

Report of Independent Auditors

To the State Oil Fund of the Republic of Azerbaijan:

We have audited the accompanying statements of financial position of the State Oil Fund of the Republic of Azerbaijan (the "Fund") as of December 31, 2004 and 2003, and the related statements of financial performance, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund at December 31, 2004 and 2003, and the results of its financial performance and its cash flows for the years then ended in conformity with International Public Sector Accounting Standards.

Ernst & Young Holdings (CIS) B.V.

May 05, 2005

Financial Statements

Statements of Financial Position

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

	Note	December 31,	
		2004	2003
ASSETS			
Current assets			
Cash and cash equivalents	3	2,360,251	1,781,665
Trading securities	4	658,707	601,565
Interest receivable		20,205	20,957
Contributions receivable		12,492	5,186
Other short-term investments		–	307,672
Other current assets		15	269
Total current assets		3,051,670	2,717,314
Non-current assets			
Securities held to maturity	6	1,687,918	1,304,121
Property and equipment, net	7	10,635	3,457
Intangible assets, net		199	156
Other assets		964	–
Total non-current assets		1,699,716	1,307,734
TOTAL ASSETS		4,751,386	4,025,048
LIABILITIES			
Current liabilities			
Payable to the State Budget	14	15,832	55,977
Other current liabilities		812	946
TOTAL LIABILITIES		16,644	56,923
NET ASSETS		4,734,742	3,968,125
NET ASSETS / EQUITY			
Contributed capital		4,294,713	3,563,024
Accumulated surplus		440,029	405,101
TOTAL NET ASSETS / EQUITY		4,734,742	3,968,125

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

Statements of Financial Performance

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

	Note	Year ended December 31,	
		2004	2003
Operating revenue			
Interest income		118,811	86,382
Income from money market funds		15,870	16,969
Net dealing (losses) / gains		(42,922)	12,896
Foreign exchange gain		–	67,196
Total operating revenue		91,759	183,443
Operating expenses			
Bank commissions		701	629
Wages, salaries and employee benefits		647	398
Communication expenses		298	241
Depreciation / amortization		1,250	148
Professional fees		435	160
Business travel expenses		248	114
Publication fees		30	40
Other operating expenses		658	259
Loss on forced liquidation of securities	6	16,224	–
Foreign exchange loss		13,258	–
Total operating expenses		33,749	1,989
Surplus before taxes		58,010	181,454
Income taxes	8	23,082	45,446
Net surplus for the year		34,928	136,008

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

Statements of Changes in Net Assets

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

	Note	Contributed Capital	Accumulated Surplus	Total
Balance at December 31, 2002		3,104,828	269,093	3,373,921
Contributions received	9	1,361,727	–	1,361,727
Net surplus for the period		–	136,008	136,008
Transfers to the State Budget	10	(533,000)	–	(533,000)
Transfers in respect of AzBTC	10	(280,532)	–	(280,532)
Transfers to the Refugees Committee	10	(89,999)	–	(89,999)
Balance at December 31, 2003		3,563,024	405,101	3,968,125
Contributions received	9	1,522,641	–	1,522,641
Net surplus for the period		–	34,928	34,928
Transfers to the State Budget	10	(650,000)	–	(650,000)
Transfers in respect of AzBTC	10	(89,000)	–	(89,000)
Transfers to the Refugees Committee	10	(51,952)	–	(51,952)
Balance at December 31, 2004		4,294,713	440,029	4,734,742

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

Statements of Cash Flows

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

	Note	Year ended December 31, 2004	2003
Cash flows from operating activities:			
Surplus before taxes		58,010	181,454
Adjustments to reconcile surplus to net cash provided by operating activities:			
Interest income	(124,968)	(105,074)	
Depreciation/amortization of fixed/intangible assets	1,250	148	
Amortization of premium of investments held-to-maturity	6,212	–	
Loss on forced liquidation of securities	16,224	–	
Foreign exchange loss / (gain)	3,258	(67,196)	
Loss on disposal of fixed assets	(34)	–	
Changes in operating assets and liabilities:			
Trading securities	(57,676)	50,745	
Other short-term investments	307,672	(307,672)	
Other current assets	269	(4,476)	
Other current liabilities	(1,098)	946	
Interest received	125,143	95,805	
Dividends received	577	–	
Income tax paid	(40,227)	(12,469)	
Net cash provided by / (used) in operating activities:		294,612	(167,789)
Cash flows from investing activities:			
Proceeds from sale and redemption of securities held to maturity	6, 13	171,795	–
Purchases of securities held to maturity	13	(577,119)	(787,038)
Purchase of property and equipment	13	(576)	(2,513)
Purchase of intangible assets		(56)	–
Net cash used in investing activities		(405,956)	(789,551)
Cash flows from financing activities:			
Contributed capital		1,507,530	1,361,727
Receipts from AzBTC		–	320,752
Transfers to the Azerbaijan Treasury for AzBTC		(94,619)	(616,615)
Transfers returned by AzBTC		5,619	–
Transfers to the State Budget		(650,000)	(510,000)
Transfers to the Refugees Committee		(74,952)	(89,813)
Net cash provided by financing activities		693,578	466,051
Net increase/(decrease) in cash and cash equivalents		582,234	(491,289)
Effect of exchange rate changes on cash and cash equivalents		(3,648)	55,774
Cash and cash equivalents, beginning of year	3	1,781,665	2,217,180
Cash and cash equivalents, end of year	3	2,360,251	1,781,665

