



**ANNUAL REPORT**

**2008**





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## INTRODUCTION

# 1

While the economic crisis engulfed the world in 2008 Azerbaijan's economy continued to grow. The global crisis has had a somewhat restrained impact on the national economy due to the growth of the country's strategic foreign exchange reserves, expansion of cash flows across the economy, ongoing banking reforms and economic diversification policy. Azerbaijan has managed to further strengthen its international position while enhancing its regional role and influence by implementing international energy projects and promoting regional cooperation.

Joint development of hydrocarbon resources with foreign companies, and expansion of export made possible by the successful National Oil Strategy, increased the national foreign exchange reserves as well as the State Oil Fund's foreign exchange resources to increase rapidly over 2008. The State Oil Fund's assets grew from **USD2.47 billion** on the 1st January 2008 to USD8.7 billion or 4.5 times to **USD11.2 billion** at the end of 2008.

Another source of income contributing to the State Oil Fund's wealth in connection with the crude oil exports via the Heydar Aliyev Baku-Tbilisi-Ceyhan (BTC) main export pipeline in 2008 came from dividends of **USD119.6 million**, which represented Azerbaijan's share in the BTC project.

Development of non-oil industries has also been a focal point alongside the oil sector. A number of large-scale investment as well as infrastructure projects and state programs for regional development are underway, being financed from the increasingly growing financial resources, in order to meet this goal. Such programs and activities have built various infrastructure and education-related objects, social and other facilities across



the country and in Baku during 2008. Considerable efforts were taken with a view to improving the living conditions and social welfare of the population, addressing social issues, reducing poverty and increasing individual incomes.

In 2008, the State Oil Fund financed a number of large-scale infrastructure and social projects as well as activities aimed at developing the irrigation and water supply systems. The Oil Fund continued financing the projects of reconstructing the Oguz-Gabala-Baku water line and Samur-Apsheron irrigation system, the Baku-Tbilisi-Kars new railway of regional significance as well as activities designed to improve the social, domestic and housing conditions of refugees and internally displaced persons, and to fulfill its state budget transfer obligations.

In 2008, the financing of the "State Program on education of Azerbaijan youth abroad in the years 2007-2015" approved by Presidential Decree of April 16, 2007, was launched. This program is expected to develop the necessary human resource capacity meeting the modern requirements and to help enhance the knowledge base of the young generation. The State Oil Fund's primary contribution to the program's financing serves the idea of "transforming the black gold into human capital" as a strategic measure taken in anticipation of long-term and long-lasting benefits.

Events which took place in global economies in 2008 centered on the worldwide financial crisis whereby the last year went down as a period of hardships and adversity in terms of financial market development. The crisis and associated tensions experienced by the international financial sectors during the year as well as the events surrounding the bankruptcies of a number of large-scale investment and banking institutions have adversely affected the operations of many investment funds managing foreign exchange assets while causing some even to incur tremendous losses in reserves and asset dropdowns.

In order to protect its foreign exchange assets against the negative effects of the global financial crisis the Oil Fund pursued a conservative investment policy aimed at preventing losses on the fixed capital and ensuring secured revenues in 2008. To this end, the Oil Fund carried on with the diversification of its investment and foreign exchange portfolios as well as with investments in highly rated investment instruments; the Fund also managed to secure appropriate income levels. According to the year-end outcomes, the Oil Fund generated AZN231 171,3 thousand in proceeds from asset management thereby executing the relevant item on the Fund's 2008 budget to the measure of 155%.

Implementation of the Extractive Industries Transparency Initiative (EITI) carried on in 2008, with Azerbaijan maintaining its leadership in realizing this Initiative. The UN General Assembly's 62nd session held on September 11, 2008 adopted the "Improvement of Industry Transparency" Resolution suggested by Azerbaijan. 27 countries supported the Resolution as co-authors and Azerbaijan's government was specifically thanked for suggesting this resolution.

15 countries, including Azerbaijan were granted the nominee status on the 3rd conference of the EITI International Management Board held on September 27, 2008 in Oslo, Norway.



## EVALUATION OF MACROECONOMIC DEVELOPMENT IN AZERBAIJAN

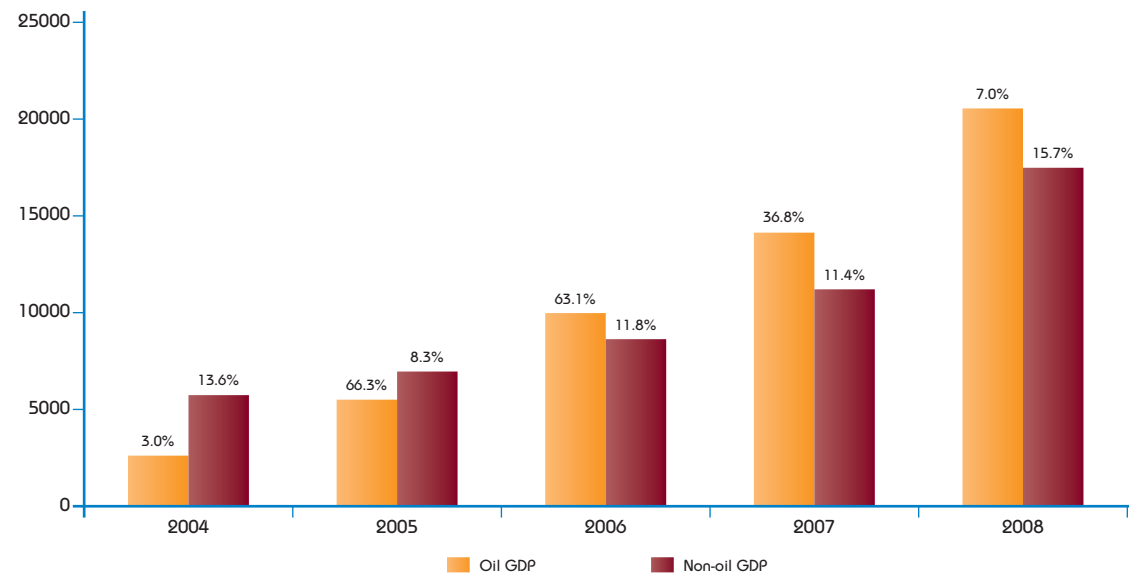
# 2

2008 was characterized with a rapid growth of the main macroeconomic indicators. In the reported year the real growth of the Gross Domestic Product (GDP) amounted to 10.8% against the year 2007 level. GDP per capita increased by AZN1 459.0 or 48.9% from 2007 to AZN4 439.9 in 2008. The non-oil sector's share of the GDP rose from 44.1% in 2007 to 45.9% in 2008. In 2008, the oil sector showed a real growth of 7.0%, and the non-oil sector 15.7%. *Chart 1* below presents the change path of the oil and non-oil sector GDP in 2004-2008.



Chart 1

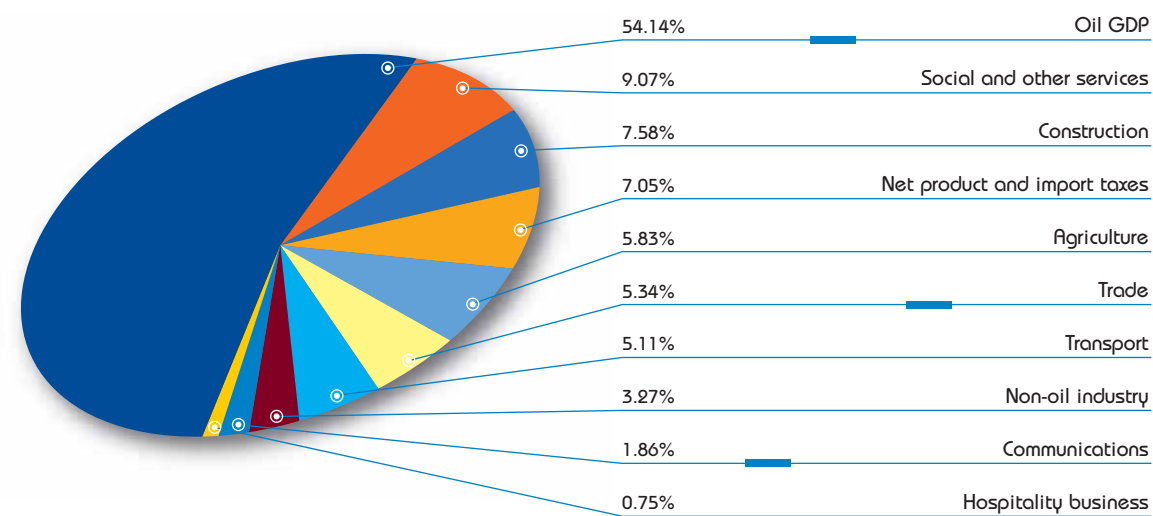
Change path of oil and non-oil GDP in 2004-2008 in Azerbaijan  
(at market prices, AZN million)



In 2008, the share of the non-oil sector's social and other services (9.07%), construction (7.58%) and transport (5.11%) sectors of the GDP increased as compared to 2007 (Chart 2 below).

Chart 2

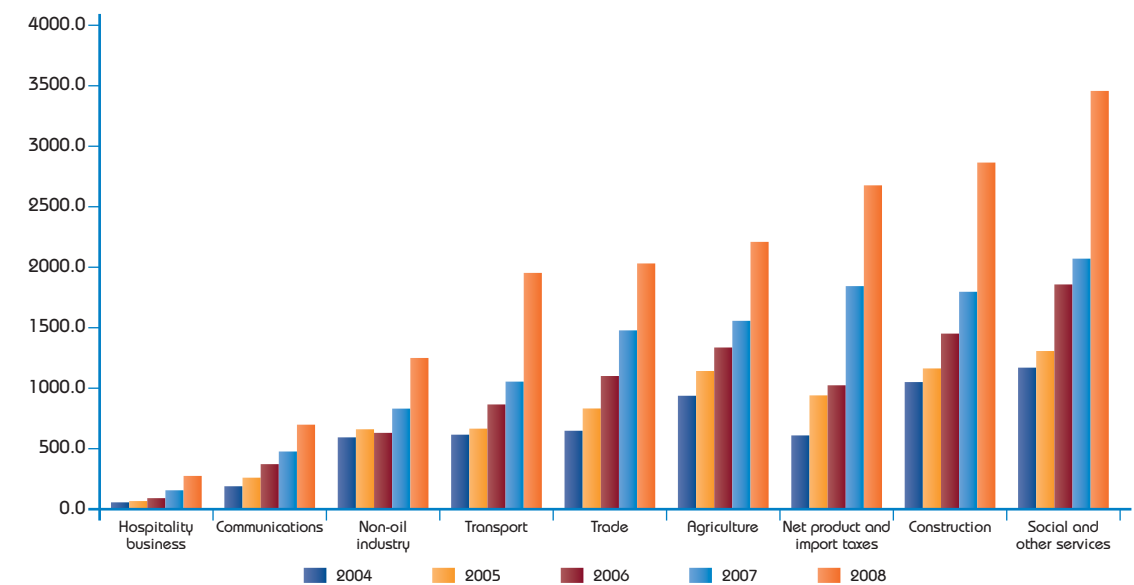
Structure of GDP in 2008



In the reported year, agriculture, construction, trade, social and other services, and net product and import taxes demonstrated higher real growth rates as compared to the previous year. Thus, in 2007 and 2008 agriculture showed real growth rates of 4.0% and 6.1% respectively, construction 16.0% and 36.0%, trade 15.3% and 15.5%, social and other services 5.2% and 7.9%, and net product and import taxes 11.3% and 15.8%.

Chart 3

Change path of non-oil sector industries in 2004-2008  
(at market prices, AZN million)



Investments in the non-oil sector increased in 2008. Capital investments in non-oil sector constituted 35.4% of non-oil GDP in 2007, and 40.3% in 2008. This was primarily due to the rise in public investment expenditure. In the reported year foreign investments totaled to USD2 708.6 million, which is 16.3% less than the last year's number.

State budget expenditures amounted to AZN10 680 million in 2008, which indicates an increase of AZN4.6 billion or 76.3% against the 2007 level. In 2008, state budget revenues increased, as a percentage of the gross domestic product, by 5.9% over the 2007 level, and state budget expenditures by 5.5%, amounting to 28.3% and 28.1% respectively.

Although the average annual inflation rate remained quite high in 2008 (20.8%), individual income increased by a nominal 37.8%, which indicates a continued two-digit growth of real individual incomes (real growth was 22.3% in 2007, and 14.1% in 2008).



## STATE OIL FUND'S FINANCIAL ACTIVITIES IN 2008

# 3

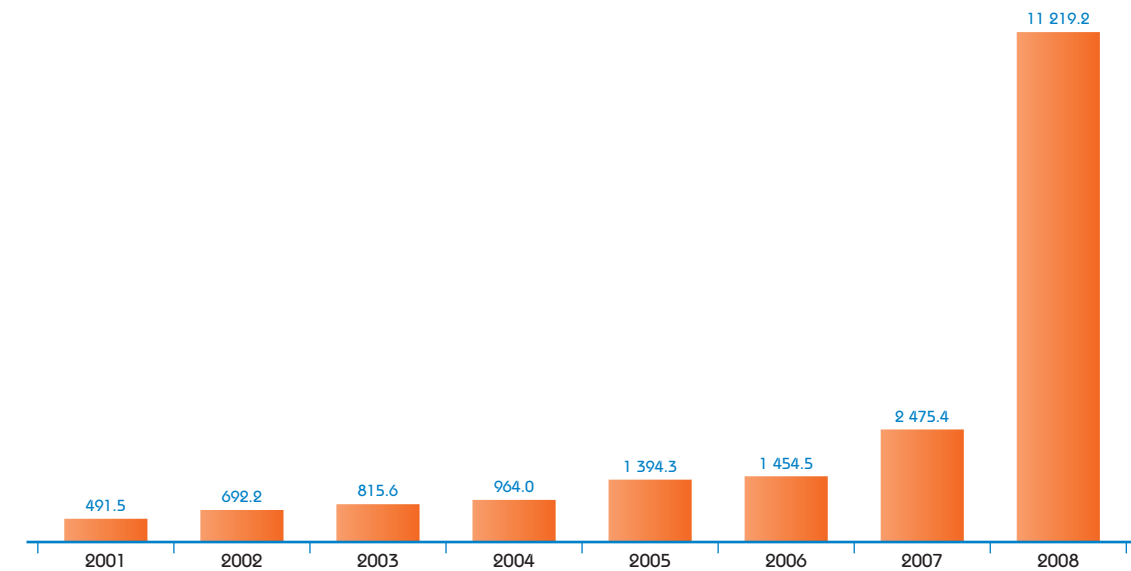
As of January 1, 2008 the State Oil Fund's total accumulations amounted to AZN2 092.4 million or USD2 475.4 million. As of December 31, 2008 the Fund's total assets amounted to **AZN8 986.7\*** million or, in USD equivalent, approximately USD11 219.2 million through an increase of AZN6 894.3 million (USD8 743.8 million) or up to 4.5 times in USD equivalent during the year.

Chart 4 below presents the change path of SOFAZ' assets during 2001-2008.

\* Year-end total assets as presented in the Statement of financial position of SOFAZ by Deloitte&Touche Limited Liability Company are above the corresponding amount as presented in the Fund's statement because of deduction of fixed assets and intangible assets (AZN7.1 million), advance payment and other short-term assets of AZN16.0 million, including AZN13.1 million of current advance tax payments from the total assets in the SOFAZ's statement.

Change path of the State Oil Fund's assets in 2001-2008  
(USD million at year-end)

Chart 4



The State Oil Fund's total revenues during 2008 amounted to AZN11 864 648.1 thousand. In the reported year the Oil Fund's total expenditures amounted to AZN4 291 751.4 thousand.

Table 1

Oil Fund's 2008 cash flow spreadsheet

Revenues	Amount	
	AZN thousand	USD million
As of 01.01.2008 <b>ASSETS ACCUMULATED</b>	<b>2 092 406.1</b>	<b>2 475.4</b>
<b>TOTAL REVENUES:</b>	<b>11 864 648.1</b>	<b>14 532.2</b>
<i>Including:</i>		
Revenues from Oil contracts	11 633 476.8	14 247.0
Revenues from management of Fund's asset	231 171.3	285.2
<b>TOTAL EXPENDITURES:</b>	<b>4 970 375.2</b>	<b>5 788.4</b>
<i>Including:</i>		
Profit tax and other taxes	25 977.9	—
Net exchange rate difference on foreign exchange transactions	652 645.9	—
As of 31.12.2008 <b>Balance of the Fund's assets</b>	<b>8 986 679.0</b>	<b>11 219.2</b>



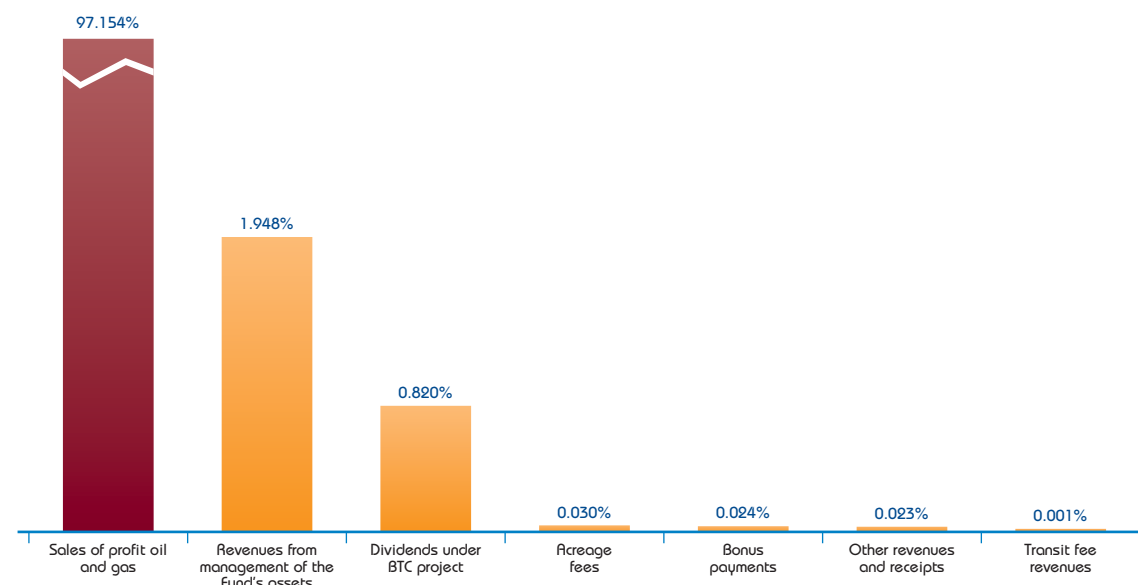
## Revenues

Other sources of the State Oil Fund's revenues in 2008 were proceeds from sales of the Republic of Azerbaijan's share of hydrocarbons (97.5%), revenues from management of the Fund's assets (1.6%), Republic of Azerbaijan's share of dividends from oil and gas projects (BTC project) (0.82%), acreage fees (0.03%), bonus payments (0.02%), proceeds from sale of assets delivered by foreign investors to Azerbaijani counterparts (0.02%), and transit fees (0.001%).

Chart 5 below presents the structure of the Fund's revenues.

Chart 5

### Structure of the State Oil Fund's revenues in 2008



### Proceeds from sales of profit oil and gas

In 2008, the State Oil Fund gained a total of AZN11 526 985.7 thousand, or USD14 116.0 million, generated from sales of the Republic of Azerbaijan's share of hydrocarbons, of which USD13 937.4 million represented the proceeds from sales of oil produced from the Azeri-Chirag-Guneshly oilfield (228 consignments of profit oil), USD29.3 million (12 consignments of profit oil) from oil produced in Mishovdag and Kalamaddin oilfield, and USD18.1 million (4 consignments of profit oil) from oil produced in Kursengi and Garabagly oilfield, and USD131.2 million in revenues from sales of gas produced from Shakhdeniz field (12 consignments of gas). Proceeds from sales of hydrocarbons amounted to 97.5% of the total income of the Oil Fund.

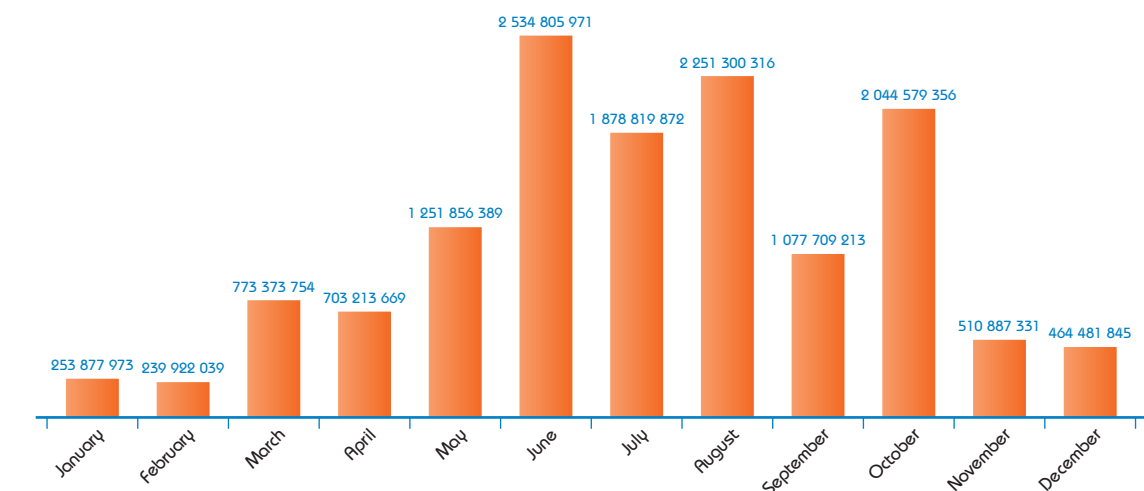
In 2008, world market prices for oil were high. The January average monthly price of Brent oil increased from USD92.56 to USD139.3 in June. The second half of the year witnessed a downward trend in oil prices. Thus, crude oil prices that were around USD123.24 in July dropped down to USD41.76 in December.

Due to the declining crude oil prices in the second half of 2008 the State Oil Fund's revenues derived from sales of profit oil were low as compared to the first six months of the year. Quite contrary to the rapid growth of the State Oil Fund's revenues in the first six months of 2008, the Fund's revenues from sale of profit oil consignments slowed down considerably as the Azerbaijani oil's transportation to the world markets had been subjected to limitations because of the events taking place in the South Caucasus region and Turkey in the second half of the year. Thus, the delays arising in the restoration of the section of the Baku-Tbilisi-Ceyhan main export oil pipeline passing through the Arzindjan district of Turkey following an explosion of August 5, 2008, coupled with the difficulties in the transportation and sales of crude oil to foreign markets due to the tensions and hostilities engulfing the entire region as a result of the Georgia - South Ossetia conflict that had erupted sometime in August last year have ultimately had a substantial negative impact on the State Oil Fund's income deriving from sale of profit oil and gas.

Chart 6 below presents the State Oil Fund's profit oil and gas revenues in 2008 on a monthly basis.

