

OPEN JOINT STOCK COMPANY XALQ BANK

Independent Auditors' Report

Consolidated Financial Statements
For the Year Ended 31 December 2007

OPEN JOINT STOCK COMPANY XALQ BANK

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007

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

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group at 31 December 2007, and the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

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

Management is also responsible for:

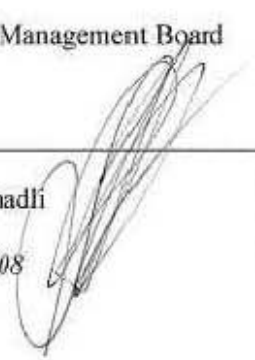
- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Group, and which enable them to ensure that the consolidated financial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

The consolidated financial statements for the year ended 31 December 2007 were authorized for issue on 22 September 2008 by the Management Board.

On behalf of the Management Board

Chairman
Mr. Asim Mammadli

22 September 2008



Acting Chief Accountant
Mrs. Tamilla Asadova

22 September 2008



INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Open Joint Stock Company Xalq Bank (the "Bank"), which comprise the consolidated balance sheet as at 31 December 2007, and the consolidated income statement, consolidated statements of changes in equity and cash flows for the year ended 31 December 2007, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. Except as discussed in the basis for qualified opinion below 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 consolidated financial statements are free from material misstatement.

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

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

Basis for qualified opinion

As discussed in Note 15, the Bank has acquired a controlling interest of 97.27% in Open Joint Stock Company Baki-Ayaqqabi 2 during the year ended 31 December 2007. Due to the absence of IFRS financial statements of the subsidiary, the Bank has not consolidated Open Joint Stock Company Baki-Ayaqqabi 2 as of 31 December 2007 and for the year then ended, which is not in compliance with the requirements of IFRS 3 "Business Combinations" and IAS 27 "Consolidated and Separate Financial Statements". We were unable to satisfy ourselves as to the fair values of assets and liabilities as at the date of acquisition and as to the carrying values of assets and liabilities, income and expenses which should be included in the consolidated financial statements of the Bank for the year ended 31 December 2007.

As discussed in Note 16, the Bank has acquired a 20% of share in Open Joint Stock Company Kapital Bank. The investment is stated at cost, which is not in accordance with the requirements of IAS 28 "Investments in Associates", which requires the use equity method when there is a significant influence over an investee. We were unable to satisfy ourselves as to the amount of investment as of 31 December 2007 and related gains or losses for the year ended 31 December 2007.

Qualified opinion

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to obtain sufficient evidence regarding the matters referred to above, the consolidated financial statements present fairly, in all material respects, the financial position of Open Joint Stock Company Xalq Bank as at 31 December 2007, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte Touche LLC

22 September 2008
The Republic of Azerbaijan

OPEN JOINT STOCK COMPANY XALQ BANK

CONSOLIDATED BALANCE SHEET FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

	Notes	Year ended 31 December 2007	Year ended 31 December 2006
Interest income	4, 26	17,304,312	4,392,712
Interest expense	4, 26	(7,776,800)	(2,158,775)
NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS		9,527,512	2,233,937
Provision for impairment losses on interest bearing assets	5, 26	(4,967,100)	(1,966,899)
NET INTEREST INCOME		4,560,412	267,038
Net (loss)/gain on foreign exchange operations	6	(58,491)	69,607
Fee and commission income	7, 26	1,908,753	993,322
Fee and commission expense	7	(277,482)	(241,660)
Other income	26	22,676	11,496
NON-INTEREST INCOME		1,595,456	832,765
OPERATING INCOME		6,155,868	1,099,803
OPERATING EXPENSES	8, 26	(3,445,761)	(1,971,098)
OPERATING PROFIT/(LOSS)		2,710,107	(871,295)
Provision for impairment losses on guarantees and other commitments	5	(231,954)	-
PROFIT/(LOSS) BEFORE INCOME TAX		2,478,153	(871,295)
Income tax expense	9	(173,056)	-
NET PROFIT/(LOSS)		2,305,097	(871,295)
Attributable to:			
Equity holders of the parent		2,305,097	(871,295)
EARNINGS / (LOSS) PER SHARE			
Basic and diluted (AZN)	10	1.243	(2,600)

On behalf of the Management Board

Chairman
Mr. Asim Mammadli

22 September 2008



Acting Chief Accountant
Mrs. Tamilla Asadova

22 September 2008

The notes on pages 9 to 56 form an integral part of these consolidated financial statements. The Independent Auditors' Report is on pages 2-3.

OPEN JOINT STOCK COMPANY XALQ BANK

CONSOLIDATED BALANCE SHEET FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

	Notes	31 December 2007	31 December 2006
ASSETS			
Cash and balances with the National Bank of the Republic of Azerbaijan	11	22,095,998	10,535,675
Due from banks	12	12,932,941	5,333,692
Loans to customers	13, 26	153,391,038	56,112,499
Factoring	14	3,360,341	-
Investments available-for-sale	15	1,633,115	42,627
Investments in associates	16, 26	5,100,000	-
Property and equipment	17	5,497,923	2,807,569
Intangible assets	18	330,083	268,807
Deferred income tax assets	9	35,793	-
Other assets	19	1,035,889	268,642
TOTAL ASSETS		205,413,121	75,369,511
LIABILITIES AND EQUITY			
LIABILITIES:			
Due to banks and government agencies	20	11,526,578	3,057,125
Customer accounts	21, 26	137,874,415	63,384,099
Provision for impairment losses on other operations	5	231,954	-
Current income tax liabilities		208,849	-
Other liabilities	22	851,382	63,441
Total liabilities		150,693,178	66,504,665
EQUITY:			
Share capital	23	53,550,000	10,000,000
Retained earnings/(accumulated deficit)		1,169,943	(1,135,154)
Total equity		54,719,943	8,864,846
TOTAL LIABILITIES AND EQUITY		205,413,121	75,369,511

On behalf of the Management Board

Chairman
Mr. Asim Mammadli

22 September 2008



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22 September 2008

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OPEN JOINT STOCK COMPANY XALQ BANK

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

	Share capital	(Accumulated deficit)/retained earnings	Total equity
31 December 2005	6,250,000	(263,859)	5,986,141
Share capital increase	3,750,000	-	3,750,000
Net loss	-	(871,295)	(871,295)
31 December 2006	10,000,000	(1,135,154)	8,864,846
Share capital increase	43,550,000	-	43,550,000
Net profit	-	2,305,097	2,305,097
31 December 2007	<u>53,550,000</u>	<u>1,169,943</u>	<u>54,719,943</u>

On behalf of the Management Board

Chairman
Mr. Asim Mammadli

22 September 2008



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22 September 2008

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OPEN JOINT STOCK COMPANY XALQ BANK

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

	Notes	Year ended 31 December 2007	Year ended 31 December 2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit/(loss) before income tax		2,478,153	(871,295)
Adjustments for:			
Provision for impairment losses on interest bearing assets		4,967,100	1,966,899
Provision for guarantees and other commitments		231,954	-
Net unrealized loss arising from changes in foreign currency exchange rates		341,450	38,370
Depreciation and amortization		671,760	394,920
Loss on disposal of property and equipment		-	16,841
Gain on disposal of intangible assets		(4,908)	(7,995)
Change in interest accruals, net		(3,804,664)	(28,807)
Cash flows from operating activities before changes in operating assets and liabilities		4,880,845	1,508,933
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the National Bank of the Republic of Azerbaijan		(7,394,869)	(6,048,578)
Due from banks		(2,119,729)	(359,455)
Loans to customers		(98,416,724)	(49,674,167)
Factoring		(3,228,561)	-
Other assets		(483,308)	19,918
Increase/(decrease) in operating liabilities:			
Due to banks and government agencies		8,358,175	40,756
Customer accounts		74,084,675	55,079,035
Other liabilities		800,804	50,577
Cash (outflow)/inflow from operating activities before taxation		(23,518,692)	617,019
Income tax paid		-	-
Net cash (outflow)/inflow from operating activities		(23,518,692)	617,019
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property, equipment and intangible assets		(3,598,747)	(1,664,748)
Proceeds on disposal of property and equipment		27,839	84,565
Purchase of investments available-for-sale		(1,590,264)	(40,000)
Purchase of investments in associates		(5,100,000)	-
Net cash outflow from investing activities		(10,261,172)	(1,620,183)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Issue of ordinary share capital		43,550,000	3,750,000
Net cash inflow from financing activities		43,550,000	3,750,000

OPEN JOINT STOCK COMPANY XALQ BANK

CONSOLIDATED STATEMENT OF CASH FLOWS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

	Notes	Year ended 31 December 2007	Year ended 31 December 2006
Effect of foreign exchange rate changes on cash and cash equivalents		(114,371)	(112,353)
NET INCREASE IN CASH AND CASH EQUIVALENTS		9,655,765	2,634,483
CASH AND CASH EQUIVALENTS, beginning of year		<u>5,973,034</u>	<u>3,338,551</u>
CASH AND CASH EQUIVALENTS, end of year	11	<u>15,628,799</u>	<u>5,973,034</u>

Interest paid and received by the Group in cash during the year ended 31 December 2007 amounted to AZN 7,373,229 and AZN 13,096,077, respectively.

