STATE OIL COMPANY OF THE AZERBAIJAN REPUBLIC

International Financial Reporting Standards
Consolidated Financial Statements

31 December 2009

Contents

Ernst & Young

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Independent Auditors' Report

To the Management of the State Oil Company of the Azerbaijan Republic:

We have audited the accompanying financial statements of the State Oil Company of the Azerbaijan Republic (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2009, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on 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 auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting 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 consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2009, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young Holdings (CIS) B.V.

30 June 2010

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

	Note	31 December 2009	31 December 2008
ASSETS			
Current assets			
Cash and cash equivalents	7	698,600	520,170
Restricted cash	8	128,750	97,898
Trade and other receivables	9	2,129,774	1,666,562
Corporate income tax prepayments		28,921	12,187
Inventories	10	707,458	600,597
Total current assets		**3,693,503**	**2,897,414**
Non-current assets			
Property, plant and equipment	12	7,946,556	6,974,067
Goodwill	32	106,905	82,837
Intangible assets	13	521,237	510,743
Investments in jointly controlled entities	14	103,061	113,685
Investments in associates	15	315,353	292,732
Receivable from jointly controlled entity	16	311,891	301,855
Deposits	8	873,169	534,183
VAT receivable		-	26,755
Deferred tax asset	29	645,623	658,892
Other long-term assets	11	316,263	127,985
Total non-current assets		**11,140,058**	**9,623,734**
TOTAL ASSETS		**14,833,561**	**12,521,148**
EQUITY			
Charter capital	23	622,726	422,726
Retained earnings		6,778,784	6,432,136
Cumulative translation differences		(143,258)	(115,621)
Equity attributable to the Group's equity holders		**7,258,252**	**6,739,241**
Non-controlling interest		782,809	747,045
TOTAL EQUITY		**8,041,061**	**7,486,286**

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

	Note	31 December 2009	31 December 2008
LIABILITIES			
Current liabilities			
Trade and other payables	17	2,087,755	1,144,525
Short-term and current portion of long-term borrowings	18	388,080	407,970
Corporate income tax payable		102,503	152,956
Other taxes payable	19	187,295	213,206
Other provisions for liabilities and charges	21	102,292	156,018
Deferred acquisition consideration payable	32	36,687	-
Total current liabilities		**2,904,612**	**2,074,675**
Non-current liabilities			
Long-term borrowings	18	2,463,894	1,702,883
Deferred acquisition consideration payable	32	272,267	308,170
Asset retirement obligations	20	170,727	86,201
Other provisions for liabilities and charges	21	356,506	347,440
Deferred income	22	105,778	-
Deferred tax liability	29	478,027	478,600
Other non-current liabilities		40,689	36,893
Total non-current liabilities		**3,887,888**	**2,960,187**
TOTAL LIABILITIES AND EQUITY		**14,833,561**	**12,521,148**

Approved for issue and signed on behalf of the Group on 30 June 2010.

AZƏRBAYCAN RESPUBLİKASI DÖVLƏT NEFT ŞİRKƏTİ
REPUBLIC STATE OIL COMPANY
SOCAR

Mr Rovnag Abdullayev
President

Mr Suleyman Gasymov
Vice-President for Economic Affairs

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

	Note	2009	2008
Revenue	24	4,195,981	4,710,845
Cost of sales	25	(2,898,902)	(2,906,918)
Gross profit		**1,297,079**	**1,803,927**
Distribution expenses	25	(155,230)	(135,147)
General and administrative expenses	25	(229,871)	(185,376)
Losses on transfers of property, plant and equipment and other		(8,511)	(71,515)
Social expenses		(159,479)	(272,557)
Exploration and evaluation expenses	25	(11,298)	(6,900)
Research and development	25	(15,279)	(4,022)
Other operating expenses	25	(313,883)	(108,379)
Other operating income	26	1,025,401	222,294
Operating profit		**1,428,929**	**1,242,325**
Finance income	27	67,678	55,524
Finance costs	28	(163,211)	(147,789)
Foreign exchange losses, net	5	(958)	(407,676)
Share of result of jointly controlled entities	14	(12,887)	1,875
Share of result of associates	15	89,854	70,542
Other expenses		(40,062)	-
Profit before income tax		**1,369,343**	**814,801**
Income tax expense	29	(475,765)	(327,985)
Profit for the year		**893,578**	**486,816**
Profit is attributable to:			
Equity holders of the Group		890,307	733,545
Non-controlling interest		3,271	(246,729)
Other comprehensive income:			
Currency translation differences		(17,771)	(333,683)
Total comprehensive income for the year		**875,807**	**153,133**
Total comprehensive income attributable to:			
Equity holders of the Group		862,670	653,051
Non-controlling interest		13,137	(499,918)
		875,807	**153,133**

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

		Attributable to the equity holders of the parent					
	Note	Charter capital	Retained earnings	Currency translation difference	Total	Non-controlling interest	Total Equity
Balance at 1 January 2008		**22,726**	**6,174,303**	**(35,127)**	**6,161,902**	**3,909**	**6,165,811**
Profit for the year		-	733,545	-	733,545	(246,729)	486,816
Other comprehensive income		-	-	(80,494)	(80,494)	(253,189)	(333,683)
Total recognised income and expense for 2008		**-**	**733,545**	**(80,494)**	**653,051**	**(499,918)**	**153,133**
Non-controlling interest arising on business combination		-	-	-	-	1,243,054	1,243,054
Increase in charter capital		400,000	-	-	400,000	-	400,000
Withdrawals by the Government	23	-	(475,712)	-	(475,712)	-	(475,712)
Balance at 31 December 2008		**422,726**	**6,432,136**	**(115,621)**	**6,739,241**	**747,045**	**7,486,286**
Profit for the year		-	890,307	-	890,307	3,271	**893,578**
Other comprehensive income		-	-	(27,637)	(27,637)	9,866	**(17,771)**
Total recognised income and expense for 2009		**-**	**890,307**	**(27,637)**	**862,670**	**13,137**	**875,807**
Purchase of share from non-controlling interest		-	-	-	-	(6,327)	(6,327)
Acquisition of subsidiary		-	(257,621)	-	(257,621)	-	(257,621)
Increase in charter capital		200,000	-	-	200,000	-	200,000
Increase in charter capital of subsidiary		-	-	-	-	28,954	28,954
Withdrawals by the Government	23	-	(286,038)	-	(286,038)	-	(286,038)
Balance at 31 December 2009		**622,726**	**6,778,784**	**(143,258)**	**7,258,252**	**782,809**	**8,041,061**

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

	Note	2009	2008
Cash flows from operating activities			
Profit before income tax		**1,369,343**	**814,801**
Adjustments for:			
Depreciation of property, plant and equipment	25	590,655	529,094
Amortisation on intangible assets	13	13,744	10,499
Impairment of property, plant and equipment	12	241,639	354,122
Gain on release of provision for trade and other receivables		(523,671)	181,935
Provisions		14,629	(162,228)
Net losses on disposals of property, plant and equipment		90,096	71,515
Transfer of property, plant and equipment from joint ventures		(18,920)	-
Finance income	27	(67,678)	(55,524)
Finance costs	28	163,211	147,789
Foreign exchange rate differences		8,126	421,238
Proceeds from sale of profit oil received from Lalaben and Caspian King	30	(150,994)	(198,010)
Share of result of associates and joint ventures	14,15	(76,967)	(72,417)
Non-controlling interest in earnings of subsidiaries		(3,271)	(246,729)
Operating cash flows before working capital changes		**1,649,942**	**1,796,085**
Decrease/(increase) in trade and other receivables		606,536	(289,113)
Decrease/(increase) in inventories		41,889	(83,034)
(Decrease)/ increase in trade and other payables		(457,848)	69,519
(Decrease)/ increase in taxes payable		(185,624)	165,876
Cash generated from operations		**1,654,895**	**1,659,333**
Income taxes paid		(474,851)	(750,208)
Interest paid		(105,504)	(88,890)
Net cash from operating activities		**1,074,540**	**820,235**
Cash flows from investing activities			
Acquisition of subsidiary, net of cash acquired		(36,688)	(1,335,419)
Purchase of property, plant and equipment		(1,204,378)	(1,129,485)
Purchase of intangible assets		(20,151)	(7,219)
Acquisition of interest in associates and jointly controlled entities		(301)	(14,081)
Deposits	8	(338,986)	(528,962)
Financing provided to third parties		(80,390)	-
Interest received		57,642	55,524
Dividends received		64,659	41,816
Net cash used in investing activities		**(1,558,593)**	**(2,917,826)**
Cash flows from financing activities			
Proceeds from long-term borrowings		1,119,433	1,951,487
Proceeds from short-term borrowings		239,448	332,836
Repayment of long-term borrowings		(337,713)	(166,949)
Repayment of short-term borrowings		(174,608)	(24,613)
Increase in charter capital		200,000	400,000
Change in restricted cash related to borrowings		(6,540)	(7,286)
Withdrawals by Government	23	(242,577)	(420,417)
Net cash from financing activities		**797,443**	**2,065,058**
Net foreign exchange translation differences		(134,960)	(50,781)
Net increase/(decrease) in cash and cash equivalents		**178,430**	**(83,314)**
Cash and cash equivalents at the beginning of the year	7	**520,170**	**603,484**
Cash and cash equivalents at the end of the year	7	**698,600**	**520,170**

1 The Group and its Operations

The State Oil Company of the Azerbaijan Republic ("SOCAR") was established by the Presidential Decree on 13 September 1992 in accordance with Azerbaijani legislation and is domiciled in the Azerbaijan Republic. In order to improve its operational efficiency SOCAR has been restructured several times and now is comprised of 19 business units dealing with their particular areas of business. SOCAR and the business units are involved in upstream, midstream and downstream operations. SOCAR's main functions pertain to managing the extraction, refining, transportation of oil, gas and gas condensates, and sale of gas and oil and gas products. SOCAR is 100 per cent owned by the government of the Azerbaijan Republic ("the Government").

On 1 July 2009, SOCAR acquired 100 per cent of the share capital of Azerigaz Closed Joint Stock Company ("Azerigaz CJSC"), a monopolist gas utility company in the Azerbaijan Republic. Following this acquisition, Azerigaz CJSC was transformed into Azerigaz Production Union ("Azerigaz PU") within SOCAR structure. For further details please refer to Note 32.

SOCAR's registered address is 73 Neftchiler avenue, AZ 1000 Baku, the Azerbaijan Republic.

2 Basis of Preparation and Significant Accounting Policies

Basis of preparation. These consolidated financial statements of SOCAR and its subsidiaries, associates and joint ventures (collectively referred to as "the Group") have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented.

Basis for consolidation. Subsidiaries are all entities (including special-purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Business combinations. The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The date of exchange is the acquisition date where a business combination is achieved in a single transaction, and is the date of each share purchase where a business combination is achieved in stages by successive share purchases.

The excess of the cost of acquisition over the fair value of the net assets of the acquiree at each exchange transaction represents goodwill. The excess of the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired over cost ("negative goodwill") is recognised immediately in profit or loss.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

Non-controlling interest is that part of the net results and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly, by the Group. Non-controlling interest forms a separate component of the Group's equity.

2 Basis of Preparation and Significant Accounting Policies (Continued)

Transactions with non-controlling interest - "parent company model"

The Group applies a policy of treating transactions with non-controlling interests as transactions with parties external to the group. Purchase of equity share from non-controlling interest result in goodwill, being the excess of the cost of consideration paid over the carrying value of the net assets of the subsidiaries. If the carrying value of the net assets of the subsidiaries exceeds the cost of consideration paid, the difference is recognized in the consolidated statement of comprehensive income.

The Group applies purchase method of accounting for business combinations with entities under the common control.

Investments in associates. Associates are all entities over which the Group has significant influence but not control. Investments in associates are accounted for using the equity method of accounting and are initially recognized at cost. The Group's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Group's share of its associates' post-acquisition profits or losses is recognized in the statement of comprehensive income, and its share of post-acquisition movements in reserves is recognized in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any receivables, regarded to be in substance the extension of the Group's investment in the associate, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates related to transfer of assets are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

Interests in joint ventures. A joint venture is a contractual arrangement whereby two or more parties (venturers) undertake an economic activity that is subject to joint control. Joint control exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the venturers. A jointly controlled entity is a joint venture that involves the establishment of a company, partnership or other entity to engage in economic activity that the Group jointly controls with its fellow venturers.

The results, assets and liabilities of a jointly controlled entity are incorporated in these consolidated financial statements using the equity method of accounting. Under the equity method, the investment in a jointly controlled entity is carried in the statement of financial position at cost plus post-acquisition changes in the Group's share of net assets of the jointly controlled entity, less distributions received and less any impairment in value of the investment. The Group statement of comprehensive income reflects the Group's share of the results after tax of the jointly controlled entity. The Group statement of equity changes reflects the Group's share of any income and expense recognised by the jointly controlled entity outside profit and loss.

Financial statements of jointly controlled entities are prepared for the same reporting period as the Group. Where necessary, adjustments are made to those financial statements to bring the accounting policies used into line with those of the Group.

The Group ceases to use the equity method of accounting on the date from which it no longer has joint control over, or significant influence in the joint venture, or when the interest becomes held for sale.

2 Basis of Preparation and Significant Accounting Policies (Continued)

Certain of the Group's upstream activities which are governed by Production Sharing Agreements ("PSAs") are conducted through joint ventures where the venturers have a direct ownership interest in and jointly control the assets of the venture. Such activities are accounted for as jointly controlled assets. Accordingly, the Group recognises its share of the jointly controlled assets, liabilities, income, and expenses of these jointly controlled assets in proportion to the Group's interest in the consolidated IFRS financial statements.

PSA is the method to execute exploitation of mineral resources by taking advantage of the expertise of a commercial oil and gas entity. The Government retains title to the mineral resources (whatever the quantity that is ultimately extracted) and often the legal title to all fixed assets constructed to exploit the resources. The Government will take a percentage share of the output which may be delivered in product or paid in cash under an agreed pricing formula. The contracting parties may only be entitled to recover specified costs plus an agreed profit margin. It may have the right to extract resources over a specified period of time. Operating company is a legal entity created by one or more contracting parties to operate PSA.

As a contracting party to various PSAs the Group evaluates and accounts for the PSAs in accordance with the substance of the arrangement. It records only its own share of oil under a PSA as revenue. Neither revenue nor cost is recorded by the Group for the oil extracted and sold on behalf of the Government. The Group acts as the Government's agent to extract and deliver the oil or sell the oil and remit the proceeds.

Costs that meet the recognition criteria as intangible or fixed assets in accordance with IAS 38 and IAS 16, respectively, are recognised where the entity is exposed to the majority of the economic risks and has access to the probable future economic benefits of the assets. Acquisition, development and exploration costs are accounted for in accordance with policies stated herein irrespective of whether such costs are recoverable or not from future cost oil and profit oil under the terms of the PSAs.

Assets subject to depreciation, depletion or amortisation are expensed using the appropriate depletion or depreciation method stipulated by the present accounting policies over the shorter of the PSA validity period or the expected useful life of the related assets.

Foreign currency translation. All amounts in these consolidated statements are presented in thousands of Azerbaijani manats ("AZN"), unless otherwise stated.

The functional currency of the majority of the Group's consolidated entities is the currency of the primary economic environment in which the entity operates. The functional currency of SOCAR and its 19 business units and the Group's presentation currency is the national currency of the Azerbaijan Republic, AZN. However, US Dollar ("USD") and Turkish Lira ("YTL") are considered the functional currency of the Group's certain subsidiaries, associates and investments in jointly controlled entities and jointly controlled assets as majority of these investments' receivables, revenues, costs and debt liabilities are either priced, incurred, payable or otherwise measured in USD.

The transactions executed in foreign currencies are initially recorded in the functional currencies of respective Group entities by applying the appropriate rates of exchanges prevailing at the date of transaction.

Monetary assets and liabilities not already measured in the functional currency of respective Group entity are translated into the functional currency of that entity at the appropriate exchange rates prevailing at the statement of financial position date.