Chart 6

### Revenues of SOFAZ from sales of profit oil in 2008 (US Dollars)

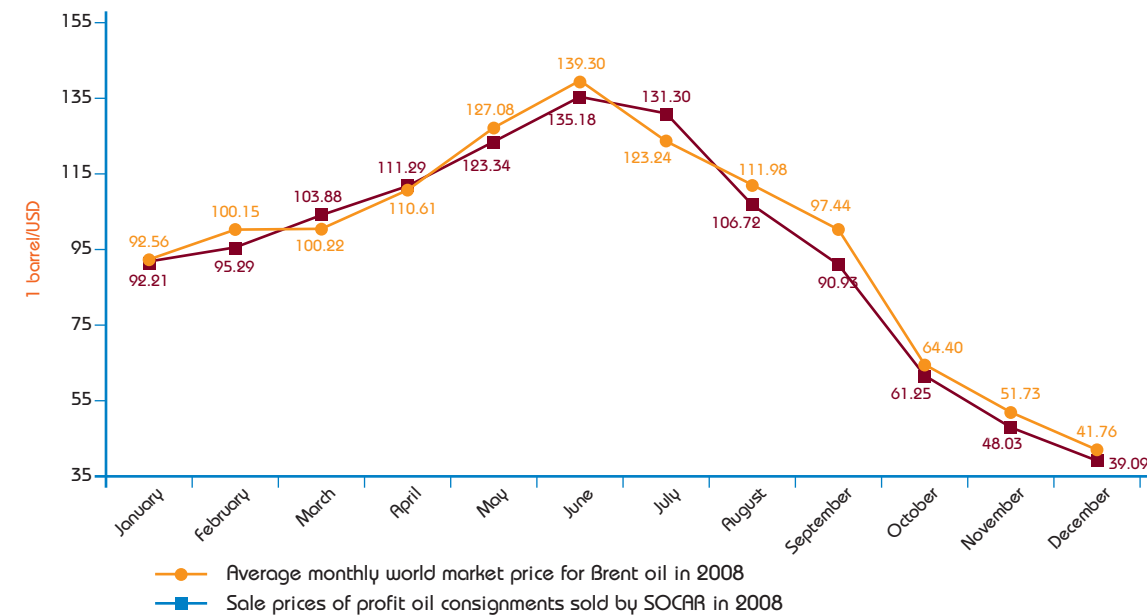


The average weighted price per barrel of profit oil consignments sold by the State Oil Company of Azerbaijan Republic and posted to the State Oil Fund in the reported year was approximately USD101.



Chart 7

Comparative change paths of world market average monthly prices for Brent oil and average monthly sale prices of profit oil consignments sold by SOCAR in 2008



SOCAR deducts oil transportation costs, banking, customs clearance, and surveyor, marketing and insurance costs when transferring the proceeds from sales of profit oil to the Oil Fund.

### Bonus payment revenues

Another source of the State Oil Fund's revenues in the reported year is attributed to bonuses paid by investors in connection with signing or execution of oil and gas contracts. Total bonus payments received by the Oil Fund during 2008 amounted to AZN2 822.2 thousand or USD3.5 million. Thus, in the reported year, Sinopek LTD, Middle East Petroleum LTD and Petro Hong-Kong LTD paid USD499.9 thousand for increasing the average daily production of crude oil at Pirsaat field; in addition, foreign oil companies paid a total of USD2 981.9 thousand for the assertion of industry-scale reserves of the Shakhdeniz field, where BP International LTD's share based on the company's participation in the field was USD844.9 thousand; Lukoil Overseas - USD331.3 thousand; Turkiye Petrolleri - USD298.2 thousand; Statoil - USD844.9 thousand; Total EP - USD331.3 thousand; Naftiran Co - USD331.3 thousand.

Table 2 below presents bonus payments by sources.

Table 2

Revenues of State Oil Fund from bonus payments in 2008

Transferor	Field	Date	Amount	
			AZN thousand	USD million
Sinopek LTD	Pirsaat	29.05.2008	205.9	0.3
Middle East Petroleum LTD	Pirsaat	04.06.2008	153.8	0.2
Petro Hong Kong LTD	Pirsaat	23.06.2008	50.9	0.1
BP International LTD	Shahdeniz	29.07.2008	681.9	0.8
Lukoil Overseas	Shahdeniz	29.07.2008	267.4	0.3
Turkiye Petrolleri	Shahdeniz	31.07.2008	683.5	0.9
Statoil	Shahdeniz	31.07.2008	241.3	0.3
Total EP	Shahdeniz	01.08.2008	268.2	0.3
Naftiran Co.	Shahdeniz	11.08.2008	269.3	0.3
<b>Total</b>			<b>2 822.2</b>	<b>3.5</b>

Bonus payment revenues constituted 0.02% of the Oil Fund's total income.

### Acreage fee revenues

Another source of the Oil Fund's revenues in the reported year was the acreage fees paid by foreign investors for the use of contract areas in connection with the development of hydrocarbon resources. Acreage fees received by the Oil Fund in 2008 totaled AZN3 567.0 thousand or approximately USD4.4 million. USD1.8 million of the acreage fees were paid by BP Azerbaijan, USD2.6 million by Lukoil Overseas.

These revenues accounted for 0.03% of the Oil Fund's total income. Table 3 below presents the acreage fee revenues of the Oil Fund during 2008.

Table 3

Revenues of State Oil Fund from acreage fee payments in 2008

Transferor	Field	Date	Amount	
			AZN thousand	USD million
BP International LTD	Inam	07.01.08	760.8	0.9
BP International LTD	Inam	02.12.08	728.5	0.9
Lukoil Overseas	Yalama	10.12.08	2 077.7	2.6
<b>Total</b>			<b>3 567.0</b>	<b>4.4</b>

Lukoil paid 58.8% and BP Azerbaijan 41.2% of the total acreage fees.



### Dividend payment revenues

Another source of revenues of SOFAZ in the reported year represented the Republic of Azerbaijan's share of dividends of AZN97 234.6 or USD119.6 million (under the BTC project) payable in view of the implementation of the oil and gas projects. USD16.5 million of this amount is the dividends paid for the Heydar Aliyev Baku-Tbilisi-Ceyhan Main Export Pipeline's 2007 operations and USD103.1 million for the pipeline's 2008 operations. The dividend payment revenues accounted for 0.82% of the Oil Fund's total income. Table 4 below lists the Oil Fund's dividend payment revenues by source in 2008.

Table 4

#### Dividend payment revenues of the Oil Fund in 2008

Transferor	Date	Amount	
		AZN thousand	USD million
AzBTC Limited	15.01.2008	13 969.5	16.5
AzBTC Limited	17.01.2008	53.4	0.1
AzBTC Limited	27.06.2008	46 419.4	57.1
AzBTC Limited	18.12.2008	36 792.3	45.9
<b>Total</b>		<b>97 234.6</b>	<b>119.6</b>

In the reported year the State Oil Fund also received transit fees of AZN165.7 thousand or USD0.2 million for oil and gas transported through the territory of Azerbaijan. These revenues constituted 0.001% of the Fund's total income in 2008.

### Other revenues and receipts

The State Oil Fund's revenues under the other revenues and receipts item in 2008 amounted to AZN2 701.6 thousand or USD3.3 million. The other revenues and receipts item includes the proceeds from sales of assets (aged or unused metal scrap, pipes) delivered by investors (foreign oil companies) under oil and gas contracts. Revenues under this item amounted to 0.02% of the Oil Fund's total income.

### Income of the State Oil Fund from asset management

Income generated from asset management constituted a significant source of the State Oil Fund's total revenues in 2008 and stood at AZN231 171.3 thousand. These revenues amounted to 1.6% of the Oil Fund's total revenues.

The current state of international financial and currency markets have a definitive bearing on investment and management of the Oil Fund's financial assets.

The events taking place in the economies across the globe in 2008 centered on the worldwide financial crisis whereby the last year went down as a period of hardships and adversity in terms of financial market development. The crisis and the associated tensions experienced by the international financial sectors during the year as well as the events surrounding the bankruptcies of a number of large-scale investment and banking institutions have adversely affected the operations of many investment funds managing foreign exchange assets while causing some even to incur tremendous reserve losses and asset dropdowns.

In order to protect its foreign exchange assets against the negative effects of the global financial crisis the Oil Fund pursued a conservative investment policy aimed at preventing losses on the fixed capital and ensuring secured revenues in 2008. To this end, the Oil Fund carried on with the diversification of its investment and foreign exchange portfolios as well as with investments in highly rated investment instruments; the Fund also managed to secure appropriate income levels.

There are several factors underpinning the global financial crisis. The failure of the US mortgage lending system earlier in the year was the primary contributor to the origination of the worldwide financial crisis. On the other hand, the soaring crude oil prices and, consequently, price leaps over the world also had their input to the emergence of the financial crisis. Thus, the WTI crude oil rose in price to USD145 per barrel\*, thus driving the consumption levels for the primary energy carrier down low and eventually reducing crude oil production. As a result, crude oil prices went down to as low as USD40 over a few months later in the year.

**Economic performance of the world's leading countries.** The global financial crisis of 2008 had an adverse effect on the economic growth of the world's leading countries.

**United States of America.** Late in 2007, the US Central Bank's "soft" monetary policy distinguished with a series of interest rate cuts considerably expanded the coverage of the mortgage lending framework while enabling the money supply to be deregulated and setting the groundwork for the unstoppable rise of the real estate prices. This dramatic price increase peaked in 2008 effectively bringing the US real estate market, which had not been based on real recovery/collection, to a failure. The failure caused the US Gross Domestic Product (GDP) to be on the low side with its growth rates. Thus, the GDP's average annual growth rate in 2008 was -0.8% (versus 2.3% in 2007). The crisis also showed itself in inflation and unemployment and while the consumer price index was 4.1% in 2007, it went down to as low as 0.1% in 2008, whereas the unemployment level rose to 7.2% in 2008 from 4.9% of 2007. In 2008, the country's exports of goods and services totaled USD1 835.8 billion, with imports amounting to USD2 516.9 million; the trade balance deficit declined by 2.7% against the 2007 level rolling down to a negative USD681.1 billion. The balance of trade in 2008 constituted 4.7% of the GDP vs. 5.1% of 2007.

**Great Britain.** Great Britain's growth performance also experienced a substantive downturn as opposed to the previous years. Thus, Great Britain's GDP growth rate was -2.0% (vs. 3.1% of 2007) in 2008. The average annual unemployment level made 5.6%. The 2008 year-end consumer price index (inflation) was 3.1% (vs. the 2007 year-end 2.1%).

\* International economic and financial figures and numbers of this section are provided by Bloomberg L.P.



**Canada, France, Germany, Italy and Japan.** The year of 2008 saw the G7 countries skidding at growth rates way below those of 2007. Thus, Canada had a GDP growth rate of 0.5% (1.9% in 2007); France of -1.7% (2.2% in 2007); Germany of -1.8% (1.7% in 2007); Italy of -3.0% (0.2% in 2007); and Japan of -4.3% (1.9% in 2007).

**China and India.** While the world's leading countries struggled on with the economic crisis, China and India carried on upon their dynamic development path although this year's growth was somewhat lower than those from the previous years. Thus, while in 2007 China had an average annual GDP growth rate of 11.2% and India of 8.7%, these two countries ranged about 6.8% and 6.7% respectively.

Table 5 below presents the GDP growth rates for the above mentioned countries.

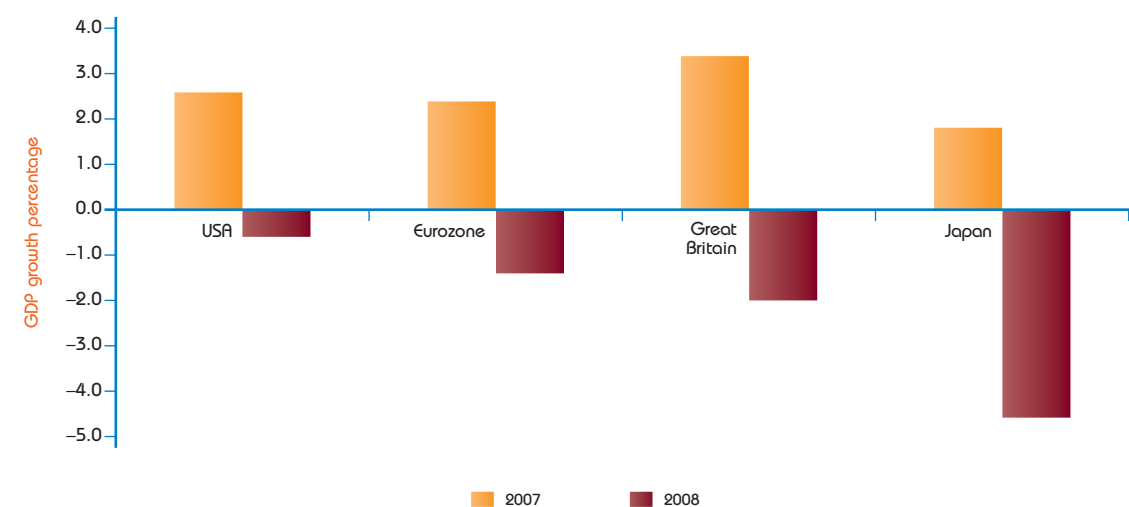
Table 5

Comparative analysis of GDP growth rates in developed countries in 2008 (%)

	2008				Average annual growth rate
	I	II	III	IV	
USA	0.9	2.8	-0.5	-6.3	-0.8
Eurozone countries	0.7	-0.3	-0.3	-1.8	-1.7
Great Britain	0.3	0.0	-0.7	-1.6	-2.0
Japan	0.8	-0.9	-0.6	-3.8	-4.3

Chart 8

GDP growth pattern in developed countries in 2007-2008

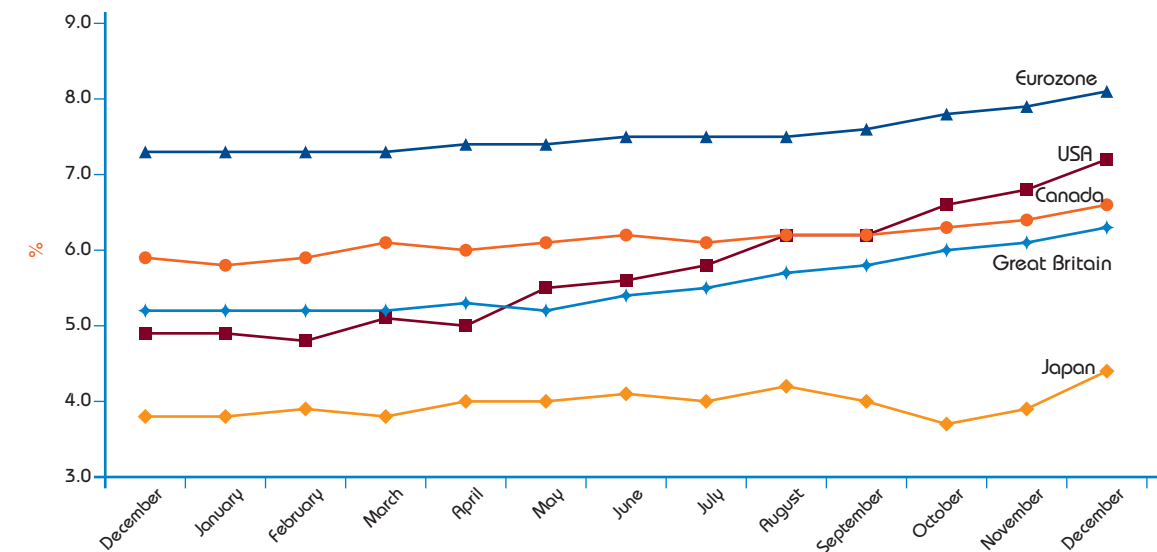


Processes taking place in the world economy in 2008 have also caused the rates of unemployment in the developed countries to go up. USA, Eurozone states and Great Britain clearly had a fair share of unemployment upturn during the year. Thus, the aver-

age unemployment rate throughout the year rose from 4.9% to 7.2% in the USA, from 7.3% to 8.1% in Eurozone, from 5.2% to 6.3% in Great Britain, from 6.6% to 5.9% in Canada; and in Japan from 3.8% to 4.4%. Chart 9 below presents unemployment rates for the leading countries.

Chart 9

Unemployment rates in developed countries in 2008 (month-end by months)



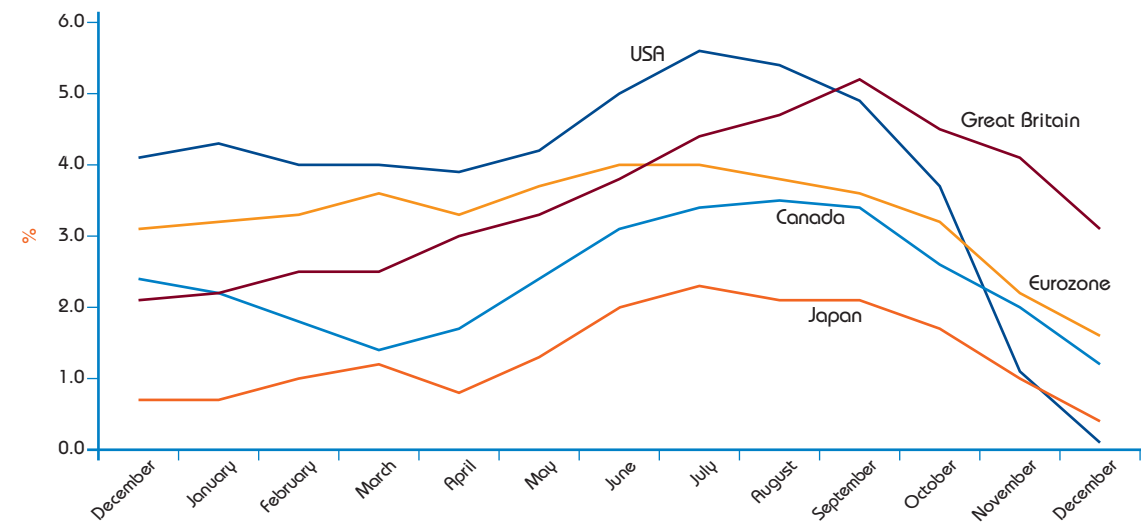
**Crude oil prices.** In 2008, crude oil prices demonstrated dramatic movements. WTI crude oil went up from the January price of USD100 per barrel to USD145 per barrel in July, before the process reversed as the prices dropped to USD40 per barrel by late December. Three major factors drove the substantial increase of crude oil prices in the first half of the year. US Dollar depreciation, increased demand for crude oil in an environment of low-cost credits and, finally, enhancing investments in this product considered to be the primary energy carrier have altogether contributed to the increase of the crude oil prices. On the other hand, widespread concerns surrounding the United States Energy Department's and other agencies' reports of oil reserves depleting, oil production reaching its peak capacity and some abusive manipulations involving oil prices are related by some to be the prime determinants of the rapid price increases during the reported year. Yet, the year of 2008 will be remembered for a very dramatic, big-scale decline of oil prices. Thus, while over a 4 year period from 2004 to July 2008 the price of oil went up from USD35 per barrel to USD145 or increased by about 4.2 times, in the following six months of 2008 price dropped down to USD40 or decreased by about 3.6 times. This more than triple decrease of the crude oil prices during the August-December, 2008 period was primarily caused by the financial crisis reigning in the USA and other countries.

In an environment of significant price volatility for energy carriers in 2008, most developed countries displayed an increase of the consumer price index in the first half of the year, and a decline thereof in the second half. This is clearly visible on the chart below.



Chart 10

Annual inflation rates in developed countries in 2008  
(month-end)

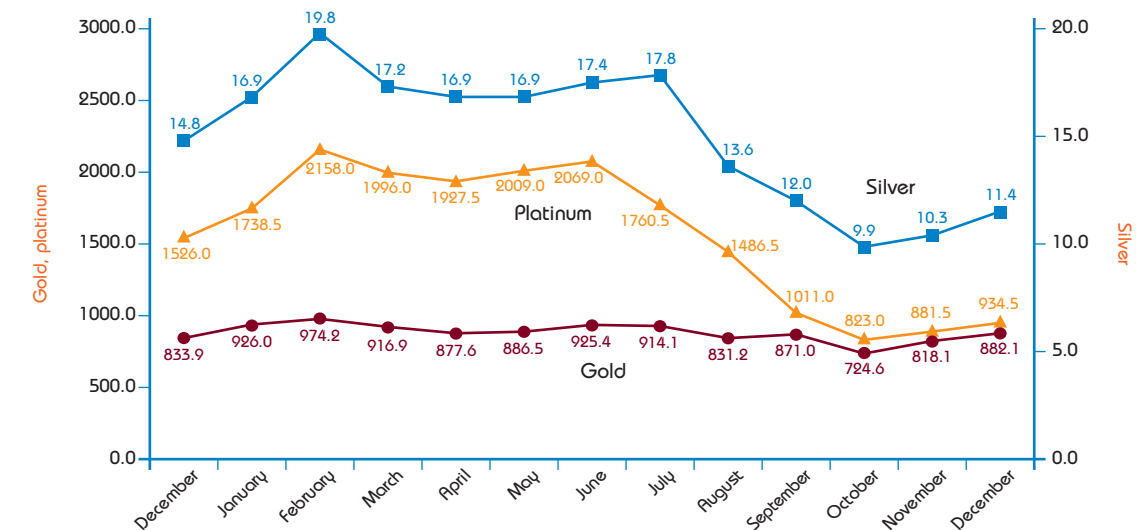


**Prices of non-ferrous metals.** As was the case with energy carriers, prices of non-ferrous metals also showed some downward trends in 2008.

Thus, the price of 1 unit of platinum went down from the USD1526.0 in the end of 2007 to the USD934.5 in the end of 2008 or 38.8%, while the price of silver declined from USD14.8 to the USD11.4 or 23.0%. Prices for gold changed in a somewhat more stable way as compared to platinum and silver. Thus, the price of 1 Trojan ounce of gold at USD833.9 at the end of 2007 fluctuated during 2008 reaching USD724.6 by the end of October; thereafter, it rose later in the year to USD882.1, thereby having increased against the 2007 year-end level by 5.8%. Chart 11 below presents the prices of gold, silver and platinum in 2008.

Chart 11

Prices of gold, silver and platinum in 2008  
(month-end, USD)

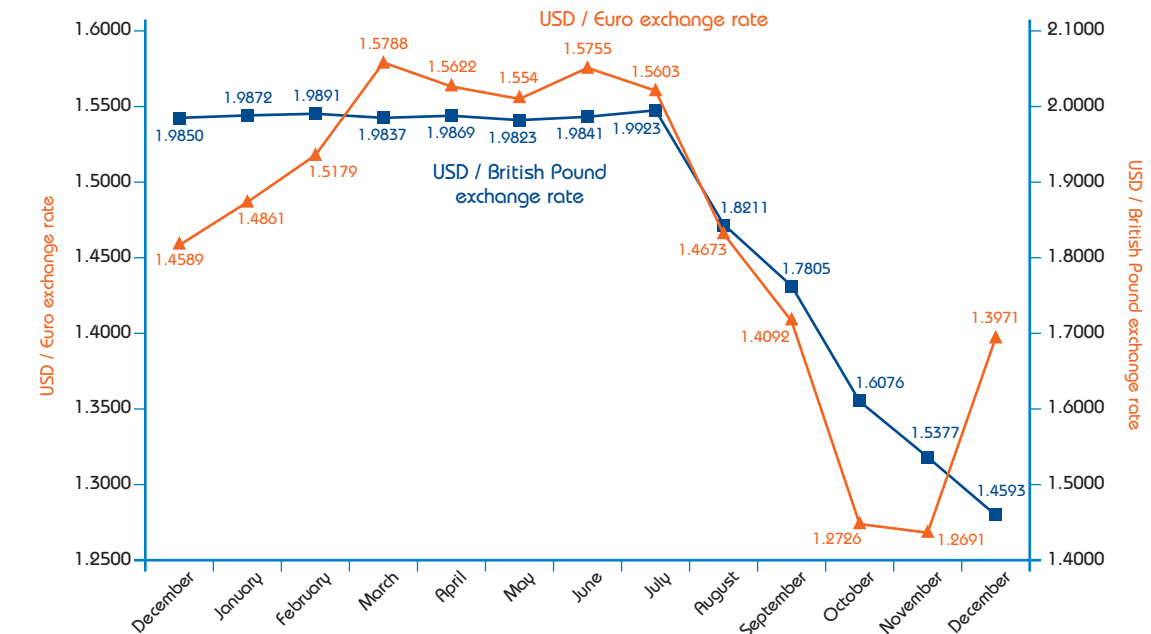


**Currency markets.** During 2008 the world's currency markets were stressed, which was primarily due to the changes in the exchange rate of the USD against other lead currencies. In the first half of the year the USD devalued against the Euro. Thus, the 1.4592 level of USD against Euro in early January rose to 1.5755 in late June.

