

**The State Oil Fund of the Republic of Azerbaijan  
Financial Statements**

*Year ended 31 December 2010*

*Together with Independent Auditors' Report*

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## **Independent auditors' report**

To the State Oil Fund of the Republic of Azerbaijan -

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 2010, and the statements of financial performance, of changes in net assets/equity, of cash flows and of comparison of budget and actual amounts for the year then ended, and a summary of significant accounting policies and other explanatory information.

### ***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 issued by the International Public Sector Accounting Standards Board of the International Federation of Accountants, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***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 about 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 auditors' 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 2010, and its financial performance and its cash flows for the year then ended in accordance with International Public Sector Accounting Standards.

30 March 2011

**Statement of financial position****As at 31 December 2010***(Thousands of Azerbaijani Manats)*

	<b>Notes</b>	<b>2010</b>	<b>2009</b>
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	5	313,783	431,244
Financial assets at fair value through surplus or deficit	6	17,851,820	11,535,234
Tax settlements other than income tax		2,242	1,106
Current income tax asset		10,710	10,710
<b>Total current assets</b>		<b>18,178,555</b>	<b>11,978,294</b>
<b>Non-current assets</b>			
Property and equipment, net	7	4,710	5,673
Other non-current and intangible assets	8	13,403	7,525
<b>Total non-current assets</b>		<b>18,113</b>	<b>13,198</b>
<b>Total assets</b>		<b>18,196,668</b>	<b>11,991,492</b>
<b>Liabilities</b>			
<b>Current liabilities</b>		<b>343</b>	<b>584</b>
<b>Net assets</b>		<b>18,196,325</b>	<b>11,990,908</b>
<b>Net assets/equity</b>			
Contributed capital	9, 10	18,441,696	11,881,919
Property revaluation reserve		4,441	5,267
Accumulated (deficit)/surplus		(249,812)	103,722
<b>Total net assets/equity</b>		<b>18,196,325</b>	<b>11,990,908</b>

30 March 2011

*The accompanying notes on pages 6 to 32 are an integral part of these financial statements.*

**Statement of financial performance****For the year ended 31 December 2010***(Thousands of Azerbaijani Manats)*

	<b>Notes</b>	<b>2010</b>	<b>2009</b>
Interest income	11	353,264	360,277
Net loss on financial assets at fair value through surplus or deficit	12	(197,358)	(54,387)
Net (loss)/gain on foreign currency translation differences	13	(502,738)	97,614
<b>Total operating (loss)/income</b>		<b>(346,832)</b>	<b>403,504</b>
Operating expenses	14	(6,702)	(5,182)
<b>(Deficit)/surplus before income tax expense</b>		<b>(353,534)</b>	<b>398,322</b>
Income tax expense	15	-	(2,419)
<b>Net (deficit)/surplus for the year</b>		<b>(353,534)</b>	<b>395,903</b>

*The accompanying notes on pages 6 to 32 are an integral part of these financial statements.*

**Statement of changes in net assets/equity****For the year ended 31 December 2010***(Thousands of Azerbaijani Manats)*

	Notes	Contributed capital	Property revaluation reserve	Accumulated surplus/ (deficit)	Total net assets/equity
<b>31 December 2008</b>		<b>9,295,958</b>	<b>6,044</b>	<b>(292,181)</b>	<b>9,009,821</b>
Contributions received	9, 7	7,870,829	(777)	-	7,870,052
Net surplus for the year		-	-	395,903	395,903
Transfers to the State Budget	10	(4,915,000)	-	-	(4,915,000)
Transfers for the reconstruction of Samur-Apsheron Irrigation system	10	(130,000)	-	-	(130,000)
Transfers for the construction of Oguz-Gabala-Baku water pipeline	10	(119,957)	-	-	(119,957)
Transfers to the Refugees Committee and Internally Displaced Peoples' Social Development Fund	10	(89,883)	-	-	(89,883)
Transfers for the construction of new Baku-Tbilisi-Kars railway line	10	(22,117)	-	-	(22,117)
Transfers for the State Program on "Education of Azerbaijani youth abroad"	10	(7,911)	-	-	(7,911)
<b>31 December 2009</b>		<b>11,881,919</b>	<b>5,267</b>	<b>103,722</b>	<b>11,990,908</b>
Contributions received	9, 7	12,932,367	(826)	-	12,931,541
Net deficit for the year		-	-	(353,534)	(353,534)
Transfers to the State Budget	10	(5,915,000)	-	-	(5,915,000)
Transfers for the reconstruction of Samur-Apsheron Irrigation system	10	(130,999)	-	-	(130,999)
Transfers for the construction of Oguz-Gabala-Baku water pipeline	10	(199,618)	-	-	(199,618)
Transfers to the State Refugees Committee and Internally Displaced Peoples' Social Development Fund	10	(104,948)	-	-	(104,948)
Transfers for the construction of new Baku-Tbilisi-Kars railway line	10	(12,420)	-	-	(12,420)
Transfers for the State Program on "Education of Azerbaijani youth abroad"	10	(9,605)	-	-	(9,605)
<b>31 December 2010</b>		<b>18,441,696</b>	<b>4,441</b>	<b>(249,812)</b>	<b>18,196,325</b>

*The accompanying notes on pages 6 to 32 are an integral part of these financial statements.*

**Statement of cash flows****For the year ended 31 December 2010***(Thousands of Azerbaijani Manats)*

	<b>Notes</b>	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities:</b>			
(Deficit)/surplus before income tax expense		(353,534)	398,322
Adjustments to reconcile surplus/(deficit) to net cash used in operating activities			
Depreciation of property and equipment	7	196	174
Amortization of intangible assets	8	158	48
Unrealized loss on change in fair value of assets through surplus or deficit	12	153,311	2,735
Unrealized foreign currency translation loss/(gain)	13	474,199	(111,705)
Change in interest accruals, net		12,376	4,423
<i>Changes in operating assets and liabilities:</i>			
Increase in financial assets at fair value through surplus or deficit		(6,977,029)	(2,901,021)
Increase in tax settlements other than income tax		(1,137)	(801)
(Decrease)/increase in other current liabilities		(251)	284
<b>Net cash used in operating activities</b>		<b>(6,691,711)</b>	<b>(2,607,541)</b>
<b>Cash flows from investing activities:</b>			
Purchase of property and equipment	7	(60)	(303)
Purchase of intangible assets	8	(146)	(16)
Increase in other non-current assets		(5,878)	(3,795)
<b>Net cash used in investing activities</b>		<b>(6,084)</b>	<b>(4,114)</b>
<b>Cash flows from financing activities:</b>			
Contributed capital	9	12,932,367	7,870,829
Transfers to the State Budget		(5,915,000)	(4,915,000)
Transfers for the reconstruction of Samur-Apsheron Irrigation system		(130,999)	(130,000)
Transfers for the construction of Oguz-Gabala-Baku water pipeline		(199,618)	(119,957)
Transfers to the State Refugees Committee and Internally Displaced Peoples' Social Development Fund		(104,948)	(89,883)
Transfers for the construction of new Baku-Tbilisi-Kars railway line		(12,420)	(22,117)
Transfers for State Program on "Education of Azerbaijani youth abroad"		(9,605)	(7,911)
<b>Net cash from financing activities</b>		<b>6,559,777</b>	<b>2,585,961</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>		<b>20,557</b>	<b>(15,593)</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(117,461)</b>	<b>(41,287)</b>
<b>Cash and cash equivalents, beginning of the year</b>	5	<b>431,244</b>	<b>472,531</b>
<b>Cash and cash equivalents, end of the year</b>	5	<b>313,783</b>	<b>431,244</b>
Operating cash flows from interest received		365,547	362,828

