the potential that assets may not be recovered at their carrying amount in the regular course of business, and a corresponding impact on the Bank's profitability.

Government programs – The Azerbaijan government continues to exercise significant influence over the Azerbaijan economy. In response to the economic crisis and to support Azerbaijani businesses, the government of Azerbaijan has introduced certain measures including taxation holidays for banking sector from 1 January 2009, support from the National Bank of the Republic of Azerbaijan and continued support for the local currency, the Azerbaijan Manat. As Azerbaijan is heavily dependent on hydrocarbon revenues, the economy's size and reserves are affected by oil prices fluctuations in the global market.

Inflation – Historically, Azerbaijan has experienced high levels of inflation. The annual rate of inflation, as measures by changes in the Consumer Price Index, was 20.8% for 2008, 16.7% for 2007 (according to the State Statistic Committee of the Republic of Azerbaijan) and is projected at the rate of approximately 13% for 2009. The financial results in the Azerbaijan economy and, consequently, the Bank's financial results will be affected if inflation is not controlled effectively.

Recoverability of financial assets – As a result of recent economic turmoil in capital and credit markets globally, and the consequential economic uncertainties existing as at balance sheet date, there exists the potential that assets may not be recovered at their carrying amount in the regular course of business.

As at 31 December 2008, the Bank has financial assets amounting to AZN 167,609 thousand (as at 31 December 2007: AZN 139,218 thousand). The recoverability of these financial assets depends to a large extent on the efficacy of the fiscal measures and other measures and other actions, beyond the Bank's control, undertaken within various countries to achieve economic stability and recovery. The recoverability of the Bank's financial assets is determined based on conditions prevailing and information available as at balance sheet date. It is the management's opinion that no additional provision on financial assets is needed at present, based on prevailing conditions and available information.

24. SUBSEQUENT EVENTS

On 18 February and 18 March 2009 debt securities issued for the amount AZN 2,021 thousand were fully repaid.

As a result of a referendum held in the Republic of Azerbaijan on 18 March 2009 in respect of amendments and supplements to the Constitution of the Republic of Azerbaijan the word "National" in the title of the National Bank of the Republic of Azerbaijan has been replaced with the word "Central".

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

25. TRANSACTIONS WITH RELATED PARTIES

Related parties or transactions with related parties, as defined by IAS 24 "Related party disclosures", represent:

- (a) Parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Bank (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Bank that gives them significant influence over the Bank; and that have joint control over the Bank;
- (b) Associates – enterprises on which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;
- (c) Joint ventures in which the Bank is a venturer;
- (d) Members of key management personnel of the Bank or its parent;
- (e) Close members of the family of any individuals referred to in (a) or (d);
- (f) Parties that are entities controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
- (g) Post-employment benefit plans for the benefit of employees of the Bank, or of any entity that is a related party of the Bank.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Bank had the following transactions outstanding as at 31 December 2008 and 2007 with related parties:

| | 31 December 2008 | | 31 December 2007 | |
|--|---------------------------|---|---------------------------|---|
| | Related party balances | Total category as per financial statements caption | Related party balances | Total category as per financial statements caption |
| Loans to customers | | 137,481 | | 122,839 |
| - the parent and parent's subsidiaries | 2,822 | | 3,071 | |
| - key management personnel of the entity | 15 | | 64 | |
| Allowance for impairment losses | | (4,857) | | (3,847) |
| - key management personnel of the entity | (1) | | (4) | |
| Customer accounts | | 84,909 | | 64,452 |
| - the parent and parent's subsidiaries | 2,489 | | 1,967 | |
| - key management personnel of the entity | 2,583 | | 1 | |
| - other related parties | 32 | | 1 | |
| Other liabilities | | 2,052 | | 884 |
| - the parent and parent's subsidiaries | 269 | | 269 | |
| - key management personnel of the entity | - | | - | |
| Guarantees issued | | 3,512 | | 3,545 |
| - the parent and parent's subsidiaries | 1,211 | | - | |
| - key management personnel of the entity | - | | 5 | |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

The remuneration of directors and other members of key management was as follows:

| | Year ended 31 December 2008 | | Year ended 31 December 2007 | |
|---|--------------------------------|---|--------------------------------|---|
| | Related party transactions | Total category as per financial statements caption | Related party transactions | Total category as per financial statements caption |
| Key management personnel compensation: | | | | |
| short-term employee benefits | 2,320 | 8,416 | 549 | 3,948 |

