The International Bank of the Republic of Azerbaijan

Consolidated Financial Statements and Auditor's Report

31 December 2006

CONTENTS

PRICEWATERHOUSECOOPERS

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INDEPENDENT AUDITOR'S REPORT

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

1 We have audited the accompanying consolidated financial statements of the International Bank of the Republic of Azerbaijan and its subsidiaries (the "Group") which comprise the consolidated balance sheet as at 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

6 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 2006, and its consolidated financial performance and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers Eastern Europe B.V. Azerbaijan branch

Baku, Republic of Azerbaijan
31 May 2007

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In thousands of Azerbaijani Manats	**Note**	**2006**	**2005**
ASSETS			
Cash and cash equivalents	7	457,382	258,370
Mandatory cash balances with the National Bank of the Republic of Azerbaijan		115,454	65,941
Due from other banks	8	135,440	54,336
Loans and advances to customers	9	1,038,416	678,470
Investment securities held to maturity	10	-	6,550
Investment in associates and joint ventures	11	809	1,363
Deferred income tax asset	23	41	420
Premises, equipment and intangible assets	12	81,598	77,323
Other assets	13	18,292	12,536
TOTAL ASSETS		**1,847,432**	**1,155,309**
LIABILITIES			
Due to other banks	14	173,380	8,778
Customer accounts	15	1,304,176	908,574
Debt securities in issue	16	40,969	42,187
Other borrowed funds	17	133,882	62,081
Current income tax liability	23	6,961	2,825
Deferred income tax liability	23	12,180	9,933
Other liabilities	18	34,646	37,428
TOTAL LIABILITIES		**1,706,194**	**1,071,806**
EQUITY			
Share capital	19	59,319	24,820
Revaluation reserve for premises and equipment	12, 23	17,444	18,092
Cumulative translation reserve		1,435	987
Retained earnings		61,512	39,604
Net assets attributable to the Bank's equity holders		**139,710**	**83,503**
Minority interest		**1,528**	-
TOTAL EQUITY		**141,238**	**83,503**
TOTAL LIABILITIES AND EQUITY		**1,847,432**	**1,155,309**

Approved for issue by the Board of Directors and signed on its behalf on 31 May 2007:

Mr. Jahangir Hajiyev
Chairman of the Board of Directors

Mr. Rovshan Ismaylov
Head of the Financial Management Department

In thousands of Azerbaijani Manats	Note	2006	2005
Interest income	20	115,811	83,150
Interest expense	20	(38,812)	(23,073)
Net interest income		**76,999**	**60,077**
Provision for impairment of due from other banks	8	(1,939)	(816)
Provision for impairment of loans to customers	9	(29,214)	(36,128)
Net interest income after provision for impairment		**45,846**	**23,133**
Foreign currency translation losses		(2,450)	(3,656)
Gains less losses arising from trading in foreign currencies		19,364	14,070
Gain on disposal of subsidiaries	30	1,925	-
Fee and commission income	21	54,408	43,763
Fee and commission expense	21	(4,378)	(4,488)
Losses on origination of assets/liabilities at rates below/above market		-	(272)
Gross insurance premiums written, net of premiums ceded		5,337	3,810
Increase of provision for unearned premiums, net of reinsurance		(1,649)	(512)
Net claims incurred		(1,360)	(1,203)
Other income		1,217	1,020
Operating income		**118,260**	**75,665**
Administrative and other operating expenses	22	(65,706)	(46,545)
Profit from operations		**52,554**	**29,120**
Share of profit/(losses) of associates and joint ventures	11	15	(62)
Profit before taxation		**52,569**	**29,058**
Income tax charge	23	(14,918)	(8,728)
Net profit after tax		**37,651**	**20,330**

In thousands of Azerbaijani Manats	Note	Attributable to equity holders of the Group: Share Capital	Revaluation reserve for premises	Cumulative translation reserve	Retained earnings	Minority interest	Total equity
Balance at 1 January 2005		**20,000**	**1,743**	**2,595**	**28,874**	**-**	**53,212**
Correction on realised revaluation reserve		-	161	-	-	-	161
Currency translation differences		-	-	(1,608)	-	-	(1,608)
Revaluation of premises	12, 23	-	20,754	-	-	-	20,754
Deferred tax liability	12, 23	-	(4,566)	-	-	-	(4,566)
Net income recognised directly in equity		**-**	**16,349**	**(1,608)**	**-**	**-**	**14,741**
Net profit for the year		-	-	-	20,330	-	20,330
Total recognised income for 2005		**-**	**16,349**	**(1,608)**	**20,330**	**-**	**35,071**
Share issue	19	4,820	-	-	-	-	4,820
Dividends declared	24	-	-	-	(9,600)	-	(9,600)
Balance at 31 December 2005		**24,820**	**18,092**	**987**	**39,604**	**-**	**83,503**
Transfer of realised revaluation reserve		-	(648)	-	648	-	-
Currency translation differences		-	-	448	-	-	448
Net income recognised directly in equity		**-**	**(648)**	**448**	**648**	**-**	**448**
Net profit for the year		-	-	-	37,651	-	37,651
Total recognised income for 2006		-	**(648)**	**448**	**38,299**	-	**38,099**
Share issue	19	34,499	-	-	-	-	34,499
Business combinations	30	-	-	-	-	1,528	1,528
Dividends declared	24	-	-	-	(16,391)	-	(16,391)
Balance at 31 December 2006		**59,319**	**17,444**	**1,435**	**61,512**	**1,528**	**141,238**

In thousands of Azerbaijani Manats	Note	2006	2005
Cash flows from operating activities			
Interest received		95,443	73,304
Interest paid		(41,366)	(23,297)
Income received from trading in foreign currencies		19,364	14,070
Fees and commissions received		54,408	43,122
Fees and commissions paid		(4,378)	(4,172)
Insurance premiums received, net		2,328	2,836
Other operating income received		1,938	1,020
Staff costs paid		(21,529)	(15,549)
Administrative and other operating expenses paid		(28,016)	(19,211)
Income tax paid		(7,623)	(7,746)
Cash flows provided from operating activities before changes in operating assets and liabilities		**70,569**	**64,377**
Changes in operating assets and liabilities			
Net (increase)/decrease in mandatory cash balances with the National Bank of the Republic of Azerbaijan		(49,513)	3,384
Net (increase)/decrease in due from other banks		(81,903)	10,858
Net increase in loans and advances to customers		(372,532)	(298,947)
Net decrease in investment securities held to maturity		6,550	28,877
Net increase in other assets		(5,986)	(301)
Net increase in due to other banks		164,602	5,044
Net increase in customer accounts		398,156	164,148
Net (decrease)/increase in debt securities in issue		(951)	259
Net (decrease)/increase in other liabilities		(316)	30,778
Net cash provided from operating activities		**128,676**	**8,477**
Cash flows from investing activities			
Acquisition of premises and equipment	12	(19,548)	(15,828)
Acquisition of intangible assets	12	(1,872)	(1,666)
Proceeds from disposal of investments in subsidiaries		815	
Proceeds from disposal of investments in associates and joint ventures		569	-
Net cash used in investing activities		**(20,036)**	**(17,494)**
Cash flows from financing activities			
Proceeds from other borrowed funds		128,843	58,626
Repayment of other borrowed funds		(57,042)	(2,879)
Issuance of ordinary shares		34,499	4,820
Dividends paid	24	(13,926)	(10,674)
Net cash provided from financing activities		**92,374**	**49,893**
Effect of exchange rate changes on cash and cash equivalents		**(2,002)**	**(5,264)**
Net increase in cash and cash equivalents for the year		**199,012**	**35,612**
Cash and cash equivalents at the beginning of the year		258,370	222,758
Cash and cash equivalents at the end of the year	7	**457,382**	**258,370**

1 Introduction

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2006 for the International Bank of the Republic of Azerbaijan (the “Bank”) and its subsidiaries (together referred to as the “Group”).

Principal activity. The International Bank of the Republic of Azerbaijan was incorporated in 1991 as a fully state-owned bank and is domiciled in the Republic of Azerbaijan. On 28 October 1992, the Bank became a joint-stock commercial bank and the Ministry of Finance of the Republic of Azerbaijan (“MoF”) became the major shareholder of the Bank. At 31 December 2006, Ministry of Finance of the Republic of Azerbaijan held 33.85% of the total paid-in share capital of the Bank with a preferential right to further purchase shares to bring its ownership up to 50.2% of the share capital of the Bank. Refer to Note 19.

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

The Bank’s head office is located in 67 Nizami Street, Baku, AZ1001, Azerbaijan. The Bank has 36 branches and 121 points of service in the Republic of Azerbaijan (2005: 36 branches, 103 points of service). The Group had 1,590 employees at 31 December 2006 (2005: 1,525 employees) of which 1,318 employees are employed by the Bank; 86 by the International Insurance Company; 45 by Azericard Limited, and 141 by the Group’s fully owned banking subsidiary in the Russian Federation (2005: 1,240 employees by the Bank; 58 by International Insurance Company; 35 by Azericard Limited, and 121 by the Group’s fully owned banking subsidiary in the Russia Federation).

A full list of subsidiaries, associates and joint ventures of the Group is included within these consolidated financial statements. Refer to Note 30.

On 24 January 2002, the Group registered its fully-owned subsidiary, International Bank of Azerbaijan Republic-Moscow, in Moscow, the Russian Federation (“IBAR Moscow”). The share capital of IBAR Moscow was established in the amount of EUR 10,000,000. It is a commercial bank in the form of a limited liability company. IBAR Moscow started its operations under a license issued by the Central Bank of the Russian Federation (“the CBRF”) on 25 January 2002. This license allows IBAR Moscow to carry out banking operations with legal entities in Russian Roubles and in foreign currencies. During the first two years after its registration due to Russian statutory requirements IBAR Moscow was restricted from attracting deposits from individuals. On 1 December 2004 IBAR Moscow received a license from the CBRF allowing it to provide a full range of banking services to individuals. IBAR Moscow’s principal activity is represented by commercial banking operations. IBAR Moscow’s registered office is located at the following address: Tverskaya 6, Bldg 2, Moscow, 105,062, Russian Federation. IBAR Moscow opened a branch in Saint Petersburg, Russian Federation on 28 May 2003 and in Yekaterinburg on 25 August 2005.

On 5 February 2002, the Group registered its fully-owned subsidiary, International Insurance Company (“Insurance Subsidiary”) at the Ministry of Justice of the Republic of Azerbaijan. The Insurance Subsidiary operates under an insurance license Number AB 029205 issued by the Ministry of Finance of the Republic of Azerbaijan on 1 April 2002 and addendum to the above license issued on 16 August 2002. Based on the decision dated 24 December 2004 of the Supervisory Council of the Group to increase the share capital of the Insurance Subsidiary, the share capital of the Insurance Subsidiary was increased by AZN 4,000 thousand to AZN 8,800 thousand during the year ended 31 December 2005.

The activity of the Insurance Subsidiary includes medical, marine third party liability, marine hull, property, casualty, life, personal insurance, insurance of banking risks and reinsurance. During 2004, the insurance subsidiary received additional licences on mandatory fire insurance and on insurance of liability for non-performance of obligations. The official address of the Insurance Subsidiary is: J. Jabbarli Street 46, Baku, AZ 1009, the Republic of Azerbaijan.

On 7 October 2002, the Group’s Insurance Subsidiary established a captive reinsurance company, Inter Protect Re AG. It was registered in Zurich, Switzerland. Refer to Note 30.

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

Azericard Limited is at present one of the biggest providers of authorisation of plastic cards operations and clearing services in the Republic of Azerbaijan. The registered office address of Azericard Limited is: Nizami Street, 67, AZ1001, Baku, the Republic of Azerbaijan.