*The accompanying notes on pages 6 to 32 are an integral part of these financial statements.*

**Statement of comparison of budget and actual amounts****For the year ended 31 December 2010***(Thousands of Azerbaijani Manats)*

	Notes*	<u>Annual budgeted amounts</u>		Actual amounts on a comparable basis
		Original	Final	
<b>Receipts</b>				
Contributions received from sales of profit oil and gas	9	5,564,477	8,615,782	12,656,098
Proceeds from the Baku-Tbilisi-Ceyhan project	9	155,814	155,814	158,661
Income from placement and management of assets		241,936	250,003	155,906
Income from transit of oil and gas through the territory of the Republic of Azerbaijan	9	-	9,641	8,302
Other gains and receipts		900	900	109,576
<b>Total receipts</b>		<b>5,963,127</b>	<b>9,032,140</b>	<b>13,088,543</b>
<b>Payments</b>				
Transfers to the State Budget		(4,915,000)	(5,915,000)	(5,915,000)
Reconstruction of Samur-Apsheron Irrigation system		(110,000)	(131,000)	(130,999)
Construction of Oguz-Gabala-Baku water pipeline		(200,000)	(200,000)	(199,618)
Transfers to the State Refugees Committee and Internally Displaced Peoples' Social Development Fund		(80,000)	(105,000)	(104,948)
Construction of new Baku-Tbilisi-Kars railway line		(80,000)	(34,000)	(12,420)
Education of Azerbaijani youth abroad		(10,000)	(10,000)	(9,605)
Expenses of management of the Fund		(33,431)	(33,431)	(14,025)
<b>Total payments</b>		<b>(5,428,431)</b>	<b>(6,428,431)</b>	<b>(6,386,615)</b>
<b>Net receipts</b>		<b>534,696</b>	<b>2,603,709</b>	<b>6,701,928</b>

\* Explanation of material differences between the annual original and final budget for which the Fund is held publicly accountable, and the final annual budget and actual amounts are part of the annual report of the Fund.

(Thousands of Azerbaijani Manats)

## 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 "Decree"). 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 and future generations of the Republic of Azerbaijan.

In accordance with the Decree and the Regulations (discussed below), the Fund is an extra-budget state organization, 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 of the Fund ("Regulation") 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 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 bodies 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 transfers to the Fund.

*(Thousands of Azerbaijani Manats)*

## **1. Fund information (continued)**

The Regulations exclude the following 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 SOCAR in any project in which SOCAR is an investor, participant or a contracting party; and
- other revenues generated from joint activities with foreign companies.

In 2010 and 2009, the Fund was a party to a custody agreement with the Bank of New York Mellon, and three investment management agreements with financial institutions with Deutsche Asset Management International GmbH, Clariden Leu Ltd. and the International Bank for Reconstruction and Development (IBRD – World Bank Group). Under the custody agreements financial institutions hold securities purchased by the Fund, whereas in accordance with the investment management agreements 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. The actual address of the Fund is 24, Neftchiler Avenue, Baku, Azerbaijan, AZ1004.

These financial statements as of and for the year ended 31 December 2010 were authorized for issue by the Fund's Management on 30 March 2011.

## **2. Basis of preparation**

These financial statements have been prepared in accordance with International Public Sector Accounting Standards ("IPSAS") issued by the International Public Sector Accounting Standards Board ("IPSASB") of the International Federation of Accountants ("IFAC"). IPSAS are developed by adopting 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 have been prepared on the assumption that the Fund is a going concern and will continue in operation for the foreseeable future.

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 in accordance with International Public Sector Accounting Standard ("IPSAS") No. 17 "Property, Plant and Equipment".

(Thousands of Azerbaijani Manats)

### 3. Significant accounting policies

#### Changes in accounting policies

The Fund has adopted the following amended IPSAS effective during the year. The principal effects of these changes are as follows:

##### *Amendment to IPSAS 4 “The Effects of Changes in Foreign Exchange Rates”*

The amendment to IPSAS 4 was issued in April 2008, and became effective for annual periods beginning on or after 1 January 2010. Main changes from the previous version of IPSAS 4 are the following:

- a) Net investment in a foreign operation: it clarifies that an entity that has a monetary item, which is, in substance, a part of the entity’s net investment in a foreign operation, and therefore accounts for such item in accordance with the requirements of this Standard, may be any controlled entity of the economic entity.
- b) Recognition of exchange differences: the standard requires that when a monetary item forms part of a reporting entity’s net investment in a foreign operation and is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, exchange differences arising on this monetary item are recognized initially in a separate component of net assets/equity in the financial statements that include the foreign operation and the reporting entity. Previously, such exchange differences were required to be recognized in surplus or deficit in the financial statements including the foreign operation and the reporting entity.

#### 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 on which the 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 surplus or deficit, transaction costs that are directly attributable to the 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.

#### Derecognition of financial assets and liabilities

##### *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 in 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.

##### *Financial liabilities*

A financial liability is derecognized when the obligation is discharged, cancelled, or expires.

*(Thousands of Azerbaijani Manats)***3. Significant accounting policies (continued)****Cash and cash equivalents**

Cash and cash equivalents include cash on hand, deposits maturing within three months from the financial statements date and short-term, highly liquid investments i.e. money market funds, 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 surplus or deficit**

Financial assets at fair value through surplus or deficit comprise equity and debt securities, and are classified as held for trading. A financial asset is classified as held for trading if it is:

- a) acquired principally for the purpose of selling or repurchasing it in the near term;
- b) on initial recognition part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking;
- c) a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

A financial asset other than a financial asset held for trading may be designated at fair value through surplus or deficit upon initial recognition if:

- a) such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or recognizing the gains and losses on them on different bases; or
- b) 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 the entity's key management personnel;

Financial assets at fair value through surplus or deficit 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 surplus or deficit. The fair value adjustment on financial assets at fair value through surplus or deficit is recognized in the statement of financial performance for the period as part of net gain or loss on financial assets at fair value through surplus or deficit. The Fund does not reclassify financial instruments in or out of this category while they are held.

