UNIBANK GROUP

Consolidated Financial Statements and Auditors' Report

31 December 2005

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AUDITORS' REPORT

To the Board of Directors of the Unibank Group:

1. We have audited the accompanying consolidated balance sheet of Unibank and its subsidiary (the "Group") as at 31 December 2005, and the related consolidated statements of income, cash flows and changes in equity for the year then ended. These consolidated financial statements are the responsibility of the Group's Management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

2. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3. In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of 31 December 2005 and the consolidated results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Baku, The Republic of Azerbaijan
5 April 2006

In millions of Azerbaijani Manats	Note	31 December 2005	31 December 2004
ASSETS			
Cash and cash equivalents	7	49,704	49,552
Mandatory cash balances with the National Bank of the Republic of Azerbaijan		9,287	3,907
Due from other banks	8	30,808	15,738
Loans and advances to customers	9	230,680	132,524
Investment securities available for sale	10	1,811	680
Deferred income tax asset	24	-	259
Investment property	11	-	1,713
Premises and equipment	12	9,709	5,778
Other assets	13	2,977	2,535
TOTAL ASSETS		**334,976**	**212,686**
LIABILITIES			
Due to other banks	14	16,400	18,858
Customer accounts	15	209,708	119,155
Debt securities in issue	16	-	5,570
Other borrowed funds	17	56,395	30,445
Deferred income tax liability	24	241	-
Current tax payable		1,471	1,632
Other liabilities	18	4,221	2,433
TOTAL LIABILITIES		**288,436**	**178,093**
EQUITY			
Share capital	19	33,000	25,000
Share premium	19	2,419	571
Revaluation reserve for available for sale securities	20	352	-
Retained earnings		10,769	9,022
TOTAL EQUITY		**46,540**	**34,593**
TOTAL LIABILITIES AND EQUITY		**334,976**	**212,686**

Approved for issue and signed on behalf of the Board of Directors on 5 April 2006.

Faig Huseynov	Emin Rasulzade
Chairman of the Board of Directors	Finance Director

In millions of Azerbaijani Manats	Note	2005	2004
Interest income	21	42,940	22,239
Interest expense	21	(14,592)	(6,857)
Net interest income		**28,348**	**15,382**
Provision for loan impairment	9	(4,400)	(2,070)
Net interest income after provision for loan impairment		**23,948**	**13,312**
Gains less losses from trading in foreign currencies		3,412	2,693
Foreign exchange translation losses less gains		(116)	(503)
Fee and commission income	22	8,240	6,958
Fee and commission expense	22	(2,620)	(1,856)
Other operating income		82	298
Operating income		**32,946**	**20,902**
Administrative and other operating expenses	23	(19,937)	(11,080)
Profit before tax		**13,009**	**9,822**
Income tax expense	24	(3,915)	(2,475)
Profit for the year		**9,094**	**7,347**

In millions of Azerbaijani Manats	Note	2005	2004
Cash flows from operating activities			
Interest received		41,728	21,643
Interest paid		(14,145)	(6,750)
Income received from trading in foreign currencies		3,412	2,693
Fees and commissions received		8,240	6,634
Fees and commissions paid		(2,620)	(1,856)
Other operating income received		30	241
Administrative and other operating expenses paid		(17,526)	(9,731)
Income tax paid		(2,205)	(853)
Cash flows from operating activities before changes in operating assets and liabilities		**16,914**	**12,021**
Changes in operating assets and liabilities			
Net (increase)/decrease in mandatory cash balances with the National Bank of the Republic of Azerbaijan		(5,380)	311
Net decrease/(increase) in due from other banks		1,398	(9,312)
Net increase in loans and advances to customers		(119,311)	(65,987)
Net increase in other assets		(565)	(2,531)
Net (decrease)/increase in due to other banks		(988)	15,580
Net increase in customer accounts		90,234	68,431
Net (decrease)/increase in debt securities in issue		(5,490)	5,490
Net increase other liabilities		2,083	1,577
Net cash (used in)/provided from operating activities		**(21,105)**	**25,580**
Cash flows from investing activities			
Acquisition of premises and equipment	12	(6,220)	(4,475)
Cash received from sale of investment property		-	1,765
Acquisition of investment securities available for sale	10	(680)	(210)
Acquisition of intangible assets		-	(66)
Dividend income received		-	57
Net cash used in investing activities		**(6,900)**	**(2,929)**
Cash flows from financing activities			
Issue of ordinary shares		8,000	-
Share premium received	19	1,848	-
Proceeds from other borrowed funds		198,941	17,615
Repayment of other borrowed funds		(173,200)	(4,771)
Dividends paid		(7,347)	(2,500)
Net cash provided from financing activities		**28,242**	**10,344**
Effect of exchange rate changes on cash and cash equivalents		**(85)**	**(202)**
Net increase in cash and cash equivalents		**152**	**32,793**
Cash and cash equivalents at the beginning of the year	7	49,552	16,759
Cash and cash equivalents at the end of the year	**7**	**49,704**	**49,552**

In millions of Azerbaijani Manats	Note	Share capital	Share premium	Revaluation reserve for available for sale securities	Revaluation reserve for premises and equipment	Retained earnings	Total equity
Balance at 1 January 2004		**25,000**	**571**	-	**237**	**3,938**	**29,746**
Premises and equipment							
- Realised revaluation reserve		-	-	-	(237)	237	-
Profit for the year		-	-	-	-	7,347	7,347
Dividends declared and paid	25	-	-	-	-	(2,500)	(2,500)
Balance at 31 December 2004		**25,000**	**571**	-	-	**9,022**	**34,593**
Available for sale investments:							
- Fair value gains less losses	20	-	-	451	-	-	451
Deferred income tax effect directly recorded in equity	24	-	-	(99)	-	-	(99)
Profit for the year		-	-	-	-	9,094	9,094
Share issue	19	8,000	1,848	-	-	-	9,848
Dividends declared and paid	25	-	-	-	-	(7,347)	(7,347)
Balance at 31 December 2005		**33,000**	**2,419**	**352**	**-**	**10,769**	**46,540**

1 Introduction

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2005 for Unibank Commercial Bank (the "Bank") and its subsidiary (together referred to as the "Group" or "Unibank Group"). Refer to Note 30.

The Bank was incorporated and is domiciled in the Republic of Azerbaijan. The Bank is a joint stock company limited by shares and was set up in accordance with Azerbaijani regulations.

Principal activity. The Bank's principal business activity is commercial and retail banking operations within the Republic of Azerbaijan. The Bank has operated under a full banking licence issued by the National Bank of the Republic of Azerbaijan ("NBAR") since 1992.

The Bank has three (2004: two) branches within the Republic of Azerbaijan.

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

57 R. Behbudov Street
AZ1022
Baku
The Republic of Azerbaijan

Presentation currency. These consolidated financial statements are presented in millions of Azerbaijani Manats ("AZM millions"). Refer to Note 31.

2 Operating Environment of the Group

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

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

3 Basis of Preparation and Significant Accounting Policies

Basis of Preparation. These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the revaluation of available-for-sale financial assets. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

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

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

3 Basis of Preparation and Significant Accounting Policies (Continued)

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

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes *transaction costs*. *Transaction costs* are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

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

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

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

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

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

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

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

3 Basis of Preparation and Significant Accounting Policies (Continued)

Cash and cash equivalents. Cash and cash equivalents are items, which can be converted into cash within a day, including mandatory cash balances in Azerbaijani Manat held with the NBAR. All short-term inter-bank placements, beyond overnight placements, are included in due from other banks. Amounts, which relate to funds that are of a restricted nature, are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

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

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

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

Finance lease receivables / Revenue recognition. Where the Group is a lessor in a lease, which transfers substantially all the risks and rewards incidental to ownership to the lessee, the assets leased out are presented as a finance lease receivable and carried at the present value of the future lease payments. The Group records the finance lease receivables in the amount equal to the net investment in the lease. At the commencement of the lease the net investment in lease is equal to the fair value of the leased asset. Net investment in the lease is calculated as the aggregate of the minimum lease payments, representing the amounts guaranteed by the lessee and any non-guaranteed residual value (together gross investment in the lease), discounted at the interest rate implicit in the lease. The interest rate implicit in the lease is the discount rate that, at the commencement of the lease, discounts the future cash flows in the lease to the fair value of the leased asset.

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

Initial direct costs incurred by lessors include amounts such as commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging a lease. They exclude general overheads such as those incurred by a sales and marketing team. For finance leases other than those involving manufacturer or dealer lessors, initial direct costs are included in the initial measurement of the finance lease receivable and reduce the amount of income recognised over the lease term.