Foreign exchange gains and losses resulting from the re-measurement into the functional currencies of respective Group's entities are recognised in profit or loss.

2 Basis of Preparation and Significant Accounting Policies (Continued)

The results and financial position of the Group entities which functional currencies differ from the presentation currency of the Group and not already measured in the Group's presentation currency (functional currency of none of these entities is a currency of a hyperinflationary economy) are translated into the presentation currency of the Group as follows:

(i) assets and liabilities for each statement of financial position are translated at the closing rate at the date of that statement of financial position;

(ii) income and expenses for each statement of comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognised as a separate component of equity – currency translation difference.

At 31 December 2009 the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 0.8031, YTL 1 = AZN 0.5315 (2008: USD 1 = AZN 0.8010, YTL 1 = AZN 0.5269).

Financial instruments – key measurement terms. Depending on their classification financial instruments are carried at fair value, cost, or amortised cost as described below.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair value is the current bid price for financial assets and current asking price for financial liabilities which are quoted in an active market. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange or other institution and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques such as discounted cash flows models or models based on recent arm's length transactions or consideration of financial data of the investees are used to fair value certain financial instruments for which external market pricing information is not available. Valuation techniques may require assumptions not supported by observable market data.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes transaction costs. Measurement at cost is only applicable to investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortised cost is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related statement of financial position items.

2 Basis of Preparation and Significant Accounting Policies (Continued)

The effective interest method is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest re-pricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

Financial assets. The Group classifies its financial assets in the following measurement categories: a) financial assets at fair value through profit or loss; b) loans and receivables; c) financial assets held-to-maturity and d) available-for–sale financial assets. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

The subsequent measurement of financial assets depends on their classification, as follows:

(a) Financial assets at fair value through profit or loss. Financial assets at fair value through profit or loss are financial assets held for trading (a financial asset is classified in this category if acquired principally for the purpose of selling in the short term) and financial assets designated upon initial recognition as at fair value through profit or loss. Derivatives are classified as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

(b) Loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the statement of financial position date. These are classified as non-current assets. Loans and receivables are classified as trade and other receivables in the statement of financial position.

(c) Held-to-maturity financial assets. This classification includes quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has both the intention and ability to hold to maturity. Management determines the classification of investment securities held-to-maturity at their initial recognition and reassesses the appropriateness of that classification at each statement of financial position date. Investment securities held-to-maturity are carried at amortised cost.

(d) Available-for-sale financial assets. Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the statement of financial position date.

Regular purchases and sales of financial assets are recognized on the trade date - the date on which the Group commits to purchase or sell the asset. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in the statement of comprehensive income. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are carried at amortized cost using the effective interest method.

Gains or losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are presented in the statement of comprehensive income within other (losses)/gains – net, in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognized in the statement of comprehensive income as part of other income when the Group's right to receive payments is established.

2 Basis of Preparation and Significant Accounting Policies (Continued)

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analyzed between translation differences resulting from changes in amortized cost of the security and other changes in the carrying amount of the security. The translation differences on monetary securities are recognized in profit or loss; translation differences on non-monetary securities are recognized in equity. Changes in the fair value of monetary and non-monetary securities classified as available-for-sale are recognized in equity.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the statement of comprehensive income as gains and losses from investment securities. Interest on available-for-sale securities calculated using the effective interest method is recognized in the statement of comprehensive income as part of other income. Dividends on available-for-sale equity instruments are recognized in the income statement as part of other income when the Group's right to receive payments is established.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

The Group assesses at each statement of financial position date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in profit or loss – is removed from equity and recognized in the statement of comprehensive income. Impairment losses recognized in the statement of comprehensive income on equity instruments are not reversed through the comprehensive income.

Financial liabilities. The Group classifies its financial liabilities into the following measurement categories: (a) held for trading which also includes financial derivatives and (b) other financial liabilities. Liabilities held for trading are carried at fair value with changes in value recognised in the consolidated statement of comprehensive income in the period in which they arise. Other financial liabilities are carried at amortised cost.

Derecognition of financial assets. The Group derecognises financial assets when (i) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (ii) the Group has transferred substantially all the risks and rewards of ownership of the assets or (iii) the Group has neither transferred nor retained substantially all risks and rewards of ownership but has not retained control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

Derecognition of financial liabilities. The Group derecognises financial liability when the obligation under the liability is discharged, cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts, together with any costs or fees incurred are recognized in profit or loss.

Property, plant and equipment. The Group elected to measure property, plant and equipment at the date of transition to IFRS (1 January 2007) at their fair value and use that fair value as their deemed cost at that date. Fair value was determined by reference to market-based evidence and by using the depreciated replacement cost method. Subsequent to transition to IFRS, property, plant and equipment are stated at cost as described below, less accumulated depreciation and provision for impairment, where required.

2 Basis of Preparation and Significant Accounting Policies (Continued)

The initial cost of an asset purchased after 1 January 2007 comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of decommissioning obligation, if any, and, for qualifying assets, borrowing costs. The capitalized value of a finance lease is also included within property, plant and equipment.

Exploration and evaluation costs. Property leasehold acquisition costs are capitalised until the determination of reserves is evaluated. If a commercial discovery has not been achieved, these costs are charged to expense. Capitalisation is made within property, plant and equipment or intangible assets according to the nature of the expenditure.

The Group accounts for exploration and evaluation activities, capitalizing exploration and evaluation costs until such time as the economic viability of producing the underlying resources is determined. Exploration and evaluation costs related to resources determined to be not economically viable are expensed through operating expenses in the consolidated statement of comprehensive income.

Development tangible and intangible assets. Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of commercially proven development wells is capitalised within tangible and intangible assets according to nature. When development is completed on a specific field, it is transferred to production assets (oil and gas properties).

The Group's principal reserves have been independently estimated by internationally recognized petroleum engineers. Other oil and gas reserves of the Group have been determined based on estimates of mineral reserves prepared by management in accordance with internationally recognized definitions. The present value of the estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, are recognized when the obligation is incurred and are included within the carrying value of property, plant and equipment, subject to depletion using unit-of-production method.

All minor repair and maintenance costs are expensed as incurred. Cost of replacing major parts or components of property, plant and equipment items are capitalized and the replaced part is retired.

At each reporting date management assess whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the statement of comprehensive income. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. Gains and losses are recognised within total recognized income or loss.

Depreciation. Property, plant and equipment related to oil and natural gas properties are depreciated using a unit-of-production method.

Depreciation of oil and gas assets is computed on a field-by-field basis over proved developed reserves or over total proved reserves, as appropriate. Shared oil and gas properties and equipment (e.g. internal delivery systems, processing units, etc.) are depleted over total proved reserves.

Land is not depreciated. Property, plant and equipment other than oil and gas properties and equipment, are depreciated on a straight-line basis over their estimated useful lives. Assets under construction are not depreciated.

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

2 Basis of Preparation and Significant Accounting Policies (Continued)

The estimated useful lives of the Group's property, plant and equipment (other than oil and gas properties) are as follows:

Buildings and constructions	12 to 40 years
Plant and machinery	1 to 47 years
Vessels	25 years.

The expected useful lives of property, plant and equipment are reviewed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively.

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life unless scrap value is significant. The assets' residual values are reviewed, and adjusted if appropriate, at each statement of financial position date.

Operating leases. Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit or loss on a straight-line basis over the lease term. The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

When assets are leased out under an operating lease the lease payments receivable are recognized as rental income on a straight-line basis over the lease term.

Goodwill. Goodwill represents the excess of the cost of an acquisition over the fair value of the acquirer's share of the net identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of exchange. Goodwill on acquisitions of subsidiaries is presented separately in the consolidated statement of financial position. Goodwill on acquisitions of associates is included in the investment in associates. Goodwill is carried at cost less accumulated impairment losses, if any.

The Group tests goodwill for impairment at least annually and whenever there are indications that goodwill may be impaired. Goodwill is allocated to the cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the business combination. Such units or groups of units represent the lowest level at which the Group monitors goodwill and are not larger than a segment. Gains or losses on disposal of an operation within a cash generating unit to which goodwill has been allocated include the carrying amount of goodwill associated with the operation disposed of, generally measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit which is retained.

Intangible assets. Intangible assets are stated at cost, less accumulated amortization and accumulated impairment losses. Intangible assets include rights and computer software, patents, licences, customer relationships, trade name, water rights and development projects

a) Rights and computer software
Software is carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method over the estimated useful lives of such assets. Land property rights consist of rights over the dam, factory site, port site, site development, site and the water transmission line. Intangible assets obtained at the acquisition of Petkim were initially recognised at their fair values in accordance with IFRS 3 as of 30 May 2008 and amortised over their remaining useful lives commencing from the date of acquisition, except for the water transmission line which is not amortised as it is deemed to have an indefinite useful life.

b) Customer relationships
As further disclosed in Note 32, customer relationships acquired with the Petkim Petrokimya Holding A.S. ("Petkim") acquisition were initially recognised at their fair value in accordance with IFRS 3 as of 30 May 2008 and amortised over their remaining useful lives of 22 years commencing from the date of acquisition (Note 13).

2 Basis of Preparation and Significant Accounting Policies (Continued)

c) Petkim trade name
As further disclosed in Note 32, Petkim trade name acquired at the Petkim acquisition was initially recognised at its fair value in accordance with IFRS 3 as of 30 May 2008. Petkim trade name is not amortised as it is deemed to have an indefinite useful life (Note 13).

d) Water rights
As further disclosed in Note 32, water rights acquired with the Petkim acquisition were initially recognised at their fair value in accordance with IFRS 3 as of 30 May 2008 and amortised over their remaining useful lives of 47 years commencing from the date of acquisition (Note 13).

e) Development projects
As further disclosed in Note 32, development projects acquired with the Petkim acquisition were initially recognised at their fair value in accordance with IFRS 3 as of 30 May 2008 and amortised on a straight-line basis over their remaining useful lives of 5 years commencing from the date of acquisition. Cost incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be operational considering its commercial and technological feasibility, and only if the cost can be measured reliably. Other expenditures on research and development activities are recognised as expense in the period in which they incurred. When there is an impairment, the carrying values of the intangible assets are written down to their recoverable amounts.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each statement of financial position date.

The carrying value of intangible assets is reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable.

Corporate income taxes. Corporate income taxes have been provided for in the consolidated financial statements in accordance with the applicable legislation enacted or substantively enacted by the statement of financial position date. The income tax charge comprises current tax and deferred tax and is recognised in the statement of comprehensive income unless it relates to transactions that are recognised, in the same or a different period, directly in equity.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxes, other than on income, are recorded within operating expenses.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income taxes are provided in full on temporary differences arising on recognition and subsequent measurement of provision for asset retirement obligation and related adjustments to cost of property, plant and equipment.

2 Basis of Preparation and Significant Accounting Policies (Continued)

Trade and other receivables. Trade and other receivables are carried at amortised cost using the effective interest method. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The amount of the provision is recognised in the statement of comprehensive income. The primary factors that the Group considers whether a receivable is impaired is its overdue status and realisability of related collateral, if any. The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

- the counterparty experiences a significant financial difficulty as evidenced by its financial information that the Group obtains;
- the counterparty considers bankruptcy or a financial reorganisation;
- there is adverse change in the payment status of the counterparty as a result of changes in the national or local economic conditions that impact the counterparty;
- the value of collateral, if any, significantly decreases as a result of deteriorating market conditions.

Trade and other receivables are derecognised upon cash payments receipts from customers and borrowers or other similar settlements.

Cash and cash equivalents. Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less.

Restricted cash. Restricted cash is presented separately from cash and cash equivalents. Restricted balances are excluded from cash and cash equivalents for the purposes of cash flow statement.

Inventories. Inventories are stated at the lower of cost and net realizable value. Cost is assigned by the weighted average method. Cost comprises direct purchase costs, cost of production, transportation and manufacturing expenses (based on normal operating capacity).

Trade payables. Trade payables are accrued when the counterparty performed its obligations under the contract. Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

Borrowings. All borrowings are initially recognized at fair value of the proceeds received net of issue costs associated with the borrowing. Borrowings are carried at amortised cost using the effective interest method.

Interest costs on borrowings to finance the construction of property, plant and equipment are capitalised, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

Government grants. Grants from the Government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred income and are credited to profit or loss on a straight line basis over the expected lives of the related assets.

Government grants relating to costs are deferred and recognised in profit or loss for the over the period necessary to match them with the costs that they are intended to compensate.

2 Basis of Preparation and Significant Accounting Policies (Continued)

Asset retirement obligations. Liabilities for asset retirement obligation costs are recognized when the Group has an obligation to dismantle and remove a facility or an item of plant and to restore the site on which it is located, and when a reasonable estimate of that liability can be made. Where an obligation exists for a new facility, such as oil and natural gas production or transportation facilities, this will be on construction or installation. An obligation for asset retirement may also crystallize during the period of operation of a facility through a change in legislation. The amount recognized is the present value of the estimated future expenditure determined in accordance with local conditions and requirements.

The cost of property, plant and equipment is also adjusted for amounts of estimated liabilities for asset retirement obligations.

Any change in the present value of the obligation resulting from changes in estimates of the amounts or timing of future expenditures is reflected as an adjustment to the provision and the corresponding capitalized costs within property, plant and equipment. Changes in estimates of the amounts or timing of future expenditures to dismantle and remove fully depreciated plant or facility is recognized in the statement of comprehensive income. Changes in the present value of the obligation resulting from unwinding of the discount are recognized as finance costs in the statement of comprehensive income.

Provisions for liabilities and charges. Provisions for liabilities and charges are liabilities of uncertain timing or amount. They are accrued when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

Withdrawals by the Government. Withdrawals by the Government represent ad-hoc cash contributions which the Group may be required to make to the state budget, various government agencies and projects administered by the government based on the particular decisions of the Government. Such withdrawals are recorded as a reduction of equity.

Value-added tax. The tax authorities permit the settlement of sales and purchases value-added tax ("VAT") on a net basis.

VAT payable: VAT payable represents VAT related to sales that is payable to tax authorities upon collection of receivables from customers, net of VAT on purchases which have been settled at the statement of financial position date. In addition, VAT related to sales which have not been settled at the statement of financial position date (VAT deferral) is also included in VAT payable. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT where applicable. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

2 Basis of Preparation and Significant Accounting Policies (Continued)

VAT recoverable: VAT recoverable relates to purchases which have not been settled at the statement of financial position date. VAT recoverable is reclaimable against VAT on sales upon payment for the purchases.

Revenue recognition. Revenue comprises the fair value of consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities. Revenue is shown net of VAT, returns, discounts, and other sales-based taxes, if any, after eliminating sales within the Group.

Revenues from sales of crude oil are recognised at the point of transfer of risks and rewards of ownership of the crude oil, normally when the oil is loaded into the oil tanker or other transportation facilities. Revenues from sales of petroleum products are recognised at the point of transfer of risks and rewards of ownership of the petroleum products, normally when the products are shipped. Revenue from sales of natural gas are recorded on the basis of regular meter readings and estimates of customer usage from the last meter reading to the end of the reporting period. Natural gas prices and gas transportation tariffs to the final consumers in the Azerbaijan Republic are established by the Tariff Council of the Azerbaijan Republic.

Revenues from sales of other goods are recognised at the point of transfer of risks and rewards of ownership of the goods.

Sales of services are recognised in the accounting period in which the services are rendered, by reference to stage of completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Interest income is recognised on a time-proportion basis using the effective interest method.

Overlift/underlift of crude oil. Overlift or underlift of crude oil occurs when the volume of oil lifted by a partner in a joint venture differs from its participating interest in the production. Overlift is recognized as a sale of crude oil at the point of lifting by the underlifter to the overlifter. Overlift is recognized as a purchase of oil by the overlifter from the underlifter. The extent of underlift is reflected by the Group as an asset in the statement of financial position, and the extent of overlift is reflected as a liability. The initial measurement of the overlift liability or underlift asset is at the market price of crude oil at the date of lifting. Subsequent measurement of overlift/underlift liabilities and assets depends on the settlement terms of the related operating agreements. If such terms allow for a cash settlement of the overlift/underlift balances between the parties, the balances are remeasured at fair value at reporting dates subsequent to initial recognition. The overlift/underlift balances that are settled through delivery of physical quantities of crude oil are measured at the lower of carrying amount and fair value at reporting dates subsequent to initial recognition.