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

Notes to the Financial Statements

1. Fund information

The State Oil Fund of the Republic of Azerbaijan (the "Fund") was established by Decree #240 of the President of the Azerbaijan Republic "On the Establishment of the State Oil Fund of the Republic of Azerbaijan" (the "Decree") dated December 29, 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 Fund's own activities for the benefit of citizens of the Azerbaijan Republic and their future generations. This Decree also granted the Cabinet of Ministers the right to resolve issues arising upon implementation of the Decree.

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

The Fund's assets are formed in accordance with Presidential Decree #579 as amended by Presidential Decree #849 "On amending certain legislative acts regulating operations of the State Oil Fund of the Republic of Azerbaijan" effective February 7, 2003. Decree #849 excluded from the list of sources of the Fund's revenue and assets the following:

- 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 State Oil Company of the Azerbaijan Republic ("SOCAR") in any project in which SOCAR is an investor, participant or a contracting party;
- other revenues generated from joint activities with foreign companies.

Pursuant to Decree #849 the Fund's assets are formed 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 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 (after a deduction 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) Oil and gas agreements signature and/or performance bonuses paid by investors under the production sharing agreements to SOCAR or an authorized state body;
 - 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 placement and management of the Fund's assets, including interest, dividend, asset revaluation and other revenues.
- c) Grants and free aids.
- d) Other revenues and receipts in accordance with Azerbaijan legislation.

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

In 2004, the Fund retained one custody agreement and two investment management agreements with well-known financial institutions. Under custody agreements the financial institutions 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.

In 2003, the Fund had one custody agreement and three investment management agreements with well-known financial institutions.

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

The number of employees in the Fund at December 31, 2004 and 2003 equaled to 42 and 19, respectively.

These financial statements for the year ended December 31, 2004 were approved by the Fund's Executive Director on May 5, 2005.

2. Significant accounting policies

Basis of presentation

The financial statements of the Fund have been prepared in accordance with International Public Sector Accounting Standards (IPSAS) issued by the Public Sector Committee of the International Federation of Accountants. IPSAS are developed by adapting International Financial Reporting Standards (IFRS) to the public sector context.

IFRS comprise standards and interpretations approved by the International Accounting Standards Board, and IFRS and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee. The public sector refers to national governments, regional governments, local governments and related governmental entities.

The Fund has elected to apply every IPSAS issued as of December 31, 2004 and 2003. As permitted by IPSAS, the Fund follows the provisions of IFRS pronouncements in the absence of equivalent IPSAS.

The financial statements have been prepared on the historical cost basis, except for the measurement at fair value of trading securities.

The Fund maintains its records in Azerbaijani Manats ("AZM") in accordance with Azeri accounting standards. The accompanying financial statements have been prepared from the Azeri accounting records for presentation in accordance with IPSAS.

Although the majority of the Fund's assets and revenues are denominated in foreign currencies, the Fund's measurement currency is AZM because all costs and distributions are incurred or priced in AZM and the valuation of the Fund's financial performance is compared against an annual budget measured in AZM.

In accordance with IPSAS No. 4 "The Effects of Changes in Foreign Exchange Rates" transactions and balances denominated in currencies other than AZM (primarily US Dollar) have been re-measured into AZM. Revenues and costs are translated at monthly average exchange rates that approximate historical exchange rates. Capital and non-monetary assets and liabilities are translated at historical exchange rates prevailing on the transaction dates. Monetary assets and liabilities are translated at exchange rates prevailing on the balance sheet date. Exchange gains and losses arising from the remeasurement of monetary assets and liabilities that are not denominated in AZM are credited or charged to operations.

AZM is not a fully convertible currency outside the territory of the Azerbaijan Republic. Within the Azerbaijan Republic, official exchange rates are determined daily by the National Bank of the Azerbaijan Republic. Market rates may differ from the official rates but the differences are, generally, within narrow parameters monitored by the National Bank of the Azerbaijan Republic. As of December 31, 2004 and 2003, the official rates of exchange were 4,903 AZM for one US Dollar and 4,923 AZM for one US Dollar, respectively.

Use of estimates

The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, revenues and expenses, contributions and distributions, and related disclosures. On an on-going basis, the management evaluates their estimates, including those related to revenue recognition and contingencies. The management bases their estimates on various market specific assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making assumptions about the carrying values of assets that are not readily apparent from other sources. Actual results may differ significantly from these estimates under different assumptions or conditions.

Recognition of financial instruments

A purchase or sale of financial assets is recognized using settlement date accounting. The settlement date is the date that an asset is delivered to or by the Fund. Settlement date accounting refers to (a) the recognition of an asset on the day it is transferred to the Fund and (b) derecognition of an asset on the day that it is transferred by the Fund. The Fund accounts for any change in the fair value of the asset to be received during the period between the trade date (the date that the Fund commits to purchase or sell an asset) and the settlement date in the same way as it will account for the acquired asset. That is, the value change is not rec-

ognized for assets carried at cost or amortized cost; it is recognized in net profit or loss for assets classified as trading; and it is recognized in net profit or loss or in equity for assets classified as available for sale.