Impairment losses are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of finance lease receivables. Impairment losses are recognised through an allowance account to write down the receivables' net carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the interest rates implicit in the finance leases. The estimated future cash flows reflect the cash flows that may result from obtaining and selling the assets subject to the lease.

Any advances made to the supplier after the date of the inception of the lease and before the date of delivery of the asset from the supplier to the Group, are recorded as finance lease receivables. Finance lease receivables are reduced by any advance payments received by the Group from the lessee in the amount attributable to recovery of the finance lease receivables. The difference between the fair value of the leased asset and finance lease receivable, i.e. the amount outstanding from the Group to the supplier, represents a commitment and is disclosed within contingencies and commitments.

Impairment of financial assets carried at amortised cost. Impairment losses are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Group determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

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

3 Basis of Preparation and Significant Accounting Policies (Continued)

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

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

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

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

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

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

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

De-recognition of financial assets. The Group derecognises financial assets when (i) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (ii) the Group has transferred substantially all the risks and rewards of ownership of the assets or (iii) the Group has neither transferred nor retained substantially all risks and rewards of ownership but has not retained control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

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

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

Subsequent expenditure is capitalised only when it is probable that future economic benefits associated with it will flow to the Group and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to premises and equipment, and its carrying amount at the date of reclassification becomes its deemed cost to be subsequently depreciated.

Premises and equipment. Premises and equipment are stated at cost less accumulated depreciation and provision for impairment, where required.

Construction in progress is carried at cost less provision for impairment where required. Upon completion, assets are transferred to premises and equipment at their carrying amount. Construction in progress is not depreciated until the asset is available for use.

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

3 Basis of Preparation and Significant Accounting Policies (Continued)

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

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

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

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

Buildings	3%;
Office and computer equipment	25%;
Furniture, fixtures and other equipment	20%;
Motor vehicles	15%; and
Leasehold improvements	over the term of the underlying lease

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

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

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Development costs that are directly associated with identifiable and unique software controlled by the Group are recorded as intangible assets if inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred. Capitalised computer software is amortised on a straight-line basis over expected useful lives of 4 to 5 years.

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

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

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

Debt securities in issue. Debt securities in issue include debentures issued by the Group. Debt securities are stated at amortised cost. If the Group purchases its own debt securities in issue, they are removed from the consolidated balance sheet and the difference between the carrying amount of the liability and the consideration paid is included in gains arising from retirement of debt.

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

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

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if financial

3 Basis of Preparation and Significant Accounting Policies (Continued)

statements are authorised prior to filing relevant tax returns. Taxes, other than on income, are recorded within administrative and other operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date, which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

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

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

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

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Group to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Group does not designate loan commitments as financial liabilities at fair value through profit or loss.

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

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

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

Foreign currency translation. Functional currency of each of the Group's consolidated entities is the currency of the primary economic environment in which the entity operates. The Bank's functional currency and the Group's presentation currency is the national currency of the Republic of Azerbaijan, Azerbaijani Manat ("AZM"). Refer to Note 31.

3 Basis of Preparation and Significant Accounting Policies (Continued)

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

At 31 December 2005 the principal rate of exchange used for translating foreign currency balances was USD 1 = AZM 4,593 (2004: USD 1 = AZM 4,903). Exchange restrictions and controls exist relating to converting Azerbaijani Manats into other currencies. At present, the Azerbaijani Manat is not a freely convertible currency in most countries outside of the Republic of Azerbaijan.

Offsetting. Financial assets and liabilities are offset and the net amount reported in the consolidated balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

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

4 Critical Accounting Estimates and Judgements in Applying Accounting Policies

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

Impairment of available for sale equity investments. The Group determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Group evaluates among other factors, the volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational or financing cash flows.

Impairment losses on loans and advances. The Group regularly reviews its loan portfolios to assess impairment. In determining whether an impairment loss should be recorded in the consolidated income statement, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

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

Tax legislation. Azerbaijani tax, currency and customs legislation is subject to varying interpretations. Refer to Note 27.

Deferred income tax asset recognition. The net deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded on the consolidated balance sheet. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future Management makes judgements and applies estimation based on last three years taxable profits and expectations of future income that are believed to be reasonable under the circumstances.

Related party transactions. In the normal course of business the Group enters into transactions with its related parties. These transactions are priced predominantly at market rates. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

5 Adoption of New or Revised Standards and Interpretations

Certain new IFRSs became effective for the Group from 1 January 2005. Listed below are those new or amended standards or interpretations, which are or in the future could be relevant to the Group's operations and the nature of their impact on the Group's accounting policies. All changes in accounting policies were applied retrospectively with adjustments made to the retained earnings at 1 January 2004, unless otherwise described below.

IAS 16 (revised 2003) Property, Plant and Equipment. The residual value is now defined as the amount that the Group estimates it would receive currently for the asset if the asset were already of the age and in the condition expected at the end of its useful life. The Group's policy is now not to cease depreciating assets during temporary periods when the assets are idle. All changes to accounting policies as a result of the revised IAS 16 were accounted for retrospectively and did not result in a significant effect on the carrying amount of the Group's assets.

IAS 17 (revised 2003) Leases. Initial direct costs incurred in negotiating a finance lease are now deferred as part of the net investment in the lease. Finance leases are now recognised at commencement based on values measured at inception. Commencement is when the lessee can start using the leased asset. Inception is the earlier of the date of the lease agreement and the date of commitment to the principal provisions of the lease. The revised IAS 17 is applied retrospectively to all leases in accordance with the transitional provisions of the standard.

IAS 24 (revised 2003) Related Party Disclosures. The definition of related parties was extended and additional disclosures required by the revised standard were made in these consolidated financial statements.

IAS 39 (revised 2003) Financial Instruments: Recognition and Measurement. The definition of 'originated loans and receivables' was amended to become 'loans and receivables'. This category now comprises originated or purchased loans and receivables that are not quoted in an active market. The Group amended its policies and may designate any financial instrument on initial recognition as one to be measured at fair value, with changes in fair value recognised in profit or loss. Subsequent reclassifications into or out of the 'at fair value through profit or loss' category are prohibited.

The Group amended its policies for de-recognition of financial assets. Under the original IAS 39, several concepts governed de-recognition. The revised IAS 39 retains the two main concepts of risks and rewards and control, but clarifies that the evaluation of the transfer of risks and rewards precedes the evaluation of the transfer of control. The Group now applies the guidance added to IAS 39 on how to determine fair values using valuation techniques and how to evaluate impairment in a group of loans, receivables or held-to-maturity investments which cannot yet be identified with any individual asset in the group. In accordance with the standard's transitional provisions the revised accounting policies are applied retrospectively, except for the clarified de-recognition rules, which are applied prospectively from 1 January 2004. Although allowed by the standard, the Group has not re-designated any financial instrument into 'at fair value through profit or loss' or 'available for sale' categories at the date of initial application of the revised IAS 39.

Effect of Adoption of New or Revised Standards. The effect of adoption of the above new or revised standards and interpretations on the Group's financial position at 31 December 2005 and 31 December 2004 and on the results of its operations for the years then ended was not significant.

6 New Accounting Pronouncements

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2006 or later periods and which the Bank has not early adopted:

IFRIC 4, Determining whether an Arrangement contains a Lease. IFRIC 4 requires that determining whether an arrangement is, or contains, a lease be based on the substance of the arrangement. It requires an assessment of whether (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset.

IAS 39 (Amendment) – The Fair Value Option. IAS 39 (as revised in 2003) permitted entities to designate irrevocably on initial recognition practically any financial instrument as one to be measured at fair value with gains and losses recognised in profit or loss ('fair value through profit or loss'). The amendment changes the definition of financial instruments 'at fair value through profit or loss' and restricts the ability to designate financial instruments as part of this category. The Group's policy is not to voluntarily designate assets and liabilities as at fair value through profit or loss.

IAS 39 (Amendment) – Financial Guarantee Contracts. Issued financial guarantees, other than those previously asserted by the entity to be insurance contracts, will have to be initially recognised at their fair value, and subsequently measured at the higher of (i) the unamortized balance of the related fees received and deferred and (ii) the expenditure required to settle the commitment at the balance sheet date. Different requirements apply for the subsequent measurement of issued financial guarantees that prevent de-recognition of financial assets or result in continuing involvement accounting.