Interest paid and received by the Group in cash during the year ended 31 December 2006 amounted to AZN 1,911,438 and AZN 4,116,568, respectively.

On behalf of the Management Board

Chairman
Mr. Asim Mammadli

22 September 2008



Acting Chief Accountant
Mrs. Tamilla Asadova

22 September 2008

The notes on pages 9 to 56 form an integral part of these consolidated financial statements. The Independent Auditors' Report is on pages 2-3.

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

1. ORGANIZATION

Xalq Bank (the "Bank") is a joint stock company which was established on 24 December 2004 in accordance with establishment agreement and was registered by the National Bank of Azerbaijan on 27 December 2004. The address of its registered office is 1145 Babek Avenue, Baku, AZ 1025, Azerbaijan. The Bank is regulated by the National Bank of Azerbaijan (the "NBA") and conducts its business under the general banking license number 246. The Bank had 4 branches in Azerbaijan as at 31 December 2007. The Bank's primary business consists of commercial activities, trading with foreign currencies, originating loans and guarantees.

The number of employees of the Bank at 31 December 2007 and 2006 was 163 and 97, respectively.

The Bank is a parent company of a banking group (the "Group") which consists of the following enterprises consolidated in the financial statements:

Name	Country of operation	The Bank ownership interest/voting rights, %		Type of operation
		2007	2006	
<i>Xalq Capital LLC</i>	<i>The Republic of Azerbaijan</i>	100	100	<i>Securities market transactions</i>

Xalq Capital LLC is a limited liability company registered in the Republic of Azerbaijan on 17 August 2007. The company's principal activity is operations with securities, broker and dealer operations.

As at 31 December 2007 and 2006 the following shareholders owned the issued shares of the Bank:

	31 December 2007	31 December 2006
	Ownership interest, %	Ownership interest, %
Ideal Biznes Ko LLC	50.00	50.00
Yevro Standart LLC	33.85	50.00
Avangard-1 LLC	16.15	-
Total	100	100

These consolidated financial statements were authorized for issue by the Management Board on 22 September 2008.

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

2. BASIS OF PRESENTATION

Accounting basis

These consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board (“IASB”) and Interpretations issued by the International Financial Reporting Interpretations Committee (“IFRIC”). These consolidated financial statements are presented in Azerbaijan Manats (“AZN”) unless otherwise indicated. These consolidated financial statements have been prepared under the historical cost convention, except for the measurement at fair value of certain financial instruments and measurement of buildings at revalued amounts according to International Accounting Standard (“IAS”) No. 16 “Property, Plant and Equipment”.

The Group maintains its accounting records in accordance with Azerbaijan law. These consolidated financial statements have been prepared based on the Azerbaijani statutory accounting records and have been adjusted to conform with IFRS. These adjustments include certain reclassifications to reflect the economic substance of underlying transactions including reclassifications of certain assets and liabilities, income and expenses to appropriate financial statement captions.

Key assumptions

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts. Such estimates and assumptions are based on the information available to the Group’s management as of the date of the consolidated financial statements. Therefore, actual results could differ from those estimates and assumptions. Estimates that are particularly susceptible to change relate to the provisions for impairment losses and the fair value of financial instruments.

Key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial period include:

	31 December 2007	31 December 2006
Loans to customers	153,391,038	56,112,499
Factoring	3,360,041	-
Investments available-for-sale	1,633,115	42,627
Investments in associates	5,100,000	-
Property and equipment	5,497,923	2,807,569

Loans to customers are measured at amortized cost less allowance for impairment losses. The estimation of allowances for impairments involves the exercise of significant judgment. The Group estimates allowances for impairment with the objective of maintaining balance sheet provisions at a level believed by management to be sufficient to absorb losses incurred in the Bank’s loan portfolio. The calculation of provisions on impaired loans is based on the likelihood of the asset being written off and the estimated loss on such a write-off. These assessments are made using statistical techniques based on historic experience. These determinations are supplemented by the application of management judgment.

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

The Group considers accounting estimates related to provisions for loans key sources of estimation uncertainty because: (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of losses relating to impaired loans and advances are based on recent performance experience, and (ii) any significant difference between the Group's estimated losses (as reflected in the provisions) and actual losses will require the Group to take provisions which, if significantly different, could have a material impact on its future income statement and its balance sheet. The Group's assumptions about estimated losses are based on past performance, past customer behavior, the credit quality of recent underwritten business and general economic conditions, which are not necessarily an indication of future losses.

Investments available-for-sale are measured at fair value less impairment losses. The estimation of impairment losses involves the exercise of significant management judgment. The accounting policy for the impairment of financial instruments is discussed in Note 3 below.

Functional currency

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

3. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and entities controlled by the Bank (its subsidiaries) made up to 31 December each year. Control is achieved where the Bank has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognized as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to the consolidated income statement in the period of acquisition. The minority interest is stated at the minority's proportion of the fair values of the assets and liabilities recognized. Subsequently, any losses applicable to the minority interest in excess of the minority interest are allocated against the interests of the parent. The equity attributable to equity holders of the parent and net income attributable to minority shareholders' interests are shown separately in the consolidated balance sheet and income statement, respectively. For a business combination involving entities or business under common control all assets and liabilities of a subsidiary are measured at their carrying values recorded in the stand-alone financial statements of a predecessor owner with the difference between the carrying value of the acquired share in net assets of the subsidiary and the cost of acquisition recorded directly in equity attributable to the equity holders of the parent.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

All significant intra-group transactions, balances, income and expenses are eliminated on consolidation.

The difference, if any, between the carrying amount of minority interest and the amount received on its purchase is recognized in equity attributable to the equity holders of the parent.

In translating the financial statements of a foreign subsidiary into the presentation currency for incorporation in the consolidated financial statements, the Group follows a translation policy in accordance with International Accounting Standard 21 "The Effects of Changes in Foreign Exchange Rates" ("IAS 21") as follows:

- Assets and liabilities, both monetary and non-monetary, of the foreign entity are translated at closing rate;
- Income and expense items of the foreign entity are translated at exchange rates at the dates of transactions;
- Equity items of the foreign entity are translated at exchange rates at the dates of transactions;
- All resulting exchange differences are classified as equity until the disposal of the investment;
- On disposal of the investment in the foreign entity related exchange differences are recognized in the consolidated income statement.

Investments in associates

An associate is an entity over which the Group is in a position to exercise significant influence, but not control or joint control, through participation in the financial and operating policy decisions of the investee.

The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting.

Investments in associates are carried in the consolidated balance sheet at cost as adjusted for goodwill and for post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of the associates in excess of the Group's interest in those associates are not recognized.

Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable assets, liabilities and contingent liabilities of the associate at the date of acquisition is recognized as goodwill. The goodwill is included in the carrying amount of the investment and is assessed for impairment as part of the investment. Any deficiency of the cost of acquisition below the Group's share of the fair values of the identifiable assets, liabilities and contingent liabilities of the associate at the date of acquisition (i.e. discount on acquisition) is credited in the consolidated income statement in the period of acquisition.

Where a Group company transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

Goodwill

Goodwill arising on the acquisition of a subsidiary or jointly controlled entity represents the excess of the cost of acquisition over the Group's interest in the fair value of assets, liabilities and contingent liabilities of a subsidiary as at the date of acquisition. Goodwill is initially recognized as an asset at cost and is subsequently measure at cost less any accumulated impairment losses.

The Group tests goodwill for impairment at least annually. An impairment loss recognized for goodwill is not reversed in a subsequent period.

If the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the Group:

- (a) Reassesses the identification and measurement of the Group's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and
- (b) Recognizes immediately in profit or loss any excess remaining after that reassessment.

On disposal of an investment, the amount of goodwill attributable is included in the determination of financial result from disposal.

Recognition and measurement of financial instruments

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

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

Cash and cash equivalents

Cash and cash equivalents include cash on hand, unrestricted balances on correspondent and time deposit accounts with the National Bank of the Republic of Azerbaijan with original maturity within 90 days, advances to banks in countries included in the Organization for Economic Cooperation and Development ("OECD"). For the purposes of determining cash flows, the minimum reserve deposit required by the National Bank of the Republic of Azerbaijan is not included as a cash equivalent due to restrictions on its availability (Note 11).

Fiduciary activities

The Group provides depositary services to its customers which include transactions with securities on their depositary accounts. Assets accepted and liabilities incurred under the fiduciary activities are not included in the Group's consolidated financial statements. The Group accepts operational risks relating to these activities, whereas the Group's customers bear the credit and market risks associated with such operations.

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

Due from banks

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

Loans to customers

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

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

The Group will take possession of any collateral held as security when a customer defaults on repayments of the loan and the loan cannot be renegotiated. The Group will engage a third party to dispose of the collateral on their behalf in the open market.

Factoring Assets

Factoring assets are non-derivative assets with determinable payments. These assets are initially recognised at fair value and any costs directly related to creation of qualifying financial assets.

Where the fair value of consideration given does not equal the fair value of the factoring asset the difference between the fair value of consideration given and the fair value of the asset is recognized as a loss on initial recognition of the asset and included in the consolidated income statement according to nature of these losses. Subsequently, factoring assets are carried at amortized cost using the effective interest method and are carried net of any allowance for impairment losses.

Write-off of loans and advances

Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the consolidated income statement in the period of recovery.