Included in the profit and loss account for the years ended 31 December 2008 and 2007 are the following amounts which arose due to transactions with related parties:

| | Year ended 31 December 2008 | | Year ended 31 December 2007 | |
|---|--------------------------------|---|--------------------------------|--|
| | Related party transactions | Total category as per financial statements caption | Related party transactions | Total category as per financial statements caption |
| Interest income | | 35,711 | | 17,842 |
| - the parent and parent's subsidiaries | 406 | | 200 | |
| - key management personnel of the entity | 3 | | 3 | |
| Interest expense | | (15,471) | | (7,925) |
| - the parent and parent's subsidiaries | (125) | | (2) | |
| - key management personnel of the entity | (107) | | (9) | |
| - other related parties | (1) | | (31) | |
| Provision for impairment losses | | (1,138) | | (2,537) |
| - key management personnel of the entity | (3) | | (4) | |
| Fee and commission income | | 2,824 | | 3,616 |
| - the parent and parent's subsidiaries | 110 | | 92 | |
| - key management personnel of the entity | 3 | | | |
| Operating expense | | (12,536) | | (6,686) |
| - the parent and parent's subsidiaries | (278) | | (258) | |
| - key management personnel of the entity | (2,320) | | (549) | |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

26. SEGMENT REPORTING

The Bank's primary format for reporting segment information is business segments.

Business segments

The Bank is organized on the basis of two main business segments:

Retail banking – representing private banking services, private customer current accounts, savings, deposits, credit and debit cards, consumer loans and mortgages.

Corporate banking – representing direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities.

Transactions between the business segments are on normal commercial terms and conditions. Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balances sheet, but excluding items such as taxation and borrowings. Segment information about these businesses is presented below.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

| | Retail Banking | Corporate banking | Unallocated | As at and for the year ended 31 December 2008 |
|--|-------------------|----------------------|-----------------|--|
| Interest income | 27,811 | 7,664 | 236 | 35,711 |
| Interest expense | (7,979) | (7,492) | - | (15,471) |
| Provisions for impairment losses on interest bearing assets | (1,090) | (48) | - | (1,138) |
| Net gain on foreign exchange operations | - | - | 889 | 889 |
| Fee and commission income | 545 | 533 | 1,746 | 2,824 |
| Fee and commission expense | (439) | (220) | (626) | (1,285) |
| Dividend income | - | 20 | - | 20 |
| Other income | - | - | 700 | 700 |
| Total operating income | 18,848 | 457 | 2,945 | 22,250 |
| Operating expenses | - | - | (12,536) | (12,536) |
| Operating profit | 18,848 | 457 | (9,591) | 9,714 |
| Recovery of provision for impairment losses on other transactions | - | 32 | - | 32 |
| Profit/(loss) before income tax | 18,848 | 489 | (9,591) | 9,746 |
| Income tax expense | - | - | (2,253) | (2,253) |
| Net profit/(loss) | 18,848 | 489 | (11,844) | 7,493 |
| Segment assets | 109,734 | 37,438 | 32,850 | 180,022 |
| Segment liabilities | (69,505) | (81,706) | (899) | (152,110) |
| Other segment items | | | | |
| Depreciation charge on property and equipment | - | - | 1,297 | 1,297 |
| Loans to customers | 95,186 | 37,438 | - | 132,624 |
| Property and equipment | - | - | 11,918 | 11,918 |
| Customer accounts | (69,505) | (15,404) | - | (84,909) |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

| | Retail banking | Corporate Banking | Unallocated | As at and for the year ended 31 December 2007 amount |
|--|-------------------|----------------------|----------------|---|
| Interest income | 12,560 | 5,250 | 32 | 17,842 |
| Interest expense | (4,559) | (3,365) | (1) | (7,925) |
| Provisions for impairment losses on interest bearing assets | (2,017) | (520) | - | (2,537) |
| Net gain on foreign exchange operations | - | - | 462 | 462 |
| Fee and commission income | 946 | 1,262 | 1,408 | 3,616 |
| Fee and commission expense | (480) | (170) | (703) | (1,353) |
| Dividend income | - | 29 | - | 29 |
| Other income | - | - | 227 | 227 |
| Total operating income | 6,450 | 2,486 | 1,425 | 10,361 |
| Operating expenses | - | - | (6,686) | (6,686) |
| Operating profit | 6,450 | 2,486 | (5,261) | 3,675 |
| (Provision)/recovery of provision for impairment losses on other transactions | - | (30) | 15 | (15) |
| Profit/(loss) before income tax | 6,450 | 2,456 | (5,246) | 3,660 |
| Income tax expense | - | - | (852) | (852) |
| Net profit/(loss) | 8,633 | 2,456 | (6,098) | 2,808 |
| Segment assets | 85,390 | 37,521 | 29,086 | 151,997 |
| Segment liabilities | (49,080) | (79,781) | (2,717) | (131,578) |
| Other segment items | | | | |
| Depreciation charge on property and equipment | - | - | 646 | 646 |
| Loans to customers | 81,471 | 37,521 | - | 118,992 |
| Property and equipment | - | - | 12,079 | 12,079 |
| Customer accounts | (49,061) | (15,391) | - | (64,452) |

The Bank conducts all its activities only within the Republic of Azerbaijan and major part of its revenue and net profit arrives from operations in the Republic of Azerbaijan.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

27. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. The estimates presented herein are not necessarily indicative of the amounts the Bank could realize in a market exchange from the sale of its full holdings of a particular instrument.