6 New Accounting Pronouncements (Continued)

IFRS 7 Financial Instruments: Disclosures and a complementary Amendment to IAS 1 Presentation of Financial Statements - Capital Disclosures. The IFRS introduces new disclosures to improve the information about financial instruments. It replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and some of the requirements in IAS 32, Financial Instruments: Disclosure and Presentation. The Amendment to IAS 1 introduces disclosures about level of an entity's capital and how it manages capital. The Group is currently assessing what impact the new IFRS and the amendment to IAS 1 will have on disclosures in its financial statements.

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Group's financial statements.

7 Cash and Cash Equivalents

In millions of Azerbaijani Manats	**2005**	**2004**
Cash on hand	18,186	16,997
Cash balances with the NBAR	12,202	9,967
Correspondent accounts and overnight placements with other banks		
- The Republic of Azerbaijan	5,708	11,898
- Other countries	13,608	10,690
Total cash and cash equivalents	**49,704**	**49,552**

Included in the balances of correspondent accounts and overnight placements with other banks as at 31 December 2005 is an overnight placement with a resident bank amounting to AZM 3,714 million. This placement was repaid on 2 January 2006. Corresponding overnight placement of this resident bank in the Bank has been recorded in due to other banks. Refer to Note 14.

Geographical, currency and interest rate analyses of cash and cash equivalents are disclosed in Note 26. The information on related party balances is disclosed in Note 29.

8 Due from Other Banks

In millions of Azerbaijani Manats	**2005**	**2004**
Current term placements with other banks	12,870	15,738
Notes of the NBAR	17,938	-
Total due from other banks	**30,808**	**15,738**

Current term placements with other banks include short-term placements with three resident banks amounting to AZM 6,715 million as at 31 December 2005. These placements have been subsequently granted by these three resident banks to Unileasing, a 100% subsidiary of the Group, under separate loan agreements bearing annual interest rates ranging between 11% and 15% with similar maturities from January 2006 to November 2006. Refer to Notes 14 and 29.

Notes of the NBAR represent short-term debt instruments issued by the NBAR with maturities of less than month and annual yield ranging from 9% to 14%. All of the notes outstanding as at 31 December 2005 were repaid by the issuer during January 2006.

As at 31 December 2004, included in current term placement with other banks was a deposit placed by the Group with a European bank in the amount of EUR 1,515,243 or AZM 10,125 million bearing EUR overnight index average (EONIA) rate minus 0.625% per annum with no specific maturity.

As at 31 December 2005 the estimated fair value of due from other banks was AZM 30,808 million (31 December 2004: AZM 15,738 million). Refer to Note 28. Geographical, currency, maturity and interest rate analyses of due from other banks are disclosed in Note 26. The information on related party balances is disclosed in Note 29.

9 Loans and Advances to Customers

In millions of Azerbaijani Manats	2005	2004
Current loans	220,196	133,416
Finance lease receivables	16,832	1,105
Overdue loans	1,847	2,946
Accrued interest income	2,503	1,355
Less: Provision for loan impairment	(10,698)	(6,298)
Total loans and advances to customers	**230,680**	**132,524**

The movement in the provision for impairment on loans to customers is, as follows:

In millions of Azerbaijani Manats	2005	2004
Provision for loan impairment as at 1 January	6,298	4,409
Charge for the year	4,400	2,070
Write off during the year	-	(181)
Provision for loan impairment as at 31 December	**10,698**	**6,298**

Economic sector risk concentration of the loan portfolio is, as follows:

In millions of Azerbaijani Manats	2005		2004	
	Amount	%	Amount	%
Consumer loans				
- purchase of motor vehicles	38,100	15.8	27,028	19.5
- trade and services	29,696	12.3	-	-
- purchase of apartments and mortgage	16,938	7.0	6,239	4.5
- manufacturing	7,390	3.1	-	-
- credit cards	1,423	0.6	1,187	0.9
- other purposes	21,835	9.0	5,887	4.2
Total consumer loans	**115,382**	**47.8**	**40,341**	**29.1**
Production	48,141	19.9	29,037	20.9
Trade and services	36,077	14.9	47,985	34.6
Leasing	21,078	8.7	1,142	0.8
Construction	10,598	4.5	15,074	10.9
Government bodies	1,993	0.8	-	-
Agriculture	463	0.2	1,243	0.9
Other	7,646	3.2	4,000	2.8
Total loans and advances to customers (aggregate amount)	**241,378**	**100.0**	**138,822**	**100.0**

The increase of the loan portfolio is attributed both to the increase of the volumes of consumer lending, mainly represented by loans issued for the purchase of automobiles, as well as to the increase of the volumes of corporate lending.

9 Loans and Advances to Customers (Continued)

Loans and advances to customers as at 31 December 2005 include finance lease receivables of the Group's leasing subsidiary in the amount of AZM 16,832 recorded net of provision for uncollectible finance lease receivables of AZM 444 million (31 December 2004: finance lease receivables of the Group's leasing subsidiary in the amount of AZM 1,105 recorded net of provision for uncollectible finance lease receivables of AZM 37 million). As at 31 December 2005 finance lease receivable is represented by 56 lease contracts primarily related to the lease of various types of vehicles and medical equipment (31 December 2004: 11 lease contracts primarily related to the lease of various types of vehicles). These finance lease contracts expire over the next three years. Lease payments are made on a monthly basis. The leasing subsidiary holds title to property in lease during the lease term. Risks related to the leased property such as damage caused by various reasons, theft and other are generally insured in the finance lease agreements. The management of the leasing subsidiary periodically assesses the financial performance of the lessees by monitoring debts outstanding and analysing their financial reports.

As at 31 December 2005 the Bank has 36 borrowers with aggregate loan amount of AZM 80,156 million or 33% of the gross loan portfolio (31 December 2004: ten borrowers with aggregate loan amount of AZM 31,956 million or 23% of the gross loan portfolio).

Finance lease payments receivable (gross investment in the leases) and their present values are, as follows:

In millions of Azerbaijani Manats	**Due in 1 year**	**Due between 2 and 5 years**	**Due after 5 years**	**Total**
Finance lease payments receivable at 31 December 2004	**276**	**1,143**	**-**	**1,419**
Unearned finance income	(54)	(223)	-	(277)
Impairment loss provision	(7)	(30)	-	(37)
Present value of lease payments receivable at 31 December 2004	**215**	**890**	**-**	**1,105**
Finance lease payments receivable at 31 December 2005	**1,316**	**19,418**	**-**	**20,734**
Unearned finance income	(248)	(3,210)		(3,458)
Impairment loss provision	(23)	(421)	-	(444)
Present value of lease payments receivable at 31 December 2005	**1,045**	**15,787**	**-**	**16,832**

As at 31 December 2005 the estimated fair value of loans and advances to customers was AZM 230,680 million (31 December 2004: AZM 132,524 million). Refer to Note 28.

Geographical, currency, maturity and interest rate analyses of loans and advances to customers are disclosed in Note 26. The information on related party balances is disclosed in Note 29.

10 Investment Securities Available for Sale

In millions of Azerbaijani Manats	**2005**	**2004**
Unlisted equity securities	1,811	680
Total investment securities available for sale	**1,811**	**680**

10 Investment Securities Available for Sale (Continued)

Details of investment securities available-for-sale are, as follows:

Name	Nature of Business	Country of Registration	Carrying value 2005	Carrying value 2004
Baku Stock Exchange	Stock Exchange	Republic of Azerbaijan	300	300
MBASK Insurance	Insurance	Republic of Azerbaijan	1,511	380
Total investment securities available for sale			**1,811**	**680**

The investment in Baku Stock Exchange was made in 2000 and represents 5.56% of its total share capital. Currently the stock market in the Republic of Azerbaijan is practically non-existent, and the activity of Baku Stock Exchange as at the reporting date is still at the start-up stage. However, the management of the Group believes that the fair value of this investment does not differ materially from its carrying value.

On 4 February 2004 the Group purchased additional shares of MBASK insurance company in the total amount of AZM 210 million, thus increasing its investment in MBASK from AZM 170 million up to AZM 380 million and the effective percentage holding in its share capital from 8.5% as at 31 December 2003 up to 10.6% as at 31 December 2004.

On 15 March 2005 the Group increased the amount of its investment in MBASK insurance company due to the overall increase in the share capital of the latter. During 2005, the total share capital of MBASK was increased from AZM 3,500 million up to AZM 10,000 million. In order to maintain its 10.6% shareholding at the existing level, the Group has contributed additional AZM 680 million to the share capital of MBASK, thus bringing the par value of its investment in MBASK to the amount of AZM 1,060 million as at 31 December 2005. As at 31 December 2005 the estimated fair value of the Group's investment in MBASK was AZM 1,511 million (31 December 2004: AZM 380 million).