Allowance for impairment losses

Assets carried at amortised cost

The Group accounts for impairment losses of financial assets that are not carried at fair value when there is objective evidence that a financial asset or group of financial assets is impaired. The impairment losses are measured as the difference between carrying amounts and the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted at the financial asset's original effective interest rate.

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

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

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

Available-for-sale financial assets

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

The determination of impairment losses is based on an analysis of the risk assets and reflects the amount which, in the judgment of management, is adequate to provide for losses incurred. Provisions are made as a result of an individual appraisal of risk assets for financial assets that are individually significant, and an individual or collective assessment for financial assets that are not individually significant.

The change in impairment losses is charged to profit either through allowance account (financial assets that are carried at amortized cost) or direct write-off (financial assets carried at cost). The total of the impairment losses is deducted in arriving at assets as shown in the balance sheet. Factors that the Group considers in determining whether it has objective evidence that an impairment loss has been incurred include information about the debtors' or issuers' liquidity, solvency and business and financial risk exposures, levels of and trends in delinquencies for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees. These and other factors may, either individually or taken together, provide sufficient objective evidence that an impairment loss has been incurred in a financial asset or group of financial assets.

It should be understood that estimates of losses involve an exercise of judgment. While it is possible that in particular periods the Group may sustain losses which are substantial relative for impairment losses, it is the judgment of management that the impairment losses are adequate to absorb losses incurred on risk assets, at the balance sheet date.

Provisions

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

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

Investments available-for-sale

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

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

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

Property, equipment and intangible assets

Property, equipment and intangible assets are carried at historical cost (except for buildings, which are stated at revalued amounts) less accumulated depreciation and amortization and any recognized impairment loss. Depreciation on assets under construction and those not placed in service commences from the date the assets are ready for their intended use.

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

Building	5%
Furniture and equipment	25%
Computers	25%
Vehicles	25%
Other equipment	20%
Intangible assets	10%

The carrying amounts of property, equipment and intangible assets are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts, and where the carrying values exceed the estimated recoverable amounts, the assets are written down to their recoverable amounts.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

Impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation charge for property and equipment is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

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

Market value of property is assessed using three methods:

- The comparable sales method which involves analysis of market sales prices for similar real estate property;
- The income-based method which assumes a direct relationship between revenues generated by the property and its market value;
- The cost method which presumes the value of property to be equal to its recoverable amount less any depreciation charges.

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

Depreciation on revalued buildings is charged to the consolidated income statement. Upon the retirement or sale of buildings, the attributable revaluation surplus is transferred to retained earnings.

Taxation

Income tax expense comprises current and deferred taxation.

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

Deferred tax is reported using the balance sheet liability method and represents income tax assets and liabilities on the temporary difference between the carrying value of assets and liabilities and the respective tax accounting data used to arrive at the taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which the respective deferred tax assets can be utilized. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in transactions that affect neither the tax profit nor the accounting profit.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying value of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that a related tax benefit will be realized sufficient for full or partial recovery of the asset.

Deferred tax assets and liabilities are offset by the Group with the resulting difference reported in the financial statements if:

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

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

Due to banks and customer accounts

Due to banks and customer accounts are initially recognized at fair value. Subsequently amounts due are stated at amortized cost and any difference between carrying and redemption value is recognized in the consolidated income statement over the period of the borrowings using the effective interest method.

Contingencies

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

Financial guarantee contracts issued

Financial guarantee contracts issued by the Group are credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. Such financial guarantee contracts issued are initially recognized at fair value. Subsequently they are measured at

the higher of (a) the amount recognized as a provision and (b) the amount initially recognized less, where appropriate, cumulative amortization of initial premium revenue received over the financial guarantee contracts issued.

Share capital

Share capital is recognized at cost.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

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

Retirement and other benefit obligations

In accordance with the requirements of the legislation of the Republic of Azerbaijan, the Group withholds amounts of pension contributions from employee salaries and pays them to the state pension fund. Such expense is charged in the period the related salaries are earned. Upon retirement all retirement benefit payments are made by the state pension fund. The Group does not have any pension arrangements separate from the state pension system of Azerbaijan, which requires current contributions by employer calculated as a percentage of current gross salary payments. In addition, the Group has no post-retirement benefits or other significant compensated benefits requiring accrual.

Recognition of income and expense

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

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

Interests earned on assets at fair value are classified within interest income.

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

Foreign currency translation

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

Rates of exchange

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

	31 December 2007		31 December 2006
USD 1	=	AZN 0.8453	USD 1 = AZN 0.8714
EUR 1	=	AZN 1.2450	EUR 1 = AZN 1.1471
GBP 1	=	AZN 1.6876	GBP 1 = AZN 1.7113
RUR 1	=	AZN 0.0346	RUR 1 = AZN 0.0331

Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segments with a majority of revenue earned from sales to external customers and whose, revenue, results are ten per cent or more of all the segments are reported separately. No geographical segments of the Group have been reported separately within these consolidated financial statements as all operations are conducted within Azerbaijan.

Offset of financial assets and liabilities

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

Adoption of new and revised standards

In the current year, the Group has adopted all of the new and revised Standards and Interpretations issued by the "IASB" and the the "IFRIC" of the IASB that are relevant to its operations and effective for reporting periods beginning on 1 January 2007. The adoption of these new and revised Standards and Interpretations has not affected significantly the accounting policies of the Group that were used to report the results of the current and preceding periods, except for the application effect of IFRS 7 "Financial Instruments: Disclosures" ("IFRS 7").

IFRS 7 is effective for the annual reporting periods beginning on 1 January 2007. IFRS 7 establishes new requirements and recommendations on financial instruments disclosure. Adoption of IFRS 7 did not affect the classification and measurement of the Group's financial instruments for the purposes of these consolidated financial statements. These financial statements contain additional disclosures required by IFRS 7 for the reporting period and the corresponding period for comparison purposes.

Amendment to IAS 1 "Capital Disclosures" ("IAS 1") - On 18 August 2005, the IASB issued an amendment to IAS 1 which requires certain disclosures to be made regarding the entity's objectives, policies and processes for managing capital. Additional information was disclosed in the consolidated financials statements for the current and comparative reporting periods as required by amended IAS 1

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

Standards and interpretations issued and not yet adopted

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

IFRS 8 “Operating segments” (“IFRS 8”) – On 30 November 2006, the IASB issued IFRS 8 which requires segmental analysis reported by an entity to be based on information used by management. IFRS 8 is effective for periods beginning on or after 1 January 2009. The Group management is currently assessing the impact of the adoption of this new Standard in future period. The Group anticipates that the adoption of other newly issued Standards and Interpretations in future periods will have no material financial impact on the consolidated financial statements of the Group.

Amendment to IAS 1 “Presentation of Financial Statement” – On 6 September 2007, the IASB issued an amendment to IAS 1 introducing changes to the titles and presentation of the financial statements. The Group anticipates that the amendment to IAS 1 will influence presentation of financial statements. The amendment to IAS 1 is effective for periods beginning on or after 1 January 2009.

IFRS 3 “Business Combinations” – The IASB published IFRS 3 and related revisions to IAS 27 “Consolidated and Separate Financial Statements” following the completion in January 2008 of its project on the acquisition and disposal of subsidiaries. They are effective for accounting periods beginning on or after 1 July 2009 but may be adopted together for accounting periods beginning on or after 1 January 2007.

Areas of significant management judgment and sources of estimation uncertainty

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

Allowance for impairment of loans and receivables

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

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

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

The carrying amount of the allowance for impairment of loans to customers is AZN 6,940,597 and AZN 2,038,068 as at 31 December 2007 and 2006.

Valuation of Financial Instruments

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

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

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

The carrying amount of the financial instruments at fair value is as follows as at 31 December 2007 and 2006:

	31 December 2007	31 December 2006
Available-for-sale investments	1,633,115	42,627

Goodwill

Goodwill is the excess cost of an acquisition over the fair value of its net assets. The determination of fair value of assets and liabilities of businesses acquired requires the exercise of management judgment; for example those financial assets and liabilities for which there are no quoted prices and those non-financial assets where valuations reflect estimates of market conditions. Difference fair values would result in changes to the goodwill arising and to the post-acquisition performance of the acquisition. Goodwill is not amortized but is tested annually or more frequently for impairment if events or changes in circumstances indicated that it might be impaired.

For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units or groups of cash-generating units expected to benefit from the combination. Goodwill impairment testing involves the comparison of the carrying value of a cash-generating unit or group of cash generating units with its recoverable amount.

The recoverable amount is the higher of the unit's fair value and its value in use. Value in use is the present value of expected future cash flows from the cash-generating unit or group of cash-generating units. Fair value is the amount obtainable for the sale of the cash-generating unit in an arm's length transaction between knowledgeable, willing parties.

Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of cash-generating units; and the valuation of the separable assets of each business whose goodwill is being reviewed.

The carrying amount of goodwill is Nil as at 31 December 2007 and 2006, respectively.