Employee benefits. Wages, salaries, contributions to the Social Protection Fund of the Republic of Azerbaijan, paid annual leave and sick leave, bonuses, and non-monetary benefits (e.g. health services and kindergarten services) are accrued in the year in which the associated services are rendered by the employees of the Group.

Related parties. Related parties are defined in IAS 24, *Related Party Disclosures*. Parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

The Group's ultimate controlling party is the Government of the Azerbaijan Republic. The President of the Group, Vice-Presidents of the Group as well as structure of SOCAR are approved directly by the President of the Azerbaijan Republic. The President of SOCAR may consult on significant matters pertaining to the operations of SOCAR with the Advisory Council which includes eight Vice-Presidents of SOCAR and some other management representatives from SOCAR. All decisions adopted by the Advisory Council of SOCAR have to be approved by the President of SOCAR before they become mandatory.

2 Basis of Preparation and Significant Accounting Policies (Continued)

Governmental economic and social policies affect the Group's financial position, results of operations and cash flows. The Government imposed an obligation on the Group to provide an uninterrupted supply of oil and gas to customers in the Azerbaijan Republic at government controlled prices. Transactions with the State include taxes which are detailed in Note 19.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

It is the nature of transactions with related parties that they cannot be presumed to be carried out on an arm's length basis.

Reclassifications. Certain reclassifications have been made to the prior year's amounts in Statement of Financial Position, Statement of Comprehensive Income, Statement of Cash Flows and corresponding notes to conform to the current year presentation. There was no material impact on the Group's financial position, results of operations and equity as a result of these reclassifications.

Consolidated Statement of Financial Position	**Amount**
Investments in jointly controlled entities were reclassified from Investments in associates	12,981
Cash and Cash Equivalents were reclassified from Restricted cash	7,998
Other non-current liabilities were reclassified from Trade and other payables	36,893
Consolidated Statement of Comprehensive Income	
Share of result of jointly controlled entities were reclassified from Share of result of associates	12,981
Consolidated Statement of Cash Flows	
Cash and Cash Equivalents were reclassified from Restricted cash	7,998

3 Critical Accounting Estimates and Judgements

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in this consolidated financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities at reporting date include:

Estimation of oil and gas reserves. Oil and gas reserves are key elements in the Group's investment decision-making process. They are also an important element of testing for impairment. Changes in proved oil and gas reserves, particularly proved developed reserves, will affect unit-of-production depreciation charges in the statement of comprehensive income.

Proved oil and gas reserves are the estimated quantities of crude oil and natural gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e. prices and costs as of the date the estimate is made. Proved developed reserves are reserves that can be expected to be recorded through existing wells with existing equipment and operating methods. Estimates of oil and gas reserves are inherently imprecise, require the application of judgment and are subject to future revision. Accordingly, financial and accounting measures (such as depletion and amortization charges and provision for asset retirement obligations) that are based on proved developed or proved reserves are also subject to change.

3 Critical Accounting Estimates and Judgements (Continued)

Proved reserves are estimated by reference to available reservoir and well information. All proved reserves estimates are subject to revision, either upward or downward, based on new information, such as from drilling and production activities of from changes in economic factors, including product prices, contract terms or development plans. In general, changes in the technical maturity of hydrocarbon reserves resulting from new information becoming available from development and production activities have tended to be the most significant cause of annual revisions.

In general, estimates of reserves for undeveloped or partially developed fields are subject to greater uncertainty over their future life than estimates of reserves for fields that are developed and being depleted. As a field goes into production, the amount of proved reserves will be subject to future revision once additional information becomes available through, for example, the drilling of additional wells or the observation of long-term reservoir performance under producing conditions. As those fields are further developed, new information may lead to revisions.

Proved reserves of SOCAR as of 31 December 2009 were based on reports prepared by independent reservoir engineers in accordance with the Society of Petroleum Engineers rules.

Asset retirement obligations. As further discussed in Note 20, management makes provision for the future costs of decommissioning oil and gas production and storage facilities, pipelines and related support equipment and site restoration based on the estimates of future cost and economic lives of those assets. Estimating future asset retirement obligations is complex and requires management to make estimates and judgements with respect to removal obligations that will occur many years in the future. Changes in the measurement of existing obligations can result from changes in estimated timing, future costs or discount rates used in valuation.

The Group assesses its asset retirement obligation liabilities in accordance with the guidelines of IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. The amount recognized as a provision is the best estimate of the expenditures required to settle the present obligation at the statement of financial position date based on current applicable legislation and regulations, and is also subject to changes because of modifications, revisions and changes in laws and regulations and respective interpretations thereof. Governmental authorities are continually considering applicable regulations and their enforcement. Consequently, the Group's ultimate asset retirement liabilities may differ from the recorded amounts. As a result of the subjectivity of these provisions there is uncertainty regarding both the amount and estimated timing of incurring such costs. Estimated liability of dismantling oil and gas production and storage facilities, including abandonment and site restoration costs, as of 31 December 2009 amounted to AZN 170,727 (2008: AZN 86,201). Changes in any of these conditions may result in adjustments to provisions recorded by the Group.

Management determines discount rates used for discounting abandonment and site restoration costs as a pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability. The discount rate used as at 31 December 2009 was 8.4 per cent (2008: 8 per cent). Management believes that this discount rate appropriately reflected all risks and uncertainties pertaining to oil and gas exploration, evaluation, development and distribution in the Azerbaijan Republic as of the reporting date.

Environmental obligations. As further discussed in Note 21, the Group records a provision in respect of estimated costs of remediation of the damage historically caused to the natural environment primarily in the Absheron area both by the activities of the Group and its legacy operations in periods preceding the formation of the Group. The amount recognized as a provision is the best estimate of the expenditures required to settle the present obligation at the statement of financial position date based on current applicable legislation and regulations, and is also subject to changes because of modifications, revisions and changes in laws and regulations and respective interpretations thereof. Governmental authorities are continually considering applicable regulations and their enforcement. Consequently, the Group's ultimate liability for environmental remediation may differ from the recorded amounts. As a result of the subjectivity of these provisions there is uncertainty regarding both the amount and estimated timing of incurring such costs. Estimated liability for environmental remediation as of 31 December 2009 amounted to AZN 416,544 (2008: AZN 446,925). Changes in any of these conditions may result in adjustments to provisions recorded by the Group.

3 Critical Accounting Estimates and Judgements (Continued)

Management determines discount rate used for discounting environmental remediation costs as pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability as of the reporting date. The discount rate used as at 31 December 2009 was 8.4 per cent (2008: 8 per cent), a nominal rate. Management believes that this discount rate appropriately reflects all risks and uncertainties pertaining to oil and gas exploration, evaluation and development industry in Azerbaijan.

Useful lives of property, plant and equipment and intangible assets. Management determines the estimated useful lives and related depreciation and amortisation charges for its property, plant and equipment and intangible assets. This estimate is based on projected period over which the Group expects to consume economic benefits from the asset. Management will increase the depreciation charge where useful lives are less than previously estimated lives, or it will write-off or write-down technically obsolete assets that have been abandoned or sold. The useful lives are reviewed at least at each financial year-end. Changes in any of the above conditions or estimates may result in adjustments to future depreciation rates.

Deferred income tax asset recognition. The net deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded on the statement of financial position. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future management makes judgements and applies estimation based on last three years taxable profits and expectations of future income that are believed to be reasonable under the circumstances.

Impairment of non-financial assets. Management assesses whether there are any indicators of possible impairment of all non-financial assets at each reporting date based on events or circumstances that indicate the carrying value of assets may not be recoverable. Such indicators include changes in the Group's business plans, changes in commodity prices leading to unprofitable performances, changes in product mixes, and for oil and gas properties, significant downward revisions of estimated proved reserves. Goodwill and other indefinite life intangibles are tested for impairment annually and at other times when impairment indicators exist. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable.

When value in use calculations are undertaken, management estimates the expected future cash flows from the asset or cash generating unit and chooses a suitable discount rate in order to calculate the present value of those cash flows.

In 2009 the Group recognized an impairment of property, plant and equipment for AZN 241,639 (2008: AZN 354,122) in the consolidated statement of comprehensive income (Note12).

Impairment provision for trade receivables. The impairment provision for trade receivables is based on management's assessment of the probability of collection of individual customer accounts receivable. Significant financial difficulties of the customer, probability that the customer will suffer bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the receivable is potentially impaired. Actual results could differ from these estimates if there is deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates.

When there is no expectation of recovering additional cash for an amount receivable, amount receivable is written off against associated provision.

Future cash flows of trade receivables that are evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

4 Adoption of New or Revised Standards and Interpretations and New Accounting Pronouncements

Certain new standards and interpretations became effective for the Group from 1 January 2009:

IFRS 8, Operating Segments. The standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their consolidated financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments, with segment information presented on a similar basis to that used for internal reporting purposes. This amendment had no impact on the consolidated financial statements of the Group.

IAS 1, Presentation of Financial Statements, revised in September 2007. The revised standard separates owner and non-owner changes in equity. The statement of changes in equity includes only details of transactions with owners, with non-owner changes in equity presented in a reconciliation of each component of equity. In addition, the standard introduces the statement of comprehensive income: it presents all items of recognised income and expense, either in one single statement, or in two linked statements. The Group has elected to present a single statement.

IAS 23, Borrowing Costs, revised in March 2007. The main change to IAS 23 is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalise such borrowing costs as part of the cost of the asset. The revised standard applies prospectively to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. The Group's accounting policy prior to the amendment to the standard was to capitalise borrowing costs relating to such assets, and therefore the amendment did not impact the Group's consolidated financial statements.

Improvements to International Financial Reporting Standards (issued in May 2008). In 2008, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The Group does not expect the amendments to have any material effect on its consolidated financial statements.

Puttable Financial Instruments and Obligations Arising on Liquidation—IAS 32 and IAS 1 Amendments. The amendment requires classification as equity of some financial instruments that meet the definition of financial liabilities. The amendment did not have an impact on these consolidated financial statements.

Vesting Conditions and Cancellations—Amendment to IFRS 2, Share-based Payment. The amendment clarifies that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The amendment did not have an impact on these consolidated financial statements.

4 Adoption of New or Revised Standards and Interpretations and New Accounting Pronouncements (Continued)

IFRIC 13, Customer Loyalty Programmes. IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. The amendment did not have an impact on these consolidated financial statements as the customer loyalty incentives are not applicable for the Group.

IFRIC 15, Agreements for the Construction of Real Estate. The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions. The amendment did not have any material impact on these consolidated financial statements.

Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate—IFRS 1 and IAS 27 Amendment. The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying value as deemed cost in the separate consolidated financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss rather than as a recovery of the investment. The amendments did not have an impact on the Group's consolidated financial statements.

Improving Disclosures about Financial Instruments - Amendment to IFRS 7, Financial Instruments: Disclosures, issued in March 2009. The amendment requires enhanced disclosures about fair value measurements and liquidity risk. The entity will be required to disclose an analysis of financial instruments using a three-level fair value measurement hierarchy. The amendment (a) clarifies that the maturity analysis of liabilities should include issued financial guarantee contracts at the maximum amount of the guarantee in the earliest period in which the guarantee could be called; and (b) requires disclosure of remaining contractual maturities of financial derivatives if the contractual maturities are essential for an understanding of the timing of the cash flows. An entity will further have to disclose a maturity analysis of financial assets it holds for managing liquidity risk, if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk. The enhanced disclosures are included in these consolidated financial statements.

Embedded Derivatives - Amendments to IFRIC 9 and IAS 39, issued in March 2009. The amendments clarify that on reclassification of a financial asset out of the 'at fair value through profit or loss' category, all embedded derivatives have to be assessed and, if necessary, separately accounted for. The amendment did not have an impact on these consolidated financial statements.

IFRIC 16, Hedges of a Net Investment in a Foreign Operation. The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied. The IFRIC allows the hedging instrument to be held by any entity or entities within a group except the foreign operation that itself is being hedged. The interpretation also clarifies how the currency translation gain or loss reclassified from other comprehensive income to profit or loss is calculated on disposal of the hedged foreign operation. Reporting entities apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16. IFRIC 16 did not have an impact on these consolidated financial statements.

Unless otherwise stated above, the amendments and interpretations did not have any significant effect on the Group's consolidated financial statements.

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2010 or later periods and which the Group has not early adopted:

4 Adoption of New or Revised Standards and Interpretations and New Accounting Pronouncements (Continued)

IFRIC 17, Distribution of Non-Cash Assets to Owners (effective for annual periods beginning on or after 1 July 2009). The amendment clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss when the entity settles the dividend payable. The Group is currently assessing the impact of the new interpretation on its consolidated financial statements.

IFRIC 18, Transfers of Assets from Customers (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers. IFRIC 18 is not expected to have any significant impact on the Group's consolidated financial statements.

IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments (effective for annual periods beginning on or after 1 July 2010). This IFRIC clarifies the accounting when an entity settles its debt by issuing its own equity instruments. A gain or loss is recognised in profit or loss based on the fair value of the equity instruments compared to the carrying amount of the debt. The Group is currently assessing the impact of the interpretation on its consolidated financial statements.

IAS 27, Consolidated and Separate Financial Statements (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

Eligible Hedged Items—Amendment to IAS 39, Financial Instruments: Recognition and Measurement (effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment is not expected to have any impact on the Group's consolidated financial statements as the Group does not apply hedge accounting.

IFRS 1, First-time Adoption of International Financial Reporting Standards (effective for the first IFRS financial statements for a period beginning on or after 1 July 2009). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The Group concluded that the revised standard does not have any effect on its consolidated financial statements.

4 Adoption of New or Revised Standards and Interpretations and New Accounting Pronouncements (Continued)

IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, goodwill will be measured as the difference at acquisition date between the fair value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

Group Cash-settled Share-based Payment Transactions - Amendments to IFRS 2, Share-based Payment (effective for annual periods beginning on or after 1 January 2010). The amendments provide a clear basis to determine the classification of share-based payment awards in both consolidated and separate financial statements. The amendments incorporate into the standard the guidance in IFRIC 8 and IFRIC 11, which are withdrawn. The amendments expand on the guidance given in IFRIC 11 to address plans that were previously not considered in the interpretation. The amendments also clarify the defined terms in the Appendix to the standard. The Group does not expect the amendments to have any material effect on its consolidated financial statements.
Classification of Rights Issues - Amendment to IAS 32 (issued 8 October 2009; effective for annual periods beginning on or after 1 February 2010). The amendment exempts certain rights issues of shares with proceeds denominated in foreign currencies from classification as financial derivatives.

Improvements to International Financial Reporting Standards (issued in April 2009; amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. The Group does not expect the amendments to have any material effect on its consolidated financial statements.

4 Adoption of New or Revised Standards and Interpretations and New Accounting Pronouncements (Continued)

Amendment to IAS 24, Related Party Disclosures (issued in November 2009 and effective for annual periods beginning on or after 1 January 2011). IAS 24 was revised in 2009 by: (a) simplifying the definition of a related party, clarifying its intended meaning and eliminating inconsistencies; and by (b) providing a partial exemption from the disclosure requirements for government-related entities.

IFRS 9, Financial Instruments Part 1: Classification and Measurement. IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets.

Key features are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
- While adoption of IFRS 9 is mandatory from 1 January 2013, earlier adoption is permitted.

The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

Additional Exemptions for First-time Adopters - Amendments to IFRS 1, First-time Adoption of IFRS (effective for annual periods beginning on or after 1 January 2010). The amendments exempt entities using the full cost method from retrospective application of IFRSs for oil and gas assets and also exempt entities with existing leasing contracts from reassessing the classification of those contracts in accordance with IFRIC 4, 'Determining Whether an Arrangement Contains a Lease' when the application of their national accounting requirements produced the same result. The amendments will not have any impact on the Group's consolidated financial statements.

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Group's consolidated financial statements.