In the environment of energy prices dropping in the second half of 2008 the USD appreciated against the world's other lead currencies. Thus, USD devalued against Euro from 1.5755 in late June to 1.2691 in late November, thereafter increasing to 1.3971 in late December. The USD's exchange rate against the British Pound, after some minor fluctuations in the first six months of 2008, decreased from 1.9841 in late July to 1.4593 by the year-end. As the year's outcome, USD appreciated against Euro by 4.3%, and by 26.5% against the British Pound during 2008. Chart 12 below presents the USD exchange rates against Euro and British Pound in 2008.

Chart 12

USD exchange rates against EURO and British Pound in 2008  
(month-end)



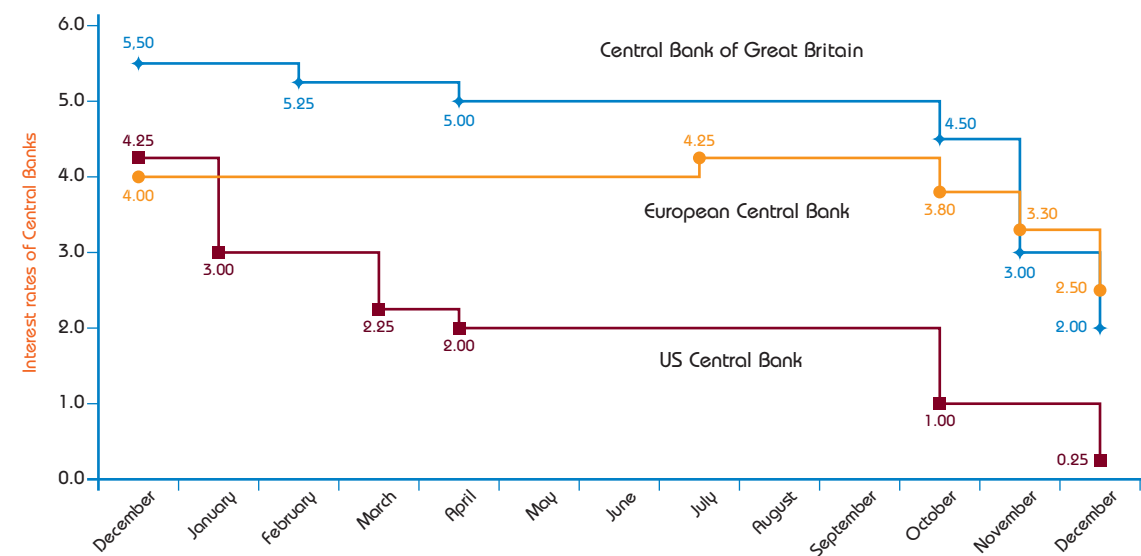
**Interest rates of central banks.** The crisis deepening in the world's financial markets in 2008 had its negative impact on the real sector of economy of the world's leading countries. Central banks of the world's leading countries sought to reduce their interest rates in order to prevent the downturn of economic growth resulting from the abovesaid negative effects, and to promote economic activity. Thus, in order to address the depressed state of the country's credit and real estate markets and provide some stimulation, the US Central Bank had 4 cuts on its interest rate. The US Central Bank's interest rate of 4.25% at the beginning of the year was reduced to 2.00% in April, to 1.00% in October and down to 0-0.25% in December, thereby having been reduced by about 12 times against the year-start level.



The US financial market crisis had an adverse effect on European economy as well. In this view, just like in the US, the Central Banks of Europe and England also pursued the policy of reducing interest rates in 2008. Thus, the Central Bank of England cut its interest rate from 5.50% to 2.00%, while the European Central Bank from 4.00% to 2.50%. *Chart 13* below presents the change path of interest rates of the US, English and European Central Banks.

Chart 13

Comparative change paths of interest rates of US Central Bank, Bank of England and European Central Bank in 2008



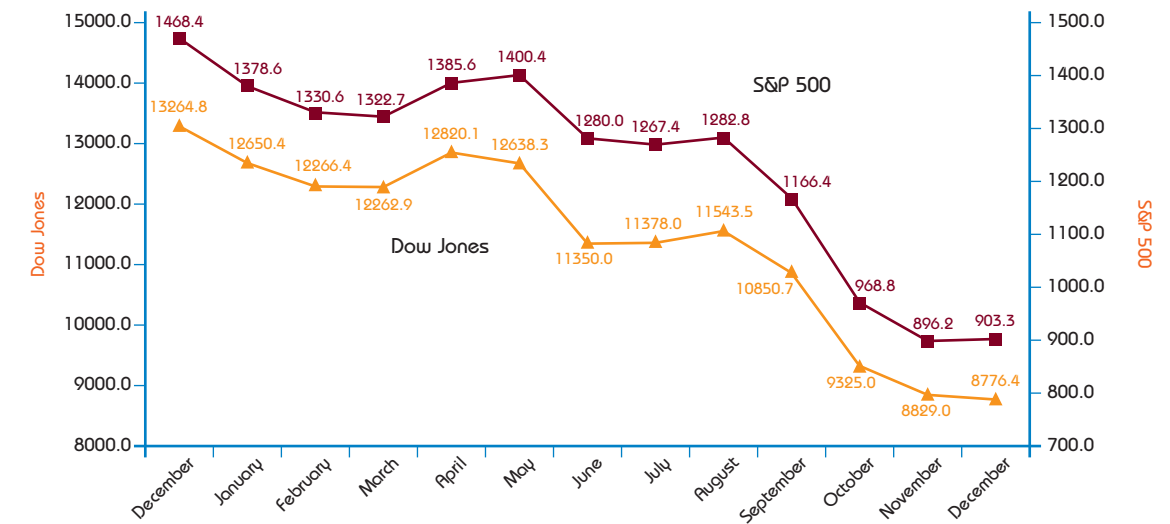
**Major stock exchange indices.** The unstable conditions prevailing on the financial markets in 2008 affected the performance of individual indices.

The world's largest financial investment entities reporting their 2007 losses early in 2008 coupled with the crude oil price going above the USD100 per barrel threshold sheerly catalyzed the downfall of the major stock exchange indices. Thus, the Dow Jones index based on the average stock prices of the world's largest industrial companies quoted on the New York Stock Exchange went down from the year-start level of 13044.0 to 8776.4 by some 32.7%, while the S&P 500 index based on the average stock prices for the US top 500 companies declined by about 37.6%, from 1447.2 to 903.3 (see *Chart 14* below).

Over the year the weighted average level of Dow Jones was 11 224 points, which is 15.0% less than the 2007 level (13 198). The weighted average level of S&P 500 index was 1 215, which is 17.8% less than the previous year's level (1 478).

Chart 14

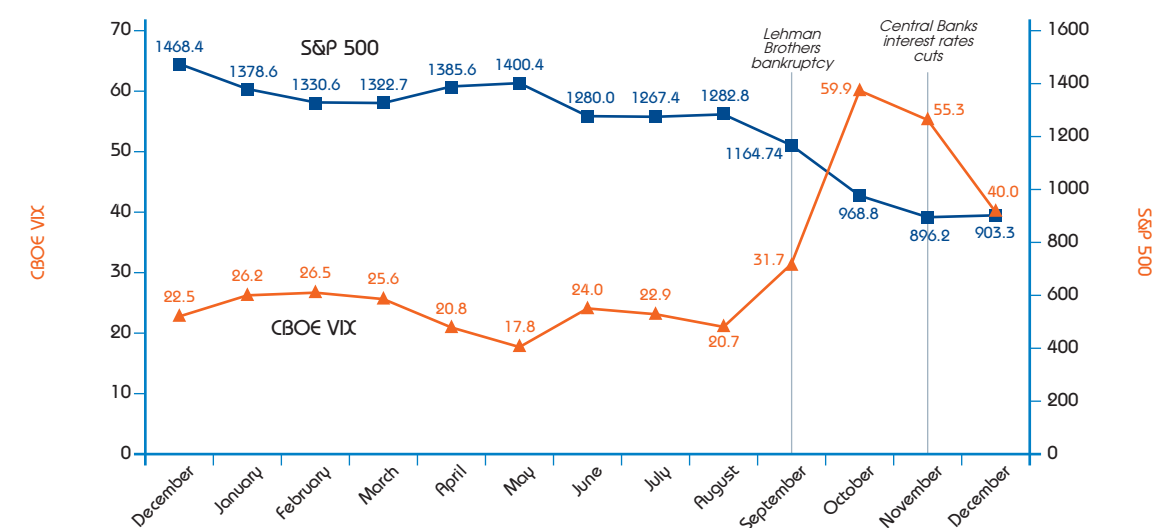
Change path of Dow Jones and S&P 500 indices in 2008 (month-end)



The Chicago Board Options Exchange (CBOE) Volatility Index (CBOE VIX) used for projecting the volatilities expected to occur within 30 days along with market risks and recognized as the "investor fear gauge", estimated based on call and put options within a broad time interval, allows for analyzing the financial market conditions. Thus, while according to the CBOE VIX the implied volatility of the S&P 500 index by the month of August 2008 was 20.7%, the uncertainty created on the markets after the bankruptcy of Lehman Brothers investment company caused the the measure to increase up to 59.9%, then following the central banks' interest rate cuts went down to 40.0%, which all in all proves the global financial system was highly volatile (see *Chart 15* below).

Chart 15

Change path of CBOE VIX and S&P 500 indices (month-end)



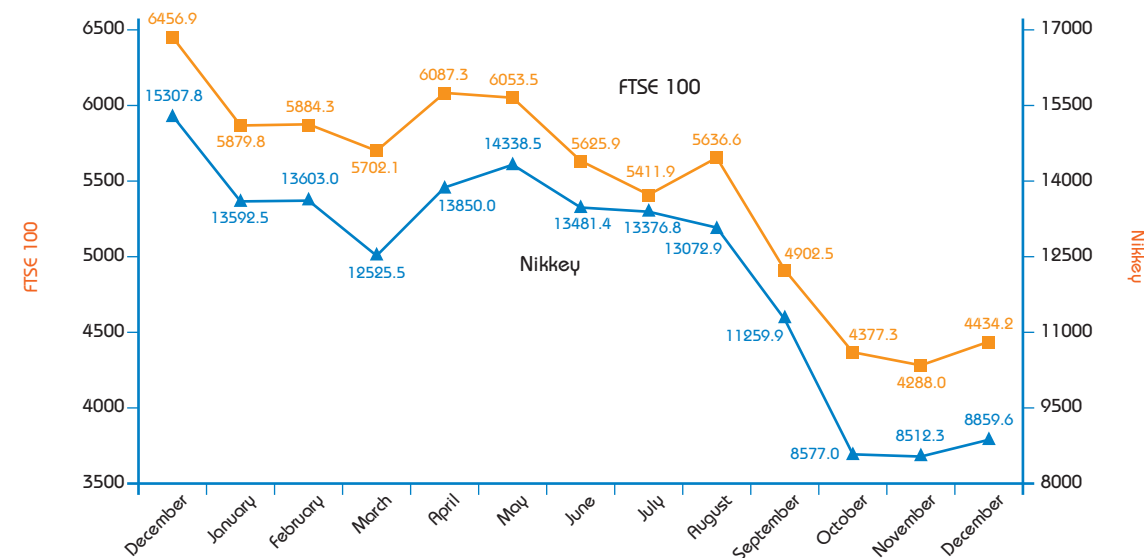


The FTSE 100 index based on the stock prices for top 100 companies quoted on the London Stock Exchange declined by 30.9% from the 2008 year-start level of 6416.7 to 4434.2 at the year-end. The weighted average annual value of this index was 5357, which is 16.6% below the 2007 level (6425).

In 2008, the stock exchange indices of Japan also declined drastically. Thus, the Nikkey index formed on the basis of stock prices for top 225 companies traded at the Tokyo Stock Exchange in the past year declined by 39.7% from 14691.4 to 8859.6 points. The weighted average annual value of this index was 12087, which is below the 2007 level (17002) by 28.9%.

Chart 16

Change path of FTSE 100 and Nikkey indices in 2008 (month-end)

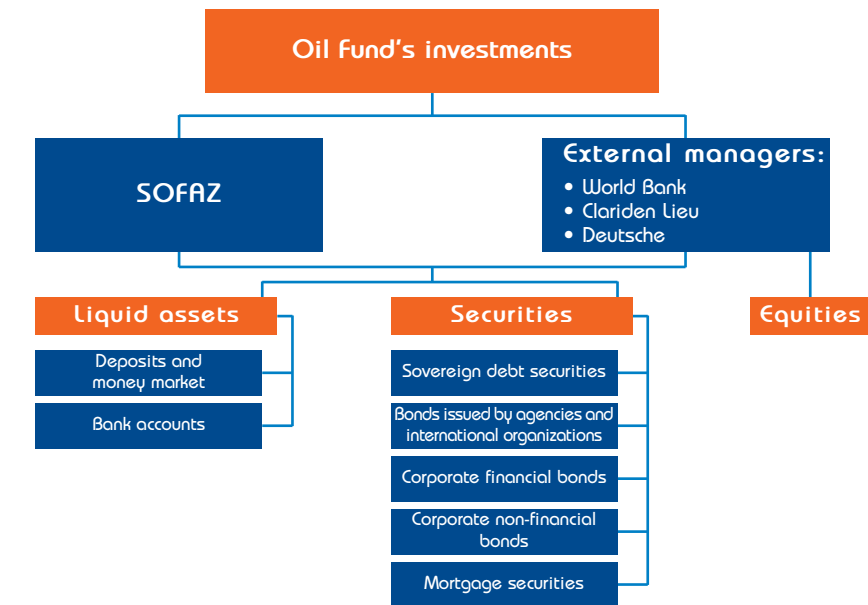


The State Oil Fund's investment portfolio is managed in accordance with the Rules on holding, placement and management of the foreign currency assets of the State Oil Fund of the Republic of Azerbaijan" approved by Presidential Decree of June 19, 2001. During the reported year the Fund's investment policy related to asset management followed the Investment Program for the State Oil Fund of the Republic of Azerbaijan, including the Investment Policy of the State Oil Fund under this program approved by the Presidential Resolution No.2582 dated December 26, 2007. This program sets the return benchmark on the Oil Fund's assets to be "3 month LIBOR" published by the British Bankers' Association for the respective currency.

Bank deposits, money market funds, securities, including sovereign debt securities, bonds, and mortgage securities were the primary investment instruments used in 2008 by the Oil Fund. At the same time, a portion of the Fund's assets was managed by external managers - Clariden Leu (Switzerland) of Credit Swiss Group, and Deutsche Asset

Management GmbH (Germany) of the Deutsche Bank Group, and the World Bank. Scheme 1 presents the Oil Fund's investment areas.

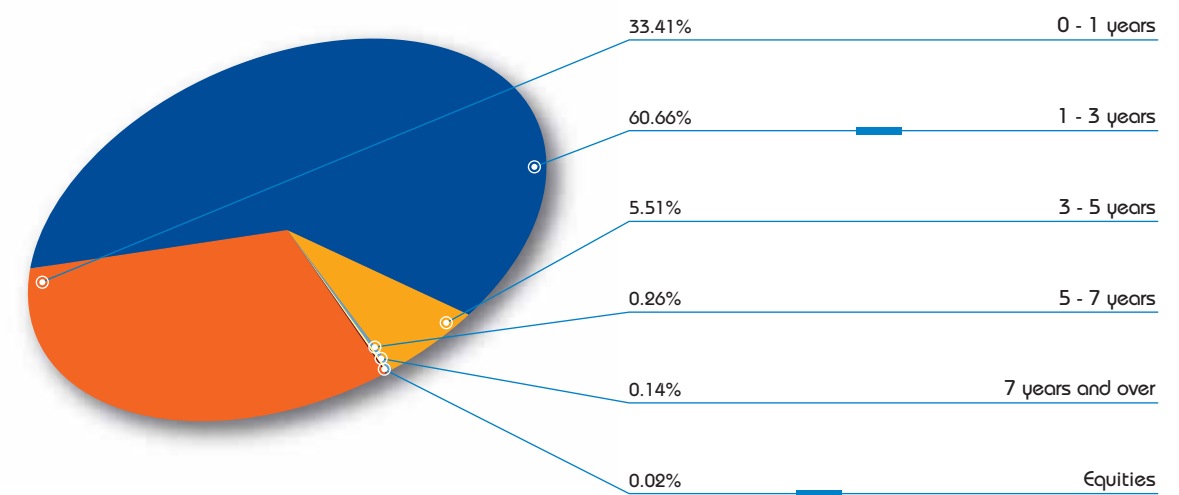
Scheme 1



A major portion of the Oil Fund's assets (60.66%) in 2008 had 1-3 years of maturity. The maturity profile of the Fund's financial assets was as follows: 0 to 1 year maturity - 33.41%, 3 to 5 year maturity - 5.51%, 5 to 7 year maturity - 0.26%, over 7 years - 0.14%. 0.02% of the Fund's assets were invested in equities. Chart 17 below presents the asset distribution by maturity.

Chart 17

Asset distribution by maturity (as of 31.12.08)





As at December 31, 2008, USD10 626.9 million or 95.56% of the Oil Fund's resources were invested in bonds, USD490.6 million or 4.42% in liquid assets, and US2.4 million or 0.02% in equities.

Table 6 below presents the structure of the Oil Fund's investment portfolio by asset class.

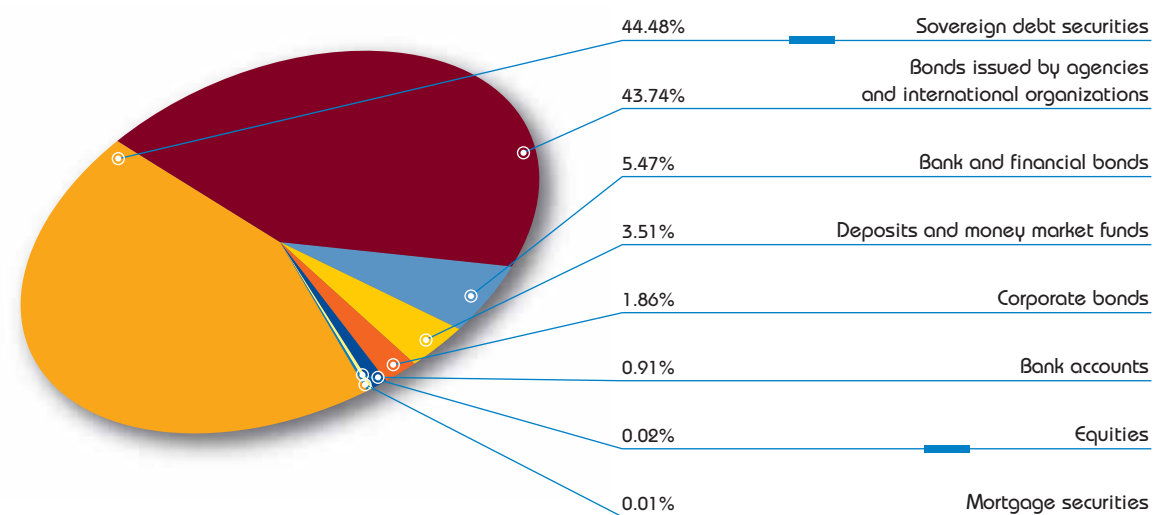
Table 6

Oil Fund's financial assets breakdown  
(as of 31.12.08) USD million

	SOFAZ	Clariden	Deutsche AsM	World Bank	TOTAL	%
<b>SECURITIES:</b>	<b>10 387.4</b>	<b>47.2</b>	<b>78.2</b>	<b>116.5</b>	<b>10 629.3</b>	<b>95.58</b>
<b>Bonds</b>	<b>10 387.4</b>	<b>44.8</b>	<b>78.2</b>	<b>116.5</b>	<b>10 626.9</b>	<b>95.56</b>
Sovereign debt securities	4 816.2	14.7	49.5	65.8	4 946.2	44.48
Bonds of agencies and international institutions	4 784.5	21.4	7.7	50.7	4 864.3	43.74
Bank and financial bonds	585.5	6.4	16.8	—	608.7	5.47
Corporate securities	201.2	1.5	4.2	—	206.9	1.86
Mortgage	—	0.8	—	—	0.8	0.01
<b>EQUITIES</b>	<b>—</b>	<b>2.4</b>	<b>—</b>	<b>—</b>	<b>2.4</b>	<b>0.02</b>
<b>CASH:</b>	<b>486.6</b>	<b>2.2</b>	<b>4.1</b>	<b>-2.3</b>	<b>490.6</b>	<b>4.42</b>
Deposits and money market funds	387.7	2.2	—	0.0	389.9	3.51
Bank accounts	98.9	0.0	4.1	-2.3	100.7	0.91
<b>TOTAL:</b>	<b>10 874.0</b>	<b>49.4</b>	<b>82.3</b>	<b>114.2</b>	<b>11 119.9</b>	<b>100.00</b>

Chart 18

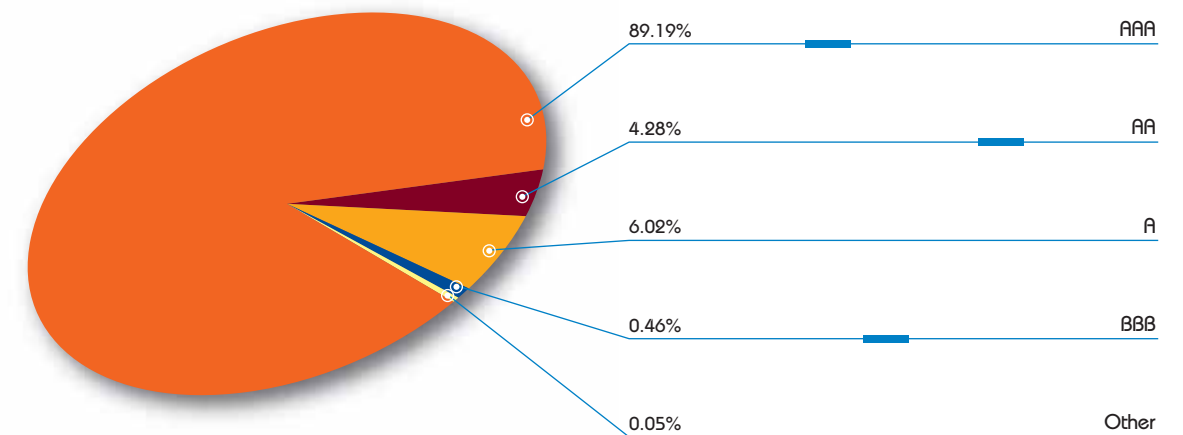
Structure of SOFAZ assets  
(as of 31.12.2008)



During the reported year both the financial institutions as well as the securities invested in by the State Oil Fund, as well as external managers, were rated not below the investment grade by the world's leading credit rating agencies (S&P, Moody's, Fitch). This is clearly indicated by Chart 19 below.