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

4. NET INTEREST INCOME

	Year ended 31 December 2007	Year ended 31 December 2006
Interest income comprises:		
Interest income on assets recorded at amortized cost:		
- interest income on assets that has been written down as a result of an impairment loss	11,500,272	798,458
- interest income on unimpaired assets	5,804,040	3,594,254
Total interest income	17,304,312	4,392,712
Interest income on assets recorded at amortized cost comprises:		
Interest on loans to customers	16,540,196	3,979,306
Interest on due from banks	601,146	125,187
Interest on factoring	93,573	-
Interest on debt securities	68,095	284,220
Interest on other operations	1,302	3,999
Total interest income on financial assets recorded at amortized cost	17,304,312	4,392,712
Interest expense comprises:		
Interest on customer accounts	7,436,549	1,841,707
Interest on due to banks and government agencies	340,251	317,068
Total interest expense on financial assets recorded at amortized cost	7,776,800	2,158,775
Net interest income before provision for impairment losses on interest bearing assets	9,527,512	2,233,937

5. ALLOWANCE FOR IMPAIRMENT LOSSES, OTHER PROVISIONS

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

	Due from banks	Loans to customers	Factoring	Total
31 December 2005	1,690	69,479	-	71,169
(Recovery of provision)/provision	(1,690)	1,968,589	-	1,966,899
31 December 2006	-	2,038,068	-	2,038,068
Provision	-	4,902,529	64,571	4,967,100
31 December 2007	-	6,940,597	64,571	7,005,168

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

The movements in provision for impairment losses on guarantees and other commitments were as follows:

	Guarantees and other commitments
31 December 2005	-
Recovery of provision	-
31 December 2006	-
Provision	231,954
31 December 2007	231,954

6. NET (LOSS)/GAIN ON FOREIGN EXCHANGE OPERATIONS

Net (loss)/gain on foreign exchange operations comprise:

	Year ended 31 December 2007	Year ended 31 December 2006
Dealing differences, net	282,960	107,977
Translation differences, net	(341,451)	(38,370)
Total net (loss)/gain on foreign exchange operations	(58,491)	69,607

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

7. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended 31 December 2007	Year ended 31 December 2006
Fee and commission income:		
Cash operations	686,003	291,870
Foreign exchange operations	496,623	395,013
Settlements	368,552	211,989
Guarantee letters	184,600	58,235
Plastic cards operations	145,024	32,549
Letters of credit	27,175	746
Other	776	2,920
Total fee and commission income	1,908,753	993,322
Fee and commission expense:		
Plastic cards operations	115,462	28,556
Settlements	109,790	88,678
Cash operations	28,986	108,549
Documentary operations	9,727	-
Foreign exchange operations	3,786	7,139
Other	9,731	8,738
Total fee and commission expense	277,482	241,660

8. OPERATING EXPENSES

Operating expenses comprise:

	Year ended 31 December 2007	Year ended 31 December 2006
Staff costs	1,367,861	726,208
Depreciation and amortization	671,760	394,920
Advertising and marketing expenses	221,819	390,678
Communications	273,257	100,506
Payments to the Deposit Insurance Fund of the Republic of Azerbaijan	167,042	-
Professional service fees	135,350	64,489
Stationery expenses	106,624	65,027
Repairs and maintenance expenses	92,777	31,304
Transportation and business trip expenses	79,274	32,269
Security expenses	58,026	36,640
Taxes, other than income tax	55,317	28,835
Entertainment	45,028	13,405
Membership fees	29,184	5,616
Utilities	20,784	13,442
Insurance	12,753	25,996
Operating leases	7,274	-
Other expenses	101,631	41,763
Total operating expenses	3,445,761	1,971,098

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

9. INCOME TAXES

The Group provides for taxes based on the tax accounts maintained and prepared in accordance with the tax regulations of countries where the Group and its subsidiaries operate and which may differ from International Financial Reporting Standards.

The Group is subject to certain permanent tax differences due to non-tax deductibility of certain expenses and a tax free regime for certain income. The statutory income tax rate is 22%.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

Temporary differences as at 31 December 2007 and 2006 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Temporary differences as at 31 December 2007 and 2006 comprise:

	31 December 2007	31 December 2006
Deductible temporary differences:		
Carry forward of unused tax losses	-	819,784
Depreciation	790,227	-
Loans origination fee	61,121	23,988
Accrued interest on deposits	4,744	-
Amortization	-	5,325
Total deductible temporary differences	856,092	849,097
Taxable temporary differences:		
Provision reversal on off balance items	(580,096)	(125,816)
Provision reversal for loans to banks	(112,817)	(72,284)
Amortization	(482)	-
Depreciation	-	(26,323)
Total taxable temporary differences	(693,395)	(224,423)
Net deferred deductible temporary differences	162,697	624,674
Net deferred tax asset at the statutory tax rate (22%)	35,793	137,428
Less: deferred tax assets not recognized	-	(137,428)
Net deferred tax asset	35,793	-

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

Relationships between tax expenses and accounting profit for the years ended 31 December 2007 and 2006 are explained as follows:

	Year ended 31 December 2007	Year ended 31 December 2006
Profit/(loss) before income tax	<u>2,478,153</u>	<u>(871,295)</u>
Tax at the statutory tax rate	545,194	(91,816)
Tax effect of permanent differences	(234,710)	283,501
Losses not recognised	<u>(137,428)</u>	<u>(91,816)</u>
Income tax expense	<u>173,056</u>	<u>-</u>
Current income tax expense	208,849	-
Provision for deferred income tax assets	<u>(35,793)</u>	<u>-</u>
Income tax expense	<u>173,056</u>	<u>-</u>
Deferred income tax assets	31 December 2007	31 December 2006
Beginning of the period	-	-
Change in the income tax assets for the period charged to profit	<u>35,793</u>	<u>-</u>
End of the period	<u>35,793</u>	<u>-</u>

10. EARNINGS PER SHARE

The earnings per share are calculated as follows:

	Year ended 31 December 2007	Year ended 31 December 2006
Profit/(loss):		
Net profit/(loss) for the year	<u>2,305,097</u>	<u>(871,295)</u>
Weighted average number of ordinary shares for basic earnings per share	<u>1,855,129</u>	<u>400,000</u>
Earnings/(loss) per share – basic and diluted (AZN)	<u>1.243</u>	<u>(2.600)</u>

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

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

Cash and balances with the National Bank of the Republic of Azerbaijan comprise:

	31 December 2007	31 December 2006
Balances with the National Bank of the Republic of Azerbaijan	18,487,921	4,211,162
Cash on hand	3,608,077	6,324,513
Total cash and balances with the National Bank of the Republic of Azerbaijan	22,095,998	10,535,675

The balances with the NBA as at 31 December 2007 and 2006 include AZN 13,532,054 and AZN 6,137,185, respectively, which represent the minimum reserve deposits required by the NBA. The Bank is entitled to use all funds on its correspondent account provided that average daily balance for 15 days period will be eventually higher than required mandatory reserve.

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

	31 December 2007	31 December 2006
Cash and balances with the National Bank of the Republic of Azerbaijan	22,095,998	10,535,675
Due from banks in OECD countries	7,064,855	1,574,544
	29,160,853	12,110,219
Less minimum reserve deposit with the National Bank of the Republic of Azerbaijan	(13,532,054)	(6,137,185)
Less restricted deposit in OECD countries	-	-
Total cash and cash equivalents	15,628,799	5,973,034

12. DUE FROM BANKS

Due from banks comprise:

	31 December 2007	31 December 2006
Correspondent accounts with other banks	7,230,219	1,677,810
Loans and time deposits with other banks	5,667,219	3,619,283
Restricted deposits	35,503	36,599
Total due from banks	12,932,941	5,333,692

Movements in allowance for impairment losses for the years ended 31 December 2007 and 2006 are disclosed in Note 5.

As at 31 December 2007 and 2006 accrued interest income included in due from banks amounted to AZN 26,360 and AZN 5,083, respectively.

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

As at 31 December 2007 and 2006 the maximum credit risk exposure of due from banks amounted to AZN 12,932,941 and AZN 5,333,692, respectively.

As at 31 December 2007 and 2006 the Bank had restricted deposits under operations with plastic cards and money transfers totaling AZN 35,503 and AZN 36,599, respectively.

As at 31 December 2006 the Bank had a loan to OJSC Azerdemiryolbank of totaling AZN 3,614,200, which individually exceeded 10% of the Bank's equity.

13. LOANS TO CUSTOMERS

Loans to customers comprise:

	31 December 2007	31 December 2006
Loans to customers	160,331,635	58,150,567
Less allowance for impairment losses	(6,940,597)	(2,038,068)
Total loans to customers	153,391,038	56,112,499

As at 31 December 2007 and 2006 accrued interest income included in loans to customers amounted to AZN 4,223,744 and AZN 360,963, respectively.

Movements in allowances for impairment losses for the years ended 31 December 2007 and 2006 are disclosed in Note 5.

