

**KAUTHAR BANK JOINT STOCK COMPANY
BAKU, AZERBAIJAN REPUBLIC**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT
FOR THE YEAR ENDED DECEMBER 31, 2009**

**KAUTHAR BANK JOINT STOCK COMPANY
BAKU, AZERBAIJAN REPUBLIC**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT
FOR THE YEAR ENDED DECEMBER 31, 2009**

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MAK AZERBAIJAN LTD

AUDIT □ VALUATION □ CONSULTANCY □ RESEARCH
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Independent Auditors' Report

To:

**The Shareholders,
Kauthar Bank Joint-Stock Company,**

44/46, B. Medjidov str.,

Baku, Azerbaijan Republic.

We have audited the accompanying financial statements of **Kauthar Bank Joint-Stock Company, Baku, Azerbaijan Republic**, which comprise the balance sheet as at December 31, 2009 and the statement of income, statement of changes in shareholders' equity, statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance, whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Basis for Qualified Opinion

Recognised allowances for impairment losses (Note 16) are not sufficient to meet risks exposed.

Qualified Opinion

Except for the effects of the matter discussed in the preceding paragraph, which may require financial adjustments, in our opinion, the financial statements referred to above, which have been prepared on the basis of the accounting policies set out in accompanying notes, present fairly, in all material respects, the financial position of **Kauthar Bank Joint-Stock Company**, Baku, Azerbaijan Republic, as of December 31, 2009 and the result of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Also, in our opinion, there were no contraventions during the year of the Civil Code of Azerbaijan Republic, regulations issued by The National Bank of Azerbaijan or the Bank's Articles of Association which might have materially affected the financial position of the **Kauthar Bank Joint-Stock Company** or the result of its operations for the year.

Dr. Zamin Husseyinov

Resident Partner

Date: June 17, 2010

Kauthar Bank Open Joint-Stock Company
Baku, Azerbaijan Republic

Balance Sheet
as of December 31, 2009 and 2008
(AZN)

	<u>Note</u>	<u>2009</u>	<u>2008</u>
Assets			
Cash on hand	4	853 353	584 118
Due from the Central Bank	4	74 370	48 739
Due from banks	4	2 380	1 563
Investments available for sale	5	13 081 460	13 108 345
Other assets	6	2 716 416	2 130 973
Non-current assets held for sale	7	242 143	242 143
Property and equipment	8	222 882	227 558
Total Assets		17 193 004	16 343 439
Liabilities and Shareholders' Equity			
Liabilities			
Customer accounts	9	3 268 735	2 557 968
Due to banks and financial institutions	10	254 775	681 587
Debt securities issued	11	2 741 124	2 343 628
Other liabilities	12	131 727	108 582
Total Liabilities		6 396 361	5 691 765
Shareholders' Equity			
Share capital	2	10 020 000	10 020 000
Revaluation reserve		206 582	206 582
Retained earnings	13	570 060	425 092
Total Shareholders' Equity		10 796 643	10 651 674
Total Liabilities and Shareholders' Equity		17 193 004	16 343 439

The accompanying notes form an integral part of these financial statements.

The Report of the Auditors is set out on pages 1 and 2.

The financial statements on pages 3 to 33 were approved by the Board of Directors on June 17, 2010 and signed on its behalf by:

Haydar Ibrahimov
Chairman

**Kauthar Bank Open Joint-Stock Company
Baku, Azerbaijan Republic**

**Statement of Income
for the year ended December 31, 2009 and 2008
(AZN)**

	Notes	2009	2008
Income on securities	14	700 397	616 699
Other income	15	1 079 151	542 575
		1 779 548	1 159 274
Allowance for impairment losses	16	4 000	6 376
Deduct: direct expenses			
Interest expenses	17	(411 259)	(347 905)
Fee and commission expenses	18	(1 065 528)	(502 578)
		(1 476 786)	(850 483)
Deduct:			
Foreign exchange income/ (loss)	19	(74 330)	(31 254)
General and administrative expenses	20	(87 463)	(174 298)
Total operating expenses		(161 793)	(205 552)
Net profit from ordinary activities before		144 969	109 615
Income tax expenses		-	(24 115)
Net profit from ordinary activities for the year		144 969	85 500
Opening balance of retained earnings		425 092	339 592
Net profit for the year		144 969	85 500
Closing balance in retained earnings		570 060	425 092
Earnings per share		2,89	1,80

The accompanying notes form an integral part of these financial statements.

The Report of the Auditors is set out on pages 1 and 2.