Financial assets and liabilities are initially recognized at cost, which is the fair value of consideration given or received, respectively, including or net of any transaction costs incurred, respectively. The accounting policies for subsequent re-measurement of these items are disclosed in the respective accounting policies set out in this note.

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.

Commercial papers and certificates of deposits

Commercial papers and certificates of deposits are carried at their fair value.

Trading securities

Securities purchased principally for the purpose of generating a profit from short-term fluctuations in price or dealers' margin are classified as trading securities. Trading securities are initially recognized under the policy for financial instruments and are subsequently measured at fair value, based on market values as of the balance sheet date. Realized and unrealized gains and losses resulting from operations with trading securities are recognized in the statement of financial performance as part of net dealing gains/losses. Interest earned on trading securities is reported as interest income.

In determining estimated fair value, securities are valued at the last trade price if quoted on an exchange, or the last bid price if traded over-the-counter. When market prices are not available or if liquidating the Fund's position would reasonably be expected to impact market prices, fair value is determined by reference to price quotations for similar instruments traded in different markets or management's objective and reliable estimates of the amounts that can be realized.

Investment securities

The Fund classifies its investment securities in two categories:

- Securities with fixed maturities and fixed or determinable payments that management has both the positive intent and the ability to hold to maturity are classified as held to maturity; and
- Securities that are not classified by the Fund as held to maturity or trading (see above) are included in the available-for-sale portfolio.

The Fund classifies investment securities depending upon the intent of management at the time of the purchase.

Investment securities held to maturity are initially recognized in accordance with the policy stated above and any discounts or premiums are subsequently re-measured at amortized cost using the effective interest method. Allowance for impairment is estimated on a case-by-case basis. Gains and losses from held to maturity securities are recorded in the statement of financial performance.

Fair values of financial instruments

Fair value is defined as the amount at which an instrument could be exchanged in a current transaction between knowledgeable willing parties on arm's length conditions, other than in forced or liquidation sale. Judgment is necessary in arriving at fair value, based on current economic conditions and the specific risks attributable to the instrument. 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 following methods and assumptions are used by the Fund to estimate the fair value of its financial instruments:

- for assets and liabilities maturing within one month, the carrying amount approximates fair value due to the relatively short-term maturity of these financial instruments.
- for longer-term assets and liabilities, the interest rates applicable reflect market rates and, consequently, the fair value approximates the carrying amounts.

Property and equipment

With the exception of the administrative building, the Fund's property and equipment is stated at historical cost less accumulated depreciation. At December 31, 2004 the Fund's administrative building was

stated at the fair value appraised by independent appraisers on September 3, 2004 less accumulated depreciation for the four months period from September 3, 2004 to December 31, 2004.

Office equipment, furniture, vehicles and other fixed assets are depreciated using the straight-line method over estimated useful lives ranging from three to seven years. Buildings are depreciated using the straight-line method over estimated a useful life of 50 years. Depreciation is charged starting the first day of the next month after the asset was put into use. Maintenance costs relating to items of property and equipment are expensed as incurred.

Net assets/Equity

Transfers are recognized as the fair value of the consideration paid by the Fund to the government and government-controlled entities on the date of payment. Actual transfers are made once the request letters sent by the government and government-controlled entities are supported by appropriate documentation.

Transfers to the State Committee for Work with Refugees and Internally Displaced People (the "Refugees Committee") are recognized when approved by the Fund's management.

Transfers to the Azerbaijan Treasury in respect of the Baku-Tbilisi-Ceyhan project are recognized when the Fund receives cash calls from Azerbaijan BTC Limited.

Transfers to the State Budget are approved by the Presidential Decrees and recognized when actually transferred by the Fund.

Net revenues generated from the sales of the Azerbaijan Republic's share of crude oil and gas are recognized as contributions to the Fund when SOCAR notifies the Fund of the amounts to be transferred.

Contributions of rental fees in 2003 paid by the Azerbaijan International Operating Company ("AIOC") and pipeline transit tariffs are recorded when the payments become due.

Contributions of bonus and acreage payments made by foreign companies are recorded when received by SOCAR or the Fund.

Termination and concession area abandonment payments as well as net revenues from sales of local market oil obligations received by SOCAR under onshore production sharing agreements are not contributed to the Fund's assets, in accordance with Presidential Decrees.

The transfers and contributions referred to above are recognized through the Fund's equity in accordance with IPSAS No. 1 "Presentation of Financial Statements."

Income and expense recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Fund and the revenue can be reliably measured. Interest income is recognized on an accrual basis.

Expenses are recognized on an accrual basis.

Income tax

The Fund has become a taxpayer effective January 1, 2003.

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognized for all taxable temporary differences. Deferred tax assets are recognized for all deductible temporary differences and carry-forward of unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carry-forward of unused tax losses can be utilized.

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 profit will be available to allow all or part of the deferred tax asset to be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates and tax laws that have been enacted or substantially enacted at the balance sheet date.