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

	31 December 2007	31 December 2006
Loans collateralized by cash	39,738,439	22,216,671
Loans collateralized by real estate	18,061,910	8,038,997
Loans collateralized by equipment	10,326,138	1,167,190
Loans collateralized by vehicles	3,871,447	2,479,468
Loans collateralized by tractors	1,392,535	1,481,209
Loans collateralized by guarantees	223,557	-
Loans collateralized by shares of other entities	100,571	926,070
Loans collateralized by inventories	82,552	201,000
Loans collateralized by other collateral	18,284,696	160,000
Unsecured loans	68,249,790	21,479,962
	160,331,635	58,150,567
Less allowance for impairment losses	(6,940,597)	(2,038,068)
Total loans to customers	153,391,038	56,112,499

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	31 December 2007	31 December 2006
Analysis by industry		
Transportation and communication	71,435,174	22,808,217
Trading	48,699,264	14,708,840
Individuals	11,673,895	5,577,369
Energy	11,656,206	196,160
Manufacturing	7,482,722	7,931,906
Construction	3,970,921	5,426,300
Agriculture	789,163	282,006
Other	4,624,290	1,219,769
	<u>160,331,635</u>	<u>58,150,567</u>
Less allowance for impairment losses	<u>(6,940,597)</u>	<u>(2,038,068)</u>
Total loans to customers	<u>153,391,038</u>	<u>56,112,499</u>

Loans to individuals comprise the following products:

	31 December 2007	31 December 2006
Mortgage loans	4,460,038	223,105
Car loans	2,559,575	1,388,836
Consumer loans	2,364,038	1,659,758
Business loans	2,180,784	2,247,843
Plastic cards	109,460	57,827
	<u>11,673,895</u>	<u>5,577,369</u>
Less allowance for impairment losses	<u>(302,394)</u>	<u>(214,358)</u>
Total loans to individuals	<u>11,371,501</u>	<u>5,363,011</u>

As at 31 December 2007 and 2006 the Bank granted 7 and 12 loans totaling AZN 99,198,000 and AZN 44,322,655, respectively, which individually exceeded 10% of the Group's equity.

As at 31 December 2007 and 2006 the maximum credit risk exposure of loans to customers amounted to AZN 153,391,038 and AZN 56,112,499, respectively.

As at 31 December 2007 and 2006 loans to customers included loans in amount of AZN 36,696,647 and AZN 7,318,495, respectively, whose terms have been renegotiated. Otherwise these loans would be past due or impaired.

As at 31 December 2007 and 2006 loans to customers included loans in amount of AZN 120,311,966 and AZN 13,056,069, respectively, that were individually determined to be impaired. As at 31 December 2007 and 2006 such loans were collateralized by real estate and equipment with a fair value of AZN 62,868,058 and AZN 2,873,087, respectively.

As at 31 December 2007 and 2006 61% and 62% of total amount of loans to customers are given to 3 and 5 entities, respectively.

A significant amount of loans (100% of loans to customers) is granted to companies operating in the Republic of Azerbaijan, which represents significant geographical concentration in one region.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

14. FACTORING

Factoring comprise:

	31 December 2007	31 December 2006
Factoring operations with the customers	3,424,912	-
Less allowance for impairment losses	(64,571)	-
Total factoring	3,360,341	-

As at 31 December 2007 and 2006 accrued interest income included in factoring amounted to AZN 196,351 and AZN nil, respectively. Movements in allowances for impairment losses for the years ended 31 December 2007 and 2006 are disclosed in Note 5.

As at 31 December 2007 and 2006 the maximum credit risk exposure of factoring amounted to AZN 3,360,341 and nil, respectively. As at 31 December 2007 and 2006 factoring included amount of AZN 3,424,912 and AZN Nil, respectively, that was individually determined to be impaired. As at 31 December 2007 this amount was unsecured.

As at 31 December 2007 100% of factoring amount is given to 1 entity. As at 31 December 2007, 100% of the factoring amount relates to company operating in the Republic of Azerbaijan, which represents significant geographical concentration in one region.

15. INVESTMENTS AVAILABLE-FOR-SALE

Investments available-for-sale comprise:

	Share %	31 December 2007	Share %	31 December 2006
Equity securities				
“Baki-Ayaqqabi 2” OJSC	97.27	1,590,264	-	-
Millikart LLC	1	40,000	1	40,000
SWIFT SCRL	-	2,851	-	2,627
Total equity securities		1,633,115		42,627

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

16. INVESTMENTS IN ASSOCIATES

The following enterprises were recorded in the consolidated financial statements using the cost method:

	31 December 2007		31 December 2006	
	Ownership interest	Carrying value	Ownership interest	Carrying value
Kapital Bank OJSC	20	<u>5,100,000</u>	-	<u>-</u>
Total investments in associates		<u>5,100,000</u>		<u>-</u>

Key financial indicators of the associates as at 31 December 2007 and for the years then ended are presented as follows:

Name of associate	Fair value of investments in associate	Total assets of associate	Total liabilities of associate	Profit before tax of associate	Net profit/(loss)
Kapital Bank OJSC	5,100,000	300,196,096	229,719,133	3,198,456	2,482,231

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17. PROPERTY AND EQUIPMENT

Property and equipment comprise:

	Land	Building	Furniture and equipment	Computers	Vehicles	Other equipment	Construction in progress	Total
At cost								
31 December 2005	-	961,345	396,086	225,655	405,032	28,464	60,000	2,076,582
Additions	-	252,336	580,300	143,410	246,171	6,956	120,570	1,349,743
Disposals	-	-	(11,802)	(1,149)	-	(4,035)	-	(16,986)
Transfers	-	60,000	(3,992)	1,708	1,145	1,139	(60,000)	-
31 December 2006	-	1,273,681	960,592	369,624	652,348	32,524	120,570	3,409,339
Additions	-	478,973	689,212	207,247	400,008	36,891	1,539,795	3,352,126
Disposals	-	-	-	(431)	(46,853)	-	-	(47,284)
Transfers	20,044	396,868	138,525	(2,042)	-	(357)	(553,038)	-
31 December 2007	20,044	2,149,522	1,788,329	574,398	1,005,503	69,058	1,107,327	6,714,181
Accumulated depreciatio								
31 December 2005	-	(74,772)	(46,923)	(35,429)	(82,748)	(3,693)	-	(243,565)
Charge for the year	-	(57,090)	(122,448)	(68,386)	(104,774)	(5,652)	-	(358,350)
Disposals	-	-	-	-	-	145	-	145
Transfers	-	-	505	(94)	(411)	-	-	-
31 December 2006	-	(131,862)	(168,866)	(103,909)	(187,933)	(9,200)	-	(601,770)
Charge for the year	-	(71,714)	(241,416)	(116,033)	(199,677)	(10,001)	-	(638,841)
Disposals	-	-	-	-	24,353	-	-	24,353
Transfers	-	-	(1,170)	1,170	-	-	-	-
31 December 2007	-	(203,576)	(411,452)	(218,772)	(363,257)	(19,201)	-	(1,216,258)
Net book								
31 December 2007	20,044	1,945,946	1,376,877	355,626	642,246	49,857	1,107,327	5,497,923
31 December 2006	-	1,141,819	791,726	265,715	464,415	23,324	120,570	2,807,569

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As at 31 December 2006 the loan from the National Bank of the Republic of Azerbaijan was secured by the pledge of the Bank's building in the amount of AZN 800,000, by other real estates belonging to the director of Bank's Supervisory Board (valued in the amount of AZN 1,250,000) and by real estate belonging to one of the Bank's customers and pledged to the Bank as collateral for a loan issued to this customer (valued in the amount of AZN 400,000).

18. INTANGIBLE ASSETS

Intangible assets comprise:

	Year ended 31 December 2007	Year ended 31 December 2006
At cost		
1 January	302,306	298,943
Additions	94,195	87,928
Disposals	-	(84,565)
31 December	396,501	302,306
Accumulated amortization		
1 January	(33,499)	(4,924)
Charge for the year	(32,919)	(36,570)
Disposals	-	7,995
31 December	(66,418)	(33,499)
Net book value		
31 December	330,083	268,807

Intangible assets include software and trailer.

19. OTHER ASSETS

Other assets comprise:

	31 December 2007	31 December 2006
Deferred expenses	452,275	5,320
Prepayments for purchases of intangible assets	216,159	42,145
Prepayments for purchase of property and equipment	174,849	196,437
Accrued interests on letters of credit	127,826	-
Settlements on money transfers	4,784	8,440
Prepayments and receivables on other transactions	59,997	16,300
Total other assets	1,035,890	268,642

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

20. DUE TO BANKS AND GOVERNMENT AGENCIES

Due to banks and government agencies comprise:

	31 December 2007	31 December 2006
Correspondent accounts of other banks	6,773,447	541,735
Amount due to Azerbaijan Mortgage Fund	2,968,651	15,390
Loans from banks	1,784,480	-
Loans from the NBA	-	2,500,000
Total due to banks and government agencies	11,526,578	3,057,125

As at 31 December 2007 and 2006 accrued interest expense included in due to banks and government agencies amounted to AZN 111,161 and nil, respectively.

As at 31 December 2006 the loan from the National Bank of the republic of Azerbaijan was secured by the pledge of the Bank's building in the amount of AZN 800,000 (note 17), by other real estates belonging to the director of Bank's Supervisory Board (valued in the amount of AZN 1,250,000) and by real estate belonging to one of the Bank's customers and pledged to the Bank as collateral for a loan issued to this customer (valued in the amount of AZN 400,000).

21. CUSTOMER ACCOUNTS

Customer accounts comprise:

	31 December 2007	31 December 2006
Time deposits	86,677,365	41,510,912
Repayable on demand	51,197,050	21,873,187
Total customer accounts	137,874,415	63,384,099

As at 31 December 2007 and 2006 accrued interest expense included in customer accounts amounted to AZN 554,136 and AZN 261,726, respectively.