**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 estimated useful lives:

	<b>Years</b>
Buildings	50
Vehicles	7
Office equipment	4
Furniture	5
Other property and equipment	3

The carrying amounts of property and equipment are reviewed at each reporting 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, 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.

(Thousands of Azerbaijani Manats)

### 3. Significant accounting policies (continued)

#### Property and equipment (continued)

Building held for administrative purposes is stated in the statement of the financial position at its revalued amount, 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 reporting date.

Any revaluation increase arising on the revaluation of such buildings is credited to the property 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 surplus or deficit for the period to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of such buildings is charged as an expense to the extent that it exceeds the balance, if any, held in the property 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 sale or retirement of a revalued property, the attributable revaluation surplus remaining in the property revaluation reserve is transferred directly to accumulated deficit or surplus.

Market value of property is assessed using any of the following 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.

#### Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

#### Taxation

Income tax expense comprises 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 the 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 balance sheet 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 reporting 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 to surplus or deficit, except when it relates to items charged or credited directly to the statement of financial performance, in which case the deferred tax is also dealt with in the statement of financial performance.

(Thousands of Azerbaijani Manats)

### 3. Significant accounting policies (continued)

#### Taxation (continued)

Deferred income tax assets and deferred income tax liabilities are offset and reported net in 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.

The Republic of Azerbaijan also has various other taxes, which are assessed on the Fund's activities. These taxes are included as a component of operating expenses in the statement of financial performance.

#### 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-budget state organization. All decisions regarding contributions to and transfers from the Fund are made based on Decrees approved by the President of the Republic of Azerbaijan. Contributions/transfers received/made by the Fund represent contributions/withdrawals and, accordingly, are recognized through net assets/equity 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 transferred 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.

#### Recognition of income and expense

##### *Recognition of interest income*

Interest income is 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 a financial liability (or a group of financial assets or financial liabilities) 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 (or 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.

*(Thousands of Azerbaijani Manats)***3. Significant accounting policies (continued)****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.

**Foreign currency translation**

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, Euro and GBP) 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 currency translation differences.

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 Central 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 Central 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:

	<b>2010</b>	<b>2009</b>
AZN/1 US Dollar	0.7979	0.8031
AZN/1 Euro	1.0560	1.1499
AZN/1 GB Pound	1.2377	1.2759

**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 derecognition, the Fund does not offset the transferred asset and the associated liability.

**Future changes in accounting policies***Standards and interpretations issued but not yet effective*

The Fund is not early adopting any of the following amendments and new improvements to IPSAS made during 2010:

**IPSAS 28 “Financial Instruments: Presentation”**

The standard replaces IPSAS 15, “Financial Instruments: Disclosure and Presentation” (issued December 2001), and should be applied for annual reporting periods beginning on or after 1 January 2013. The objective of this Standard is to establish principles for presenting financial instruments as liabilities or net assets/equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends or similar distributions, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset. Management is currently assessing the impact of this standard.

(Thousands of Azerbaijani Manats)

### 3. Significant accounting policies (continued)

#### Future changes in accounting policies (continued)

*Standards and interpretations issued but not yet effective (continued)*

IPSAS 29 “Financial Instruments: Recognition and Measurement”

The standard prescribes recognition and measurement principles for financial instruments and is primarily drawn from IAS 39, “Financial Instruments: Recognition and Measurement”. The objective of this Standard is to establish principles for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting information about financial instruments are in IPSAS 28, “Financial Instruments: Presentation.” Requirements for disclosing information about financial instruments are in IPSAS 30, “Financial Instruments: Disclosures.” The standard is issued in January 2010 and should be applied for annual reporting periods beginning on or after 1 January 2013. Management is currently assessing the impact of this standard.

IPSAS 30 “Financial Instruments: Disclosures”

This Standard prescribes disclosure requirements for financial instruments and is drawn from IFRS 7, “Financial Instruments: Disclosures”. The objective of this Standard is to require entities to provide disclosures in their financial statements that enable users to evaluate:

- (a) The significance of financial instruments for the entity’s financial position and performance; and
- (b) The nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

The principles in this Standard complement the principles for recognizing, measuring, and presenting financial assets and financial liabilities in IPSAS 28, “Financial Instruments: Presentation” and IPSAS 29, “Financial Instruments: Recognition and Measurement.” The standard is issued in January 2010 and should be applied for annual reporting periods beginning on or after 1 January 2013. Management is currently assessing the impact of this standard.

IPSAS 31 Intangible Assets”

IPSAS 31 prescribes the accounting treatment for intangible assets. It is adopted for public sector entities from IAS 38, “Intangible Assets.” The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. This Standard requires an entity to recognize an intangible asset if, and only if, specified criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets, and requires specified disclosures about intangible assets. The standard is issued in January 2010 and should be applied for annual reporting periods beginning on or after 1 April 2011. Management is currently assessing the impact of this standard.

In January 2010, improvements to IPSASs effective for annual periods beginning on or after 1 January 2011 were made which included amendments in the following standards: IPSAS 1 “Presentation of Financial Statements”, IPSAS 2 “Cash Flow Statements”, IPSAS 3 “Accounting Policies, Changes in Accounting Estimates and Errors”, IPSAS 7 “Investments in Associates”, IPSAS 8 “Investments in Joint Ventures”, IPSAS 10 “Financial Reporting in Hyperinflationary Economies”, IPSAS 14 “Events after the Reporting Date”, IPSAS 16 “Investment Property”, IPSAS 17 “Property, Plant and Equipment”, IPSAS 25 “Employee Benefits” and IPSAS 26 “Impairment of Cash-generating Assets”. Management is currently assessing the impact of these improvements.

### 4. Significant judgments and estimates

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 reporting 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.

*(Thousands of Azerbaijani Manats)***4. Significant judgments and estimates (continued)***Valuation of financial instruments*

Financial instruments that are classified at fair value through surplus or deficit are stated at fair value. The fair value of such financial instruments is the estimated amount at which the instrument could be exchanged 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 missed, 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 performance 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 estimates related to valuation of financial instruments where quoted markets prices are not available are a key source of estimating uncertainty because: (i) they are 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 in the 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 surplus.

*Deferred tax assets*

The management of the Fund is confident that valuation allowance against deferred tax assets at the reporting date is considered necessary, because it is more likely that the deferred tax asset will not be realized.