State social protection fund

The Fund contributes to the Azerbaijan Republic's State Social Protection Fund with respect to its employees.

Reclassifications

Certain previously reported amounts in the statement of financial performance have been reclassified to conform to current year presentation.

3. Cash and cash equivalents

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

	2004	2003
Deposits	1,491,228	1,437,752
Money market funds	717,919	254,451
Cash in bank accounts	147,995	87,154
US Dollar account at the National Bank of the Azerbaijan Republic	3,109	2,308
	2,360,251	1,781,665

Deposits

At December 31, 2004, the Fund had six deposits with banks bearing fixed interest from 2.24% to 2.35%. All deposits matured in January 2005. Bank deposits were placed in different banks with a credit rating ranging from A to AA (Standard & Poor's, Fitch).

At December 31, 2003, the Fund had six deposits with banks bearing fixed interest from 1.05% to 9.5%. All deposits matured in January 2004. Bank deposits were placed in different banks with a long-term credit rating ranging from A to AA (Standard & Poor's). Two out of six deposits are represented by Dual Currency Deposits held at JP Morgan Chase (London) and the Royal Bank of Scotland in the amounts of 196,920 million AZM and 295,380 million AZM, respectively, and bear interest rates of 9% and 9.5%, respectively.

Money market funds

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

Cash in bank accounts

Cash in bank accounts at December 31, 2004 were denominated in the following currencies:

	2004	2003
US Dollar	143,500	43,826
Euro	2,867	17
Azerbaijani Manats	1,325	43,276
British Pounds	134	35
Other	169	-
	147,995	87,154

The Fund's accounts were opened in well-known banks with long-term ratings ranging from A/Stable/A-1 to AA/Stable/A-1+ (Standard & Poor's).

US Dollar bank account with the National Bank of the Azerbaijan Republic

The Fund has a bank account in US Dollars at the National Bank of the Azerbaijan Republic. In accordance with an agreement between the National Bank of the Azerbaijan Bank and the Fund, all cash deposited by the Fund in the National Bank of the Azerbaijan Republic is transferred to a special investment account held in the Federal Reserve Bank of New York. All interest income earned on this account is accumulated on the account at the National Bank of the Azerbaijan Republic and recognized by the Fund on a daily basis.

4. Trading securities

Trading securities consisted of the following at December 31:

	2004	2003
Foreign government securities	290,480	299,937
Financial institution securities	267,069	93,997
American agencies securities	53,294	61,398
Corporate equity securities	18,286	17,394
Corporate debt securities	17,404	64,449
Multilateral institution bonds	12,174	12,346
SPDR Trust	-	52,044
	658,707	601,565

Trading securities of 658,707 million AZM were held under asset management in Deutsche Bank and Clariden Bank and custodian bank ("State Street Corporation") at December 31, 2004 and bear fixed and floating interest rates ranging from 1.75% to 8.75%. Trading securities of 601,565 million AZM held under asset management in Deutsche Bank, Clariden Bank and Societe Generale at December 31, 2003 had fixed and floating interest rates ranging from 1.08% to 13.625%.

Foreign government securities

Foreign government securities at December 31, 2004 are represented by bonds issued by Eastern European and Asian governments bearing interest ranging from 2% to 8.75% and maturing during the period from May 2005 to April 2011. Foreign government securities were purchased and held by the Fund's asset manager, Deutsche Bank AG.

Foreign government securities at December 31, 2003 are represented by US treasury notes, as well as bonds issued by Eastern European and Asian governments bearing interest ranging from 1.75% to 8.75% and maturing during the period from September 2004 to April 2011. Foreign government securities were purchased and held by the Fund's asset managers Clariden Bank and Deutsche Bank AG.

Financial institution securities

Financial institution securities at December 31, 2004 were represented by investments in debt securities issued by various European, Australian, North and Latin American financial institutions. These securities bear interest ranging from 2.25% to 3.375% and mature during the period from December 2005 to July 2014.

Included in financial institution securities at December 31, 2004 is a bond with a fair value of 155,920 million AZM maturing on December 9, 2009 and bearing an interest rate which is linked to the performance of share prices of certain companies. The Fund's management believes that it is impractical to determine the fair value of the embedded derivative included in this security. Accordingly, at December 31, 2004 the bond was classified as a trading security and stated at its fair market value. The revaluation of this bond at December 31, 2004 to its fair market value resulted in a 15,685 million AZM revaluation loss that is recognized in the statement of financial performance as a net dealing loss.

Financial institution securities at December 31, 2003 were represented by investments in debt securities issued by Deutsche Bank SSD, KfW and other European banks. These securities bear interest ranging from 1.17% to 7% and mature during the period from July 2004 to October 2008.

American agencies securities

Investments in American agencies securities at December 31, 2004 consisted of bonds issued by Fannie Mae, Freddie Mac and Federal Home Loan Banks bearing interest rates from 1.75% to 2.875% and maturing from December 2005 to August 2007.

Investments in American agencies securities at December 31, 2003 consisted of bonds issued by Fannie Mae, Freddie Mac and Federal Home Loan Banks bearing interest rates from 1.875% to 2.75% and maturing from March 2006 to December 2006.