The movements in the Group's investment in MBASK are, as follows:

In millions of Azerbaijani Manats	Year ended 31 December 2005	Year ended 31 December 2004
Carrying amount as at 1 January	**380**	**170**
Movement in fair value reserve for investment securities available for sale for the year	451	-
Purchase of additional shares	680	210
Carrying amount as at 31 December	**1,511**	**380**

The movement in fair value reserve for investment securities available for sale in the amount of AZM 451 million, net of deferred income tax in the amount of AZM 99 million (Refer to Note 28), was recorded as revaluation reserve on available for sale securities in the net amount of AZM 352 million in the consolidated statement of changes in equity for the year ended 31 December 2005. Refer to Note 19.

Geographical, currency, maturity and interest rate analyses of investment securities available for sale are provided in Note 26**.**

11 Investment Property

During 2003 the Group's head office moved out from its office building to other premises rented by the Group, and the Group rented out its office building to a third party. Therefore, this office building was reclassified to investment property.

On 15 November 2004 the Group signed an agreement with an independent third party for the sale of the Group's investment property for the total cash proceeds of AZM 1,765 million or USD 360,000. Under the terms of the agreement, the legal title over the property was to be transferred to the buyer in 2005, upon completion of appropriate legal work. As at 31 December 2004 total price of the property was fully prepaid by the buyer and was recorded as deferred proceeds in other liabilities. Refer to Note 18. The legal title of the building was transferred to the buyer on 11 March 2005.

As at 11 March 2005, the carrying value of the sold investment property amounted to AZM 1,701 million. The resulting gain on sale of investment property amounting to AZM 64 million was recorded under other operating income in the consolidated statement of income for the year ended 31 December 2005.

12 Premises and Equipment

In millions of Azerbaijani Manats	Note	Leasehold Improvements	Land and buildings	Office and computer equipment	Furniture, fixtures and other	Construc-tion in progress	Total
Cost at 1 January 2004		307	102	1,335	2,918	123	4,785
Accumulated depreciation		(306)	(5)	(579)	(1,415)	-	(2,305)
Carrying amount at 1 January 2004		**1**	**97**	**756**	**1,503**	**123**	**2,480**
Additions		282	-	1,777	2,373	43	4,475
Transfers		-	128	-	-	(128)	-
Disposals		-	-	(12)	-	-	(12)
Depreciation charge	23	(64)	(6)	(447)	(648)	-	(1,165)
Carrying amount at 31 December 2004		**219**	**219**	**2,074**	**3,228**	**38**	**5,778**
Cost at 31 December 2004		589	230	3,100	5,293	38	9,250
Accumulated depreciation		(370)	(11)	(1,026)	(2,065)	-	(3,472)
Carrying amount at 31 December 2004		**219**	**219**	**2,074**	**3,228**	**38**	**5,778**
Additions		552	-	2,694	2,537	437	6,220
Transfers		38	-	-	-	(38)	-
Disposals		-	-	(3)	(48)	-	(51)
Depreciation charge	23	(221)	(6)	(1,001)	(1,010)	-	(2,238)
Carrying amount at 31 December 2005		**588**	**213**	**3,764**	**4,707**	**437**	**9,709**
Cost at 31 December 2005		1,179	230	5,791	7,778	437	15,415
Accumulated depreciation		(591)	(17)	(2,027)	(3,071)	-	(5,706)
Carrying amount at 31 December 2005		**588**	**213**	**3,764**	**4,707**	**437**	**9,709**

Included in the closing balance of premises and equipment as at 31 December 2005 are fully depreciated assets still in use in the amount of AZM 954 million (31 December 2004: AZM 632 million).

Included in additions to premises and equipment during the year ended 31 December 2005 are two safes purchased for total AZM 1,084 million and two high-capacity servers in the total amount of AZM 1,158 million, as well as other computer equipment for banking and plastic cards operations and leasehold improvements in the total amount of AZM 590 million, which are mostly represented by refurbishments at newly opened Yasamal branch of the Bank.

13 Other Assets

In millions of Azerbaijani Manats	2005	2004
Advances on equipment purchased for leasing purposes	918	421
Prepayments for purchase of fixed and intangible assets	780	521
Restricted cash balances	266	284
Prepaid insurance	207	119
Intangible assets	190	141
Equipment for leasing	-	819
Miscellaneous	616	230
Total other assets	**2,977**	**2,535**

Advances on equipment purchased for leasing purposes represent advances to suppliers of equipment, which is intended for subsequent lease.

Included in prepayments for purchase of fixed and intangible assets as at 31 December 2005 is prepayment for the purchase of accounting software in the amount of AZM 519 million (31 December 2004: prepayment for the purchase of accounting software in the amount of AZM 422 million).

Restricted cash balances represent security deposits placed with two resident banks to ensure rendering of plastic cards processing services, as well as a guarantee deposit placed with a payment system operator.

Equipment for leasing as at 31 December 2004 represented equipment purchased for leasing purposes, for which specific leasing contracts had not yet been negotiated. Equipment for leasing as at 31 December 2004 primarily consisted of vehicles and construction equipment and was usually held by the Group for the period of one to three months, until the inception of new lease agreements.

Geographical, currency, maturity and interest rate analyses of other assets are provided in Note 26.

14 Due to Other Banks

In millions of Azerbaijani Manats	2005	2004
Correspondent accounts and overnight placements of other banks	3,714	480
Current term placements of other banks	12,686	16,374
Guarantee deposits obtained in relation to providing short-term foreign currency denominated financing	-	2,004
Total due to other banks	**16,400**	**18,858**

Included in correspondent accounts and overnight placements of other banks is an overnight placement amounting to AZM 3,714 million received from a resident bank as at 31 December 2005. This placement was repaid on 2 January 2006. Corresponding placement of the Bank with this resident bank was recorded in cash and cash equivalents. Refer to Note 7.

Included in current term placements of other banks are short-term loans amounting to AZM 6,715 million granted by three resident banks to Unileasing, a 100% subsidiary of the Group, under separate loan agreements bearing annual interest rates ranging between 11% and 15% with similar maturities from January 2006 to November 2006. Refer to Note 8 and Note 29.

Guarantee deposits obtained in relation to providing short-term foreign currency denominated financing as at 31 December 2004 represented EUR denominated guarantee deposits obtained from an Azerbaijani bank. This deposit was fully repaid by the Group in 2005.

Geographical, currency, maturity and interest rate analyses of due to other banks are disclosed in Note 26. The information on related party balances is disclosed in Note 29.

15 Customer Accounts

In millions of Azerbaijani Manat	2005	2004
State and public organisations	**14,979**	**8,217**
- Current/settlement accounts	12,778	7,166
- Term deposits	2,201	1,051
Other legal entities	**61,842**	**37,368**
- Current/settlement accounts	46,745	31,034
- Term deposits	15,097	6,334
Individuals	**132,561**	**73,563**
- Current/demand accounts	14,510	8,858
- Term deposits	118,051	64,705
Accrued interest expense	326	7
Total customer accounts	**209,708**	**119,155**

In the course of 2005 the Bank focused on increasing the amount of term deposits from both individuals and corporate customers and attracted both short-term and long-term deposits from individuals and corporate customers through aggressive advertising campaign and increase of interest rates.

Economic sector concentrations within customer accounts are, as follows:

	2005		2004	
In millions of Azerbaijani Manat	**Amount**	**%**	**Amount**	**%**
Individuals	132,887	63.4	73,570	61.7
Trade and Services	30,023	14.3	14,722	12.4
Insurance	19,168	9.1	11,801	9.9
Energy	15,389	7.3	13,755	11.5
Transportation	3,628	1.7	1,818	1.5
Communication	3,456	1.6	-	-
Manufacturing	2,027	1.0	813	0.7
Construction	1,365	0.7	658	0.6
Public	142	0.1	-	-
Agriculture	52	-	-	-
Other	1,571	0.8	2,018	1.7
Total customer accounts	**209,708**	**100**	**119,155**	**100**

At 31 December 2005 the estimated fair value of customer accounts was AZM 209,708 millions (2004: AZM 119,155 millions). Refer to Note 28.

Geographical, currency, maturity and interest rate analyses of customer accounts are disclosed in Note 26. The information on related party balances is disclosed in Note 29.