The fair value of financial assets and liabilities compared with the corresponding carrying amount in the balance sheet of the Bank is presented below:

| | 31 December 2008 | | 31 December 2007 | |
|--|------------------|------------|------------------|------------|
| | Carrying value | Fair value | Carrying value | Fair value |
| Cash and balances with the National Bank of the Republic of Azerbaijan | 11,307 | 11,307 | 12,721 | 12,721 |
| Due from banks | 7,743 | 7,743 | 5,125 | 5,125 |
| Investments available-for-sale | 15,597 | 15,597 | 2,001 | 2,001 |
| Due to banks and other credit institutions | 59,009 | 59,009 | 57,881 | 57,881 |
| Customer accounts | 84,909 | 84,909 | 64,452 | 64,452 |
| Debt securities issued | 2,021 | 2,021 | 6,153 | 6,153 |

The fair value of loans to customers can not be measured reliably as there is no active market for such instruments in Azerbaijan.

The fair value of equity investments available-for-sale can not be measured reliably as they do not have a quoted market price in an active market.

28. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total (12%) and tier 1 capital (6%) to risk weighted assets.

The ratio was calculated according to the principles employed by the Basle Committee by applying the relevant risk estimates to the assets and off-balance sheet commitments net of allowances for impairment losses.

As at 31 December 2008 the Bank's total capital amount for Capital Adequacy purposes was AZN 31,852 thousand and tier 1 capital amount was AZN 21,212 thousand with ratios of 20.82% and 13.87%, respectively.

As at 31 December 2007 the Bank's total capital amount for Capital Adequacy purposes was AZN 22,369 thousand and tier 1 capital amount was AZN 13,321 thousand with ratios of 15.44% and 9.19%, respectively.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

As at 31 December 2008 and 2007 the Bank included in the computation of total capital for Capital adequacy purposes the subordinated debt of AZN 2,027 thousand and AZN 2,113 thousand, respectively, limited up to 50% of Tier 1 capital. In the event of bankruptcy or liquidation of the Bank, repayment of this debt is subordinate to the repayments of the Bank's liabilities to all other creditors.

29. CAPITAL MANAGEMENT

The Bank manages its capital to ensure that entities in the Bank will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance.

The capital structure of the Bank consists of debt, which includes subordinated debt disclosed in Note 18, and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in the statement of changes in equity.

The Management Board reviews the capital structure on a monthly basis. As a part of this review, the Board considers the cost of capital and the risks associated with each class of capital. Based on recommendations of the Board, the Bank balances its overall capital structure through the payment of dividends, new share issues as well as the issue of new debt or the redemption of existing debt.

The Bank's overall capital risk management policy remains unchanged from 2007.

30. RISK MANAGEMENT POLICIES

Management of risk is fundamental to the Bank's business and is an essential element of the Bank's operations. The main risks inherent to the Bank's operations are those related to:

- Credit risk
- Liquidity risk
- Market risk.

The Bank recognizes that it is essential to have efficient and effective risk management processes in place. To enable this, the Bank has established a risk management framework, whose main purpose is to protect the Bank from risk and allow it to achieve its performance objectives. Through the risk management framework, the Bank manages the following risks:

Credit risk

The Bank is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

The Credit Committee and the Risk Management Committee perform risk management and monitoring within set limits of authority. Before the Credit Committee makes any approvals, it analyzes all cases and recommendations on credit appraisals (borrower's financial statements, terms of the credit, adequacy of the proposed collateral, credit history of the applicant, limits approved, amendments to the loan agreements, etc.). The Head of the Credit Department, Branch Credit Divisions, the Risk Management Department and loan officers perform daily risk management.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

The Bank structures the level of credit risk and undertakes it by placing limits on the amount of risk accepted in relation to one borrower, or group of related borrowers to industry and geographical segments. The Risk Management Committee approves limits on the level of credit risk by borrower and the product (by industry sector, by region). Allocation of limits per borrower or the group of related borrowers is conducted in accordance with the regulations of the National Bank of the Republic of Azerbaijan. The exposure to any one borrower is further restricted by sub-limits covering on and off-balance sheet exposures, which are set by the Credit Committee within the parameters prescribed by the Risk Management Committee and the Assets and Liabilities Management Committee (the "ALMC"). Loans above certain limits are approved by the Supervisory Board. Actual exposures against limits are monitored daily.

In the case of most loans, the Bank obtains collateral, as well as personal and corporate guarantees, which, in significant portion, is real estate. Such risks are monitored on a continuous basis and subject to frequent reviews. Commitments to extend credit represent unused portions of credit in the form of loans, guarantees or letters of credit. The credit risk on off-balance sheet financial instruments is defined as a probability of losses due to the inability of counterparty to comply with the contractual terms and conditions. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of the loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank applies the same credit policy to the contingent liabilities as it does to the balance sheet financial instruments, i.e. the one based on the procedures for approving loans, using limits to mitigate the risk, and current monitoring. The Bank monitors the term to maturity of off balance sheet contingencies because longer term commitments generally have a greater degree of credit risk than short-term commitments.