5 Financial Risk Management

Financial risk factors. In the ordinary course of business, the Group is exposed to market risks from fluctuating prices on commodities purchased and sold, prices of other raw materials, currency exchange rates and interest rates. Depending on degree of price volatility, such fluctuations in market prices may create volatility in the Group's financial position. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. To effectively manage the variety of exposures that may impact financial results, the Group's overriding strategy is to maintain a strong financial position. Although there are no structured formal management procedures, management of the Group identifies and evaluates financial risks with reference to the current market position.

5 Financial Risk Management (Continued)

Market risk. Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates, commodity prices and equity prices, will affect the Group's financial results or the value of its holdings of financial instruments. The primary objective of mitigating these market risks is to manage and control market risk exposures, while optimizing the return on risk.

The Group is exposed to market price movements relating to changes in commodity prices such as crude oil, oil condensate, natural gas and oil products (commodity price risk), foreign currency exchange rates, interest rates, equity prices and other indices that could adversely affect the value of the Group's financial assets, liabilities and expected future cash flows.

(i) Foreign exchange risk

The Group is exposed to foreign exchange risk arising from various exposures in the normal course of business, primarily with respect to USD. Foreign exchange risk arises primarily from future commercial transactions, recognised assets and liabilities when assets and liabilities are denominated in a currency other than the functional currency.

The majority of the Group's borrowings and sales as well as receivables from foreign customers are denominated in USD. There has been no significant devaluation of USD against AZN during the year ended 31 December 2009 and 2008. However, due to significant USD denominated borrowings of the Group's subsidiary, STEAŞ, the Group experienced net foreign exchange loss recognised in the statement of comprehensive income of the Group for the year ended 31 December 2009 in the amount of AZN 958 (2008: AZN 407,676).

Management does not hedge the Group's foreign exchange risk.

At 31 December 2009, if the AZN had weakened/strengthened by 10 per cent against the USD with all other variables held constant, after-tax profit for the year ended 31 December 2009 would have been 34,310 lower/higher (2008: AZN 102,141 higher/lower), mainly as a result of foreign exchange gains/losses on translation of USD denominated borrowings, bank balances, trade receivables and trade payables.

(ii) Commodity price risk

Although significant portion of the sales of the Group are regulated by the Azerbaijani Government, the Group is still exposed to certain price risk due to volatility of oil market prices. Presently, the Group does not use commodity derivative instruments for trading purposes to mitigate price volatility.

(iii) Cash flow and fair value interest rate risk

The Group is subject to interest rate risk on financial liabilities with variable interest rates. To mitigate this risk, the Group's management performs periodic analysis of the current interest rate environment and depending on that analysis management makes decisions whether it would be more beneficial to obtain financing on a fixed-rate or variable-rate basis. In case where the change in the current market fixed or variable interest rates is considered significant management may consider refinancing a particular debt on more favorable interest rate terms.

Changes in interest rates impact primarily debt by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group's exposure should be to fixed or variable rates. However, at the time of raising new debts management uses its judgment to decide whether it believes that a fixed or variable rate would be more favorable over the expected period until maturity.

The floating rate for majority of interest bearing liabilities exposes the Group to fluctuation in interest payments and receipts due to changes in LIBOR. At 31 December 2009, if LIBOR had been 10 basis points lower/higher with all other variables held constant, post-tax profit would have been AZN 977 (2008: AZN 8,743 – change in LIBOR by 100 basis points had been used) higher/lower.

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

5 Financial Risk Management (Continued)

The Group's variable interest bearing assets include loan receivable from Carlina Overseas Corp., a jointly controlled entity, which exposes the Group to fluctuation in LIBOR. If LIBOR had been 10 basis points lower/higher with all other variables held constant, post-tax profit for the year ended 31 December 2009 would have been AZN 156 (2008: AZN 7,928 – change in LIBOR by 100 basis points had been used) lower/higher.

Credit risk and concentration of credit risk. Credit risk refers to the risk exposure that a potential financial loss to the group may occur if counterparty defaults on its contractual obligations.
The Group's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, including restricted cash, trade receivables and loans receivable.

The Group's maximum exposure to credit risk is represented by carrying amounts of financial assets and is presented by class of assets as shown in the table below:

	2009	2008
Cash and cash equivalents (Note 7)	698,600	520,170
Restricted cash (Note 8)	128,750	97,898
Trade receivables, net (Note 9)	1,585,633	1,270,328
Other receivables	131,540	118,780
Receivable from jointly-controlled entity (Note 16)	311,891	301,855
Deposits (Note 8)	873,169	534,183
Total exposure on statement of financial position	**3,729,583**	**2,843,214**
Financial guarantees–amounts of guarantees of indebtedness of others	(200,268)	(164,606)
Total maximum exposure to credit risk	**3,529,315**	**2,678,608**

The Group places its cash with reputable financial institutions in the Azerbaijan Republic. Overwhelming majority of the Group's cash is placed with the International Bank of Azerbaijan ("IBA") which is controlled by the Government. The balance of cash and cash equivalents and restricted cash held with the IBA at 31 December 2009 was AZN 1,200,072 (2008: AZN 844,242). The Group continually monitors the status of the banks where its accounts are maintained.

Trade receivables consist primarily of balances with local and foreign customers, including related parties, for crude oil, oil products and natural gas sold. SOCAR has an obligation to secure uninterrupted supply of crude oil, oil products and natural gas to certain customers under control of the Government, including such companies as Azerenerji JSC and Azal JSC operating important public infrastructure facilities in the Azerbaijan Republic. Actual settlement terms applicable to the Group's relationships with these customers are affected to a large extent by the social and economic policies of the Government. The Group's credit risk arising from its trade balance with private sector and other third-party unrelated customers is mitigated by continuous monitoring of their creditworthiness. The Group does not believe that it is exposed to high credit risk as far as the existing debtors are concerned beyond the impairment provision amounts already accrued in the accompanying consolidated financial statements.

As at 31 December 2009, letters of guarantee in the amount of AZN 200,268 (YTL 376,797,795) (2008: AZN 164,606 (YTL 312,404,610) were received from domestics and foreign customers of STEAŞ for sales of thermoplastics and fiber materials.

As more fully described in Note 16, at 31 December 2009 the Group has receivable from SOCAR Petroleum in the amount of AZN 8,749 and a loan receivable of AZN 349,963 (31 December 2008: AZN 329,889) due from Carlina Overseas Corp., a jointly controlled entity offset against Group's share in losses of Carlina Overseas Corp that exceeds the Group's interest in Carlina Overseas Corp. in the amount of AZN 46,821 (2008: AZN 28,034). In accordance with the Share Pledge and Retention Agreement dated 28 December 2006 and Share Charge and Retention Agreement dated 12 April 2007 between the other owners of Carlina Overseas Corp. and the Group's subsidiary Azerbaijan (ACG) Limited ("AzACG"), the other owners of Carlina Overseas Corp. pledged in favour of AzACG all of their rights and interest in all proceeds and funds received or receivable by Carlina Overseas Corp. and all of their shares and any other equity interests in Carlina Overseas Corp.

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

5 Financial Risk Management (Continued)

Balances with major state-controlled and private and other category customers are as follows:

	Trade receivables, gross		Impairment loss provision		Trade receivables, net	
	2009	**2008**	**2009**	**2008**	**2009**	**2008**
State-controlled customers						
Azerenerji JSC	1,279,498	1,215,381	(1,251,184)	(1,027,912)	28,314	187,469
Azerigaz PU	-	871,055	-	(820,693)	-	50,362
Azal	195,469	142,199	(154,108)	(138,541)	41,361	3,658
Ethylene Plant	74,917	73,734	(74,917)	(73,734)	-	-
Other	184,822	750,225	(19,294)	(180,367)	165,528	569,858
Total state-controlled customers	**1,734,706**	**3,052,594**	**(1,499,503)**	**(2,241,247)**	**235,203**	**811,347**
Private and other customers	**1,583,666**	**799,091**	**(101,696)**	**(221,329)**	**1,481,970**	**577,762**
Total trade receivables and other receivables without prepayments and taxes	**3,318,372**	**3,851,685**	**(1,601,199)**	**(2,462,576)**	**1,717,173**	**1,389,109**

Liquidity risk. Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. In managing liquidity risk, the Group maintains adequate cash reserves and debt facilities, continuously monitors forecast and actual cash flows.

Prudent liquidity risk management includes maintaining sufficient working capital and the ability to close out market positions. Management monitors rolling forecasts of the Group's liquidity reserve on the basis of expected cash flows.

All of the Group's financial liabilities represent non-derivative financial instruments. The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period from the statement of financial position date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months approximate their carrying values, as the impact of discounting is not significant.

At 31 December 2009	**less than 3 months**	**3-12 months**	**1-5 years**	**more than 5 years**	**Total**
Total financial payables	2,122,994	-	-	-	2,122,994
Interest bearing borrowings	120,632	387,820	2,136,333	595,430	3,240,215
Total future payments, including future principal	**2,243,626**	**387,820**	**2,136,333**	**595,430**	**5,363,209**

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

5 Financial Risk Management (Continued)

The maturity analysis of financial liabilities as of 31 December 2008 is as follows:

At 31 December 2008	less than 3 months	3-12 months	1-5 years	more than 5 years	Total
Total financial payables	997,592	-	-	-	997,592
Interest bearing borrowings	238,375	212,763	1,623,030	330,820	2,404,988
Total future payments, including future principal and interest payments	**1,235,967**	**212,763**	**1,623,030**	**330,820**	**3,402,580**

Capital management. The primary objective of the Group's capital management policy is to ensure a strong capital base to fund and sustain its business operations through prudent investment decisions and to maintain government, investor and creditor confidence to support its business activities.

The Group considers total capital under management to be as follows:

	2009	2008
Total borrowing	2,851,974	2,110,853
Total equity attributable to the Group's equity holders	7,258,252	6,739,241
Less: cash and cash equivalents	(698,600)	(520,170)
Total capital under management	**9,411,626**	**8,329,924**

The Group is occasionally mandated to contribute to the state budget and financing of various projects undertaken by the Government of the Azerbaijan Republic.

There were no changes to the Group's approach to capital management during the year.

Fair value of financial instruments. The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. The Azerbaijan Republic continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may be outdated or reflect distress sale transactions and therefore not represent fair values of financial instruments. Management has used all available market information in estimating the fair value of financial instruments.

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other 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.

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

5 Financial Risk Management (Continued)

As at 31 December 2009, the Group measured the provision for asset retirement obligations of its associates, environmental obligations and disability payments at fair value. The following table shows an analysis of its associates financial instrument recorded at fair value by level of the fair value hierarchy:

Year ended 31 December 2009	Level 1	Level 2	Level 3	Total
Asset Retirement Obligations (per ACG and SD PSA)	-	-	106,851	106,851
Environmental obligations	-	-	416,544	416,544
Disability payments	-	-	39,421	39,421
	-	-	562,816	562,816

Refer to Note 20 for description of the determination of fair value for asset retirement obligations and Note 21 for environmental obligations and disability payments as well as for reconciliation of opening and closing balances.

Impact on fair value of level 3 financial instruments measured at fair value of changes to key assumptions

The following table shows the maximum impact on the fair value of level 3 instruments of using reasonably possible alternative assumptions:

	31 December 2009	
	Carrying amount	Effect of reasonably possible alternative assumptions Increase/(decrease)
Asset Retirement Obligations (per ACG and SD PSA)	106,851	56,110 / (35,433)
Environmental obligations	416,544	31,148 / (27,872)
Disability payments	39,421	29,567 / (13,873)

In order to determine reasonably possible alternative assumptions the Group adjusted key unobservable inputs as follows: increase / decrease of discount rate by 3 per cent and increase / decrease of long-term inflation rate by 1 per cent.

(i) Financial assets carried at amortised cost. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on credit risk of the counterparty. Carrying amounts of trade receivables approximate fair values due to their short-term maturities.

(ii) Liabilities carried at amortised cost. Carrying amounts of trade payables and due to related parties approximate fair values due to their short-term maturities. Carrying values of long-term borrowings approximate their fair values as virtually all debt has been obtained under market conditions, which were still applicable at period end.

6 Balances and Transactions with Related Parties

Key management compensation. Key management of the Group includes the President of SOCAR and its eight Vice-Presidents. All of the Group's key management are appointed by the President of the Azerbaijan Republic. Key management individuals are entitled to salaries and benefits of SOCAR in accordance with the approved payroll matrix as well as to compensation for serving as members of the Boards of directors for certain Group companies. During 2009 compensation of key management personnel totaled to AZN 168 (2008: AZN 183).

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

6 Balances and Transactions with Related Parties (Continued)

The nature of the related party relationships for those related parties with whom the Group entered into significant transactions or had significant balances outstanding are detailed below.

At 31 December 2009, the outstanding balances with related parties were as follows:

	Note	The government and entities under government control	Associates and joint ventures
Gross amount of trade receivables		1,734,706	818,730
Impairment provisions for trade and other receivables		(1,148,284)	-
Cash and cash equivalents		495,933	-
Deposit and restricted cash		890,499	-
VAT and other taxes receivable		338,971	-
Prepayment for corporate income tax		3,628	-
Receivable from a jointly controlled entity	16	-	311,891
Borrowings from IBA (contractual interest rates varying from LIBOR plus 2 per cent to LIBOR plus 3 per cent)		-	(868,303)
Trade and other payables		(63,780)	(198,980)
Payable to State Oil Fund of Azerbaijan Republic (SOFAZ)		(1,139,186)	-
Other taxes payable		(298,431)	-
Corporate income tax payable		(51,856)	-
Fair value of net assets of associates acquired	15	-	301
Fair value of net assets of jointly controlled entities acquired	14	-	18,920

The income and expense items with related parties for the year ended 31 December 2009 were as follows:

		The government and entities under government control	Associates and joint ventures
Sales of natural gas		298,809	25
Sales of oil products		231,336	85,178
Services rendered		29,094	39,480
Corporate income tax		(285,010)	-
Excise tax		(362,209)	-
Price margin tax		(50,360)	-
Mining tax		(122,861)	-
Other taxes		(248,087)	-
Utilities costs		(52,761)	(3,194)
Other operating expenses		(94,671)	(173,898)
Social security deductions		(79,692)	-
Transportation expenses		(15,588)	-
Purchases of property, plant and equipment and inventory		(57,116)	(99,438)
Share of after tax results of jointly controlled entities	14	-	(12,887)
Dividends received from jointly controlled entities	14	-	(6,178)
Share of after tax results of associates	15	-	89,854
Dividends received from associates	15	-	(58,481)

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

6 Balances and Transactions with Related Parties (Continued)

At 31 December 2008, the outstanding balances with related parties were as follows:

	Note	The government and entities under government control	Associates and joint ventures
Gross amount of trade receivables		3,037,844	14,750
Impairment provisions for trade and other receivables		(2,235,963)	(5,284)
Cash and cash equivalents		465,882	-
Deposit and restricted cash		534,183	-
VAT and other taxes receivable		257,230	-
Prepayment for corporate income tax		12,187	-
Receivable from a jointly controlled entity	16	-	301,855
Corporate income tax payable		152,956	-
Borrowings from IBA (contractual interest rates varying from LIBOR plus 2 per cent to LIBOR plus 3 per cent)		655,850	-
Payable to State Oil Fund of Azerbaijan Republic (SOFAZ)		122,981	-
Trade and other payables		440,917	53,877
Other taxes payable		90,225	-
Fair value of net assets of associates acquired	15	-	17
Fair value of net assets of jointly controlled entities acquired	14	-	14,064

The income and expense items with related parties for the year ended 31 December 2008 were as follows:

		The government and entities under government control	Associates and joint ventures
Sales of natural gas		342,217	-
Sales of oil products		141,211	9,444
Construction contract revenue		-	3,682
Sales of crude oil		-	-
Services rendered		11,630	5,162
Operational lease income		-	271
Other operating income		19,847	22,177
Corporate income tax		570,595	-
Excise tax		367,266	-
Price margin tax		108,110	-
Mining tax		126,748	-
Utilities costs		93,569	574
Other operating expenses		109,669	54,437
Social security deductions		76,138	-
Transportation expenses		31,407	3,240
Purchases of property, plant and equipment		3	85,427
Share of after tax results of jointly controlled entities	14	-	1,875
Dividends received from jointly controlled entities	14	-	(6,714)
Share of after tax results of associates	15	-	70,542
Dividends received from associates	15	-	(35,102)

Terms and conditions of transactions with related parties. The sales to and purchases from related parties are made at market prices regulated by the Government. Outstanding balances at the year-end are unsecured and settlement occurs in cash. There have been no guarantees provided or receivable for any related party receivables or payables, except for guarantee received for receivable from a jointly-controlled entity which is more fully discussed in Note 16.