1 Introduction (Continued)

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

In September 2006, the Group sold 100% of its interest in “Inter” professional football club to a related-party company, on the basis of an independent valuation report. Refer to Note 30.

On 18 June 1999, the Group established a leasing subsidiary “Azerileasing” with the charter capital of AZN 369 thousand. On 29 July 2004, the Group increased the share capital of its leasing subsidiary by contributing an additional AZN 331 thousand. As a result, the share capital of the leasing subsidiary was AZN 700 thousand at 31 December 2006 (2005: AZN 700 thousand).

In October 2006, the Group signed an agreement for the sale of 52.4% of its interest in the share capital of “Azerileasing” to a British based entity. Management of the Group believes that terms and conditions of this contract constitute those an ordinary arms-length contract with an unrelated party. Refer to Note 30.

On 16 November 2006, the Group registered its 75% owned subsidiary, International Bank of Azerbaijan Republic-Georgia (“IBAR Georgia”), in Tbilisi, Georgia. The share capital of IBAR Georgia was established in the amount of USD 7,000,000, with the minority interest in the amount of AZN 1,528 thousand being paid-in by a resident bank as at 31 December 2006. At 31 December 2006, IBAR Georgia was operationally inactive, since the license for rendering banking services from the National Bank of Georgia (“the NBG”) was not obtained until 5 February 2007. IBAR Georgia’s registered office is located at the following address: Kostava 65, Tbilisi, 0171, Republic of Georgia. Refer to Note 30.

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

67 Nizami Street,
AZ1005, Baku
Republic of Azerbaijan

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

2 Operating Environment of the Group

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

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

3 Basis of Preparation and Significant Accounting Policies

Basis of Preparation. These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention, as modified by the revaluation of premises. 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.

3 Basis of Preparation and Significant Accounting Policies (Continued)

Going concern. Management have prepared these consolidated financial statements on a going concern basis. In making this judgement Management have considered the current favourable macroeconomic environment for financial institutions operating in Azerbaijan, positive cash flows, the profitability of operations and access to foreign financial resources as required. As disclosed in Note 26 to these consolidated financial statements, the Group has a cumulative liquidity gap up to twelve months as at 31 December 2006. Management is confident that the Group will be able to obtain required funds in order to replace attracted liabilities with duration of up to twelve months. In particular, Management believe that the continued support of its shareholders and access to borrowings from international financial institutions means that the Group would be able to obtain appropriate resources should all liabilities require settlement as disclosed in Note 26. Management's ongoing discussions with its current lenders have reaffirmed Management's view that the borrowings subjected to covenant agreements as detailed in Notes 17 and 27 will not in practice require repayment prior to the contractual dates.

Consolidated financial statements. Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. 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 subsidiaries use uniform accounting policies consistent with the Group's policies.

Associates. Associates are entities over which the Group has significant influence, but not control, generally accompanying a shareholding of between 20 and 50 percent of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost. The carrying amount of associates includes goodwill identified on acquisition less accumulated impairment losses, if any. The Group's share of the post-acquisition profits or losses of associates is recorded in the consolidated income statement, and its share of post-acquisition movements in reserves is recognised in reserves. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

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

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.

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

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*. Measurement at cost is only applicable to investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments.

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.

3 Basis of Preparation and Significant Accounting Policies (Continued)

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 or premium (including fees deferred at origination, if any), 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 repricing 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 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 assets 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 asset. All other purchases and sales are recognised on the settlement date with the change in value between the commitment date and settlement date not recognised for assets carried at cost or amortised cost; recognised in profit or loss for trading securities, derivatives and other financial assets at fair value through profit or loss; and recognised in equity for assets classified as available for sale.

Cash and cash equivalents. Cash and cash equivalents are items, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. 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 and CBRF. Mandatory cash balances held with the NBAR and CBRF are carried at amortised cost and represent non-interest bearing mandatory reserve deposits, which are not available to finance the Group's day-to-day operations, and hence are not considered as part of cash and cash equivalents for the purposes of the consolidated cash flow statement.

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

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

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

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

Uncollectable 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.

Credit related commitments. The Group enters into credit related commitments, including letters of credit and financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment. At each balance sheet date, the commitments are measured at the higher of (i) the unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the balance sheet date.

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

Promissory notes purchased. Promissory notes purchased are included in trading securities, or in due from other banks or in loans and advances to customers, depending on their substance and are recorded, subsequently remeasured and accounted for in accordance with the accounting policies for these categories of assets.

Derecognition 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.

Goodwill. Goodwill represents the excess of the cost of an acquisition over the fair value of the acquirer's share of the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of exchange. Goodwill on acquisitions of subsidiaries is presented separately in the consolidated balance sheet. Goodwill on acquisitions of associates is included in the investment in associates. Goodwill is carried at cost less accumulated impairment losses, if any.

The Group tests goodwill for impairment at least annually and whenever there are indications that goodwill may be impaired. Goodwill is allocated to the cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the business combination. Such units or group of units represent the lowest level at which the Group monitors goodwill and are not larger than a segment. Gains or losses on disposal of an operation within a cash generating unit to which goodwill has been allocated include the carrying amount of goodwill associated with the operation disposed of, generally measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit which is retained.

3 Basis of Preparation and Significant Accounting Policies (Continued)

Premises and equipment. Premises are stated at revalued amounts. Equipments are stated at cost less accumulated depreciation and impairment losses, where required. Cost of premises and equipment of acquired subsidiaries is the estimated fair value at the date of acquisition.

Premises of the Group are subject to revaluation on a regular basis. The frequency of revaluation depends upon the movements in the fair values of the premises being revalued. The revaluation reserve for premises and equipment included in equity is transferred directly to retained earnings when the surplus is realised, i.e. either on the retirement or disposal of the asset, or as the asset is used by the Group; in the latter case, the amount of the surplus realised is the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost.

Construction in progress is carried at cost less provision for impairment where required. Cost includes borrowing costs incurred on specific or general funds borrowed to finance construction of qualifying assets. Upon completion, assets are transferred to premises and equipment at their carrying amount. Construction in progress is not depreciated until the asset is available for use.

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

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

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

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

	2006	**2005**
Premises	4%-5%	4%-5%
Leasehold improvements	10%-15%	10%-15%
Computers and other communication equipment	25%	25%
Plastic cards operations equipment	33%	33%
Furniture, fixtures, automated teller machines and other	25%	25%
Motor vehicles	25%	25%

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

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

Acquired computer software licences 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 the 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 between one to four years.

3 Basis of Preparation and Significant Accounting Policies (Continued)

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 are charged to profit or loss on a straight-line basis over the period of the lease.

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

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.

Where the Group is a lessee in a lease, which transferred substantially all the risks and rewards incidental to ownership to the Group, the assets leased are capitalised in premises and equipment at the commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of future finance charges, are included in other borrowed funds. The interest cost is charged to the income statement over the lease period, using the effective interest method. The assets acquired under finance leases are depreciated over their useful life or the shorter lease term if the Group is not reasonably certain that it will obtain ownership by the end of the lease term.

Finance lease receivables are included in "Loans and advances to customers" in the consolidated financial statements.

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.

3 Basis of Preparation and Significant Accounting Policies (Continued)

Income taxes. Income taxes have been provided for in the consolidated financial statements in accordance with relevant legislation enacted or substantively enacted by the balance sheet date in a country of legislation of the Group's entity. 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 consolidated financial 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.

Deferred income tax is provided on post acquisition retained earnings of subsidiaries, except where the Group controls the subsidiary's dividend policy and it is probable that the difference will not reverse through dividends or otherwise in the foreseeable future.

Provisions for liabilities and charges. Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Trade and other payables. Trade payables are accrued when the counterparty performed its obligations under the contract and are carried at amortised cost.

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

Dividends. Dividends are recorded in equity in the period, in which they are declared. Dividends declared after the balance sheet date and before the consolidated financial statements are authorised for issue are disclosed in the subsequent events note. Azerbaijani 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.

The statutory banking regulations that the Bank is subject to prohibit the distribution of the revaluation surplus as a dividend to shareholders.

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.

3 Basis of Preparation and Significant Accounting Policies (Continued)

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. The functional currency of each of the Group's consolidated entities is the currency of the primary economic environment, in which that entity operates. The Bank's functional currency and the Group's presentation currency is the national currency of the Republic of Azerbaijan, Azerbaijani Manat ("AZN").

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

Currency translation differences. The results and financial position of each group entity (the functional currency of none of which is a currency of a hyperinflationary economy) are translated into the presentation currency as follows:

(i) assets and liabilities of each Group entity included in these consolidated financial statements are translated into presentation currency at the rates as at the date of these consolidated financial statements;

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses included in these consolidated financial statements are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognised as a separate component of equity.

At 31 December 2006, the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 0.8714 (2005: USD 1 = AZN 0.9186). Exchange restrictions and controls exist relating to converting Azerbaijani Manats into other currencies. At present, the Azerbaijani Manat is not a freely convertible currency in most countries outside of the Republic of Azerbaijan.

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

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

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies

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

Held-to-maturity financial assets. Management applies judgement in assessing whether financial assets can be categorised as held-to-maturity, in particular its intention and ability to hold the assets to maturity. If the Group fails to keep these investments to maturity other than for certain specific circumstances – for example, selling an insignificant amount close to maturity – it will be required to reclassify the entire class as available-for-sale. The investments would, therefore, be measured at fair value rather than amortised cost.

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 peer group experience for comparable groups of financial assets to assess the impairment loss for such assets.

Revaluation of premises. Management uses judgement to determine when factors dictate that an independent valuation report is needed in order to provide a basis for revaluation of the Group's premises in order for the balance sheet to reflect fair value at each balance sheet date. The fair value of premises is usually determined from market-based evidence by an appraisal that is undertaken by professionally qualified valuers. The evidence used by the valuers includes estimates of prevailing market prices per square metre of properties with characteristics similar to those of the Group's premises. These estimates are based on the valuer's experience using comparable sale information and represent a benchmark of the current situation and trends in the market. The valuer also calculates valuations using an income capitalisation approach taking into account future rental incomes and other factors before confirming an overall valuation for each of the Group's properties. The most significant estimate made in performing the valuations is the sale price per square metre for comparable buildings. Had the movement in real estate prices been considered to have been greater, an external valuation would have been appropriate. For every 5% increase in the valuation, the value of the Bank's premises statements would be AZN 1.9 million higher at 31 December 2006, deferred taxation would be AZN 0.4 million higher and net equity would have been AZN 1.5 million higher.

Issue of equity shares. Management have used judgement in determining the recognition and disclosure of the additional shares authorised and issued as at 31 December 2006. This judgement has included consideration as to whether at least fifty per cent of the share issue will be subscribed for and the implications for the share issue where this did not happen. Management have considered the risk of any potential outflow of resources to be remote, given the knowledge of the committed intentions of its majority shareholder and the discretion available at any future shareholder meeting where the minimum fifty per cent of the share issue is not paid in. Accordingly the shares issued and paid as at 31 December 2006 have been recorded as equity in these consolidated financial statements. Refer to Note 19.

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, Russian and Georgian 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.

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

Initial recognition of related party transactions. In the normal course of business the Group enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. 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 2006. 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, as applicable, made to the retained earnings at 1 January 2005, unless otherwise described below.

IFRIC 4, Determining whether an Arrangement contains a Lease (effective from 1 January 2006). 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. The Group reassessed its arrangements and concluded that no adjustments are required as a result of adoption of IFRIC 4.

IAS 39 (Amendment) – The Fair Value Option (effective from 1 January 2006). 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 amendment did not have an impact on these consolidated financial statements.

IAS 39 (Amendment) - Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006). The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in the consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss. The Group does not apply hedge accounting and therefore the amendment did not have an impact on these consolidated financial statements.