**5. Cash and cash equivalents**

Cash and cash equivalents comprise:

	<b>2010</b>	<b>2009</b>
Money market funds	12,626	204,731
Bank accounts	101,571	106,030
Deposits	199,586	120,483
<b>Total cash and cash equivalents</b>	<b>313,783</b>	<b>431,244</b>

**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.

*(Thousands of Azerbaijani Manats)***5. Cash and cash equivalents (continued)**

The Fund had the following investments in the money market funds with AAA credit ratings:

	<b>2010</b>	<b>2009</b>
BlackRock ICS-Institution Liquidity Funds plc	11,028	202,866
Goldman Sachs EURO Liquidity Funds	1,365	1,631
Royal Bank of Scotland plc, Global Treasury Funds plc	233	234
<b>Total money market funds</b>	<b>12,626</b>	<b>204,731</b>

**Bank accounts**

Bank accounts were denominated in the following currencies:

	<b>2010</b>	<b>2009</b>
AZN	70,931	64,855
USD	30,551	40,972
EUR	70	99
GBP	19	104
<b>Total bank accounts</b>	<b>101,571</b>	<b>106,030</b>

The Fund's AZN accounts were opened with the Central Bank of the Republic of Azerbaijan and the International Bank of Azerbaijan. At 31 December 2010 the Fund had AZN 70,889 thousand and AZN 54 thousand, held at bank accounts in the Central Bank of the Republic of Azerbaijan and the International Bank of Azerbaijan (2009: AZN 64,834 thousand and AZN 34 thousand), respectively.

Other accounts originated in foreign currencies were opened with non-resident banks with long-term ratings Aa2/AA (Standard & Poor's/Fitch/Moody's).

**Deposits**

The Fund's investments in deposits comprise:

	<b>2010</b>	<b>2009</b>
BNP Paribas	119,794	120,483
The Royal Bank of Scotland plc., UK	79,792	-
<b>Total deposits</b>	<b>199,586</b>	<b>120,483</b>

As at 31 December 2010, the Fund placed AZN 199,586 thousand (2009: AZN 120,483 thousand) in deposits with non-resident banks maturing through January 2011 (2009: January 2010) with credit ratings AA/Aa2 (Standard & Poor's/ Fitch/Moody's).

*(Thousands of Azerbaijani Manats)***6. Financial assets at fair value through surplus or deficit**

Financial assets at fair value through surplus or deficit comprise:

	<b>2010</b>	<b>2009</b>
Foreign government debt securities	9,992,468	7,037,756
Financial institution debt securities	4,916,188	2,732,188
Corporate debt securities	2,503,543	892,163
Securities of USA agencies	420,002	868,643
Equity securities	11,145	4,311
SPDR Trust	8,472	-
Mortgage securities	2	173
<b>Total financial assets at fair value through surplus or deficit</b>	<b>17,851,820</b>	<b>11,535,234</b>

As at 31 December 2010 the Fund held AZN 210,701 thousand (264,069 thousand USD) under asset management agreements with financial institutions (“external managers”) including cash and cash equivalents (2009: AZN 206,155 thousand (256,699 thousand USD)). The management fees in 2010 to these institutions were AZN 574 thousand (2009: AZN 570 thousand). During the years 2010 and 2009 the Fund’s external managers were Deutsche Bank AG, Clariden Leu Ltd. and International Bank for Reconstruction and Development (World Bank). All securities are held in the custodian - Bank of New York Mellon.

**Foreign government debt securities**

Foreign government securities are 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 0.5% p.a. to 9.875% p.a. and USD LIBOR, EURIBOR, GBP LIBOR with the spread ranging from +0.03% p.a. to +2% p.a. (2009: from 0.875% p.a. to 7.5% p.a. and USD LIBOR, EURIBOR with the spread ranging from +0% p.a. to +2% p.a.) and mature during the period from January 2011 to January 2017 (2009: from January 2010 to October 2019). Discount securities are also included in this group. As at December 31, 2010 total accrued interest on these securities amounted AZN 92,247 thousand (2009: AZN 118,633 thousand). These securities were held in the portfolio managed both directly by the Fund as well as the Fund’s external managers.

**Financial institution debt securities**

Financial institution securities are represented by investments in debt securities issued by various European, Asian and American financial institutions. These securities bear fixed interest ranging from 1.875% p.a. to 8.25% p.a. and USD LIBOR, GBP LIBOR and EURIBOR with the spread ranging from +0.03% p.a. to +3.5% p.a. (2009: from 2.375% p.a. to 6.75% p.a. and USD LIBOR, GBP LIBOR and EURIBOR with the spread ranging from +0.03% p.a. to +3.5% p.a.) and mature during the period from January 2011 to February 2016 (2009: January 2010 to February 2016). Discount securities are also included in this group. As at December 31, 2010 total accrued interest on these securities amounted AZN 24,537 thousand (2009: AZN 14,151 thousand). These securities were held in the portfolio managed both directly by the Fund as well as the Fund’s external managers, Deutsche Bank AG, Clariden Leu Ltd. and World Bank.

**Corporate debt securities**

Corporate debt securities are represented by investments in debt securities issued by corporations of Europe, Asia and America. These securities bear fixed interest ranging from 1.9% p.a. to 8.875% p.a. and USD LIBOR with the spread ranging from +0.15% p.a. to +1.05% p.a. (2009: from 3.55% p.a. to 7.5% p.a. and USD LIBOR with the spread ranging from +0.15% p.a. to +1.05% p.a.) and maturing during the period from January 2011 to December 2015 (2009: from April 2010 to December 2015). Discount securities are also included in this group. As at December 31, 2010 total accrued interest on these securities amounted AZN 17,967 thousand (2009: AZN 6,530 thousand). 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.

*(Thousands of Azerbaijani Manats)***6. Financial assets at fair value through surplus or deficit (continued)****Securities of the USA Agencies**

Securities of the USA Agencies at are represented by investments in debt securities issued by Fannie Mae, Freddie Mac and Federal Home Loan Banks. These securities bear fixed interest ranging from 0.75% p.a. to 6.0% p.a. and stepped interest ranging from 0.75% p.a. to 1.5% p.a. (2009: from 0.8% p.a. to 7% p.a. and USD LIBOR with the spread ranging from -0.16% p.a. to -0.05% p.a.) and mature during the period from May 2011 to August 2015 (2009: from January 2010 to February 2015). As at December 31, 2010 total accrued interest on these securities amounted AZN 1,602 thousand (2009: AZN 9,137 thousand). These securities were held in the portfolio managed both directly by the Fund and the Fund's external managers, Clariden Leu Ltd. and World Bank.

**Equity securities**

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

	<b>2010</b>	<b>2009</b>
Private equity	6,126	-
Consumer	1,474	1,110
Telecommunication and information technologies	1,153	854
Materials	826	617
Healthcare	588	839
Finance	432	702
Transport	273	-
Energy	168	125
Industrials	105	64
<b>Total equity securities</b>	<b>11,145</b>	<b>4,311</b>

**SPDR Trust**

In its internally managed portfolio SOFAZ invests in S&P 500 stock index incorporated in the United States via SPDR Trust. S&P 500 index consists of a portfolio representing 500 large-cap stocks such as Exxon Mobil Corp, Apple Inc, Chevron Corp, General Electric, Microsoft Corp, JPMorgan Chase &Co, AT&T Inc, Procter & Gamble, Wells Fargo & Co. The main sectors are Oil & Gas, Banks, Computers, Retail, Telecommunications, Pharmaceuticals.