Maximum Exposure

The Banks maximum exposure to credit risk varies significantly and is dependant on both individual risks and general market economy risks.

The following table presents the maximum exposure to credit risk of balance sheet and off balance sheet financial assets. For financial assets in the balance sheet, the maximum exposure is equal to the carrying amount of those assets prior to any offset or collateral. For financial guarantees and other off balance sheet assets, the maximum exposure to credit risk is the maximum amount the Bank would have to pay if the guarantee was called on or in the case of commitments, if the loan amount was called on.

| | | | | | 31 December 2008 |
|--------------------------------|---------------------|--------|------------------------------|-----------------------|--|
| | Maximum exposure | Offset | Net exposure after offset | Collateral Pledged | Net exposure after offset and collateral |
| Due from banks | 7,743 | - | 7,743 | - | 7,743 |
| Loans to customers | 132,624 | 1,124 | 131,500 | 131,215 | 285 |
| Investments available-for-sale | 15,756 | - | 15,756 | - | 15,756 |
| Other financial assets | 179 | - | 179 | - | 179 |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

| | | | | | 31 December 2007 |
|--------------------------------|---------------------|--------|------------------------------|-----------------------|--|
| | Maximum exposure | Offset | Net exposure after offset | Collateral Pledged | Net exposure after offset and collateral |
| Due from banks | 5,125 | - | 5,125 | - | 5,125 |
| Loans to customers | 118,992 | 527 | 118,465 | 118,429 | 36 |
| Investments available-for-sale | 2,160 | - | 2,160 | - | 2,160 |
| Other financial assets | 220 | - | 220 | - | 220 |

Financial assets are graded according to the current credit rating they have been issued by an internationally regarded agency such as Fitch. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

The following table details the credit ratings of financial assets held by the Bank:

| | | | | | | 31 December 2008 |
|--------------------------------|-----|-------|-------|------|--------------|---------------------|
| | AAA | A | BBB | <BBB | Not rated | Total |
| Due from banks | 80 | 5,780 | 1,727 | 86 | 70 | 7,743 |
| Loans to customers | - | - | - | - | 132,624 | 132,624 |
| Investments available-for-sale | - | - | - | - | 15,756 | 15,756 |
| Other financial assets | - | - | - | - | 179 | 179 |

| | | | | | | 31 December 2007 |
|--------------------------------|----|-------|-------|------|--------------|---------------------|
| | AA | A | BBB | <BBB | Not Rated | Total |
| Due from banks | 3 | 2,428 | 2,548 | 67 | 79 | 5,125 |
| Loans to customers | - | - | - | - | 118,992 | 118,992 |
| Investments available-for-sale | - | - | - | - | 2,160 | 2,160 |
| Other financial assets | - | - | - | - | 220 | 220 |

The banking industry is generally exposed to credit risk through its loans to customers and inter bank deposits. With regard to the loans to customers this risk exposure is concentrated within the Republic of Azerbaijan. The exposure is monitored on a regular basis to ensure that the credit limits and credit worthiness guidelines established by the Bank's risk management policy are not breached.

The following table details the carrying value of assets that are impaired and the ageing of those that are past due but not impaired:

| | | | | 31 December 2008 |
|--------------------------------|----------------------------------|---|---|------------------|
| | Neither past due nor impaired | Financial assets that have been individually impaired | Financial assets that have been collectively impaired | Total |
| Due from banks | 7,743 | - | - | 7,743 |
| Loans to customers | 17,783 | 6,668 | 108,173 | 132,624 |
| Investments available-for-sale | 15,597 | 159 | - | 15,756 |
| Other financial assets | 179 | - | - | 179 |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

| | | | | 31 December 2007 |
|--------------------------------|----------------------------------|---|---|------------------|
| | Neither past due nor impaired | Financial assets that have been individually impaired | Financial assets that have been collectively impaired | Total |
| Due from banks | 5,125 | - | - | 5,125 |
| Loans to customers | 20,612 | 4,856 | 93,524 | 118,992 |
| Investments available-for-sale | 2,001 | 159 | - | 2,160 |
| Other financial assets | 220 | - | - | 220 |

Geographical concentration

The ALMC exercises control over the risk in the legislation and regulatory arena and assesses its influence on the Bank's activity. This approach allows the Bank to minimize potential losses from the investment climate fluctuations in Azerbaijan. The Bank's Risk Management Committee sets up country limits, which mainly applies to banks of the Commonwealth of Independent States and Baltic countries.