***IAS 39 (Amendment) – Financial Guarantee Contracts (effective from 1 January 2006)*.** As a result of this amendment, the Group measures issued financial guarantees initially at their fair value, which is normally evidenced by the amount of fees received. This amount is then amortised on a straight line basis over the life of the guarantee. At each balance sheet date, the guarantees are measured at the higher of (i) the unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the balance sheet date. This amendment did not have a significant impact on these consolidated financial statements.

IAS 21 (Amendment) - Net Investment in a Foreign Operation (effective from 1 January 2006). This amendment requires foreign exchange gains and losses on monetary items that form part of net investment in a foreign operation to be reported in consolidated equity even if the loans are not in the functional currency of either the lender or the borrower. Previously, such exchange differences were required to be recognised in consolidated profit or loss. It also extended the definition of 'net investment in a foreign operation' to include loans between sister companies. This amendment did not have a significant impact on these consolidated financial statements.

IAS 19 (Amendment) - Employee Benefits (effective from 1 January 2006). The amendment introduced an additional option to recognise actuarial gains and losses arising in post-employment defined benefit plans in full directly in retained earnings in equity. It also requires new disclosures about defined benefit plans and clarifies accounting for a contractual agreement between a multi-employer plan and participating employers. This amendment did not have a significant impact on these consolidated financial statements.

Effect of Adoption of New or Revised Standards. The effect of adoption of the above new or revised standards and interpretations on the Group's consolidated financial position at 31 December 2006 and 31 December 2005 and on the consolidated 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 2007 or later periods and which the Bank has not early adopted:

IFRS 7 Financial Instruments: Disclosures and a complementary Amendment to IAS 1 Presentation of Financial Statements - Capital Disclosures (effective from 1 January 2007). The IFRS introduces new disclosures to improve the information about financial instruments. The volume of disclosures will increase significantly with an emphasis on quantitative aspects of risk exposures and the methods of risk management. The quantitative disclosures will provide information about the extent of exposure to risk, based on information provided internally to the entity's key management personnel. Qualitative and quantitative disclosures will cover exposure to credit risk, liquidity risk and market risk including sensitivity analysis to market risk. IFRS 7 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 Bank's and its subsidiary'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 consolidated financial statements.

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

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

Other new standards or interpretations. The Group has not early adopted the following other new standards or interpretations:

- IFRIC 7, Applying the Restatement Approach under IAS 29 (effective for periods beginning on or after 1 March 2006, that is from 1 January 2007).
- IFRIC 8, Scope of IFRS 2 (effective for periods beginning on or after 1 May 2006, that is from 1 January 2007).
- IFRIC 9, Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 1 June 2006, that is from 1 January 2007);
- IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006, that is from 1 January 2007);
- IFRIC 11, IFRS 2—Group and Treasury Share Transactions (effective for annual periods beginning on or after 1 March 2007, that is from 1 January 2008); and
- IFRIC 12, Service Concession Arrangements (effective for annual periods beginning on or after 1 January 2008, that is from 1 January 2008).

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

7 Cash and Cash Equivalents

In thousands of Azerbaijani Manats	**2006**	**2005**
Cash on hand	86,068	46,552
Cash balances with the National/Central banks (other than mandatory reserve deposits)	337,616	159,744
Correspondent accounts and overnight placements with other banks		
- The Republic of Azerbaijan	4,712	907
- Other countries	28,986	51,167
Total cash and cash equivalents	**457,382**	**258,370**

7 Cash and Cash Equivalents (Continued)

Included in cash balances with National/Central banks (other than mandatory reserve deposits) are the balances on correspondent accounts of the Bank and its subsidiary, IBAR Moscow, with the NBAR and CBRF amounting to AZN 332,743 thousand and AZN 4,873 thousand (2005: AZN 155,684 thousand and AZN 4,060 thousand), respectively.

Overnight placements with other banks include AZN 18,548 thousand (2005: AZN 10,129 thousand) placed with foreign banks at annual interest rates of 3.80% to 4.20% per annum with maturities in January 2007 (2005: 3.10% to 3.45% per annum, with maturities in January 2006).

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

8 Due from Other Banks

In thousands of Azerbaijani Manats	**2006**	**2005**
Current term placements with other banks	88,434	47,521
Notes of the National Bank of Azerbaijan	48,511	5,875
Overdue placements with other banks	3,212	4,781
Debentures of resident banks	1,281	2,199
Accrued interest income	780	158
		-
Less: Provision for impairment of due from other banks	(6,778)	(6,198)
Total due from other banks	**135,440**	**54,336**

Current term placements with other banks include short-term EUR denominated placements with non-resident banks, which amounted to AZN 11,471 thousand at 31 December 2006 with annual interest rates of 7% and with maturities in January 2007 (2005: short term USD denominated placements in the amount of AZN 11,319 thousand and EUR denominated placements in the amount of AZN 6,531 thousand with several European banks, with maturities from January to October 2006 and interest rates ranging from 2.0% to 4.3% per annum).

Notes of the NBAR represent short-term government securities issued by the NBAR at Baku Stock Exchange purchased by the Group at a discount. The notes outstanding at 31 December 2006 had an average effective interest rate of 13.84 % per annum and matured in January 2007 (2005: average effective interest rate of 11.93% per annum and matured in January to March 2006).

The movement in the provision for impairment of due from other banks is as follows:

In thousands of Azerbaijani Manats	**2006**	**2005**
Provision for impairment of due from other banks at 1 January	**6,198**	**5,632**
Provision for impairment of due from other banks during the period	1,939	816
Due from other banks written off during the period as uncollectible	(1,359)	(250)
Provision for impairment of due from other banks at 31 December	**6,778**	**6,198**

During the year ended 31 December 2006, the Supervisory Council of the Group approved a decision to write off bad loans issued to resident and non-resident banks in previous years of AZN 1,359 thousand (2005: AZN 250 thousand).

At 31 December 2006, the estimated fair value of due from other banks was AZN 135,440 thousand (2005: AZN 54,336 thousand). 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 provided in Note 29.

9 Loans and Advances to Customers

In thousands of Azerbaijani Manats	**2006**	**2005**
Current loans	1,056,406	651,955
Overdue loans	91,537	96,207
Net investment in finance lease	-	11,961
Total loans and advances to customers, gross	**1,147,943**	**760,123**
Less: provision for loan impairment	(109,527)	(80,845)
Less: provision for uncollectible finance lease receivables	-	(808)
Total provision for impairment to loans and advances to customers	**(109,527)**	**(81,653)**
Total loans and advances to customers, net	**1,038,416**	**678,470**

Included in overdue loans comparative figure for 2005 is an amount of AZN 44,375 thousand that had previously been categorised as being current loans.

The movements in the provisions for impairment of loans and advances to customers and for uncollectible lease receivables are as follows:

In thousands of Azerbaijani Manats	**2006**	**2005**
Provision for loan impairment at 1 January	**81,653**	**51,376**
Provision for loan impairment during the period	29,214	35,576
Provision for uncollectible finance lease receivables for the period	-	552
Loans and advances to customers written off during the period	-	(5,915)
Provision on loans(leases) of subsidiary sold	(1,340)	-
Effect of changes in exchange rates	-	64
Provision for loan impairment at 31 December	**109,527**	**81,653**

Included in the gross amount of total loans and advances to customers at 31 December 2006, are the loans granted to twenty companies amounting to AZN 557,386 thousand (2005: eighteen companies amounting to AZN 427,608 thousand) and representing a significant concentration of 48.6% (2005: 57.4%) of the total loan portfolio of the Group.

Included in the gross amount of total loans and advances to customers at 31 December 2006, are the loans granted to government institutions and state enterprises of the Republic of Azerbaijan amounting to AZN 219,014 thousand (2005: AZN 257,662 thousand) and representing 19.1% (2005: 26.7%) of the total loan portfolio of the Group.

Included in total gross amount of loans and advances granted to government institutions and state enterprises of the Republic of Azerbaijan outstanding at 31 December 2006, are loans to state-owned companies of AZN 65,009 thousand (2005: AZN 131,220 thousand) guaranteed by the government of the Republic of Azerbaijan. Included in overdue loans at 31 December 2006, is a loan of AZN 2,175 thousand (2005: AZN 4,123 thousand) due from the Azerbaijan State Airlines covered by the letter of guarantee of the Ministry of Finance of the Republic of Azerbaijan, on which no provision has been recorded in the consolidated financial statements of the Group.

9 Loans and Advances to Customers (Continued)

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

	2006		2005	
In thousands of Azerbaijani Manats	**Amount**	**%**	**Amount**	**%**
Manufacturing	280,883	24.5	211,098	27.8
Construction	220,937	19.2	72,577	9.5
Railroad and other transportation	159,295	13.9	103,755	13.6
Individuals	155,003	13.5	63,853	8.4
Trade	142,384	12.4	109,974	14.5
State and public organisations*	102,092	8.9	84,030	11.1
Air transportation	52,587	4.6	96,039	12.6
Communication	19,642	1.7	1,576	0.2
Power production and distribution	13,956	1.2	2,270	0.3
Net investment in finance lease	-	-	11,962	1.6
Other	1,164	0.1	2,989	0.4
Total loans and advances to customers (before impairment)	**1,147,943**	**100.0**	**760,123**	**100.0**

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

At 31 December 2006, included in loans issued to state and public organisations is an amount of AZN 18,074 thousand (2005: AZN 8,131 thousand), which represents non-interest bearing one-day overdrafts on current accounts of the State Budget of the Republic of Azerbaijan with the Group.

Included in the total amount of loans to individuals at 31 December 2006 are the outstanding balances drawn on credit cards of AZN 10,965 thousand (2005: AZN 7,155 thousand).

At 31 December 2006, the estimated fair value of loans and advances to customers was AZN 1,038,416 thousand (2005: AZN 678,470 thousand). 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 provided in Note 29.

10 Investment Securities Held to Maturity

In thousands of Azerbaijani Manats	**2006**	**2005**
Promissory notes of Russian companies and banks	-	6,550
Total investment securities held to maturity	**-**	**6,550**

At 31 December 2005, promissory notes represented debt securities of a Russian bank with the purchase price of AZN 6,445 thousand. These promissory notes are quoted and traded at the Russian Trade System Stock Exchange in Moscow, Russian Federation. These promissory notes matured during the year ended 31 December 2006.

At 31 December 2006, the estimated fair value of investment securities held to maturity was nil (2005: AZN 6,550 thousand).

11 Investment in Associates and Joint Ventures

In thousands of Azerbaijani Manats	2006	2005
Investment in Baku Inter-Bank Currency Exchange (BICE)	809	794
Investment in Trans-service	-	569
Total investments in associates and joint ventures	**809**	**1,363**

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

	2006		2005	
In thousands of Azerbaijani Manats	BICE	Trans-service	BICE	Trans-service
Carrying amount at 1 January	**794**	**569**	**864**	**611**
Net share of results of associate/joint venture after tax for the period	15	-	(70)	8
Decrease of the share capital	-	-	-	(50)
Disposal of joint venture	-	(569)	-	-
Carrying amount at 31 December	**809**	**-**	**794**	**569**

At 31 December 2006, the Group held 20% interest in BICE. The Group's investment in Trans-service was sold to an unrelated party company during the year ended 31 December 2006 without the Group making any gains or incurring any losses as a result of this transaction. Trans-service was a joint venture with another Azerbaijani company established to operate parking facilities for the purpose of profit-making. It was included in the Group's consolidated financial statements as an investment in a joint venture, using the equity accounting method for the first time as of 31 December 2003.

In October 2006, the Group signed an agreement for the sale of 52.4% of its interest in the share capital of "Azerileasing". Management believes that terms and conditions of this contract constitute those of an ordinary arms-length contract with an unrelated party. As a result of this transaction, Azerileasing became an associate of the Group. At 31 December 2006, the net liabilities of Azerileasing amounted to AZN 857 thousand. The carrying value of the Group's interest in Azerileasing was nil on the date of recognition as an associate and as at 31 December 2006.

