OJSC Bank of Baku and Subsidiary

Consolidated Financial Statements

Year ended 31 December 2010
Together with Independent Auditors' Report

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Notes to consolidated financial statements

ERNST & YOUNG

Ernst & Young Holdings (CIS) B.V.
Hyatt International Center
Hyatt Tower III, 1st Floor
Izmir Street, 1033
Baku, AZ1065, Azerbaijan

Tel: +994 (12) 490 7020
Fax: +994 (12) 490 7017
www.ey.com/Azerbaijan

Ernst & Yanq Holdinqs (SiAyEs) Bi.Vi.
Hyatt Internaşnl Senter
Hyatt Tauer III, 1-ci Mərtəbə
İzmir küçəsi, 1033
Bakı, AZ1065, Azərbaycan

Tel: +994 (12) 490 7020
Faks: +994 (12) 490 7017

Independent auditors' report

To the Shareholders and Board of Directors of OJSC Bank of Baku -

We have audited the accompanying consolidated financial statements of OJSC Bank of Baku and its subsidiary, which comprise the consolidated statement of financial position as at 31 December 2010, and the consolidated income statement, the consolidated statements of comprehensive income, of changes in equity and of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of OJSC Bank of Baku and its subsidiary as at 31 December 2010, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young Holdings (CIS) B.V.

10 May 2011

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2010

(Thousands of Azerbaijani manats)

	Notes	*2010*	*2009*
Assets			
Cash and cash equivalents	5	17,055	21,580
Amounts due from credit institutions	6	4,946	7,774
Loans to customers	7	178,176	129,030
Investment securities available-for-sale	8	30,233	14,369
Property and equipment	9	8,620	9,290
Intangible assets	10	292	341
Other assets	11	605	395
Total assets		**239,927**	**182,779**
Liabilities			
Amounts due to banks and other financial institutions	12	39,584	51,693
Amounts due to customers	13	155,756	93,360
Current income tax liability	14	18	30
Deferred income tax liabilities	14	1,433	1,433
Other liabilities	11	3,975	532
Subordinated debts	15	2,856	2,871
Total liabilities		**203,622**	**149,919**
Equity			
Share capital	16	12,852	6,800
Retained earnings		18,665	20,904
Revaluation reserve for property and equipment		4,788	5,156
Total equity		**36,305**	**32,860**
Total liabilities and equity		**239,927**	**182,779**

Signed and authorized for release on behalf of the Management Board of the Bank:

Farid Alizade Chairman of the Management Board

Rena Efendiyeva Chief Accountant

10 May 2011

The accompanying notes on pages 6 to 38 are an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2010

(Thousands of Azerbaijani manats)

	Notes	2010	2009
Interest income			
Loans to customers, excluding finance lease receivables		41,562	31,723
Amounts due from credit institutions		380	172
Investment securities available-for-sale		340	157
Guarantees issued		126	142
		42,408	**32,194**
Finance lease receivables		724	720
		43,132	**32,914**
Interest expense			
Amounts due to customers		(14,104)	(8,776)
Amounts due to banks and other financial institutions		(4,384)	(5,180)
Subordinated debts		(374)	(396)
Debt securities issued		-	(47)
		(18,862)	**(14,399)**
Net interest income		**24,270**	**18,515**
Loan impairment charge	7	(2,143)	(2,489)
Net interest income after loan impairment charge		**22,127**	**16,026**
Net fee and commission income	18	2,421	1,206
Net gains/(losses) from foreign currencies:			
- dealing		560	442
- translation differences		56	(48)
Other income	19	1,385	1,703
Non-interest income		**4,422**	**3,303**
Personnel expenses	20	(10,318)	(8,982)
Depreciation and amortization	9, 10, 20	(1,297)	(1,418)
Other operating expenses	20	(3,251)	(2,765)
Non-interest expenses		**(14,866)**	**(13,165)**
Profit before income tax expense		**11,683**	**6,164**
Income tax expense	14	(86)	(75)
Profit for the year		**11,597**	**6,089**

The accompanying notes on pages 6 to 38 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2010

(Thousands of Azerbaijani manats)

	Note	*2010*	*2009*
Profit for the year		**11,597**	**6,089**
Other comprehensive (loss) income			
Revaluation loss on buildings		-	(1,641)
Income tax relating to revaluation of buildings	14	-	328
Other comprehensive loss for the year, net of tax		**-**	**(1,313)**
Total comprehensive income for the year		**11,597**	**4,776**

The accompanying notes on pages 6 to 38 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2010

(Thousands of Azerbaijani manats)

	Share capital	*Retained earnings*	*Revaluation reserve for property and equipment*	*Total*
31 December 2008	**6,800**	**14,411**	**6,701**	**27,912**
Total comprehensive income (loss) for the year	-	6,089	(1,313)	4,776
Depreciation of revaluation reserve	-	404	(232)	172
31 December 2009	**6,800**	**20,904**	**5,156**	**32,860**
Total comprehensive income (loss) for the year	-	11,597	-	11,597
Depreciation of revaluation reserve	-	368	(368)	-
Capitalization of profit for the year 2009 (Note 16)	6,052	(6,052)	-	-
Dividend tax on capitalized profit of 2009 and 2010	-	(2,152)	-	(2,152)
Dividends declared (Note 16)	-	(6,000)	-	(6,000)
31 December 2010	**12,852**	**18,665**	**4,788**	**36,305**

The accompanying notes on pages 6 to 38 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2010

(Thousands of Azerbaijani manats)

	Notes	*2010*	*2009*
Cash flows from operating activities			
Interest received		43,615	32,036
Interest paid		(16,665)	(15,782)
Fees and commissions received		3,506	2,318
Fees and commissions paid		(1,085)	(1,112)
Net realized gains from dealing in foreign currencies		560	442
Other income received		1,356	1,703
Personnel expenses paid		(9,147)	(8,997)
Other operating expenses paid		(3,111)	(2,751)
Cash flows from operating activities before changes in operating assets and liabilities		**19,029**	**7,857**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		2,392	(2,619)
Loans to customers		(52,349)	1,994
Other assets		(51)	(81)
Net increase /(decrease) in operating liabilities			
Amounts due to banks and other financial institutions		(12,309)	(5,590)
Amounts due to customers		61,563	10,980
Other liabilities		(405)	(2,077)
Net cash flows from operating activities before income tax		**17,870**	**10,464**
Income tax paid		-	(1,674)
Net cash from operating activities		**17,870**	**8,790**
Cash flows from investing activities			
Purchase of investment securities		(124,057)	(93,089)
Proceeds from sale and redemption of investment securities		108,264	94,483
Purchase of property and equipment		(724)	(398)
Proceeds from sale of property and equipment		11	-
Acquisition of intangible assets		-	(29)
Net cash (used in)/from investing activities		**(16,506)**	**967**
Cash flows from financing activities			
Dividends paid		(5,126)	-
Withholding tax paid on capitalization		(672)	-
Net change in subordinated debts		(14)	(1)
Redemption of debt securities issued		-	(2,021)
Net cash used in financing activities		**(5,812)**	**(2,022)**
Effect of exchange rate changes on cash and cash equivalents		(77)	(47)
Net (decrease)/increase in cash and cash equivalents		**(4,525)**	**7,688**
Cash and cash equivalents, 1 January		**21,580**	**13,892**
Cash and cash equivalents, 31 December	5	**17,055**	**21,580**

The accompanying notes on pages 6 to 38 are an integral part of these consolidated financial statements.

Notes to the 2010 Consolidated Financial Statements

(Thousands of Azerbaijani manats unless otherwise indicated)

1. Principal activities

OJSC Bank of Baku is the parent company of the Group. On 18 February 2005, Open Joint Stock Commercial Bank "Bank of Baku" and Closed Joint Stock Commercial Bank Ilkbank combined and formed a new bank under the name Open Joint Stock Commercial Bank Bank of Baku ("the Bank"). The Bank operates under banking licence number 247 issued by the Central Bank of the Republic of Azerbaijan ("CBA") on 18 February 2005. 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 accepts deposits from the public and extends credit, transfers payments in Azerbaijan and abroad, exchanges currencies and provides other banking services to its commercial and retail customers. Its main office is in Baku and it has 15 branches (2009: 14) in Baku and other cities in Azerbaijan and 1 servicing outlet (2009: 2). The Bank's registered legal address is 42 Ataturk Avenue, Baku, AZ 1069, Azerbaijan.

Starting from 30 July 2007, the Bank is a member of the deposit insurance system. The system operates under the Law on Deposit Insurance and other regulations and is governed by the Azerbaijan Deposit Insurance Fund. Insurance covers the Bank's liabilities to individual depositors for the amount up to AZN 30 thousand for each individual in case of business failure and revocation of the CBA banking licence.