The financial statements on pages 3 to 33 were approved by the Board of Directors on June 17, 2010 and signed on its behalf by:

Haydar Ibrahimov
Chairman

Kauthar Bank Open Joint-Stock Company
Baku, Azerbaijan Republic

Statement of Changes in Shareholders' Equity
for the year ended December 31, 2009 and 2008
(AZN)

	<u>Share Capital</u>	<u>Revaluation Reserve</u>	<u>Retained Earnings</u>	<u>Total</u>
Balance at January 1, 2008	9 470 000	206 582 #	339 592	10 016 174
<u>Changes in Shareholders' Equity:</u>				
a. Shareholders' capital increase	550 000			550 000
b. Net profit for the year			85 500	85 500
Balance at December 31, 2008	<u>10 020 000</u>	<u>206 582 #</u>	<u>425 092</u>	<u>10 651 674</u>
<u>Changes in Shareholders' Equity:</u>				
a. Net profit for the year			144 969	144 969
Balance at December 31, 2009	<u>10 020 000</u>	<u>206 582</u>	<u>570 060</u>	<u>10 796 643</u>

The accompanying notes form an integral part of these financial statements.

The Report of the Auditors is set out on pages 1 and 2.

Kauthar Bank Open Joint-Stock Company
Baku, Azerbaijan Republic

Statement of Cash Flows
for the year ended December 31, 2009 and 2008
(AZN)

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities		
Profit before income tax	144 969	85 500
Adjustment for:		
Allowance for impairment losses	(4 000)	(6 376)
Depreciation and amortization expense	4 700	4 836
Net unrealized loss arising from changes in foreign currency exchange rates	74 330	31 254
Net change in interest accruals	460 849	318 071
Operating cash flow before changes in operating assets and liabilities	<u>680 849</u>	<u>433 285</u>
Changes in minimum reserve deposits with CBA	32 395	155 879
(Increase)/Decrease in placements with banks and financial institutions	(817)	111 246
(Increase)/ Decrease in other assets	(585 443)	(346 870)
Increase/ (Decrease) in deposit from customers	710 767	693 469
Increase/ (Decrease) in deposits and balances from banks and financial institutions	(426 812)	677 442
Increase in other liabilities	23 145	77 655
Cash from operations	<u>434 084</u>	<u>1 802 107</u>
Net cash (outflows)/inflows from operating activities	<u>434 084</u>	<u>1 802 107</u>
Cash flows from investing activities:		
Net movements in investments	26 885	(2 932 260)
Net cash from/(used in) investing activities	<u>26 885</u>	<u>(2 932 260)</u>
Cash flows from financing activities:		
Debt securities issued	-	-
Proceeds from partner contributions	-	550 000
Net cash (used in) financing activities	-	550 000
Effect of foreign exchange rate changes on cash and cash equivalents	(133 708)	(29 248)
Net increase in cash and cash equivalents	<u>327 261</u>	<u>(609 402)</u>
Cash and cash equivalents, beginning of the year	584 118	1 193 520
Cash and cash equivalents, end of the year	<u>911 379</u>	<u>584 118</u>
Represented by:		
Cash at bank	853 353	584 118
Balances with the CBA	58 026	-
	<u>911 379</u>	<u>584 118</u>

The accompanying notes form an integral part of these financial statements.

The Report of the Auditors is set out on pages 1 and 2.

Kauthar Bank Joint Stock Company

Baku, Azerbaijan Republic

Notes to the Financial Statements for the year ended December 31, 2009

1. Legal status and business activity:

- 1.1. Open Joint Stock Bank Kauthar Bank (the "Bank") is a joint stock bank which was established in 1988 in accordance with establishment agreement and was registered by the Central Bank of Azerbaijan. The previous name of the bank was "Universal Bank". The Bank is regulated by the Central Bank of Azerbaijan (the "CBA") and conducts its business under the general banking license number 92 obtained on 21 October 2002.
- 1.2. The bank works according to the Islam banking system and carries on banking activities such as acceptance of deposits, investing, foreign exchange business and other banking activities and financial services.
- 1.3. The address of its registered office is 44/46 B. Medjidov str., Baku, Azerbaijan Republic. The Bank has a physical presence at the above address. Bank has 2 branches in the Azerbaijan Republic.
- 1.4. The management and control are vested with the Chairman of the Board Mr. Heydar Ibragimov and the Chairman of the Observation Board Mr. O. Al Dimashki.