The table below summarises financial information for each associate as at 31 December 2006, and for the year then ended:

In thousands of Azerbaijani Manats	BICE	Azerileasing
Total assets	4,046	24,598
Total liabilities	2	25,455
Total equity	**4,044**	**(857)**
Total revenue	438	1,675
Total expenses	(363)	(2004)
Net profit/(loss)	**75**	**(329)**

12 Premises, Equipment and Intangible Assets

In thousands of Azerbaijani Manats	Note	Premises	Leasehold improvements	Office and computer equipment	Banking equipment, furniture, fixtures, vehicles & other	Intangible assets	Construction in progress	Total
Cost or valuation at 1 January 2005		24,431	776	17,158	23,160	2,229	480	68,234
Accumulated depreciation		(5,509)	(66)	(5,692)	(5,885)	(1,206)	-	(18,358)
Carrying amount at 1 January 2005		**18,922**	**710**	**11,466**	**17,275**	**1,023**	**480**	**49,876**
Additions		303	388	5,705	4,843	5,031	1,667	17,937
Transfers		1,125	-	(5,094)	(1,355)	-	6,449	1,125
Disposals		(162)	-	(74)	(33)	-	-	(269)
Depreciation charge		(1,124)	(91)	(3,701)	(5,116)	(1,450)	-	(11,482)
Revaluation		20,754	-	-	-	-	-	20,754
Effect of translation to presentation currency		(531)	-	(77)	(6)	-	(4)	(618)
Carrying amount at 31 December 2005		**39,287**	**1,007**	**8,225**	**15,608**	**4,604**	**8,592**	**77,323**
Cost or valuation at 31 December 2005		49,494	1,164	17,587	26,576	7,261	8,592	110,674
Accumulated depreciation		(10,207)	(157)	(9,362)	(10,968)	(2,657)	-	(33,351)
Carrying amount at 31 December 2005		**39,287**	**1,007**	**8,225**	**15,608**	**4,604**	**8,592**	**77,323**
Additions		624	-	4,736	6,727	1,872	7,461	21,420
Transfers		-	-	1,629	1,246	-	(2,875)	-
Disposals		(67)	(17)	(144)	(931)	(93)	(6)	(1,258)
Depreciation charge	22	(1,688)	(98)	(3,890)	(6,805)	(3,681)	-	(16,162)
Effect of translation to presentation currency		241	-	30	3	-	1	275
Carrying amount at 31 December 2006		**38,397**	**892**	**10,586**	**15,848**	**2,702**	**13,173**	**81,598**
Cost or valuation at 31 December 2006		54,977	1,147	27,267	34,325	5,187	13,173	136,076
Accumulated depreciation		(16,580)	(255)	(16,681)	(18,477)	(2,485)	-	(54,478)
Carrying amount at 31 December 2006		**38,397**	**892**	**10,586**	**15,848**	**2,702**	**13,173**	**81,598**

Premises were independently valued at 30 December 2005. The valuation was carried out by an independent firm of valuers, DTZ Debenham Tie Leung. The basis used for the valuation was market value. As a result of the valuation, the net carrying amount of buildings increased by AZN 20,754 thousand. Revaluation surplus of AZN 16,188 thousand relating to revaluation of buildings, net of deferred tax of AZN 4,566 thousand, was recorded in the "Revaluation Reserve" for premises in the consolidated statement of changes in equity for the year ended 31 December 2005.

Additions to premises and equipment in 2006 primarily consist of 65 kiosk bank service terminals acquired for the purposes of provision of banking services of AZN 2,335 thousand; 100 automated teller machines ("ATMs") of AZN 3,373 thousand and vehicles of AZN 822 thousand (2005: 100 kiosk bank service terminals of AZN 2,352 thousand; 20 ATMs of AZN 776 thousand and vehicles of nil).

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

Included in additions to construction in progress are advance payments of AZN 7,352 thousand (2005: AZN 1,651 thousand) made by the Group to contractors for the purposes of construction of its new office building on land purchased by the Group in the centre of Baku. At 31 December 2006 the carrying amount of premises would have been AZN 13,977 thousand (2005: AZN 13,142 thousand) had the assets been carried at cost less depreciation.

13 Other Assets

In thousands of Azerbaijani Manats	Note	2006	2005
Advances for purchases of intangible assets and equipment		3,576	755
Receivables for plastic cards transactions		3,067	304
Prepaid expenses		2,253	708
Policyholder receivables		1,751	1,127
Amounts in the course of settlement		1,453	629
Property in the course of disposal		905	472
Deferred acquisition costs on insurance premiums written		582	163
Prepaid insurance		100	615
Advances for equipment purchased for the purposes of leasing		-	3,917
Restricted cash		-	615
Other		4,605	3,231
Total other assets		**18,292**	**12,536**

Advances for purchases of intangible assets and equipment at 31 December 2006 include AZN 3,486 thousand equivalent of USD 4,000 thousand prepaid by the Bank for the purchase of new office premises of its subsidiary in Tbilisi, Georgia.

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

Prepaid expenses balances at 31 December 2006 include advance payment of AZN 1,042 thousand for the purchase of plastic cards by the Bank from local and foreign suppliers.

Advances for equipment purchased for the purposes of leasing at 31 December 2005 represented equipment purchased for leasing purposes, for which specific leasing contracts had not yet been identified as at the reporting date. As the leasing subsidiary of the Group had been disposed of at 31 December 2006, the associated advances for equipment purchased for the purposes of leasing are no longer recorded in the consolidated financial statements of the Group.

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

14 Due to Other Banks

In thousands of Azerbaijani Manats	2006	2005
Correspondent accounts and overnight placements of other banks	173,159	8,516
Blocked accounts of resident banks in relation to plastic cards operations	221	262
Total due to other banks	**173,380**	**8,778**

Included in the closing balance of correspondent accounts of other banks at 31 December 2006 are short-term placements of non-resident banks with the Bank at fixed annual rates ranging between 5.45%-7.35% per annum and with maturities in January-February 2007, amounting to AZN 128,096 thousand. Also included in the closing balance of correspondent accounts of other banks at 31 December 2006 are non-interest bearing correspondent accounts of resident banks with the Bank.

At 31 December 2006, the estimated fair value of due to other banks was AZN 173,380 thousand (2005: AZN 8,778 thousand). Refer to Note 28.

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

15 Customer Accounts

In thousands of Azerbaijani Manats	**2006**	**2005**
State and public organisations		
- Current/settlement accounts	431,136	241,151
- Term deposits	288,053	320,629
- Restricted customer deposits	85	52,199
Other legal entities		
- Current/settlement accounts	245,397	107,264
- Term deposits	16,167	6,914
- Restricted customer deposits	92,432	16,287
Individuals		
- Current/demand accounts	70,951	47,383
- Term deposits	159,955	116,747
Total customer accounts	**1,304,176**	**908,574**

At 31 December 2006, the Group had a significant concentration of customer accounts attracted from a state organisation involved in the oil industry sector of AZN 443,230 thousand and government body of AZN 195,560 thousand or 49.0% of total customer accounts in aggregate (2005: AZN 423,444 thousand or 46.6%, respectively).

Included in term deposits of state and public organisations are call deposits of a state organisation involved in the oil industry sector of the Republic of Azerbaijan of AZN 265,777 thousand (2005: AZN 312,256 thousand) and of government bodies of AZN 1,168 (2005: AZN 1,089 thousand). The average interest rates on these call deposits were 0.5% and 1.5% per annum respectively (2005: 0.5% and 2.0% per annum).

Included in the current and settlement accounts of state and public organisations at 31 December 2006 are balances on current interest bearing accounts of state-owned enterprises and government bodies of AZN 24,315 thousand (2005: AZN 11,649 thousand). Interest rates on these accounts vary from 0.5% to 2.5% per annum (2005: 0.5% to 2.5% per annum).

Restricted customer deposits amounting to AZN 92,517 thousand at 31 December 2006 (2005: AZN 68,486 thousand) represent balances on customer accounts held by the Group as collateral for irrevocable commitments under import letters of credit and guarantees issued by the Group on behalf of its customers. The information on letters of credit and guarantees outstanding at 31 December 2006 and 31 December 2005 is disclosed in Note 27.

The economic sector concentrations within customer accounts are as follows:

	2006		**2005**	
In thousands of Azerbaijani Manats	**Amount**	**%**	**Amount**	**%**
Energy	547,829	42.0	502,581	55.3
Individuals	231,874	17.8	164,131	18.0
State and public organisations, except energy sector*	147,479	11.3	38,883	4.3
Trade and services	141,085	10.8	48,816	5.4
Construction	93,271	7.2	23,303	2.6
Manufacturing	77,957	6.0	69,922	7.7
Transportation and communication	25,165	1.9	7,371	0.8
Other	39,516	3.0	53,567	5.9
Total customer accounts	**1,304,176**	**100.0**	**908,574**	**100 .0**

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

At 31 December 2006, the estimated fair value of customer accounts was AZN 1,304,176 thousand (2005: AZN 908,574 thousand). 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 thousands of Azerbaijani Manats	2006	2005
Debentures	27,213	24,897
Deposit certificates	13,756	17,290
Total debt securities in issue	**40,969**	**42,187**

During the year ended 31 December 2006, the Group incurred interest expense on the debentures of AZN 2,415 thousand (2005: AZN 2,304 thousand) recorded in the consolidated income statement. Refer to Note 20.

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

At 31 December 2006, the estimated fair value of debt securities in issue was AZN 40,969 thousand (2005: AZN 42,187 thousand). Refer to Note 28.

Geographical, currency, maturity and interest rate analyses of debt securities in issue are disclosed in Note 26.

17 Other Borrowed Funds

In thousands of Azerbaijani Manats	2006	2005
Syndicated borrowings:		
- Syndicated borrowing agreement signed on 19 August 2005	-	52,414
- Syndicated borrowing agreement signed on 10 November 2006	114,978	-
Black Sea Trade and Development Bank (BSTDB)	10,241	7,535
Islamic Development Corporation (IDC)	3,771	2,132
Rabobank	4,065	-
Societe Generale	827	-
Total other borrowed funds	**133,882**	**62,081**

The balance of funds attracted under syndicated borrowings at 31 December 2006 represent the funds attracted under a syndicated borrowing agreement signed on 10 November 2006 with foreign banks led by one of major German banks in the total amount of USD 130,000,000 for the Group's financing of large energy projects carried out by the government of the Republic of Azerbaijan. The borrowing facility bears an annual interest rate of LIBOR plus 0.9% and matures on 10 November 2007. The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement. At 31 December 2006, Management of the Bank believes that the Bank was in compliance with those covenants.

On 21 January 2002, the Group signed an agreement with the Black Sea Trade and Development Bank (registered in Thessaloniki, Greece) for a multiple buyer revolving credit facility in the amount of USD 5,500 thousand. The amount drawn down on this revolving facility net of repayments at 31 December 2006 amounted to AZN 4,292 thousand or USD 4,925 thousand (2005: AZN 2,008 thousand or USD 2,187 thousand) and is used for the financing of various projects related to the manufacturing and transportation sectors of the Republic of Azerbaijan. The borrowing facility bears an annual interest rate of LIBOR plus 5%.

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

The Group is obliged to comply with certain financial covenants stipulated by the borrowing agreements signed with the Black Sea Trade and Development Bank. At 31 December 2006, management believes that the Group was in compliance with those covenants, except for the restrictions set out in relation to the maximum amount of loans issued to connected entities. While the Group does not anticipate these loans will be repaid as a result of these breaches, the outstanding amounts related to these borrowings as at 31 December 2006 have been classified within as the "Demand and up to 1 month" category in the liquidity table to reflect the potential impact of the breaches. Refer to Note 27.