16 Debt Securities in Issue

In millions of Azerbaijani Manats	2005	2004
Debentures	-	5,490
Accrued interest expense	-	80
Total debt securities in issue	**-**	**5,570**

On 14 April 2004 the Group issued 10,000 publicly traded (in the Republic of Azerbaijan) corporate debentures through a primary placement at the Baku Stock Exchange with the par value of AZM 1 million each in the total amount of AZM 10,000 million. All of the issued debentures were denominated in AZM, had interest rate of 6% p.a. and were sold on 14 April 2004. Of this issue, debentures in the amount of AZM 8,000 million were bought back by the Group on 17 September 2004 and remained on offer at BSE till their expiry date on 8 April 2005. Debentures on offer at BSE in the amount of AZM 8,000 million were recorded by the Group within credit related commitments as at 31 December 2004. The remaining corporate debentures in the amount of AZM 2,000 million were repaid by the Group at maturity, on 8 April 2005.

On 28 July 2004 the Group issued 5,000 publicly traded (in the Republic of Azerbaijan) corporate debentures through a primary placement at the BSE, with par value of AZM 1,000. These debentures are denominated in AZM, bear interest rate of 9% p.a. and have a maturity date of 28 July 2005. 3,490 of these debentures were sold on the issue date to the unrelated local banks, while the remaining 1,510 were sold on 25 May 2005 to a company related to the Group. Debentures sold by the Group to a related company in the amount of AZM 1,510 million were recorded by the Group within credit related commitments as at 31 December 2004. These corporate debentures were repaid by the Group in full at maturity, on 28 July 2005.

17 Other Borrowed Funds

In millions of Azerbaijani Manats	2005	2004
Funds borrowed from resident banks and organizations:		
- National Fund for Support of Entrepreneurship (the Republic of Azerbaijan)	11,423	7,469
Funds borrowed from or through EBRD	31,366	9,529
Funds borrowed from German-Azerbaijan Fund	10,099	13,364
Funds borrowed from Black Sea Trade and Development Bank (BSTB)	3,215	-
Accrued interest expense	292	83
Total other borrowed funds	**56,395**	**30,445**

On 5 September 2003 the Group signed credit agreement with the National Fund for Support of Entrepreneurship, a programme under the auspices of the Ministry for Economic Development of the Republic of Azerbaijan, for financing of small and medium size enterprises. The borrowing bears interest rate of 1.0%-2.0% per annum and each drawdown is repayable within five years from issue.

The Group signed a Loan Agreement with the European Bank for Reconstruction and Development ("EBRD") dated 29 November 2002 for obtaining a credit line in the amount not exceeding US$ 1,500,000 to finance loans to small and medium sized enterprises of the Republic of Azerbaijan. On 6 June 2003 Amendment to the Loan Agreement was signed increasing the total amount of the credit line from EBRD up to US$ 3,000,000. The credit line carries an interest rate of LIBOR plus 5.5% per annum and is repayable in seven equal semi-annual instalments with the first instalment due on 6 November 2004. As at 31 December 2005 the Group has drawn down USD 1,829,067 or AZM 8,401 million (31 December 2004: USD 1,943,600 or AZM 9,529 million) from this credit line facility.

Included in the balance of the "Funds borrowed from or through EBRD" as at 31 December 2005 is the balance of syndicated loan organised by EBRD. On 8 April 2005 the Group signed a syndicated borrowing agreement with foreign banks led by EBRD in the total amount of USD 5,000,000 for the purposes of financing loans to small and medium size enterprises in the Republic of Azerbaijan. Under the agreement, EBRD, the lead lender, provided USD 1,500,000 or AZM 6,890 million with maturity of three years from the date of the placement and annual interest rates of LIBOR plus 3.5%, progressively increasing by 0.25% in the second and third years. The other lenders, Anglo-Romanian Bank registered in the Great Britain and Bank Creditanstalt registered in Austria, provided the remaining USD 3,500,000 or AZM 16,075 million of the loan for the period of one year at an annual interest rate of LIBOR plus 3.5%.

17 Other Borrowed Funds (Continued)

Funds borrowed from German-Azerbaijan Fund ("GAF") as at 31 December 2005 represent EUR 1,950,000 or AZM 10,099 million (31 December 2004: EUR 2,000,000 or AZM 13,364 million) received from GAF as part of the programme to finance loans to private small and medium enterprises of the Republic of Azerbaijan. GAF was established pursuant to the agreement on financial cooperation signed by the governments of the Republic of Azerbaijan and the Federal Republic of Germany on 21 December 1998 and a subsequent loan and financing agreement between Kreditanstalt fur Wiederaufbau ("KFW") of Germany and the Republic of Azerbaijan dated 8 September 1999.

On 16 January 2003 a revised framework agreement was signed between the Bank and the Savings Bank Foundation for International Cooperation (Germany), which superseded all previously signed agreements. In accordance with this framework agreement (hereinafter referred to as "the Framework Agreement") the Group restructured all the loans previously received from GAF into one credit line amounting to EUR 1,000,000 repayable in 10 equal semi-annual instalments following a grace period of 2 years after 16 January 2003, but no later than on 31 December 2010. The credit line bears interest based on 6-month EURIBOR plus a premium of 3.5% per annum. In accordance with two amendments to the Framework Agreement signed on 3 July 2003 and 14 October 2003 respectively the amount of credit line was increased up to EUR 1,500,000. On 20 September 2004 the amount of credit line was again increased up to EUR 2,000,000. First repayment in the amount of EUR 100,000 was made by the Group on 30 June 2005.

In accordance with the Framework Agreement, the Group issued promissory notes in the amount of each drawdown received from GAF plus additional amount, used by GAF as a collateral in case of non-repayment by the Group. In the event of default on the principal amount of the borrowing in the amount of EUR 1,950,000 (2004: EUR 2,000,000) or AZM 10,099 million (2004: AZM 13,364 million) the borrower is subject to repayment of EUR 2,200,000 (2004: EUR 2,200,000) or AZM 11,394 million (2004: AZM 14,700 million). Therefore a contingent liability in the amount of EUR 250,000 or AZM 1,295 million (2004: EUR 200,000 or AZM 1,336 million) was recorded on off balance sheet accounts. Refer to Note 27.

On 30 November 2005 the Group signed credit agreement with the Black Sea Trade and Development Bank (BSTDB) registered in Greece on opening credit line in the total amount of USD 3,000,000. As at 31 December 2005, the Group has utilized USD 700 thousand or AZM 3,215 million of this credit line.

As at 31 December 2005 the estimated fair value of other borrowed funds was AZM 56,395 million (31 December 2004: AZM 30,445 million).

Geographical, currency, maturity and interest rate analyses of other borrowed funds are disclosed in Note 26. The information on related party balances is disclosed in Note 29.

18 Other Liabilities

In millions of Azerbaijani Manats	**2005**	**2004**
Advances received from lessees on equipment leased out	1,775	384
Payable to suppliers for equipment for the purposes of subsequent leasing	1,628	-
Deferred proceeds from sale of investment property	-	1,765
Professional fees payable	228	126
Other	590	158
Total other liabilities	**4,221**	**2,433**

Included in deferred proceeds from sale of investment property as at 31 December 2004 is cash received from a third party for the sale of the Group's investment property. On 15 November 2004 the Group agreed to sell its investment property (an office building) with a net book value of AZM 1,713 million to a third party for total cash proceeds in the amount of AZM 1,765 million. As at 31 December 2004 the buyer prepaid the amount due for the building, whereas the title was transferred to the buyer on 11 March 2005. Refer to Note 11.

As at 31 December 2005, the Group's leasing subsidiary has AZM 1,628 million payable to suppliers of equipment that is intended to be leased out on finance lease.

Geographical, currency, maturity and interest rate analyses of other liabilities are provided in Note 26. The information on related party balances is disclosed in Note 29.

19 Share Capital

In millions of Azerbaijani Manats	**Number of outstanding shares [in thousands]**	**Ordinary shares**	**Share premium**	**Total**
At 1 January 2004	2,500	25,000	571	25,571
At 31 December 2004	2,500	25,000	571	25,571
New shares issued	800	8,000	1,848	9,848
At 31 December 2005	3,300	33,000	2,419	35,419

The par value of the registered amount of the Bank's issued share capital is AZM 33,000 million (2004: AZM 25,000 million). At 31 December 2005, all of the Bank's outstanding shares were authorised, issued and fully paid in.

Mr. Eldar Garibli, the chairman of the Bank's Supervisory Council, owns 50.556% of the Bank's shares (2004: 52.796%).

All ordinary shares have a nominal value of AZM 10 thousand per share (2004: AZM 10 thousand per share) and rank equally. Each share carries one vote.