Corporate equity securities

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

	2004	2003
Consumer	4,246	4,603
Industrials	3,121	1,434
Energy	3,028	2,386
Healthcare	2,429	2,269
Telecommunication and information technologies	2,356	2,410
Utilities	2,108	1,540
Other	998	2,752
	18,286	17,394

Corporate debt securities

Debt securities at December 31, 2004 are mainly represented by securities issued by Bristol-Myers Squibb Company and Eli Lilly & Co, bearing interest of 4.75% and 2.41% and maturing in October and December 2006, respectively.

Debt securities at December 31, 2003 are mainly represented by securities issued by Bristol-Myers Squibb Company, Morgan Stanley and other European and American companies bearing interest from 1.211% to 6.25% and maturing during the period from October 2006 to May 2008.

Multilateral institution bonds

Investments in multilateral institution bonds at December 31, 2004 and December 31, 2003 consisted of bonds issued by the European Investment Bank and Asian Development Bank bearing interest rates of 2.35% and 2.375% and maturing in April 2006 and March 2006, respectively.

5. Asset management agreements

At December 31, 2004 the Fund held 563,739 million AZM under asset management agreements with well-known international financial institutions (802,804 million AZM – at December 31, 2003).

6. Securities held to maturity

The carrying value of securities held to maturity consisted of the following at December 31:

	2004	2003
Debt securities - financial institutions	1,343,902	1,033,387
American agencies securities	269,646	270,734
Foreign government securities	25,231	-
Corporate securities - other	49,139	-
	1,687,918	1,304,121

At December 31, 2004 securities held to maturity consisted of 1,103,175 million AZM of debt securities bearing fixed interest rates ranging from 2% to 8.75% and 584,743 million AZM of debt securities bearing floating interest rates ranging from London Inter Bank Offered Rate ("LIBOR") plus 0.95% to LIBOR plus 2.1%.

At December 31, 2003 securities held to maturity consisted of 1,230,276 million AZM of debt securities bearing fixed interest rates ranging from 2.375% to 8.5% and 73,845 million AZM of a debt security bearing a floating interest rate of LIBOR plus 2.1%.

Debt securities – financial institutions

At December 31, 2004 investments in financial institutions securities held to maturity amounted to 1,343,902 million AZM and consisted of financial institution bonds bearing interest rates ranging from 3.69% to 7.875% and maturing during the period from March 2005 to July 2013.

At December 31, 2003 investments in financial institution securities held to maturity amounted to 1,033,387 million AZM and consisted of financial institution bonds bearing interest rates ranging from 1% to 8.5% and maturing during the period from March 2008 to July 2013.

In March 2004 callable securities of Netherlands Investment Bank Capital with a carrying value of 49,859 million AZM and a maturity date of March 31, 2008 and Banque Generale DU Luxembourg with a carrying value of 49,710 million AZM and a maturity date of March 28, 2008 were called and redeemed by the issuers. The Fund did not incur any gain or loss from this event.

In December 2004, the Fund replaced Netherlands Investments Bank Capital securities with a carrying value of 245,145 million AZM to Bank TuranAlem CLN Range Accrual and Gazprom CLN Range Accrual notes with the same face value and similar fair value of 228,921 million AZM. As a result of this transaction, the Fund has recognized a loss of 16,224 million AZM in the statement of financial performance. This exchange transaction was carried out as a risk management remedy in response to an isolated event which was beyond the Fund's control.

American agencies securities

At December 31, 2004 and 2003 the Fund had 269,646 and 270,734 million AZM, respectively, invested in securities issued by American agencies bearing interest rates ranging from 2.375% to 4.625% and maturing during the period from June 2007 to May 2013.

Foreign government securities

At December 31, 2004 the Fund had 25,231 million AZM invested in a Russian government bond, bearing an interest rate of 8.75% with a maturity date of July 24, 2005.

At December 31, 2003 the Fund had no investments in foreign government securities.

Corporate securities - others

At December 31, 2004 the Fund had 49,139 million AZM invested in bonds of two corporations, General Motors Acceptance Corporation and Skylark Ltd., bearing floating interest rates of three-month USD LIBOR plus 1.25% and 1.10%, respectively, and maturing on January 15, 2006 and September 20, 2009, respectively.

At December 31, 2003 the Fund had no investments in corporate securities.

All securities at December 31, 2004 had a long-term credit rating of at least Baa3 (Moody's) and BBB- (Standard & Poor's), and were denominated in US Dollars with the exception of 33,409 million AZM Barclays Bank plc security bearing an interest rate of three-months LIBOR plus 150 basis points and denominated in Euro.

Securities at December 31, 2003 had a long-term credit rating of at least AA- (Standard & Poor's) and were denominated in US Dollars.

At December 31, 2004 included in securities held to maturity were 686,218 million AZM of redeemable accrual notes bearing step-up fixed interest rates ranging from 4% to 8%, and floating interest rates ranging from six-month USD LIBOR plus 0.95% - 1.80% and maturing during the period from December 2009 to July 2013. The Fund's semiannual and quarterly receipt of the interest income on these notes is contingent upon three-month USD LIBOR staying within a range of 4% - 7%, and six-month USD LIBOR staying within a range of 3.67% - 6.5% till the maturity. Management believes that any future changes of USD LIBOR will not have a material impact on the financial statements.