17 Other Borrowed Funds (Continued)

In addition, certain other of the Group's other borrowing agreements include cross-default clauses impacting these agreements where the Group is not in compliance with covenants specified in any of its other borrowing agreements. While the Group does not anticipate that these loans will be repaid as a result of these breaches, the outstanding amounts related to these borrowings as at 31 December 2006 have been classified within as the "Demand and up to 1 month" category in the liquidity table to reflect the potential impact of the breaches. Refer to Note 27.

On 12 April 2004, the Group signed a Line of Financing Agreement with the Islamic Development Corporation (a member of Islamic Development Bank Group, an international financial institution with head-quarters in Jeddah, Saudi Arabia) for a credit line of USD 4,500 thousand for a period of seven years at a market interest rate for financing of various investment projects in the Republic of Azerbaijan. At 31 December 2006, the amount drawn down on this credit line was AZN 3,582 thousand or USD 4,111 thousand (2005: AZN 2,088 thousand or USD 2,274 thousand) and was used for the purposes of financing a project in the manufacturing sector of Azerbaijan.

On 11 August 2006, the Group signed an agreement with the Cooperative Centrale Raiffeisen-Boerenleenbank B.A. ("Rabobank") for the credit line of EUR 5,330 thousand for the period of five years at EURIBOR plus 0.85% per annum for financing of the investment project in the Republic of Azerbaijan. As at 31 December 2006, the amount drawn down on this credit line comprised AZN 4,013 thousand or EUR 3,498 thousand (31 December 2005: AZN nil) and is used for financing of the project related to manufacturing sector in the Republic of Azerbaijan. The loan will be repaid in ten equal semi-annual installments with the first installment subsequently paid in February 2007.

On 22 June 2005, the Group signed a credit agreement with Societe Generale for obtaining funds not exceeding EUR 15,000 thousand for a period of two years at EURIBOR plus 0.7% per annum for the financing of commercial contracts entered into by local companies. This credit line is designated to finance Azerbaijani companies, which purchase French equipment. As the number of such companies is very limited, this credit line was not effectively utilised over the last year. At 31 December 2006, the amount drawn down on this credit line was AZN 827 thousand or EUR 715 thousand.

At 31 December 2006, the estimated fair value of other borrowed funds was AZN 133,882 thousand (2005: AZN 62,081 thousand). Refer to Note 28. Geographical, currency, maturity and interest rate analysis of other borrowed funds are disclosed in Note 26.

18 Other Liabilities

In thousands of Azerbaijani Manats	Note	2006	2005
Items in course of settlement		18,343	26,071
Dividends payable to shareholders	24	4,865	2,400
Deferred revenue on plastic cards operations		3,857	1,515
Insurance reserves		3,432	1,876
Plastic cards creditors		1,579	-
Insurance premiums and broker commissions payable		1,008	513
Deferred ceding commissions on insurance operations		75	74
Trade creditors		58	1,997
Payable for software		-	1,080
Payable on purchase of intangibles for Inter football club		-	269
Other liabilities		1,429	1,633
Total other liabilities		**34,646**	**37,428**

Items in course of settlement include payables to the Central Treasury ("Central Treasury") Department of the Ministry of Finance of the Republic of Azerbaijan amounting to AZN 3,139 thousand representing the funds collected by the Bank on behalf of Central Treasury, which are subsequently transferred to Central Treasury's bank accounts (2005: AZN 25,773 thousand). This balance was debited from the current accounts of Bank customers on the last day of the year and was subsequently transferred to the account of Central Treasury in the NBAR.

Deferred revenue on plastic cards operations represents the unearned portion of revenue related to fees charged for the annual maintenance of plastic card accounts. This fee is charged upon the issuance of cards and amortised over their respective term. Included in deferred revenue on plastic cards operations at 31 December 2006 is AZN 3,857 thousand (2005: AZN 628 thousand) representing the deferral of revenue arising from the servicing of plastic cards issued by the Bank to Azerbaijani pensioners in accordance with the contract signed by the Bank with the State Social Security Funds of the Republic of Azerbaijan on 23 January 2004. Refer to Notes 13 and 21.

Geographical, currency and maturity analyses of provisions for liabilities and charges and other liabilities are disclosed in Note 26. The information on related party balances is disclosed in Note 29.

19 Share Capital

The authorised, issued and paid-in share capital of the Bank at 31 December 2006 and at 31 December 2005 is as follows:

In thousands of AZN except for number of shares	**Number of paid-in shares**	**Ordinary shares**	**Total**
At 1 January 2005	**100,000**	**20,000**	**20,000**
New shares issued	24,100	4,820	4,820
At 31 December 2005	**124,100**	**24,820**	**24,820**
New shares issued	172,495	34,499	34,499
At 31 December 2006	**296,595**	**59,319**	**59,319**

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

In 2006, the Bank issued additional shares to increase its share capital to AZN 100,000 thousand. This issue granted a right to existing shareholders to purchase these shares at the nominal face value of AZN 0.2 per share. At 31 December 2006, not all shareholders exercised this right and out of AZN 100,000 thousand of authorised share capital of the Bank only AZN 59,319 thousand was paid in. Therefore, the par value of the Bank's issued paid-in share capital is AZN 59,319 thousand at 31 December 2006 (2005: AZN 24,820 thousand). Management do not consider that the Bank has a financial asset representing the remaining issued shares until such time as payment has been made for those shares, since the Bank has no right to demand that all the issued shares are subscribed for by the existing shareholders.

At 31 December 2006, Ministry of Finance of the Republic of Azerbaijan ("MoF") held 33.85% of the total paid-in share capital of the Bank (2005: 59.87% of the total paid-in share capital of the Bank). Management believes that, MoF retained control of the Bank at 31 December 2006 even though its economic interest had been diluted as at 31 December 2006 since it had not yet paid for its allocated shares as at this date. The MoF subsequently exercised its rights to pay for a part of its allocated shares, which increased its economic interest in the Bank's share capital to 42.84% as at 10 May 2007. Refer to Note 31.

At 31 December 2006, the Group's employees held 8.89% of the total share capital of the Bank, or 26,365 ordinary shares with a par value of AZN 5,273 thousand (2005: 4.71%, or 5,845 ordinary shares with a par value of AZN 1,169 thousand, respectively). Refer to Note 29.

20 Interest Income and Expense

In thousands of Azerbaijani Manats	2006	2005
Interest income		
Loans and advances to customers	94,595	72,225
Due from other banks and correspondent accounts	17,869	9,358
Interest income on investment securities	3,347	1,567
Total interest income	**115,811**	**83,150**
Interest expense		
Savings deposits of individuals and deposit certificates	16,326	10,898
Term deposits of legal entities	15,509	7,959
Deposits from banks and other borrowed funds	4,562	1,912
Debentures	2,415	2,304
Total interest expense	**38,812**	**23,073**
Net interest income	**76,999**	**60,077**

21 Fee and Commission Income and Expense

In thousands of Azerbaijani Manats	2006	2005
Fee and commission income		
- Plastic cards operations	14,387	10,879
- Transactions with foreign currencies and securities	17,247	14,025
- Cash transactions	10,525	8,370
- Settlement transactions	8,186	7,084
- Letters of credit issued	1,791	1,559
- Guarantees issued	645	567
- Servicing intermediary loans	314	394
- Other	1,313	885
Total fee and commission income	**54,408**	**43,763**
Fee and commission expense		
- Cash transactions	2,030	667
- Settlement transactions	1,169	890
- Policy acquisition costs on insurance operations	602	368
- Plastic cards operations	428	2,176
- Transactions with foreign currencies and securities	-	110
- Other	149	277
Total fee and commission expense	**4,378**	**4,488**
Net fee and commission income	**50,030**	**39,275**

Included in fee and commission income on plastic cards operations is AZN 1,810 thousand (2005: AZN 1,554 thousand) representing commission income arising from servicing plastic cards issued by the Group to Azerbaijani pensioners in accordance with the contract signed on 23 January 2004 with the State Social Security Fund of the Republic of Azerbaijan. These plastic cards were issued within the project for implementation of the retirement benefits payment system through plastic cards in the largest local cities arranged by the Group under the abovementioned contract with the State Social Security Fund of the Republic of Azerbaijan. Refer to Note 18.

The relevant information on related party balances is disclosed in Note 29.

22 Administrative and Other Operating Expenses

In thousands of Azerbaijani Manats	Note	2006	2005
Staff costs		21,529	15,549
Depreciation of premises and equipment	12	12,481	10,032
Advertising and marketing services		4,850	1,816
Customs duties and other taxes other than on income		3,902	1,147
Amortisation of software and other intangible assets	12	3,681	1,450
Rent		2,723	2,244
Transportation of valuables		2,255	2,039
Premises, equipment and investment property maintenance		2,009	1,820
Other operating expenses		6,754	7,037
Miscellaneous expenses		5,522	3,411
Total administrative and other operating expenses		**65,706**	**46,545**

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

Staff costs include payroll and other employee benefits of the Bank of AZN 17,366 thousand (2005: AZN 12,300 thousand); IBAR Moscow of AZN 2,281 thousand (2005: AZN 1,361 thousand); the Insurance Subsidiary of AZN 862 thousand (2005: 499 thousand); Azericard Limited of AZN 624 thousand (2005: AZN 429 thousand); the Leasing Subsidiary of AZN 41 thousand (2005: AZN 43 thousand) and “Inter” professional football club of AZN 354 thousand (2005: AZN 917 thousand).

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

The relevant information on related party balances is disclosed in Note 29.

23 Income Taxes

Income tax expense comprises the following:

In thousands of Azerbaijani Manats	2006	2005
Current tax	(12,559)	(7,747)
Deferred tax	(2,359)	(981)
Income tax expense for the year	**(14,918)**	**(8,728)**

The income tax rate applicable to the majority of the Group's income is 22% at 31 December 2006 (2005: 24%). Effective from 1 January 2004, the statutory tax rate of the Republic of Azerbaijan was reduced from 25% to 24%. Starting from 1 January 2006, the statutory tax rate was further reduced from 24% to 22%. The income tax rate applicable to the operations of IBAR Moscow is 24%. A 24% statutory income tax rate for IBAR Moscow was enacted in August 2001, and applicable from 1 January 2002.

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

In thousands of Azerbaijani Manats	2006	2005
IFRS profit before tax	**52,569**	**29,058**
Theoretical tax charge at statutory rate (2006: 22%; 2005: 24%)	(11,565)	(6,974)
Tax effect of items, which are not deductible or assessable for taxation purposes:		
- Non-deductible expenses	(2,050)	(1,056)
- Non-recoverable tax losses of the subsidiary sold	(1,489)	(1,050)
- Effect of change in tax rates	-	439
Other non-temporary differences	186	(87)
Income tax expense for the year	**(14,918)**	**(8,728)**

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

23 Income Taxes (Continued)

Differences between IFRS and Azerbaijani and Russian (for IBAR Moscow) statutory taxation regulations give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below and is recorded at the rate of 22% (2005: 24%).