On 27 April 2005, the General Meeting of the Group's Shareholders approved an increase in the Bank's authorized share capital from AZM 25,000 million up to AZM 33,000 million. Additional 800 thousand shares, each with a par value of AZM 10,000, were issued by the Group on 7 July 2005. During the second half of 2005 existing shareholders of the Group purchased 525,000 out of 800,000 newly issued shares for a total consideration of AZM 5,722 million, including AZM 5,250 million payment at the shares' nominal value of AZM 10 thousand per share and a premium of AZM 472 million. On 31 May 2005 the Group signed a Subscription Agreement with Deutsche Investitions Entwicklunsgesllshaft mbH bank ("DEG") for the subscription to 8.33% of the Bank's authorized share capital, as increased by the decision of the General Meeting of the Group's Shareholders on 27 April 2005. On 22 December 2005, DEG has purchased the remaining 275 thousand out of the 3,300 thousand of the Bank's shares, which were available from the increase of share issue on 7 July 2005, for a total consideration of AZM 4,126 million, including AZM 2,750 million payment at the shares' nominal value of AZM 10 thousand per share and a premium of AZM 1,376 million.

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

20 Other Reserves

	Revaluation reserve for		**Total reserves**
In millions of Azerbaijani Manats	**Available for sale securities**	**Premises and equipment**	
At 1 January 2004	-	237	237
Realised revaluation reserve	-	(237)	(237)
At 31 December 2004	-	-	-
Revaluation	451	-	451
Income tax effects	(99)	-	(99)
At 31 December 2005	**352**	**-**	**352**

20 Other Reserves (Continued)

Revaluation reserve for available for sale securities is transferred to profit or loss when realised through sale or impairment of these securities. Revaluation reserve for premises and equipment is transferred to retained earnings when realised through depreciation, impairment, sale or other disposal.

In accordance with Azerbaijani legislation, the Group allocates profits as dividends or transfers them to reserves accounts on the basis of statutory financial statements prepared in accordance with Azerbaijani Accounting Rules. The Bank's reserves under Azerbaijani Accounting Rules at 31 December 2005 are AZM 10,771 million (2004: AZM 8,898 million).

21 Interest Income and Expense

In millions of Azerbaijani Manats	**Year ended 31 December 2005**	**Year ended 31 December 2004**
Interest income		
Interest income on originated loans and advances to customers	37,575	21,691
Interest income on correspondent accounts and due from other banks	3,114	503
Interest income on finance lease	2,251	45
Total interest income	**42,940**	**22,239**
Interest expense		
Interest expense on customer accounts	(9,977)	(4,403)
Interest expense on due to banks and other borrowed funds	(4,377)	(1,730)
Interest expense on debt securities in issue	(238)	(724)
Total interest expense	**(14,592)**	**(6,857)**
Net interest income	**28,348**	**15,382**

22 Fee and Commission Income and Expense

In millions of Azerbaijani Manats	**2005**	**2004**
Fee and commission income		
Commission on cash transactions	3,870	3,313
Commissions on settlement transactions	1,528	1,501
Commissions on plastic cards operations	1,257	652
Commissions on foreign currency operations	1,010	301
Commissions on guarantees and letters of credit issued	90	653
Other fees and commissions	485	538
Total fee and commission income	**8,240**	**6,958**
Fee and commission expense		
Commissions on plastic cards operations	(838)	(397)
Commissions on settlement transactions	(600)	(426)
Commissions on guarantees and letters of credit	(543)	(258)
Commissions on cash collection	(340)	(514)
Other fees and commissions	(299)	(261)
Total fee and commission expense	**(2,620)**	**(1,856)**
Net fee and commission income	**5,620**	**5,102**

23 Administrative and Other Operating Expenses

In millions of Azerbaijani Manats	Year ended 31 December 2005	Year ended 31 December 2004
Staff costs	9,240	3,996
Depreciation on premises and equipment and investment property	2,238	1,165
Advertising	1,859	1,395
Rent and lease expenses	1,046	685
Communication expenses	956	591
Professional fees	702	504
Insurance expenses	537	697
Publishing and stationary expenses	473	532
Security expenses	454	305
Business trip expense	311	188
Repair and maintenance expenses	274	156
Expenses related to plastic cards operations	26	110
Other expenses	1,821	756
Total administrative and other operating expenses	**19,937**	**11,080**

24 Income Taxes

Income tax expense comprises the following:

In millions of Azerbaijani Manats	Year ended 31 December 2005	Year ended 31 December 2004
Current tax	3,514	2,492
Deferred tax	401	(17)
Income tax expense for the year	**3,915**	**2,475**

The income tax rate applicable to the majority of the Group's income is 24% (2004: 24%). The income tax rate applicable to the subsidiary's income is 24% (2004: 24%). A reconciliation between the expected and the actual taxation charge is provided below.

In millions of Azerbaijani Manats	Year ended 31 December 2005	Year ended 31 December 2004
IFRS profit before tax	**13,009**	9,822
Theoretical tax charge at statutory rate (2005: 24%; 2004: 24%)	(3,122)	(2,357)
Tax effect of items, which are not deductible or assessable for taxation purposes:		
- Income which is exempt from taxation	-	20
- Non deductible expenses	(813)	(138)
Effects of change in income tax rate from 24% to 22%	20	-
Income tax expense for the year	**(3,915)**	**(2,475)**

A deferred tax liability of AZM 99 million (2004: AZM nill) has been recorded directly in equity in respect of the fair valuation of investment securities available for sale. Refer to Notes 10 and 20.

24 Income Taxes (continued)

Differences between IFRS and Azerbaijani statutory taxation regulations give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and for the purposes of calculation of their tax bases. The tax effect of the movements in these temporary differences is detailed below and is recorded at the rate of 22% (2004: 24%).

In millions of Azerbaijani Manats	31 December 2004	Recorded in the Income Statement	Recorded directly in equity	31 December 2005
Tax effect of deductible temporary differences				
Loan impairment provision	8	(8)	-	-
Accruals	25	(25)		
Other	27	(27)	-	-
Gross deferred tax asset	**60**	**(60)**	**-**	**-**
Tax effect of taxable temporary differences				
Fair valuation of investment securities available for sale (Notes 10, 20)	-	-	(99)	(99)
Depreciation of premises and equipment	199	(341)		(142)
Gross deferred tax liability	**199**	**(341)**	**(99)**	**(241)**
Recognised deferred tax asset/(liability)	**259**	**(401)**	**(99)**	**(241)**

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

In millions of Azerbaijani Manats	1 January 2004	Recorded in the Income Statement	Recorded directly in equity	31 December 2004
Tax effect of deductible temporary differences				
Loan impairment provision	28	(20)	-	8
Depreciation of premises and equipment	140	59	-	199
Accruals	74	(49)		25
Other	-	27	-	27
Recognised deferred tax asset	**242**	**17**		**259**

25 Dividends

In millions of Azerbaijani Manats	2005	2004
Dividends payable at 1 January	-	-
Dividends declared during the year	7,347	2,500
Dividends paid during the year	(7,347)	(2,500)
Dividends payable at 31 December	**-**	**-**
Dividends per share declared during the year	**0.0002**	**0.0001**

All dividends are declared and paid in Azerbaijani Manats.

26 Financial Risk Management

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

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

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

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

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

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

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

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

In millions of Azerbaijani Manats	**Azerbaijan**	**OECD**	**Non OECD**	**Total**
Assets				
Cash and cash equivalents	36,094	12,647	963	49,704
Mandatory cash balances with the NBAR	9,287	-	-	9,287
Due from other banks	30,798	10	-	30,808
Loans and advances to customers	230,680	-	-	230,680
Investment securities available for sale	1,811	-	-	1,811
Premises and equipment	9,709	-	-	9,709
Other assets	1,710	748	519	2,977
Total assets	**320,089**	**13,405**	**1,482**	**334,976**
Liabilities				
Due to other banks	16,400	-	-	16,400
Customer accounts	209,708	-	-	209,708
Other borrowed funds	11,457	44,938	-	56,395
Deferred income tax liability	241	-	-	241
Other liabilities	4,064	1,628	-	5,692
Total liabilities	**241,870**	**46,566**	**-**	**288,436**
Net balance sheet position	**78,219**	**(33,161)**	**1,482**	**46,540**
Credit related commitments	**(35,660)**	**(1,845)**	**(550)**	**(38,055)**

26 Financial Risk Management (Continued)

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

The geographical concentration of the Group’s assets and liabilities at 31 December 2004 is set out below:

In millions of Azerbaijani Manats	**Azerbaijan**	**OECD**	**Non OECD**	**Total**
Assets				
Cash and cash equivalents	38,862	9,771	919	49,552
Mandatory cash balances with the NBA	3,907	-	-	3,907
Due from other banks	1,471	14,267	-	15,738
Loans and advances to customers	132,524	-	-	132,524
Investment securities available for sale	680	-	-	680
Deferred income tax asset	259	-	-	259
Premises and equipment	5,778	-	-	5,778
Investment property	1,713	-	-	1,713
Other assets	1,678	15	842	2,535
Total assets	**186,872**	**24,053**	**1,761**	**212,686**
Liabilities				
Due to other banks	18,858	-	-	18,858
Customer accounts	119,155	-	-	119,155
Debt securities in issue	5,570	-	-	5,570
Other borrowed funds	7,469	22,976	-	30,445
Other liabilities	3,994	-	71	4,065
Total liabilities	**155,046**	**22,976**	**71**	**178,093**
Net balance sheet position	**31,826**	**1,077**	**1,690**	**34,593**
Credit related commitments	**(29,859)**	**(1,673)**	**-**	**(31,532)**

26 Financial Risk Management (Continued)

Currency risk. The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board of Directors sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily. The table below summarises the Group's exposure to foreign currency exchange rate risk at 31 December 2005:

In millions of Azerbaijani Manats	AZM	USD	Euro	Other	Total
Assets					
Cash and cash equivalents	20,314	20,054	8,509	827	49,704
Mandatory cash balances with the NBAR	-	9,287	-	-	9,287
Due from other banks	17,938	12,860	10	-	30,808
Loans and advances to customers	55,301	170,456	4,923	-	230,680
Investment securities available for sale	1,811	-	-	-	1,811
Premises and equipment	9,709	-	-	-	9,709
Other assets	1,379	1,325	273	-	2,977
Total assets	**106,452**	**213,982**	**13,715**	**827**	**334,976**
Liabilities					
Due to other banks	-	16,392	8	-	16,400
Customer accounts	40,242	158,160	11,266	40	209,708
Other borrowed funds	11,433	34,833	10,129	-	56,395
Deferred income tax liability	241	-	-	-	241
Other liabilities	1,524	2,554	1,614	-	5,692
Total liabilities	**53,440**	**211,939**	**23,017**	**40**	**288,436**
Net balance sheet position, excluding currency derivatives	**53,012**	**2,043**	**(9,302)**	**787**	**46,540**
Foreign currency forwards	**-**	**(8,126)**	**8,188**	**-**	**-**
Net balance sheet position	**53,012**	**(6,083)**	**(1,114)**	**787**	**46,602**

26 Financial Risk Management (Continued)

At 31 December 2004, the Group had the following positions in currencies:

In millions of Azerbaijani Manats	AZM	USD	EUR	Other	Total
Assets					
Cash and cash equivalents	14,665	26,034	8,125	728	49,552
Mandatory cash balances with the NBAR	235	3,672	-	-	3,907
Due from other banks	1,470	1,471	12,797	-	15,738
Loans and advances to customers	35,440	95,756	1,328	-	132,524
Investment securities available for sale	680	-	-	-	680
Deferred tax asset	259	-	-	-	259
Premises and equipment	5,778	-	-	-	5,778
Investment property	1,713	-	-	-	1,713
Other assets	1,635	900	-	-	2,535
Total assets	**61,875**	**127,833**	**22,250**	**728**	**212,686**
Liabilities					
Due to other banks	11,531	6,847	480	-	18,858
Customer accounts	13,417	99,681	5,866	191	119,155
Debt securities in issue	5,570	-	-	-	5,570
Other borrowed funds	7,469	9,529	13,447	-	30,445
Other liabilities	3,387	678	-	-	4,065
Total liabilities	**41,374**	**116,735**	**19,793**	**191**	**178,093**
Net balance sheet position, excluding currency derivatives	**20,501**	**11,098**	**2,457**	**537**	**34,593**
Foreign currency forwards	**-**	**-**	**-**	**-**	**-**
Net balance sheet position	**20,501**	**11,098**	**2,457**	**537**	**34,593**

The Group has extended loans and advances denominated in foreign currencies. Movements in foreign exchange rates affect the borrowers' repayment ability and insurance of loan losses.

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

The table below shows assets and liabilities at 31 December 2005 by their remaining contractual maturity, unless there is evidence that any of the assets are impaired and will be settled after their contractual maturity dates, in which case the expected date of settlement of the assets is used. Some of the assets and liabilities, however, may be of a longer-term nature; for example, loans are frequently renewed and accordingly short term loans can have a longer-term duration.

Overdue liabilities, such as term deposits not withdrawn by the Bank's customers, are classified within the "demand and less than 1 month" column. Overdue assets are allocated based on their expected maturity. Certain assets, for example available for sale equity securities are assumed to mature on the expected date on which the assets will be realised. Mandatory cash balances with the NBAR are included within demand and less than one month as the requirement is to maintain as a reserve a specified percentage of certain liabilities which are also included within this category.

26 Financial Risk Management (Continued)

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

In millions of Azerbaijani Manats	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	Over 12 months	Total
Assets					
Cash and cash equivalents	49,704	-	-	-	49,704
Mandatory cash balances with the NBAR	9,287	-	-	-	9,287
Due from other banks	20,704	10,104	-	-	30,808
Loans and advances to customers	10,517	25,356	63,508	131,299	230,680
Investment securities available for sale	-	-	-	1,811	1,811
Premises and equipment	-	-	-	9,709	9,709
Other assets	2,060	13	-	904	2,977
Total assets	**92,272**	**35,473**	**63,508**	**143,723**	**334,976**
Liabilities					
Due to other banks	6,929	-	-	9,471	16,400
Customer accounts	96,764	67,559	35,748	9,637	209,708
Other borrowed funds	228	-	16,105	40,062	56,395
Deferred income tax liability	-	-	241	-	241
Other liabilities	4,064	-	1,628	-	5,692
Total liabilities	**107,985**	**67,559**	**53,722**	**59,170**	**288,436**
Net liquidity gap	**(15,713)**	**(32,086)**	**9,786**	**84,553**	**46,540**
Cumulative liquidity gap at 31 December 2005	**(15,713)**	**(47,799)**	**(38,013)**	**46,540**	

26 Financial Risk Management (Continued)

The liquidity position of the Group at 31 December 2004 is set out below.

In millions of Azerbaijani Manats	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	Over 12 months	Total
Assets					
Cash and cash equivalents	49,552	-	-	-	49,552
Mandatory cash balances with the NBA	3,907	-	-	-	3,907
Due from other banks	11,594	4,144	-	-	15,738
Loans and advances to customers	2,246	26,071	38,366	65,841	132,524
Investment securities available for sale	-	-	-	680	680
Deferred tax asset	-	-	-	259	259
Premises and equipment	-	-	-	5,778	5,778
Investment property	-	-	-	1,713	1,713
Other assets	1,763	262	-	510	2,535
Total assets	**69,062**	**30,477**	**38,366**	**74,781**	**212,686**
Liabilities					
Due to other banks	6,914	11,944	-	-	18,858
Customer accounts	48,379	13,612	34,738	22,426	119,155
Debt securities in issue	-	2,080	3,490	-	5,570
Other borrowed funds	83	1,894	2,228	26,240	30,445
Other liabilities	542	3,523	-	-	4,065
Total liabilities	**55,918**	**33,053**	**40,456**	**48,666**	**178,093**
Net liquidity gap	**13,144**	**(2,576)**	**(2,090)**	**26,115**	**34,593**
Cumulative liquidity gap at 31 December 2004	**13,144**	**10,568**	**8,478**	**34,593**	

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

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

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

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Group does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

26 Financial Risk Management (Continued)

Interest rate risk. The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The table below summarises the Group's exposure to interest rate risks at 31 December 2005. Included in the table are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual re-pricing or maturity dates.