As at 31 December 2007 and 2006 customer accounts amounting to AZN 55,234,054 and AZN 42,703,484 were due to 7 and 8 customers representing a significant concentration, being approximately 40% and 67%, respectively.

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	31 December 2007	31 December 2006
Individuals	79,924,095	49,234,445
Transport and communication	23,057,093	369,319
Trade	12,684,173	385,677
Insurance	11,738,042	2,345,804
Construction	9,096,589	902,249
Energy	1,173,129	96,317
Manufacturing	198,970	9,953,057
Other	2,324	97,231
Total customer accounts	137,874,415	63,384,099

22. OTHER LIABILITIES

Other liabilities comprise:

	31 December 2007	31 December 2006
Settlements on money transfers and plastic cards	444,643	5,302
Deferred revenue	102,778	-
Payables to the Deposit Insurance Fund	97,393	-
Professional fees payable	73,160	20,448
Accrued expenses	33,416	19,772
Taxes other than income tax	35,598	11,025
Payables to the State Social Protection Fund	34,541	-
Payables to the employees	19,449	-
Other	10,404	6,894
Total other liabilities	851,382	63,441

23. SHARE CAPITAL

As of 31 December 2007 and 2006 the Group's shareholders' authorized, issued and fully paid capital amounted to AZN 53,550,000 and AZN 10,000,000, respectively and comprised 2,142,000 and 400,000 ordinary shares with a par value of AZN 25, respectively. Each share entitles one vote to the shareholder.

During 2007 and 2006 shareholders' capital of the Group was increased by AZN 43,550,000 and AZN 3,750,000, respectively.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

24. FINANCIAL COMMITMENTS AND CONTINGENCIES

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

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

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

Provision for losses on contingent liabilities amounted to AZN 231,954 and nil as at 31 December 2007 and 2006, respectively.

As at 31 December 2007 and 2006, the nominal or contract amounts and the risk amounts were:

	31 December 2007		31 December 2006	
	Nominal Amount	Risk Weighted Amount	Nominal Amount	Risk Weighted Amount
Contingent liabilities and credit commitments				
Guarantees issued and similar commitments	13,766,047	13,766,047	8,163,995	8,163,995
Letters of credit and other transaction related contingent obligations	11,700,770	5,850,385	-	-
Commitments on credits and unused credit lines	<u>6,101,389</u>	<u>2,773,391</u>	<u>2,144,367</u>	<u>270,251</u>
Total contingent liabilities and credit commitments	<u>31,568,206</u>	<u>22,389,823</u>	<u>10,308,362</u>	<u>8,434,246</u>

Capital commitments – The Group had no material commitments for capital expenditures outstanding as at 31 December 2007.

Legal proceedings - From time to time and in the normal course of business, claims against the Group are received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these consolidated financial statements.

The Group is receiving claims from individual customers with respect to certain commissions withheld by the Group for loan agreements service. Management is of the opinion that such claims would not have adverse consequences for the Group, and is in the process of establishing procedures on disclosing additional information in loan agreements in compliance with the NBA instruction.

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Taxes - Azerbaijan commercial legislation and tax legislation in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result the Group may be assessed additional taxes, penalties and interest. Tax years remain open to review by the tax authorities for three years. Management believes that the Group has already made all tax payments that are due, and therefore no provisions have been made in these consolidated financial statements for any potential liabilities.

Pensions and retirement plans - Employees receive pension benefits from the Republic of Azerbaijan in accordance with the laws and regulations of the country. As at 31 December 2007 the Group was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

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

25. SUBSEQUENT EVENTS

The Group has opened 2 branches in April and May 2008 and 2 service points in February 2008. These branches and services points are regulated by the permission of the National Bank of the Republic of Azerbaijan.

26. TRANSACTIONS WITH RELATED PARTIES

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

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

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In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Group had the following transactions outstanding as at 31 December 2007 and 2006 with related parties:

	31 December 2007		31 December 2006	
	Related party balances	Total category as per financial statements caption	Related party balances	Total category as per financial statements caption
Loans to customers		160,331,635		58,150,567
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	2,100,000		899,885	
- <i>key management personnel of the entity</i>	75,312		367,292	
Allowance for impairment losses		(6,940,597)		(2,038,068)
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	(126,000)		(18,000)	
- <i>key management personnel of the entity</i>	(4,818)		(11,347)	
Investments in associates		5,100,000		-
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	5,100,000		-	
Customer accounts		137,874,415		63,384,099
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	11,135,623		2,151,379	
- <i>key management personnel of the entity</i>	3,965,082		22,808	
Guarantees issued		13,766,047		8,163,995
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	445,271		-	
Unused loan commitments		11,700,770		2,144,367
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	26,858		10,917	

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

	Year ended 31 December 2007		Year ended 31 December 2006	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Key management personnel compensation:				
short-term employee benefits	244,342	1,367,861	221,357	726,208

Included in the consolidated income statement for the years ended 31 December 2007 and 2006 are the following amounts which arose due to transactions with related parties:

	Year ended 31 December 2007		Year ended 31 December 2006	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Interest income		17,304,312		4,392,712
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	237,667		95,090	
- <i>key management personnel of the entity</i>	9,797		4,940	
Interest expense		(7,776,800)		(2,158,775)
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	(939,635)		(114,226)	
- <i>key management personnel of the entity</i>	(336,619)		(108)	
Provision for impairment losses		(4,902,529)		(1,966,899)
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	(108,000)		(18,000)	
- <i>key management personnel of the entity</i>	6,529		(11,020)	
Fee and commission income		1,908,753		993,322
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	66,733		43,056	
- <i>key management personnel of the entity</i>	206		72	
Other income		22,676		11,496
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	12,000		7,995	
Operating expense		(3,445,761)		(1,971,098)
- <i>key management personnel of the entity</i>	(244,342)		(221,357)	

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

27. SEGMENT REPORTING

The Group's activity is sufficiently integrated and primarily relates to the banking sector. Accordingly, for purposes of IAS 14 "Segment reporting" the Group is accounted for as a single segment. The Group's assets are located in the Republic of Azerbaijan and major parts of its revenue and net profit arrives from operations in the Republic of Azerbaijan. The Group's operations include transactions with banks, legal entities and individuals. Data on other transaction balances and their results are provided in the respective notes to the consolidated financial statements.

28. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments are made in accordance with the requirements of IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement". Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. The estimates presented herein are not necessarily indicative of the amounts the Group could realize in a market exchange from the sale of its full holdings of a particular instrument.

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

	31 December 2007		31 December 2006	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and balances with the National Bank of the Republic of Azerbaijan	22,095,998	22,095,998	10,535,675	10,535,675
Due from banks	12,932,941	12,932,941	5,333,692	5,333,692
Investments in associates	5,100,000	5,100,000	-	-
Due to banks and government agencies	11,526,578	11,526,578	3,057,125	3,057,125
Customer accounts	137,874,415	137,874,415	63,384,099	63,384,099

The fair value of loans to customers cannot be measured reliably as it is not practicable to obtain market information or apply any other valuation techniques on such instruments.

The fair value of equity securities included in investments available-for-sale cannot be measured reliably. As at 31 December 2007 and 2006 the cost of them was 1,633,115 and AZN 42,627, respectively. Since these shares are not publicly traded and the range of reasonable fair value estimates is significant, it is not possible to estimate their fair value.

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29. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Group to maintain minimum amounts and ratios (as set forth in the table below) of total (8%) and tier 1 capital (4%) to risk weighted assets.

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

As at 31 December 2007 the Group's total capital amount for Capital Adequacy purposes was AZN 54,719,943 and tier 1 capital amount was AZN 54,719,943 with ratios of 35% and 35%, respectively.

As at 31 December 2006 the Group's total capital amount for Capital Adequacy purposes was AZN 8,864,846 and tier 1 capital amount was AZN 8,864,846 with ratios of 19% and 19%, respectively.

In addition, the Group has to maintain a statutory capital adequacy ratio based on the National Bank of Azerbaijan requirements. During the years ended 31 December 2007 and 2006 the Group was in compliance with the minimum capital requirements imposed by the NBA.

30. CAPITAL MANAGEMENT

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

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

The Group's overall capital risk management policy remains unchanged from 2006.

31. RISK MANAGEMENT POLICIES

Management of risk is fundamental to the banking business and is an essential element of the Group's operations. The main risks inherent to the Group's operations are those related to credit exposures, liquidity and market movements in interest rates and foreign exchange rates. A description of the Group's risk management policies in relation to those risks follows.

The Group manages the following risks:

Credit risk

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

Risk management and monitoring is performed within set limits of authority, by the Credit Committees and the Group's Management Board. Before any application is made by the Credit Committee, all recommendations on credit processes (borrower's limits approved, or amendments made to loan agreements, etc.) are reviewed and approved by the experts of Credit Department. Daily risk management is performed by the Head of Credit Departments and Branch.

Credit Divisions.

The Group structures the level 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 industry (and geographical) segments. Limits on the level of credit risk by a borrower and a product (by industry sector, by region) are approved monthly (quarterly) by the Management Board. The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures which are set by the Credit Committee. Actual exposures against limits are monitored daily.