The geographical concentration of assets and liabilities is set out below:

| | Azerbaijan | Other non-OECD countries | OECD countries | 31 December 2008 Total |
|--|----------------|--------------------------------|-----------------|------------------------------|
| FINANCIAL ASSETS | | | | |
| Cash and balances with the NBA | 11,307 | - | - | 11,307 |
| Due from banks | 94 | 105 | 7,544 | 7,743 |
| Loans to customers | 132,624 | - | - | 132,624 |
| Investments available-for-sale | 15,756 | - | - | 15,756 |
| Other financial assets | 179 | - | - | 179 |
| TOTAL FINANCIAL ASSETS | 159,960 | 105 | 7,544 | 167,609 |
| FINANCIAL LIABILITIES | | | | |
| Due to banks and other credit institutions | 28,047 | 1,958 | 29,004 | 59,009 |
| Customer accounts | 84,909 | - | - | 84,909 |
| Debt securities issued | - | 2,021 | - | 2,021 |
| Other financial liabilities | 2,052 | - | - | 2,052 |
| TOTAL FINANCIAL LIABILITIES | 115,008 | 3,979 | 29,004 | 147,991 |
| NET POSITION | 44,952 | (3,874) | (21,460) | |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

| | Azerbaijan | Other non-OECD countries | OECD countries | 31 December 2007 Total |
|--|----------------|--------------------------------|-----------------|------------------------------|
| FINANCIAL ASSETS | | | | |
| Cash and balances with the NBA | 12,661 | - | 60 | 12,721 |
| Due from banks | 86 | 2,606 | 2,433 | 5,125 |
| Loans to customers | 118,992 | - | - | 118,992 |
| Investments available-for-sale | 2,160 | - | - | 2,160 |
| Other financial assets | 220 | - | - | 220 |
| TOTAL FINANCIAL ASSETS | 134,119 | 2,606 | 2,493 | 139,218 |
| FINANCIAL LIABILITIES | | | | |
| Due to banks and other credit institutions | 34,390 | 8,089 | 15,402 | 57,881 |
| Customer accounts | 49,759 | 9,610 | 5,083 | 64,452 |
| Debt securities issued | - | 6,153 | - | 6,153 |
| Other financial liabilities | 803 | - | - | 803 |
| TOTAL FINANCIAL LIABILITIES | 84,952 | 23,852 | 20,485 | 129,289 |
| NET POSITION | 49,167 | (21,246) | (17,992) | |

Liquidity risk

Liquidity risk refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due.

The ALMC controls these types of risks by means of maturity analysis, determining the Bank's strategy for the next financial period. Current liquidity is managed by the Treasury Department on a daily basis, which deals in the money markets for current liquidity support and cash flow optimization.

In order to manage liquidity risk, the Bank performs daily monitoring of future expected cash flows on clients' and banking operations, which is a part of assets/liabilities management process. The ALMC, with the approval of the Supervisory Board sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level on interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

An analysis of the liquidity and interest rate risks is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the Bank.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

| | Up to 1 month | 1 month to 3 months | 3 month to 1 year | 1 year to 5 years | Over 5 years | Maturity undefined | 31 December 2008 Total |
|--|------------------|------------------------|----------------------|----------------------|-----------------|-----------------------|------------------------------|
| FINANCIAL ASSETS | | | | | | | |
| Due from banks | 7,375 | - | - | - | - | 104 | 7,479 |
| Loans to customers | 15,101 | 14,514 | 46,232 | 55,213 | 1,564 | - | 132,624 |
| Investments available-for-sale | 15,756 | - | - | - | - | - | 15,756 |
| Total interest bearing financial assets | 38,232 | 14,514 | 46,232 | 55,213 | 1,564 | 104 | 155,859 |
| Cash and balances with the National Bank of the Republic of Azerbaijan | 6,253 | - | - | - | - | 5,054 | 11,307 |
| Due from banks | 264 | - | - | - | - | - | 264 |
| Other financial assets | 179 | - | - | - | - | - | 179 |
| Total financial assets | 44,928 | 14,514 | 46,232 | 55,213 | 1,564 | 5,158 | 167,609 |
| FINANCIAL LIABILITIES | | | | | | | |
| Due to banks and other credit institutions | 4,747 | 5,231 | 17,359 | 23,574 | 3,927 | - | 54,838 |
| Customer accounts | 2,987 | 10,973 | 29,693 | 22,877 | 856 | - | 67,386 |
| Debt securities issued | - | 2,021 | - | - | - | - | 2,021 |
| Other financial liabilities | 13 | 22 | 18 | 6 | - | - | 59 |
| Total interest bearing financial liabilities | 7,747 | 18,247 | 47,070 | 46,457 | 4,783 | - | 124,304 |
| Due to banks and other credit institutions | 4,171 | - | - | - | - | - | 4,171 |
| Customer accounts | 17,523 | - | - | - | - | - | 17,523 |
| Other financial liabilities | 1,993 | - | - | - | - | - | 1,993 |
| Total financial liabilities | 31,434 | 18,247 | 47,070 | 46,457 | 4,783 | - | 147,991 |
| Liquidity gap | 13,494 | (3,733) | (838) | 8,756 | (3,219) | | |
| Interest sensitivity gap | 30,485 | (3,733) | (838) | 8,756 | (3,219) | | |
| Cumulative interest sensitivity gap | 30,485 | 26,752 | 25,914 | 34,670 | 31,451 | | |
| Cumulative interest sensitivity gap as a percentage of total assets | 18.19% | 15.96% | 15.46% | 20.69% | 18.76% | | |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