In thousands of Azerbaijani Manats	31 December 2005	Charged/ (credited) to profit or loss	Business combinations	31 December 2006
Tax effect of temporary differences				
Losses on assets and liabilities at non-market rates	1,621	(138)	-	1,483
Deferred revenue recognition	577	(116)	-	461
Provision for letters of credit and guarantees	168	-	-	168
Difference in amortisation rates	8	6	-	14
Accruals and other	55	(22)	-	33
Net deferred tax asset of subsidiaries sold in 2006	267	-	(267)	-
Loan impairment provision	(5,535)	(2,075)	-	(7,610)
Difference in depreciation rates of fixed assets	(1,256)	27	-	(1,229)
Movement of the revaluation of premises	(5,103)	183	-	(4,920)
Revenue accruals	(82)	(122)	-	(204)
Tax effect of share of profits of associates	(136)	-	-	(136)
Deferral of prepaid expenses	(46)	-	-	(46)
Other	(51)	(102)	-	(153)
Recognised deferred tax liability	**(9,513)**	**(2,359)**	**(267)**	**(12,139)**

23 Income Taxes (Continued)

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

In thousands of Azerbaijani Manats	1 January 2005	Charged/ (credited) to profit or loss	Charged / (credited) directly to equity	31 December 2005
Tax effect of temporary differences				
Losses on assets and liabilities at non-market rates	1,869	(248)	-	1,621
Deferred revenue recognition	236	341	-	577
Provision for letters of credit and guarantees	185	(17)	-	168
Accruals and other	354	(32)	-	322
Difference in amortisation rates of intangibles	8	-	-	8
Provision for impairment of loans	(4,176)	(1,359)	-	(5,535)
Difference in depreciation rates	(1,381)	125	-	(1,256)
Movement of the revaluation of premises	(698)	161	(4,566)	(5,103)
Tax effect of share of profits of associates	(164)	28	-	(136)
Revenue accruals	(92)	10	-	(82)
Deferral of prepaid expenses	(50)	4	-	(46)
Other	(57)	6	-	(51)
Recognised deferred tax liability	**(3,966)**	**(981)**	**(4,566)**	**(9,513)**

23 Income Taxes (Continued)

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

In thousands of Azerbaijani Manats	2006	2005
Total net deferred tax assets of subsidiaries	41	420
Total net deferred tax liability of the parent Bank	(12,180)	(9,933)
Total net deferred tax liability of the Group	**(12,139)**	**(9,513)**

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

24 Dividends

	2006		2005	
In thousands of Azerbaijani Manats	Ordinary	Preference	Ordinary	Preference
Dividends payable at 1 January	**2,400**	**-**	**3,474**	-
Dividends declared during the year	16,391	-	9,600	-
Dividends paid during the year	(13,926)	-	(10,674)	-
Dividends payable at 31 December	**4,865**	**-**	**2,400**	**-**

All dividends are declared and paid in Azerbaijani Manats by the Bank.

Dividends are declared at quarter-ends and paid in the following quarter to the shareholders of the Bank in accordance with their shareholding percentage in the issued and paid share capital as at the end of the quarter.

25 Segment Analysis

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

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

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

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

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

The Group's lines of business and operations in countries outside of Republic of Azerbaijan are not considered significant for separate analysis or disclosure within this note.

Segment information for the main reportable business segments of the Group for the years ended 31 December 2006 and 2005 is set out below:

	Retail banking		Corporate banking		Total	
In thousands of Azerbaijani Manats	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
External revenues	30,458	21,652	159,125	119,330	189,583	140,982
Revenues from other segments	857	585	4,480	3,225	5,337	3,810
Total revenues	**31,315**	**22,237**	**163,605**	**122,555**	**194,920**	**144,792**
Total revenues comprise:						
- Interest income	18,606	12,770	97,205	70,380	115,811	83,150
- Fee and commission income	8,741	6,721	45,667	37,042	54,408	43,763
- Gains less losses from trading in foreign currencies	3,111	2,161	16,253	11,909	19,364	14,070
- Gross insurance premiums written, net of premiums ceded	857	585	4,480	3,225	5,337	3,810
Total revenues	**31,315**	**22,237**	**163,605**	**122,555**	**194,920**	**144,792**

25 Segment Analysis (Continued)

	Retail banking		Corporate banking		Total	
In thousands of Azerbaijani Manats	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
Segment result	**24,158**	**17,656**	**126,212**	**98,372**	**150,370**	**116,029**
Unallocated costs	-	-	-	-	(97,816)	(86,909)
Share of after tax results of associates	-	-	-	-	15	(62)
Profit before tax					**52,569**	**29,058**
Income tax expense					(14,918)	(8,728)
Profit					**37,651**	**20,330**
Non-current assets (or disposal groups) held for sale	-	-	-	-	-	-
Other segment assets	280,620	163,357	1,466,072	900,310	1,746,692	1,063,667
Total segment assets	**280,620**	**163,357**	**1,466,072**	**900,310**	**1,746,692**	**1,063,667**
Investment in associates	-	-	-	-	809	1,363
Current and deferred tax assets	-	-	-	-	41	419
Other unallocated assets	-	-	-	-	99,890	89,859
Total assets	**280,620**	**163,357**	**1,466,072**	**900,310**	**1,847,432**	**1,155,309**
Liabilities directly associated with non-current assets (or disposal groups) held for sale	-	-	-	-	-	-
Other segment liabilities	265,472	156,900	1,386,934	864,721	1,652,406	1,021,620
Total segment liabilities	**265,472**	**156,900**	**1,386,934**	**864,721**	**1,652,406**	**1,021,620**
Current and deferred tax liabilities	-	-	-	-	19,141	12,758
Other unallocated liabilities	-	-	-	-	34,647	37,428
Total liabilities	**265,472**	**156,900**	**1,386,934**	**864,721**	**1,706,194**	**1,071,806**
Other segment items						
Capital expenditure	4,016	2,871	20,980	15,821	24,996	18,692
Depreciation and amortisation expense	2,596	1,763	13,565	9,719	16,161	11,482
Other non-cash expenses	4,894	6,079	25,567	33,501	30,461	39,580

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.

26 Financial Risk Management (Continued)

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 2006 is set out below:

In thousands of Azerbaijani Manats	**Republic of Azerbaijan**	**OECD**	**Non OECD**	**Total**
Assets				
Cash and cash equivalents	412,814	25,389	19,179	457,382
Mandatory cash balances with the NBAR	112,600	-	2,854	115,454
Due from other banks	92,451	11,485	31,504	135,440
Loans and advances to customers	919,096	-	119,320	1,038,416
Investment securities held to maturity	-	-	-	-
Investment in associates and joint ventures	809	-	-	809
Deferred income tax asset	41	-	-	41
Premises, equipment and intangible assets	73,825	-	7,773	81,598
Other assets	14,356	262	3,674	18,292
Total assets	**1,625,992**	**37,136**	**184,304**	**1,847,432**
Liabilities				
Due to other banks	1,860	141,169	30,351	173,380
Customer accounts	1,282,584	-	21,592	1,304,176
Debt securities in issue	40,969	-	-	40,969
Other borrowed funds	-	130,111	3,772	133,882
Current income tax liability	6,916	-	45	6,961
Deferred income tax liability	11,519	-	661	12,180
Other liabilities	33,495	857	294	34,646
Total liabilities	**1,377,343**	**272,137**	**56,714**	**1,706,194**
Net balance sheet position	**248,649**	**(235,001)**	**127,590**	**141,238**
Credit related commitments (Note 27)	**1,374,308**	**-**	**14,166**	**1,388,474**

26 Financial Risk Management (Continued)

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

In thousands of Azerbaijani Manats	**Republic of Azerbaijan**	**OECD**	**Non OECD**	**Total**
Assets				
Cash and cash equivalents	200,729	49,589	8,052	258,370
Mandatory cash balances with the NBAR	65,096	-	845	65,941
Due from other banks	26,068	8,168	20,100	54,336
Loans and advances to customers	661,543	-	16,927	678,470
Investment securities held to maturity	-	-	6,550	6,550
Investment in associates and joint ventures	1,363	-	-	1,363
Deferred income tax asset	420	-	-	420
Premises, equipment and intangible assets	68,982	-	8,341	77,323
Other assets	7,355	3,592	1,589	12,536
Total assets	**1,031,556**	**61,349**	**62,404**	**1,155,309**
Liabilities				
Due to other banks	3,372	-	5,406	8,778
Customer accounts	902,435	-	6,139	908,574
Debt securities in issue	42,187	-	-	42,187
Other borrowed funds	-	59,951	2,130	62,081
Current income tax liability	2,816	-	9	2,825
Deferred income tax liability	9,169	-	764	9,933
Other liabilities	35,917	-	1,511	37,428
Total liabilities	**995,896**	**59,951**	**15,959**	**1,071,806**
Net balance sheet position	**35,660**	**1,398**	**46,445**	**83,503**
Credit related commitments (Note 27)	**(364,934)**	**(209,040)**	**(87,867)**	**(661,841)**

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

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 2006:

In thousands of Azerbaijani Manats	AZN	USD	Euro	RUR	Other	Non-monetary	Total
Assets							
Cash and cash equivalents	95,326	351,315	5,804	3,239	1,698	-	457,382
Mandatory cash balances with the NBAR	14,427	100,370	-	657	-	-	115,454
Due from other banks	52,226	71,103	11,476	-	635	-	135,440
Loans and advances to customers	282,830	699,325	38,096	18,165	-	-	1,038,416
Investment securities held to maturity	-	-	-	-	-	-	-
Investment in associates and joint ventures	809	-	-	-	-	-	809
Deferred income tax asset	41	-	-	-	-	-	41
Premises, equipment and intangible assets	-	-	-	-	-	81,598	81,598
Other assets	10,806	5,117	1,172	196	99	902	18,292
Total assets	**456,465**	**1,227,230**	**56,548**	**22,257**	**2,432**	**82,500**	**1,847,432**
Liabilities							
Due to other banks	59	162,638	68	10,599	16	-	173,380
Customer accounts	338,560	895,829	46,891	21,592	1,304	-	1,304,176
Debt securities in issue	8	40,961	-	-	-	-	40,969
Other borrowed funds	-	122,490	11,392	-	-	-	133,882
Current income tax liability	6,916	-	-	45	-	-	6,961
Deferred income tax liability	11,519	-	-	661	-	-	12,180
Other liabilities	22,159	10,508	1,731	207	41	-	34,646
Total liabilities	**379,221**	**1,232,426**	**60,082**	**33,104**	**1,361**	**-**	**1,706,194**
Net balance sheet position	**77,244**	**(5,196)**	**(3,534)**	**(10,847)**	**1,071**	**82,500**	**141,238**

26 Financial Risk Management (Continued)

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

In thousands of Azerbaijani Manats	AZN	USD	Euro	RUR	Other	Non-monetary	Total
Assets							
Cash and cash equivalents	63,272	180,630	6,032	4,177	4,259	-	258,370
Mandatory cash balances with the NBAR	-	65,096	-	845	-	-	65,941
Due from other banks	5,114	41,160	6,531	1,531	-	-	54,336
Loans and advances to customers	155,182	491,020	28,446	3,822	-	-	678,470
Investment securities held to maturity	-	6,550	-	-	-	-	6,550
Investment in associates and joint ventures	1,363	-	-	-	-	-	1,363
Deferred income tax asset	420	-	-	-	-	-	420
Premises, equipment and intangible assets	-	-	-	-	-	77,323	77,323
Other assets	7,429	2,821	630	-	524	1,132	12,536
Total assets	**232,780**	**787,277**	**41,639**	**10,375**	**4,783**	**78,455**	**1,155,309**
Liabilities							
Due to other banks	58	4,325	162	4,233	-	-	8,778
Customer accounts	135,992	732,805	34,662	3,320	1,795	-	908,574
Debt securities in issue	19	42,168	-	-	-	-	42,187
Other borrowed funds	-	56,528	5,553	-	-	-	62,081
Current income tax liability	2,816	-	-	9	-	-	2,825
Deferred income tax liability	9,169	-	-	764	-	-	9,933
Other liabilities	33,014	2,994	246	-	1,174	-	37,428
Total liabilities	**181,068**	**838,820**	**40,623**	**8,326**	**2,969**	**-**	**1,071,806**
Net balance sheet position	**51,712**	**(51,543)**	**1,016**	**2,049**	**1,814**	**78,455**	**83,503**

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

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

The table below shows assets and liabilities at 31 December 2006 by their remaining contractual maturity, unless there is evidence that any of the assets are impaired and will be settled after their contractual maturity dates, in which case the expected date of settlement of the assets is used. Some of the assets and liabilities, however, may be of a longer term nature; for example, loans are frequently renewed and accordingly short term loans can have a longer term duration.