"Bob Broker" Ltd. (the "Subsidiary") is a wholly-owned subsidiary of the Bank and is consolidated in the financial statements of the Bank. The Subsidiary was formed as a limited liability company under the laws of the Republic of Azerbaijan on 28 February 2007. It is principally engaged in brokerage of securities in the Azerbaijan stock market. It possesses a licence for operations with securities from the State Securities Committee of the Republic of Azerbaijan dated 15 May 2007.

As of 31 December, the following shareholders owned the outstanding shares of the Bank:

Shareholder	*2010* %	*2009* %
NAB Holding	40.00	40.00
Azpetrol Neft Shirketi LLC	28.89	28.89
Mr. Rafig Aliyev	11.22	11.22
Mr. Elchin Isayev	10.00	10.00
Azinvest LLC	9.89	9.89
Total	**100.00**	**100.00**

NAB Holding is ultimately controlled by Nader Mohaghegh Oromi, Bahram Mohaghegh Oromi and Shahram Mohaghegh Oromi. The ultimate shareholder of Azpetrol Neft Shirketi LLC is Mammadov Ibrahim; of Azinvest LLC is Mr. Rafig Aliyev. Mr. R. Aliyev owns 21.11% (11.22% of direct ownership and 9.89% through Azinvest LLC) of the share capital of the Bank.

The Management Board (the "Board") of the Bank is composed of the following members:

As of 31 December 2010:

Name	Position
Mr. Jalal Gasimov	Chairman
Mr. Farid Alizade	Deputy Chairman
Mr. Farid Huseynov	Deputy Chairman
Mr. Zaur Qaraisayev	Deputy Chairman
Mr. Abbas Ibrahimov	Deputy Chairman
Mr. Khalid Ahadov	Assistant to the Chairman
Mr. Farid Mammadov	Assistant to the Chairman

As of 31 December 2009:

Name	Position
Mr. Jalal Gasimov	Chairman
Mr. Farid Alizade	Deputy Chairman
Mr. Farid Huseynov	Deputy Chairman
Mr. Khalid Ahadov	Deputy Chairman
Mr. Farid Mammadov	Deputy Chairman

As of 31 December 2010, Mr. Elchin Isayev, a member of the Supervisory Board, controlled 340,000 shares or 10% of the Bank (2009: 340,000 shares or 10%).

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

2. Basis of preparation

General

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The Bank is required to maintain its records and prepare its consolidated financial statements in Azerbaijani manat and in accordance with IFRS.

The Azerbaijani manat is the reporting and functional currency of the Bank as the majority of the transactions are denominated, measured, or funded in Azerbaijani manat. Transactions in other currencies are treated as transactions in foreign currencies. These consolidated financial statements are presented in thousands of Azerbaijani manats ("AZN"), except per share amounts and unless otherwise indicated.

The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. For example, available-for-sale securities, derivative financial instruments and buildings have been measured at fair value.

3. Summary of significant accounting policies

Changes in accounting policies

The Bank has adopted the following amended IFRS and new IFRIC Interpretations during the year. The principal effects of these changes are as follows:

Amendment to IAS 39 "Financial Instruments: recognition and measurement" - Eligible Hedged Items
The amendment to IAS 39 was issued in August 2008, and became effective for annual periods beginning on or after 1 July 2009. The amendment addresses the designation of a one-sided risk in a hedged item, and designation of inflation as a hedged risk or portion in particular situations. It clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as hedged item. The amendment did not affect the Bank's consolidated financial statements as the Bank has not entered into any such hedges.

IFRS 3 "Business Combinations" (revised in January 2008) and IAS 27 "Consolidated and Separate Financial Statements" (revised in January 2008)
The revised standards were issued in January 2008 and became effective for financial years beginning on or after 1 July 2009. Revised IFRS 3 introduces a number of changes in the accounting for business combinations that impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs, and future reported results. Revised IAS 27 requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change has no impact on goodwill, nor it gives rise to a gain or loss. Furthermore, the revised standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes introduced by the revised Standards are applied prospectively and will affect only future acquisitions and transactions with non-controlling interests. The amendment did not affect the Bank's consolidated financial statements.

IFRS 2 Share-based Payment: Group Cash-settled Share-based Payment Transactions
The amendment to IFRS 2 was issued in June 2009 and became effective for financial years beginning on or after 1 January 2010. The amendment clarifies the scope and the accounting for group cash-settled share-based payment transactions. This amendment also supersedes IFRIC 8 and IFRIC 11. This amendment had no impact on the Bank's consolidated financial statements.

IFRIC 17 "Distribution of Non-Cash Assets to Owners"
IFRIC Interpretation 17 was issued on 27 November 2008 and is effective for annual periods beginning on or after 1 July 2009. IFRIC 17 applies to pro rata distributions of non-cash assets except for common control transactions and requires that a dividend payable should be recognized when the dividend is appropriately authorized and is no longer at the discretion of the entity; an entity should measure the dividend payable at the fair value of the net assets to be distributed; an entity should recognize the difference between the dividend paid and the carrying amount of the net assets distributed in profit or loss. The Interpretation also requires an entity to provide additional disclosures if the net assets being held for distribution to owners meet the definition of a discontinued operation. This interpretation had no impact on the Bank's consolidated financial statements.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

3. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

Improvements to IFRSs
In April 2009, the IASB issued the second omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. Most of the amendments are effective for annual periods beginning on or after 1 January 2010. There are separate transitional provisions for each standard. Amendments included in the April 2009 "Improvements to IFRS" had no impact on the accounting policies, financial position or performance of the Bank, except the following amendments resulting in changes to accounting policies, as described below.

- IFRS 5 Non-current Assets Held for Sale and Discontinued Operations: clarifies that the disclosures required in respect of non-current assets and disposal groups classified as held for sale or discontinued operations are only those set out in IFRS 5. The disclosure requirements of other IFRSs only apply if specifically required for such non-current assets or discontinued operations.
- IFRS 8 Operating Segment Information: clarifies that segment assets and liabilities need only be reported when those assets and liabilities are included in measures that are used by the chief operating decision maker. As the Bank's chief operating decision maker does not review segment assets and liabilities, the Bank does not disclose this information.
- IAS 7 Statement of Cash Flows: Explicitly states that only expenditure that results in recognising an asset can be classified as a cash flow from investing activities.

Subsidiaries

Subsidiaries, which are those entities in which the Bank has an interest of more than one half of the voting rights, or otherwise has power to exercise control over their operations, are consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Bank and are no longer consolidated from the date that control ceases. All intra-group transactions, balances and unrealized gains on transactions between group companies are eliminated in full; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Bank.

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognized initially, they are measured at fair value, and, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

All regular way purchases and sales of financial assets are recognized on the settlement date. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category 'financial assets at fair value through profit or loss'. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognized in the consolidated income statement.

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Bank has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held-to-maturity investments are subsequently measured at amortized cost. Gains and losses are recognized in the consolidated income statement when the investments are impaired, as well as through the amortization process.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

3. Summary of accounting policies (continued)

Financial assets (continued)

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in the consolidated income statement when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for sale financial assets are measured at fair value with gains or losses being recognized in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to the consolidated income statement. However, interest calculated using the effective interest method is recognized in the consolidated income statement.

Determination of fair value

The fair value for financial instruments traded in active market at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

Offsetting

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the consolidated statement of financial position.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- a financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity;
- other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Bank has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the CBA excluding obligatory reserves, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

3. Summary of accounting policies (continued)

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to banks and other financial institutions, amounts due to customers, debt securities issued, and subordinated debt. After initial recognition, borrowings are subsequently measured at amortized cost using the effective interest method. Gains and losses are recognized in the consolidated income statement when the borrowings are derecognized as well as through the amortization process.

Leases

Finance - Bank as lessee

The Bank recognizes finance leases as assets and liabilities in the consolidated statement of financial position at the date of commencement of the lease term at amounts equal to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. In calculating the present value of the minimum lease payments the discount factor used is the interest rate implicit in the lease, when it is practicable to determine; otherwise, the Bank's incremental borrowing rate is used. Initial direct costs incurred are included as part of the asset. Lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

The costs identified as directly attributable to activities performed by the lessee for a finance lease, are included as part of the amount recognized as an asset under the lease.

i. Finance - Bank as lessor

The Bank recognizes lease receivables at value equal to the net investment in the lease, starting from the date of commencement of the lease term. Finance income is based on a pattern reflecting a constant periodic rate of return on the net investment outstanding. Initial direct costs are included in the initial measurement of the lease receivables.

ii. Operating - Bank as lessee

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognized as expenses on a straight-line basis over the lease term and included into other operating expenses.

iii. Operating - Bank as lessor

The Bank presents assets subject to operating leases in the consolidated statement of financial position according to the nature of the asset. Lease income from operating leases is recognized in the consolidated income statement on a straight-line basis over the lease term as other income. The aggregate cost of incentives provided to lessees is recognized as a reduction of rental income over the lease term on a straight-line basis. Initial direct costs incurred specifically to earn revenues from an operating lease are added to the carrying amount of the leased asset.