Where appropriate, and in the case of most loans, the Group obtains collateral and corporate and personal guarantees but a significant portion is personal lending, where no such facilities can be obtained. Such risks are monitored on a continuous basis and subject to annual or more frequent reviews.

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

Maximum Exposure

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

The following table presents the maximum exposure to credit risk of financial assets and contingent liabilities. For financial assets the maximum exposure equals to a carrying value of those assets prior to any offset or collateral. For financial guarantees and other contingent liabilities the maximum exposure to credit risk is the maximum amount the Group would have to pay if the guarantee was called on or in the case of commitments, if the loan amount was called on.

31 December 2007

	Maximum exposure	Net exposure after offset	Collateral Pledged	Net exposure after offset and collateral
Due from banks	12,932,941	12,932,941	-	12,932,941
Loans to customers	153,391,038	153,391,038	85,141,248	68,249,790
Factoring	3,360,341	3,360,341	-	3,360,341
Investments available-for-sale	1,633,115	1,633,115	-	1,633,115
Investments in associates	5,100,000	5,100,000	-	5,100,000

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				31 December 2006
	Maximum exposure	Net exposure after offset	Collateral Pledged	Net exposure after offset and collateral
Due from banks	5,333,692	5,333,692	-	5,333,692
Loans to customers	56,112,499	56,112,499	35,897,440	20,215,059
Investments available-for-sale	42,627	42,627	-	42,627

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

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

							31 December 2007
	AAA	AA	A	BBB	<BBB	Not rated	Total
Due from banks	-	7,064,855	-	-	5,447,783	420,303	12,932,941
Loans to customers	-	-	-	-	-	153,391,038	153,391,038
Factoring	-	-	-	-	-	3,360,341	3,360,341
Investments available-for-sale	-	-	-	-	-	1,633,115	1,633,115
Investments in associates	-	-	-	-	5,100,000	-	5,100,000

							31 December 2006
	AAA	AA	A	BBB	<BBB	Not Rated	Total
Due from banks	-	1,555,373	-	-	3,758,652	19,667	5,333,692
Loans to customers	-	-	-	-	-	56,112,499	56,112,499
Investments available-for-sale	-	-	-	-	-	42,627	42,627

The banking industry is generally exposed to credit risk through its financial assets and contingent liabilities. Credit risk exposure of the Group is concentrated within the Republic of Azerbaijan. The exposure is monitored on a regular basis to ensure that the credit limits and credit worthiness guidelines established by the Group's risk management policy are not breached.

The Group enters into numerous transactions where the counterparties are not rated by international rating agencies.

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Rating model

The Group has developed internal rating model, which allow it to determine the rating of counterparties. The rating of corporate borrower is based on an analysis of the financial ratios of the borrower, and an analysis of the market and industry sector, in which the borrower operates. The model also takes into consideration various qualitative factors, such as management efficiency and borrower's market share.

The application of the internal rating model results in a standardized approach in the analysis of corporate borrowers and provides a quantitative assessment of the creditworthiness of a borrower that does not have a rating from an international rating agency. The model takes into account specific local market conditions.

The quality of the internal rating model is examined on a regular basis through an assessment of both its effectiveness and validity. The Group revises the model when deficiencies are identified.

The Group applies internal rating methodologies to specific corporate loans and groups of retail and small business loans, which incorporate various underlying master scales that are different from that used by international rating agencies. As a result, it is not possible to make a cross-product score comparison which would agree to the outstanding balance of loans to customers per the balance sheet. As such, more detailed information is not being presented.

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

	Financial assets past due but not impaired					31 December 2007	
	Neither past due nor impaired	0-3 months	3-6 months	6 months to 1 year	Greater than one year	Financial assets that have been impaired	Total
Due from banks	12,932,941	-	-	-	-	-	12,932,941
Loans to customers	10,779,202	-	-	-	-	142,611,836	153,391,038
Factoring	-	-	-	-	-	3,360,341	3,360,341
Investments available-for-sale	1,633,115	-	-	-	-	-	1,633,115
Investments in associates	5,100,000	-	-	-	-	-	5,100,000

	Financial assets past due but not impaired					31 December 2006	
	Neither past due nor impaired	0-3 months	3-6 months	6 months to 1 year	Greater than one year	Financial assets that have been impaired	Total
Due from banks	5,333,692	-	-	-	-	-	5,333,692
Loans to customers	39,820,117	-	-	-	-	16,292,382	56,112,499
Investments available-for-sale	42,627	-	-	-	-	-	42,627

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Geographical concentration

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

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

	The Republic of Azerbaijan	CIS countries	OECD countries	31 December 2007 Total
ASSETS				
Cash and balances with the National Bank of the Republic of Azerbaijan	22,095,998	-	-	22,095,998
Due from banks	5,808,322	59,764	7,064,855	12,932,941
Loans to customers	153,391,038	-	-	153,391,038
Factoring	3,360,341	-	-	3,360,341
Investments available-for-sale	1,630,264	-	2,851	1,633,115
Investments in associates	5,100,000	-	-	5,100,000
Property and equipment	5,497,923	-	-	5,497,923
Intangible assets	330,083	-	-	330,083
Deferred income tax assets	35,793	-	-	35,793
Other assets	1,018,234	15,378	2,277	1,035,889
TOTAL ASSETS	198,267,996	75,142	7,069,983	205,413,121
LIABILITIES				
Due to banks and government agencies	11,522,433	-	4,145	11,526,578
Customer accounts	137,874,415	-	-	137,874,415
Provision for impairment losses on other	231,954	-	-	231,954
Current income tax liabilities	208,849	-	-	208,849
Other liabilities	692,289	269	158,824	851,382
TOTAL LIABILITIES	150,529,940	269	162,969	150,693,178
NET POSITION	47,738,056	74,873	6,907,014	

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

	The Republic of Azerbaijan	CIS countries	OECD countries	Non-OECD countries	31 December 2006 Total
ASSETS					
Cash and balances with the National Bank of the Republic of Azerbaijan	10,535,675	-	-	-	10,535,675
Due from banks	3,662,068	97,080	1,574,544	-	5,333,692
Loans to customers	56,112,499	-	-	-	56,112,499
Investments available-for-sale	40,000	-	2,627	-	42,627
Property and equipment	2,807,569	-	-	-	2,807,569
Intangible assets	268,807	-	-	-	268,807
Other assets	243,940	8,541	16,161	-	268,642
TOTAL ASSETS	73,670,558	105,621	1,593,332	-	75,369,511
LIABILITIES					
Due to banks and government agencies	3,057,125	-	-	-	3,057,125
Customer accounts	63,384,099	-	-	-	63,384,099
Other liabilities	56,866	-	1,273	5,302	63,441
TOTAL LIABILITIES	66,498,090	-	1,273	5,302	66,504,665
NET POSITION	7,172,468	105,621	1,592,059	(5,302)	

Liquidity risk

Liquidity risk refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due. In order to manage liquidity risk, the Group performs daily monitoring of expected future cash flows on clients' and banking operations, which is a part of the assets/liabilities management process. The Assets and Liabilities Management Committee sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

An analysis of the liquidity and interest rate risks is presented in the following table. The tables have been drawn up to detail:

(i) The remaining contractual maturity of non-derivative financial liabilities based on the undiscounted cash flows of financial liabilities (both interest and principal cash flows) based on the earliest date on which the Group can be required to pay, and

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(ii) The expected maturity for non-derivative financial assets based on the undiscounted contractual maturities of the financial assets including interest that will be earned on those assets except where the Group anticipates that the cash flow will occur in a different period.

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2007 Total
ASSETS								
Due from banks	12.00%	6,069,562	2,958,164	2,808,087	-	-	-	11,835,813
Loans to customers	18.76%	38,285,300	33,976,876	53,139,624	45,952,876	5,940,272	(6,620,382)	170,674,566
Factoring	5.73%	1,262,155	2,193,258	-	-	-	(64,571)	3,390,842
Total interest bearing assets at fixed rates		45,617,017	39,128,298	55,947,711	45,952,876	5,940,272	(6,684,953)	185,901,221
Total interest bearing assets		45,617,017	39,128,298	55,947,711	45,952,876	5,940,272	(6,684,953)	185,901,221
Cash and balances with the National Bank of the Republic of Azerbaijan		8,563,944	-	-	-	-	13,532,054	22,095,998
Due from banks		-	1,439,913	-	-	-	35,503	1,475,416
Loans to customers		1,280,859	-	-	-	-	(320,215)	960,644
Investments available-for-sale		-	-	-	-	-	1,633,115	1,633,115
Investments in associates		-	-	-	-	-	5,100,000	5,100,000
Other assets		9,467	55,313	-	-	-	-	64,780
		55,471,287	40,623,524	55,947,711	45,952,876	5,940,272	13,295,054	217,231,174
LIABILITIES								
Due to banks and government agencies	2-5%	1,799,270	29,580	133,110	709,920	2,767,663	-	5,439,543
Customer accounts	11.38%	1,603,494	27,962,002	30,650,995	35,879,011	-	-	96,095,502
Total interest bearing liabilities at fixed rates		3,402,764	27,991,582	30,784,105	36,588,931	2,767,663	-	101,535,045
Total interest bearing liabilities		3,402,764	27,991,582	30,784,105	36,588,931	2,767,663	-	101,535,045
Due to banks and government agencies		6,773,447	-	-	-	-	-	6,773,447
Customer accounts		51,197,050	-	-	-	-	-	51,197,050
Current income tax liabilities		-	208,849	-	-	-	-	208,849
Other liabilities		518,071	75,152	121,965	-	-	-	715,188