| | Up to 1 month | 1 month to 3 months | 3 month to 1 year | 1 year to 5 years | Over 5 years | Maturity undefined | 31 December 2007 Total |
|--|------------------|------------------------|----------------------|----------------------|-----------------|-----------------------|------------------------------|
| FINANCIAL ASSETS | | | | | | | |
| Due from banks | 4,779 | - | - | - | - | - | 4,779 |
| Loans to customers | 29,468 | 11,539 | 39,572 | 36,729 | 1,684 | - | 118,992 |
| Investments available-for-sale | 2,160 | - | - | - | - | - | 2,160 |
| Total interest bearing financial assets | 36,407 | 11,539 | 39,572 | 36,729 | 1,684 | - | 125,931 |
| Cash and balances with the National Bank of the Republic of Azerbaijan | 6,233 | - | - | - | - | 6,488 | 12,721 |
| Due from banks | 346 | - | - | - | - | - | 346 |
| Other financial assets | 220 | - | - | - | - | - | 220 |
| Total financial assets | 43,206 | 11,539 | 39,572 | 36,729 | 1,684 | 6,488 | 139,218 |
| FINANCIAL LIABILITIES | | | | | | | |
| Due to banks and other credit institutions | 3,609 | 11,619 | 10,818 | 23,424 | 3,535 | - | 53,005 |
| Customer accounts | 4,457 | 4,487 | 22,205 | 13,856 | 19 | - | 45,024 |
| Debt securities issued | - | - | 4,137 | 2,016 | - | - | 6,153 |
| Total interest bearing financial liabilities | 8,066 | 16,106 | 37,160 | 39,296 | 3,554 | - | 104,182 |
| Due to banks and other credit institutions | 4,876 | - | - | - | - | - | 4,876 |
| Customer accounts | 19,428 | - | - | - | - | - | 19,428 |
| Other financial liabilities | 803 | - | - | - | - | - | 803 |
| Total financial liabilities | 33,173 | 16,106 | 37,160 | 39,296 | 3,554 | - | 129,289 |
| Liquidity gap | 10,033 | (4,567) | 2,412 | (2,567) | (1,870) | | |
| Interest sensitivity gap | 28,341 | (4,567) | 2,412 | (2,567) | (1,870) | | |
| Cumulative interest sensitivity gap | 28,341 | 23,774 | 26,186 | 23,619 | 21,749 | | |
| Cumulative interest sensitivity gap as a percentage of total assets | 20.36% | 17.08% | 18.81% | 16.97% | 15.62% | | |

A further analysis of the liquidity and interest rate risks is presented in the following tables in accordance with IFRS 7. The amounts disclosed in these tables do not correspond to the amounts recorded on the balance sheet as the presentation below includes a maturity analysis for financial liabilities that indicates the total remaining contractual payments (including interest payments), which are not recognized in the balance sheet under the effective interest rate method.

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

| | Weighted average effective interest rate | Up to 1 month | 1 month to 3 months | 3 month to 1 year | 1 year to 5 years | Over 5 years | Maturity undefined | 31 December 2008 Total |
|--|---|------------------|------------------------|----------------------|----------------------|-----------------|-----------------------|------------------------------|
| FINANCIAL LIABILITIES | | | | | | | | |
| Due to banks and other credit institutions | 7.44% | 5,236 | 5,799 | 16,503 | 22,095 | 1,639 | - | 51,272 |
| Customer accounts | 14.07% | 3,383 | 11,747 | 32,437 | 28,854 | 2,301 | - | 78,722 |
| Debt securities issued | 13.75% | - | 2,070 | - | - | - | - | 2,070 |
| Other financial liabilities | 17.05% | 14 | 23 | 20 | 6 | - | - | 63 |
| Total interest bearing financial liabilities at fixed rates | | 8,633 | 19,639 | 48,960 | 50,955 | 3,940 | - | 132,127 |
| Due to banks and other credit institutions | 2.49% | 229 | 320 | 1,973 | 5,911 | 4,743 | - | 13,176 |
| Total interest bearing financial liabilities at variable rates | | 229 | 320 | 1,973 | 5,911 | 4,743 | - | 13,176 |
| Total interest bearing liabilities | | 8,862 | 19,959 | 50,933 | 56,866 | 8,683 | - | 145,303 |
| Due to banks and other credit institutions | | 4,172 | - | - | - | - | - | 4,172 |
| Customer accounts | | 17,523 | - | - | - | - | - | 17,523 |
| Other financial liabilities | | 1,993 | - | - | - | - | - | 1,993 |
| Total financial liabilities | | 32,550 | 19,959 | 50,933 | 56,866 | 8,683 | - | 168,991 |