Impairment of financial assets

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

Amounts due from credit institutions and loans to customers

For amounts due from credit institutions and loans to customers carried at amortized cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the consolidated income statement. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the consolidated income statement.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Held-to-maturity financial investments

For held-to-maturity investments the Bank assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognized in the consolidated income statement. If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, any amounts formerly charged are credited to the consolidated income statement.

Available-for-sale financial investments

For available-for-sale financial investments, the Bank assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition coast and the current fair value, less any impairment loss on that investment previously recognized in the consolidated income statement – is reclassified from other comprehensive income to the consolidated income statement. Impairment losses on equity investments are not reversed through the consolidated income statement; increases in their fair value after impairment are recognized in other comprehensive income.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

Available-for-sale financial investments (continued)

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in the consolidated income statement. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated income statement, the impairment loss is reversed through the consolidated income statement.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

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.

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank 's continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank 's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged or 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 derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the consolidated income statement.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

3. Summary of accounting policies (continued)

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognized in the consolidated financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortized premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the consolidated income statement. The premium received is recognized in the consolidated income statement on a straight-line basis over the life of the guarantee.

Taxation

The current income tax expense is calculated in accordance with the regulations of the Republic of Azerbaijan.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting date.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Azerbaijan also has various operating taxes that are assessed on the Bank's activities. These taxes are included as a component of other operating expenses.

Property and equipment

Equipment is carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

The carrying values of equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Following initial recognition at cost, buildings are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Any revaluation surplus is credited to the revaluation reserve for property and equipment included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognized in the consolidated income statement, in which case the increase is recognized in the consolidated income statement. A revaluation deficit is recognized in the consolidated income statement, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

An annual transfer from the revaluation reserve for property and equipment to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original cost. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

3. Summary of accounting policies (continued)

Property and equipment (continued)

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis using the following rates:

	%
Buildings	5%
Furniture and equipment	20%
Computers and communication equipment	25%
Vehicles	20%
Others	20%

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

Costs related to repairs and renewals are charged when incurred and included in other operating expenses, unless they qualify for capitalization.

Intangible assets

Intangible assets include computer software and licences. Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic lives of 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortization periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end. Intangible assets with indefinite useful lives are not amortized, but tested for impairment annually.

Provisions

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

Retirement and other employee benefit obligations

The Bank does not have any pension arrangements separate from the state pension system of the Republic of Azerbaijan, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such expense is charged in the period the related salaries are earned. In addition, the Bank has no post-retirement benefits.

Share capital

Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognized as additional paid-in capital.

Dividends

Dividends are recognized as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the financial statements are authorized for issue.

Segment reporting

The Bank's operations are in Azerbaijan and constitute a single industry segment - commercial banking. Accordingly for purposes of IFRS 8 "Operating Segments" the Bank is treated as one operating segment.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

3. Summary of accounting policies (continued)

Contingencies

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

Recognition of income and expenses

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue and expense is recognized:

Interest and similar income and expense

For all financial instruments measured at amortized cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense. Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original effective interest rate applied to the new carrying amount.

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.

Dividend income

Revenue is recognized when the Bank's right to receive the payment is established.

Foreign currency translation

The consolidated financial statements are presented in Azerbaijani manat, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognized in the consolidated income statement as gains less losses from foreign currencies - translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the Central Bank exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies.

The Bank used the following official exchange rates in the preparation of these consolidated financial statements:

	2010	2009
1 US dollar	0.7979 AZN	0.8031 AZN
1 euro	1.0560 AZN	1.1499 AZN

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

3. Summary of accounting policies (continued)

Future changes in accounting policies

Standards and interpretations issued but not yet effective

IAS 24 "Related party disclosures" (Revised)
The revised IAS 24, issued in November 2009, simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. Previously, an entity controlled or significantly influenced by a government was required to disclose information about all transactions with other entities controlled or significantly influenced by the same government. The revised standard requires disclosure about these transactions only if they are individually or collectively significant. The revised IAS 24 is effective for annual periods beginning on or after 1 January 2011, with earlier application permitted. The Bank expects that the revised standard will have no impact on the Bank's consolidated financial statements.

Amendments to IAS 32 "Financial instruments: Presentation": Classification of Rights Issues"
In October 2009, the IASB issued amendment to IAS 32. Entities shall apply that amendment for annual periods beginning on or after 1 February 2010. Earlier application is permitted. The amendment alters the definition of a financial liability in IAS 32 to classify rights issues and certain options or warrants as equity instruments. This is applicable if the rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, in order to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. The Bank expects that this amendment will have no impact on the Bank's consolidated financial statements.

IFRS 9 "Financial Instruments"
In November 2009, the IASB issued the first phase of IFRS 9 Financial instruments. This Standard will eventually replace IAS 39 Financial Instrument: Recognition and Measurement. IFRS 9 becomes effective for financial years beginning on or after 1 January 2013. Entities may adopt the first phase for reporting periods ending on or after 31 December 2009. The first phase of IFRS 9 introduces new requirements on classification and measurement of financial assets. In particular, for subsequent measurement all financial assets are to be classified at amortized cost or at fair value through profit or loss with the irrevocable option for equity instruments not held for trading to be measured at fair value through other comprehensive income. The Bank is currently evaluating the impact of the adoption of the new Standard and is considering the initial application date.

IFRS 7 and its accompanying documents have been amended by:

- IFRS 9 Financial Instruments (issued November 2009)
- Disclosures—Transfers of Financial Assets (issued October 2010)
- IFRS 9 Financial Instruments (issued October 2010)

Those amendments have an effective date after 1 January 2011. The Bank expects that the revised standard will have no impact on the Bank's consolidated financial statements.

IAS 12 has been amended by IFRS 9 Financial Instruments (issued November 2009 and October 2010). Those amendments have an effective date of 1 January 2013. The Bank expects that the revised standard will have no impact on the Bank's consolidated financial statements.

IFRIC 14 Amendment - Prepayments of a Minimum Funding Requirement
The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction was developed by the International Financial Reporting Interpretations Committee and issued by the International Accounting Standards Board in July 2007. IFRIC 14 and its accompanying documents have been amended by Prepayments of a Minimum Funding Requirement (issued November 2009). Those amendments have an effective date of 1 January 2011. IFRIC 14 is not expected to have any material impact on the Bank's consolidated financial statements.

IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments"
IFRIC Interpretation 19 was issued in November 2009 and is effective for annual periods beginning on or after 1 July 2010. The interpretation clarifies the accounting when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor to extinguish all or part of the financial liability. IFRIC 19 is not expected to have any material impact on the Bank's consolidated financial statements.

Improvements to IFRSs
In May 2010, the IASB issued the third omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. Most of the amendments are effective for annual periods beginning on or after 1 January 2011. There are separate transitional provisions for each standard.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

3. Summary of significant accounting policies (continued)

Future changes in accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

Amendments included in May 2010 "Improvements to IFRS" will have impact on the accounting policies, financial position or performance of the Bank, as described below.

- IFRS 3 Business combinations: limits the scope of the measurement choices that only the components of NCI that are present ownership interests that entitle their holders to a proportionate share of the entity's net assets, in the event of liquidation, shall be measured either at fair value or at the present ownership instruments' proportionate share of the acquiree's identifiable net assets. As the amendment should be applied from the date the Bank applies IFRS 3 Revised, it may be required to restate for effects incurred under IFRS 3 Revised, but before the adoption of this amendment. The Bank expects that other amendments to IFRS 3 will have no impact on consolidated financial statements of the Bank.
- IFRS 7 Financial instruments: Disclosures; introduces the amendments to quantitative and credit risk disclosures. The additional requirements are expected to have minor impact as information is expected to be readily available.

Amendments resulting from Improvements to IFRSs to the following standards do not have any impact on the the accounting policies, financial position or performance of the Bank: IFRS 1 First-time adoption of IFRS, IAS 1 Presentation of Financial Statements, and IFRIC 13 Customer Loyalty Programmes.

4. Significant accounting judgment and estimates

In the process of applying the Bank's accounting policies, management has used its judgment and made estimates in determining the amounts recognized in the consolidated financial statements. The most significant use of judgments and estimates are as follows:

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its judgment to estimate the amount of any impairment loss in cases where a borrower is in 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 the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its judgment to adjust observable data for a group of loans or receivables to reflect current circumstances.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values.