Chart 19

Credit rating of the financial institutions and securities invested in by the State Oil Fund

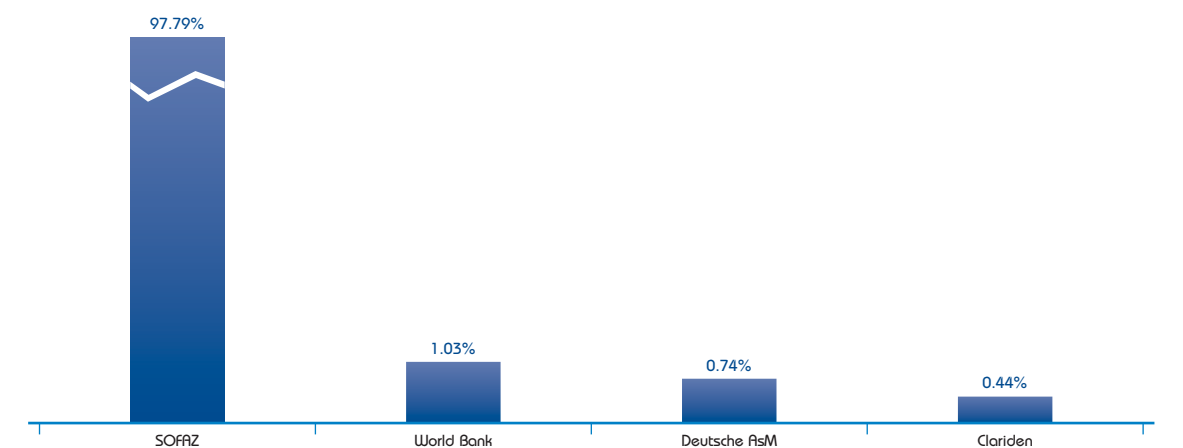


In 2008 a portion of the Fund's assets was allocated to external managers - Clariden (Switzerland), a member of Credit Swiss Group, and Deutsche Asset Management GmbH (Germany), a member of Deutsche Bank Group, and the World Bank. As of December 31, 2008 total assets under external management were approximately USD245.9 million or 2.2% of the Fund's total assets.

Chart 20 below presents the weight of assets managed by external managers as total assets of SOFAZ.

Chart 20

Percentage of assets managed by external managers within SOFAZ's total assets

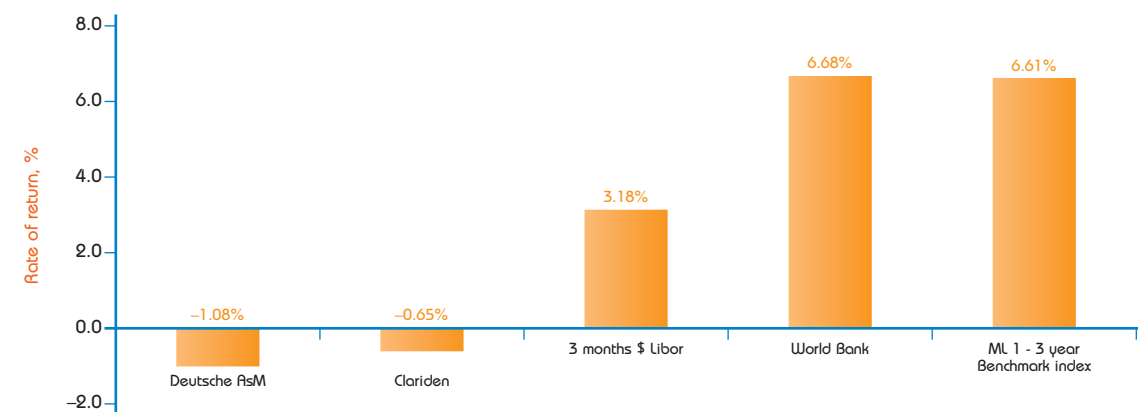




Clariden's actual annual rate of return was -0.65%, Deutsche AsM's -1.08%, and the World Bank's 6.68% in 2008. Dynamics of return of the external managers in management of assets can be compared from *Chart 21* below.

Chart 21

Actual rates of return provided by external managers in 2008



As of the end of 2008, a major portion of the Oil Fund's assets (56.02%) was retained in the European region. In addition, North American and international financial institutions played a major role in investing the Fund's assets (29.65% and 11.83% respectively).

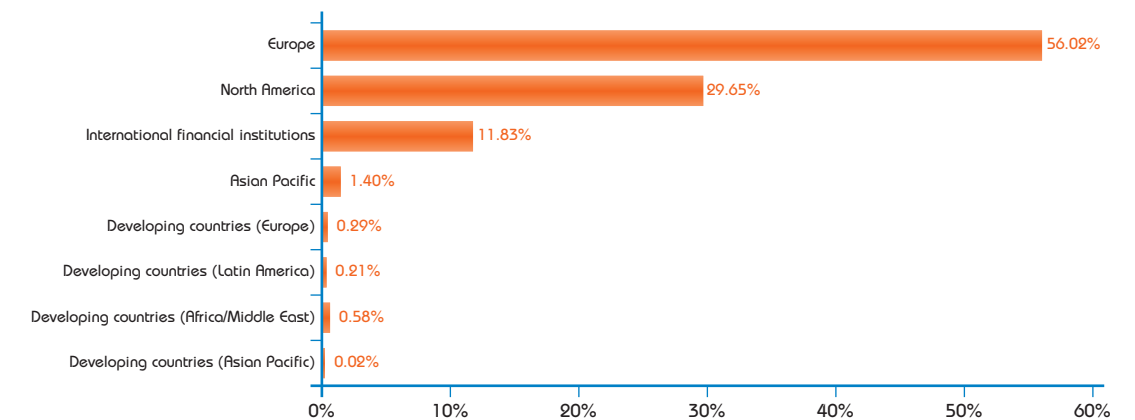
*Table 7* below presents the geographic distribution of the State Oil Fund's investment portfolio.

Table 7

Geographic distribution of SOFAZ investment portfolio  
(as of 31.12.2008)

Geographic region	USD mil.	%
Europe	6 229.71	56.02
North America	3 297.01	29.65
International financial institutions	1 315.74	11.83
Asian Pacific	155.36	1.40
Developing countries (Europe)	32.59	0.29
Developing countries (Latin America)	23.18	0.21
Developing countries (Africa/Middle East)	64.25	0.58
Developing countries (Asian Pacific)	2.05	0.02
<b>Total investment portfolio</b>	<b>11 119.89</b>	<b>100.00</b>

Geographic distribution of SOFAZ investment portfolio  
(as of 31.12.2008)

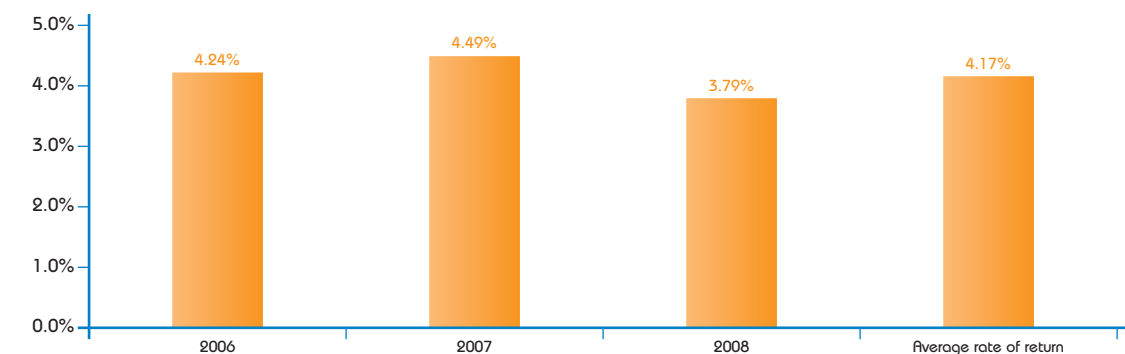


As per the requirements with respect to the currency basket as specified by the Investment Policy (Investment objectives) of the State Oil Fund for 2008 as approved by Resolution No.2582 of the President of the Republic of Azerbaijan dated December 26, 2007, 50% of the total amount of the investment portfolio of the Fund was to be invested in assets denominated in US Dollars, 40% in assets denominated in Euro, 5% in assets denominated in GBP, whereas 5% of the total amount of the investment portfolio of the Fund was to be invested in assets denominated either in currencies of countries with the long-term country ratings (sovereign debt) not less than the credit ratings A (Standard&Poor's, Fitch) or A2 (Moody's), or US Dollars or on prorate base among US Dollars, Euro and GBP. As of December 31, 2008 52.6% of the Fund's investment portfolio (less the expenditures portfolio) were denominated in US Dollars, 42.95% in Euro and 4.38% in British Pounds

The rates of return on the State Oil Fund's financial assets, without the exchange rate fluctuations taken into account, amounted to 4.24% in 2006, to 4.49% in 2007 and 3.79% in 2008. The average rate of return for 2006, 2007 and 2008 was 4.17%. *Chart 23* below presents the rates of return on the Fund's total assets for 2006-2008.

Chart 23

Rate of return on the State Oil Fund's currency portfolio in 2006-2008





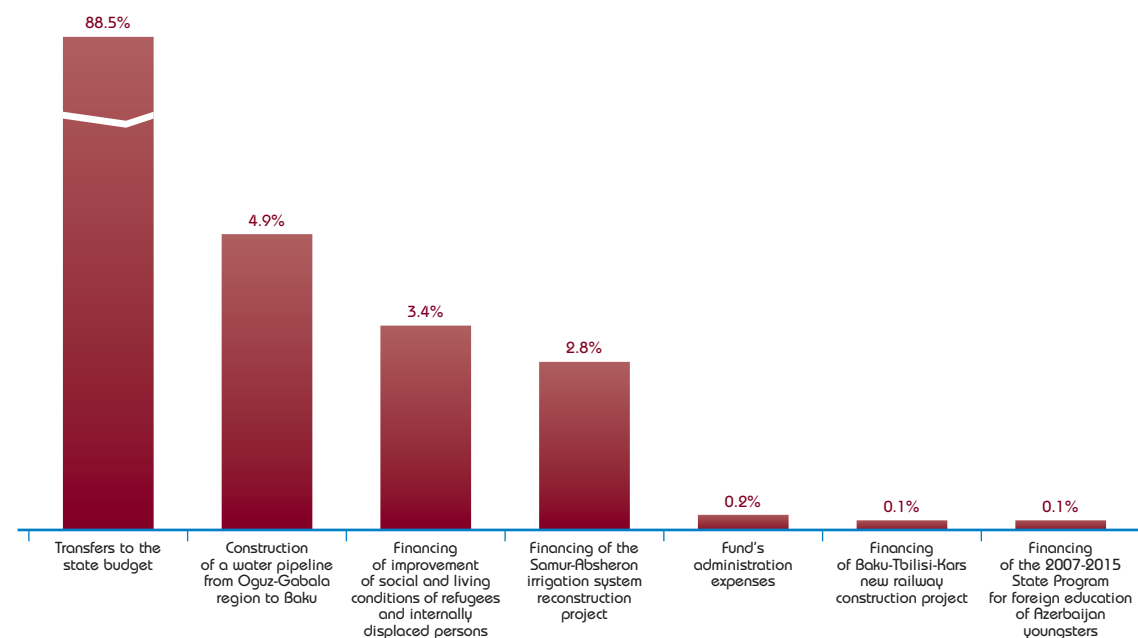
## Expenditures

In the reported year the State Oil Fund continued to finance the project of improvement of social and economic conditions and settlement of refugees and internally displaced persons; "Construction of a water pipeline from Oguz-Gabala region to Baku city"; "Reconstruction of the Samur Apsheron irrigation system"; and the "Baku-Tbilisi-Kars new railway" in 2008; also, the Oil Fund started financing the "State Program on education of Azerbaijan youth abroad in the years 2007-2015" approved by Presidential Decree No.1746 of October 19, 2006. At the same time, a major part of the Fund's resources was transferred to the state budget.

Chart 24 below presents the structure of the Oil Fund's budget expenditures in 2008.

Chart 24

### Structure of the State Oil Fund's budget expenditures in 2008



### Transfers to the state budget of Azerbaijan Republic in 2008

In the reported year, AZN3 800 000.0 thousand were transferred to the state budget in line with the Law of Azerbaijan Republic on the 2008 state budget as well as the execution of the State Oil Fund's 2008 budget approved by Presidential Decree No.687 of December 26, 2007. These expenses constituted 88.5% of the Fund's total budgetary expenditures. The amounts were transferred to the Finance Ministry's account at the Central Treasury. The Oil Fund's transfers to the state budget during 2003-2008 totaled

AZN5 350 000.0 thousand. AZN100 000.0 thousand was transferred in 2003, AZN130 000.0 thousand in 2004, AZN150 000.0 thousand in 2005, AZN585 000.0 thousand in 2006, AZN585 000.0 thousand in 2007 and AZN3 800 000.0 thousand in 2008.

### Financing of the project of constructing a water pipeline from Oguz-Gabala region to Baku city

During the reported year the State Oil Fund allocated AZN211 819.5 thousand to finance the project of "Construction of a water pipeline from Oguz-Gabala region to Baku city". These expenses amounted to 4.9% of the Fund's total budgeted expenditures.

Resolution No.42s of February 24, 2006 by the Cabinet of Ministers of the Republic of Azerbaijan assigned the responsibilities of the project implementation and executing agency to Azersu Joint Stock Company. The project's feasibility study and project/design documents were developed by CES Consulting Engineers, Germany.

The project is designed to use an underground water source in Oguz-Gabala region to supply water to Baku by gravity feed at the flow rate of 5 cubic meters per second and thus provide the residents with high quality water. To this end, a water intake will be built that will draw water from approximately 100 wells (150 m deep, 350 mm diameter). Pressure of water to be trafficked to Baku will reach up to 19 cubic meters per second and will be sufficient to provide 24 hour supply of water to the city. Pressure control facilities will be built along the pipeline alignment in Shamakhi and Apsheron districts.

209.5 km of the water pipeline out of the total of 267 km planned under the project were laid in 2008; preparations were completed for well drilling and construction works and the manufacturer commenced supplying the glass fiber polyester pipes.



Completed part of Oguz-Gabala-Baku water pipeline



The State Oil Fund has allocated a total of AZN427.5 million to finance the project of "Construction of a water pipeline from Oguz-Gabala to Baku city" by January 1, 2009, including AZN82.8 million in 2006, AZN132.9 million in 2007, and AZN211.8 million in 2008.

#### Financing of the improvement of the social and economic conditions of refugees and internally displaced persons

In 2008, along the lines of executing the State Oil Fund's budget as well as the relevant Presidential Decrees, the Fund allocated a total of AZN144 999.4 thousand for financing the improvement of the social and economic conditions of refugees and internally displaced persons. The Fund's resources were used to build 32 settlements, including 15635 residential houses for refugees and internally displaced persons in different regions of Azerbaijan. In addition, construction of relevant infrastructural systems and other social and cultural facilities was continued in all settlements.

The State Oil Fund has allocated a total of AZN523.0 million to finance these activities during 2001-2008 period. The Fund's expenses under this item constituted 3.4% of the Oil Fund's total expenditures in 2008.

Financing of the above mentioned projects by the State Oil Fund was realized based on properly substantiated requests from the implementing agencies. Based on these requests, the resources of the Fund were transferred to the state treasury accounts of the above mentioned agencies and had been paid to contractors by the implementing agencies. The implementing agencies are responsible for overall supervision of project implementation, carrying out bidding processes and other relevant proceedings, and coordination of works through site offices.

The Social Development Fund for Internally Displaced Persons (SDFIDP) is the executing agency for the projects addressing the social and economic and settlement issues of internally displaced persons. In 2008, the SDFIDP implemented projects designed to settle IDP families currently residing in Barda, Agjabedi, Saatly, Sabirabad and Imishly to Fizuli, Bilesuvar, Agdam, Agjabedi and Sabirabad and alleviate their social and economic problems.



A view of settlements built for internally displaced persons in Agdam and Bilasuvar districts

#### Financing of the Samur Absheron irrigation system reconstruction project

In 2008, the State Oil Fund allocated AZN120 600.0 thousand to finance the Samur Absheron irrigation system reconstruction project. This expense item constituted 2.8% of the Oil Fund's total budgeted expenditures for 2008.

Resolution No.42s of February 24, 2006 by the Cabinet of Ministers of the Republic of Azerbaijan assigned the responsibilities of the project implementation and executing agency to "Azerbaijan Irrigation Systems and Water Industry" Joint Stock Company. The "Long-Term Strategy and Feasibility Study for the Samur-Absheron Canal System" were developed by "Nippon Koei", Japan and a local company "Sulako" in 2004.

A portion of the project funds was used to continue the financing of the draining of the water reservoir area, constructing a new settlement where refugees settled in this area will be relocated to, and relocating the existing roads, main oil and gas pipelines located in the floodable/submersible area, leveling the bottom of the water reservoir, and performing the patchwork as part of the dam construction activity in the Takhtakorpu water reservoir site. Pebblestones, sand and small stones/rocks were delivered to the site from relevant quarries; also, production of fill materials was set up. A total of 1500 individuals were hired for this job in its entirety.

Under the Takhtakorpu-Jeyranbatan Canal Construction project, works were performed to build a canal connecting the Takhtakorpu water reservoir located in Devechi district with the Jeyranbatan water reservoir, including canal trench excavation and ground-works, and pile-driving and concreting works for the canal foundation.



Dam building in Takhtakorpu Water Reservoir



### Financing of the Baku-Tbilisi-Kars new railway

Pursuant to the Presidential Resolution No.1974 of February 21, 2008, the State Oil Fund allocated AZN5 271.1 thousand to finance the Baku-Tbilisi-Kars new railway construction project. These expenses amounted to 0.1% of the Fund's total budgeted expenditures in 2008. The project is designed to build a 105 km long Kars-Akhalkalaki railway line, 76 km of which pass through Turkey and 29 km through Georgia, and to rehabilitate and reconstruct the 160 km long Akhalkalaki-Marabda railway in Georgia. The project contemplates construction of a wheel pair/wheelset replacement facility in an area between the Marabda station in Georgia and the state border with Turkey. Implementation of the international project of building the Baku-Tbilisi-Kars railway line and construction of a railway tunnel in the Bosphorus strait, in addition to connecting the Trans-European and Trans-Asian railway networks, and ensuring the capabilities necessary for delivering cargo and passenger traffic to Europe and Asia by going directly through Azerbaijan, Georgia and Turkey, would also serve the purpose of enhancing the transit potential of the region's countries, accelerating the process of integrating into Europe, further promoting cooperation under the European Neighborhood Policy, strengthening Azerbaijan's independence and sovereignty and expanding our country's foreign economic contacts and relations. The Oil Fund's allocations financed the design works and pre-construction preparation activities for the construction of the Marabda-Kartsakhi Railway.

### Financing of the State Program on education of Azerbaijan youth abroad in the years 2007-2015

In the reported year, with a view to executing the State Oil Fund's 2008 budget as well as the Presidential Decree No.2090 of April 16, 2007 the Oil Fund allocated AZN2 295.6 thousand to finance the State Program on education of Azerbaijan youth abroad in the years 2007-2015. The Fund's expenses under this item constituted 0.1% of the Oil Fund's total 2008 budget expenditures. For the purposes of executing the State Program, the Cabinet of Ministers' Decree No.128 of June 3, 2008 approved the "Procedures for Selection of Azerbaijani youth Eligible for Foreign Education" and Resolution No.204s of June 3, 2008 approved the "List of Higher Education Providers for Foreign Education of Azerbaijan Youth". Also, in order to set up a financing vehicle for overseas/foreign education under the State Program, the Cabinet of Ministers of Azerbaijan Republic issued a Decree No.261 on November 27, 2008 approving the "Procedures for Foreign Higher Education Tuition Financing for Azerbaijan Youth". As of December 31, 2008 there were 164 students studying overseas under the State Program financed by the State Oil Fund. This Program is expected to develop a human resource capacity meeting the latest requirements of knowledge and expertise, and to enhance the scope of education of the younger generations to compliance with the best international standards and practices. As the Program is mainly financed by the State Oil Fund, it serves the idea of "turning black gold into human capital" as a strategic step taken towards long-term goals.

### State Oil Fund's administration expenses

Pursuant to the State Oil Fund's Regulations, the Oil Fund's budget for operating costs is subject to presentation by the Fund's Executive Director to the President of the Republic of Azerbaijan for approval. The Oil Fund's 2008 operating expenditures were approved by Presidential Decree No.2582 of December 26, 2007.

In the reported year, the State Oil Fund's administration and operating costs amounted to AZN6 765.8 thousand, which constituted 69.83% of the Fund's total budgeted administration and operating expenditures (AZN9 751.6 thousand) for that year, thus saving AZN2 985.8 thousand. The Fund's expenses under this item amounted to 0.2% of the Oil Fund's total expenditures budgeted for 2008.

The Oil Fund's administration expenses broke down as follows: payroll/salary expenses - AZN904.1 thousand; procurement of goods (works and services) - AZN474.6 thousand; pensions and social benefits - AZN34.8 thousand; other costs - AZN2 295.4 thousand; acquisition of intangible assets - AZN3 056.9 thousand. The savings (AZN2 986.6 thousand) were mostly generated due to lesser uses of the funds booked for financing the external managers' fees in the Fund's budget.

### State Oil Fund's extrabudgetary expenses

The State Oil Fund's extrabudgetary expenses and payments in the reported year totaled AZN678 623.8 thousand.

In 2008, the Oil Fund's expenses associated with the fluctuations of the Fund's asset-related currency exchange rates amounted to AZN652 645.9 thousand. Thus, foreign exchange assets or foreign exchange-denominated investment tools comprise the Oil Fund's assets, while in the meantime the Fund's assets are diversified by placements in US Dollars, EURO, British Pounds and other currencies; on the other hand, as the Fund's balance sheet is executed in the Azerbaijani Manat, the Fund incurred additional balance sheet expenses resulting from a revaluation of the Fund's assets (denominated in Azerbaijani Manats) because of the fluctuating foreign exchange rates as well as the Azerbaijani Manat's appreciation against foreign currencies.

At the same time, the Oil Fund paid AZN25 977.9 thousand of profit tax and other taxes.



## State Oil Fund's 2008 budget execution

The State Oil Fund's 2008 annual budget was approved by Presidential Decree No.687 of December 26, 2007. Amendments and additions to the State Oil Fund's 2008 budget were approved by Presidential Decree No.802 of July 11, 2008.

Thus, based on the amendments, the Oil Fund's 2008 budget was supplemented with a new revenue item of AZN70 623.1 thousand representing the State Oil Fund's proceeds from crude oil export prices; the revenue item of net income from sales of Azerbaijan Republic's share of hydrocarbons was increased from AZN3 473 109.6 thousand to AZN9 819 516.0 thousand; the revenue item representing Azerbaijan Republic's share of dividends from oil and gas projects increased from AZN13 423.2 thousand to AZN104 806.0 thousand; the Fund's revenues from asset management increased from AZN121 928.2 thousand to AZN148 898.1 thousand, and, correspondingly, the Fund's total budgeted revenues were increased from AZN3 609 361.0 thousand to AZN10 144 743.2 thousand. Resulting from the amendments and alterations, the Fund's expenses associated with the transfer to the state budget were increased from AZN1 100 000.0 thousand to AZN3 800 000.0 thousand and, correspondingly, the Fund's total budgeted expenditures rose from AZN1 680 853.6 thousand to AZN4 380 853.6 thousand.