(Thousands of Azerbaijani Manats)

**7. Property and equipment**

	<b>Building</b>	<b>Vehicles</b>	<b>Office equipment</b>	<b>Furniture</b>	<b>Other property and equipment</b>	<b>Total</b>
<b>Revalued amount or cost</b>						
<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>
Additions	-	253	44	6	-	303
Disposals	-	(22)	-	-	-	(22)
Revaluation	(901)	(35)	-	-	-	(936)
<b>31 December 2009</b>	<b>5,300</b>	<b>325</b>	<b>366</b>	<b>148</b>	<b>3</b>	<b>6,142</b>
Additions	-	5	37	16	2	60
Disposals	-	-	(3)	(8)	-	(11)
Revaluation	(950)	-	-	-	-	(950)
<b>31 December 2010</b>	<b>4,350</b>	<b>330</b>	<b>400</b>	<b>156</b>	<b>5</b>	<b>5,241</b>
<b>Accumulated depreciation</b>						
<b>31 December 2008</b>	<b>(21)</b>	<b>(56)</b>	<b>(258)</b>	<b>(120)</b>	<b>(3)</b>	<b>(458)</b>
Depreciation charge	(121)	(19)	(27)	(7)	-	(174)
Disposals	-	14	-	-	-	14
Revaluation	124	25	-	-	-	149
<b>31 December 2009</b>	<b>(18)</b>	<b>(36)</b>	<b>(285)</b>	<b>(127)</b>	<b>(3)</b>	<b>(469)</b>
Depreciation charge	(106)	(44)	(37)	(8)	(1)	(196)
Disposals	-	-	2	8	-	10
Revaluation	124	-	-	-	-	124
<b>31 December 2010</b>	<b>-</b>	<b>(80)</b>	<b>(320)</b>	<b>(127)</b>	<b>(4)</b>	<b>(531)</b>
<b>Net book value</b>						
<b>As at 31 December 2008</b>	<b>6,180</b>	<b>73</b>	<b>64</b>	<b>22</b>	<b>-</b>	<b>6,339</b>
<b>As at 31 December 2009</b>	<b>5,282</b>	<b>289</b>	<b>81</b>	<b>21</b>	<b>-</b>	<b>5,673</b>
<b>As at 31 December 2010</b>	<b>4,350</b>	<b>250</b>	<b>80</b>	<b>29</b>	<b>1</b>	<b>4,710</b>

In accordance with Resolution #99 of the Cabinet of Ministers, dated 27 May 2002, the Fund received an administrative building from the Government. As at 31 December 2010 and 2009 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 approach), 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 4,350 thousand as at 31 December 2010 (2009: AZN 5,282 thousand).

The Fund engaged an independent appraiser to determine the fair value of its buildings. Fair value is determined by reference to market-based evidence. If the buildings were measured using the cost model, the carrying amounts would be as follows:

	<b>2010</b>	<b>2009</b>
Cost	2,049	2,049
Accumulated depreciation	(287)	(246)
<b>Net carrying amount</b>	<b>1,762</b>	<b>1,803</b>

*(Thousands of Azerbaijani Manats)***8. Other non-current and intangible assets**

Other non-current and intangible assets comprise:

	<b>2010</b>	<b>2009</b>
Prepayments for services	12,612	6,728
Intangible assets	730	742
Used equipment held for sale	61	55
<b>Total non-current assets</b>	<b>13,403</b>	<b>7,525</b>

The movements in intangible assets were as follows:

	<b>Licenses</b>	<b>Computer software</b>	<b>Total</b>
<b>At cost</b>			
<b>31 December 2008</b>	<b>86</b>	<b>754</b>	<b>840</b>
Additions	10	6	16
<b>31 December 2009</b>	<b>96</b>	<b>760</b>	<b>856</b>
Additions	145	1	146
<b>31 December 2010</b>	<b>241</b>	<b>761</b>	<b>1,002</b>
<b>Accumulated depreciation</b>			
<b>31 December 2008</b>	<b>(14)</b>	<b>(52)</b>	<b>(66)</b>
Amortisation charge	(7)	(41)	(48)
<b>31 December 2009</b>	<b>(21)</b>	<b>(93)</b>	<b>(114)</b>
Amortisation charge	(114)	(44)	(158)
<b>31 December 2010</b>	<b>(135)</b>	<b>(137)</b>	<b>(272)</b>
<b>Net book value</b>			
<b>As at 31 December 2008</b>	<b>72</b>	<b>702</b>	<b>774</b>
<b>As at 31 December 2009</b>	<b>75</b>	<b>667</b>	<b>742</b>
<b>As at 31 December 2010</b>	<b>106</b>	<b>624</b>	<b>730</b>

**9. Capital contributions**

The movements in capital contributions to the Fund were as follows:

	<b>2010</b>	<b>2009</b>
Contributions received from sales of profit oil and gas	12,656,098	7,702,635
Payments on Baku-Tbilisi-Ceyhan project	158,661	156,823
Proceeds from difference arising as a result of contractual sale price revision of gas produced during implementation of Shah Deniz Stage I	105,022	-
Pipeline transit tariffs	8,302	8,909
Acreage fees	1,201	1,064
Bonuses	1,602	804
Other	1,481	594
<b>Total capital contributions</b>	<b>12,932,367</b>	<b>7,870,829</b>

*(Thousands of Azerbaijani Manats)***10. Transfers by the Fund**

During 2010 transfers to the State Budget, as well as to the state institutions, state-owned entities and companies were made in accordance with:

- Law of the Republic of Azerbaijan “On the State Budget for 2010” dated 26 November 2009,
- Decree #204 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 2010” dated 25 December 2009, “Program on main directions of Expensing of Assets of The State Oil Fund of the Republic of Azerbaijan for 2010” as approved by Resolution #661 of the President of the Republic of Azerbaijan dated 25 December 2009 “On some measures for execution of the budget of The State Oil Fund of the Republic of Azerbaijan for 2010”, and
- Decrees of the President of the Republic of Azerbaijan #307 and #330 “On Amendments and changes to the Budget of The State Oil Fund of the Republic of Azerbaijan” dated 22 July 2010 and 30 September 2010, respectively.