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	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2007 Total
Guarantees issued and similar commitments		15,224	7,933,692	2,681,231	3,135,900	-	-	13,766,047
Letters of credit and other transaction related contingent obligations		103,086	-	7,109,459	4,488,225	-	-	11,700,770
Commitments on credits and unused credit lines		554,607	-	-	5,546,782	-	-	6,101,389
		62,564,249	36,209,275	40,696,760	49,759,838	2,767,663	-	191,997,785
Liquidity gap		(7,092,962)	4,414,249	15,250,951	(3,806,962)	3,172,609		
Interest sensitivity gap for fixed rate instruments		42,214,253	11,136,716	25,163,606	9,363,945	3,172,609		
Interest sensitivity gap		42,214,253	11,136,716	25,163,606	9,363,945	3,172,609		
Cumulative interest sensitivity gap		42,214,253	53,350,969	78,514,575	87,878,520	91,051,129		

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	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2006 Total
ASSETS								
Due from banks	14.00%	2,483,092	60,998	274,491	2,619,283	-	-	5,437,864
Loans to customers	16.21%	11,562,747	12,363,316	21,285,439	19,783,503	224,819	(2,038,068)	63,181,756
Total interest bearing assets at fixed rates		14,045,839	12,424,314	21,559,930	22,402,786	224,819	(2,038,068)	68,619,620
Total interest bearing assets		14,045,839	12,424,314	21,559,930	22,402,786	224,819	(2,038,068)	68,619,620
Cash and balances with the National Bank of the Republic of Azerbaijan		4,398,490	-	-	-	-	6,137,185	10,535,675
Due from banks		229,106	-	-	-	-	36,599	265,705
Investments available-for-sale		-	-	-	-	-	42,627	42,627
Other assets		24,740	-	-	-	-	-	24,740
		18,698,175	12,424,314	21,559,930	22,402,786	224,819	4,178,343	79,488,367
LIABILITIES								
Due to banks and government agencies	2%-9.5%	559,030	1,037,065	1,519,212	1,231	18,063	-	3,134,601
Customer accounts	11.16%	665,193	1,206,543	27,623,976	17,628,335	-	-	47,124,047
Total interest bearing liabilities at fixed rates		1,224,223	2,243,608	29,143,188	17,629,566	18,063	-	50,258,648
Total interest bearing liabilities		1,224,223	2,243,608	29,143,188	17,629,566	18,063	-	50,258,648
Due to banks and government agencies		1,872	-	-	-	-	-	1,872
Customer accounts		21,873,187	-	-	-	-	-	21,873,187
Other liabilities		8,140	55,301	-	-	-	-	63,441
Guarantees issued and similar commitments		-	-	7,563,995	600,000	-	-	8,163,995
Commitments on credits and unused credit lines		-	-	540,501	1,603,866	-	-	2,144,367
		23,107,422	2,298,909	37,247,684	19,833,432	18,063	-	82,505,510
Liquidity gap		(4,409,247)	10,125,405	(15,687,754)	2,659,354	206,756		
Interest sensitivity gap for fixed rate instruments		12,821,616	10,180,706	(7,583,258)	4,773,220	206,756		
Interest sensitivity gap		12,821,616	10,180,706	(7,583,258)	4,773,220	206,756		
Cumulative interest sensitivity gap		12,821,616	23,002,322	15,419,064	20,192,284	20,399,040		

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Market Risk

Market risk covers interest rate risk, currency risk and other pricing risks to which the Group is exposed. There have been no changes as to the way the Group measures risk or to the risk it is exposed in 2007.

The Group is exposed to interest rate risks as entities in the Group borrow funds at both fixed and floating rates. The risk is managed by the Group maintaining an appropriate mix between fixed and floating rate borrowings.

The ALMC also manages interest rate and market risks by matching the Group's interest rate position, which provides the Group with a positive interest margin. The Department of Financial Control conducts monitoring of the Group's current financial performance, estimates the Group's sensitivity to changes in interest rates and its influence on the Group's profitability.

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

Interest rate risk

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

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

Impact on profit before tax:

	As at 31 December 2007		As at 31 December 2006	
	Interest rate +1%	Interest rate -1%	Interest rate -1%	Interest rate -1%
Assets:				
Due from banks	56,409	(56,409)	36,142	(36,142)
Loans to customers	1,561,079	(1,561,079)	577,896	(577,896)
Factoring	32,286	(32,286)	-	-
Liabilities:				
Due to banks and government agencies	(46,420)	46,420	(25,154)	25,154
Customer accounts	(859,633)	859,633	(410,748)	410,748
Net impact on profit before tax	743,721	(743,721)	178,136	(178,136)

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Impact on shareholders equity:

	As at 31 December 2007		As at 31 December 2006	
	Interest rate +1%	Interest rate -1%	Interest rate -1%	Interest rate -1%
Assets:				
Due from banks	56,409	(56,409)	36,142	(36,142)
Loans to customers	1,561,079	(1,561,079)	577,896	(577,896)
Factoring	32,286	(32,286)	-	-
Liabilities:				
Due to banks and government agencies	(46,420)	46,420	(25,154)	25,154
Customer accounts	(859,633)	859,633	(410,748)	410,748
Net impact on shareholders equity	743,721	(743,721)	178,136	(178,136)

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Currency risk

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

The Management Board sets limits on the level of exposure by currencies. These limits also comply with the minimum requirements of the NBA. The Group's exposure to foreign currency exchange rate risk is presented in the table below:

	AZN	USD USD 1 = AZN 0.8453	EUR EUR 1 = AZN 1.2450	Other currency	31 December 2007 Total
ASSETS					
Cash and balances with the National Bank of the Republic of Azerbaijan	19,273,830	1,690,079	1,132,089	-	22,095,998
Due from banks	400,155	11,356,283	1,092,195	84,308	12,932,941
Loans to customers	149,844,918	1,912,835	32,606	1,600,679	153,391,038
Factoring	2,136,814	1,223,527	-	-	3,360,341
Investments available-for-sale	1,630,264	-	2,851	-	1,633,115
Investments in associates	5,100,000	-	-	-	5,100,000
Property and equipment	5,497,923	-	-	-	5,497,923
Intangible assets	330,083	-	-	-	330,083
Deferred income tax assets	35,793	-	-	-	35,793
Other assets	1,018,257	17,632	-	-	1,035,889
TOTAL ASSETS	185,268,037	16,200,356	2,259,741	1,684,987	205,413,121
LIABILITIES					
Due to banks and government agencies	2,968,652	6,081,296	750,635	1,725,995	11,526,578
Customer accounts	120,291,390	14,340,863	3,242,118	44	137,874,415
Provision for impairment losses on other operations	231,954	-	-	-	231,954
Current income tax liabilities	208,849	-	-	-	208,849
Other liabilities	659,924	167,735	23,723	-	851,382
TOTAL LIABILITIES	124,360,769	20,589,894	4,016,476	1,726,039	150,693,178
OPEN BALANCE SHEET POSITION	60,907,268	(4,389,538)	(1,756,735)	(41,052)	

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	AZN	USD USD 1 = AZN 0.8714	EUR EUR 1 = AZN 1.1471	Other currency	31 December 2006 Total
ASSETS					
Cash and balances with the National Bank of the Republic of Azerbaijan	4,288,739	6,212,694	34,242	-	10,535,675
Due from banks	1,000,000	4,283,325	26,024	24,343	5,333,692
Loans to customers	52,625,952	3,486,547	-	-	56,112,499
Investments available-for-sale	40,000	-	2,627	-	42,627
Property and equipment	2,807,569	-	-	-	2,807,569
Intangible assets	268,807	-	-	-	268,807
Other assets	243,940	24,601	101	-	268,642
TOTAL ASSETS	61,275,007	14,007,167	62,994	24,343	75,369,511
LIABILITIES					
Due to banks and government agencies	2,515,391	356,166	185,568	-	3,057,125
Customer accounts	51,812,846	11,004,128	567,115	10	63,384,099
Other liabilities	36,418	25,750	1,273	-	63,441
TOTAL LIABILITIES	54,364,655	11,386,044	753,956	10	66,504,665
OPEN BALANCE SHEET POSITION	6,910,352	2,621,123	(690,962)	24,333	

Currency risk sensitivity

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

	As at 31 December 2007		As at 31 December 2006	
	AZN/USD +10%	AZN/USD -10%	AZN/USD +10%	AZN/USD -10%
Impact on profit or loss	438,954	(438,954)	(262,112)	262,112

	As at 31 December 2007		As at 31 December 2006	
	AZN/EURO +10%	AZN/ EURO -10%	AZN/ EURO +10%	AZN/EURO -10%
Impact on profit or loss	175,674	(175,674)	69,096	(69,096)

OPEN JOINT STOCK COMPANY XALQ BANK

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEAR ENDED 31 DECEMBER 2007 (in Azerbaijan Manats)

Limitations of sensitivity analysis

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

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

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

Other price risks

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