Proceeds from sales and redemption of securities

In May 2004, the Fund acquired 73,755 million AZM of Fannie Mae securities bearing interest of 1.85% and intended to keep them till their maturity June 3, 2005. However, due to a decrease of the credit rating of the issuer the Fund's management determined the bonds were no longer in accordance with the Fund's approved investment policies and sold them in December 2004.

In August 2004, the Fund acquired 98,040 million AZM of Lloyds TSB Bank PLC Callable Notes bearing interest rate of 2.7% which were redeemed by the issuer in November 2004. The Fund did not incur a gain or loss from this transaction.

7. Property and equipment

An analysis of activity in property and equipment for the years ended December 31, 2004 and 2003 was as follows:

	Vehicles	Office equipment	Furniture	Building	Total
Cost/Valuation					
December 31, 2003	157	1,002	156	2,352	3,667
Additions	69	167	408	-	644
Revaluation	-	-	-	7,830	7,830
Disposals	-	(23)	(25)	-	(48)
December 31, 2004	226	1,146	539	10,182	12,093
Accumulated depreciation					
December 31, 2003	(56)	(100)	(24)	(30)	(210)
Depreciation charge	(59)	(379)	(118)	(706)	(1,262)
Disposals	-	7	7	-	14
December 31, 2004	(115)	(472)	(135)	(736)	(1,458)
Net book value:					
December 31, 2004	111	674	404	9,446	10,635
December 31, 2003	101	902	132	2,322	3,457

In accordance with resolution of Cabinet of Ministers #99 dated May 27, 2002 the Fund has received an administrative building. On September 3, 2004 the building was appraised by an independent valuation group. Accordingly, at December 31, 2004 the building was reflected at its revalued amount of 10,182 million AZM less accumulated depreciation of 736 million AZM. The cost of the building at December 31, 2003 totaling 2,352 million AZM represents capitalized renovation costs.

8. Income taxes

Income taxes consisted of the current tax payable to the State Budget. In accordance with amendments to the Tax Code starting from January 1, 2003 the Fund's income became subject to income tax. Income tax expense is calculated at 24% (25% in 2003) on any surplus before taxes.

The Fund had no material deferred tax balances at December 31, 2004 and 2003.

9. Contributed capital

Capital contributions for the years ended December 31, 2004 and 2003 include the following:

	Net revenue received from sales of profit oil	Pipeline transit tariffs	Rental fees	Acreage fees	Boneses	Revaluation reserve	Other	Total
Contributions								
for 2004	1,294,834	67,018	-	43,261	105,991	7,830	3,707	1,522,641
Contributions								
for 2003	909,624	68,767	586	94,556	288,194	-	-	1,361,727

Contributions amounting to 1,294,834 million AZM were transferred by SOCAR in 2004 and represent sales proceeds in respect of the Azerbaijan Republic's share of profit oil (909,624 million AZM in 2003) from the Azeri, Chirag, Guneshli production sharing agreement.

The revaluation reserve totaling 7,830 million AZM represents the surplus from the revaluation of the Fund's administrative building in 2004 as discussed in Note 7 above.

10. Transfers

Transfers to the State Budget

Transfers to the State Budget in 2004 are represented by 650,000 million AZM transferred in accordance with Decree #41 of the President of the Azerbaijan Republic "On the Budget of the State Oil Fund of the Azerbaijan Republic for the year 2004" dated March 31, 2004, for the purposes of sustaining the State Budget.

Transfers to the State Budget in 2003 are represented by 500,000 million AZM transferred in accordance with Decree #848 of the President of the Azerbaijan Republic "On the Budget of the State Oil Fund of the Azerbaijan Republic for the year 2003" dated January 27, 2003, for the purposes of sustaining the State Budget, and 33,000 million AZM of VAT transfers resulting from transfers to the Refugees Committee.

Transfers to the Azerbaijan Treasury for AzBTC

In accordance with Decree #739 of the President of the Azerbaijan Republic "On financing the participating interest share of the State Oil Company of the Azerbaijan Republic in the Baku-Tbilisi-Ceyhan main export pipeline project" dated July 30, 2002, the Fund provides part of the funding required for the construction of the main export pipeline from Baku over Georgian territory to the Turkish Mediterranean port of Ceyhan (the "BTC project"). Decree #739 authorizes the use of financial reserves under the responsibility of the Fund for investment in the pipeline. The Ministry of Economic Development of the Republic of Azerbaijan ("MED"), through Azerbaijan (BTC) limited ("AzBTC"), holds a twenty-four percent share in the oil pipeline consortium - BTC Company.

BTC Company intends to provide up to thirty percent of the project cost through equity contributions of the participants including Amerada Hess (BTC) Limited, Azerbaijan (BTC) Limited, BP Pipelines (BTC) Limited, ConocoPhillips (BTC) Limited, Eni BTC Limited, INPEX BTC Pipeline, Limited, ITOCHU Oil Exploration (BTC) Inc., Statoil BTC Caspian AS, TOTAL (BTC) Limited, Turkish Petroleum BTC Ltd., Unocal BTC Pipeline, Ltd. and BTC International Investment Company and to raise the remaining seventy percent from international financial institutions, export credit agencies and private banks.