**11. Interest income**

	<b>2010</b>	<b>2009</b>
Interest income on financial assets at fair value through surplus or deficit	317,719	352,661
<i>Interest income on assets at amortized cost:</i>		
Interest on term deposits	28,552	6,569
Interest on demand deposits	4,878	175
Income from money market funds	2,115	872
<b>Total interest income</b>	<b>353,264</b>	<b>360,277</b>

**12. Net loss on financial assets at fair value through surplus or deficit**

Net loss on operations with financial assets at fair value through surplus or deficit comprise:

	<b>2010</b>	<b>2009</b>
Unrealized loss on change in fair value adjustment	(153,311)	(2,735)
Realized loss on trading operations	(44,047)	(51,652)
<b>Total net loss on operations with financial assets at fair value through surplus or deficit</b>	<b>(197,358)</b>	<b>(54,387)</b>

*(Thousands of Azerbaijani Manats)***13. Foreign currency translation differences**

Net foreign currency translation differences from financial assets at fair value through surplus or deficit comprise of:

	<b>2010</b>	<b>2009</b>
Net unrealized (loss)/gain on foreign currency translation differences	(474,199)	111,705
Net realized loss on foreign currency translation differences	(28,539)	(14,091)
<b>Total net (loss)/gain on foreign currency translation differences</b>	<b>(502,738)</b>	<b>97,614</b>

**14. Operating expenses**

Operating expenses are comprised of:

	<b>2010</b>	<b>2009</b>
Bank commissions	(2,799)	(1,931)
Wages, salaries and employee benefits	(1,651)	(1,548)
Rental expenses	(878)	(249)
Depreciation and amortization (Notes 7 and 8)	(354)	(222)
Communication expenses	(231)	(218)
Other employment expenses	(187)	(120)
Professional fees	(120)	(344)
Other operating expenses	(482)	(550)
<b>Total operating expenses</b>	<b>(6,702)</b>	<b>(5,182)</b>

**15. Income taxes**

The Fund provides for income 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 and tax free regime for certain income.

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 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Temporary differences comprise:

	<b>2010</b>	<b>2009</b>
<b>Deductible temporary differences:</b>		
Financial assets at fair value through surplus or deficit	171,745	44,266
<b>Total deductible temporary differences</b>	<b>171,745</b>	<b>44,266</b>
<b>Taxable temporary differences:</b>		
Property and equipment	(3,161)	(3,987)
Intangible assets	(11)	(81)
Other assets	(68)	(30)
<b>Total taxable temporary differences</b>	<b>(3,240)</b>	<b>(4,098)</b>
<b>Net deferred deductible temporary differences</b>	<b>168,505</b>	<b>40,168</b>
Net deferred tax asset at 20% statutory rate	33,701	8,034
Unrecognized deferred tax assets	(33,701)	(8,034)
<b>Net deferred tax asset/(liability)</b>	<b>-</b>	<b>-</b>

*(Thousands of Azerbaijani Manats)***15. Income taxes (continued)**

The effective income tax differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	<b>2010</b>	<b>2009</b>
<b>(Deficit)/surplus before income tax expense</b>	<b>(353,534)</b>	<b>398,322</b>
Statutory tax rate	20%	22%
<b>Theoretical income tax benefit/(expense) at the statutory rate</b>	<b>70,707</b>	<b>(87,631)</b>
Change in deferred tax asset not recognized	(25,667)	86,077
Tax loss carry forward	(45,297)	-
Tax effect of permanent differences	257	(62)
Effect of tax rate, different from the prime rate of 22 % to 20%	-	(803)
<b>Income tax expense reported in the statement of financial performance</b>	<b>-</b>	<b>(2,419)</b>

**16. Fair value of financial instruments**

The Fund uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The Fund's valuation approach and fair value hierarchy categorisation for certain significant classes of financial instruments recognised at fair value are as follows:

<b>At 31 December 2010</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Financial assets at fair value through surplus or deficit	17,735,319	110,375	6,126	<b>17,851,820</b>
<b>At 31 December 2009</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Financial assets at fair value through surplus or deficit	11,476,949	58,285	-	<b>11,535,234</b>

Level 3 financial assets consist of investment in International Finance Corporation (IFC) Private Equity fund. IFC African, Latin American and Caribbean Fund has been set up with the purpose of making investments in businesses in Africa, Latin America and the Caribbean.

**17. Risk management**

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, market and operational 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 cause a financial loss for the other party by failing to discharge an obligation. 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 2010" as approved by Order #661 of the President of the Republic of Azerbaijan, dated 25 December 2009.

(Thousands of Azerbaijani Manats)

**17. Risk management (continued)****Credit risk (continued)**

Credit risk is managed and controlled through proper selection of investment assets, credit quality of investment assets and setting limits on the amount of investment per investment asset.

The Fund's maximum exposure to credit risk varies significantly and is dependent on both individual risks and general market economy risks. The table below shows the maximum exposure to credit risk for the components of the statement of financial position.

	<i>Notes</i>	<i>Maximum exposure 2010</i>	<i>Maximum exposure 2009</i>
Cash and cash equivalents	5	313,783	431,244
Financial assets at fair value through surplus or deficit (excluding private equity securities)	6	17,845,694	11,535,234
<b>Total credit risk exposure</b>		<b>18,159,477</b>	<b>11,966,478</b>

In accordance with Order #179 of the President of the Republic of Azerbaijan "Program on Expensing of Assets of The State Oil Fund of the Republic of Azerbaijan for 2010" dated 25 December 2009, 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.

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, 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 financial instruments held by the Fund. The credit rating is issued by internationally regarded agencies S&P's and Moody's. If the agencies have assigned different credit ratings to an asset, the highest one was used.

	<b>AAA</b>	<b>AA</b>	<b>A</b>	<b>BBB</b>	<b>Non- investment rating</b>	<b>Total 2010</b>
Cash and cash equivalents	12,626	230,212	2	-	70,943	<b>313,783</b>
Financial assets at fair value through surplus or deficit	7,879,254	4,184,071	4,634,818	1,128,197	25,480	<b>17,851,820</b>
	<b>AAA</b>	<b>AA</b>	<b>A</b>	<b>BBB</b>	<b>Non- investment rating</b>	<b>Total 2009</b>
Cash and cash equivalents	204,731	161,643	2	-	64,868	<b>431,244</b>
Financial assets at fair value through surplus or deficit	7,025,187	2,088,795	2,274,569	135,290	11,393	<b>11,535,234</b>

As at 31 December 2010 and 2009, the minimum long term credit ratings of securities or their issuers were Baa3 (Moody's) or BBB- (Standard & Poor's). As at 31 December 2010 bonds of Lehman Brothers LEH 05/11 have carrying amount (fair value) of AZN 4,963 thousand (2009: AZN 3,378 thousand), and Kaupthing KAUP 08/12 of AZN 900 thousand (2009: AZN 2,357 thousand). The following table details the information regarding these securities:

*(Thousands of Azerbaijani Manats)***17. Risk management (continued)****Credit risk (continued)**

Securities	ISIN	Nominal value (in thousands)	Currency	Date of receipt	Maturity	Rating at the date of acquisition (Moody's/S&P)	Rating at 31 December 2010 (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 08/12	XS0226781242	10,000	EUR	02.03.2007	17.08.2012	Aaa/AAA	NR/NR*

\* not rated

On 15 September 2008 “Lehman Brothers Holdings Inc.” filed for 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 to restructure.