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management interpretation of such legislation and changes, including the new law allowing financial institutions to be exempt from payment of profit tax starting 1 January 2009 (for 3 consequent years) if the current year profit is capitalized, as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. As such, additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three years including the year of review. Management believes that as at 31 December 2010 its interpretation of the relevant legislation is appropriate and that the Bank's tax position will be sustained.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2010	*2009*
Cash on hand	8,707	6,810
Current accounts with the Central Bank of the Republic of Azerbaijan	1,368	2,962
Current accounts with other credit institutions	6,980	11,808
Cash and cash equivalents	**17,055**	**21,580**

As of 31 December 2010, current accounts with other credit institutions included AZN 2,654 thousand placed with two internationally recognized Organization for Economic Co-operation and Development ("OECD") banks (2009 – AZN 11,021 thousand placed with two internationally recognized OECD banks).

As of 31 December 2010, current accounts with other credit institutions included AZN 3,961 thousand placed with three Azerbaijani banks (2009 – AZN 20 thousand placed with two Azerbaijani banks).

Non-cash transactions performed by the Bank during 2010 comprised the capitalization of its 2009 profits and issuance of share capital for AZN 6,052 thousand (2009 – nil).

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2010	*2009*
Time deposits for more than 90 days	2,384	5,507
Loan to a credit institution	1,500	1,500
Obligatory reserve with the Central Bank of the Republic of Azerbaijan	709	412
Blocked accounts	353	355
Amounts due from credit institutions	**4,946**	**7,774**

As of 31 December 2010, time deposits included AZN 2,260 thousand (2009 - AZN 5,175 thousand) placed with two (2009: one) Azerbaijani and other CIS banks (2009: internationally recognized OECD bank) with effective annual interest rates of 2.5%- 14% (2009 - 0.6%) maturing in January and April 2011 (2009 - March 2010).

As of 31 December 2010, the loan to a credit institution of AZN 1,500 thousand (2009 – AZN 1,500 thousand) was placed with one (2009 – one) Azerbaijani bank with an effective annual interest rate of 9.5% (2009 - 15.0%) maturing in January 2011 (2009 – maturing in January 2010).

Credit institutions in Azerbaijan are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBA, the amount of which depends on the level of funds attracted by the credit institution. The Bank's ability to withdraw such deposit is significantly restricted by the statutory legislation.

Blocked accounts represent security deposits placed to secure settlement operations through MasterCard International.

7. Loans to customers

Loans to customers comprise:

	2010	*2009*
Consumer loans	74,194	28,607
Auto loans	61,291	50,314
Business loans	28,302	35,682
Microloans	16,560	14,344
Cards	6,291	6,912
Gross loans to customers	**186,638**	**135,859**
Less – Allowance for impairment	(8,462)	(6,829)
Loans to customers	**178,176**	**129,030**

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

7. Loans to customers (continued)

Allowance for impairment of loans to customers

A reconciliation of the allowance for impairment of loans to customers by class is as follows:

	Auto loans 2010	Business loans 2010	Consumer loans 2010	Microloans 2010	Cards 2010	Total 2010
At 1 January 2010	**923**	**2,752**	**1,990**	**901**	**263**	**6,829**
Charge for the year	839	795	29	456	24	2,143
Amounts written off	(12)	-	(495)	(27)	(43)	(577)
Recoveries	-	-	14	2	51	67
At 31 December 2010	**1,750**	**3,547**	**1,538**	**1,332**	**295**	**8,462**
Individual impairment	-	255	-	-	-	255
Collective impairment	1,750	3,292	1,538	1,332	295	8,207
	1,750	**3,547**	**1,538**	**1,332**	**295**	**8,462**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	-	505	-	-	-	505

	Auto loans 2009	Business loans 2009	Consumer loans 2009	Microloans 2009	Cards 2009	Total 2009
At 1 January 2009	**1,459**	**983**	**1,190**	**377**	**848**	**4,857**
Charge (reversal) for the year	(412)	1,769	799	515	(182)	2,489
Amounts written off	(127)	-	-	-	(531)	(658)
Recoveries	3	-	1	9	128	141
At 31 December 2009	**923**	**2,752**	**1,990**	**901**	**263**	**6,829**
Individual impairment	-	404	-	-	-	404
Collective impairment	923	2,348	1,990	901	263	6,425
	923	**2,752**	**1,990**	**901**	**263**	**6,829**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	-	3,344	-	-	-	3,344

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2010, comprised AZN 137 thousand (2009 – AZN 126 thousand).

The fair value of collateral that the Bank holds relating to loans individually determined to be impaired at 31 December 2010 amounts to AZN 600 thousand (2009: AZN 8,447 thousand). In accordance with the CBA requirements, loans may only be written off with the approval of the Supervisory Board and, in certain cases, with the respective decision of the Court.

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

7. Loans to customers (continued)

Collateral and other credit enhancements (continued)

The main types of collateral obtained are as follows:

- For auto lending: cash, liens over vehicles, third party guarantees,
- For business lending: charges over real estate, inventory and trade receivables, third party guarantees,
- For consumer lending: cash, charges over credited consumer appliances, third party guarantees, mortgages over residential properties,
- For microloans: cash, inventory and trade receivables, third party guarantees, charges over real estate
- For card lending: cash, third party guarantees

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

As of 31 December 2010, the outstanding amount of properties is AZN 87 thousand, which the Bank is in the process of selling. It is the Bank's policy to dispose repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Bank does not occupy repossessed properties for business use.

Loans have been extended to the following types of customers:

	2010	*2009*
Individuals	174,782	118,980
Private companies	11,856	15,275
State-owned companies	-	1,604
Gross loans to customers	**186,638**	**135,859**

Loans are made principally within Azerbaijan in the following industry sectors:

	2010	*2009*
Individuals	174,782	118,980
Trade and services	7,616	9,463
Agriculture and food processing	3,265	1,362
Manufacturing	564	2,877
Real estate construction	411	1,954
Other	-	1,223
Gross loans to customers	**186,638**	**135,859**

Finance lease receivables

Included in the corporate lending portfolio are finance lease receivables. The analysis of finance lease receivables at 31 December 2010 is as follows:

	Not later than 1 year	*Later than 1 year and not later than 5 years*	*Later than 5 years*	*Total*
Gross investment in finance leases	2,038	889	202	3,129
Unearned future finance income on finance leases	(264)	(283)	(41)	(588)
Net investment in finance leases	**1,774**	**606**	**161**	**2,541**

Included in the corporate lending portfolio are finance lease receivables. The analysis of finance lease receivables at 31 December 2009 is as follows:

	Not later than 1 year	*Later than 1 year and not later than 5 years*	*Later than 5 years*	*Total*
Gross investment in finance leases	2,862	1,051	-	3,913
Unearned future finance income on finance leases	(447)	(140)	-	(587)
Net investment in finance leases	**2,415**	**911**	-	**3,326**

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

8. Investment securities available-for-sale

Available-for-sale securities comprise:

	2010	*2009*
Treasury bills of the Ministry of Finance of the Republic of Azerbaijan	15,759	8,072
Notes issued by the Central Bank of the Republic of Azerbaijan	10,690	5,948
Notes issued by Azerbaijan Mortgage Fund	3,617	-
Corporate bond	-	200
Other	167	149
Available-for-sale securities	**30,233**	**14,369**

Nominal interest rates and maturities of these securities are as follows:

	2010		**2009**	
	Annual interest rate	**Maturity**	**Annual interest rate**	**Maturity**
Treasury bills of the Ministry of Finance of the Republic of Azerbaijan	1.5%-2.99%	1-6 months	0.4%-1.7%	1-5 months
Notes issued by the Central Bank of the Republic of Azerbaijan	1.3%-2.2%	1 month	1.0%	1 month
Notes issued by Azerbaijan Mortgage Fund	3.0%-3.1%	72-108 months	-	-
Corporate bond	-	-	14.0%	12 months

9. Property and equipment

The movements in property and equipment were as follows:

	Land and Buildings	*Furniture and equipment*	*Computers and communication equipment*	*Vehicles*	*Other*	*Total*
Cost or revalued amount						
31 December 2008	**13,606**	**1,784**	**1,533**	**336**	**14**	**17,273**
Additions	49	164	136	60	2	411
Disposals	(22)	(2)	(6)	-	-	(30)
Transfers	-	(14)	-	-	9	(5)
Effect of revaluation	(2,392)	-	-	-	-	(2,392)
31 December 2009	**11,241**	**1,932**	**1,663**	**396**	**25**	**15,257**
Additions	-	219	329	45	1	594
Disposals	-	(146)	(35)	(21)	-	(202)
Effect of revaluation	-	-	-	-	-	-
31 December 2010	**11,241**	**2,005**	**1,957**	**420**	**26**	**15,649**
Accumulated depreciation						
31 December 2008	**(3,603)**	**(882)**	**(757)**	**(107)**	**(6)**	**(5,355)**
Depreciation charge	(679)	(320)	(305)	(62)	(3)	(1,369)
Eliminated on revaluation	751	-	-	-	-	751
Disposals	3	1	2	-	-	6
31 December 2009	**(3,528)**	**(1,201)**	**(1,060)**	**(169)**	**(9)**	**(5,967)**
Depreciation charge	(567)	(300)	(308)	(69)	(4)	(1,248)
Disposals	-	146	19	21	-	186
31 December 2010	**(4,095)**	**(1,355)**	**(1,349)**	**(217)**	**(13)**	**(7,029)**
Net book value:						
31 December 2008	10,003	902	776	229	8	11,918
31 December 2009	7,713	731	603	227	16	9,290
31 December 2010	7,146	650	608	203	13	8,620

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

9. Property and equipment (continued)

As of 31 December 2010, included in property and equipment were fully depreciated assets of AZN 1,251 thousand (2009: AZN 899 thousand)

The Bank engaged an independent appraiser to determine an indicative market value of its buildings as at 31 December 2010 and the potential difference in the value of the buildings as at the subject valuation date compared to value provided by the previous year valuation procedure. The date of the revaluation was 31 December 2010.

If the buildings were measured using the cost model, the carrying amounts would be as follows:

	2010	*2009*
Cost	2,022	2,022
Accumulated depreciation and impairment	(531)	(446)
Net carrying amount	**1,491**	**1,576**

10. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
31 December 2008	**143**	**331**	**474**
Additions	8	21	29
31 December 2009	**151**	**352**	**503**
Additions	-	-	-
31 December 2010	**151**	**352**	**503**
Accumulated amortization			
31 December 2008	**(38)**	**(75)**	**(113)**
Amortization charge	(16)	(33)	(49)
31 December 2009	**(54)**	**(108)**	**(162)**
Amortization charge	(16)	(33)	(49)
31 December 2010	**(70)**	**(141)**	**(211)**
Net book value:			
31 December 2008	**105**	**256**	**361**
31 December 2009	**97**	**244**	**341**
31 December 2010	**81**	**211**	**292**

11. Other assets and liabilities

Other assets comprise:

	2010	*2009*
Items in the course of settlement	300	180
Prepayments for purchase of property and equipment	148	20
Foreclosed property	87	87
Deferred expenses	18	74
Other	52	34
Other assets	**605**	**395**

Other liabilities comprise:

	2010	*2009*
Accrued tax on capitalized profit of 2009 and 2010	1,481	-
Accrued expenses	991	16
Dividends payable to shareholders of the Bank	874	269
Liabilities in the course of settlement	355	241
Social security costs	274	-
Other	-	6
Other liabilities	**3,975**	**532**

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

12. Amounts due to banks and other financial institutions

Amounts due to banks and other financial institutions comprise:

	2010	*2009*
Demand deposits	915	604
Time deposits	15,626	17,144
Loans from financial institutions	20,190	28,922
Blocked accounts	2,853	5,023
	39,584	**51,693**

As of 31 December 2010, demand deposits included balances of AZN 615 thousand (2009 – AZN 456 thousand) due to two (2009 - two) Azerbaijani financial institutions.

As of 31 December 2010, time deposits and loans included balances of AZN 26,148 thousand (2009 – AZN 37,242 thousand) due to ten (2009 - ten) OECD and non-OECD financial institutions.

Blocked accounts represent amounts placed by a counterparty company as security for loans granted and guaranteed by that company.

Demand and time deposits include accounts with the following types of institutions:

	2010	*2009*
Insurance companies	12,832	10,147
Investment companies	3,029	3,309
Banks	64	3,058
Other financial institutions	616	1,234
Demand and time deposits	**16,541**	**17,748**

As of 31 December 2010, time deposits were due to financial institutions with effective annual interest rates of 9.0% - 17.0% (2009 – 7.0% - 16.3%) and mature in 2011 - 2012 (2009: 2010 - 2011).

Loans from financial institutions include accounts with the following types of institutions:

	2010	*2009*
The National Fund for Entrepreneurship Support	6,463	7,791
Banks	3,581	4,738
European Bank for Reconstruction and Development	3,118	6,595
German Azerbaijan Fund	2,378	2,943
Azerbaijan Mortgage Fund	1,745	1,833
Asian Development Bank	1,443	2,189
Investment companies	1,462	1,920
Other financial institutions	-	913
Loans from financial institutions	**20,190**	**28,922**

Nominal interest rates and maturities of these loans are as follows:

	2010		*2009*	
	Annual interest rate	*Maturity*	*Annual interest rate*	*Maturity*
The National Fund for Entrepreneurship Support	1.0 %	2011 – 2015	1.0%	2010 – 2014
Banks	8.0 % - 10.0 %	2011	14.5% - 16.0%	2010
Investment companies	9%-18%	2011-2012	17.0% - 18.0%	2011 – 2012
European Bank for Reconstruction and Development	4.9 % - 16.0 %	2011 - 2013	2.5% - 16.0%	2010 – 2013
German Azerbaijan Fund	4.7 % - 4.8 %	2011 – 2015	4.4% - 4.8%	2010 - 2015
Azerbaijan Mortgage Fund	2.0 %	2014 – 2032	2.0%	2014 – 2032
Asian Development Bank	6.9%	2011 – 2012	4.8% - 6.9%	2010 - 2012
Other financial institutions	-	-	15.5%	2010

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

13. Amounts due to customers

Amounts due to customers include the following:	*2010*	*2009*
Current accounts	21,399	19,118
Time deposits	134,357	74,242
Amounts due to customers	**155,756**	**93,360**
Held as security against guarantees (Note 17)	122	11
Held as security against loans	174	180
Held as security against undrawn credit facilities (Note 17)	2,535	1,246

As of 31 December 2010, time deposits were due to customers with effective annual interest rates of 1.0% - 21.0 % (2009 – 2.0% - 21.0 %) and mature in 2011-2024 (2009: mature in 2010 - 2024).

As of 31 December 2010, amounts due to customers of AZN 25,916 thousand (17%) were due to the ten (2009 - ten) largest customers of the Bank (2009 – AZN 23,397 thousand (25%)).

Included in time deposits are deposits of individuals of AZN 131,666 thousand (2009 – AZN 72,205 thousand). In accordance with the Azerbaijan Civil Code, the Bank is obliged to repay such deposits upon demand of a depositor. In the event that a term deposit is repaid upon demand of the depositor prior to maturity, interest on it is paid based on the interest rate for demand deposits, unless a different interest rate is specified in the agreement.

Amounts due to customers include accounts with the following types of customers:

	2010	*2009*
Individuals	140,764	77,717
Private enterprises	13,770	14,381
Employees	775	1,034
State and budgetary organizations	447	140
Other	-	88
Amounts due to customers	**155,756**	**93,360**

An analysis of customer accounts by economic sector follows:

	2010	*2009*
Individuals and employees	141,539	78,751
Energy	7,170	5,792
Trade and service	4,675	6,241
Constructions	1,419	1,291
Transport and communication	888	379
Manufacturing	64	207
Agriculture	1	699
Amounts due to customers	**155,756**	**93,360**

14. Taxation

The corporate income tax expense comprises:

	2010	*2009*
Current tax charge	86	(75)
Income tax expense	**(86)**	**(75)**

Deferred tax related to items charged or credited to other comprehensive income during the year is as follows:

	2010	2009
Revaluation of buildings	-	328
Income tax charged to other comprehensive income	**-**	**328**

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

14. Taxation (continued)

Azerbaijani legal entities must file individual tax declarations.

On 19 June 2009, an amendment to the Tax Code was enacted to reduce the corporate income tax rate from 22% to 20% effective from 1 January 2010.

In accordance with the Law of the Republic of Azerbaijan on enhancement of the activities of banks, insurance and reinsurance companies (N710-IIIQ and dated 28 October 2008), financial institutions are exempt from payment of profit tax with effect from 1 January 2009 for a period of three consecutive years, if the current year's profit is capitalized. As a result, based on the shareholders' meeting held on 9 March 2010, the Bank decided to utilise the tax exemption in accordance with the law for the years 2009 – 2011.

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2010	*2009*
Profit before tax	**11,597**	**6,164**
Statutory tax rate	20%	22%
Theoretical income tax expense at the statutory rate	**(2,319)**	**(1,356)**
Tax-exempt income	2,666	1,356
Non-deductible expenses	(433)	(75)
Income tax expense	**(86)**	**(75)**

Current income tax liability as of 31 December 2010 amounted to AZN 18 thousand (2009 – AZN 30 thousand).