2. Share capital:

Authorised, issued and paid up capital of the Bank is AZN 10,020,000 (previous year AZN 9,470,000) divided into 50,100 (previous year 47,370) shares of AZN 200 each fully paid. The shares are held by the following individuals:

Shareholders	Nationality	Share (%) in capital	
		2008	2007
Mrs. Ibrahimova I.	Azerbaijan	1,67	1,77
Mr. Ibrahimov V.	Azerbaijan	5,05	2,59
Mrs. Ibrahimova M.	Azerbaijan	10,58	11,19
Mr. Rustamov K.	Azerbaijan	1,97	2,08
Mr. Seidov A.	Azerbaijan	10,57	11,19
Mr. Bagirov I.	Azerbaijan	10,57	11,19
Mr. Kazimov K.	Azerbaijan	6,29	6,65
Mr. Gabibov B.	Azerbaijan	2,99	3,17
Mr. Mamedov M.	Azerbaijan	2,99	3,17
Mr. Gabibov V.	Azerbaijan	8,43	5,86
Mr. Guliyev E.	Azerbaijan	2,99	3,17
Mrs. Kazimova A.	Azerbaijan	7,09	7,5
Mr. Gurbanov E.	Azerbaijan	10,57	11,19
Mr. Gasimov E.	Azerbaijan	10,57	11,19
Mr. Muhammad F.	Saudi Arabia	2,2	2,32
Mr. Hiroshi K.	Japan	2,2	2,32
Mr. Al-Dimashki O.	Canada	2,2	2,32
Others		1,07	1,13
		<u>100.0</u>	<u>100.0</u>

Kauthar Bank Joint Stock Company

Baku, Azerbaijan Republic

Notes to the Financial Statements for the year ended December 31, 2009

3. Summary of significant accounting policies

Basis of preparation

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), interpretations issued by International Financial Reporting Interpretations Committee (IFRIC), and applicable requirements of the Azerbaijan Republic Banking Act and the revised banking regulations in Azerbaijan Republic, which are administered by the National Bank. A summary of the significant accounting policies, which have been applied consistently, are set out below.

The Bank maintains its accounting records in accordance with Azerbaijan law. These 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. A copy of the financial statements can be obtained from the Bank's registered office (see note 1.3).

Kauthar Bank Joint Stock Company

Baku, Azerbaijan Republic

Notes to the Financial Statements for the year ended December 31, 2009

3 Summary of significant accounting policies (continued):

Basis of measurement

Accounting convention and Measurement

These financial statements have been prepared under historical cost convention basis except for derivatives, which are measured at fair value. The accounting policies are consistent with those used in the previous year. The financial statements have been presented in New Azerbaijani Manat (AZN).

The financial statements are prepared on a fair value basis for derivative financial instruments, and financial assets and liabilities held for trading and available-for-sale, except those for which a reliable measure of fair value is not available. Other financial assets and liabilities and non-financial assets and liabilities are stated at amortized cost or historical cost.

The national currency of the Republic of Azerbaijan is the New Azerbaijan Manat ("AZN"). Management has determined the Bank's measurement currency to be the AZN it reflects the economic substance of the underlying events and circumstances of the Bank. The AZN is also the Bank's presentation currency for the purposes of these financial statements.

Going concern

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realisation of assets and the satisfaction of liabilities in the normal course of business. The recoverability of the Bank's assets, as well as the future operation of the Bank, may be significantly affected by the current and future economic environment and the economic dependence on the Bank. The accompanying financial statements do not include any adjustments should the Bank be unable to continue as a going concern.

Significant accounting policies

The following significant accounting policies have been applied in the preparation of the financial statements. The accounting policies have been consistently applied.

Kauthar Bank Joint Stock Company

Baku, Azerbaijan Republic

Notes to the Financial Statements for the year ended December 31, 2009

3 Summary of significant accounting policies (continued):

Foreign currency transactions

Transactions in foreign currencies are translated to the appropriate measurement currency at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the measurement currency at the foreign exchange rate ruling at the year end. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated to the measurement currency manats at the foreign exchange rate ruling at the date of the transaction.

Cash and cash equivalents

Cash and cash equivalents are items, which can be converted into cash within a day. All short-term inter-bank placements, beyond overnight placements, are included in due from other banks.

Amounts, which relate to funds that are of a restricted nature, are excluded from cash and cash equivalents.

The Bank considers cash and nostro accounts with the NBA to be cash and cash equivalents. Mandatory cash balance with the NBA represents regulatory minimum reserve deposit, which is calculated by using daily average balances and deposited at the NBA. Mandatory cash balance (the minimum reserve deposit) is not available to finance the Bank's day-to-day operations and hence is not considered as part of cash and cash equivalents for the purposes of the cash flow statement due to restrictions on its with drawability.