### Revenues

The Oil Fund's actual revenues in 2008 exceeded the budgeted amount (AZN 10 144 743.2 thousand) by 17% and totaled AZN11 864 648.1 thousand. The breakdown of the revenues by source is presented in Table 9 below.

In 2008, the State Oil Fund received AZN11 526 985.7 thousand or USD14 116.0 million from sales of the Republic of Azerbaijan's share of hydrocarbon resources. These revenues exceeded the budgeted amount (AZN9 819 516.0 thousand) by 17.4%. The 17.4% excess revenues from sales of profit oil and gas versus projections are mostly attributable to substantially higher actual oil prices compared with the budgeted price. Thus, the Fund's budget projected oil price was USD70 per barrel of crude oil in 2008, while, in reality, the average weighted net price was approximately USD101 per barrel of the Oil Fund's share of oil (less transportation and marketing costs), which, in turn, despite of the Baku-Tbilisi-Ceyhan being out of operation for a certain period of time, caused the excess in the Oil Fund's revenues.

Another source of the Fund's revenues in the reported year was represented by the Republic of Azerbaijan's (State Oil Fund's) share of dividends under the oil and gas projects of USD119.6 million or AZN97 234.6 thousand (under the BTC project). USD16.5 million of this amount are the dividends paid for the Heydar Aliyev Baku-Tbilisi-Ceyhan Main Export Pipeline's 2007 operation and USD103.1 million for the pipeline's 2008 operations. The State Oil Fund's outturn of this revenue item constituted 92.8% of the budgeted amount (AZN104 806.0 thousand).

Table 8

Execution of State Oil Fund's 2008 budgeted revenues  
AZN thousand

№	Revenue items	Revenue amounts		Execution percentage
		Budgeted	Actual	
1.	Net flows from sales of Azerbaijan's share of hydrocarbon resources (less hydrocarbon transportation costs, banking, customs clearance, independent supervision (surveyor), marketing and insurance costs, as well as revenues of the State Oil Company as investor, shareholder or counterpart in relevant projects it participates in)	9 819 516.0	11 526 985.7	117.4
2.	Republic of Azerbaijan's share of dividends paid under oil and gas projects (BTC project)	104 806.0	97 234.6	92.8
3.	Collections paid to the State Oil Fund from crude oil export price	70 623.1	0	0.0
4.	Revenues from investment and management of the State Oil Fund's assets	148 898.1	231 171.3	155.3
5.	Other revenues and receipts	900.0	2 701.6	300.2
6.	Acreage fees paid by investors for the use of contract areas in connection with development of hydrocarbon resources		3 567.0	
7.	Revenues from transportation of oil and gas through the territory of Azerbaijan Republic		165.7	
8.	Bonuses paid by investors to the State Oil Company of Azerbaijan Republic or relevant authorities in connection with signing or execution of oil and gas contracts		2 822.2	
<b>Total revenues</b>		<b>10 144 743.2</b>	<b>11 864 648.1</b>	<b>117.0</b>

The State Oil Fund's revenues from asset management in 2008 exceeded the budgeted amount (AZN148 898.1 thousand) by 55.3% and totaled AZN231 171.3 thousand.

In 2008, the State Oil Fund's other revenues and receipts totaled AZN2 701.6 thousand. The other revenues and receipts item includes the proceeds from sales of assets (aged or unused metal scrap, pipes) delivered by investors (foreign oil companies) under oil and gas contracts. Revenues under this item were executed to an extent of 200.2% against the budgeted amount (AZN900 thousand).

During the reported year the State Oil Fund received acreage fees, transit fees, bonus payments, which had not been budgeted for 2008.

Thus, in 2008 the State Oil Fund received AZN3 567.0 thousand (USD4.4 million) of acreage fees from foreign investors for using contract areas for development of hydrocarbon resources; AZN165.7 thousand (USD0.2 million) of revenues from transportation of oil and gas through the territory of Azerbaijan Republic (transit fees); and AZN2 822.2 thousand (USD3.5 million) of bonuses paid in connection with signing or execution of oil and gas contracts.



As the State Oil Fund did not receive any transfers of crude oil export price revenues from the State Oil Company of Azerbaijan Republic this year, this particular item on the Oil Fund's 2008 budget remain unexecuted.

### Expenditures

The Oil Fund's 2008 budget expenditures totaled AZN4 291 751.4 thousand.

In 2008, the State Oil Fund continued to finance the project of improvement of social and economic conditions and settlement of refugees and internally displaced persons; "Construction of a water pipeline from Oguz-Gabala region to Baku city"; "Reconstruction of the Samur Apsheron irrigation system"; and the "Baku-Tbilisi-Kars new railway" in 2008; also, the Oil Fund started financing the "State Program for Foreign Education of Azerbaijani Youngsters in 2007-2015" approved by Presidential Decree No.1746 of October 19, 2006. At the same time, a major part of the Fund's resources was transferred to the state budget.

### Structure of the State Oil Fund's 2008 budget expenditures

In 2008, a major item of the State Oil Fund's total budget expenditures comprised the financing of the improvement of social and economic and housing conditions of refugees and internally displaced persons. In 2008, along the lines of executing the State Oil Fund's budget as well as the relevant Presidential Decrees, the Fund allocated a total of AZN144 999.4 thousand for financing the improvement of the social and economic conditions of refugees and internally displaced persons. This expenditure item was executed at 100.0% of the total amount budgeted for this purpose (AZN145 000.0 thousand). The State Oil Fund has allocated a total of AZN523.0 million to finance this project over the period of 2001-2008.

The State Oil Fund transferred AZN3 800 000.0 thousand to the state budget in 2008, whereby the expenditures under this item were executed in full - 100% - against the budgeted amount (AZN3 800 000.0 thousand).

In the reported year the State Oil Fund allocated AZN211 819.5 thousand to finance the project of constructing a water pipeline from Oguz-Gabala region to Baku. The Fund's spending under this item was executed in the scope of 100% against the budgeted amount (AZN211 820.0 thousand).

In 2008, the State Oil Fund allocated AZN120 600.0 thousand to finance the project of reconstructing the Samur-Apsheron irrigation system. Thus, the Fund's spending under this item was executed in the scope of 100% against the budgeted amount (AZN120 600.0 thousand).

As per the Presidential Decree No.1974 of February 21, 2008, the State Oil Fund allocated AZN5 271.1 thousand in 2008 to finance the Baku-Tbilisi-Kars new railway project, thereby executing the Oil Fund's expense obligations under this item to the extent of

5.9% against the Fund's budgeted amount committed to this purpose (AZN88 682.0 thousand). The primary reason behind the smaller outturn was the negative effect of the events taking place in Georgia on the timely implementation of the project works.

In the meantime, with a view to executing the State Oil Fund's 2008 budget as well as the Presidential Decree No.1746 of October 19, 2006, the Oil Fund allocated AZN2 295.6 thousand in the reported year to finance the "2007-2015 State Program for Overseas/Foreign Education of Azerbaijani Youngsters". The Oil Fund's execution of this item was 45.9% of the Fund's budgeted commitment to this initiative (AZN5 000.0 thousand).

The Oil Fund's administration and operating expenditures in 2008 were executed to the extent of AZN6765.8 thousand or 69.4% of the budgeted amount (AZN9 751.6 thousand).

In 2008, the State Oil Fund also had extrabudgetary expenses of AZN678 623.8 thousand. Thus, the Oil Fund paid profit tax and other taxes of AZN25 977.9 thousand, while incurring AZN652 645.9 thousand in expenses associated with the Oil Fund's asset exchange rate fluctuations.

Table 9

### Execution of Oil Fund's 2008 budgeted expenditures AZN thousand

№	Expense items	Expense amounts		Execution percentage
		Budgeted	Actual	
1.	Expenses related to the financing of efforts to mitigate and alleviate the social and economic conditions and settlement problems of refugees and internally displaced persons	145 000.0	144 999.4	100.0
2.	Transfer to the state budget	3 800 000.0	3 800 000.0	100.0
3.	Construction of a water pipeline from Oguz-Gabala region to Baku	211 820.0	211 819.5	100.0
4.	Financing the project of reconstruction of the Samur-Apsheron irrigation system	120 600.0	120 600.0	100.0
5.	Financing of the "Baku-Tbilisi-Kars new Railway" project	88 682.0	5 271.1	5.9
6.	Financing of the State Program on education of Azerbaijan youth abroad in the years 2007-2015	5 000.0	2 295.6	45.9
7.	State Oil Fund's administration and operating expenditures	9 751.6	6 765.8	69.4
<b>Total budget expenditures</b>		<b>4 380 853.6</b>	<b>4 291 751.4</b>	<b>98.0</b>
<b>Extrabudgetary expenditures</b>				
	Profit tax and other taxes		25 977.9	
	Exchange rate spread on foreign exchange transactions		652 645.9	
<b>Total extrabudgetary expenditures</b>			<b>678 623.8</b>	



## OIL FUND'S MANAGEMENT SYSTEM



# 4

The Supervisory Board is responsible for discharging the oversight of the Fund's operations.

The Oil Fund's Supervisory Board meeting held on June 27, 2008 reviewed the State Oil Fund's 2007 annual performance report, audit report on the financial statements, Oil Fund's 2007 budget performance and outturn and considered proposed changes to the Fund's 2008 budget. The Supervisory Board found the Fund's 2007 annual performance report and the independent auditor's report (Deloitte and Touche) on the Fund's 2007 financial statements satisfactory and recommended submission of the State Oil Fund's 2007 budget execution report to the President of Azerbaijan Republic for approval. The Supervisory Board found the proposed amendments to the Fund's 2008 budget acceptable and recommended submission of these amendments to the President of Azerbaijan Republic for approval.

Presidential Decree No.73 of November 27, 2008 approved the new composition of the Supervisory Board of the State Oil Fund. According to the Decree, the Prime Minister of Azerbaijan Republic Artur Rasi-zadeh, Deputy Chairman of the Milli Melis (National Parliament) of Azerbaijan Republic Valekh Alasgarov, State Advisor on Economic Policy

Issues of Azerbaijan Republic Vahid Akhundov, Minister of Finance of Azerbaijan Republic Samir Sharifov, Minister of Economic Development of Azerbaijan Republic Shahin Mustafayev, Governor of the Central Bank of Azerbaijan Republic Elman Rustamov, President of the National Academy of Sciences of Azerbaijan Republic Makhmud Kerimov were approved as members of the Supervisory Board.

Prime Minister of Azerbaijan Republic Mr. A.Rasizadeh was re-appointed as the Chairman of the State Oil Fund's Supervisory Board.

During the reporting year the Oil Fund's executive discipline was further strengthened, compliance with the internal disciplinary rules and guidelines was ensured and authority division between the business units within the Fund has been further improved.

### Development of the Oil Fund's human resources

In 2008 the Oil Fund continued implementing measures aimed at developing its human resources potential.

During the reported year, personnel of the Oil Fund's relevant business units attended a number of training seminars and courses organized by the Fund's partner investment banks as well as the International Monetary Fund, World Bank, Asian Development Bank. Through such seminars and courses the Oil Fund's employees used the opportunity to enhance their knowledge and skills in investment policies, portfolio management, risk management, project management, information technologies. Furthermore, for skills development purposes a number of the Fund's experienced professionals were enabled to participate in the Chartered Financial Analyst (CFA) program delivered by the Association for Investment Management and Research, AIMR).

Selection and professional qualification of specialized staff members in order to staffing of the Oil Fund's office continued in 2008.

In the reported year various measures were taken to improve the Oil Fund's salary and motivation system. Thus, Presidential Decree No.797 of July 10, 2008 "On a range of personnel remuneration related issues of the State Oil Fund's Head Office" was signed, which will ensure that the Oil Fund's head office personnel would be remunerated in compliance with the latest best practices and requirements starting from 2009.

In 2008, the Oil Fund continued to take efforts aimed at improving the social welfare and conditions of its staff members. As part of this initiative, the Fund provided its employees as well as their family members with discounted medical insurances. Also, payment of bonuses was another arrangement aimed at improving the overall social welfare of the Fund's employees.



## Reporting system

In 2008 the State Oil Fund put a strong emphasis on improvement of, and enhancement of transparency of the reporting mechanisms.

A significant safeguard for the transparency of the Oil Fund's operations and the reporting system is a regular audit of the Fund's financial statements by an independent auditor. The Oil Fund's 2008 financial statements were audited by Deloitte and Touche. Thus, to audit the Oil Fund's 2007, 2008 and 2009 (separately for each year) financial statements, the State Oil Fund carried out a tender in 2007 based on requests for quotations, in accordance with the applicable public procurement laws of Azerbaijan and, following the evaluation of bids submitted by reputable audit firms based on the requests for quotations they had received, the Azerbaijani office of Deloitte and Touche was selected as the winning bidder. According to the Oil Fund's Regulations and the Presidential Consent of August 17, 2007, the winning bidder was appointed to audit the Fund's financial activities in 2007, 2008 and 2009.

The State Oil Fund regularly advertises information regarding its operations, projects its finances and decisions by the Fund's Supervisory Board through the Fund's web-site, and makes periodic disclosures to the press and general public in 2008. The Fund's Executive Director held quarterly press conferences to report to the public the Oil Fund's operations and its EITI activities and accomplishments during the reported year.

In 2008 the Fund's web-site ([www.oilfund.az](http://www.oilfund.az)) posted press-releases, in both Azerbaijani and English, about the Fund's revenues and expenditures.

## OIL FUND'S INTERNATIONAL RELATIONS

# 5

In 2008, the State Oil Fund of Azerbaijan Republic hosted meetings with the officials of a number of foreign states and representatives of international organizations. The Fund's Executive Director had meetings with the delegations visiting Azerbaijan in 2008 such as the ones headed by the US Senator Richard Lugar; Mr. Hang Chuon Naro, Chief Secretary, Ministry of Economy and Finance, Kingdom of Cambodia; Mr. Ruben Jeffrey, US Deputy Secretary of State for Economy, Energy and Agriculture; Mrs. Liv Monica Stubholdt, Deputy Minister of Petrol and Energy, Norway; Mr. Danyar Akshiyev, Deputy President of the National Bank of Kazakhstan; Mrs. Henrietta Fore, Administrator of the United States of America Agency for International Development (USAID) and US Foreign Assistance Director; Mr. Dan Stein, Regional Director, US Trade and Development Agency; and Mrs. Lana Ekimoff, Director for Russian and Eurasian Region, US State Energy Department.

During these meetings the counterparties were provided with broad information about the State Oil Fund's operations, management of the Fund's assets, issues related to the implementation of the Extractive Industries Transparency Initiative (EITI), particularly the EITI's success story in Azerbaijan. Discussions also covered the country's current economic reforms, the role played by Azerbaijan's oil sector, the non-oil sector's development as a top priority and other issues and topics.



Representatives of the world's most famous and reputable mass-media companies visited the State Oil Fund and interviewed the Fund's Executive Director in 2008. Meetings of this kind are of utmost importance for worldwide recognition and building up a true and accurate public perception of the Fund globally. The Fund also hosted meetings with journalists from the European Union countries-members of the European Neighborhood Policy program organized by the European Center for Journalism, representing reputable media agencies such as "Pravo" (Czech Republic); Radio 4 (Estonia); YLE TV (Finland); Der Tagesspiegel (Germany); Eleftherotypia (Greece); RTE TV (Ireland); Newstalk/BBC (Ireland); SWH Radio (Latvia); De Telegraaf (the Netherlands); Slovak Radio (Slovakia), sharing comprehensive and detailed information about the Fund's activities.

In 2008, just as in the previous years, the Oil Fund attached great significance to learning best practices and advanced experiences as part of the overall development of its international relations. Under the grant agreement signed between the State Oil Fund and the US Trade and Development Agency, the SOFAZ continued close cooperation with Overture Financial Services, the company responsible for implementing the project of the SOFAZ Institutional Development in 3 phases, whereby external managers were selected, external manager oversight procedures were established, efforts were taken to improve the risk monitoring and management system, and relevant training courses were delivered to the Oil Fund's employees.

Under the Investment Governance and Advisory Services Agreement signed between the State Oil Fund and the International Bank for Reconstruction and Development (IBRD), the IBRD established the RAMP program whereby the Oil Fund was provided with continual advisory support and the Fund's personnel were furnished with training courses and seminars on a variety of topics ranging from investment policy and portfolio management to risk management and investment administration.

In 2008, the Fund's Executive Director attended a number of international events organized and hosted by various foreign countries, such as the National Oil and Gas Forum held in Akra, capital city of Ghana; the "Public Asset Administration Funds" conference organized by the reputable Central Banking Publications in London; the Global Conference organized by the renowned Milken Institute in Los-Angeles.

### Accomplishments in implementation of the Extractive Industries Transparency Initiative

In 2003 upon instruction by President of Azerbaijan Azerbaijan joined the Extractive Industries Transparency Initiative (EITI) and since then the country has managed to take a leading position in the implementation of the Initiative. The EITI Commission discloses the government's reports on the extractive industry aggregate revenues along with the international auditor's opinions on such reports twice a year, and so, up until 31.12.2008 the Commission has published 9 reports and auditor opinions on these reports.

In 2008, the EITI Commission published two reports (eighth and ninth reports) on the extractive industry's aggregate revenues. Thus, on June 5, 2008 the EITI Commission published Republic of Azerbaijan's Government's eighth report (annual for January-December, 2007) and on December 18, 2008 the ninth report (semiannual for the first six months of 2008). These reports included the auditor's opinions based on analysis of individual reports presented by production (oil and gas) companies.

Absheron Investments Ltd., a company that opened for business in Azerbaijan quite recently signed the accession protocol to join the Memorandum of Understanding concerning Azerbaijan's implementation of the Extractive Industries Transparency Initiative (EITI) on February 6, 2008. Thus, there are now 26 companies that have become signatories to the Memorandum of EITI application in Azerbaijan, with all extractive industry companies involved in the EITI implementation process.

The UN General Assembly's 62nd session held on September 11, 2008 unanimously adopted the "Improvement of Industry Transparency" Resolution suggested by Azerbaijan. The primary purpose of the Resolution is to ensure that the Extractive Industries Transparency Initiative (EITI) is recognized by the UN General Assembly, and 27 countries supported the Resolution as co-authors. Azerbaijan's government was specifically thanked for suggesting this resolution.

15 countries, including Azerbaijan were granted the nominee status on the 3rd conference of the EITI International Management Board held on September 27, 2008 in Oslo, Norway. According to the Management Board's decision, any country wishing to become a full member of the EITI has to undergo a special evaluation process. The EITI International Management Board has set a deadline for nominee states, agreeing upon identification of the states' EITI status by this deadline. The evaluation process will assess the Transparency Initiative progress achieved by the EITI-implementing countries and will identify exactly what more they need to do in order to accomplish better and faster progress. The evaluation will be carried out by an independent evaluator using an Evaluation Spreadsheet (and the associated Evaluation Tool Indicator) developed in accordance with the EITI's Evaluation Guidelines.

Evaluation of Azerbaijan started first from 2008. A meeting of the 9 member Working Group was held on November 18, 2008, which represents EITI counterparties established in connection with the Extractive Industries Transparency Initiative-related evaluation process, including the EITI Governmental Commission, local and foreign companies operating in the extractive industries in Azerbaijan, and the NGO Coalition for the Extractive Industry Transparency Enhancement. For the purposes of evaluating this process in EITI member countries as defined by the EITI International Management Board, the Working Group carried out a tender in order to select a company to conduct the evaluation process in Azerbaijan. 7 internationally recognized companies (validators): Coffey Int. Dev. Ltd., ECON, The IDL Group, Goldwyn Int Strategies, Hart Nurse Limited, Oxford Policy Management, PricewaterhouseCoopers and Accountability took part in the tender. Four companies, Coffey International Development, Goldwyn International, Hart Group and ECON were short listed. **Coffey International Development** was appointed to conduct the evaluation process in Azerbaijan.



# AUDIT REPORT ON THE STATE OIL FUND'S 2008 FINANCIAL STATEMENTS



# 6

## Independent Auditors' Report

To the State Oil Fund of the Republic of Azerbaijan:

### Report on the Financial Statements

We have audited the accompanying financial statements of the State Oil Fund of the Republic of Azerbaijan, which comprise the statement of financial position as at 31 December 2008, and the statement of financial performance, statements of changes in net assets and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Public Sector Accounting Standards ("IPSAS") issued by International Public Sector Accounting Standards Board ("IPSASB") of the International Federation of Accountants ("IFAC"). 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 the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### Opinion

In our opinion, the financial statements present fairly, in all material respects the financial position of the State Oil Fund of the Republic of Azerbaijan as at 31 December 2008, and its financial performance and cash flows for the year then ended in accordance with International Public Sector Accounting Standards.

*Deloitte & Touche*

14 April 2009  
Baku, Azerbaijan



## Financial Statements for the year ended 31 December 2008

### STATEMENT OF FINANCIAL POSITION

(Amounts are presented in thousands of Azerbaijani Manats, unless otherwise indicated)

	Notes	31 December 2008	31 December 2007
<b>ASSETS</b>			
<b>CURRENT ASSETS</b>			
Cash and cash equivalents	4, 18	472,531	316,210
Securities at fair value through profit or loss	5	8 514,050	1 776,219
Advance payments and other current assets	7, 18	16,318	1,750
<b>TOTAL CURRENT ASSETS</b>		<b>9,002,899</b>	2,094,179
<b>NON-CURRENT ASSETS</b>			
Property and equipment, net	6	6,339	5,706
Other non-current and intangible assets	7	883	227
<b>TOTAL NON-CURRENT ASSETS</b>		<b>7,222</b>	5,933
<b>TOTAL ASSETS</b>		<b>9,010,121</b>	2,100,112
<b>CURRENT LIABILITIES:</b>			
Payables to the State Budget	8, 18	-	12,608
Other current liabilities	8	300	27
<b>TOTAL CURRENT LIABILITIES</b>		<b>300</b>	12,635
<b>NET ASSETS</b>		<b>9,009,821</b>	2,087,477
<b>NET ASSETS / EQUITY</b>			
Contributed capital	9, 10, 18	9,295,958	1,948,628
Revaluation reserve		6,044	5,314
Accumulated (deficit) / surplus		(292,181)	133,535
<b>TOTAL NET ASSETS / EQUITY</b>		<b>9,009,821</b>	2,087,477

The notes on pages 51-71 form an integral part of these financial statements.

### STATEMENT OF FINANCIAL PERFORMANCE

(Amounts are presented in thousands of Azerbaijani Manats, unless otherwise indicated)

	Notes	31 December 2008	31 December 2007
Interest income	11	240,094	77,687
Net loss on securities at fair value through profit or loss	12	(8,923)	(5,402)
Foreign exchange translation differences, net	13	(652,646)	13,948
<b>TOTAL OPERATING (LOSS) / INCOME</b>		<b>(421,475)</b>	86,233
<b>Operating expenses</b>	14, 18	<b>(4,241)</b>	(2,663)
<b>(DEFICIT) / SURPLUS BEFORE INCOME TAX</b>		<b>(425,716)</b>	83,570
<b>INCOME TAXES</b>	15, 18	-	(13,129)
<b>(DEFICIT) / SURPLUS FOR THE YEAR</b>		<b>(425,716)</b>	70,441

The notes on pages 51-71 form an integral part of these financial statements.