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

7 Cash and Cash equivalents

	2009	**2008**
USD denominated bank balances	544,065	378,273
AZN denominated bank balances	83,055	71,272
EUR denominated bank balances	36,848	41,177
YTL denominated bank balances	28,267	24,219
Other denominated bank balances	4,660	4,902
Cash on hand	1,705	327
Total cash and cash equivalents	**698,600**	**520,170**

Included in USD denominated bank balances as at 31 December 2009 are two call deposits of AZN 112,434 and AZN 214,469 placed with IBA (2008: AZN 120,150 and AZN 181,607, respectively). The interest rate on these deposits during the years ended 31 December 2009 and 2008 is 3.5 per cent per annum.

Term deposits have original maturities of less than three months. All the bank balances and term deposits are neither past due nor impaired.

8 Restricted Cash and Deposits

	2009	**2008**
Deposit account with IBA in USD	873,169	534,183
Current accounts with BNP Paribas in USD	60,233	24,883
Letter of credit for purchase of fixed assets	21,210	5,253
Funds held on Lalaben account with BNP Paribas in USD	14,673	8,230
Funds held on Caspian King account with Societe Generale in USD	-	36,417
Restricted account with IBA in USD	-	8,302
Funds held on SOCAR Energy Georgia account with Bank of Georgia	-	7,743
Other restricted cash	32,634	7,070
Total restricted cash and deposits	**1,001,919**	**632,081**

Deposits
As discussed in Note 18, SOCAR maintains a AZN 873,169 deposit with IBA as at 31 December 2009 (2008: AZN 534,183) to collateralize the Group's obligations to IBA under the loan facility obtained from IBA in May 2008. The deposit bears interest at an annual rate of LIBOR plus 2 per cent.

Restricted cash
Current accounts with BNP Paribas are used to accumulate proceeds received by the Group from its customers from the sales of cost recovery petroleum in accordance with the relevant Accounts Agreement signed between AzACG, BNP Paribas and Societe Generale ("SG") on 23 December 2005 and syndication credit agreement signed with BNP Paribas. In accordance with this agreement, disbursements from the Group's current account with BNP Paribas are limited mainly to the expenditures related to the Group's participation in Azeri-Chirag-Guneshli ("ACG") PSA.

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

8 Restricted Cash and Deposits (Continued)

Funds held on Lalaben account represent proceeds received directly from customers of the Group from the sale of the Reserved Profit Petroleum (7,000 barrels of profit petroleum per day attributable to the Group) on the Group's account with BNP Paribas. In accordance with Advance Payment Agreement with Lalaben LLC ("Lalaben") the Group uses these proceeds from crude oil sales to repay Lalaben loan. The funds held on Lalaben account with BNP Paribas under the terms of the respective agreements, are limited to the following payments:

- profit petroleum tariffs;
- operating expenses; and
- profit taxes.

As discussed in Note 33 the Group fully repaid Lalaben loan subsequent to year-end 2009.

On 18 December 2008 the Group signed an Asset Purchase Agreement with Caspian King Ltd. in accordance with which the financing facility was provided to the Group in the amount of USD 100 millions (AZN 80,199). According to the terms of this agreement all proceeds from the sale of the applicable condensate and applicable gas (petroleum) are transferred by customers directly to the Caspian King Ltd.'s current account with SG, until the Group's obligations to the Caspian King Ltd. under this agreement are fully settled.

9 Trade and Other Receivables

	2009	2008
Trade receivables	3,186,832	3,732,904
Less impairment loss provision	(1,601,199)	(2,462,576)
Total trade receivables	**1,585,633**	**1,270,328**
VAT recoverable	295,706	230,475
Prepayments	97,005	46,686
Other tax receivable	19,890	292
Other receivables	131,540	118,781
Total trade and other receivables	**2,129,774**	**1,666,562**

Trade receivables mainly represent receivables for crude oil, oil products and natural gas sold to customers of the Group.

At 31 December 2009 trade receivables and other receivables in the amount of AZN 1,592,612 (2008: AZN 378,973) were denominated in foreign currencies, mainly in USD.

Trade receivables of AZN 1,601,199 (2008: AZN 2,462,576) were impaired and provided for in full. These impaired receivables mainly relate to overdue debts (in excess of 360 days) for oil, natural gas and oil products supplied primarily to state-owned entities. There are no other past due receivables.

VAT recoverable relates to purchases which have not been settled at the statement of financial position date. VAT recoverable is reclaimable against VAT on sales upon payment for the purchases.

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

9 Trade and Other Receivables (Continued)

Movements on the provision for impairment of trade receivables are as follows:

	2009	2008
At 1 January	**2,462,576**	**2,307,678**
Receivables written off during the year as uncollectible	(337,706)	(27,037)
Additional provision provided during the year (Note 25)	297,022	181,935
Gain on settlement of pre-existing business relationship with Azerigaz PU (Note 26)	(820,693)	-
At 31 December	**1,601,199**	**2,462,576**

Before the business combination with Azerigaz CJSC (Note 32) the Group recognized impairment loss provision for receivables from Azerigaz CJSC as of 31 December 2008 in the amount of AZN 820,693. As a result of acquisition of Azerigaz CJSC, inter-company balances with Azerigaz PU, the successor of Azerigaz CJSC, were eliminated as at 31 December 2009 and consequently, related impairment provision for inter-company receivable in the amount of AZN 820,693 was reversed and credited to the consolidated statement of comprehensive income.

10 Inventories

	2009	2008
Raw materials and spare parts	455,036	476,010
Finished goods	95,973	41,497
Work in progress	55,606	35,310
Crude oil	51,151	20,061
Goods in transit	37,353	18,953
Other	12,339	8,766
Total inventories	**707,458**	**600,597**

11 Other long-term assets

At 31 December 2009 other long-term assets were represented by long-term prepayments for purchase of property, plant and equipment and materials in the amount of AZN 231,263 (2008: AZN 127,985) and loan receivable from third party in the amount of AZN 85,000 (2008: nil) bearing the annual interest rate of LIBOR plus four percent and with the maturity date of September 30, 2015. The loan and principal are payable on a quarterly basis. This loan is secured by the 340 shares out of total 514 shares of the borrower.

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

12 Property, Plant and Equipment

Movements in the carrying amount of property, plant and equipment ("PPE") were as follows:

	Buildings and constructions	Oil and gas properties and equipment	Plant and machinery	Vessels	Other	Construction in progress	Total
Cost:							
At 1 January 2008	**964,196**	**3,397,954**	**719,452**	**204,607**	**118,607**	**493,736**	**5,898,552**
Additions	50,674	557,758	90,527	24,238	48,693	344,093	**1,115,983**
Acquisition through business combination	88,531	-	1,342,794	-	876,696	16,486	**2,324,507**
Disposals	(11,016)	(22,704)	(12,350)	(208)	(7,169)	(89,619)	**(143,066)**
Transfers	(14,927)	99,560	(105,041)	485	18,450	1,473	**-**
Translation to presentation currency	(21,023)	(69,631)	(298,506)	-	(201,023)	(15,574)	**(605,757)**
At 31 December 2008	**1,056,435**	**3,962,937**	**1,736,876**	**229,122**	**854,254**	**750,595**	**8,590,219**
Additions	14,678	450,794	97,044	25,304	38,791	509,100	**1,135,711**
Acquisition through business combination	200,619	491,753	35,235	-	4,280	55,157	**787,044**
Disposals	(47,305)	(25,488)	(26,521)	(97)	(4,618)	(8,818)	**(112,847)**
Transfers	(107,929)	355,207	89,685	81	7,955	(344,999)	**-**
Translation to presentation currency	4,885	2,586	7,413	-	5,795	(6,525)	**14,154**
At 31 December 2009	**1,121,383**	**5,237,789**	**1,939,732**	**254,410**	**906,457**	**954,510**	**10,414,281**
Depreciation and impairment:							
At 1 January 2008	(168,738)	(309,916)	(103,562)	(16,287)	(73,902)	(63,762)	**(736,167)**
Depreciation charge for the year	(62,865)	(271,096)	(152,715)	(29,297)	(26,146)	-	**(542,119)**
Impairment	(13)	(191,038)	(5,576)	-	-	(157,495)	**(354,122)**
Disposals	3,541	2,818	5,843	150	3,904	-	**16,256**
Transfers	3,765	(48,478)	51,024	(148)	(6,163)	-	**-**
At 31 December 2008	**(224,310)**	**(817,710)**	**(204,986)**	**(45,582)**	**(102,307)**	**(221,257)**	**(1,616,152)**
Depreciation charge for the year	(67,476)	(361,879)	(179,842)	(28,456)	(25,168)	-	**(662,821)**
Disposals	26,341	10,335	14,621	97	1,186	307	**52,887**
Transfers	6,181	(68,313)	3,183	(37)	(8,253)	67,239	**-**
Impairment	(158)	(127,687)	(2,345)	(13,000)	-	(98,449)	**(241,639)**
At 31 December 2009	**(259,422)**	**(1,365,254)**	**(369,369)**	**(86,978)**	**(134,542)**	**(252,160)**	**(2,467,725)**
Net book value:							
At 1 January 2008	**795,458**	**3,088,038**	**615,890**	**188,320**	**44,705**	**429,974**	**5,162,385**
At 31 December 2008	**832,125**	**3,145,227**	**1,531,890**	**183,540**	**751,947**	**529,338**	**6,974,067**
At 31 December 2009	**861,961**	**3,872,535**	**1,570,363**	**167,432**	**771,915**	**702,350**	**7,946,556**

Included in the disposed property, plant and equipment as of 31 December 2009 were assets with net book value of AZN 43,451 (2008: AZN 55,295) which were transferred to governmental entities as part of social program approved by the Government and recognized in the withdrawals of government (See Note 23).

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

12 Property, Plant and Equipment (Continued)

Capitalised interest included in oil and gas properties as of 31 December 2009 amounted to AZN 828 (2008: AZN 11,906). The capitalization rates used during 2009 to determine the amount of borrowing costs eligible for capitalization were in the range from LIBOR plus 2 per cent p.a. to LIBOR plus 3 per cent p.a. (2008: LIBOR plus 2 per cent p.a. to LIBOR plus 3 per cent p.a.).

13 Intangible Assets

The movement of intangible assets and related accumulated amortisation for the year ended 31 December 2008 was as follows:

	Land and Property rights	Water rights	Trade name	Customer relationships	Other intangible assets	Total
Carrying amount at 1 January 2008	**-**	**-**	**-**	**-**	**4,460**	**4,460**
Acquisitions through business combinations (Note 32)	216,424	259,666	49,676	131,316	1,887	**658,969**
Additions	-	-	-	-	7,219	**7,219**
Amortisation charge	(2,578)	(2,874)	-	(3,106)	(1,941)	**(10,499)**
Translation difference	(49,043)	(58,872)	(11,337)	(29,550)	(604)	**(149,406)**
Carrying amount at 31 December 2008	**164,803**	**197,920**	**38,339**	**98,660**	**11,021**	**510,743**

The movement of intangible assets and related accumulated amortisation for the year ended 31 December 2009 was as follows:

	Land and Property rights	Water rights	Trade name	Customer relationships	Other intangible assets	Total
Carrying amount at 1 January 2009	**164,803**	**197,920**	**38,339**	**98,660**	**11,021**	**510,743**
Additions	-	-	-	-	20,151	**20,151**
Amortisation charge	(3,769)	(4,203)	-	(3,770)	(2,002)	**(13,744)**
Translation difference	1,351	1,630	335	755	16	**4,087**
Carrying amount at 31 December 2009	**162,385**	**195,347**	**38,674**	**95,645**	**29,186**	**521,237**

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

13 Intangible Assets (Continued)

During 2009, total amortization expense amounting to AZN 13,744 (2008: AZN 10,499) have been allocated to cost of sales by AZN 6,910, marketing (2008: AZN 5,452), selling and distribution expenses by AZN 4,395 (2008: AZN 3,150) and general administrative expenses by AZN 2,439 (2008: AZN 1,897).

14 Investments in Jointly Controlled Entities

The table below summarises the movements in the carrying amount of the Group's investment in jointly controlled entities.

	Note	2009	2008
Carrying amount at 1 January		**113,685**	**75,724**
Fair value of net assets of jointly controlled entities acquired	6	18,920	14,064
Share of after tax results of jointly controlled entities	6	(12,887)	1,875
Dividends received from jointly controlled entities	6	(6,178)	(6,714)
Loss offset with receivables from jointly controlled entity		18,788	28,034
Derecognition of jointly controlled entities		(39,114)	-
Exchange differences		(78)	702
Other		9,925	-
Carrying amount at 31 December		**103,061**	**113,685**

On 1 July 2009, Caspian Drilling Company (CDC) repurchased 45 per cent of outstanding shares held by the other investor and the Group effectively became the sole owner of CDC. Accordingly, CDC is classified as subsidiary effective from 1 July 2009. In October 2009 Anshad Petrol and Shirvan Oil were closed.

At 31 December 2009, the Group's interests in its principal jointly controlled entities and their summarised aggregate financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Total assets	Total liabilities	Revenue	Profit/ (loss)	% interest held	Country of incorporation
Carlina Overseas Corp.	215,724	374,991	18,812	(23,572)	51%	British Virgin Islands
Azgerneft	33,543	11,920	18,530	3,080	40%	Azerbaijan
Azeri Fugro	802	404	886	(18)	60%	Azerbaijan
Azfen	24,284	10,644	25,371	128	60%	Azerbaijan
Bosshelf LLC	8,621	8,417	9,576	54	50%	Azerbaijan
Azturqaz	1,239	827	732	(129)	50%	Azerbaijan
Caspian Offshore Fabricators	1,137	104	571	(15)	50%	Azerbaijan
Azeri M.I. Drilling Fluids	43,821	33,541	68,215	6,654	51%	Azerbaijan
SOCAR – KPS	613	545	3,269	(37)	50%	Azerbaijan
Oil and Gas Proservice	2,416	213	3,244	1,509	30%	Azerbaijan
Ekol Engineering Services	11,618	8,608	9,509	278	51%	Azerbaijan
Caspian Shipyard Company	19,976	721	52,812	10,556	20%	Azerbaijan
Energy Solutions Group	62	507	-	(15)	51%	Azerbaijan
Socar Petroleum CJSC	34,738	13,997	81,928	144	51%	Azerbaijan
SOCAR-UGE	12,729	242	-	(1,405)	97%	Azerbaijan
SOCAR Umid	10,353	2,165	-	(204)	80%	Azerbaijan
Sarmatia	451	290	79	(1,524)	25%	Poland
SOCAR Baglan LLC	-	-	-	-	51%	Azerbaijan
SOCAR AQS	114,148	40,262	118,468	46,530	51%	Azerbaijan
Total	**536,275**	**508,398**	**412,002**	**42,014**		

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

14 Investments in Jointly Controlled Entities (Continued)

At 31 December 2008, the Group's interests in its principal jointly controlled entities and their summarised aggregate financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Total assets	Total liabilities	Revenue	Profit/ (loss)	% interest held	Country of incorporation
Carlina Overseas Corp.	199,522	348,297	10,256	(54,967)	51%	British Virgin Islands
Anshad Petrol	32,995	1,984	15,905	2,834	51%	Azerbaijan
Azgerneft	25,421	6,879	22,726	7,997	40%	Azerbaijan
Shirvan Oil	58,353	7,515	42,421	2,254	49%	Azerbaijan
Azeri Fugro	903	477	6,331	89	60%	Azerbaijan
Azfen	25,064	4,304	46,781	(2,806)	60%	Azerbaijan
Bosshelf LLC	6,021	5,109	15,591	744	50%	Azerbaijan
Azturqaz	1,382	646	957	32	50%	Azerbaijan
Caspian Offshore Fabricators	1,731	684	2,554	626	50%	Azerbaijan
Azeri M.I. Drilling Fluids	63,236	48,717	114,927	10,996	51%	Azerbaijan
SOCAR - KPS	939	834	6,881	70	50%	Azerbaijan
Oil and Gas Proservice	181	232	990	526	34%	Azerbaijan
Ekol Engineering Services	11,935	9,204	16,887	911	51%	Azerbaijan
Caspian Shipyard Company	22,618	7,525	63,318	10,288	20%	Azerbaijan
Energy Solutions Group	64	505	-	(16)	51%	Azerbaijan
Sarmatia	1,884	271	100	(242)	25%	Poland
Caspian Drilling Company	28,945	7,746	40,625	6,968	55%	Azerbaijan
SOCAR AQS	58,452	25,455	48,623	28,331	51%	Azerbaijan
Total	**539,646**	**476,384**	**455,873**	**14,635**		

Carrying value of the Group's investments in Carlina Overseas Corp. and Energy Solutions Group is nil both at 31 December 2009 and 2008.