Kauthar Bank Joint Stock Company

Baku, Azerbaijan Republic

Notes to the Financial Statements for the year ended December 31, 2009

3 Summary of significant accounting policies (continued):

Financial instruments

Financial instruments comprise financial assets and financial liabilities. Financial assets and financial liabilities are recognised on the Bank's balance sheet when the Bank has become a party to the contractual provisions of the instrument. A financial asset is any asset that is cash, a contractual right to receive cash or other financial asset, a contractual right to exchange financial instruments under conditions that are potentially favourable or an equity instrument. A financial liability is any liability that is a contractual obligation to deliver cash or another financial asset, or to exchange financial instruments under conditions that are potentially unfavourable.

Classification

Trading instruments are those that the Bank principally holds for the purpose of short-term profit taking. These include investments and derivative contracts that are not designated and effective hedging instruments, and liabilities from short sales of financial instruments. All trading derivatives in a net receivable position (positive fair value), as well as options purchased, are reported as an asset. All trading derivatives in a net payable position (negative fair value) as well as options written are reported as a liability. Held-to-maturity assets are financial assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity.

Available-for-sale assets are financial assets that are not held for trading purposes, originated by the Bank, or held to maturity.

Kauthar Bank Joint Stock Company

Baku, Azerbaijan Republic

**Notes to the Financial Statements
for the year ended December 31, 2009**

3 Summary of significant accounting policies (continued):

Recognition

The Bank recognises financial instruments held for trading and available-for-sale assets on the date it commits to purchase the assets.

Held-to-maturity assets and receivables are recognised on the day they are transferred to or originated by the Bank.

Measurement

Financial instruments are measured initially at cost, including transaction costs.

Subsequent to initial recognition all trading and all available-for-sale instruments are measured at fair value, except that any instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured is stated at cost, including transaction costs, less impairment losses.

All non-trading financial liabilities, receivables and held-to-maturity assets are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

Fair value measurement principles

The fair value of financial instruments is based on their quoted market price at the balance sheet date without any deduction for transaction costs. If a quoted market price is not available, the fair value of the instrument is estimated using pricing models or discounted cash flow techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate at the balance sheet date for an instrument with similar terms and conditions. Where pricing models are used, inputs are based on market related measures at the balance sheet date.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Bank would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties.

Kauthar Bank Joint Stock Company

Baku, Azerbaijan Republic

Notes to the Financial Statements for the year ended December 31, 2009

3 Summary of significant accounting policies (continued):

Gains and losses on subsequent measurement

Gains and losses arising from a change in the fair value of all trading instruments and available-for-sale securities trading are recognized in the income statement.

Derecognition

A financial asset is derecognised when the Bank loses control over contractual rights that comprises those assets. This occurs when the rights are realized, expire or are surrendered.

A financial liability is derecognized when it is extinguished.

Available-for-sale assets and assets held for trading that are sold are derecognised and corresponding receivables from the buyer for the payment are recognized as of the date the Bank commits to sell the asset. The Bank uses the specific identification method to determine the gain or loss on derecognition.

Held-to-maturity instruments and receivables are derecognized on the day they are transferred by the Bank.

Offsetting

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

Property and equipment

Owned assets

Items of property and equipment are stated at cost (except for furniture & equipments, which are stated at revalued amounts) less accumulated depreciation and impairment losses.

Kauthar Bank Joint Stock Company

Baku, Azerbaijan Republic

Notes to the Financial Statements for the year ended December 31, 2009

3 Summary of significant accounting policies (continued):

Depreciation

Depreciation is charged to the income statement on a diminishing balance basis over the estimated useful lives of the individual assets. Depreciation commences the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Land is not depreciated. Depreciation is calculated at the following annual rates:

Buildings	4%
Furniture & equipment	8%
Computers	10%
Vehicles	14%

Impairment of assets

The carrying amounts of the Bank's assets, other than deferred tax assets are reviewed for impairment, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If any such indication exists, the assets' recoverable amounts are estimated. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognised in the statement of income.

Calculation of recoverable amount

The recoverable amount of the Bank's investments in held-to-maturity securities and receivables is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset. The recoverable amount of the Bank's trading investments and investments available-for-sale is their fair value.

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Kauthar Bank Joint Stock Company

Baku, Azerbaijan Republic

Notes to the Financial Statements for the year ended December 31, 2009

3 Summary of significant accounting policies (continued):

Reversals of impairment

An impairment loss in respect of a held-to-maturity security or receivable is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognized.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

Interest bearing borrowings

Interest-bearing borrowings are recognized initially at cost, net of any transaction costs incurred. Subsequent to initial recognition, interest-bearing borrowings are stated at amortized cost with any difference between cost and redemption value being recognized in the income statement over the period of the borrowings.