## STATEMENT OF CHANGES IN NET ASSETS

(Amounts are presented in thousands of Azerbaijani Manats, unless otherwise indicated)

	Notes	Capital contributions / Transfers	Revaluation reserve	Accumulated surplus / (deficit)	Total
<b>Balance at 31 December 2006</b>		1,219,687	1,488	63,094	1,284,269
Contributions to Fund	9, 18	1,786,136	3,826		1,789,962
Net surplus for the period				70,441	70,441
Transfers to the State Budget	10, 18	(585,000)	-	-	(585,000)
Transfers to the State Refugees Committee and Internally Displaced Peoples' Social Development Fund	10, 18	(154,117)	-	-	(154,117)
Transfers for the construction of water pipeline Oguz-Gabala-Baku	10, 18	(132,907)	-	-	(132,907)
Settlement with regard to SOCAR participation shares in Azeri-Chirag-Guneshli project	10, 18	(87,559)	-	-	(87,559)
Transfers for the reconstruction of the Samur-Apshehon Irrigation system	10, 18	(76,900)	-	-	(76,900)
Transfers for the construction of new Baku-Tbilisi-Kars railway line	10, 18	(20,712)	-	-	(20,712)
<b>Balance at 31 December 2007</b>		<b>1,948,628</b>	<b>5,314</b>	<b>133,535</b>	<b>2,087,477</b>
Contributions to Fund	9, 18	11,632,316	730	-	11,633,046
Net surplus for the period		-	-	(425,716)	(425,716)
Transfers to the State Budget	10, 18	(3,800,000)	-	-	(3,800,000)
Transfers for the construction of water pipeline Oguz-Gabala-Baku	10, 18	(211,820)	-	-	(211,820)
Transfers to the State Refugees Committee and Internally Displaced Peoples' Social Development Fund	10, 18	(144,999)	-	-	(144,999)
Transfers for the reconstruction of the Samur-Apshehon Irrigation system	10, 18	(120,600)	-	-	(120,600)
Transfers for the construction of new Baku-Tbilisi-Kars railway line	10, 18	(5,271)	-	-	(5,271)
Transfers for realization of the State Program on "Education of Azerbaijani youth in abroad"	10, 18	(2,296)	-	-	(2,296)
<b>Balance at 31 December 2008</b>		<b>9,295,958</b>	<b>6,044</b>	<b>(292,181)</b>	<b>9,009,821</b>

The notes on pages 51-71 form an integral part of these financial statements.

## STATEMENT OF CASH FLOWS

(Amounts are presented in thousands of Azerbaijani Manats, unless otherwise indicated)

	Notes	Year ended 31 December	
		2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
(Deficit)/surplus before income tax		(425,716)	83,570
Adjustments to reconcile surplus to net cash used in operating activities:			
Interest income	11	(240,094)	(77,687)
Depreciation of property and equipment	6	170	135
Amortization of intangible assets	7	40	5
Foreign exchange loss on cash and cash equivalents	13	594,226	1,193
Changes in operating assets and liabilities:			
Increase in securities at fair value through profit or loss		(7,159,403)	(566,405)
Increase in advance payments and other current assets		(1,439)	(678)
Decrease / (increase) in other current liabilities		274	(484)
Interest received		104,635	65,899
Income tax paid		(25,737)	(521)
<b>Net cash used in operating activities</b>		<b>(7,153,044)</b>	<b>(494,973)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of property and equipment	6	(73)	(67)
Purchase of intangible assets	7	(725)	(28)
Other non-current assets		29	(4)
<b>Net cash used in investing activities</b>		<b>(769)</b>	<b>(99)</b>

The notes on pages 51-71 form an integral part of these financial statements.



## STATEMENT OF CASH FLOWS

(Amounts are presented in thousands of Azerbaijani Manats, unless otherwise indicated)

	Notes	Year ended 31 December	
		2008	2007
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Contributed capital	9	11,632,316	1,799,740
Transfers to the State Budget	10	(3,800,000)	(585,000)
Transfers for the construction of water pipeline Oguz-Gabala-Baku	10	(211,820)	(132,907)
Transfers to the State Refugees Committee and Internally Displaced Peoples' Social Development Fund	10	(144,999)	(154,117)
Transfers for the reconstruction of Samur-Apsheron Irrigation system	10	(120,600)	(76,900)
Transfers for the construction of new Baku-Tbilisi-Kars railway	10	(5,271)	(20,712)
Transfers for realization of the State Program on "Education of Azerbaijani youth in abroad"	10	(2,296)	–
Settlement with regard to SOCAR participation shares in Azeri-Chirag-Guneshli project	10	–	(87,559)
<b>Net cash provided by financial activities</b>		<b>7,347,330</b>	<b>742,545</b>
Effect of exchange rate changes on cash and cash equivalents		(37,196)	1,193
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>		<b>193,517</b>	<b>247,473</b>
CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR	4	316,210	69,930
<b>CASH AND CASH EQUIVALENTS, END OF THE YEAR</b>	<b>4</b>	<b>472,531</b>	<b>316,210</b>

### Significant non-cash transaction:

During the year ended 31 December 2007 the Fund received the plant from the government free of charge for its new office at the amount of AZN 366 thousand.

The notes on pages 51-71 form an integral part of these financial statements.

## Notes to the Financial Statements

(Amounts are presented in thousands of Azerbaijani Manats, unless otherwise indicated)

### 1. FUND INFORMATION

The State Oil Fund of the Republic of Azerbaijan (the "Fund") was established by Decree #240 of the President of the Republic of Azerbaijan on the "Establishment of the State Oil Fund of the Republic of Azerbaijan" dated 29 December 1999. The purpose of the Fund is to ensure the accumulation, effective management, and use of income and other inflows generated from agreements related to oil and gas exploration and development, as well as, from the Funds' own activities for the benefit of citizens of the Republic of Azerbaijan and future generations.

In accordance with Decree and the Regulations, the Fund is an extra-budget institution, formed as a separate legal entity, which is accountable and responsible to the President of the Republic of Azerbaijan.

The Fund's assets are contributed in accordance with the Regulation ("Regulation") of the Fund approved by Presidential Decree #434 dated 29 December 2000 as amended by Presidential Decrees #849 and #202 on "Amending Certain Legislative Acts Regulating the Operations of the State Oil Fund of the Republic of Azerbaijan" dated 7 February 2003 and 1 March 2005, respectively, and Article 2.3 of the "Regulations on Development and Implementation of the Annual Program of Income and Expenses (Budget) of the Fund" approved by Presidential Decree #579 dated 12 September 2001 as amended by Presidential Decrees #849 and #202 mentioned earlier. Pursuant to the Regulations of the Fund, its assets are contributed from the following sources:

- a) Revenues generated from implementing agreements on exploration, development and production sharing for oil and gas fields in the territory of the Republic of Azerbaijan including the Azerbaijan Sector of the Caspian Sea, as well as the other agreements on oil and gas exploration, development and transportation entered into between the State Oil Company of the Republic of Azerbaijan ("SOCAR") or other authorized state body and investors, including:
  - i. Net revenues from the sale of hydrocarbons related to the share of the Republic of Azerbaijan (net of expenditures incurred for hydrocarbons transportation, customs clearance and bank costs, marketing, insurance and independent surveyor fees) excluding revenues related to the participating interest or investment of SOCAR in a project in which SOCAR is an investor, participant or a contracting party;
  - ii. Bonuses paid by investors under the production sharing agreements to SOCAR or an authorized state body in connection with oil and gas agreements;
  - iii. Acreage payments due to SOCAR and/or an authorized state body of the Republic of Azerbaijan from investors for the use of the contract area in connection with oil and gas exploration and development;
  - iv. Dividends and profit participation revenues related to the share of the Republic of Azerbaijan in connection with oil and gas agreements, excluding revenues related to a participating interest or investment of SOCAR in a project in which SOCAR is an investor, participant or a contracting party;
  - v. Revenues generated from oil and gas transported over the territory of the Republic of Azerbaijan with the use of the Baku-Supsa, Baku-Tbilisi-Ceyhan ("BTC") and Baku-Tbilisi-Erzurum export pipelines;
  - vi. Revenues generated from transfer of assets from investors to SOCAR and/or an authorized state body within the framework of oil and gas agreements.
- b) Revenues generated from investment, management, sale and other disposal of the Fund's assets (including financial assets and assets contributed by investors within oil and gas agreements), other non-sale revenue or revenue from revaluation of the Fund's assets in its reporting currency (Azerbaijani manats), etc.
- c) Grants and other free aids.
- d) Other revenues and receipts in accordance with the legislation of the Republic of Azerbaijan.

Under the provisions of the Fund's Regulations approved by the President of the Republic of Azerbaijan, SOCAR or an authorized state body implements the collection of the fees and revenues listed above and their transfer to the Fund.

The Regulations exclude the followings from the list of sources of the Fund's revenue and assets:

- ♦ the rental fees from the use of state property under contracts with foreign companies;
- ♦ revenues from the sale of hydrocarbons related to the participating interest or investment of the State Oil Company of the Republic of Azerbaijan ("SOCAR") in any project in which SOCAR is an investor, participant or a contracting party;
- ♦ other revenues generated from joint activities with foreign companies.

During 2008 transfers to the State Budget, as well as to the state institutions, state-owned entities and companies are made in accordance with the Law of the Republic of Azerbaijan "On the State Budget for 2008" dated 30 November 2008, Decree #687 of the President of the Republic of Azerbaijan "On Ratifying



the Budget of the State Oil Fund of the Republic of Azerbaijan for the year 2008" dated 26 December 2007, Program on Expensing of Assets of the State Oil Fund of the Republic of Azerbaijan for 2008 as approved by the Order #2582, dated 26 December 2007, the Decree of the President of Azerbaijan #802 "On Amendments and supplements to the Law of the Republic of Azerbaijan on the State Budget for the year 2008" dated 11 July 2008, the Law of the Republic of Azerbaijan "On Amendments to the State of the Republic of Azerbaijan for the year 2008" dated 2 May 2008.

In 2008, the Fund was a party to one custody agreement with the Bank of New York Mellon (in 2007 - two - the Bank of New York Mellon and Clariden Leu Ltd) and three investment management agreements with financial institutions with Deutsche Asset Management International GmbH, Clariden Leu Ltd. and International Bank for Reconstruction and Development (IBRD - World Bank Group) (in 2007 - three - Deutsche Asset Management International GmbH, Clariden Leu Ltd and International Bank for Reconstruction and Development). Under the custody agreement the financial institution hold securities purchased by the Fund, whereas in accordance with the investment management agreements the financial institutions manage the Fund's investments based on general investment policies established by the Fund.

The Fund's registered office address is: 20, Bulbul Avenue, Baku, Azerbaijan, AZ1014.

These financial statements for the year ended 31 December 2008 were authorized for issue by the Fund's Management on 14 April 2009.

## 2. BASIS OF PRESENTATION

The financial statements of the Fund have been prepared in accordance with International Public Sector Accounting Standards ("IPSAS") issued by International Public Sector Accounting Standards Board ("IPSASB") of the International Federation of Accountants ("IFAC"). IPSAS are developed by adapting International Financial Reporting Standards ("IFRS") to the public sector context. IFRS comprise standards issued by the International Accounting Standards Board ("IASB"), and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC"). The public sector refers to national governments, regional governments, local governments and related governmental entities.

As permitted by IPSAS, the Fund follows the provisions of IFRS pronouncements in the absence of equivalent IPSAS.

These financial statements are presented in thousands of Azerbaijani Manats ("AZN"), unless otherwise indicated. These 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 Public Sector Accounting Standard ("IPSAS") No. 17 "Property, Plant and Equipment".

### Functional currency

Items included in the financial statements of the Fund are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to the Fund (the "functional currency"). Although the majority of the Fund's assets and income are denominated in foreign currencies, the functional currency of the financial statements is AZN as all the costs and transfers are incurred or priced in AZN and the valuation of the Fund's financial performance is compared against an annual budget measured in AZN.

## 3. SIGNIFICANT ACCOUNTING POLICIES

### Recognition and measurement of financial instruments

The Fund recognizes financial assets and liabilities on its statement of financial position when it becomes a party to the contractual obligations of the instrument. A purchase or sale of financial assets is recognized using trade date accounting (Resolution #32 dated 13 June 2007 issued by the Supervisory Board of the State Oil Fund of the Republic of Azerbaijan). The trade date is the date that Fund commits to purchase or sell an asset.

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 are defined as cash on hand, deposits maturing within three months from the financial statements date and short-term, highly liquid investments readily convertible to known amounts of cash and subject to low risk of changes in value, with an original maturity of three months or less. Cash on hand, cash in banks and deposits are carried at cost plus interest, if any.

### Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss represent securities (1) acquired principally for the purpose of selling them in the near future, (2) which are a part of portfolio of identified financial instruments

that are managed together and for which there is evidence of a recent and actual pattern of short-term profit taking, or (3) which are designated by the Fund at fair value through profit or loss upon initial recognition. A financial asset other than a financial asset held for trading may be designated at fair value through profit or loss upon initial recognition if: (1) such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or (2) the financial asset forms part of a group of financial assets or liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Fund's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or (3) it forms part of a contract containing one or more embedded derivatives, and IAS 39 "Financial Instruments: Recognition and Measurement" permits the entire combined contract (asset or liability) to be designated as at fair value through profit or loss.

Financial assets at fair value through profit or loss are initially recorded and subsequently measured at fair value. The Fund uses quoted market prices to determine fair value for financial assets at fair value through profit or loss. The fair value adjustment on financial assets at fair value through profit or loss is recognized in the statement of financial performance for the period. The Fund does not reclassify financial instruments in or out of this category while they are held.

### Derecognition of financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized where:

- the rights to receive cash flows from the asset have expired;
- the Fund has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- the Fund either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial asset is derecognized when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Fund either: (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Fund reassesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. If substantially all the risks and rewards have been retained, the asset remains on the statement of financial position. If substantially all of the risks and rewards have been transferred, the asset is derecognized. If substantially all the risks and rewards have been neither retained nor transferred, the Fund assesses whether or not it has retained control of the asset. If it has not retained control, the asset is derecognized. Where the Fund has retained control of the asset, it continues to recognize the asset to the extent of its continuing involvement.

### Property and equipment

The Fund's property and equipment are tangible assets held for administrative purposes with an expected useful life of more than one accounting period and with the cost exceeding 100 AZN.

Depreciation is charged on the carrying value of property and equipment and is designed to write off assets over their useful economic lives. Depreciation is calculated on a straight line basis at the following annual prescribed rates:

	Years
Buildings	50
Vehicles	7
Office equipment	4
Furniture	5
Other property	3

The carrying amounts of property and equipment are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts. The recoverable amount is the higher of fair value less costs to sell and value in use. Where carrying values exceed the estimated recoverable amount, assets are written down to their recoverable amount, an 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.

Building held for administrative purposes is stated in the statement of the financial position at its revalued amounts, being the fair value at the date of revaluation, determined from market-based evidence by



appraisal undertaken by professional independent appraisers, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the statement of the financial position date.

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

Depreciation on revalued buildings is charged to the statement of financial performance. On the subsequent retirement of a revalued property, the attributable revaluation surplus remaining in the property and equipment revaluation reserve is transferred directly to retained earnings.

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 costs method which presumes the value of property to be equal to its recoverable amount less any depreciation charges.

#### **Taxation**

Income tax expense represents the sum of the current and deferred tax expense.

The current tax expense is based on taxable profit for the year. Taxable profit differs from net profit before tax as reported in the statement of financial performance 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 Fund's current tax expense is calculated using tax rates that have been enacted during the reporting period.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the financial position liability method. 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 deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

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

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the statement of financial position if:

- ◆ The Fund has a legally enforceable right to set off current income tax assets against current income tax liabilities; and
- ◆ Deferred income tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

#### **Contingencies**

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

#### **Net assets/Equity**

As discussed in Note 1, in accordance with the Decrees and the Regulation, the Fund is an extra-budgetary organization. All decisions regarding contributions to and transfers from the Fund are made by its ultimate owner. Contributions/transfers received/made by the Fund represent owner's contributions/withdrawals and, accordingly, are recognized through net assets at the fair value of the consideration received/paid.

Transfers to the State Budget, as well as state institutions, state-owned entities and companies are recognized on the date of payment. All transfers are made within the approved budget of the Fund and trans-

ferred to the State Treasury of the Republic of Azerbaijan for payments to eligible budgetary beneficiaries (state institutions, state-owned entities and companies) based on their requests for payments.

#### **Retirement and other benefit obligations**

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

#### **Recognition of income and expense**

Interest income recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset (or group of financial assets) and of allocating the interest income 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.

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.

Interest earned on assets at fair value is classified within interest income.

Expenses are recognized on accrual basis, i.e. when they are incurred.

#### **Foreign currency translation**

The financial statements of the Fund are presented in currency of the primary economic environment in which the Fund operates (its functional currency). In preparing the financial statements of the Fund, monetary assets and liabilities denominated in currencies other than the Fund's functional currency (foreign currencies - primarily US Dollar and Euro) are translated at the appropriate spot rates of exchange rates prevailing at the reporting date. Transactions in currencies other than the functional currency are accounted for at the exchange rates prevailing at the date of the transaction. Profit or losses arising from these translations are included in net gain / (loss) on foreign exchange operations.

AZN is not a fully convertible currency outside the territory of the Republic of Azerbaijan. Within the Republic of Azerbaijan, official exchange rates are determined daily by the National Bank of the Republic of Azerbaijan. World market foreign exchange rates may differ from the official rates but the differences are, generally, within narrow parameters monitored by the National Bank of the Republic of Azerbaijan.

#### **Rates of exchange**

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

	31 December 2008	31 December 2007
AZN/1 US Dollar	0.8010	0.8453
AZN/1 Euro	1.1292	1.2450
AZN/1 GBP	1.1621	1.6876

#### **Offset of financial assets and liabilities**

Financial assets and liabilities are offset and reported net on the statement of financial position when the Fund has a legally enforceable right to set off the recognized amounts and the Fund 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 de-recognition, the Fund does not offset the transferred asset and the associated liability.

#### **Areas of significant management judgment and sources of estimation uncertainty**

The preparation of the Fund'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 Fund's financial condition.

#### **Valuation of financial instruments**

Financial instruments that are classified at fair value through profit or loss are stated at fair value. 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 statement of financial position 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 Fund 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 statement of financial position 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 Fund's reported net income.

The carrying amount of the financial instruments at fair value is as follows as at 31 December 2008 and 2007 is AZN 8,514,050 thousands and AZN 1,776,219 thousands, respectively.

#### **Adoption of new and revised standards**

In the current year, the Fund has adopted all of the new and revised Standards issued by the International Public Sector Accounting Standards Board ("IPSASB") of the International Federation of Accountants ("IFAC") and Standards and Interpretations issued by the International Accounting Standards Board (the "IASB") and the International Financial Reporting Interpretations Committee (the "IFRIC") of the IASB that are relevant to its operations and effective for annual reporting periods ending on 31 December 2008. The adoption of these new and revised Standards and Interpretations has not resulted in significant changes to the Fund's accounting policies that have affected the amounts reported for the current or prior years.

Amendments to IAS 39, "Financial Instruments: Recognition and Measurement", and IFRS 7, "Financial Instruments: Disclosures", titled "Reclassification of Financial Assets" - on 13 October 2008 IASB issued amendments to IAS 39 and IFRS 7 which permits certain reclassifications of non-derivative financial assets (other than those designated as at fair value through profit or loss at initial recognition under the fair value option) out of the fair value through profit or loss category and also allow reclassification of financial assets from the available for sale category to the loans and receivables category in particular circumstances. The amendments to IFRS 7 introduce additional disclosure requirements if an entity has reclassified financial assets in accordance with the amendments to IAS 39. The amendments are effective as of 13 October 2008 and in certain circumstances can be applied retrospectively from 1 July 2008. The Fund has elected not to apply the amendments to IAS 39 and IFRS 7.

IPSAS 22 - "Disclosure of Financial Information about the General Government Sector" published in December 2006. The objective of this Standard is to prescribe disclosure requirements for governments which elect to present information about the general government sector (GGS) in their consolidated financial statements. The disclosure of appropriate information about the GGS of a government can enhance the transparency of financial reports, and provide for a better understanding of the relationship between the market and non-market activities of the government and between financial statements and statistical bases of financial reporting. The adoption of IPSAS 22 had no impact on the Fund's financial statements.

#### **Standards and interpretations issued and not yet adopted**

At the date of authorization of these financial statements, other than the Standards adopted by the Fund in advance of their effective dates, the following Standards were in issue but not yet effective.

**IPSAS 4** - "The Effects of Changes in Foreign Exchange Rates" published in April 2008, which prescribes how to include foreign currency transactions and foreign operations in the financial statements, as well as

how to translate financial statements into a presentation currency. The technical updates to IPSAS 4 clarify the requirements for public sector entities to convert foreign currency transactions and balances into their reporting currency. The standard is effective for periods beginning on or after 1 January 2010. Management is currently assessing the impact of the adoption of IPSAS 4.

**IPSAS 25** - "Employee Benefits" published in February 2008. The objective of this Standard is to prescribe the accounting and disclosure for employee benefits. The standard is effective for periods beginning on or after 1 January 2011. Management is currently assessing the impact of the adoption of IPSAS 25.

**IPSAS 26** - "Impairment of Cash-Generating Assets" published in February 2008. The objective of this Standard is to prescribe the procedures that an entity applies to determine whether a cash-generating asset is impaired and to ensure that impairment losses are recognized. This Standard also specifies when an entity should reverse an impairment loss and prescribes disclosures. The standard is effective for periods beginning on or after 1 April 2009. Management is currently assessing the impact of the adoption of IPSAS 26.

**IPSAS 23** - "Revenue from Non-Exchange Transactions (Taxes and Transfers)" published in December 2006. The objective of this Standard is to prescribe requirements for the financial reporting of revenue arising from non-exchange transactions, other than non-exchange transactions that give rise to an entity combination. The Standard deals with issues that need to be considered in recognizing and measuring revenue from non-exchange transactions including the identification of contributions from owners. The standard is effective for periods beginning on or after 30 June 2008. Management is currently assessing the impact of the adoption of IPSAS 23.

**IPSAS 24** - "Presentation of Budget Information in Financial Statements" published in December 2006. This standard requires a comparison of budget amounts and the actual amounts arising from execution of the budget to be included in the financial statements of entities which are required to, or elect to, make publicly available their approved budget(s) and for which they are, therefore, held publicly accountable. The standard also requires disclosure of an explanation of the reasons for material differences between the budget and actual amounts. The standard is effective for periods beginning on or after 1 January 2009. Management is currently assessing the impact of the adoption of IPSAS 24.

**IFRS 7** - "Financial Instruments: Disclosures", on 5 March 2009 the Standard was amended. The amendments are in response to calls from constituents for enhanced disclosures about fair value measurements and liquidity risk in the wake of the recent financial crisis. The amendments expand the disclosures required in respect of fair value measurements recognized in the statement of financial position. The revised disclosure requirements are applicable for annual periods beginning on or after 1 January 2009. Management is currently assessing the impact of this adoption.