15 Investments in Associates

The table below summarises the movements in the carrying amount of the Group's investment in associates.

	Note	2009	2008
Carrying amount at 1 January		**292,732**	**265,509**
Fair value of net assets of associates acquired	6	301	17
Share of after tax results of associates	6	89,854	70,542
Dividends received from associates	6	(58,481)	(35,102)
Derecognition of associates		(948)	-
Exchange differences		(8,105)	(8,234)
Carrying amount at 31 December		**315,353**	**292,732**

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

15 Investments in Associates (Continued)

At 31 December 2009, the Group's interests in its principal associates and their summarised aggregate financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Total assets	Total liabilities	Revenue	Profit/ (loss)	% interest held	Country of incorporation
Azerbaijan BTC Ltd	710,130	52,815	266,223	241,033	23%	Cayman Islands
Caspian Geophysical	3,923	1,926	8,891	1,916	45%	Azerbaijan
AzLab	914	237	741	154	50%	Azerbaijan
Azerbaijan John Brown	65	8	236	(39)	40%	Azerbaijan
Cross Caspian Oil and Gas Logistics	5,290	5,208	65,493	(176)	34%	Azerbaijan
SOCAR – ASM	8,353	7,814	30,309	118	30%	Azerbaijan
Ateshgah Insurance Company	18,646	11,905	14,359	870	10%	Azerbaijan
Caspian Pipe Coatings LLC	7,482	677	795	(2,232)	50%	Azerbaijan
Supra Holding	1,489,456	1,387,350	8,359,374	49,777	50%	Malta
South Caspian Pipeline Company	1,096,686	66,891	169,173	107,986	9.8%	Cayman Islands
South Caspian Pipeline Company Holding Company	21,091	614	1,403	1,370	10%	Cayman Islands
Total	**3,362,036**	**1,535,445**	**8,916,997**	**400,777**		

At 31 December 2008, the Group's interests in its principal associates and their summarised aggregate financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Total assets	Total liabilities	Revenue	Profit/ (loss)	% interest held	Country of incorporation
Azerbaijan BTC Ltd	653,711	33,948	180,981	160,751	22.56%	Cayman Islands
Caspian Geophysical	9,541	2,817	12,950	4,549	45%	Azerbaijan
AzLab	864	271	837	(18)	50%	Azerbaijan
Cross Caspian Oil and Gas Logistics	5,308	5,208	42,201	(262)	34%	Azerbaijan
SOCAR – ASM	4,492	4,034	18,382	116	30%	Azerbaijan
Azerineftgaztikinti	348	296	2,751	(10)	25%	Azerbaijan
Ateshgah Insurance Company	16,440	(11,512)	17,203	170	10%	Azerbaijan
Azeri Drilling Company	51,025	54,449	23,763	2,709	35%	Azerbaijan
Caspian Pipe Coatings LLC	9,601	593	8,027	(742)	50%	Azerbaijan
Supra Holding	277,820	226,122	8,381,847	49,351	50%	Malta
South Caspian Pipeline Company	1,125,796	(50,102)	155,694	49,917	9.8%	Cayman Islands
South Caspian Pipeline Company Holding Company	22,040	(779)	1,035	1,007	10%	Cayman Islands
Total	**2,176,986**	**265,345**	**8,845,671**	**267,538**		

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

16 Receivable from Jointly Controlled Entity

Receivable from jointly controlled entity represents receivable balance from SOCAR Petroleum in the amount of AZN 8,749 (2008: nil) and a loan provided by the Group to Carlina Overseas Corp. in accordance with terms of the loan agreement signed on 28 December 2006 between Carlina Overseas Corp. and AzACG. Outstanding balance of the receivable as of 31 December 2009 comprised AZN 349,963 (2008: AZN 329,889) offset against Group's share in losses of Carlina Overseas Corp. that exceeds the Group's interest in Carlina Overseas Corp. in the amount of AZN 46,821 (2008: AZN 28,034). The loan bears an annual interest rate of LIBOR plus 2.5 per cent payable on a quarterly basis. The maturity date of the loan is 28 December 2014. In accordance with the Share Pledge and Retention Agreement dated 28 December 2006 and Share Charge and Retention Agreement dated 12 April 2007 between the other owners of Carlina Overseas Corp. and AzACG, the other owners of Carlina Overseas Corp. pledged in favour of AzACG all of their rights and interest in all proceeds and funds received or receivable by Carlina Overseas Corp. and all of their shares and any other equity interests in Carlina Overseas Corp. Management of the Group believes that the value of the collateral provides an adequate security for this receivable.

Under the terms of the loan agreement, if Carlina fails to repay accrued interest at the end of quarter interest is charged at default rate of LIBOR + 4.5 per cent.

Receivable from Carlina Overseas Corp. is past due as no interest payments have been received by the Group from Carlina Overseas Corp. as of 31 December 2009 and 2008. As a result, default interest rate of LIBOR plus 4.5 per cent was charged on the unpaid principal loan balance during 2009 and 2008. The receivable is not considered impaired as management of the Group believes that they will be able to recover the value of this loan in full.

17 Trade and Other Payables

	2009	2008
Trade payables	1,604,814	900,911
Accrued liabilities	289,195	96,681
Total financial payables	**1,894,009**	**997,592**
Liabilities for overlift of oil	120,453	47,326
Advances from customers	31,603	53,732
Payable to employees	41,690	45,875
Total trade and other payables	**2,087,755**	**1,144,525**

Trade payables of AZN 1,513,741 (2008: AZN 493,649) are denominated in foreign currencies, mainly in USD. Trade payables mainly represent payables for drilling, transportation and utilities provided by vendors of the Group.

Accrued liabilities represent Group's share in the respective accrued liabilities reported by the operators of ACG PSA and Shah Deniz PSA.

Liabilities for overlift relate to the oil lifted by the Group in excess of its participating interest in ACG PSA and Shah Deniz PSA and thus, represent the Group's obligation to deliver physical quantities of oil out of its share of future production.

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

18 Borrowings

	2009	2008
Short-term borrowings		
Xalqbank loan	93,002	62,000
Deutsche Bank loan	64,248	-
Viani loan	-	180,881
Caspian King Ltd. loan	-	80,199
Akbank T.A.Ş loan	28,010	-
Turkiye Garanti Bankasi A. Ş loan	16,005	-
International Bank of Azerbaijan loan	16,065	27,696
Accrued interest payable	16,773	20,546
Current portion of long-term borrowings	147,094	21,578
Prepaid borrowing commission	(1,396)	(1,384)
Other short-term borrowings	8,279	16,454
Total short-term borrowings and current portion of long-term borrowings	**388,080**	**407,970**
Long-term borrowings		
International Bank of Azerbaijan loans	1,727,598	628,154
Akbank T.A.Ş/Turkiye Garanti Bankasi A. Ş loan	500,175	498,019
ABN Amro/Citibank loan	163,297	489,468
Japan Bank for International Cooperation (JBIC) loan	132,403	-
Lalaben loan	49,454	115,866
Natixis S.A loan	24,093	-
International Development Association (IDA) loan	6,926	-
Other long-term borrowings	12,755	-
Less:		
Current portion of long-term borrowings	(147,094)	(21,578)
Prepaid borrowing commission	(5,713)	(7,046)
Total long-term borrowings	**2,463,894**	**1,702,883**
Total borrowings	**2,851,974**	**2,110,853**

Xalqbank loan. In December 2008 the Group entered into a loan agreement with Xalqbank for a total amount of AZN 62,000 for the period of 12 months until 31 December 2009. In December 2009 Group repaid fully its commitment under this facility and entered in a new loan agreement with Xalqbank for a total amount of AZN 93,002 for the period of 1 month until 28 January 2010. The loan bears an annual interest rate of 3.15 per cent. The amount outstanding under this facility as at 31 December 2009 is AZN 93,002. This loan was subsequently repaid.

Deutsche Bank loan. On 29 October 2009 the Deutsche Bank provided a loan to the Group for a 12 month period. The total amount of financing available under this facility agreement was USD 80 million (AZN 64 thousand). The loan bears an annual interest rate of LIBOR plus 2 per cent. At 31 December 2009 the total outstanding balance under this facility was AZN 64,248.

18 Borrowings (Continued)

Viani loan. On 23 May 2008, the Group entered into a convertible loan facility agreement with Viani Holdings Limited ("Viani loan facility" or "loan facility"). The Group received USD 400 million (AZN 320.5 thousand) under the Viani loan facility. The necessary financing for Viani Holdings Limited ("Viani") had been arranged by Credit Suisse ("the Funding Party") representing a syndicate of financial institutions. In accordance with the terms of the loan facility, the funds were made available to the Group to finance the acquisition of Petkim (Note 32). The loan is repayable on demand but no later than 54 (fifty-four) months following the date of the agreement and bears an annual interest rate of 5 per cent. While the loan remains outstanding, Viani has a conditional option to convert the amount owed under the facility into 38 per cent of ordinary share capital of SOCAR & Turcas Petrokimya A.Ş, a subsidiary holding the Group's 51 per cent voting interest in Petkim Petrokimya Holding A.Ş. The conversion option is exercisable only if Viani's liability to the Funding Party and other financing providers is fully discharged and the Funding Party consents to the exercise of the option. In December 2008 based on the agreement signed by the Group with Viani, the conversion option mentioned above initially granted to Viani, was cancelled and the Group prepaid USD 175 million (AZN 140,543) to Viani. During 2009, the Group has repaid the remaining USD 227 million (AZN 180,881) to Viani.

Caspian King Ltd loan. As discussed in Note 8, on 18 December 2008 the Group obtained financing from Caspian King Ltd. in the amount of AZN 80,199. This loan bears annual interest of LIBOR plus 3 per cent and matures on 31 December 2009. Interest and principal are payable on 31 March 2009 and thereafter at the end of each quarter. The loan was fully repaid by the Group as of 31 December 2009.

Akbank T.A.Ş loan. On 4 December 2009 Akbank T.A.Ş. provided a loan to the Group with maturity date of 6 April 2010. The total amount of financing available under this facility agreement was USD 35 million (AZN 28 thousand). The loan bears an annual interest rate of 2.2 per cent. At 31 December 2009 the total outstanding balance under this facility was AZN 28,010.

Akbank T.A.Ş./Turkiye Garanti Bankasi A.Ş loan. In May 2008, the Group obtained a syndicated loan from Turkiye Garanti Bankasi A.Ş. and Akbank T.A.Ş. acting as lead arrangers for a total amount of USD 625 million bearing annual interest of LIBOR plus 3 per cent from May 2008 through May 2012, and LIBOR plus 4 per cent from May 2012 through maturity in May 2017. The loan is repayable in 7 (seven) pre-defined annual installments commencing in 2011. Loan maturity date is 30 June 2017. In accordance with the terms of the loan, the funds were made available to the Group to finance the acquisition of Petkim (Note 32). The Group pledged its 99.75 per cent interest in STEAŞ, a subsidiary holding the Group's 51 per cent voting interest in Petkim Petrokimya Holding A.Ş. ("Petkim") as collateral for the amounts due under this facility. The amount outstanding under this facility as at 31 December 2009 was AZN 500,175 (2008: AZN 498,019).

Turkiye Garanti Bankasi A. Ş loan. On 4 December 2009 Turkiye Garanti Bankasi A.Ş provided a loan to the Group with maturity date of 5 April 2010. The total amount of financing available under this facility agreement was USD 20 million (AZN 16 thousand). The loan bears an annual interest rate of 2.1 per cent. At 31 December 2009 the total outstanding balance under this facility was AZN 16,005.

International Bank of Azerbaijan loan. On 21 May 2007, IBA provided a credit line with a USD 50 million (AZN 40,155) limit to the Group for the period of 36 months until 21 May 2010. The loan bears annual interest rate of LIBOR plus 2 per cent. During the year ended 31 December 2009, the Group repaid USD 16.7 million (AZN 13,412) on this facility. The amount outstanding under this facility as at 31 December 2009 is AZN 6,692 (2008: AZN 20,025).

On 24 October 2007, IBA provided a credit line with a USD 60 million (AZN 48,186) limit to the Group for the period of 36 months until 24 October 2010. The loan bears annual interest rate of LIBOR plus 3 per cent. During the year ended 31 December 2009, the Group did not draw down any amount on this credit line. The amount outstanding under this facility as at 31 December 2009 is AZN 46,300 (2008: AZN 46,196).

On 6 December 2007, IBA provided an additional credit line to the Group for a total amount of up to USD 40 million (AZN 32,124) for the period of 36 months until 6 December 2010. The loan bears annual interest rate of LIBOR plus 3 per cent. The amount outstanding under this facility as at 31 December 2009 is AZN 32,124 (2008: AZN 32,040).

18 Borrowings (Continued)

On 22 May 2008, IBA provided a loan to the Group of USD 665 million (AZN 534,062) for the period of 36 months until 22 May 2011. The loan bears an annual interest of LIBOR plus 2 per cent. This borrowing is collateralized by a special cash deposit of USD 665 million (AZN 534,062) placed with IBA (Note 8). The amount outstanding under this facility as at 31 December 2009 was AZN 532,186 (2008: AZN 529,893).

On 21 July 2009, IBA provided a loan to the Group of AZN 750 million for the period of 84 months until July 2016 for the purposes of refinancing of existing loans and finance the Group's investment activities. The loan bears an annual interest rate of 3 per cent. The amount outstanding under this facility as at 31 December 2009 was AZN 750,000.

On 27 July 2009, the Group obtained a new loan from IBA amounting USD 420 million (AZN 337,302) with a fixed rate 3.5 per cent maturing on 22 July 2014. With the proceeds of this new loan, the Group fully paid the debt to Viani amounting to USD 227 million (AZN 182,304) in 2009.

At 31 December 2009 the Group had other loans from IBA in the total amount of AZN 22,994.

ABN Amro/Citibank loan. In February 2008 the Group entered into a loan agreement with a bank syndicate led by ABN AMRO Bank N.V., London Branch and Citibank N.A., London Branch for a total amount of USD 610 million (AZN 489,891) bearing annual interest of LIBOR plus 1.75 per cent and repayable in three semi-annual instalments commencing in February 2010. Loan maturity date is 1 April 2011. The proceeds from this facility were directed towards the acquisition of Petkim. The terms of the facility contain certain financial and nonfinancial covenants, including a minimum interest cover requirement and a total indebtedness cap. The amount outstanding under this facility as at 31 December 2009 was AZN 163,297 (2008: AZN 489,468).

Japan Bank for International Cooperation loan. In April 2000, the Azerigaz CJSC, which became a part of the Group since 1 July 2009, entered into a loan agreement with Japan Bank for International Corporation for a total amount of JPY 15,462,232 thousand bearing an annual interest rate of 1.5 per cent and repayable in 60 semi-annual instalments commencing on 20 September 2009. Loan maturity date is 20 September 2039. The proceeds from this facility were directed towards implementation of gasification program in the Azerbaijan Republic. The amount outstanding under this facility as at 31 December 2009 was AZN 132,403 (2008: AZN Nil).