Deferred tax assets and liabilities as of 31 December and their movements for the respective years comprise:

		Origination and reversal of temporary differences			*Origination and reversal of temporary differences*		
	2008	*In the income statement*	*In other comprehensive income*	*2009*	*In the income statement*	*In other comprehensive income*	*2010*
Tax effect of deductible temporary differences:							
Allowance for loan impairment	174	(174)	-	-	-	-	-
Property and equipment	4	(4)	-	-	-	-	-
Deferred tax assets	**178**	**(178)**	**-**	**-**	**-**	**-**	**-**
Tax effect of taxable temporary differences:							
Property and equipment	(1,944)	11	500	(1,433)	-	-	(1,433)
Provision for credit lines and guarantees	(147)	147	-	-	-	-	-
Loans from credit institutions	(20)	20	-	-	-	-	-
Deferred tax liabilities	**(2,111)**	**178**	**500**	**(1,433)**	**-**	**-**	**(1,433)**
Net deferred tax liabilities	**(1,933)**	**-**	**500**	**(1,433)**	**-**	**-**	**(1,433)**

15. Subordinated debts

	2010	*2009*
NAB Dış Ticaret (US dollars 1,000,000 semi-annual payment, with annual interest rate of 19.45%, issued on 19 March 2008, maturing on 19 March 2018)	837	843
JSC Bank of Georgia (US dollars 2,500,000 semi-annual payment, with annual interest rate of six month LIBOR plus 10.0%, issued on 18 November 2007, maturing on 18 November 2017)	2,019	2,028
Subordinated debts	**2,856**	**2,871**

In the event of bankruptcy or liquidation of the Bank, repayment of these loans is subordinate to the repayment of the Bank's liabilities to all other creditors.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

16. Equity

Movements in shares outstanding, issued and fully paid were as follows:

	Date registered	*Number of shares*	*Nominal amount (in full amount)*	*Total*
31 December 2008 and 2009		**3,400,000**	**2.00**	**6,800,000**
Capitalization of retained earnings	1 July 2010		3.78	6,052,000
31 December 2010		**3,400,000**	**3.78**	**12,852,000**

The number of authorized ordinary shares is 3,400,000 with a nominal value per share of AZN 3.78. One share equals one vote. All authorized shares have been issued and fully paid.

The share capital of the Bank was contributed by the shareholders in Azerbaijani manat and they are entitled to dividends and any capital distribution in Azerbaijani manat.

On 10 March 2010, the General Meeting of Shareholders declared dividends of AZN 6,000 thousand or AZN 1.8 per share from its 2008 earnings. This was fully paid during 2010.

Revaluation reserve for property and equipment

The revaluation reserve for property and equipment is used to record increases in the fair value of buildings and decreases to the extent that such decrease relates to an increase on the same asset previously recognized in equity.

17. Commitments and contingencies

Operating environment

As an emerging market, Azerbaijan does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature market economy. However, there have been a number of developments that positively affect the overall investment climate of the country.

While operations in Azerbaijan may involve risks that are not typically associated with those in developed markets (including the risk that the Azerbaijan manat is not freely convertible outside of the country and undeveloped debt and equity markets), over the last few years the Azerbaijani government has made progress in implementing the reforms necessary to create banking, judicial, taxation and regulatory systems. The existing tendency aimed at the overall improvement of the business environment is expected to persist. The future stability of the Azerbaijani economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government. However, the Azerbaijan economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The Azerbaijan Government has introduced a range of stabilization measures aimed at ensuring solvency and providing liquidity and supporting refinancing of foreign debt for Azerbaijan banks and companies.

While management believes it is taking appropriate measures to support the sustainability of the Bank's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Bank's results and financial position in a manner not currently determinable.

Taxation

Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant regional and federal authorities. Recent events within the Republic of Azerbaijan suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years proceeding the year of review.

As at 31 December 2010, management believes that its interpretation of the relevant legislation is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

17. Commitments and contingencies (continued)

Legal

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank.

Insurance

The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions. Liability insurance is generally not available in Azerbaijan at present.

Commitments and contingencies

As of 31 December, the Bank's commitments and contingencies comprised the following:

	2010	*2009*
Credit related commitments		
Undrawn loan commitments	4,534	5,098
Guarantees issued	4,223	2,601
Other contingent liabilities	1,187	231
	9,944	**7,930**
Operating lease commitments		
Not later than 1 year	630	464
Later than 1 year but not later than 5 years	978	672
	1,608	**1,136**
Commitments and contingencies (before deducting collateral)	**11,552**	**9,066**
Less – Cash held as security against guarantees issued (Note 13)	(122)	(11)
Less – Cash held as security against undrawn credit facility (Note 13)	(2,535)	(1,246)
Commitments and contingencies	**8,895**	**7,809**

18. Net fee and commission income

Net fee and commission income comprises:

	2010	*2009*
Cash operations	2,238	1,244
Plastic card operations	876	638
Currency conversion operations	194	214
Settlements operations	164	209
Guarantees	15	4
Other	19	9
Fee and commission income	**3,506**	**2,318**
Plastic card operations	(469)	(358)
Settlements operations	(377)	(364)
Cash operations	(94)	(128)
Guarantees	(65)	(66)
Securities operations	(62)	(60)
Currency conversion operations	(1)	(5)
Other	(17)	(131)
Fee and commission expense	**(1,085)**	**(1,112)**
Net fee and commission income	**2,421**	**1,206**

19. Other income

	2010	*2009*
Fines and penalties received in relation to loans to customers	1,320	1,537
Dividend income	20	20
Other	45	146
Total other income	**1,385**	**1,703**

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

20. Personnel and other operating expenses

Personnel and other operating expenses comprise:	*2010*	*2009*
Salaries and bonuses	(8,382)	(7,289)
Social security costs	(1,857)	(1,581)
Other employment expenses	(79)	(112)
Personnel expenses	**(10,318)**	**(8,982)**
Depreciation charge (note 9)	(1,248)	(1,369)
Amortization charge (note 10)	(49)	(49)
Depreciation and amortization	**(1,297)**	**(1,418)**
Occupancy and rent	(958)	(797)
Deposit insurance fee	(450)	(271)
Marketing and advertising	(417)	(440)
Legal and consultancy	(273)	(242)
Security	(249)	(224)
Office supplies	(193)	(147)
Operating taxes	(174)	(78)
Communications	(141)	(143)
Repair and maintenance of property and equipment	(111)	(77)
Utilities	(84)	(82)
Business travel and related expenses	(39)	(33)
Vehicle running costs	(35)	(30)
Printing	(25)	(37)
Insurance	(24)	(32)
Membership	(21)	(29)
Loss on disposal of property and equipment	-	(14)
Other	(57)	(89)
Other operating expenses	**(3,251)**	**(2,765)**

21. Risk management

Introduction

Various risks are inherent in the Bank's activities and managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's sustainability and profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk, market risk and operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Risk management structure

Supervisory Board

The Supervisory Board is responsible for the overall risk management approach and for approving risk strategies and principles.

Audit Committee

The Audit Committee has the responsibility of reviewing the internal auditing reports and critically evaluate the findings, recommendations, and management's response. It accomplishes its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Risk Committee

The Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

21. Risk management (continued)

Introduction (continued)

Risk management structure (continued)

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Bank.

The Assets and Liabilities Management Committee ("ALMC")

The ALMC is responsible for the development and implementation of strategy and tools related to all aspects of financial management of the Bank.

The Risk Management Department

The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Treasury Department

The Treasury Department is primarily responsible for the funding and liquidity risks of the Bank.

Assets and Liabilities Management Department

The Assets and Liabilities Management Department is responsible for managing the Bank's assets and liabilities and the overall financial structure.

Internal Audit

Risk management processes throughout the Bank are audited annually by the internal audit function that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting systems

The Bank's credit risks are measured using a roll-rate method which reflects both the expected loss likely to arise in normal circumstances, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also utilizes the vintage-par methodology that measures the past-due amounts in relation to the specific period of loan issuance. Additionally, on a quarterly basis, the Bank conducts and submits to the CBA extensive stress tests and models the quality of the portfolio as well as major regulatory covenants in various scenarios.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected products. Information compiled from all the businesses is examined and processed in order to analyze, control and identify early risks. This information is presented to the Risk Committee, that develops the risk management methodology and limits which are in turn are approved by the Supervisory Board. The execution of the limits is controlled by the Management Board of the Bank.

On a daily basis, the Risk Management Department analyses reports that contain detailed information related to the portfolio credit quality. Senior management assesses the appropriateness of the allowance for credit losses on a monthly basis. The Supervisory Board receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

For all levels throughout the Bank, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

The Bank actively uses collateral to reduce its credit risks (see below for more detail).