26 Financial Risk Management (Continued)

Overdue liabilities, such as term deposits not withdrawn by the Group's customers, are classified within the "demand and less than 1 month" column. Overdue assets are allocated based on their expected maturity. Certain assets, for example available for sale equity securities and non-current assets held for sale (or disposal groups), are assumed to mature on the expected date on which the assets will be realised. (Mandatory cash balances with the NBAR and the CBRF are included within the same categories as the majority of liabilities, to which these balances relate).

The liquidity position of the Group at 31 December 2006 is set out below:

In thousands of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 6 months**	**From 6 to 12 months**	**Over 12 months**	**Total**
Assets					
Cash and cash equivalents	457,382	-	-	-	457,382
Mandatory cash balances with the NBAR	81,350	1,374	1,025	31,705	115,454
Due from other banks	107,957	8,220	14,075	5,188	135,440
Loans and advances to customers	36,380	206,599	285,779	509,658	1,038,416
Investment securities held to maturity	-	-	-	-	-
Investment in associates and joint ventures	-	-	-	809	809
Deferred income tax asset	-	-	-	41	41
Premises, equipment and intangible assets	-	-	-	81,598	81,598
Other assets	3,773	3,011	4,363	7,145	18,292
Total assets	**686,842**	**219,204**	**305,242**	**636,144**	**1,847,432**
Liabilities					
Due to other banks	130,852	-	5,728	36,800	173,380
Customer accounts	918,940	15,519	11,581	358,136	1,304,176
Debt securities in issue	1,729	1,970	8,289	28,981	40,969
Other borrowed funds	129,284	827	-	3,771	133,882
Current income tax liability	-	6,961	-	-	6,961
Deferred income tax liability	-	-	-	12,180	12,180
Other liabilities	8,052	4,859	1,998	19,737	34,646
Total liabilities	**1,188,857**	**30,136**	**27,596**	**459,605**	**1,706,194**
Net liquidity gap	**(502,015)**	**189,068**	**277,646**	**176,539**	**141,238**
Cumulative liquidity gap at 31 December 2006	**(502,015)**	**(312,947)**	**(35,301)**	**141,238**	

Other borrowed funds classified as due on "Demand and up to 1 month" include certain amounts that have been reclassified from their contractual settlement dates as detailed in Note 27.

26 Financial Risk Management (Continued)

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

In thousands of Azerbaijani Manats	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	Over 12 months	Total
Assets					
Cash and cash equivalents	258,370	-	-	-	258,370
Mandatory cash balances with the NBAR	34,377	3,358	2,242	25,964	65,941
Due from other banks	20,484	6,059	16,708	11,085	54,336
Loans and advances to customers	75,989	56,652	209,444	336,385	678,470
Investment securities held to maturity	-	6,550	-	-	6,550
Investment in associates and joint ventures	-	-	-	1,363	1,363
Deferred income tax asset	-	-	-	420	420
Premises, equipment and intangible assets	-	-	-	77,323	77,323
Other assets	3,606	4,121	867	3,942	12,536
Total assets	**392,826**	**76,740**	**229,261**	**456,482**	**1,155,309**
Liabilities					
Due to other banks	8,534	161	83	-	8,778
Customer accounts	473,669	46,261	30,885	357,759	908,574
Debt securities in issue	843	-	-	41,344	42,187
Other borrowed funds	7,135	-	52,348	2,598	62,081
Current income tax liability	-	2,825	-	-	2,825
Deferred income tax liability	-	-	-	9,933	9,933
Other liabilities	28,648	2,113	982	5,685	37,428
Total liabilities	**518,829**	**51,360**	**84,298**	**417,319**	**1,071,806**
Net liquidity gap	**(126,003)**	**25,380**	**144,963**	**39,163**	**83,503**
Cumulative liquidity gap at 31 December 2005	**(126,003)**	**(100,623)**	**44,340**	**83,503**	

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 considers that the current favourable macroeconomic environment for financial institutions operating in Azerbaijan, positive cash flows, the profitability of operations and access to foreign financial resources as required significantly decrease the risk of losses arising from current liquidity mismatches.

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 2006. Included in the table are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates:

In thousands 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	457,382	-	-	-	-	457,382
Mandatory cash balances with the NBAR	81,350	1,374	1,025	31,705	-	115,454
Due from other banks	107,957	8,220	14,075	5,188	-	135,440
Loans and advances to customers	110,583	206,599	322,860	398,374	-	1,038,416
Investment securities held to maturity	-	-	-	-	-	-
Investment in associates and joint ventures	-	-	-	-	809	809
Deferred income tax asset	-	-	-	-	41	41
Premises, equipment and intangible assets	-	-	-	-	81,598	81,598
Other assets	-	-	-	-	18,292	18,292
Total assets	**757,272**	**216,193**	**337,960**	**435,267**	**100,740**	**1,847,432**
Liabilities						
Due to other banks	130,852	-	5,728	36,800	-	173,380
Customer accounts	918,940	15,519	11,581	358,136	-	1,304,176
Debt securities in issue	1,729	1,970	8,289	28,981	-	40,969
Other borrowed funds	129,284	827	-	3,771	-	133,882
Current income tax liability	-	-	-	-	6,961	6,961
Deferred income tax liability	-	-	-	-	12,180	12,180
Other liabilities	-	-	-	-	34,646	34,646
Total liabilities	**1,180,805**	**18,316**	**25,598**	**427,688**	**53,787**	**1,706,194**
Net sensitivity gap	**(423,533)**	**197,877**	**312,362**	**7,579**	**46,953**	**141,238**

26 Financial Risk Management (Continued)

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

In thousands 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	258,370	-	-	-	-	258,370
Mandatory cash balances with the NBAR	34,377	3,357	2,242	25,965	-	65,941
Due from other banks	20,484	6,059	16,708	11,085	-	54,336
Loans and advances to customers	148,449	56,652	209,444	263,925	-	678,470
Investment securities held to maturity	-	6,550	-	-	-	6,550
Investment in associates and joint ventures	-	-	-	-	1,363	1,363
Deferred income tax asset					420	420
Premises, equipment and intangible assets	-	-	-	-	77,323	77,323
Other assets	-	-	-	-	12,536	12,536
Total assets	**461,680**	**72,618**	**228,394**	**300,975**	**91,642**	**1,155,309**
Liabilities						
Due to other banks	2,025	2,491	4,262	-	-	8,778
Customer accounts	473,669	46,261	30,885	357,759	-	908,574
Debt securities in issue	843	-	-	41,344	-	42,187
Other borrowed funds	-	62,081	-	-	-	62,081
Current income tax liability	-	-	-	-	2,825	2,825
Deferred income tax liability	-	-	-	-	9,933	9,933
Other liabilities	-	-	-	-	37,428	37,428
Total liabilities	**476,537**	**110,833**	**35,147**	**399,103**	**50,186**	**1,071,806**
Net sensitivity gap	**(14,857)**	**(38,215)**	**193,247**	**(98,128)**	**41,456**	**83,503**

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

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

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 period-end effective rates used for amortisation of the respective assets/liabilities.

	2006					2005				
In % p.a.	**USD**	**AZN**	**Euro**	**RUR**	**Other**	**USD**	**AZN**	**Euro**	**RUR**	**Other**
Assets										
Cash and cash equivalents	3.7	-	-	0.7	-	3.1	-	-	0.5	-
Due from resident banks	15.1	14.0	-	3.5	-	13.0	-	-	-	-
Due from non resident banks	5.1	-	7.0	7.8	-	2.2	-	2.2	-	-
Loans and advances to customers – individuals	19.5	15.2	13.7	15.6	-	20.9	18.7	18.1	12.0	-
Loans and advances to customers – corporate	13.7	14.1	8.2	15.4	-	15.8	11.1	16.1	15.6	15.2
Investment securities held to maturity	-	-	-	-	-	4.3	-	-	-	-
Liabilities										
Customer accounts – corporate	3.9	5.4	1.8	7.2	6.0	1.7	5.5	1.9	6.9	6.0
Customer accounts – individuals	10.9	10.5	8.9	10.1	8.0	8.9	9.4	8.4	9.8	-
Due to other banks	6.7	-	-	-	-	-	-	-	-	-
Debt securities in issue	9.0	9.0	-	-	-	9.0	9.0	-	-	-
Other borrowed funds	8.0	-	8.5	-	-	6.9	-	9.0	-	-

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

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 at 31 December 2006 and 31 December 2005 respectively.

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 Bank may be challenged by the relevant authorities.

The Azerbaijani 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 Bank's Management believes that its interpretation of the relevant legislation is appropriate and the Bank's tax, currency legislation and customs positions will be sustained. Accordingly, at 31 December 2006 no provision for potential tax liabilities was recorded (2005: no provision).

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

Capital expenditure commitments. At 31 December 2006, the Group has contractual capital expenditure commitments towards a local construction company in respect of the Bank's new administrative building totalling AZN 15,473 thousand (2005: AZN 22,934 thousand).

27 Contingencies and Commitments (Continued)

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

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

In thousands of Azerbaijani Manats	2006	2005
Not later than 1 year	100	150
Later than 1 year and not later than 5 years	607	160
Later than 5 years	2,513	580
Total operating lease commitments	**3,220**	**890**

Compliance with covenants. The Group is subject to certain covenants related primarily to its borrowings. Non-compliance with such covenants may result in negative consequences for the Group, including growth in the cost of borrowings and the timing of repayment of existing facilities. Management believes that during the year the Group has complied with the covenants that were in force, except for the restrictions that limits the maximum exposure of the Bank to (i) any single party which is a connected party to the Bank to ten per cent of the Bank's equity (excluding any single party which is the Government of the Republic of Azerbaijan or an entity in which the majority of the shares or interest are owned by the Government of the Republic of Azerbaijan) and (ii) a ratio of the aggregate exposure to parties that are connected parties to the Bank to twenty five per cent of the Bank's equity.

As at 31 December 2006, as disclosed in these consolidated financial statements, the exposure of the Bank to a single party that was a connected party was 31% and the ratio of aggregate exposure to parties that are connected parties to the Bank's equity was 136%. As a result, the Group was not in compliance with these covenants as at 31 December 2006, and at certain other times during the year then ended. As a result of cross-default clauses being included in certain other of the Group's borrowing agreements, the agreements provide for these other lenders to have the right to declare some or all of their loans repayable on demand.

The total borrowings affected by the breach of these covenants was AZN 128,990 thousand as at 31 December 2006. In accordance with those agreements, where covenants are breached or are affected by cross-default clauses, provision is made for the borrowings to become due and/or repayable on demand. Accordingly, the borrowings impacted have been reclassified to being on demand within these consolidated financial statements.

In addition, the Bank was not in compliance with certain statutory covenants stipulated by the National Bank of Azerbaijan's regulations. Management considers that the Bank has obtained formal agreement with the National Bank of Azerbaijan through the development of an action plan aimed at enabling the Bank to comply with all statutory requirements by 31 December 2008. Management believes that this agreement represents a waiver from these requirements in the years prior to 31 December 2008 and as a result there will be no adverse consequents for the Bank of the potential areas of non compliance. Management consider that the Bank is on schedule with the action plan agreed in 2005 and will be in a position to fully comply with all requirements by 31 December 2008.