Lalaben loan. On 20 July 2007, the Group entered into an RPO Advance Payment Agreement with Lalaben LLC ("Lalaben"). Total amount of financing provided to the Group in 2007 under the RPO Advance Payment Agreement was USD 300 million (AZN 240,930) ("the RPO facility") for the purpose of financing upgrade and refurbishment of SOCAR's gas production assets. Lalaben in turn obtained a USD 300 million (AZN 240,930) loan from a syndicate of banks and financial institutions led by BNP Paribas, ABN Amro Bank N.V. and Societe Generale.

The facility provided to the Group under the RPO Advance Payment Agreement bears annual interest of LIBOR plus 0.6 per cent for the period from 20 July 2007 through 20 July 2010, LIBOR plus 0.75 per cent for the period from 20 July 2010 through 20 July 2011, LIBOR plus 0.9 per cent for the period from 20 July 2011 through 20 July 2012, and LIBOR plus 0.975 per cent for the period from 20 July 2012 until the maturity of the agreement. Interest and principal are payable at the end of each quarter. The RPO facility matures on 20 July 2013.

At 31 December 2009 the loan balance due to Lalaben under the RPO facility was AZN 49,454 (2008: AZN 115,866) and it was included in the long-term borrowings.

According to the terms of the RPO Advance Payment Agreement all proceeds from the sale of the Reserved Profit Petroleum are transferred by customers directly to Lalaben's current accounts with BNP Paribas until the Group's obligations to Lalaben under the RPO facility are fully settled (Note 8).

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

18 Borrowings (Continued)

Natixis S.A Bank loan. On 16 December 2009, Natixis S.A Bank (France) provided a loan to the Group in the amount of USD 30 million for the period of 36 months. The loan is repayable in pre-determined instalments starting from 2010. The loan bears an annual interest of LIBOR plus 5 per cent. At 31 December 2009 the amount outstanding under this loan was AZN 24,093, including AZN 6,571 related to current portion.

International Development Association loan. In July 1996 the Azerigaz CJSC entered into a loan agreement with International Development Association for a total amount of USD 17,234 thousand bearing annual interest rate applicable for World Bank Currency Pool Loans with interest rate of 7.79 per cent in the reporting period and repayable in 29 semi-annual instalments commencing on 15 December 2001. Loan maturity date is 15 June 2016. The proceeds from this facility were directed towards implementation of gasification program in the Azerbaijan Republic. The amount outstanding under this facility as at 31 December 2009 was AZN 6,926 (2008: nil).

The Group's borrowings are denominated in currencies as follows:

	2009	2008
Borrowings denominated in:		
- USD	1,863,207	2,004,713
- AZN	845,752	62,000
- JPY	132,403	-
- Georgian Lari	8,075	30,914
- YTL	2,537	13,226
Total borrowings	**2,851,974**	**2,110,853**

19 Other Taxes Payable

	2009	2008
Payable to SOFAZ	122,981	122,981
Export charges	12,984	3,959
VAT payable	10,176	37,828
Property taxes and duties	8,326	9,412
Tax penalties and interests	1,104	384
Social security deductions	2,632	6,337
Personal income tax	2,690	3,328
Payable to budget	1,188	1,229
Excise tax	-	23,088
Other taxes payable	25,214	4,660
Total other taxes payable	**187,295**	**213,206**

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

20 Asset Retirement Obligations

The Group has legal and constructive obligation with respect to decommissioning of oil and gas production and storage facilities and environmental clean-up. Movements in provisions for the related asset retirement obligations are as follows:

	Note	2009	2008
Carrying amount at 1 January		**86,201**	**146,688**
Additions		(2,064)	27,689
Unwinding of the present value discount	28	6,865	12,098
Effect of change in discount rate		79,911	(97,337)
Exchange differences		(186)	(2,937)
Carrying amount at 31 December		**170,727**	**86,201**

The Group makes full provision for the future cost of oil and natural gas production facilities retirement and related pipelines on a discounted basis on the installation of those facilities. The provision has been estimated using existing technology, at current prices and discounted using nominal discount rates regarded as a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability as of the reporting date. These costs are expected to be incurred over the useful life of the fields and properties ranging between 15 and 73 years from the reporting date. Included within the asset retirement obligations at 31 December 2009 was AZN 34,582 (2008: AZN 9,948) relating specifically to estimated site restoration liabilities. The following inflation rates were applied in calculation of discounted cash flows:

Year	2010	2011	2012	2013	2014	2015 and later
Inflation rate	4.7%	3.5%	3.4%	3.3%	3.1%	3.0%

While the provision is based on the best estimate of future costs and the economic lives of the facilities and pipelines, there is uncertainty regarding both the amount and timing of incurring these costs.

Estimated costs of dismantling oil and gas production facilities, pipelines and related processing and storage facilities, including abandonment and site restoration costs amounting to AZN 102,579 at 31 December 2009 (2008: AZN 53,079) are included in the cost of oil and gas properties and equipment. Asset retirement obligations related to the PSAs are determined with reference to capital costs incurred by contractor parties and they are limited to the maturities of respective PSAs. Governmental authorities are continually reviewing regulations and their enforcement. Consequently, the Group's ultimate liabilities may differ from the recorded amounts.

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

21 Other Provisions for Liabilities and Charges

Movements in other provisions for liabilities and charges are as follows:

	Note	Environmental obligations	Disability payments	Unused vacation	Total
Carrying amount at 1 January 2008		**505,761**	**42,177**	**6,856**	**554,794**
Charge to profit or loss		-	14,723	17,621	32,344
Utilisation		(42,571)	(9,233)	(17,487)	(69,291)
Unwinding of the present value discount	28	36,431	1,876	-	38,307
Discount rate change		(52,696)	-	-	(52,696)
Carrying amount at 31 December 2008		**446,925**	**49,543**	**6,990**	**503,458**
of which:					
Current		*139,347*	*9,681*	*6,990*	*156,018*
Non-current		*307,578*	*39,862*	-	*347,440*
Charge to profit or loss		(51,172)	4,320	19,264	(27,588)
Utilisation		(50,118)	(8,564)	(23,421)	(82,103)
Unwinding of the present value discount	28	35,754	3,960	-	39,714
Discount rate change		35,155	(9,838)	-	25,317
Carrying amount at 31 December 2009		**416,544**	**39,421**	**2,833**	**458,798**
of which:					
Current		*89,665*	*9,794*	*2,833*	*102,292*
Non-current		*326,879*	*29,627*	-	*356,506*

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

21 Other Provisions for Liabilities and Charges (Continued)

Under the Presidential Decree number 1697 dated 28 September 2006 the Group prepared and approved Action Plan for Environmental Restoration with respect to the damage caused to the environment as a result of the Group's activities within Apsheron area. In 2009 the Group amended the Action Plan in accordance with the Presidential Decree dated 14 April 2009. Corresponding provision is recognised at the present value of future costs to be incurred for the environmental remediation. The Group estimates that the related costs will be incurred from 2010 through 2013.

The Group has an obligation to compensate its employees for the damage caused to their health during their employment, as well as to compensate the families of the employees died at work. The compensation provided is linked to the salaries paid to the affected employees. The Company calculated the present value of the disability payments to employees using a discount rate of 8.4 per cent. For the purpose of calculation of the lifetime payments to injured employees, the Company estimated a life expectancy as 75 and 70 for men and women, respectively. The inflation rates in Note 20 were applied to match the escalation in average salaries.

Management expects that the related injury payments will occur until 31 December 2066.

22 Deferred income

The Group obtained government grants aimed at gasification of Baku suburban area and regions of the Azerbaijan Republic recognised them in deferred income as follows:

	2009	2008
Deferred income at 1 January	-	-
Acquisitions through business combinations (Note 32)	110,178	-
Amortisation of deferred income to match related depreciation	(4,400)	-
Deferred income at 31 December	**105,778**	-

23 Charter Capital

Parent company of the Group, SOCAR, has a legal status of a state enterprise. At the date of incorporation of the Group, the Government of the Azerbaijan Republic contributed property with net book value of AZN 22,726 at the date of contribution which was assigned to the charter capital. Under the Decree of the Cabinet of Ministers number 436s dated 11 December 2008, the Group's charter capital was increased by AZN 600,000, of which AZN 400,000 was received by the Group in 2008 and the remaining amount has been received in 2009.

Withdrawals by the Government

Based on ad-hoc decisions of the Government, the Group is mandated to make direct cash contributions or finance construction and repair works for the state budget, various government agencies and projects administered by the Government. In 2009, direct cash contributions and financing amounted to AZN 143,698 and AZN 142,340, respectively (2008: AZN 313,922 and AZN 161,790, respectively), mainly for repair and reconstruction of existing, as well as construction of new recreational, transport, educational and medical infrastructure of the Azerbaijan Republic.

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

24 Analysis of Revenue by Categories

	2009	2008
Oil products, net	1,524,504	2,203,789
Crude oil, net	939,154	1,119,004
Petrochemicals	1,068,525	785,407
Natural gas	549,963	515,065
Other revenue	113,835	87,580
Total revenue	**4,195,981**	**4,710,845**

Revenue from crude oil sales is stated net of price margin tax which is levied on the margins between the international market price and internal state-regulated price on crude oil. The difference between the market price and the internal state-regulated price is taxed at the rate of 30 per cent and the amount of tax is transferred to the State Budget.

Revenue from oil product sales is stated net of excise tax of AZN 362,209 (2008: AZN 367,266).

Revenue from sales of crude oil produced under ACG PSA and condensate produced under Shah Deniz PSA is not subject to excise and price margin taxes mentioned above.

25 Analysis of Expenses by Nature

	Note	2009	2008
Raw materials and consumables used		1,266,663	976,047
Wages, salaries and social security costs		455,776	516,881
Depreciation of property, plant and equipment		590,655	529,094
Transportation and vehicle maintenance		109,148	213,681
Impairment of trade and other receivables	9	297,022	181,935
Impairment of property, plant and equipment	12	241,639	354,122
Repairs and maintenance expenses		143,278	64,376
Mining tax		120,519	126,748
Taxes other than on income		77,567	53,121
Utilities expense		50,920	90,507
Amortization expense		13,744	10,499
Other		257,532	229,731
Total cost of sales, exploration and evaluation, distribution, general and administrative, research and development and other operating expenses		**3,624,463**	**3,346,742**

Social expenses are comprised of expenditures related to medical, utilities, recreational and cultural services provided to SOCAR employees as well as expenditures of Treatment and Diagnostics Centers which provide free medical services to citizens in the regions of the Azerbaijan Republic.

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

26 Other Operating Income

	Note	2009	2008
Gain on settlement of pre-existing business relationship with Azerigaz PU (Note 9)		820,693	-
Sales of other goods and services rendered		204,708	73,865
Change in asset retirement and environmental provision		-	148,429
Total other operating income		**1,025,401**	**222,294**

27 Finance Income

	2009	2008
Interest income on deposits and bank accounts	44,664	18,336
Interest on loans from related parties	20,033	20,966
Other	2,981	16,222
Total finance income	**67,678**	**55,524**

28 Finance Costs

	Note	2009	2008
Interest expense		117,460	109,290
Environmental provision: unwinding of the present value discount	21	35,754	36,431
Provisions for asset retirement obligations: unwinding of the present value discount	21	6,865	12,098
Provision for disability payments: unwinding of the present value discount	21	3,960	1,876
Less capitalised borrowing costs		(828)	(11,906)
Total finance costs recognised in the consolidated statement of comprehensive income		**163,211**	**147,789**

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

29 Income Taxes

Income tax expense comprises the following:

	2009	2008
Current tax expense	361,123	570,595
Deferred tax charge/(benefit)	114,642	(242,610)
Income tax expense for the year	**475,765**	**327,985**

A reconciliation between the expected and the actual taxation charge is provided below:

	2009	2008
Profit before tax	**1,369,343**	**814,801**
Theoretical tax charge at statutory rate of 22 per cent (2008: 22 per cent)	301,255	179,256
Effects of different tax rates for certain subsidiaries (25 per cent)	7,104	22,182
Effects of different tax rates for certain subsidiaries (20 per cent)	895	9,316
Dividends income taxable at 10 per cent	-	(3,792)
Tax effect of items which are not deductible or assessable for taxation purposes:		
- Income which is exempt from taxation	(79,008)	(14,315)
- Non-deductible expenses	199,440	61,996
Unrecognised deferred tax assets	-	45,340
Carryforward loss on which no deferred income tax asset was recognized	13,238	19,492
Correction of previous years current tax	(1,518)	12,985
Impact of change in tax rate to 20 per cent	41,514	-
Other	(7,155)	(4,475)
Income tax expense for the year	**475,765**	**327,985**

Non-deductible expenses mainly comprise social and employee-related expenses.

Differences between IFRS and applicable domestic tax regulations give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below:

	1 January 2009	Acquired through business combination	Charged/ (credited) to profit or loss	31 December 2009
Tax effect of deductible/(taxable) temporary differences				
Accrued revenue	46,095	-	(37,845)	8,250
Impairment provision for receivables	441,019	99,816	(170,070)	370,765
Inventories	11,652	1,504	1,147	14,303
PPE	53,472	(33,047)	169,953	190,378
Provisions for liabilities and charges	106,602	18,025	(43,523)	81,104
Other	52	13,094	(32,323)	(19,177)
Deferred tax asset	**658,892**	**99,392**	**(112,661)**	**645,623**

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

29 Income Taxes (continued)

	2009	Credited/ (charged) to profit or loss	Translation difference	31 December 2009
Tax effect of deductible/(taxable) temporary differences				
Accruals	(5,970)	15,461	202	9,693
Investments in associates and jointly controlled entities	(16,315)	16,315	-	-
Impairment provision for receivables	(30,459)	(5,107)	-	(35,566)
Inventory	12,872	1,830	-	14,702
PPE	(475,005)	(4,639)	10,114	(469,531)
Provisions for liabilities and charges	20,851	(8,133)	(10,370)	2,347
Carry forward losses	14,479	8,543	-	23,022
Employment termination benefits	9,432	(983)	-	8,449
Other	(8,485)	(25,268)	2,608	(31,145)
Deferred tax liability	**(478,600)**	**(1,981)**	**2,554**	**(478,027)**

The tax effect of the movements in the temporary differences for the year ended 31 December 2008 is as follows:

	1 January 2008	Credited/(charged) to profit or loss	31 December 2008
Tax effect of deductible/(taxable) temporary differences			
Accrued revenue	8,001	38,094	46,095
Investments in associates and jointly controlled entities	99	(99)	-
Impairment provision for receivables	374,094	66,925	441,019
Inventories	3,790	7,862	11,652
PPE	(89,986)	143,458	53,472
Provisions for liabilities and charges	139,461	(32,859)	106,602
Other	(927)	979	52
Deferred tax asset	**434,532**	**224,360**	**658,892**

	1 January 2008	Acquired through business combination	Credited/ (charged) to profit or loss	Translation difference	31 December 2008
Tax effect of deductible/(taxable) temporary differences					
Accruals	(25,816)	857	17,986	1,003	(5,970)
Investments in associates and jointly controlled entities	(13,647)	144	(2,812)	-	(16,315)
Impairment provision for receivables	(7,519)	-	(22,940)	-	(30,459)
Inventory	127	2,089	10,656	-	12,872
Other	(1,673)	(1,376)	(5,671)	235	(8,485)
PPE	(218,002)	(269,564)	18,671	(6,110)	(475,005)
Provisions for liabilities and charges	16,539	1,952	2,360	-	20,851
Carry forward losses	-	14,479	-	-	14,479
Employment termination benefits	-	9,432	-	-	9,432
Deferred tax liability	**(249,991)**	**(241,987)**	**18,250**	**(4,872)**	**(478,600)**

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

29 Income Taxes (Continued)

The Group does not file a consolidated tax return. In the context of the Group's current structure, tax losses and current tax assets of different Group companies may not be offset against current tax liabilities and taxable profits of other Group companies and, accordingly, taxes may accrue even where there is a consolidated tax loss. Therefore, deferred tax assets and liabilities are offset only when they relate to the same taxable entity.