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

21. Risk management (continued)

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Credit-related commitments risks

The Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

The table below shows the maximum exposure to credit risk for the components of the consolidated statement of financial position, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	Notes	*Maximum exposure 2010*	*Maximum exposure 2009*
Cash and cash equivalents (excluding cash on hand)	5	8,348	14,770
Amounts due from credit institutions	6	4,946	7,774
Loans to customers	7	178,176	129,030
Investment securities available-for-sale	8	30,066	14,220
Other assets		316	185
		221,852	165,979
Financial commitments and contingencies	17	9,944	7,930
Total credit risk exposure		231,796	173,909

Where financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

For more detail on the maximum exposure to credit risk for each class of financial instrument, reference should be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 7.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank's internal credit ratings. The table below shows the credit quality by class of asset for loan-related lines in the consolidated statement of financial position, based on the Bank's credit rating system. In the table below loans to banks and customers of high grade are those having a minimal level of credit risk, normally with a government guarantee or very well collateralized. Other borrowers with good financial position and good debt service are included in the standard grade. Sub-standard grade comprises loans below standard grade but not individually impaired. Investment securities of high grade are those issued by government and its agencies with very low default probability and at risk free rate.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

21. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets (continued)

	Notes	*Neither past due nor impaired* High grade 2010	*Neither past due nor impaired* Standard grade 2010	*Neither past due nor impaired* Sub-standard grade 2010	*Past due but not impaired 2010*	*Individually impaired 2010*	*Total 2010*
Amounts due from credit institutions	6	477	4,469	-	-	-	4,946
Loans to customers	7						
Auto loans		1,617	55,719	-	3,955	-	61,291
Business loans		74	22,581	-	5,142	505	28,302
Consumer loans		870	70,923	-	2,401	-	74,194
Microloans		6	15,113	-	1,441	-	16,560
Cards		944	4,841	-	506	-	6,291
		3,511	**169,177**	**-**	**13,445**	**505**	**186,638**
Investment securities available-for-sale	8	30,066	167	-	-	-	30,233
Total		**34,054**	**173,813**	**-**	**13,445**	**505**	**221,817**

	Notes	*Neither past due nor impaired* High grade 2009	*Neither past due nor impaired* Standard grade 2009	*Neither past due nor impaired* Sub-standard grade 2009	*Past due but not impaired 2009*	*Individually impaired 2009*	*Total 2009*
Amounts due from credit institutions	6	5,657	2,117	-	-	-	7,774
Loans to customers	7						
Auto loans		3,499	41,388	-	5,427	-	50,314
Business loans		1,898	23,999	-	6,441	3,344	35,682
Consumer loans		602	25,019	-	2,986	-	28,607
Microloans		2	13,076	-	1,266	-	14,344
Cards		1,007	4,999	-	906	-	6,912
		7,008	**108,481**	**-**	**17,026**	**3,344**	**135,859**
Investment securities available-for-sale	8	14,020	349	-	-	-	14,369
Total		**26,685**	**110,947**	**-**	**17,026**	**3,344**	**158,002**

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The attributable risk ratings are assessed and updated regularly.

Ageing analysis of past due but not impaired loans per class of financial assets

	Less than 30 days 2010	*31 to 60 days 2010*	*61 to 90 days 2010*	*More than 90 days 2010*	*Total 2010*
Loans to customers					
Auto loans	163	753	451	2,588	3,955
Business loans	966	730	143	3,303	5,142
Consumer loans	192	359	122	1,728	2,401
Microloans	25	36	30	1,350	1,441
Cards	72	46	16	372	506
Total	**1,418**	**1,924**	**762**	**9,341**	**13,445**

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

21. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets (continued)

	Less than 30 days 2009	*31 to 60 days 2009*	*61 to 90 days 2009*	*More than 90 days 2009*	*Total 2009*
Loans to customers					
Auto loans	2,986	713	404	1,324	5,427
Business loans	3,558	248	171	2,464	6,441
Consumer loans	736	148	180	1,922	2,986
Microloans	263	93	80	830	1,266
Cards	446	65	30	365	906
Total	**7,989**	**1,267**	**865**	**6,905**	**17,026**

See Note 7 for more detailed information with respect to the allowance for impairment of loans to customers.

Carrying amount per class of financial assets whose terms have been renegotiated

The table below shows the carrying amount for renegotiated financial assets, by class:

	2010	*2009*
Loans to customers		
Auto loans	146	185
Business loans	-	1,478
Consumer loans	172	174
Microloans	-	16
Cards	24	11
Total	**342**	**1,864**

Impairment assessment

The main considerations for the loan impairment assessment are based on the information provided by the roll-rate model, which measures the movement of the past due amounts balances in various time brackets. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realizable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to customers that are not individually significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration the roll-rate model assessment. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for loans.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

21. Risk management (continued)

Credit risk (continued)

The geographical concentration of Bank's monetary assets and liabilities is set out below:

	2010				*2009*			
	Azerbaijan	*OECD*	*CIS and other foreign countries*	*Total*	*Azerbaijan*	*OECD*	*CIS and other foreign countries*	*Total*
Assets:								
Cash and cash equivalents	14,109	2,875	71	17,055	9,798	11,668	114	21,580
Amounts due from credit institutions	3,410	477	1,059	4,946	2,117	5,657	-	7,774
Loans to customers	178,176	-	-	178,176	129,030	-	-	129,030
Investment securities available-for-sale	30,233	-	-	30,233	14,369	-	-	14,369
Other assets	316	-	-	316	185	-	-	185
	226,244	3,352	1,130	230,726	155,499	17,325	114	172,938
Liabilities:								
Amounts due to banks and other financial institutions	27,717	5,585	6,282	39,584	31,814	9,547	10,332	51,693
Amounts due to customers	155,756	-	-	155,756	93,360	-	-	93,360
Other liabilities	3,873	102	-	3,975	522	10	-	532
Subordinated debts	-	837	2,019	2,856	-	-	2,871	2,871
	187,346	6,524	8,301	202,171	125,696	9,557	13,203	148,456
Net assets / (liabilities)	38,898	(3,172)	(7,171)	28,555	29,803	7,768	(13,089)	24,482

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has developed a sophisticated system for comprehensive assessment of expected cash flows. The methodology of the liquidity management tools and reports is approved by the Supervisory Board of the bank, prepared by the Assets and Liabilities Management department and reviewed on the monthly basis by ALMC.

The Bank maintains a portfolio of highly liquid and secure marketable assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. Additionally, the Bank utilizes a highly effective cash management system across all its branches, ATMs and balances of the correspondent accounts.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on minimum liquidity ratio of 30% established by the CBA. As at 31 December, these ratios were as follows:

	2010, %	*2009, %*
Instant Liquidity Ratio	212	211

Analysis of financial liabilities by remaining contractual maturities

The tables below summarize the maturity profile of the Bank's financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

Financial liabilities As at 31 December 2010	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to banks and other financial institutions	12,336	15,736	9,717	2,026	39,815
Amounts due to customers	50,674	73,597	56,424	14	180,709
Other liabilities	3,974	1	-	-	3,975
Subordinated debts	78	286	1,455	3,598	5,417
Total undiscounted financial liabilities	67,062	89,620	67,596	5,638	229,916

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

21. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities (continued)

Financial liabilities As at 31 December 2009	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to banks and other financial institutions	15,642	16,854	19,931	2,366	54,793
Amounts due to customers	41,202	38,762	23,977	215	104,156
Other liabilities	526	6	-	-	532
Subordinated debts	20	193	841	3,432	4,486
Total undiscounted financial liabilities	**57,390**	**55,815**	**44,749**	**6,013**	**163,967**

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
2010	93	2,299	7,545	7	9,944
2009	824	2,005	4,581	520	7,930

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The Bank does not receive any significant funds from any one organization or private individual. The maturity analysis does not exhibit any significant negative gaps in any given period.

Included in due to customers are term deposits of individuals. In accordance with the Azerbaijan legislation, the Bank is obliged to repay such deposits upon demand of a depositor. Refer to Note 13.

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates and foreign exchanges. The Bank does not have any significant equity, corporate fixed income or derivatives holdings.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The risk is managed by the Bank by matching floating rate borrowings and assets. Additionally the ALMC on quarterly basis reviews the overall interest rate spreads by detailed analysis of the assets and liabilities interest rate structure. The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's income statement.

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December.

