

OJSC Kapital Bank

Separate financial statements

*Year ended 31 December 2022
together with independent auditor's report*

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Independent auditor's report

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Independent auditor's report

To the Shareholders and Supervisory Board of
OJSC Kapital Bank

Opinion

We have audited the separate financial statements of OJSC Kapital Bank (hereinafter, the "Bank"), which comprise the separate statement of financial position as at 31 December 2022, and the separate statement of profit or loss, separate statement of comprehensive income, separate statement of changes in equity and separate statement of cash flows for the year then ended, and notes to the separate financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying separate financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2022, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the separate financial statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' (IESBA) International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of management and Audit Committee for the separate financial statements

Management is responsible for the preparation and fair presentation of the separate financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the separate financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

The Audit Committee is responsible for overseeing the Bank's financial reporting process.

Auditor's responsibilities for the audit of the separate financial statements

Our objectives are to obtain reasonable assurance about whether the separate financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these separate financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- ▶ Identify and assess the risks of material misstatement of the separate financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- ▶ Obtain an understanding of internal control relevant to the audit 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 Bank's internal control.
- ▶ Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- ▶ Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the separate financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- ▶ Evaluate the overall presentation, structure and content of the separate financial statements, including the disclosures, and whether the separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- ▶ Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Bank to express an opinion on the separate financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Ernst & Young Holdings (CIS) B.V.

Baku, Azerbaijan

31 March 2023

Separate statement of financial position**As at 31 December***(Amounts presented are in thousands of Azerbaijani manats)*

	<i>Notes</i>	<i>2022</i>	<i>2021</i>
Assets			
Cash and cash equivalents	5	1,561,597	2,607,885
Amounts due from credit institutions	6	392,424	254,867
Investment securities	7	2,522,423	1,134,388
Investment in subsidiary	1	31,360	8,540
Loans to customers	8	3,028,281	2,519,429
Property and equipment	9	72,644	62,853
Right-of-use assets	11	35,032	34,034
Intangible assets	10	26,200	25,612
Current income tax assets		-	5,535
Other assets	14	211,507	112,855
Total assets		7,881,468	6,765,998
Liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations	17	403,936	339,803
Amounts due to credit institutions	18	18,669	8,016
Amounts due to customers	15	6,158,046	5,328,597
Deferred income tax liabilities	12	38,777	42,593
Current income tax liabilities		47,066	-
Lease liabilities	11	41,031	38,954
Debt securities issued	16	59,578	59,578
Subordinated loan	19	8,521	8,521
Other liabilities	14	121,894	138,539
Total liabilities		6,897,518	5,964,601
Equity			
Share capital	20	265,850	245,850
Additional paid-in capital		20,870	20,870
Unrealized gain on investment securities		6,506	7,094
Revaluation reserve for premises		2,067	1,339
Retained earnings		688,657	526,244
Total equity		983,950	801,397
Total liabilities and equity		7,881,468	6,765,998

Signed and authorized for release on behalf of the Management Board of the Bank:

Rovshan Allahverdiyev

Chairman of the Executive Board, Chief Executive Officer

Emin Mammadov

Executive Board Member, Chief Financial Officer



31 March 2023

The accompanying notes on pages 6 to 63 are an integral part of these financial statements.

Separate statement of profit or loss**For the year ended 31 December***(Amounts presented are in thousands of Azerbaijani manats)*

	Notes	2022	2021
Interest income			
Loans to customers		532,197	443,080
Investment securities		81,170	65,506
Amounts due from credit institutions		10,217	1,523
Cash and cash equivalents		3,038	1,735
Interest income calculated using effective interest rate		626,622	511,844
Interest expense			
Amounts due to customers		(62,529)	(53,156)
Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations		(7,227)	(6,542)
Lease liabilities	11	(4,571)	(4,441)
Debt securities issued		(3,995)	(3,995)
Amounts due to credit institutions		(1,189)	(694)
Other		(510)	(510)
		(80,021)	(69,338)
Net interest income		546,601	442,506
Credit loss expense on financial assets	13	(64,463)	(36,344)
Net interest income after credit loss expense		482,138	406,162
Net fee and commission income	22	166,212	118,030
Net gains from foreign currencies		70,236	42,445
Net losses on initial recognition of financial instruments		-	(1,955)
Net losses realised on sale of investment securities		(4,330)	-
Other operating income	23	17,351	13,886
Non-interest income		249,469	172,406
Personnel expenses	24	(164,407)	(131,030)
General and administrative expenses	25	(125,852)	(90,242)
Depreciation of property and equipment and amortisation of intangible assets	9, 10	(28,587)	(23,361)
Depreciation of right-of-use assets	11	(8,924)	(7,488)
Reversal/(provision) of impairment for credit related commitments and other impairment	13	249	(17,285)
Non-interest expenses		(327,521)	(269,406)
Profit before income tax expense		404,086	309,162
Income tax expense	12	(88,400)	(66,196)
Profit for the year		315,686	242,966

The accompanying notes on pages 6 to 63 are an integral part of these financial statements.