In millions of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 6 months**	**From 6 to 12 months**	**More than 1 year**	**Non-monetary**	**Total**
Assets						
Cash and cash equivalents	49,704	-	-	-	-	49,704
Mandatory cash balances with the NBAR	9,287	-	-	-	-	9,287
Due from other banks	20,704	10,104	-	-	-	30,808
Loans and advances to customers	8,014	25,356	63,508	133,802	-	230,680
Investment securities available for sale	-	-	-	-	1,811	1,811
Premises and equipment	-	-	-	-	9,709	9,709
Other assets	2,060	13	-	904	-	2,977
Total assets	**89,769**	**35,473**	**63,508**	**134,706**	**11,520**	**334,976**
Liabilities						
Due to other banks	6,929	-	-	9,471	-	16,400
Customer accounts	96,438	67,559	35,748	9,963	-	209,708
Other borrowed funds	227	25,390	16,106	14,672	-	56,395
Deferred income tax liability	-	241	-	-	-	241
Other liabilities	4,064	-	1,628	-	-	5,692
Total liabilities	**107,658**	**93,190**	**53,482**	**34,106**	**-**	**288,436**
Net sensitivity gap	**(17,889)**	**(57,717)**	**10,026**	**100,600**	**11,520**	**46,540**
Cumulative sensitivity gap at 31 December 2005	**(17,889)**	**(75,606)**	**(65,580)**	**35,020**	**46,540**	

26 Financial Risk Management (Continued)

The following table summarises the Group's exposure to interest rate risks at 31 December 2004 by showing assets and liabilities in categories based on the earlier of contractual re-pricing or maturity dates.

In millions of Azerbaijani Manats	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	More than 1 year	Non-monetary	Total
Assets						
Cash and cash equivalents	49,552	-	-	-	-	49,552
Mandatory cash balances with the NBA	3,907	-	-	-	-	3,907
Due from other banks	11,594	4,144	-	-	-	15,738
Loans and advances to customers	2,246	26,071	38,366	65,841	-	132,524
Investment securities available for sale	-	-	-	-	680	680
Deferred tax asset	-	259	-	-	-	259
Premises and equipment	-	-	-	-	5,778	5,778
Investment property	-	-	-	-	1,713	1,713
Other assets	-	2,535	-	-	-	2,535
Total assets	**67,299**	**33,009**	**38,366**	**65,841**	**8,171**	**212,686**
Liabilities						
Due to other banks	6,914	11,944	-	-	-	18,858
Customer accounts	48,372	13,612	34,738	22,433	-	119,155
Debt securities in issue	-	2,000	3,490	80	-	5,570
Other borrowed funds	-	20,748	2,228	7,469	-	30,445
Other liabilities	-	4,065	-	-	-	4,065
Total liabilities	**55,286**	**52,369**	**40,456**	**29,982**	**-**	**178,093**
Net sensitivity gap	**12,013**	**(19,360)**	**(2,090)**	**35,859**	**8,171**	**34,593**
Cumulative sensitivity gap at 31 December 2004	**12,013**	**(7,347)**	**(9,437)**	**26,422**	**34,593**	

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

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

26 Financial Risk Management (Continued)

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

	2005				2004			
In % p.a.	**USD**	**AZM**	**Euro**	**Other**	**USD**	**AZM**	**Euro**	**Other**
Assets								
Cash and cash equivalents	2.1	-	2.3	-	2.0	-	2.3	-
Due from other banks	11	14	-	-	3.0	-	3.5	-
Loans and advances to customers	21.2	16.8	21.5	-	21.8	20.9	22.3	-
Liabilities								
Due to other banks	12.6	11.0	-	-	10.3	10.0	-	-
Customer accounts	10.6	12.1	9.9	-	10.2	11.8	9.3	-
Debt securities in issue	-	7.9	-	-	-	7.9	-	-
Other borrowed funds	7.1	1.0	5.9	-	6.8	1.0	5.7	-

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

27 Contingencies and Commitments

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

Tax legislation. 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 Group may be challenged by the relevant regional and federal authorities. Recent events within the Republic of Azerbaijan suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

The Group's Management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained. Accordingly, at 31 December 2005 no provision for potential tax liabilities has been recorded (2004: no provision).

Capital expenditure commitments. At 31 December 2005 the Group does not have material contractual capital expenditure commitments in respect of premises and equipment (2004: no capital expenditure commitments).

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

In millions of Azerbaijani Manats	**2005**	**2004**
Not later than 1 year	65	823
Later than 1 year and not later than 5 years	249	1,555
Later than 5 years	-	148
Total operating lease commitments	**314**	**2,526**

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

27 Contingencies and Commitments (Continued)

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

In millions of Azerbaijani Manats	**2005**	**2004**
Letters of guarantee	23,971	16,128
Un-drawn credit lines	9,611	3,725
Contingent liability that may arise in the event of Bank not meeting its obligations on the borrowing from GAF	1,295	1,336
Debentures on offer at BSE	-	9,510
Import letters of credit	3,178	833
Total credit related commitments	**38,055**	**31,532**

The total outstanding contractual amount of un-drawn credit lines, letters of credit, and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded. Fair value of credit related commitments was AZM 38,055 million at 31 December 2005 (2004: AZM 31,532 million).

28 Fair Value of Financial Instruments

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

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

Financial instruments carried at fair value. Investment securities available for sale are carried on the consolidated balance sheet at their fair value. Cash and cash equivalents are carried at amortised cost which approximates current fair value.

Fair values were determined based on quoted market prices except for certain investment securities available for sale for which there were no available external independent market price quotations. These securities have been fair valued by the Group on the basis of results of recent sales of equity interests in the investees between unrelated third parties, consideration of other relevant information such as discounted cash flows and financial data of the investees and application of other valuation methodologies. Valuation techniques required certain assumptions that were not supported by observable market data. Changing any such used assumptions to a reasonably possible alternative would not result in a significantly different profit, income, total assets or total liabilities. Total net fair value gain estimated, using valuation techniques that was recognised in consolidated income statement amounts to AZM 451 million (2004: AZM nil). Refer to Note 10.

Loans and receivables carried at amortised cost. The fair value of floating rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

Liabilities carried at amortised cost. The fair value is based on quoted market prices, if available. The estimated fair value of fixed interest rate instruments with stated maturity, for which a quoted market price is not available, was estimated based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity. The fair value of liabilities repayable on demand or after a notice period ("demandable liabilities") is estimated as the amount payable on demand, discounted from the first date that the amount could be required to be paid. Refer to Notes 14, 15, 16 and 17 for the estimated fair values of due to other banks, customer accounts, debt securities in issue and other borrowed funds, respectively.

29 Related Party Transactions

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

The outstanding balances with related parties at 31 December 2005, which primarily include EBRD, MBask insurance company and key management personnel, and the income and expense items with related parties for the year 2005 were as follows:

	2005		2004	
In millions of Azerbaijani Manats	**Key management**	**Shareholders**	**Key management**	**Shareholders**
Loans and advances to customers				
Loans and advances as at year-end (contractual interest rates: 2005: 9%-26%; 2004: 10% - 26%)	112	2,571	743	1,696
Provision for impairment of loans and advances to customers as at year end	(2)	(48)	(2)	(77)
Interest income on loans and advances to customers for the year	-	136	75	245
Other assets				
Prepaid insurance expense outstanding as at year end	-	179	-	119
Other borrowed funds				
Funds borrowed from EBRD	-	31,366	-	9,529
Interest expense on other borrowed funds	-	(2,135)	-	(527)
Customer accounts				
Current/settlements accounts as at year end	30.5	2,000	-	4,667
Term deposits outstanding as at year-end (2005: 8%-13%; 2004: 8%-12%)	1,153	3,049	3,395	1,657
Interest expense for the year	(88)	(242)	(190)	(144)
Credit related commitments				
Letters of guarantee as at year end	-	2,405	-	2,733
Fee and commission income for the year	**-**	**333**	**-**	**167**
Insurance expense for the year	**-**	**(180)**	**-**	**(697)**

Included in current term placements with other banks are short-term placements with three resident banks amounting to AZM 6,715 million as at 31 December 2005. These placements have been further granted to Unileasing, a 100% subsidiary of the Group, under separate loan agreements bearing annual interest rates ranging between 11% and 15% with similar maturities from January 2006 to November 2006. Refer to Notes 8 and 14.

In 2005, the remuneration of members of the Board of Directors comprised salaries, discretionary bonuses and other short-term benefits totalling AZM 2,092 million (2004: AZM 785 million).

30 Subsidiary

Name	Nature of business	Percentage of voting rights	Percentage of ownership	Country of registration
Unileasing	Leasing	100.0%	100.0%	Azerbaijan

During 2005, the Bank has contributed additional AZM 2,500 million to the share capital of Unileasing, the Group's leasing subsidiary, thus bringing the total value of the share capital of Unileasing to AZM 3,500 million.

31 Subsequent events

According to the Presidential Decree of the Republic of Azerbaijan dated 7 February 2005, the national currency of the Republic of Azerbaijan which is Azerbaijani Manat was denominated in the ratio of 5,000 AZM to 1 New Azerbaijani Manat ("AZN") starting from 1 January 2006. These financial statements are presented in millions of old Azerbaijani Manats ("AZM"). Presentation of the financial statements in AZN is mandatory starting from 1 January 2006.