	2010			*2009*		
Currency	*Increase in % rate*	*Sensitivity of net interest income*	*Sensitivity of equity*	*Increase in % rate*	*Sensitivity of net interest income*	*Sensitivity of equity*
USD	1.0%	(57)	-	1.0%	(100)	-
EUR	1.0%	(24)	-	1.0%	(29)	-

	2010			*2009*		
Currency	*Decrease in % rate*	*Sensitivity of net interest income*	*Sensitivity of equity*	*Decrease in % rate*	*Sensitivity of net interest income*	*Sensitivity of equity*
USD	1.0%	57	-	(0.3%)	25	-
EUR	1.0%	24	-	(0.3%)	7	-

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

21. Risk management (continued)

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Supervisory Board of the Bank has set limits on positions by currency based on the CBA regulations. The Treasury Department monitors the currency position of the Bank on a daily basis.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the AZN, with all other variables held constant on the income statement). The effect on equity does not differ from the effect on the income statement. A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase.

Currency	*Increase in currency rate in % 2010*	*Effect on profit before tax 2010*	*Increase in currency rate in % 2009*	*Effect on profit before tax 2009*
USD	8.35%	(157)	15.60%	(934)
EUR	14.70%	(199)	12.40%	(36)

Currency	*Decrease in currency rate in % 2010*	*Effect on profit before tax 2010*	*Decrease in currency rate in % 2009*	*Effect on profit before tax 2009*
USD	(8.35%)	157	(15.60%)	934
EUR	(14.70%)	199	(12.40%)	36

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but a control framework and monitoring and responding to potential risks could be effective tools to manage the risks. Controls should include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

22. Fair values of financial instruments

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

At 31 December 2010	*Level 1*	*Level 2*	*Level 3*	*Total*
Financial assets				
Investment securities – available-for-sale	30,066	167	-	30,233
At 31 December 2009				
Financial assets				
Investment securities – available-for-sale	14,220	149	-	14,369

Financial instruments recorded at fair value

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Bank's estimate of assumptions that a market participant would make when valuing the instruments.

Investment securities available-for-sale
Investment securities available-for-sale valued using a valuation technique primarily consists of unquoted equity securities.

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

22. Fair values of financial instruments (continued)

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the consolidated statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2010	Fair value 2010	Unrecognized gain/(loss) 2010	Carrying value 2009	Fair value 2009	Unrecognized gain/(loss) 2009
Financial assets						
Cash and cash equivalents	17,055	17,055	-	21,580	21,580	-
Amounts due from credit institutions	4,946	4,946	-	7,774	7,774	-
Loans to customers	178,176	178,176	-	129,030	129,030	-
Financial liabilities						
Amounts due to banks and other financial institutions	39,584	39,584	-	51,693	51,693	-
Amounts due to customers	155,756	155,756	-	93,360	93,360	-
Subordinated debts	2,856	2,856	-	2,871	2,871	-
Total unrecognized change in unrealized fair value			-			-

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and savings accounts without a specific maturity.

Fixed and variable rate loans

The fair values of loans are estimated by discounting future cash flows using rates currently available for loans on similar terms, credit risk and remaining maturities.

23. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 22 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2010			2009		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Cash and cash equivalents	17,055	-	17,055	21,580	-	21,580
Amounts due from credit institutions	4,946	-	4,946	7,774	-	7,774
Loans to customers	119,706	58,470	178,176	80,157	48,873	129,030
Investment securities available-for-sale	30,094	139	30,233	14,369	-	14,369
Property and equipment	-	8,620	8,620	-	9,290	9,290
Intangible assets	-	292	292	-	341	341
Other assets	605	-	605	395	-	395
Total	**172,406**	**67,521**	**239,927**	**124,275**	**58,504**	**182,779**
Amounts due to banks and other financial institutions	29,287	10,297	39,584	36,288	15,405	51,693
Amounts due to customers	112,596	43,160	155,756	74,046	19,314	93,360
Current income tax liability	18	-	18	30	-	30
Deferred income tax liabilities	-	1,433	1,433	-	1,433	1,433
Other liabilities	3,101	874	3,975	263	269	532
Subordinated debts	64	2,792	2,856	60	2,811	2,871
Total	**145,066**	**58,556**	**203,622**	**110,687**	**39,232**	**149,919**
Net	**27,340**	**8,965**	**36,305**	**13,588**	**19,272**	**32,860**

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

24. Related party disclosures

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

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

	2010				*2009*			
	Shareholders	*Entities under common control*	*Key management personnel*	*Total*	*Shareholders*	*Entities under common control*	*Key management personnel*	*Total*
Loans outstanding at 1 January, gross	-	3,571	190	3,761	-	2,882	88	2,970
Loans issued during the year	48	3,752	415	4,215	-	9,550	586	10,136
Loan repayments during the year	(48)	(5,519)	(501)	(6,068)	-	(8,839)	(480)	(9,319)
Other movements	-	16	1	17	-	(22)	(4)	(26)
Loans outstanding at 31 December, gross	-	**1,820**	**105**	**1,925**	-	**3,571**	**190**	**3,761**
Less: allowance for impairment at 31 December	-	(14)	(3)	(17)	-	(151)	(16)	(167)
Loans outstanding at 31 December, net	-	**1,806**	**102**	**1,908**	-	**3,420**	**174**	**3,594**
Interest income on loans	-	388	28	416	-	543	27	570
Impairment charge for loans	-	(134)	(13)	(147)	-	(93)	-	(93)
Deposits at 1 January	367	-	2,229	2,596	21	-	2,740	2,761
Deposits received during the year	912	-	5,228	6,140	481	-	2,551	3,032
Deposits repaid during the year	(853)	-	(2,611)	(3,464)	(158)	-	(3,297)	(3,455)
Other movements	(55)	-	(536)	(591)	23	-	235	258
Deposits at 31 December	**371**	-	**4,310**	**4,681**	**367**	-	**2,229**	**2,596**
Current accounts at 31 December	2,007	574	193	2,774	90	1,079	118	1,287
Interest expense on deposits	(250)	-	(293)	(543)	(16)	-	(133)	(149)
Borrowings at 1 January	**843**	**2,065**	-	**2,908**	**841**	**2,998**	-	**3,839**
Borrowings received during the year	-	1,310	-	1,310	-	1,720	-	1,720
Borrowings repaid during the year	-	(1,525)	-	(1,525)	(158)	(3,960)	-	(4,118)
Other movements	-	(857)	-	(857)	160	1,307	-	1,467
Borrowings at 31 December	**843**	**993**	-	**1,836**	**843**	**2,065**	-	**2,908**
Interest expense on borrowings	-	192	-	192	(158)	(924)	-	(1,082)
Guarantees issued	-	213	-	213	-	143	-	143

Compensation of key management personnel was comprised of the following:

	2010	*2009*
Salaries and other short-term benefits	2,872	2,684
Social security costs	632	590
Total key management personnel compensation	**3,504**	**3,274**

Subsidiary

As of 31 December 2010 and 2009 the consolidated financial statements include the following subsidiary:

Subsidiary	*Ownership, %*	*Country*	*Date of incorporation*	*Industry*
"Bob Broker" Ltd	100	Azerbaijan	28 February 2007	Securities brokerage

Notes to the 2010 Consolidated Financial Statements (Continued)

(Thousands of Azerbaijani manats unless otherwise indicated)

25. Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the ratios established by the CBA in supervising the Bank.

The objectives of management when managing the Bank's capital are (i) to comply with the capital requirements set by CBA, (ii) to safeguard the Bank's ability to continue as a going concern and (iii) to maintain strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value. Compliance with capital adequacy ratios set by CBA is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Chief Accountant and Chairman of the Management Board. The other objectives of capital management are evaluated annually.

CBA capital adequacy ratio

The CBA requires each bank or banking group to:

a) hold the minimum level of share capital of AZN 10,000 thousand (2009: AZN 10,000 thousand);
b) maintain a ratio of total regulatory capital to risk-weighted assets (the 'total capital ratio') at or above the prescribed minimum of 12% (2009: 12%); and
c) maintain a ratio of tier 1 capital to risk-weighted assets (the 'Tier 1 capital ratio') at or above the prescribed minimum of 6% (2009: 6%).

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2010.

As of 31 December 2010, the Bank's capital adequacy ratio on this basis was as follows:

	2010	*2009*
Tier 1 capital	20,780	21,379
Tier 2 capital	19,847	11,977
Less: deductions from capital	(446)	(492)
Total regulatory capital	**40,181**	**32,864**
Risk-weighted assets	**198,705**	**144,105**
Tier 1 capital adequacy ratio	10.3%	14.5%
Total capital adequacy ratio	20.2%	22.8%

26. Event after the reporting period

On 4 April 2011, the General Meeting of Shareholders:

- declared dividends of AZN 2,222 thousand or AZN 0.7 per share before tax on dividend from its 2010 earnings;
- declared capitalization in the amount of AZN 13,328 thousand after 10% dividend tax. The number of authorized ordinary shares remains 3,400,000 with an increased nominal value per share of AZN 7.70.