| | Weighted average effective interest rate | Up to 1 month | 1 month to 3 months | 3 month to 1 year | 1 year to 5 years | Over 5 years | Maturity undefined | 31 December 2007 Total |
|--|---|------------------|------------------------|----------------------|----------------------|-----------------|-----------------------|------------------------------|
| FINANCIAL LIABILITIES | | | | | | | | |
| Due to banks and other credit institutions | 6.69% | 3,198 | 11,169 | 5,719 | 13,450 | 1,652 | - | 35,188 |
| Customer accounts | 13.22% | 5,604 | 6,106 | 27,014 | 18,279 | 27 | - | 57,030 |
| Debt securities issued | 13.92% | - | 279 | 4,486 | 2,069 | - | - | 6,834 |
| Total interest bearing financial liabilities at fixed rates | | 8,802 | 17,554 | 37,219 | 33,798 | 1,679 | - | 99,052 |
| Due to banks and other credit institutions | 3.20% | 780 | 1,268 | 7,290 | 14,129 | 3,654 | - | 27,121 |
| Total interest bearing financial liabilities at variable rates | | 780 | 1,268 | 7,290 | 14,129 | 3,654 | - | 27,121 |
| Total interest bearing liabilities | | 9,582 | 18,822 | 44,509 | 47,927 | 5,333 | - | 126,173 |
| Due to banks and other credit institutions | | 4,876 | - | - | - | - | - | 4,876 |
| Customer accounts | | 19,428 | - | - | - | - | - | 19,428 |
| Other financial liabilities | | 803 | - | - | - | - | - | 803 |
| Total financial liabilities | | 34,689 | 18,822 | 44,509 | 47,927 | 5,333 | - | 151,280 |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Market Risk

Market risk covers interest rate risk, currency risk and other pricing risks to which the Bank is exposed. There have been no changes as to the way the Bank measures risk or to the risk it is exposed.

The Bank is exposed to interest rate risks as funds are borrowed at both fixed and floating rates. The risk is managed by the Bank maintaining an appropriate mix between fixed and floating rate borrowings.

The ALMC also manages interest rate and market risks by matching the Bank's interest rate position, which provides the Bank with a positive interest margin. The Assets-Liabilities Management Committee conducts monitoring of the Bank's current financial performance, estimates the Bank's sensitivity to changes in interest rates and its influence on the Bank's profitability.

The majority of the Bank's loan contracts and other financial assets and liabilities that bear interest are either variable or contain clauses enabling the interest rate to be changed at the option of the lender. The Bank monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

Interest rate risk

The Bank manages fair value interest rate risk through periodic estimation of potential losses that could arise from adverse changes in market conditions. The Assets – Liabilities Management Department conducts monitoring of the Bank's current financial performance, estimates the Bank's sensitivity to changes in fair value interest rates and its influence on the Bank's profitability.

The following table presents a sensitivity analysis of interest rate risk, which has been determined based on "reasonably possible changes in the risk variable". The level of these changes is determined by management and is contained within the risk reports provided to key management personnel.

Impact on profit before tax:

| | As at 31 December 2008 | | As at 31 December 2007 | |
|--|------------------------|----------------------|------------------------|----------------------|
| | Interest rate +1% | Interest rate -1% | Interest rate +1% | Interest rate -1% |
| Financial assets: | | | | |
| Due from banks | 75 | (75) | 26 | (26) |
| Loans to customers | 1,326 | (1,326) | 1,190 | (1,190) |
| Investments available-for-sale | 158 | (158) | 22 | (22) |
| Financial liabilities: | | | | |
| Due to banks and other credit institutions | (548) | 548 | (531) | 531 |
| Customer accounts | (674) | 674 | (450) | 450 |
| Debt securities issued | (20) | 20 | (62) | 62 |
| Other financial liabilities | (1) | 1 | - | - |
| Net impact on profit before tax | 316 | (316) | 195 | (195) |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Impact on shareholders equity:

| | As at 31 December 2008 | | As at 31 December 2007 | |
|--|------------------------|----------------------|------------------------|----------------------|
| | Interest rate +1% | Interest rate -1% | Interest rate +1% | Interest rate -1% |
| Financial assets: | | | | |
| Due from banks | 58 | (58) | 37 | (37) |
| Loans to customers | 1,034 | (1,034) | 928 | (928) |
| Investments available-for-sale | 123 | (123) | 17 | (17) |
| Financial liabilities: | | | | |
| Due to banks and other credit institutions | (428) | 428 | (413) | 413 |
| Customer accounts | (526) | 526 | (351) | 351 |
| Debt securities issued | (16) | 16 | (48) | 48 |
| Net impact on shareholders equity | 245 | (245) | 170 | (170) |

Currency risk

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The ALMC controls currency risk by management of the open currency position taking into consideration current and forecasted macroeconomic indicators. The Treasury Department performs daily monitoring of the Bank's open currency position within the guidelines and regulations of the National Bank of the Republic of Azerbaijan.