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, 9 October 2008 and 9 February 2009, the credit ratings for the bonds of Kaupthing Bank hf. fell to Ba1, Caa2 and C, 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 AA- (Standard & Poor's, Fitch) or Aa3 (Moody's).

The Fund is allowed to maintain Funds in the Republic of Azerbaijan only in the Central 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 & Poor's, 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 & Poor's, 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 & Poor's, 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.

*(Thousands of Azerbaijani Manats)***17. Risk management (continued)****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 2010” as approved by Order #179, dated 26 February 2009, specified requirements for Investment Policy (investment trend) of the Fund for 2010 and currency basket of the Fund’s portfolio for 2010. 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 & Poor’s, 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 at 31 December 2010, 53% of the Fund’s investment portfolio was denominated in USD (2009: 54%), 41% in EUR (2009: 40%) and 5% in GBP (2009: 5%). On 13 January 2011, rebalance of currency classification of the Fund’s investment portfolio was completed pursuant to the diversification criteria defined in the Investment Policy.

The table below summarizes the Fund’s exposure to foreign currency exchange rate risk at the reporting date:

<b>2010</b>	<b>AZN</b>	<b>USD</b>	<b>EUR</b>	<b>GBP</b>	<b>Total</b>
<b>Financial assets</b>					
Cash and cash equivalents	70,931	241,046	1,436	370	313,783
Financial assets at fair value through surplus or deficit	-	9,417,185	7,502,219	932,416	17,851,820
<b>Total financial assets</b>	<b>70,931</b>	<b>9,658,231</b>	<b>7,503,655</b>	<b>932,786</b>	<b>18,165,603</b>
<b>Financial liabilities</b>					
Other financial liabilities	32	311	-	-	343
<b>Total financial liabilities</b>	<b>32</b>	<b>311</b>	<b>-</b>	<b>-</b>	<b>343</b>
<b>Open position</b>	<b>70,899</b>	<b>9,657,920</b>	<b>7,503,655</b>	<b>932,786</b>	<b>18,165,260</b>
	<b>0.39%</b>	<b>53.17%</b>	<b>41.31%</b>	<b>5.13%</b>	
<b>2009</b>	<b>AZN</b>	<b>USD</b>	<b>EUR</b>	<b>GBP</b>	<b>Total</b>
<b>Financial assets</b>					
Cash and cash equivalents	64,855	321,780	1,731	42,878	431,244
Financial assets at fair value through surplus or deficit	-	6,142,748	4,839,428	553,058	11,535,234
<b>Total financial assets</b>	<b>64,855</b>	<b>6,464,528</b>	<b>4,841,159</b>	<b>595,936</b>	<b>11,966,478</b>
<b>Financial liabilities</b>					
Other financial liabilities	324	194	66	-	584
<b>Total financial liabilities</b>	<b>324</b>	<b>194</b>	<b>66</b>	<b>-</b>	<b>584</b>
<b>Open position</b>	<b>64,531</b>	<b>6,464,334</b>	<b>4,841,093</b>	<b>595,936</b>	<b>11,965,894</b>
	<b>0.54%</b>	<b>54.02%</b>	<b>40.46%</b>	<b>4.98%</b>	

*(Thousands of Azerbaijani Manats)***17. Risk management (continued)****Currency risk (continued)**

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 by the management of the Fund. Daily risk management is performed by the Risk Management Department.

**Currency risk sensitivity**

The tables below indicate the currencies to which the Fund had significant exposure at 31 December on its monetary assets and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the AZN, with all other variables held constant on the statement of financial performance. The effect on net assets/equity does not differ from the effect on the statement of financial performance.

	AZN/USD		AZN/EUR		AZN/GBP	
	+8.35%	-8.35%	+14.7%	-14.7%	+10%	-10%
<b>31 December 2010</b>						
Impact on surplus/(deficit) for the year	806,436	(806,436)	1,103,037	(1,103,037)	93,279	(93,279)
	AZN/USD		AZN/EUR		AZN/GBP	
	+10%	-10%	+10%	-10%	+10%	-10%
<b>31 December 2009</b>						
Impact on surplus/(deficit) for the year	646,433	(646,433)	484,109	(484,109)	59,594	(59,594)

**Geographical concentration**

2010	Azerbaijan	Europe	America	Asia	Africa	Australia and Oceania	International organizations	Total
<b>Financial assets</b>								
Cash and cash equivalents	70,943	212,376	30,464	-	-	-	-	313,783
Financial assets at fair value through surplus or deficit	-	12,676,761	2,334,723	902,512	20,372	535,181	1,382,271	17,851,820
<b>Total financial assets</b>	<b>70,943</b>	<b>12,889,137</b>	<b>2,365,187</b>	<b>902,512</b>	<b>20,372</b>	<b>535,181</b>	<b>1,382,271</b>	<b>18,165,603</b>
<b>Financial liabilities</b>								
Other financial liabilities	343	-	-	-	-	-	-	343
<b>Total financial liabilities</b>	<b>343</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>343</b>
<b>Net position</b>	<b>70,600</b>	<b>12,889,137</b>	<b>2,365,187</b>	<b>902,512</b>	<b>20,372</b>	<b>535,181</b>	<b>1,382,271</b>	<b>18,165,260</b>

(Thousands of Azerbaijani Manats)

**17. Risk management (continued)****Geographical concentration (continued)**

2009	Australia and Oceania						International organizations	Total
	Azerbaijan	Europe	America	Asia	Africa	Oceania		
<b>Financial assets</b>								
Cash and cash equivalents	64,868	324,503	41,873	-	-	-	-	431,244
Financial assets at fair value through surplus or deficit	-	7,749,058	2,136,180	345,605	8,516	-	1,295,875	11,535,234
<b>Total financial assets</b>	<b>64,868</b>	<b>8,073,561</b>	<b>2,178,053</b>	<b>345,605</b>	<b>8,516</b>	<b>-</b>	<b>1,295,875</b>	<b>11,966,478</b>
<b>Financial liabilities</b>								
Other financial liabilities	584	-	-	-	-	-	-	584
<b>Total financial liabilities</b>	<b>584</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>584</b>
<b>Net position</b>	<b>64,284</b>	<b>8,073,561</b>	<b>2,178,053</b>	<b>345,605</b>	<b>8,516</b>	<b>-</b>	<b>1,295,875</b>	<b>11,965,894</b>

**Interest rate sensitivity**

At 31 December 2010 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/(deficit) before tax:

	31 December 2010		31 December 2009	
	Interest rate +1%	Interest rate -1%	Interest rate +1%	Interest rate -1%
<b>Assets:</b>				
Cash and cash equivalents	-	-	6	(6)
Financial assets at fair value through surplus or deficit	(90,466)	90,466	(72,860)	72,860
<b>Net impact on surplus/(deficit) before tax</b>	<b>(90,466)</b>	<b>90,466</b>	<b>(72,854)</b>	<b>72,854</b>

*(Thousands of Azerbaijani Manats)***17. Risk management (continued)****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/equity.