#### **4. CASH AND CASH EQUIVALENTS**

Cash and cash equivalents consisted of the following at 31 December:

	31 December 2008	31 December 2007
Deposits	295,411	109,052
Bank accounts	160,217	73,713
Money market funds	16,903	133,445
<b>Total cash and cash equivalents</b>	<b>472,531</b>	<b>316,210</b>
<b>Deposits</b>		
	31 December 2008	31 December 2007
Citibank N.A., London	84,678	-
BNP Paribas CIB/ITO/Capital markets IT and operations JV	82,591	21,189
Deutsche Bank AG, London	76,639	21,246
Royal Bank of Scotland plc., UK	51,503	-
UBS AG, London	-	33,830
Societe Generale Corporate & Investment Banking, Paris	-	29,600
UBS AG, London	-	1,695
UBS AG, London	-	1,492
<b>Total deposits</b>	<b>295,411</b>	<b>109,052</b>



At 31 December 2008, the Fund had four deposits placed with four banks with credit ratings ranging from AA+/Aa1 to AA-/Aa3 (Standard & Poors/Moody's/Fitch) and maturity in January 2009 and March 2009. One deposit denominated in EUR bears interest rate of 2.70%. Three deposits denominated in GBP bear fixed interest rates from 5.17% to 5.82%.

At 31 December 2007, the Fund had six deposits placed with four banks with credit ratings ranging from AA/Aa2 to AAA/Aaa (Standard & Poors/Moody's) and maturity in January 2008. Four deposits denominated in USD bear fixed interest rates from 4.3% to 4.72%. Two deposits denominated in GBP bear fixed interest rates from 5.68% to 6.26%.

#### Bank accounts

Bank accounts were denominated in the following currencies at 31 December:

	31 December 2008	31 December 2007
USD	80,450	40,898
AZN	79,550	32,592
EUR	136	187
GBP	81	36
<b>Total bank accounts</b>	<b>160,217</b>	<b>73,713</b>

The Fund's AZN accounts were opened with the National Bank of the Republic of Azerbaijan and the International Bank of Azerbaijan with long-term ratings BB+/Baa2 (Fitch/Moody's). Other accounts originated in foreign currencies were opened with foreign banks with long-term ratings ranging from AA/Aa1 to AA/Aa3 (Standard & Poors/Moody's).

#### Money market funds

Investments in money market funds represent share ownership in funds, payable on demand. Investments in money market funds are highly liquid. Money market funds invest their assets in short-term debt and debt related instruments, such as commercial paper, certificates of deposit, bonds bearing floating interests, US treasury bonds, Eurobonds and asset-backed securities. Interest and dividends payable to the Fund are reinvested.

At 31 December the Fund had investments in the money market funds with credit ratings AAA:

	31 December 2008	31 December 2007
Goldman Sachs GBR Liquidity Funds	7,751	1,490
Universal Liquidity Funds plc	6,042	-
Barclays Global Investors Funds plc	2,877	25,106
The Royal Bank of Scotland plc, Global Treasury Funds plc	233	42,822
Wachovia STIF Liquidity Funds	-	839
JP Morgan Fleming Liquidity Funds	-	63,188
<b>Total money market funds</b>	<b>16,903</b>	<b>133,445</b>

## 5. SECURITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

Securities at fair value through profit or loss consisted of the following at 31 December:

	31 December 2008	31 December 2007
Foreign government securities	5,951,601	359,882
Securities of USA agencies	1,906,631	416,221
Financial institution securities	487,565	789,960
Corporate debt securities	165,751	203,881
Equity securities	1,877	2,144
Mortgage securities	625	4,131
<b>Total securities at fair value through profit or loss</b>	<b>8,514,050</b>	<b>1,776,219</b>

At 31 December 2008 the Fund held AZN 196,958 thousand (245,890 thousand USD) under asset management agreements with financial institutions including cash and cash equivalents ("external managers") (31 December 2007: AZN 202,840 thousand (239,963 thousand USD)). The management fees to these institutions were AZN 698 thousand and AZN 514 thousand in 2008 and 2007, respectively. During the year 2008 and 2007 the Fund's external managers were Deutsche Bank AG, Clariden Leu Ltd. and International Bank for Reconstruction and Development (World Bank), all securities held in the custodian Bank of New York Mellon.

#### Foreign government securities

Foreign government securities at 31 December 2008 and 2007 were represented by investments in debt securities issued by various sovereign and international organizations of Europe, Asia, Africa and America. These securities bear fixed interest ranging from 0.875% - 8.75% and USD LIBOR, EURIBOR with the spread ranging from +0.24% to +0.8125% (2007: from 3% to 9.5% and USD LIBOR, EURIBOR with the spread ranging from +0.05% to +0.8125%) and mature during the period from January 2009 to November 2017 (2007: from January 2008 to February 2013). Discount securities are also included to this group. These securities were held in the portfolio managed both directly by the Fund as well as the Fund's external managers.

#### Securities of the USA Agencies

Securities of the USA Agencies at 31 December 2008 and 2007 were represented by investments in debt securities issued by Fannie Mae, Freddie Mac, Federal Home Loan Banks and Federal Farm Credit Banks Funding Corporation. These securities bear fixed interest ranging from 2.25% to 7.25% and USD LIBOR with the spread ranging from - 0.16% to - 0.02% (2007: from 3.25% to 7.25%) and mature during the period from January 2009 to May 2013 (2007: from November 2008 to November 2011). These securities were held in the portfolio managed both directly by the Fund as well as the Fund's external managers, Clariden Leu Ltd. and World Bank.

#### Financial institution securities

Financial institution securities at 31 December 2008 and 2007 were represented by investments in debt securities issued by various European, Asian and American financial institutions. These securities bear fixed interest ranging from 4% to 8.5% and USD LIBOR, GBP LIBOR and EURIBOR with the spread ranging from +0.03% to +1.7% (2007: from 3.6% to 8.5% and USD LIBOR, GBP LIBOR and EURIBOR with the spread ranging from +0.03% to +2%) and mature during the period from February 2009 to February 2016 (2007: from February 2008 to December 2016). These securities were held in the portfolio managed both directly by the Fund as well as the Fund's external managers, Deutsche Bank AG and Clariden Leu Ltd.

#### Corporate debt securities

Corporate debt securities at 31 December 2008 and 2007 were represented by investments in debt securities issued by corporations of Europe, Asia and America. These securities bear fixed interest ranging from 4.125% to 6.875% and USD LIBOR with the spread ranging from +0.21% to +0.60% (2007: from 4.125% to 6.875% and USD LIBOR and EURIBOR with the spread ranging from +0.40% to +0.60%) and maturing during the period from June 2009 to September 2016 (2007: from March 2008 to October 2014). These securities were held in the portfolio managed both directly by the Fund as well as the Fund's external managers Deutsche Bank AG and Clariden Leu Ltd.

#### Equity securities

The carrying value of corporate equity securities consisted of the following at 31 December:

	31 December 2008	31 December 2007
Healthcare	471	369
Consumer	424	173
Finance	381	539
Industrials	189	95
Energy	175	255
Telecommunication and information technologies	170	522
Other	67	191
<b>Total equity securities</b>	<b>1,877</b>	<b>2,144</b>

#### Mortgage securities

Mortgage securities at 31 December 2008 and 2007 were represented by investments in debt securities issued by the financial institutions of the United States of America bearing USD LIBOR with the spread ranging from +0.05% to +0.16% (2007: from +0.05% to +0.16% and fixed interest rate 3.72%) and maturity during the period from June 2018 to May 2038 (from July 2009 to May 2038). These securities were held in the portfolio managed both directly by the Fund as well as the Fund's external manager, Clariden Leu Ltd.



## 6. PROPERTY AND EQUIPMENT

	Building	Vehicles	Office equipment	Furniture	Other property	Total
<b>At initial/Revalued cost</b>						
31 December 2006	2,047	82	246	125	3	2,503
Additions	366	5	54	8	-	433
Disposal	(366)	-	-	-	-	(366)
Revaluation	3,584	-	-	-	-	3,584
<b>31 December 2007</b>	<b>5,631</b>	<b>87</b>	<b>300</b>	<b>133</b>	<b>3</b>	<b>6,154</b>
Additions	-	42	22	9	-	73
Revaluation	570	-	-	-	-	570
<b>31 December 2008</b>	<b>6,201</b>	<b>129</b>	<b>322</b>	<b>142</b>	<b>3</b>	<b>6,797</b>
<b>Accumulated depreciation</b>						
31 December 2006	(226)	(37)	(217)	(73)	(2)	(555)
Depreciation charge	(81)	(11)	(17)	(25)	(1)	(135)
Revaluation	242	-	-	-	-	242
<b>31 December 2007</b>	<b>(65)</b>	<b>(48)</b>	<b>(234)</b>	<b>(98)</b>	<b>(3)</b>	<b>(448)</b>
Depreciation charge	(116)	(8)	(24)	(22)	-	(170)
Revaluation	160	-	-	-	-	160
<b>31 December 2008</b>	<b>(21)</b>	<b>(56)</b>	<b>(258)</b>	<b>(120)</b>	<b>(3)</b>	<b>(458)</b>
<b>Net book value:</b>						
<b>31 December 2008</b>	<b>6,180</b>	<b>73</b>	<b>64</b>	<b>22</b>	<b>-</b>	<b>6,339</b>
31 December 2007	5,566	39	66	35	-	5,706

In accordance with Resolution #99 of Cabinet of Ministers, dated 27 May 2002, the Fund has received an administrative building from the Government. As at 31 December 2008 and 2007 the building owned by the Fund was revalued to market value according to the report of an independent appraiser. The following methods were used for the estimation of their fair value: discounted cash flow method (income approach), integrated cost estimation method (cost based method), method of sales comparison (comparative approach). For the estimation of the final value, certain weights were assigned to the results obtained using different approaches, depending on the degree to which the estimates met the following characteristics: reliability and completeness of the information, specifies the estimated property and other.

As a result, the carrying value of the buildings amounted to AZN 6,180 thousand and AZN 5,566 thousand as at 31 December 2008 and 2007, respectively. If the buildings were accounted at historical cost less accumulated depreciation, its carrying value would be AZN 467 thousand and AZN 502 thousand as at 31 December 2008 and 2007, respectively.

## 7. OTHER ASSETS

Other assets comprise:

	31 December 2008	31 December 2007
<b>Other financial assets recorded as loans and receivables in accordance with IAS 39:</b>		
Other	-	761
<b>Other non-financial current assets:</b>		
Income tax prepaid	13,129	-
Prepayments for services	2,880	989
Tax settlements, other than income tax	309	-
<b>Other non-financial non-current assets:</b>		
Intangible assets	774	89
Used equipment held for sale	109	138
<b>Total other assets</b>	<b>17,201</b>	<b>1,977</b>

## Intangible assets

<b>At cost</b>	
31 December 2006	87
Additions	28
<b>31 December 2007</b>	<b>115</b>
Additions	725
<b>31 December 2008</b>	<b>840</b>
<b>Accumulated amortization</b>	
31 December 2006	(21)
Charge for the year	(5)
<b>31 December 2007</b>	<b>(26)</b>
Charge for the year	(40)
<b>31 December 2008</b>	<b>(66)</b>
<b>Net book value</b>	
<b>31 December 2008</b>	<b>774</b>
31 December 2007	89

Intangible assets include software and licenses.

## 8. OTHER LIABILITIES

Other liabilities comprise:

	31 December 2008	31 December 2007
<b>Other financial liabilities:</b>		
Other account payables	300	27
<b>Total other financial liabilities</b>	<b>300</b>	<b>27</b>
<b>Other non-financial liabilities:</b>		
Income tax payable	-	12,608
<b>Total other non-financial liabilities</b>	<b>-</b>	<b>12,608</b>

## 9. CAPITAL CONTRIBUTIONS

Capital contributions to the Fund comprise:

	Year ended 31 December 2008	Year ended 31 December 2007
Contributions received from sales of profit oil and gas	11,526,986	1,675,019
Payments on BTC project	97,235	-
Bonuses	2,802	58,068
Acreage fees	1,495	6,356
Pipeline transit tariffs	1,493	-
Price margin from oil sales	-	45,596
Other	2,305	1,097
<b>Total capital contributions</b>	<b>11,632,316</b>	<b>1,786,136</b>

In accordance with the Decree of the President of the Republic of Azerbaijan "On Amendments and additions to the Budget of the Fund for 2006" dated 7 June 2006, if in 2007 the contractual cost of the crude oil produced and exported in Azerbaijan exceeded the established price, the payments made to Fund from this amount will represent proceeds from difference between the contractual prices on exported crude oil produced in the Republic of Azerbaijan and the internal wholesale price, and reflects a new source of income for the Fund for the year 2007.



## 10. TRANSFERS BY THE FUND

### Transfers to the State Budget

In 2008, as in previous years, a certain portion of the Fund's assets was transferred to the State Budget to cover the budget deficit. In accordance with the Decree #687 of the President of the Republic of Azerbaijan "On the Budget of the State Oil Fund of the Republic of Azerbaijan for 2008" dated 26 December 2007, as well as the Program on Expensing of Assets of the State Oil Fund of the Republic of Azerbaijan for 2008, as approved by the President Decree #2582, dated 26 December 2007 and the Decree of the President of the Republic of Azerbaijan #802 "On Amendments and supplements to the Law of the Republic of Azerbaijan on the State Budget for the year 2008" dated 11 July 2008, during 2008 the Fund transferred AZN 3,800,000 thousand to the State Budget (2007: AZN 585,000 thousand).

### Transfers for the construction of water pipeline Oguz-Gabala-Baku

In accordance with the Decree #687 of the President of the Republic of Azerbaijan "On Budget of the State Oil Fund of the Republic of Azerbaijan for 2008" dated 26 December 2007, as well as the Program on Expensing of Assets of the State Oil Fund of the Republic of Azerbaijan for 2008 as approved by the Order #2582, dated 26 December 2007, the Fund transferred AZN 211,820 thousand (2007: AZN 132,907 thousand) to finance the project for the construction of water pipeline from the Oguz-Gabala zone to Baku in 2008.

### Transfers to the State Refugees Committee and Internally Displaced Peoples' Social Development Fund

In 2008 the amount of AZN 144,999 thousand (2007: AZN 154,117 thousand) was transferred to finance the projects for improvement of social conditions of refugees and internally displaced people. Transfers were made pursuant to the Decree #687 of the President of the Republic of Azerbaijan "On Budget of the State Oil Fund of the Republic of Azerbaijan for 2008" dated 26 December 2007, as well as the Program on Expensing of Assets of the State Oil Fund of the Republic of Azerbaijan for 2008 as approved by the Decree # 2582 of the President of the Republic on "Amendments to the budget of the State Oil Fund for 2008" dated 26 December 2007.

### Transfers for the reconstruction of the Samur-Apsheron irrigation system

In accordance with the Decree #687 of the President of the Republic of Azerbaijan "On Budget of the State Oil Fund of the Republic of Azerbaijan for 2008" dated 26 December 2007, as well as the Program on Expensing of Assets of the State Oil Fund of the Republic of Azerbaijan for 2008 as approved by the Order #2582, dated 26 December 2007, the Fund transferred AZN 120,600 thousand (2007: AZN 76,900 thousand) to finance the project for reconstruction of the Samur-Apsheron irrigation system in 2008.

### Transfers for the construction of the new Baku-Tbilisi-Kars railway line

In accordance with the Decree #687 of the President of the Republic of Azerbaijan "On Budget of the State Oil Fund of the Republic of Azerbaijan for 2008" dated 26 December 2007, as well as the Program on Expensing of Assets of the State Oil Fund of the Republic of Azerbaijan for 2008 as approved by the Order #2582, dated 26 December 2007, the Fund transferred AZN 5,271 thousand (2007: AZN 20,712 thousand) to finance the project for construction of the new Baku-Tbilisi-Kars railway line in 2008.

### Transfers in respect of State Program on Education of the Azerbaijani Youth in Abroad

Starting from 2008, pursuant to Decree #687 of the President of the Republic of Azerbaijan "On Budget of the State Oil Fund of the Republic of Azerbaijan for 2008" dated 26 December 2007, as well as the Program on Expensing of Assets of the State Oil Fund of the Republic of Azerbaijan for 2008 as approved by the Order #2582, dated 26 December 2007, in 2008 the Fund transferred AZN 2,296 thousand to finance the state program on education of the Azerbaijani Youth in abroad.

### 2007 transfer for controlling shares of SOCAR in Azeri-Chirag-Guneshli project

In accordance with Decree #601 "On the Amendments and additions to the Budget of the State Oil Fund of the Republic of Azerbaijan for the year 2007" dated 28 July 2007, amount of AZN 87,559 thousand was transferred to SOCAR in 2007 as the financing of the share of the Republic of Azerbaijan in Azeri-Chirag-Guneshli project.

## 11. INTEREST INCOME

	Year ended 31 December 2008	Year ended 31 December 2007
Interest income on assets at fair value through profit or loss	210,786	70,614
Interest income on assets recorded at amortized cost:		
Interest income on unimpaired assets:		
Interest on term deposits	16,140	1,911
Income from money market funds	8,964	2,989
Interest on demand deposits	4,204	2,173
<b>Total interest income</b>	<b>240,094</b>	<b>77,687</b>

## 12. NET LOSS ON FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	Year ended 31 December 2008	Year ended 31 December 2007
Net loss on operations with securities designated at fair value through profit or loss comprise:		
Unrealized loss on fair value adjustment	(28,248)	(4,855)
Realized gain/(loss) on trading operations	19,325	(547)
<b>Total net loss on operations with securities designated at fair value through profit or loss</b>	<b>(8,923)</b>	<b>(5,402)</b>

## 13. FOREIGN EXCHANGE TRANSLATION DIFFERENCES, NET

	Year ended 31 December 2008	Year ended 31 December 2007
Unrealized translation differences, net	(594,226)	15,935
Realized translation differences, net	(58,420)	(1,987)
<b>Total translation differences, net</b>	<b>(652,646)</b>	<b>13,948</b>

## 14. OPERATING EXPENSES

	Year ended 31 December 2008	Year ended 31 December 2007
Bank commissions	1,842	687
Wages, salaries and employee benefits	904	558
Professional fees	406	871
Communication expenses	216	161
Depreciation and amortization	210	140
Business travel expenses	145	81
Transportation costs	45	42
Insurance expenses	30	27
Publication fees	9	8
Other operating expenses	434	88
<b>Total operating expenses</b>	<b>4,241</b>	<b>2,663</b>

## 15. INCOME TAXES

The Fund provides for taxes based on the tax accounts maintained and prepared in accordance with the tax regulations of the Republic of Azerbaijan and which may differ from IPSAS.

The Fund is subject to certain permanent tax differences due to non-tax deductibility of certain expenses.

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 2008 and 2007 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 2008 and 2007 comprise:



	2008	2007
<b>Deductible temporary differences:</b>		
Tax loss for the year ended 31 December 2008	409,915	-
Securities at fair value through profit or loss	22,616	7,244
<b>Total deductible temporary differences:</b>	<b>432,531</b>	7,244
<b>Taxable temporary differences:</b>		
Property, plant and equipment	(4,702)	(3,975)
Intangible assets	(50)	(11)
<b>Total taxable temporary differences:</b>	<b>(4,752)</b>	(3,986)
<b>Net deferred deductible temporary differences</b>	<b>427,779</b>	<b>3,258</b>
Net deferred tax asset at the statutory rate (22%)	94,111	716
Deferred tax assets not recognized	(94,111)	(716)
<b>Net deferred tax asset / (liability)</b>	-	-

Relationship between tax expense and accounting profit for the year ended 31 December 2008 and 2007 are explained as follows:

	2008	2007
(Deficit)/ surplus before income tax	(425,716)	83,570
At a statutory rate of 22%	(93,658)	18,385
Change in deferred tax assets not recognized	93,395	716
Tax effect of permanent differences	263	1,410
Deferred tax benefit arising from net operating losses carried forward	-	(7,382)
Income tax expenses reported in the statement of financial performance	-	13,129

The tax rate used for the 2008 and 2007 reconciliations above is the corporate income tax rate of 22% payable by corporate entities in the Republic of Azerbaijan on taxable profits under the tax law of this jurisdiction.

## 16. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

The management believes that the fair value of all financial assets and liabilities approximate the corresponding carrying amount in the balance sheet of the Fund. Fair values of securities at fair value through profit or loss were determined directly by reference to published price quotations in an active market.

## 17. RISK MANAGEMENT POLICIES

Management of risk is an essential element of the Fund's operations. Risks inherent to the Fund's operations are those related to credit exposures, liquidity and market risks. A summary description of the Fund's risk management policies in relation to those risks is discussed below.

### Credit risk

The Fund 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. The Fund is subject to credit risk from its portfolio of cash and cash equivalents and its investments. The Fund manages its credit risk in accordance with the "Rules on Holding, Placement and Management of Foreign Currency Assets of the State Oil Fund of the Republic of Azerbaijan" approved by Decree #511 of the President of the Republic of Azerbaijan dated 19 June 2001 as amended by Decree #607 dated 21 December 2001, Decree #202 dated 1 March 2005, as well as "Program on Expensing of Assets of the State Oil Fund of the Republic of Azerbaijan for 2008 as approved by the Order #2582, dated 26 December 2007.

### Maximum Exposure

The Fund's maximum exposure to credit risk varies significantly and is dependant on both individual risks and general market economy risks. The maximum exposure on the financial assets at fair value through profit or loss amounts to AZN 8,514,050 thousand and AZN 1,776,219 thousand at 31 December 2008 and 2007, respectively.

Per Investment Policy of the Fund, the maximum weight of one financial institution or one investment in the investment portfolio is set at 15% of total amount of the investment portfolio. At 31 December 2008, sovereign debt securities (bonds) of the Federal Republic of Germany amounting to AZN 1,396,828 thousand represented 15.68% of the Fund's investment portfolio and considered as an exceptional case. At the closing day (1 December 2008) the maximum weight bonds received from Federal Republic of Germany was 13.96% (taking into account all bonds of the issuer received previously) in the investment portfolio of the Fund. In December 2008 as a result of the huge budget transfers and foreign currency differences the weight (ratio) of issuers in the portfolio has been changed at the end of December 2008. Therefore, special weight of sovereign debt securities (bonds) of the Federal Republic of Germany exceeded 15% of the Fund's investment portfolio. Since one of the bonds of the issuer (Deutschland Rep 3.75 01/09) with nominal value EUR 39,400 thousand matured on 4 January 2009 and the other two bonds were sold on 13 and 16 January 2009 (Bundesobl 04/10 and BKO 3 03/10) with nominal value EUR 150,000 thousand, the ratio showing maximum weight of one financial institution or one investment in the investment portfolio subsequently dropped down to 12.85%.

According to the Investment Policy of the Fund foreign currency assets of the Fund could be placed into assets or issuer that have rating not less than investing credit rating (Baa3 (Moody's) or BBB- (Standard & Poor's, Fitch)).

The following table details the credit ratings of securities held by the Fund. The credit rating issued by internationally regarded agencies Standard & Poor's and Moody's. If an asset has different credit ratings, the highest one was used.