When borrowings are repurchased or settled before maturity, any difference between the amount repaid and the carrying amount is recognised immediately in the income statement.

Provisions

A provision is recognised in the balance sheet when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Dividends

The ability of the Bank to declare and pay dividends is subject to the rules and regulations of the NBA and other Azerbaijan legislation.

Dividends in relation to ordinary shares are reflected as an appropriation of retained earnings as and when declared.

Kauthar Bank Joint Stock Company

Baku, Azerbaijan Republic

**Notes to the Financial Statements
for the year ended December 31, 2009**

3 Summary of significant accounting policies (continued):

Other income

Other income is fee and commission income which is recognized when the corresponding service is provided.

Dividend income

Dividend income from investments is recognized in the income statement on the date that the dividend is declared.

Kauthar Bank Open Joint-Stock Company
Baku, Azerbaijan Republic

Notes to the Financial Statements (continued)
for the year ended December 31, 2009 and 2008

4 Cash and placements with financial institutions

	December 31,	
	2009	2008
	(AZN)	(AZN)
Cash on hand	853 353	584 118
Balances with the Central Bank	58 026	-
Minimum reserve deposits with the Central Bank	16 344	48 739
Due from banks :		
- within Azerbaijan Republic	1 913	1 097
- other countries	467	466
	930 103	634 420

The minimum reserve deposit is a mandatory non-interest bearing deposit calculated in accordance with regulations issued by the CBA and whose withdrawal is restricted. At the end of 2008 minimum reserve of the bank had to be AZN 136,723. The nostro balances represented with the CBA at the year end of 2008 was not enough to cover the minimum reserve.

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

	December 31,	
	2009	2008
	(AZN)	(AZN)
Cash on hand and balances with the Central Bank	927 723	632 857
Less minimum reserve deposits with the Central Bank	(16 344)	(48 739)
Total cash and cash equivalents	911 379	584 118

Kauthar Bank Open Joint-Stock Company
Baku, Azerbaijan Republic

Notes to the Financial Statements (continued)
for the year ended December 31, 2009 and 2008

5 Investments available for sale

Investments available for sale comprises:

	December 31,	
	2009	2008
	(AZN)	(AZN)
Debt securities	12 651 080	12 648 560
Equity securities	439 163	472 568
Less allowance for impairment losses	(8 783)	(12 783)
Total investments available for sale	13 081 460	13 108 345

Movements in allowances for impairment losses for the years ended 31 December 2009 and 2008 are disclosed in Note 16.

Debt securities

	Interest to nominal %	December 31,	
		2009	2008
		(AZN)	(AZN)
Sevindj -M LLC	12	9 918 620	9 916 100
Orudj Ezizov	12	274 860	274 860
Vuqar Esedov	12	507 600	507 600
Bagirov Ilgar	12	850 000	850 000
Abbas Mustafayev	12	1 100 000	1 100 000
Total debt securities		12 651 080	12 648 560

Kauthar Bank Open Joint-Stock Company
Baku, Azerbaijan Republic

Notes to the Financial Statements (continued)
for the year ended December 31, 2009 and 2008

5 Investments available for sale (continued)

Equity securities		Main Activity	December 31,	
			Controlled	2009
			(AZN)	(AZN)
		%		
Tur-Tikinti Servis JSC	Manufacturing	0,1%	9 223	9 228
Kommersant Company	Trading		-	3 400
Universal Traid Company	Trading		-	29 060
First Universal Group JV	Trading		-	940
Milan -Heyat LLC	Insurance	71,7%	429 940	429 940
			439 163	472 568
Less: Allowance for impairment losses			(8 783)	(12 783)
Total equity securities			869 543	932 353

The above investments are stated at cost as the investments do not have a quoted market price in an active market and their fair value cannot be reliably measured.

6 Other assets

	December 31,	
	2009	2008
	(AZN)	(AZN)
Receivables for loans sold	1 047 306	1 349 244
Receivables for property sold	382 540	383 640
Receivables on accrued revenue	1 035 471	301 834
Prepaid taxes	662	8 477
Receivables on financial leasing	160 620	57 931
Payment on progress	41 497	27 718
Other	48 321	2 130
	2 716 416	2 130 973

Bank as a result of decision to manage its operations on a Islamic Banking basis in 2005 sold its interest bearing loans portfolio to Sevindj-M LLC.

Kauthar Bank Open Joint-Stock Company
Baku, Azerbaijan Republic

Notes to the Financial Statements (continued)
for the year ended December 31, 2009 and 2008

7 Non-current assets held for sale

	December 31,	
	2009	2008
	(AZN)	(AZN)
Non-current assets held for sale	<u>242 143</u>	<u>242 143</u>
	<u>242 143</u>	<u>242 143</u>

Non-current assets held for sale includes the collateral received in satisfaction of non-performing loans.