Separate statement of comprehensive income**For the year ended 31 December***(Amounts presented are in thousands of Azerbaijani manats)*

	Notes	2022	2021
Profit for the year		315,686	242,966
Other comprehensive income			
<i>Other comprehensive income to be reclassified to profit or loss in subsequent periods</i>			
Net change in fair value of debt instruments at fair value through other comprehensive income		(375)	312
Reclassification of cumulative gains on disposal of debt instruments at fair value through other comprehensive income to the income statement		(147)	(105)
Income tax relating to components of other comprehensive income		104	(41)
Net other comprehensive income to be reclassified to profit or loss in subsequent periods		(418)	166
<i>Other comprehensive income not to be reclassified to profit or loss in subsequent periods</i>			
Revaluation of premises	9	910	221
(Loss)/gain on equity instruments at fair value through other comprehensive income		(213)	32
Income tax relating to components of other comprehensive income		(139)	(50)
Total other comprehensive income not to be reclassified to profit or loss in subsequent periods		558	203
Other comprehensive income for the year, net of tax		140	369
Total comprehensive income for the year		315,826	243,335

The accompanying notes on pages 6 to 63 are an integral part of these financial statements.

Separate statement of changes in equity**For the year ended 31 December***(Amounts presented are in thousands of Azerbaijani manats)*

	<i>Share capital</i>	<i>Additional paid-in capital</i>	<i>Unrealized gain on investment securities</i>	<i>Revaluation reserve for premises</i>	<i>Retained earnings</i>	<i>Total Equity</i>
1 January 2021	245,850	20,870	6,902	1,162	443,037	717,821
Profit for the year	-	-	-	-	242,552	242,552
Other comprehensive income for the year	-	-	192	177	-	369
Total comprehensive income for the year	-	-	192	177	242,552	242,921
Dividends to shareholders of the Bank (Note 20)	-	-	-	-	(159,345)	(159,345)
31 December 2021	245,850	20,870	7,094	1,339	526,244	801,397
Profit for the year	-	-	-	-	315,686	315,686
Other comprehensive income / (loss) for the year	-	-	(588)	728	-	140
Total comprehensive income / (loss) for the year	-	-	(588)	728	315,686	315,826
Issuance of ordinary shares (Note 20)	20,000	-	-	-	-	20,000
Dividends to shareholders of the Bank (Note 20)	-	-	-	-	(153,273)	(153,273)
31 December 2022	265,850	20,870	6,506	2,067	688,657	983,950

The accompanying notes on pages 6 to 63 are an integral part of these financial statements.

Separate statement of cash flows**For the year ended 31 December***(Amounts presented are in thousands of Azerbaijani manats)*

	Notes	2022	2021
Cash flows from operating activities			
Interest received		617,807	510,549
Interest paid		(75,192)	(73,237)
Fees and commissions received		259,743	199,204
Fees and commissions paid		(86,466)	(71,006)
Net realized gains from foreign currency operations		59,780	36,828
Other operating income received		16,797	13,047
Personnel expenses paid		(152,158)	(134,761)
General and administrative expenses paid		(128,521)	(87,198)
Recoveries of loans to customers previously written off		7,217	7,821
Payment for issued letters of guarantee		(23,775)	-
Cash flows from operating activities before changes in operating assets and liabilities		495,232	401,247
<i>Net (increase)/decrease in operating assets</i>			
Amounts due from credit institutions		(138,357)	(142,165)
Loans to customers		(568,926)	(513,698)
Other assets		(45,472)	(16,534)
<i>Net increase/(decrease) in operating liabilities</i>			
Amounts due to customers		781,239	1,334,647
Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations		64,096	105,594
Amounts due to credit institutions		7,812	(4,353)
Other liabilities		(7,770)	3,013
Net cash flows from operating activities before income tax		587,854	1,167,751
Income tax paid		(39,700)	(82,000)
Net cash from operating activities		548,154	1,085,751
Cash flows used in investing activities			
Purchase of investment securities		(2,968,215)	(1,653,310)
Proceeds from sale and redemption of investment securities		1,579,077	1,506,743
Investment in subsidiary	1	(22,820)	(3,550)
Purchase of property and equipment		(26,568)	(19,788)
Proceeds from sale of property and equipment		552	3,156
Purchase of intangible assets		(11,235)	(9,299)
Net cash used in investing activities		(1,449,209)	(176,048)
Cash flows used in financing activities			
Proceeds from issue of share capital	21	20,000	-
Lease liability paid	12	(12,030)	(10,561)
Dividends paid to shareholders of the Bank	20	(153,273)	(170,945)
Net cash used in financing activities		(145,303)	(181,506)
Effect of exchange rates changes on cash and cash equivalents		70	(4,644)
Net (decrease)/increase in cash and cash equivalents		(1,046,288)	723,553
Cash and cash equivalents, beginning		2,607,885	1,884,332
Cash and cash equivalents, ending	5	1,561,597	2,607,885