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

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

27 Contingencies and Commitments (Continued)

In thousands of Azerbaijani Manats	2006	2005
Export letters of credit	616,581	274,043
Import letters of credit	372,938	245,622
Guarantees issued	355,413	120,192
Commitments to extend credit and un-drawn credit lines	43,542	22,863
Total credit related commitments	**1,388,474**	**662,720**

The total outstanding contractual amount of undrawn credit lines, letters of credit, and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded. Fair value of credit related commitments was AZN 1,388,474 thousand at 31 December 2006 (2005: AZN 662,720 thousand). Credit related commitments are denominated in currencies as follows:

In thousands of Azerbaijani Manats	2006	2005
Azerbaijani Manats	211,152	15,515
US Dollars	868,396	534,187
Euro	283,580	111,087
Other	25,346	1,931
Total	**1,388,474**	**662,720**

At 31 December 2006, the Group had a significant concentration of import letters of credit of AZN 237,547 thousand or 63.7% of total credit related commitments issued to 14 entities and guarantees of AZN 112,051 thousand or 30.0% of total credit related commitments issued to 8 entities.

Of the total export letters of credit at 31 December 2006, AZN 607,448 thousand (2005: AZN 202,620 thousand) were issued by foreign banks for exports by the Azerbaijani state organisations related to the oil industry. All export letters of credit are covered by guarantees of foreign banks, and the Group does not bear any credit risk in relation to these export letters of credit.

At 31 December 2006, credit related commitments of AZN 92,517 thousand (2005: AZN 68,486 thousand) are secured by Azerbaijan government guarantees or blocked customer deposits. Refer to Note 15.

On 15 June 2004, the Group signed a credit agreement where an Azerbaijani company acted as a borrower, the Group as a guarantor of the Azerbaijani company, Commerzbank AG - as a lender and Export-Import Bank of the United States as a guarantor of Commerzbank AG for a credit line of USD 12,904 thousand (2005: USD 19,638 thousand) at the rate of LIBOR plus 0.10% per annum repayable in sixteen semi-annual instalments beginning from 5 November 2006 for the purposes of construction of a business and entertainment complex in the centre of Baku. At 31 December 2006, an import letter of credit of USD 6,734 thousand or AZN 5,868 thousand (2005: USD 6,645 thousand or AZN 6,103 thousand) had been issued by the Group for this borrower under the above credit facility.

27 Contingencies and Commitments (Continued)

Intermediary loans. At 31 December 2006, the Group had borrowed funds amounting to AZN 26,046 thousand (2005: AZN 35,294 thousand) on behalf of the Government of the Republic of Azerbaijan from foreign banks and financial institutions for the purposes of providing intermediary loans to state-owned enterprises and government bodies of the Republic of Azerbaijan. The loan agreements signed between the Group and these foreign banks and financial institutions are secured by unconditional letters of guarantee of the Government of the Republic of Azerbaijan, whereby the Government acts as the primary obligor in relation to these borrowings. As a result, the Group acts as a loan-servicing agent for the Government of the Republic of Azerbaijan by transferring collected principal and interest payments to foreign banks and financial institutions and earns no interest margin on these loans.

As the Group does not receive the benefits and does not bear the risks of these intermediary loans, the Group has recorded these intermediary loans amounting at 31 December 2006 to AZN 26,046 thousand (2005: AZN 35,294 thousand) on off-balance sheet accounts. Similarly funds received by the Group to finance these intermediary loans in the corresponding amounts have also been recorded on off balance sheet accounts.

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

In thousands of Azerbaijani Manats	**2006**	**2005**
Export Credit Bank of Turkey (Eximbank):		
- Trade finance facility	26,046	35,294
Total funds borrowed for the purposes of providing intermediary loans and transferred to off-balance sheet accounts	**26,046**	**35,294**

28 Fair Value of Financial Instruments and Financial Assets

Fair value is the amount, at which a financial instrument or financial asset 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 and financial assets 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. Where Management have assessed that the fair value of the financial instruments or financial assets is not significantly different to the carrying values as disclosed in the consolidated financial statements, Management have not performed a further detailed assessment to quantity the actual fair values. In these circumstances, the carrying values have been recorded as being Management's best estimate of the fair value of these financial instruments or financial assets.

Financial instruments carried at fair value. Cash and cash equivalents are carried at amortised cost, which approximates current fair value.

Fair values have been determined based on quoted market prices. Changing any of the assumptions used to a reasonably possible alternative would not result in a significantly different profit, income, total assets or total liabilities.

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 a 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 or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 "Related Party Disclosures". In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

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

29 Related Party Transactions (Continued)

The outstanding balances of the transactions of the Group at 31 December 2006 and 31 December 2005 with related parties are, as follows:

	2006		
In thousands of Azerbaijani Manats	**Shareholders and management**	**Government bodies and state-owned entities**	**Other***
Cash and cash equivalents	-	324,422	-
Mandatory balances with NBAR	-	112,600	-
Loans and advances to customers			
Loans and advances to customers at year end	-	219,014	224,094
Provision for impairment of loans and advances to customers at year end	-	(4,419)	(48,077)
Interest income for the year	-	378	24
Due from other banks			
Term placements with resident banks at year end	8,278	-	-
Provision for impairment of due from banks at year end	(1,089)	-	-
Interest income on due from other banks	3	-	-
Other assets	-	-	-
Due to other banks			
Corresponding accounts of other banks at year end	632	-	-
Customer accounts			
Current/settlements accounts at year end	-	405,988	-
Term deposits outstanding at year end	-	288,053	-
Interest expense for the year	-	918	-
Other liabilities	4,865	11,523	**-**
Credit related commitments			
Letters of guarantees as at year end	-	193,418	-
Gain on disposal of Inter FC	-	-	721
Fee and commission income for the period	-	9,048	-
Other expense			
Staff costs	(537)	-	-
Other operating expenses	-	-	(2,495)
Insurance operations			
Insurance related commission expense	-	-	780

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

29 Related Party Transactions (Continued)

	2005		
In thousands of Azerbaijani Manats	**Shareholders and management**	**Government bodies and state-owned entities**	**Other***
Cash and cash equivalents	299	155,683	-
Mandatory balances with NBAR	-	65,096	-
Loans and advances to customers			
Loans and advances to customers at year end	-	257,662	88,960
Provision for impairment of loans and advances to customers at year end	-	(5,488)	(19,085)
Interest income for the year	-	4,318	145
Due from other banks			
Term placements with resident banks at year end	8,661	-	-
Provision for impairment of due from banks at year end	(556)	-	-
Interest income on due from other banks	3	-	-
Other assets	-	1	71
Due to other banks			
Corresponding accounts of other banks at year end	1,083	-	-
Customer accounts			
Current/settlements accounts at year end	69	241,317	111
Term deposits outstanding at year end	14	320,568	-
Interest expense for the year	1	60	-
Other liabilities	2,400	26,285	-
Credit related commitments			
Letters of guarantees at year end	37	66,338	-
Fee and commission income for the year	-	4,219	-
Other expense			
Staff costs	(409)	-	-
Other operating expenses	-	-	(1,230)
Insurance operations			
Insurance premiums receivable	124	-	-
Insurance premiums written during the year	356	-	-
Insurance premiums ceded during the year	3	-	-

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

During the year ended 31 December 2006, the total remuneration of members of the Board of Directors and key management personnel of the Group including discretionary compensation amounted to AZN 537 thousand (2005: AZN 409 thousand).

At 31 December 2006, the Group's employees held 8.89% of the total share capital of the Group, or 26,365 ordinary shares with a par value of AZN 5,273 thousand (2005: 4.71%, or 5,845 ordinary shares with a par value of AZN 1,169 thousand respectively). Refer to Note 19.

In September 2006, the Group sold 100% of its interest in "Inter" professional football club to a related-party company on the basis of an independent valuation report for a total consideration of AZN 540 thousand. As a result of this sale the Group recorded a gain of AZN 721 in consolidated income statement.

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

30 Principal Subsidiaries, Associates and Joint Ventures

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

Name	**Subsidiary/ associate**	**Nature of business**	**Country of Registration**	**Percentage of ownership 2006**	**Percentage of ownership 2005**
Baku Inter-Bank Currency Exchange	Associate	Currency	Republic of Azerbaijan	20.0	20.0
Azerileasing	Associate	Leasing	Republic of Azerbaijan	47.6	100.0
IBAR Moscow	Subsidiary	Banking	Russian Federation	100.0	100.0
IBAR Georgia	Subsidiary	Banking	Georgia	75.0	-
International Insurance Company	Subsidiary	Insurance	Republic of Azerbaijan	100.0	100.0
Inter Protect Re AG	Subsidiary	Reinsurance	Switzerland	100.0	100.0
Azericard Limited	Subsidiary	Plastic cards	Republic of Azerbaijan	100.0	100.0

The financial statements of Trans-service were included in the consolidated financial statements of the Group as investment in a joint venture as at 31 December 2003 for the first time, using the equity accounting method. The Group's net share of losses of Trans-service accumulated prior to 1 January 2003 totalling AZN 137 thousand were recorded as part of other movements in the consolidated statement of shareholders equity of the Group for year ended 31 December 2003. The Group sold its interest in Trans-service in 2006 to an unrelated party company.

On 7 October 2002, the Group's Insurance Subsidiary established a reinsurance company, Inter Protect Re AG. It was registered in Zurich, Switzerland. The Insurance Subsidiary of the Group transferred CHF 1,450 thousand as contribution to the share capital and reserves of Inter Protect Re AG. Of the total amount transferred, CHF 1,200 thousand was used to pay for 1,000 shares at CHF 1,200 par value each, CHF 200 thousand as a payment for the share premium and the remaining CHF 50 thousand as contribution to the capital reserves of the company.

The financial statements of Azerileasing, the Group's leasing subsidiary, were included in the consolidated financial statements of the Group for the first time as at 31 December 2003. In October 2006, the Group sold 52.4% of its interest in "Azerileasing" to a British leasing company with a total consideration of AZN 24,170 thousand. The Management of the Group believes that terms and conditions of this contract constitute those of an ordinary arms-length contract with an unrelated party. As a result of this sale the Group recorded a gain of AZN 1,204 thousand in consolidated income statement. As at 31 December 2006, the Group holds 47.6% interest in the company and applies equity method consolidation principles to account for its investment in this associate.

On 20 June 2004, "Inter" professional football club was established and registered with the Ministry of Justice of the Republic of Azerbaijan. In accordance with the foundation agreement signed between the Bank and Azericard Limited, the charter capital of the professional football club was set at AZN 402 thousand, of which AZN 300 thousand was contributed by the Bank and the remaining AZN 102 thousand by Azericard Limited. This club is a member of the Azerbaijan Football Federations Association is one of the leading professional football clubs in the country. During the year ended 31 December 2006, the Bank provided financial aid to "Inter" in the amount of AZN 5,926 thousand (2005: AZN 4,500 thousand). At 31 December 2004, financial statements of "Inter" professional football club were included in consolidated financial statements of the Group as a fully owned subsidiary of the Bank for the first time.

In September 2006, the Group sold 100% of its interest in "Inter" professional football club to a related-party company on the basis of an independent valuation report for a total consideration of AZN 540 thousand. As a result of this sale the Group recorded a gain of AZN 721 in consolidated income statement.

On 10 November 2006, the Group registered its 75% owned subsidiary, International Bank of Azerbaijan Republic-Georgia ("IBAR Georgia"), in Tbilisi, Georgia. The share capital of IBAR Georgia was established at USD 7,000,000 with the minority interest in the amount of AZN 1,528 thousand being paid-in by a resident bank at the reporting date. At 31 December 2006, IBAR Georgia was operationally inactive, since the license for rendering banking services from the National Bank of Georgia ("the NBG") was only obtained on 5 February 2007.

31 Subsequent Events

On 5 February 2007, IBAR Georgia obtained a license for rendering banking services from the National Bank of Georgia.

On 27 March 2007, IBAR Moscow signed a borrowing agreement with Switzerland's Banque de Commerce et de Placements SA on obtaining a credit facility of USD 5 million for a one year period.

On 10 May 2007, the Ministry of Finance exercised its rights following the Bank's share issue during 2006 and paid for part of the shares allocated to it, which increased the Ministry of Finance's economic interest in the Bank's share capital to 42.84% on that date.