Kauthar Bank Open Joint-Stock Company
Baku, Azerbaijan Republic

Notes to the Financial Statements (continued)
for the year ended December 31, 2009 and 2008

8 Property and equipment

	<u>Buildings</u>	<u>Furniture & equipments</u>	<u>Computers</u>	<u>Vehicles</u>	<u>Construction in progress</u>	<u>Total</u>
	(AZN)	(AZN)	(AZN)	(AZN)	(AZN)	(AZN)
Cost:						
At January 1, 2009	50 920	83 642	80 519	13 840	176 093	405 013
Additions	-	-	-	-	-	-
At December 31, 2009	<u>50 920</u>	<u>83 642</u>	<u>80 519</u>	<u>13 840</u>	<u>176 093</u>	<u>405 013</u>
Accumulated Depreciation:						
At January 1, 2009	(10 800)	(80 656)	(76 146)	(9 853)	-	(177 455)
Depreciation for the year	(1 440)	(1 933)	(745)	(558)	-	(4 676)
At December 31, 2009	<u>(12 240)</u>	<u>(82 589)</u>	<u>(76 892)</u>	<u>(10 411)</u>	<u>-</u>	<u>(182 132)</u>
Net book value:						
At December 31, 2009	<u>38 680</u>	<u>1 053</u>	<u>3 628</u>	<u>3 429</u>	<u>176 093</u>	<u>222 882</u>
At December 31, 2008	40 120	2 986	4 373	3 987	176 093	227 558

As at 31 December 2009 and 2008 property and equipment included fully depreciated assets in amount of AZN 128,1 thousands and AZN 127,2 thousands, respectively.

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9 Customer accounts

	December 31,	
	2009	2008
	(AZN)	(AZN)
Current accounts	732 831	613 687
Deposit accounts	2 535 904	1 944 281
	3 268 735	2 557 968

As at 31 December 2009 and 2008 customer accounts amounted to AZN 29,28 thousand and AZN 29,76 thousand, respectively, were held as security against loans to customers.

10 Due to banks and financial institutions

	December 31,	
	2009	2008
	(AZN)	(AZN)
Short-term loans from financial institutions	66 062	130 100
Correspondent accounts of the banks	188 713	551 487
	254 775	681 587

Concentration of due to banks and financial institutions:-

As at 31 December 2009 and 2008, due to banks and financial institutions were as follows:

	December 31,	
	2009	2008
	(AZN)	(AZN)
Texnikbank JSC	-	50 000
OMNI non banking credit organization	50 000	-
Rabitabank JSC	200 775	627 587
Karvan Credit Union	4 000	4 000
	254 775	681 587

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Notes to the Financial Statements (continued)
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11 Debt securities issued

Debt securities issued comprise:

	Maturity date	Annual coupon rate	December 31,	
			2009	2008
	month/year	%	(AZN)	(AZN)
Manat-denominated bonds	Sept-2010	17	2 741 124	2 343 628
			2 741 124	2 343 628

12 Other liabilities

	December 31,	
	2009	2008
	(AZN)	(AZN)
Current tax liabilities	17 077	24 115
Sundry creditors	84 325	56 968
Payables to state funds	1 627	1 807
Items in suspense	3 505	2 242
Reserves on other assets	554	554
Deferred income	3 312	2 753
Payments in progress	8 850	8 850
Payables to employees	12 477	11 293
	131 727	108 582

13 Retained earnings

	December 31,	
	2009	2008
	(AZN)	(AZN)
Opening balance	425 092	339 592
Net profit for the year	144 969	85 500
Closing balance	570 061	425 092

The Bank didn't declare a dividend.

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Notes to the Financial Statements (continued)
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14 Income on securities

	For the year ended December 31,	
	2009	2008
	(AZN)	(AZN)
Income on securities	700 397	616 699
	700 397	616 699
	For the year ended December 31,	
	2 009	2 008
	(AZN)	(AZN)
Income on securities comprise:		
Income on debt securities	700 397	589 051
Income on equity securities	-	27 648
	700 397	616 699

15 Other income

	For the year ended December 31,	
	2009	2008
	(AZN)	(AZN)
Foreign exchange operations	1 041 514	500 446
Servicing customer accounts	8 690	-
Cash withdrawal operations	22 300	35 589
Others	6 647	6 540
	1 079 151	542 575

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Notes to the Financial Statements (continued)
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16 Allowance for impairment losses