The accompanying notes on pages 6 to 63 are an integral part of these financial statements.

(Amounts presented are in thousands of Azerbaijani manats)

1. Principal activities

Open Joint Stock Company Kapital Bank (the "Bank") was established in accordance with the legislation of the Republic of Azerbaijan. The Bank operates under banking license No. 244 issued by the Central Bank of the Republic of Azerbaijan ("the CBAR") on 25 February 2000.

The Bank's principal business activity is corporate and retail banking operations. This includes deposit taking and commercial lending in freely convertible currencies and in Azerbaijani manat ("AZN"), transfer payments in Azerbaijan and abroad, support of clients' export/import transactions, foreign currency exchange and other banking services to its commercial and retail customers. As at 31 December 2022, the Bank's network comprised of head office, 26 divisions (2021: 23) and 114 branches (2021: 104).

The Bank participates in the State deposit insurance program, which was introduced by the Azeri Law, *Insurance of Individual Deposits in the Republic of Azerbaijan* dated 29 December 2006. Azerbaijan Deposit Insurance Fund fully guarantees deposits for a period of three years in local currency with an interest rate up to 12% (2021: 12%), as well as deposits in foreign currency with an interest rate up to 2.5% (2021: 2.5%).

The number of Bank's employees as at 31 December 2022 was 4,828 (2021: 4,100).

The Bank's registered legal address is 71 Fuzuli Street, Baku, AZ1014, Azerbaijan.

As at 31 December, the following shareholders owned the outstanding shares of the Bank:

Shareholder	2022, %	2021, %
PASHA Holding LLC	99.89	99.88
Individuals	0.11	0.12
Total	100.00	100.00

As at 31 December 2022 and 2021, the Bank is ultimately owned by Mrs. Leyla Aliyeva, Mrs. Arzu Aliyeva, Mr. Arif Pashayev and Mr. Mir Jamal Pashayev, who exercise collective control over the Bank.

As at 31 December 2022 and 2021, the Bank owns 100% of "Birkart non-bank credit organization" Limited Liability Company (the "subsidiary" or "Birkart NBCO"), which was established by the Bank on 3 May 2018 in accordance with the legislation of the Republic of Azerbaijan. During 2022, the Bank additionally paid up in full for 2,282 new AZN 10 shares of the subsidiary and as of 31 December 2022, the share capital of the subsidiary totalled AZN 31,360 (2021: AZN 8,540). The first branch of "Birkart NBCO" was opened on 3 April 2019. As at 31 December 2022, "Birkart NBCO" has no branches (2021: 29) and 6 employees (2021: 36). The subsidiary is not involved in any lending activity.

On 6 March 2020 the subsidiary purchased 25% of the share capital in "Competo" LLC (the "associate") amounting to AZN 50. "Competo" LLC was established on 9 February 2018 and is operating in retail banking IT and consulting service. During 2021 and 2022, the shareholders of "Competo" LLC, including "Birkart NBCO" LLC, made additional capital injections in amount of AZN 4,569 (2021: AZN 3,482) into "Competo" LLC in proportion to their ownership percentage.

On 18 August 2021 the subsidiary purchased 20% of the share capital in "Komtec LTD" LLC (the "associate") amounting to AZN 4. "Komtec LTD" was established in 2008 and is operating in the market of electronic payments and cash payment terminals. As at 10 March 2022 the subsidiary purchased 79% of the share capital in "Komtec LTD" LLC and became 99% owner of the entity. The Bank has rebranded the subsidiary to "PashaPay" LLC after the acquisition.

As at 31 December 2022, the subsidiary owns 100% of "Red Hearts" Charity Foundation, which was established by the subsidiary on 15 December 2020. As at 31 December 2022, the subsidiary fully paid up issued and outstanding share capital totaling AZN 35 divided into 35 shares, each with a par value of AZN 1. (2021: AZN 10).