The Bank's exposure to foreign currency exchange rate risk is presented in the table below:

| | AZN | USD 1 USD= AZN 0.8010 | EUR 1 EUR= AZN 1.1292 | Other currencies | 31 December 2008 Total |
|--|----------------|-----------------------------|-----------------------------|---------------------|------------------------------|
| Financial assets | | | | | |
| Cash and balances with the NBA | 8,283 | 836 | 2,119 | 69 | 11,307 |
| Due from banks | - | 3,107 | 4,539 | 97 | 7,743 |
| Loans to customers | 85,908 | 46,706 | 10 | - | 132,624 |
| Investments available-for-sale | 15,756 | - | - | - | 15,756 |
| Other financial assets | 36 | 143 | - | - | 179 |
| Total financial assets | 109,983 | 50,792 | 6,668 | 166 | 167,609 |
| Financial liabilities | | | | | |
| Due to banks and other credit institutions | 30,731 | 23,747 | 4,531 | - | 59,009 |
| Customer accounts | 50,335 | 30,944 | 3,615 | 15 | 84,909 |
| Debt securities issued | 2,021 | - | - | - | 2,021 |
| Other financial liabilities | 2,002 | 33 | 17 | - | 2,052 |
| Total financial liabilities | 85,089 | 54,724 | 8,163 | 15 | 147,991 |
| OPEN BALANCE SHEET POSITION | 24,894 | (3,932) | (1,495) | 151 | |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

| | AZN | USD 1 USD= AZN 0.8453 | EUR 1 EUR= AZN 1.2450 | Other currencies | 31 December 2007 Total |
|--|---------------|-----------------------------|-----------------------------|---------------------|---------------------------------|
| Financial assets | | | | | |
| Cash and balances with the NBA | 8,657 | 3,669 | 378 | 17 | 12,721 |
| Due from banks | - | 2,861 | 2,221 | 43 | 5,125 |
| Loans to customers | 69,473 | 48,667 | 852 | - | 118,992 |
| Investments available-for-sale | 2,160 | - | - | - | 2,160 |
| Other financial assets | 220 | - | - | - | 220 |
| Total financial assets | 80,510 | 55,197 | 3,451 | 60 | 139,218 |
| Financial liabilities | | | | | |
| Due to banks and other credit institutions | 29,282 | 25,513 | 3,086 | - | 57,881 |
| Customer accounts | 36,306 | 25,883 | 2,229 | 34 | 64,452 |
| Debt securities issued | 6,153 | - | - | - | 6,153 |
| Other financial liabilities | 803 | - | - | - | 803 |
| Total financial liabilities | 72,544 | 51,396 | 5,315 | 34 | 129,289 |
| OPEN BALANCE SHEET POSITION | 7,966 | 3,801 | (1,864) | 26 | |

Currency risk sensitivity

The following table details the Bank's sensitivity to a 10% increase and decrease in the USD and EUR against the AZN. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Bank where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

| | As at 31 December 2008 | | As at 31 December 2007 | |
|--------------------------|------------------------|-----------------|------------------------|-----------------|
| | USD/AZN +10% | USD/AZN -10% | USD/AZN +10% | USD/AZN -10% |
| Impact on profit or loss | (393) | 393 | 380 | (380) |
| | | | | |
| | As at 31 December 2008 | | As at 31 December 2007 | |
| | EUR/AZN +10% | EUR/AZN -10% | EUR/AZN +10% | EUR/AZN -10% |
| Impact on profit or loss | (150) | 150 | (186) | 186 |

OPEN JOINT STOCK COMPANY BANK OF BAKU

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2008

Limitations of sensitivity analysis

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analyses do not take into consideration that the Bank's assets and liabilities are actively managed. Additionally, the financial position of the Bank may vary at the time that any actual market movement occurs. For example, the Bank's financial risk management strategy aims to manage the exposure to market fluctuations. As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation and taking other protective action. Consequently, the actual impact of a change in the assumptions may not have any impact on the liabilities, whereas assets are held at market value on the balance sheet. In these circumstances, the different measurement bases for liabilities and assets may lead to volatility in shareholder equity.

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Bank's view of possible near-term market changes that cannot be predicted with any certainty; and the assumption that all interest rates move in an identical fashion.

Price risk

The Bank is exposed to equity price risks arising from equity investments. Equity investments are held for strategic rather than trading purposes. The Bank does not actively trade these investments.