In accordance with the Fund's budget for 2004 approved by the President, the Fund continued to finance seventy percent of the MED's equity investment in AzBTC. The remaining thirty percent of AzBTC's funding requirement is financed by SOCAR.

Accordingly, during 2004 and 2003 the Fund transferred from its net assets 89,000 million AZM and 280,532 million AZM, respectively, to the Azerbaijan Treasury to finance seventy percent of the MED's share of AzBTC.

Transfers to the Refugees Committee

In accordance with Decrees of the President of the Azerbaijan Republic #562 dated August 22, 2001 and #577 September 7, 2001, the Fund has provided financing of 51,952 million AZM to the Refugees Committee (89,999 million AZM in 2003) for construction and renovation of houses for internally displaced persons.

11. 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 and market movements in interest and foreign exchange rates. A summary description of the Fund's risk management policies in relation to those risks is discussed below.

The Fund is subject to credit risk from its portfolio of cash and cash equivalents and its investments. In accordance with the Rules approved by Decree #849 signed on February 3, 2003 amending Decree #511 of the President of the Azerbaijan Republic dated June 19, 2001, the Fund manages its credit risk by investing its assets in financial instruments of financial institutions with investment ratings not lower than BBB- (Standard & Poor's, Fitch) or Baa3 (Moody's). Asset management and custodian services are performed by financial institutions with credit ratings of not lower than AA- (Standard & Poor's, Fitch) or Aa3 (Moody's). The Fund keeps its clearing bank accounts outside the Republic of Azerbaijan at banks with credit ratings not lower than AA- (Standard & Poor's, Fitch) or Aa3 (Moody's).

The Fund also places its assets in the National Bank of the Azerbaijan Republic, which are automatically transferred to a special investment account held in the Federal Reserve Bank of New York. The goals of the Fund's investment strategy, in order of priority, are safety and preservation of principal, diversification of risk and a competitive rate of return.

The Fund is exposed to the effects of fluctuation in the prevailing foreign currency exchange rates on its financial position and cash flows. In accordance with Decree #1134 of the President of the Azerbaijan Republic "On the Implementation of the Budget of the State Oil Fund of the Azerbaijan Republic for the year 2003" dated January 27, 2003, the Fund's investment portfolio is required to be diversified into US Dollars (60-70%), Euro (25-35%) and British Pounds (0-10%) in order to mitigate the risk of currency fluctuations. The Fund has not met this diversification criterion in 2004 (as at December 31, 2004 99% of the Fund's assets were denominated in US Dollars and 1% in Euro).

In 2004, the Fund incurred 13,258 million AZM exchange losses. These foreign exchange losses arose as a result of the depreciation of major currencies against the Azerbaijani Manat.

At December 31, 2004 and 2003 deposits, debt securities, cash on hand and other bank accounts, as well as the US Dollar bank account with the National Bank of the Azerbaijan Republic were interest-bearing and, therefore, were exposed to interest rate risk. Floating interest on securities is re-priced at intervals of less than one year. Fixed interest on trading securities is fixed until the maturity of the financial instrument. Since substantially all securities held to maturity at December 31, 2004 and 2003 were represented by debt securities, the Fund's exposure to interest rate risk is significant. The Fund is managing this risk by gradually increasing the proportion of securities with floating interest rate in its held-to-maturity portfolio.

The geographical concentration of the Fund's assets and liabilities is set out below:

	2004					Total	2003				Total
	Azerbaijan	Europe	USA	Asia	Others		Azerbaijan	Europe	USA	Total	
Assets:											
Cash and cash equivalents	4,718	2,353,307	2,226	-	-	2,360,251	45,585	1,731,750	4,330	1,781,665	
Trading securities	-	658,707	-	-	-	658,707	-	549,521	52,044	601,565	
Interest receivable	-	7,997	695	8,538	2,975	20,205	-	6,170	14,787	20,957	
Contribution receivable	12,492	-	-	-	-	12,492	5,186	-	-	5,186	
Other short-term investments	-	-	-	-	-	-	98,460	209,212	-	307,672	
Other current assets	15	-	-	-	-	15	269	-	-	269	
	17,225	3,020,011	2,921	8,538	2,975	3,051,670	149,500	2,496,653	71,161	2,717,314	
Investments held to maturity	-	351,298	294,271	895,259	147,090	1,687,918	-	-	1,304,121	1,304,121	
Property and equipment, net	10,635	-	-	-	-	10,635	3,457	-	-	3,457	
Intangible assets	199	-	-	-	-	199	156	-	-	156	
Other long-term assets	964	-	-	-	-	964	-	-	-	-	
	11,798	351,298	294,271	895,259	147,090	1,699,716	3,613	-	1,304,121	1,307,734	
	29,023	3,371,309	297,192	903,797	150,065	4,751,386	153,113	2,496,653	1,375,282	4,025,048	
Liabilities:											
Payable to the State Budget	15,832	-	-	-	-	15,832	55,977	-	-	55,977	
Other current liabilities	222	590	-	-	-	812	946	-	-	946	
	16,054	590	-	-	-	16,644	56,923	-	-	56,923	
Net financial position	12,969	3,370,719	297,192	903,797	150,065	4,734,742	96,190	2,496,653	1,375,282	3,968,125	