(Amounts presented are in thousands of Azerbaijani manats)

2. Basis of preparation

General

These separate financial statements (hereinafter: “financial statements”) have been prepared in accordance with International Financial Reporting Standards (“IFRS”). The Bank has prepared the financial statements on the basis that it will continue to operate as a going concern.

The Azerbaijani manat is the functional and presentation currency of the Bank as the majority of the transactions are denominated, measured, or funded in Azerbaijani manat. Transactions in other currencies are treated as transactions in foreign currencies. The Bank maintains its records and prepares its financial statements in Azerbaijani manat and in accordance with IFRS. These financial statements are presented in thousands of Azerbaijani manat (“AZN”), except per share amounts and unless otherwise indicated. These financial statements have been prepared under the historical cost convention except for premises and investment securities at FVOCI and derivative financial assets and liabilities, which have been measured at fair value.

Estimation uncertainty

To the extent that information is available as at 31 December 2022, the Bank has reflected revised estimates of expected future cash flows in its ECL assessment (Note 8), estimation of fair values of financial instruments (Note 27).

3. Summary of accounting policies

Changes in accounting policies

New and amended standards and interpretations

The Bank applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2022. The Bank has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective.

Reference to the Conceptual Framework – Amendments to IFRS 3

The amendments replace a reference to a previous version of the IASB’s *Conceptual Framework* with a reference to the current version issued in March 2018 without significantly changing its requirements.

The amendments add an exception to the recognition principle of IFRS 3 *Business Combinations* to avoid the issue of potential ‘day 2’ gains or losses arising for liabilities and contingent liabilities that would be within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or IFRIC 21 *Levies*, if incurred separately. The exception requires entities to apply the criteria in IAS 37 or IFRIC 21, respectively, instead of the *Conceptual Framework*, to determine whether a present obligation exists at the acquisition date.

The amendments also add a new paragraph to IFRS 3 to clarify that contingent assets do not qualify for recognition at the acquisition date.

In accordance with the transitional provisions, the Bank applies the amendments prospectively, i.e., to business combinations occurring after the beginning of the annual reporting period in which it first applies the amendments (the date of initial application).

These amendments had no impact on the financial statements of the Bank as there were no contingent assets, liabilities or contingent liabilities within the scope of these amendments that arose during the period.

Property, Plant and Equipment: Proceeds before Intended Use – Amendments to IAS 16

The amendment prohibits entities from deducting from the cost of an item of property, plant and equipment, any proceeds of the sale of items produced while bringing that asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Instead, an entity recognises the proceeds from selling such items, and the costs of producing those items, in profit or loss.

In accordance with the transitional provisions, the Bank applies the amendments retrospectively only to items of PP&E made available for use on or after the beginning of the earliest period presented when the entity first applies the amendment (the date of initial application).

These amendments had no impact on the financial statements of the Bank as there were no sales of such items produced by property, plant and equipment made available for use on or after the beginning of the earliest period presented.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

Onerous Contracts – Costs of Fulfilling a Contract – Amendments to IAS 37

An onerous contract is a contract under which the unavoidable of meeting the obligations under the contract costs (i.e., the costs that the Bank cannot avoid because it has the contract) exceed the economic benefits expected to be received under it.

The amendments specify that when assessing whether a contract is onerous or loss-making, an entity needs to include costs that relate directly to a contract to provide goods or services including both incremental costs and an allocation of costs directly related to contract activities. General and administrative costs do not relate directly to a contract and are excluded unless they are explicitly chargeable to the counterparty under the contract.

These amendments had no impact on the financial statements of the Bank, as there were no such onerous contracts identified during the period.

IFRS 1 First-time Adoption of International Financial Reporting Standards – Subsidiary as a first-time adopter

The amendment permits a subsidiary that elects to apply paragraph D16(a) of IFRS 1 to measure cumulative translation differences using the amounts reported in the parent's financial statements, based on the parent's date of transition to IFRS, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary. This amendment is also applied to an associate or joint venture that elects to apply paragraph D16(a) of IFRS 1.

These amendments had no impact on the financial statements of the Bank, as it is not a first time adopter.

IFRS 9 Financial Instruments – Fees in the '10 per cent' test for derecognition of financial liabilities

The amendment clarifies the fees that an entity includes when assessing whether the terms of a new or modified financial liability are substantially different from the terms of the original financial liability. These fees include only those paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf. There is no similar amendment proposed for IAS 39 *Financial Instruments: Recognition and Measurement*.