In accordance with the Azerbaijan Republic tax legislation, tax losses arising in one period can be carried forward for five years.

30 Significant Non-Cash Investing and Financing Activities

Investing and financing transactions that did not require the use of cash and cash equivalents and were excluded from the cash flow statement are as follows:

	2009	2008
Non-cash investing activities		
Transfer of PPE to the Government	43,451	55,295
Transfer of PPE to third parties	-	27,658
Non-cash investing activities	**43,451**	**82,953**

	2009	2008
Non-cash financing activities		
Offsetting transactions	-	34,347
Repayment of loans via proceeds from crude oil sales	150,994	198,010
Non-cash financing activities	**150,994**	**232,357**

31 Contingencies, Commitments and Operating Risks

Operating environment. Whilst there have been improvements in economic trends in the Azerbaijan Republic, the country continues to display certain characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Azerbaijan Republic. The tax, currency and customs legislation within the Azerbaijan Republic is subject to varying interpretations, and changes, which can occur frequently.

The future economic direction of the Azerbaijan Republic is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments. Management is unable to predict all developments in the economic environment which would have an impact on the Group's operations and consequently what effect, if any, they could have on the financial position of the Group.

Impact of the ongoing global financial and economic crisis. The ongoing global financial and economic crisis that emerged out of the severe reduction in global liquidity which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector and wider economy, and, at times, higher interbank lending rates and very high volatility in stock and currency markets. The uncertainties in the global financial markets have also led to failures of banks and other corporates, and to bank rescues in the United States of America, Western Europe, Russia and elsewhere. The full extent of the impact of the ongoing financial crisis is proving to be difficult to anticipate or completely guard against.

The availability of external funding in financial markets has significantly reduced since August 2007. Such circumstances may affect the ability of the Group to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions.

Debtors of the Group may be adversely affected by the financial and economic environment, which could in turn impact their ability to repay the amounts owed. Deteriorating economic conditions for customers may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, management has properly reflected revised estimates of expected future cash flows in its impairment assessments.

Management is unable to reliably determine the effects on the Group's future financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and development of the Group's business in the current circumstances.

Legal proceedings. From time to time and in the normal course of business, claims against the Group are received. On the basis of its own estimates and both internal and external professional advice management is of the opinion that no material losses will be incurred in respect of claims in excess of provisions that have been made in this consolidated financial statements.

Tax legislation. The Azerbaijan Republic tax, currency and customs legislation is subject to varying interpretations, and changes, which may occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant authorities.

Fiscal periods remain open to review by the tax authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances such reviews may cover longer periods.

The Group's management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained and potential tax liabilities of the Group will not exceed the amounts recorded in these consolidated financial statements. Accordingly, at 31 December 2009 no provision for potential tax liabilities had been recorded (2008: nil).

31 Contingencies, Commitments and Operating Risks (Continued)

Environmental matters. The enforcement of environmental regulation in the Azerbaijan Republic is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognised immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage above environmental obligation provision currently made by the Group (see Note 21).

The Group is subject to numerous national and local environmental laws and regulations concerning its products, operations and other activities. These laws and regulations may require the Group to take future action to remediate the effects on the environment of prior disposal or release of chemicals or petroleum substances by the Group or other parties. Such contingencies may exist for various sites including refineries, chemical plants, oil fields, service stations, terminals and waste disposal sites. In addition, the Group may have obligations relating to prior asset sales or closed facilities. The ultimate requirement for remediation and its cost are inherently difficult to estimate. However, the estimated cost of known environmental obligations has been provided in the consolidated financial statements in accordance with the Group's accounting policies. While the amounts of future costs could be significant and could be material to the Group's results of operations in the period in which they are recognized, it is not practical to estimate the amounts involved. The Group does not expect these costs to have a material effect on the Group's financial position or liquidity.

The Group also has obligations to decommission oil and natural gas production facilities and related pipelines. Provision is made for the estimated costs of these activities, however there is uncertainty regarding both the amount and timing of these costs, given the long-term nature of these obligations. The Group believes that the impact of any reasonably foreseeable changes to these provisions on the Group's results of operations, financial position or liquidity will not be material.

Compliance with covenants. The Group is subject to certain covenants related primarily to its borrowings. Non-compliance with such covenants may result in negative consequences for the Group including growth in the cost of borrowings and declaration of default. Management believes that, as of 31 December 2009 and 2008 the Group was in compliance with all applicable covenants.

With respect to the credit facilities obtained for the acquisition of Petkim shares, there are certain restrictions on the Group related to the distribution of cash and non-cash dividends and related to investment of the dividends received from Petkim. Another requirement brought by the same credit facilities is that the Group has committed to identify and complete the necessary work at Petkim in order to provide compliance of Petkim with the currently effective environmental regulations.

Commitments and contingent liabilities given for Petkim acquisition. Letters of guarantee amounting to USD 491,750 thousand equivalent to AZN 395,859 for the acquisition of Petkim were given to the Republic of Turkey Ministry Privatisation Administration ("Administration") on 30 May 2008. The letter of guarantee amounting to USD 38,030 thousand was released as of 31 December 2009. The balance of letters guarantee given to Administration is USD 453,720 thousand equivalent to AZN 364,383.

Letters of guarantee given to Administration were provided by the Group based on payment, investment, production and inspection commitments stated in the "Share Sales Agreement". The aforementioned commitments will be cancelled by the Administration as soon as they have been fulfilled in accordance with the clauses of the "Share Sales Agreement".

Based on the Share Sales Agreement, the Group has accepted and committed to take the Administration's approval for any kind of stock transfer that will result in change of controlling interest of Petkim for the following three years after signing the Share Sales Agreement.

31 Contingencies, Commitments and Operating Risks (Continued)

The Group has committed to preserve the rights of union member personnel subject to Labor Law Article 4857 of the Republic of Turkey and to pay their employment termination benefits (including periods they have worked in other public institutions) along with all other rights they have earned. The Group has accepted and committed that Petkim has the responsibility to compensate for the unused vacation rights of the personnel whose service contracts are still valid and have the right to be transferred to other public institutions as of the effective date of the Share Sales Agreement.

The Group has accepted and committed to make investments over a certain amount for infrastructure and services for Petkim harbour, increase production capabilities of factories and established new factories for the following three years after the Share Sales Agreement. The Group also has accepted and committed to continue production in the Ethylene Plant and produce a certain amount for at least three years after signing the Share Sales Agreement unless there are unforeseen situations that do not involve the Group.

The Group is responsible for all operations, all unrecorded payables, payables and liabilities that are related to the period prior to the acquisition of Petkim. The Group has accepted and committed that it has no right of application or rescinding that may result in binding of Administration or Petkim about aforementioned matters. This liability will be valid for continuing share transfers.

Commitment to the government of Georgia

Based on the investment agreement signed between the Group and the Ministry of Economical Development of Georgia (MEDG) on 26 December 2008 the Group acquired controlling stake in 19 regional gas distribution companies and certain stand-alone gas distribution pipelines (jointly referred to "RGC") for a consideration of GEL 166 thousand (AZN 80) and commitment to invest additional USD 40 million (AZN 32,000) in development of gas networks till year 2011.

Commitment to SOCAR Umid

SOCAR Umid is a joint venture established in 2008 by the Group and Nobel Oil Exploration and Production. Initial investment of the Group in this company was AZN 8. In 2009, the Group committed to invest additional funds in the form of cash contributions (AZN 28,645) and transfer of property, plant and equipment (AZN 65,000). During 2009, the Group made cash contribution in the amount of AZN 8,382 to SOCAR Umid. The balance of commitment as at 31 December 2009 is AZN 85,263.

Contingent liability to Azerbaijan Gas Supply Company (AGSC)

Based on "Gas sales and purchase agreement" signed on 27 February 2003 between AGSC and Ministry of Oil and Energy of the Azerbaijan Republic (currently purchase rights under this agreement are executed by the Group), the Group has obligation to purchase seller's minimum annual quantity as indicated in the agreement. Monetary amount of commitment to purchase seller's minimum annual quantity is USD 86,840 thousand (AZN 69,741).

32 Business Combinations

Azerigaz CJSC On 1 July 2009 the Group acquired 100 per cent of the share capital of Azerigaz CJSC. According to the Presidential Decree number 366 dated 1 July 2009 "On improvement of management framework in the oil and gas industry" Azerigaz CJSC was transferred to SOCAR. Based on the results of analysis of acquired rights SOCAR management concluded that 1 July 2009 should be considered as a date of transition of control over Azerigaz CJSC. The Company is involved in transportation of gas via gas pipelines between manufacturers, consumers and gas storages in the Azerbaijan Republic as well as transit of gas for export to Russia, Georgia and Iran. Following this acquisition, Azerigaz CJSC was transformed into Azerigaz PU within SOCAR structure.

Details of the fair value allocation and the purchase consideration related to Azerigaz PU acquisition are as follows:

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

32 Business Combinations (Continued)

	IFRS carrying amount immediately before business combination	Attributed fair value
Cash and cash equivalents	3,398	3,398
Restricted cash	403	403
Trade and other receivables	684,998	545,186
Corporate income tax prepayments	32	32
Inventories	72,756	69,507
Property, plant and equipment	601,283	787,044
Intangible assets	14	14
Other non-current assets	5	5
Trade and other payables	(1,291,498)	(1,265,163)
Short-term and current portion of long-term borrowings	(17,209)	(11,734)
Corporate income tax payable	(29,677)	(43,835)
Other taxes payable	(164,915)	(185,957)
Other provisions	(808)	(15,371)
Deferred income	(110,178)	(110,178)
Long-term borrowings	(130,034)	(130,034)
Asset retirement obligations	(330)	(330)
Deferred tax asset	-	99,392
Net assets of subsidiary	**(381,760)**	**(257,621)**
Acquired interest in net assets of subsidiary	**-**	**(257,621)**
Total purchase consideration	**-**	**(257,621)**
Goodwill arising at the acquisition date	**-**	**-**
Goodwill at 31 December 2009	**-**	**-**

There was neither exchange of assets nor cash consideration paid as part of this business combination. In accordance with provisions of IFRS 3, the Group had sought an independent valuation for identification of fair value of purchase consideration of this business combination. The independent valuators' report determined that fair value of purchase consideration in the business combination is equal to fair value of 100 per cent of net assets of Azerigaz CJSC as of 1 July 2009, using net assets approach for identification of purchase consideration of the business combination.

The Group had pre-existing business relations with Azerigaz CJSC before the business combination date. Gain on settlement of this pre-existing relationship between SOCAR and Azerigaz PU is recognized as other income within statement of comprehensive income for the year ended 31 December 2009.

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

32 Business Combinations (Continued)

Other acquisitions. During 2009 the Group has also acquired a number of subsidiaries in Georgia, Ukraine as well as controlling interest in Caspian Drilling Company. These acquisitions did not have a material impact on the Group's consolidated IFRS financial statements.

Petkim Petrokimya Holding A.Ş. On 30 May 2008 the Group completed an acquisition of 51 per cent of the voting share capital of Petkim Petrokimya Holding A.Ş ("Petkim"), a leading petrochemical concern primarily involved in production and marketing of a variety of petrochemical products in the Turkish as well as international markets. The Group acquired Petkim as a result of a privatization tender held by the Turkish government in 2007. The Group participated in the tender through SOCAR & Turcas Petrokimya A.Ş. ("STPAŞ"), a 99.74 per cent subsidiary of STEAŞ, a 51 per cent subsidiary of SOCAR, acting in consortium with Injaz Projects Company Limited, a Saudi-based investment company. As a result, SOCAR's acquired economic ownership interest in Petkim was 25.94 per cent as of the date of acquisition.

Subsequent to the purchase of 51 per cent of Petkim shares with the privatization process on 30 May 2008, the Group purchased an additional 1.76 per cent of Petkim shares during the year ended 31 December 2008.

Details of the final fair value allocation and the purchase consideration related to Petkim acquisition are as follows:

	IFRS carrying amount immediately before business combination	Attributed fair value
Cash and cash equivalents	60,678	60,678
Trade and other receivables	200,538	200,538
Inventories	155,626	155,626
Other current assets	19,629	19,632
PPE	849,309	2,324,507
Intangible assets	799	658,969
Other non-current assets	23,477	23,477
Trade and other payables	(156,573)	(156,573)
Deferred tax liability	(20,983)	(323,579)
Other liabilities	(113,621)	(113,622)
Net assets of subsidiary	**1,018,879**	**2,849,653**
Non-controlling interest	-	(2,082,879)
Acquired interest in net assets of subsidiary	-	**766,774**
SOCAR's share in total purchase consideration	-	**874,104**
Goodwill arising at the acquisition date	-	**107,330**
Translation difference		(24,493)
Goodwill at 31 December 2008		**82,837**

The goodwill comprises the value of expected benefits arising from the Group's entry to the regional market in which Petkim operates.

Total purchase consideration is comprised of the following at acquisition date:

Total purchase consideration	**(1,713,929)**
Fair value of deferred purchase consideration at acquisition	317,832
Cash and cash equivalents – acquired	60,678
Outflow of cash and cash equivalents on acquisition	**(1,335,419)**

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

32 Business Combinations (Continued)

The total purchase consideration of USD 2,040 million comprises cash of USD 1,660 million (AZN 1,396,097) paid on the date of acquisition and deferred cash consideration of USD 380 million (AZN 317,832). Deferred consideration of USD 40 million (AZN 32,992) is payable no later than 30 May 2010, with the remaining balance payable no later than 30 May 2011 and bears interest at the rate of LIBOR+1 per cent per annum (Note 18). The carrying value of deferred purchase consideration at 30 May 2008 and at 31 December 2008 amounted to AZN 317,832 and AZN 308,170, respectively. As at 31 December 2009 the carrying value of deferred purchase consideration amounted to AZN 308,954.

The acquisition was primarily financed with long-term debt (Note 18). As more fully described in Note18, the Group has pledged its 99.74 per cent interest in STPAŞ as collateral under the Akbank T.A.Ş./Turkiye Garanti Bankasi A.Ş. loan facility. Also, the Group has issued an embedded call option on 38 per cent of voting interest in STPAŞ as part of the Viani loan facility which was cancelled in December 2008 (Note 18).

Goodwill

Movement in goodwill amount of the Group for the years 2009 and 2008 is as follows:

1 January 2008	-
Acquisition of Petkim Petrokimya Holding A.Ş	82,837
1 January 2009	**82,837**
Acquisition of other subsidiaries	24,068
31 December 2009	**106,905**

33 Events after the Reporting Period

Gas agreement with the Republic of Turkey

In June 2010 certain agreements related to the sale of Azerbaijan gas in the Republic of Turkey and its transportation to the European Markets through the territory of the Republic of Turkey have been signed. The Group will account for the impact of these agreements on its consolidated IFRS financial statements prospectively.

Borrowings

On 19 March 2010 the Group signed loan agreement with BNP Paribas in the amount of USD 100,000,000 for the period of 36 months.

On 31 March 2010 the Group singed loan agreement with Natixis S.A in the amount of USD 50,000,000 for the period of 36 months.

Newly signed PSA agreement

The Group signed a Production Sharing Agreement on rehabilitation of onshore oil fields of Balakhani-Sabunchi-Ramana-Kurdahani with UGE Lanser Ltd.

Repayment of Lalaben Loan

On 31 March 2010 the Group fully repaid the remaining balance of the Lalaben loan in the amount of USD 61,841,000. Subsequent to repayment of the obligations to Lalaben the Group was released from its commitments under the Intercreditor Deed signed between a syndicate of lenders and the Group.

33 Events after the Reporting Period (continued)

Business combination with Azerkimya

In accordance with decree of the President of the Azerbaijan Republic signed on 22 April 2010, the state owned company Azerkimya was transferred under control of the Group. The Group is currently in the process of performing a purchase price allocation related to this business combination.