The Fund's exposure to foreign currency exchange rate risk follows:

	2004			2003		
	AZM	Freely convertible	Total	AZM	Freely convertible	Total
Assets:						
Cash and cash equivalents	1,324	2,358,927	2,360,251	1,738,389	43,276	1,781,665
Trading securities	-	658,707	658,707	-	601,565	601,565
Interest receivable	-	20,205	20,205	-	20,957	20,957
Contributions receivable	-	12,492	12,492	-	5,186	5,186
Other short-term investments	-	-	-	98,460	209,212	307,672
Other current assets	15	-	15	-	269	269
	1,339	3,050,331	3,051,670	1,836,849	880,465	2,717,314
Investments held to maturity	-	1,687,918	1,687,918	-	1,304,121	1,304,121
Property and equipment, net	10,635	-	10,635	3,457	-	3,457
Intangible assets	199	-	199	156	-	156
Other long-term assets	-	964	964	-	-	-
	10,834	1,688,882	1,699,716	3,613	1,304,121	1,307,734
	12,173	4,739,213	4,751,386	1,840,462	2,184,586	4,025,048
Liabilities:						
Payable to the State Budget	15,832	-	15,832	55,977	-	55,977
Other current liabilities	-	812	812	946	-	946
	15,832	812	16,644	56,923	-	56,923
Net financial position	(3,659)	4,738,401	4,734,742	1,783,539	2,184,586	3,968,125

Freely convertible currencies in the table above are represented by US Dollars, British Pounds, and Euros.

12. Fair values of financial instruments

In accordance with International Accounting Standard No. 32 "Financial Instruments: Disclosure and Presentation" the Fund is required to disclose the fair value of its financial assets which are stated at cost or amortized cost on the face of the financial statements. To arrive at these fair values management is required to make certain estimates. The estimated fair market values may differ significantly from the values that would have been used had a ready market existed.

The carrying value and estimated fair value of the Fund's securities held to maturity was as follows at December 31:

	Carrying value		Estimated Fair Value	
	2004	2003	2004	2003
Quoted on financial markets	500,370	319,767	510,617	309,342
Not quoted on financial markets	1,187,548	984,354	1,144,067	948,022
Total	1,687,918	1,304,121	1,654,684	1,257,364

The fair value of securities quoted on financial markets is determined by reference to the sales price on the December 31, 2004.

The fair value of securities not quoted on financial markets is estimated either by reference to fair values of similar securities quoted on financial markets, or through obtaining price quotations on these securities from the Fund's counterparties.

13. Significant non-cash transactions

In December 2004 the Fund has exchanged a number of its securities in a non-cash transaction, which is more fully described in Note 6.

As discussed in Note 7, the Fund has obtained an independent appraisal of the value of its administrative building as of September 3, 2004. As a result of this revaluation, the Fund recognized 7,830 million AZM of revaluation reserve through net assets.

14. Related parties

Settlements with related parties consisted of the following at December 31:

Related Party		Receipts from related parties	Transfers to related parties	Amounts owed to related parties
Refugees Committee	2004	–	51,952	–
	2003	–	89,999	–
Azerbaijan Treasury	2004	–	94,615	–
	2003	320,752	616,615	–
State Budget	2004	–	650,000	15,832
	2003	–	522,469	55,977
SOCAR	2004	1,294,807	–	–
	2003	909,624	–	–

The amount of 15,839 million AZM due to the State Budget represents payables as of December 31, 2004 for profit tax. The amount of 55,977 million AZM payable to the State Budget as of December 31, 2003 is represented by 32,977 million AZM and 23,000 million AZM payables to the State Budget for profit tax and VAT for payments to the refugees committee, respectively.

Key management personnel

The senior management group consists of the Fund's Executive Director, Director of Finance and Operations and heads of departments. 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:

	2004	2003
Aggregate remuneration	10	9
Number of persons	5	5

15. Contingent liabilities

In 2004, a legal action totaling approximately six million US Dollars 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 Netherlands. The Fund's management believes this legal action is without merit and that the Republic of Azerbaijan will prevail. However, at the date of these financial statements the outcome of the legal action is uncertain. These financial statements do not include any adjustments which could result from the possible outcome of this uncertainty.

16. Subsequent events

In January 2005, a Callable Range Accrual note of Banque Et Caisse D'Epargne De L'etat Luxemburg with a total carrying value of 148,223 million AZM classified as held-to-maturity was exchanged to an Anglo-Irish Bank Corp plc 10 year Callable Ratchet Inverse Floater security with the same carrying value. The exchange of securities was carried out without the actual flow of cash.

The Fund did not recognize any gain or loss under these exchange transactions. The fair value of these securities approximated carrying value at the date of transaction. These exchange transactions were carried out as a risk management remedy in response to an isolated event which was beyond the Fund's control.