	For the year ended December 31,	
	2009	2008
	(AZN)	(AZN)
Balance at the beginning of the year	12 783	19 160
Provision during the year	(4 000)	(6 376)
Balance at the end of the year	8 783	12 783

17 Interest expenses

	For the year ended December 31,	
	2009	2008
	(AZN)	(AZN)
Interest expense on loans from banks	13 763	30 300
Interest expense on debt securities	397 496	317 606
	411 259	347 905

18 Fee and commission expenses

	For the year ended December 31,	
	2009	2008
	(AZN)	(AZN)
Cash operations		550
Servicing correspondent accounts	23 069	954
Foreign exchange operations	1 042 459	501 074
	1 065 528	502 578

19 Foreign exchange income/ (loss)

	For the year ended December 31,	
	2009	2008
	(AZN)	(AZN)
Translation differences, net	(74 330)	(31 254)
	(74 330)	(31 254)

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Notes to the Financial Statements (continued)
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20 General and administrative expenses

	For the year ended December 31,	
	2009	2008
	(AZN)	(AZN)
Depreciation and amortization	4 700	4 836
Employee compensation	20 087	17 153
Unified social tax contribution	4 944	3 772
Communications and information services	26 783	23 049
Professional and other services	-	12 450
Utilities	1 120	2 084
Property and other non-revenue based taxes	454	1 502
Advertisement expenses	163	50 331
Security expenses	8 370	10 272
Entertainment expenses	-	2 438
Others	20 841	46 411
	<u>87 463</u>	<u>174 298</u>

21 Staff strength

	December 31,	
	2009	2008
Number of employees (average)	<u>26</u>	<u>26</u>

22 Financial instruments

Financial instruments of the bank comprise of placement with banks and financial institutions, advances to customers and others, other assets, deposit from customers, due to banks and other liabilities.

Credit risk

Financial assets which potentially expose the bank to concentration of credit risk comprise principally of placement with banks and financial institutions, investments and other assets.

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The bank accounts are placed with high credit quality financial institutions.

Investments available for sale are stated net of allowance for doubtful recoveries. At the balance sheet date, the bank's maximum exposure to credit risk is given below:

Risk management

Credit Risk

Policies relating to credit are reviewed and approved by the bank's management. The bank limits risk through diversification of its assets by geography and industry sector limits.

As at December 31, 2009 the Bank had exposure to the following significant geographic concentration of financial assets:-

	<u>Due from banks</u>	<u>Investments available for sale</u>	<u>Other assets</u>
	(AZN)	(AZN)	(AZN)
OECD countries	467	-	
Azerbaijan Republic	1 913	13 081 460	2 716 416
31 December 2009	2 380	13 081 460	2 716 416
31 December 2008	1 563	13 108 345	2 130 973

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 Bank could realize in a market exchange from the sale of its full holdings of a particular instrument.

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

	31 December 2009		31 December 2008	
	Current Value	Fair Value	Current Value	Fair Value
Cash & balances with the CBA	927 723	927 723	632 857	632 857
Due from banks	2 380	2 380	1 563	1 563
Investments available for sale	13 081 460	13 081 460	13 108 345	13 108 345
Customer accounts	3 268 735	3 268 735	2 557 968	2 557 968
Due to banks and financial institutions	254 775	254 775	681 587	681 587

Currency risk

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

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

	AZN	USD USD 1= 0,8031 AZN	EUR EUR 1= 1,1499 AZN	31 December 2009 Total
ASSETS				
Cash & balances with the CBA	776 204	18 025	133 494	927 723
Due from banks		1 928	452	2 380
Investments available for sale	12 117 740	963 720	-	13 081 460
Property and equipment	222 882	-	-	222 882
Other assets	2 157 649	558 767	-	2 716 416
Non-current assets held for sale	242 143			242 143
TOTAL ASSETS	15 516 618	1 542 440	133 946	17 193 004