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 tables:

<b>2010</b>	<b>Up to 1 month</b>	<b>1 month to 3 months</b>	<b>3 months to 1 year</b>	<b>1 year to 5 years</b>	<b>Over 5 years</b>	<b>Maturity undefined</b>	<b>Total</b>
<b>Financial assets</b>							
Cash and cash equivalents	313,783	-	-	-	-	-	313,783
Financial assets at fair value through surplus or deficit	562,704	1,547,613	3,953,441	11,038,575	729,871	19,616	17,851,820
<b>Total financial assets</b>	<b>876,487</b>	<b>1,547,613</b>	<b>3,953,441</b>	<b>11,038,575</b>	<b>729,871</b>	<b>19,616</b>	<b>18,165,603</b>
<b>Financial liabilities</b>							
Other financial liabilities	343	-	-	-	-	-	343
<b>Total financial liabilities</b>	<b>343</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>343</b>
<b>Liquidity gap</b>	<b>876,144</b>	<b>1,547,613</b>	<b>3,953,441</b>	<b>11,038,575</b>	<b>729,871</b>	<b>19,616</b>	<b>18,165,260</b>

*(Thousands of Azerbaijani Manats)***17. Risk management (continued)****Liquidity risk (continued)**

2009	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	Total
<b>Financial assets</b>							
Cash and cash equivalents	431,244	-	-	-	-	-	431,244
Financial assets at fair value through surplus or deficit	693,144	840,690	2,796,821	7,064,505	135,765	4,309	11,535,234
<b>Total financial assets</b>	<b>1,124,388</b>	<b>840,690</b>	<b>2,796,821</b>	<b>7,064,505</b>	<b>135,765</b>	<b>4,309</b>	<b>11,966,478</b>
<b>Financial liabilities</b>							
Other financial liabilities	584	-	-	-	-	-	584
<b>Total financial liabilities</b>	<b>584</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>584</b>
<b>Liquidity gap</b>	<b>1,123,804</b>	<b>840,690</b>	<b>2,796,821</b>	<b>7,064,505</b>	<b>135,765</b>	<b>4,309</b>	<b>11,965,894</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 market and specific 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 2010		31 December 2009	
	1% increase in securities price	1% decrease in securities price	1% increase in securities price	1% decrease in securities price
Impact on surplus/(deficit) before tax	177,154	(177,154)	113,868	(113,868)
Impact on net assets/equity	141,723	(141,723)	88,817	(88,817)

**Operational risk**

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Fund cannot expect to eliminate all operational risks, but a control framework and monitoring and responding to potential risks could be effective tools to manage the risks. Controls should include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

(Thousands of Azerbaijani Manats)

**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.

All government entities are considered to be related parties to the Fund. Transactions with related parties are disclosed below:

<b>Related parties</b>	<b>Year</b>	<b>Contributions received from related parties</b>	<b>Transfers to related parties</b>	<b>Payables to related parties</b>	<b>Receivables from related parties</b>	<b>Bank accounts with related parties</b>	<b>Income Tax expense</b>	<b>Off-balance sheet transactions</b>
The State Refugees Committee and Internally Displaced People’ Social Development Fund	2010	-	<b>104,948</b>	-	-	-	-	-
	2009	-	89,883	-	-	-	-	-
The State Budget	2010	-	<b>5,915,000</b>	-	<b>12,952</b>	-	-	-
	2009	-	4,915,000	-	11,816	-	2,419	-
“Azerbaijan melioration and water-sludge system” OSC	2010	-	<b>130,999</b>	-	-	-	-	-
	2009	-	130,000	-	-	-	-	-
The Ministry of Transportation	2010	-	<b>12,420</b>	-	-	-	-	-
	2009	-	22,117	-	-	-	-	-
“Azersu” OSC	2010	-	<b>119,618</b>	-	-	-	-	-
	2009	-	119,957	-	-	-	-	-
State Oil Company of the Republic of Azerbaijan	2010	<b>12,761,120</b>	-	-	-	-	-	-
	2009	7,702,635	-	-	-	-	-	-
Ministry of Education of the Republic of Azerbaijan	2010	-	<b>9,605</b>	-	-	-	-	-
	2009	-	7,911	-	-	-	-	-
Central Bank of the Republic of Azerbaijan	2010	-	-	-	-	<b>70,889</b>	-	-
	2009	-	-	-	-	64,834	-	-
International Bank of Azerbaijan	2010	-	-	-	-	<b>54</b>	-	-
	2009	-	-	-	-	34	-	-
Ministry of Finance of the Republic of Azerbaijan	2010	-	-	-	-	-	-	<b>274,874</b>
	2009	-	-	-	-	-	-	167,809

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

*(Thousands of Azerbaijani Manats)***18. Transactions with related parties (continued)****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:

	<b>2010</b>	<b>2009</b>
Aggregate remuneration	122	132
Number of persons	3	3

**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 of the Republic of Azerbaijan. At 31 December 2010 assets received under above agreement were AZN 274,874 thousand (USD 277,263 thousand, EUR 50,587 thousand and GBP 183 thousand (2009: AZN 167,809 thousand (USD 184,433 thousand, EUR 16,923 and GBP 182 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 First International Merchant Bank (the "Claimant 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. Further, in a verdict dated 17 February 2010 (the "Verdict"), the Court has rejected the claims of the Claimant Bank. Currently, the claim is at the court of appellate jurisdiction. The Management of the Fund believes that there is no possibility of any outflow in the settlement and there is no need for provision.

**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 legal, regulatory, and political environment.

*(Thousands of Azerbaijani Manats)*

## **20. Events after the reporting period**

### **Receivables and transfers**

In accordance with Decree #365 on “Ratifying the Budget of The State Oil Fund of the Republic of Azerbaijan for 2011” dated 28 December 2010, the Fund’s budgeted income and expenses for 2011 are estimated at AZN 9,132,941 thousand and AZN 6,886,155 thousand, respectively. The following types of main expenses for the year 2011 are budgeted:

- Transfer to the State Budget of the Republic of Azerbaijan – AZN 6,480,000 thousand;
- Reconstruction of Samur-Apsheron irrigation system – AZN 110,000 thousand;
- Financing of the measures for improvement of social conditions of refugees and internally displaced people – AZN 110,000 thousand;
- Construction of new Baku-Tbilisi-Kars railway line – AZN 80,215 thousand;
- Construction of water pipeline from Oguz-Gabala zone to Baku city – AZN 33,446 thousand;
- Financing the State Program on Education of Azerbaijan youth in foreign countries during 2007-2015 – AZN 15,000 thousand.