	AAA	AA	A	BBB	Non-investment rating	Total at 31 December 2008
Cash and cash equivalents	16,903	376,062	-	-	79,566	472,531
Securities at fair value through profit or loss	7,449,452	519,121	503,038	37,981	4,458	8,514,050

	AAA	AA	A	BBB	Non-investment rating	Total at 31 December 2007
Cash and cash equivalents	166,436	116,313	839	-	32,622	316,210
Securities at fair value through profit or loss	853,966	548,914	278,818	57,769	36,752	1,776,219

At 31 December 2008 and 2007, the minimum long term credit ratings of securities or their issuers were Baa3 (Moody's) or BBB- (Standard & Poor's). Bonds of Lehman Brothers LEH 05/11 with carrying amount (fair value) of AZN 2,154 thousand, Kaupthing KAUP 05/10 of AZN 1,626 thousand and Kaupthing KAUP 08/12 of AZN 678 thousand were considered as an exceptional by the Fund. The following table details the information regarding these securities.

Securities	ISIN	Nominal value (in thousand)	Currency	Date of receipt	Maturity	Rating at the date of acquisition (Moody's/S&P)	Rating at 31 December 2008 (Moody's/S&P)
LEH 05/11	XS0252835110	10,000	EUR	06.03.2007	04.05.2011	A1/A+	NR/NR*
		10,000		25.07.2007		A1/A+	
KAUP 05/10	XS0219823266	24,000	EUR	02.03.2007	25.05.2010	Aaa/AAA	Caa2/NR*
KAUP 08/12	XS0226781242	10,000	EUR	02.03.2007	17.08.2012	Aaa/AAA	Caa2/NR*

\* - not rated

On 15 September 2008 "Lehman Brothers Holdings Inc." made a statement regarding its bankruptcy ("Chapter 11"). Pursuant to this Chapter "Lehman Brothers Holdings Inc." remains the owner of its assets for the period set by the court and obtained the right of restructuring.

On 9 October 2008, the Icelandic Financial Supervisory Authority based on the particular financial condition in the country and with the respective decision of the Parliament of the Republic of Iceland declared receipt of control for "Kaupthing Bank hf.". On 8 October 2008 and 9 October 2008, the credit ratings for the bonds of Kaupthing Bank hf. fall to Ba1 and Caa2, respectively.



### Bank accounts

In accordance with the "Rules on Holding, Placement and Management of Foreign Currency Assets of the State Oil Fund of the Republic of Azerbaijan" approved by Decree #511 of the President of the Republic of Azerbaijan dated 19 June 2001 as amended by Decree #607 dated 21 December 2001 and # 202 dated 1 March 2005, currency settlement accounts of the Fund may be held in banks with long-term credit ratings not lower than A- (Standard & Poors, Fitch) or Aa3 (Moody's).

At 31 December 2008 the Fund had AZN 78,402 thousand and AZN 1,164 thousand, held at bank accounts in the National Bank of the Republic of Azerbaijan and the International Bank of Azerbaijan, respectively (2007: AZN 31,998 thousand and AZN 624 thousand), which are rated BB. The Fund is allowed to maintain funds in the country only in the National Bank of the Republic of Azerbaijan and the International Bank of Azerbaijan.

### Depository services

In accordance with the "Rules on Holding, Placement and Management of Foreign Assets of the State Oil Fund of the Republic of Azerbaijan" approved by Decree #511 of the President of the Republic of Azerbaijan dated 19 June 2001 as amended by Decree #607 dated 21 December 2001 and # 202 dated 1 March 2005, the Fund's depository services may be provided by commercial banks and other financial institutions with long-term credit ratings not lower than A- (Standard & Poors, Fitch) or A3 (Moody's).

### Financial market counterparties

In accordance with the "Rules on Holding, Placement and Management of Foreign Assets of the State Oil Fund of the Republic of Azerbaijan" approved by Decree #511 of the President of the Republic of Azerbaijan dated 19 June 2001 as amended by Decree #607 dated 21 December 2001 and # 202 dated 1 March 2005, the Fund's counterparties at international financial markets may involve commercial banks and other financial institutions within investment credit ratings (not lower than Baa3 (Moody's) or BBB- (Standard & Poors, Fitch)).

### External managers

In accordance with the "Rules on Holding, Placement and Management of Foreign Assets of the State Oil Fund of the Republic of Azerbaijan" approved by Decree #511 of the President of the Republic of Azerbaijan dated 19 June 2001 as amended by Decree #607 dated 21 December 2001 and # 202 dated 1 March 2005, when an external manager is engaged in management of the Fund's currency assets, the external manager or its principal founder should have investment credit ratings (not lower than Baa3 (Moody's) or BBB- (Standard & Poors, Fitch)) or have at least five years of positive history of management of assets, or be experienced in managing assets with a value not less than one billion USD.

### 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 Fund is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

Program on Expensing of Assets of the State Oil Fund of the Republic of Azerbaijan for 2008 as approved by the Order #2582, dated 26 December 2007, specified requirements for Investment Policy (investment trend) of the Fund for 2008 and currency basket of the Fund's portfolio for 2008. In accordance with these requirements, 50% of the total amount of the investment portfolio of the Fund invests in assets denominated in USD, 40% in assets denominated in EUR, 5% in assets denominated in GBP, whereas 5% of the total amount of the investment portfolio, the Fund invests in assets denominated either in currencies of countries with the long-term country ratings (sovereign debt) not less than the credit ratings A (Standard & Poors, Fitch) or A2 (Moody's), or in USD, EUR and GBP based on their percentage in the weight, or entirely in USD. In case of noncompliance the Fund is to rebalance the portfolio during 10 business days subsequent to the end of each quarter. As of 31 December 2008, 53% of the Fund's investment portfolio were denominated in USD, 43% in EUR and 4% in GBP. On 16 January 2009, rebalance of currency classification of the Fund's investment portfolio was completed pursuant to the diversification criteria defined in the Investment Policy.

The Investment Policy of the Fund for 2007 as approved by the Order #1878 of the President of the Republic of Azerbaijan dated 28 December 2006, specified requirements for Investment Policy (investment trend) of the Fund for 2007 and currency basket of the Fund's portfolio for 2007. In accordance with these requirements, 55% of the total amount of the investment portfolio of the Fund invests in assets denominated in USD, 35% in assets denominated in EUR, 5% in assets denominated in GBP, whereas 5% of the total amount of the investment portfolio, the Fund invests in assets denominated either in currencies of countries with the long-term country ratings (sovereign debt) not less than the credit ratings A (Standard & Poors, Fitch) or A2 (Moody's), or in USD, EUR and GBP based on their percentage in the weight, or entirely in USD.

In case of noncompliance the Fund is to rebalance the portfolio during 10 business days subsequent to the end of each quarter. As of 31 December 2007, 62% of the Fund's investment portfolio was denominated in USD, 34% in EUR and 4% in GBP. On 16 January 2008, currency classification of the Fund's investment portfolio was rebalanced pursuant to the diversification criteria defined in the Investment Policy.

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

	31 December 2008				
	AZN	USD	EUR	GBP	Total
<b>FINANCIAL ASSETS:</b>					
Cash and cash equivalents	79,550	86,724	92,567	213,690	472,531
Securities at fair value through profit or loss	-	4,604,898	3,733,106	176,046	8,514,050
<b>Total financial assets</b>	<b>79,550</b>	<b>4,691,622</b>	<b>3,825,673</b>	<b>389,736</b>	<b>8,986,581</b>
<b>FINANCIAL LIABILITIES:</b>					
Other financial liabilities	65	170	65	-	300
<b>Total financial liabilities</b>	<b>65</b>	<b>170</b>	<b>65</b>	<b>-</b>	<b>300</b>
<b>OPEN POSITION</b>	<b>79,485</b>	<b>4,691,452</b>	<b>3,825,608</b>	<b>389,736</b>	<b>8,986,281</b>
	<b>1%</b>	<b>52%</b>	<b>43%</b>	<b>4%</b>	

	31 December 2007				
	AZN	USD	EUR	GBP	Total
<b>FINANCIAL ASSETS:</b>					
Cash and cash equivalents	32,592	253,610	25,295	4,713	316,210
Securities at fair value through profit or loss	-	1,016,250	677,076	82,893	1,776,219
Other financial assets	-	761	-	-	761
<b>Total financial assets</b>	<b>32,592</b>	<b>1,270,621</b>	<b>702,371</b>	<b>87,606</b>	<b>2,093,190</b>
<b>FINANCIAL LIABILITIES:</b>					
Other financial liabilities	27	-	-	-	27
<b>Total financial liabilities</b>	<b>27</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>27</b>
<b>OPEN POSITION</b>	<b>32,565</b>	<b>1,270,621</b>	<b>702,371</b>	<b>87,606</b>	<b>2,093,163</b>
	<b>1%</b>	<b>61%</b>	<b>34%</b>	<b>4%</b>	

Risk management and monitoring is performed within above set limits, by the Investment Committee and the Fund's Management. All recommendations/decisions are proposed/made by the Investment Committee and subsequently are subject to the approval of the management of the Fund. Daily risk management is performed by the Risk Management Department.

### Currency risk sensitivity

The following table details the sensitivity of the Fund's assets to a 10% increase and decrease in the USD, EUR and GBP 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 cash and cash equivalents as well as securities at fair value through profit or loss. 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.

	31 December 2008					
	AZN/USD		AZN/EUR		AZN/GBP	
	+10%	-10%	+10%	-10%	+10%	-10%
Impact on net surplus for the year	469,145	(469,145)	382,561	(382,561)	38,974	(38,974)

	31 December 2007					
	AZN/USD		AZN/EUR		AZN/GBP	
	+10%	-10%	+10%	-10%	+10%	-10%
Impact on net surplus for the year	127,062	(127,062)	70,237	(70,237)	8,761	(8,761)

**Geographical concentration**

	Azerbaijan	Europe	America	Asia	Africa	International Organizations	31 December 2008 Total
<b>FINANCIAL ASSETS:</b>							
Cash and cash equivalents	79,563	313,948	79,020	-	-	-	472,531
Securities at fair value through profit or loss	-	4,702,139	2,572,743	176,884	8,380	1,053,904	8,514,050
<b>Total financial assets</b>	<b>79,563</b>	<b>5,016,087</b>	<b>2,651,763</b>	<b>176,884</b>	<b>8,380</b>	<b>1,053,904</b>	<b>8,986,581</b>
<b>FINANCIAL LIABILITIES:</b>							
Other financial liabilities	300	-	-	-	-	-	300
<b>Total financial liabilities</b>	<b>300</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>300</b>
<b>NET POSITION</b>	<b>79,263</b>	<b>5,016,087</b>	<b>2,651,763</b>	<b>176,884</b>	<b>8,380</b>	<b>1,053,904</b>	<b>8,986,281</b>

	Azerbaijan	Europe	America	Asia	Africa	International Organizations	31 December 2007 Total
<b>FINANCIAL ASSETS:</b>							
Cash and cash equivalents	32,622	242,886	40,702	-	-	-	316,210
Securities at fair value through profit or loss	-	602,733	1,004,292	99,987	9,281	59,926	1,776,219
Other financial assets	-	-	761	-	-	-	761
<b>Total financial assets</b>	<b>32,622</b>	<b>845,619</b>	<b>1,045,755</b>	<b>99,987</b>	<b>9,281</b>	<b>59,926</b>	<b>2,093,190</b>
<b>FINANCIAL LIABILITIES:</b>							
Other financial liabilities	27	-	-	-	-	-	27
<b>Total financial liabilities</b>	<b>27</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>27</b>
<b>NET POSITION</b>	<b>32,595</b>	<b>845,619</b>	<b>1,045,755</b>	<b>99,987</b>	<b>9,281</b>	<b>59,926</b>	<b>2,093,163</b>

**Interest rate risk**

At 31 December 2008 and 2007, deposits and debt securities were interest-bearing and, therefore, were exposed to the interest rate risk. Depending on the market conditions the Fund is managing this risk by gradually increasing or decreasing the duration of assets in the investment portfolio.

Risk management and monitoring is performed within above set limits, by the Investment Committee and the Fund's Management. All recommendations/decisions are proposed / made by the Investment Committee and subsequently are subject to the approval of the management of the Fund. Daily risk management is performed by the Risk Management Department.

The following table presents a net impact of change of the fair value of securities, when market interest rate changed by 1%. Sensitivity analysis of interest rate risk 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 surplus before tax:

	As at 31 December 2008		As at 31 December 2007	
	Interest rate +1%	Interest rate -1%	Interest rate +1%	Interest rate -1%
<b>Assets:</b>				
Cash and cash equivalents	-	-	4	(4)
Securities at fair value through profit or loss	(105,526)	105,526	(22,309)	22,309
<b>Net impact on surplus before tax</b>	<b>(105,526)</b>	<b>105,526</b>	<b>(22,305)</b>	<b>22,305</b>

**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 Fund's assets and liabilities are actively managed. Additionally, the financial position of the Fund may vary at the time that any actual market movement occurs. For example, the Fund'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 the 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 statement of the financial position. In these circumstances, the different measurement bases for liabilities and assets may lead to volatility in net assets.

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Fund'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.

**Liquidity Risk**

Management's guiding policies are to maintain conservative levels of liquidity to ensure that the Fund has the ability to meet its obligations under all conceivable circumstances.

An analysis of the liquidity risk of financial position items is presented in the following table:

As at 31 December 2008:

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	Total
<b>FINANCIAL ASSETS:</b>							
Cash and cash equivalents	261,799	210,732	-	-	-	-	472,531
Securities at fair value through profit or loss	317,919	98,409	2,396,279	5,664,214	35,352	1,877	8,514,050
<b>Total financial assets</b>	<b>579,718</b>	<b>309,141</b>	<b>2,396,279</b>	<b>5,664,214</b>	<b>35,352</b>	<b>1,877</b>	<b>8,986,581</b>
<b>FINANCIAL LIABILITIES:</b>							
Other financial liabilities	300	-	-	-	-	-	300
<b>Total financial liabilities</b>	<b>300</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>300</b>
<b>Liquidity gap</b>	<b>579,418</b>	<b>309,141</b>	<b>2,396,279</b>	<b>5,664,214</b>	<b>35,352</b>	<b>1,877</b>	<b>8,986,281</b>

As at 31 December 2007:

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	Total
<b>FINANCIAL ASSETS:</b>							
Cash and cash equivalents	316,210	-	-	-	-	-	316,210
Securities at fair value through profit or loss	15,081	100,254	699,673	879,042	80,025	2,144	1,776,219
Other financial assets	761	-	-	-	-	-	761
<b>Total financial assets</b>	<b>332,052</b>	<b>100,254</b>	<b>699,673</b>	<b>879,042</b>	<b>80,025</b>	<b>2,144</b>	<b>2,093,190</b>
<b>FINANCIAL LIABILITIES:</b>							
Other financial liabilities	27	-	-	-	-	-	27
<b>Total financial liabilities</b>	<b>27</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>27</b>
<b>Liquidity gap</b>	<b>332,025</b>	<b>100,254</b>	<b>699,673</b>	<b>879,042</b>	<b>80,025</b>	<b>2,144</b>	<b>2,093,163</b>

**Price risk**

Price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market. The Fund is exposed to price risks of its products which are subject to general and specific market fluctuations.

The Fund manages price risk through periodic estimation of potential losses that could arise from adverse changes in market conditions and establishing and maintaining appropriate stop-loss limits and margin and collateral requirements.

Risk management and monitoring is performed within above set limits, by the Investment Committee and the Fund's Management. All recommendations/decisions are proposed/made by the Investment Committee and subsequently are subject to the approval of the management of the Fund. Daily risk management is performed by the Risk Management Department.

	31 December 2008		31 December 2007	
	1% increase in securities price	1% increase in securities price	1% increase in securities price	1% increase in securities price
Impact on profit before tax	85,140	(85,140)	17,762	(17,762)
Impact on equity	85,140	(85,140)	17,762	(17,762)



## 18. TRANSACTIONS WITH RELATED PARTIES

Related parties or transactions with related parties, as defined by IPSAS 20 "Related party disclosures", represent parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Fund; have an interest in the Fund that gives them significant influence over the Fund; and that have joint control over the Fund.

Settlements with related parties are disclosed below:

Related party		Contributions received from related parties	Transfers to related parties	Payables to related parties	Receivables from related parties	Bank accounts with related parties	Income tax expense	Off-balance sheet transactions
SOCAR	2008	11,526,986	-	-	-	-	-	-
	2007	1,675,019	-	-	-	-	-	-
The State Budget	2008	-	3,800,000	-	13,129	-	-	-
	2007	-	585,000	12,608	-	-	13,129	-
Construction of water pipeline Oguz-Gabala-Baku	2008	-	211,820	-	-	-	-	-
	2007	-	132,907	-	-	-	-	-
The State Refugees Committee and Internally Displaced Peoples' Social Development Fund	2008	-	144,999	-	-	-	-	-
	2007	-	154,117	-	-	-	-	-
Reconstruction of the Samur-Apsheron irrigation system	2008	-	120,600	-	-	-	-	-
	2007	-	76,900	-	-	-	-	-
Construction of the new Baku-Tbilisi-Kars railway line	2008	-	5,271	-	-	-	-	-
	2007	-	20,712	-	-	-	-	-
Controlling shares of SOCAR in ACG projects	2008	-	-	-	-	-	-	-
	2007	-	87,559	-	-	-	-	-
Ministry of Education of the Republic of Azerbaijan	2008	-	2,296	-	-	-	-	-
	2007	-	-	-	-	-	-	-
National Bank of the Republic of Azerbaijan	2008	-	-	-	-	78,402	-	-
	2007	-	-	-	-	31,998	-	-
International Bank of Azerbaijan	2008	-	-	-	-	1,164	-	-
	2007	-	-	-	-	624	-	-
Ministry of Finance of the Republic of Azerbaijan	2008	-	-	-	-	-	-	128,584
	2007	-	-	-	-	-	-	535,000

Transactions with related parties are fully described in Note 9, 10 and 19.

### Key management personnel

The senior management group consists of the Fund's Executive Director and heads of administrations. The aggregate remuneration of members of the senior management group and the number of managers determined on a full-time equivalent basis receiving remuneration within this category are:

	2008	2007
Aggregate remuneration	50	39
Number of persons	3	2

## 19. COMMITMENTS AND CONTINGENCIES

### Off-balance sheet transactions

On 11 August 2006 the Fund signed an Asset Management Agreement on "Granting free budget (balance) funds to trustworthy management" with the Ministry of Finance of the Republic of Azerbaijan. According to this agreement free budget funds of the Ministry of Finance of the Republic of Azerbaijan are to be transferred to and managed by the Fund within the asset management rules set in the agreement with the Ministry of Finance of the Republic of Azerbaijan. The Fund manages these assets free of charge, on its own behalf and in favor, at the expense and at the risks of the Ministry of Finance. At 31 December 2008 assets received under above agreement were AZN 128,584 thousand (USD 128,724 thousand, GBP 5,629 thousand and EUR 16,768 thousand (2007: AZN 535,229 thousand (USD 570,722 thousand and GBP 31,286 thousand)) including accrued interest.

### Legal proceedings

In 2004, a legal action totaling approximately six million USD was brought against the government of the Republic of Azerbaijan along with a number of Azerbaijan governmental institutions, including the Ministry of Communications of the Republic of Azerbaijan, the State Oil Company of the Republic of Azerbaijan and the Fund. This legal action was brought by a foreign bank in the District Court of Rotterdam (the "Court"), the Netherlands. In an interim-verdict dated 24 December 2008, the Court ruled that the Claimant Bank should submit additional evidence supporting the major facts on legal proceeding. The further hearing of witnesses is expected to take place in the course of 2009. Thus, at the date of these financial statements the outcome of the legal action is uncertain.

The Fund's management believes this legal action is without merit and that the Republic of Azerbaijan will prevail. These financial statements do not include any adjustments which could result from the possible outcome of this uncertainty.

### Taxation

The calculation of profit tax in Azerbaijan tax legislation can be subject to various interpretations and this may lead to certain possible additional obligations of the Fund, including additional taxes, penalties and interest. Tax years for the calculation of profit tax, Value Added Tax, personal income tax, withholding taxes and other taxes remain open to review by the tax authorities for three years. Management believes that the Fund has already made all necessary tax payments due, and therefore no provisions have been made in these financial statements for any other potential liabilities.

### Operating environment

The Fund is established and operates in the Republic of Azerbaijan. Laws and regulations affecting the business environment in the Republic of Azerbaijan are subject to rapid changes and the Fund's assets and operations could be at risk due to negative changes in the political and business environment.

## 20. SUBSEQUENT EVENTS

### Receivables and transfers

In accordance with Decree #68 on "Ratifying the Budget of the State Oil Fund of the Republic of Azerbaijan for 2009" dated 26 February 2009, the Fund's budgeted income and expenses for 2009 estimated at AZN 8,361,016 thousand and AZN 5,319,535 thousand respectively. The following types of main expenses for the year 2009 are budgeted:

- Transfer to the State Budget of the Republic of Azerbaijan - AZN 4,915,000 thousand;
- Reconstruction of the Samur-Apsheron irrigation system - AZN 110,000 thousand;
- Construction of water pipeline from Oguz-Gabala zone to Baku city - AZN 100,000 thousand;
- Financing of the measures for improvement of social conditions of refugees and internally displaced people- AZN 80,000 thousand;
- Construction of the new Baku-Tbilisi-Kars railway line - AZN 80,000 thousand;
- Financing the State Program on "Education of Azerbaijan youth in foreign countries" during 2007-2015 - AZN 10,000 thousand.

### Specific volatility in global financial markets

In recent months a number of major economies around the world have experienced volatile capital and credit markets. A number of major global financial institutions have either been placed into bankruptcy, taken over by other financial institutions and/or supported by government funding. As a consequence of the recent market turmoil in capital and credit markets globally, notwithstanding any potential economic stabilization measures that may be put into place by the several governments in global markets, there exists as at the date these financial statements are authorized for issue economic uncertainties surrounding the continual availability, and cost, of credit both for the Fund and its counterparties, the potential for economic uncertainties to continue in the foreseeable future and, as a consequence, the potential that assets may be not be recovered at their carrying amount in the ordinary course of business, and a corresponding impact on the Fund's profitability.

### Recoverability of financial assets

As a result of recent economic turmoil in capital and credit markets globally, and the consequential economic uncertainties existing as at balance sheet date, there exists the potential that assets may not be recovered at their carrying amount in the regular course of business.

As at year end, the Fund has financial assets amounted to AZN 8,986,581 thousands (31 December 2007: AZN 2,093,190 thousands). The recoverability of these financial assets depends to a large extent on the efficacy of the fiscal measures and other measures and other actions, beyond the Fund's control, undertaken within various countries to achieve economic stability and recovery. The recoverability of the Fund's financial assets is determined based on information available as at the reporting date. It is the management's opinion that no further adjustments to the fair value of financial assets are needed at present, based on prevailing conditions and available information.

## STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

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 financial statements of the State Oil Fund of the Republic of Azerbaijan (the "Fund").

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Fund at 31 December 2008, the results of its operations, cash flows and changes in net assets for the year then ended, in accordance with International Public Sector Accounting Standards ("IPSAS").

In preparing the financial statements, management is responsible for:

- ♦ Selecting suitable accounting principles and applying them consistently;
- ♦ Making judgments and estimates that are reasonable and prudent; and
- ♦ Preparing the financial statements on a going concern basis, unless it is inappropriate to presume that the Fund 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 Fund;
- ♦ Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Fund, and which enable them to ensure that the financial statements of the Fund comply with IPSAS;
- ♦ Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- ♦ Taking such steps as are reasonably available to them to safeguard the assets of the Fund; and
- ♦ Detecting and preventing fraud, errors and other irregularities.

The financial statements for the year ended 31 December 2008 were authorized for issue on 14 April 2009 by the management of the Fund.