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Customer accounts	1 305 348	745 356	1 218 031	3 268 735
Due to banks and other financial institutions	54 000	200 775	-	254 775
Debt securities issued	2 741 124	-	-	2 741 124
Other liabilities	131 727	-	-	131 727
TOTAL LIABILITIES	4 232 199	946 131	1 218 031	6 396 361
OPEN BALANCE SHEET POSITION	11 284 419	596 309	(1 084 085)	
	AZN	USD	EUR	31 December
		USD 1=	EUR 1=	2008
		0,801 AZN	1,1292 AZN	Total
ASSETS				
Cash & balances with the NBA	76 598	556 247	13	632 857
Due from banks	-	1 065	498	1 563
Investments available for sale	12 147 145	961 200	-	13 108 345
Property and equipment	227 558	-	-	227 558
Other assets	1 735 193	395 780	-	2 130 973
Non-current assets held for sale	242 143	-	-	242 143
TOTAL ASSETS	14 428 637	1 914 291	511	16 343 439
LIABILITIES				
Customer accounts	1 757 000	796 506	4 462	2 557 968
Due to banks and other financial institutions	188 100	493 487	-	681 587
Debt securities issued	2 343 628	-	-	2 343 628
Other liabilities	108 582	-	-	108 582
TOTAL LIABILITIES	4 397 310	1 289 993	4 462	5 691 765
OPEN BALANCE SHEET POSITION	10 031 327	624 299	(3 952)	

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Currency risk sensitivity

The following table details the Bank'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 Bank where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

	As at 31 December 2009		As at 31 December 2008	
	AZN/USD		AZN/USD	
	+10%	-10%	+10%	-10%
Impact on profit or loss	59 631	(59 631)	62 430	(62 430)

	AZN/EURO		AZN/EURO	
	+10%	-10%	+10%	-10%
Impact on profit or loss	(108 409)	108 409	(395)	395

Limitations of sensitivity analysis

The above sensitivity analyses include the following limitations: the use of hypothetical market movements to demonstrate potential risk that only represent the Bank's view of possible near-term market changes that cannot be predicted with any certainty;

The followings were neglected within the frame of sensitivity analyses: a) the Bank's assets and liabilities are actively managed; b) the financial position of the Bank may vary at the time that any actual market movement occurs.

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The analysis of interest rate and liquidity risk on balance sheet transactions is presented in the following table:

	Weighted average effective interest rate	Up to 1 month	1month o 3 month	3 month to 1year	1 year to 5 years	Maturity undefined	31 December 2009 Total
ASSETS							
Cash & balances with CBA		927 723	-	-	-	-	927 723
Due from banks		2 380	-	-	-	-	2 380
Property & equipment		-	-	-	-	222 882	222 882
Investments available for sale		-	-	866 000	11 785 080	430 380	13 081 460
Other assets		983 253	522 043	459 022	526 469	225 629	2 716 416
Non-current assets held for sale		-	-	-	-	242 143	242 143
TOTAL ASSETS		1 913 356	522 043	1 325 022	12 311 549	1 121 034	17 193 004
LIABILITIES							
Debt securities issued	17%	-	-	-	2 741 124	-	2 741 124
<i>Total interest bearing liabilities</i>		-	-	-	2 741 124	-	2 741 124
Due to banks and financial institutions		-	-	250 775	-	4 000	254 775
Customer accounts		733 840	-	640 000	1 894 895	-	3 268 735
Other liabilities		29 388	-	75 730,93	-	26 608	131 727
TOTAL LIABILITIES		763 228	-	966 506	4 636 019	30 608	6 396 361
Liquidity gap		1 150 128	522 043	358 516	7 675 530		

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The analysis of interest rate and liquidity risk on balance sheet transactions is presented in the following table:

	Weighted average effective interest rate	Up to 1 month	1month o 3 month	3 month to 1year	1 year to 5 years	Maturity undefined	31 December 2008 Total
ASSETS							
Cash & balances with NBA		632 857	-	-	-	-	632 857
Due from banks		1 563	-	-	-	-	1 563
Property & equipment		-	-	-	-	227 558	227 558
Investments available for sale		-	-	866 000	11 782 560	459 785	13 108 345
Other assets		10 607	301 834	85 648	-	1 732 883	2 130 973
Non-current assets held for sale		-	-	-	-	242 143	242 143
TOTAL ASSETS		645 027	301 834	951 648	11 782 560	2 662 369	16 343 439
LIABILITIES							
Debt securities issued	17%	-	-	-	2 343 628	-	2 343 628
<i>Total interest bearing liabilities</i>		-	-	-	2 343 628	-	2 343 628
Due to banks and financial institutions		-	-	130 100	-	551 487	681 587
Customer accounts		613 690	-	529 000	1 415 278	-	2 557 968
Other liabilities		37 215	-	-	-	71 367	108 582
TOTAL LIABILITIES		650 905	-	659 100	3 758 906	622 854	5 691 765
Liquidity gap		(5 878)	301 834	292 548	8 023 654		

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23 Related party transactions

Total remuneration of directors and senior management included in employee compensation (refer note 20) is as follows :

	<u>2 009</u>	<u>2 008</u>
	AZN	AZN
Directors	<u>3 630</u>	<u>3 142</u>
	<u><u>3 630</u></u>	<u><u>3 142</u></u>