In accordance with the transitional provisions, the Bank applies the amendment to financial instruments that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment (the date of initial application). These amendments had no impact on the financial statements of the Bank as the fees paid or received by the Bank upon contract renegotiations were very insubstantial for each renegotiated financial instrument.

IAS 41 Agriculture – Taxation in fair value measurements

The amendment removes the requirement in paragraph 22 of IAS 41 that entities exclude cash flows for taxation when measuring the fair value of assets within the scope of IAS 41.

These amendments had no impact on the financial statements of the Bank as it did not have assets in scope of IAS 41 as at the reporting date.

Fair value measurement

The Bank measures financial instruments carried at FVPL and FVOCI and non-financial assets such as premises at fair value at each balance sheet date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- ▶ In the principal market for the asset or liability; or
- ▶ In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Fair value measurement (continued)

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- ▶ Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- ▶ Level 2 – valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;
- ▶ Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Financial assets and liabilities

Initial recognition

Date of recognition

All regular way purchases and sales of financial assets and liabilities are recognised on the trade date i.e. the date that the Bank commits to purchase the asset or liability. Regular way purchases or sales are purchases or sales of financial assets and liabilities that require delivery of assets and liabilities within the period generally established by regulation or convention in the marketplace.

Initial measurement

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Financial instruments are initially measured at their fair value and, except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount.

Measurement categories of financial assets and liabilities

The Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- ▶ Amortised cost;
- ▶ FVOCI;
- ▶ FVPL.

The Bank classifies and measures its derivative and trading portfolio at FVPL. The Bank may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVPL when they are held for trading, are derivative instruments or the fair value designation is applied.

Amounts due from credit institutions, loans to customers, investments securities at amortised cost

The Bank only measures amounts due from credit institutions, loans to customers, investment debt securities and other financial investments at amortized cost if both of the following conditions are met:

- ▶ The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows;
- ▶ The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI).

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

The details of these conditions are outlined below.

Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- ▶ How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- ▶ The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- ▶ How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected);
- ▶ The expected frequency, value and timing of sales are also important aspects of the Bank's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

The SPPI test

As a second step of its classification process the Bank assesses the contractual terms of financial asset to identify whether they meet the SPPI test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

Debt instruments at FVOCI

The Bank measures debt instruments at FVOCI when both of the following conditions are met:

- ▶ The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets;
- ▶ The contractual terms of the financial asset meet the SPPI test.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest revenue and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

The ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit and loss upon derecognition of the asset.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

Equity instruments at FVOCI

Upon initial recognition, the Bank occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of equity under IAS 32 *Financial Instruments: Presentation* and are not held for trading. Such classification is determined on an instrument-by-instrument basis.

Gains and losses on these equity instruments are never recycled to profit or loss. Dividends are recognised in profit or loss as other income when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment. Upon disposal of these instruments, the accumulated revaluation reserve is transferred to retained earnings.

Financial guarantees, letters of credit and undrawn loan commitments

The Bank issues financial guarantees, letters of credit and loan commitments.

Financial guarantees are initially recognised in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the statement of profit or loss, and an ECL provision.

Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, these contracts are in the scope of the ECL requirements.

The Bank occasionally issues loan commitments at below market interest rates drawdown. Such commitments are initially recognized at fair value and subsequently measured at the higher of the amount of the ECL allowance and the amount initially recognised less, when appropriate, the cumulative amount of income recognised.

Performance guarantees

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Performance guarantees do not transfer credit risk. The risk under performance guarantee contracts is the possibility that the failure to perform the contractual obligation by another party occurs.

Reclassification of financial assets and liabilities

The Bank does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank changes the business model for managing financial assets. Financial liabilities are never reclassified. The Bank did not reclassify any of its financial assets and liabilities in 2022.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the CBAR, excluding obligatory reserves, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Derivative financial instruments

In the normal course of business, the Bank enters into various derivative financial instruments including futures, forwards, swaps and options in the foreign exchange and capital markets. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of profit or loss as net gains from foreign currencies as net gains/(losses) from financial instruments at fair value through profit or loss or net gains/(losses) from foreign currencies, depending on the nature of the instrument.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Derivative financial instruments (continued)

An embedded derivative is a component of a hybrid instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract. A derivative that is attached to a financial instrument, but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.

Derivatives embedded in liabilities and non-financial host contracts are treated as separate derivatives and recorded at fair value if they met the definition of a derivative (as defined above), their economic characteristics and risks were not closely related to those of the host contract, and the host contract was not itself held for trading or designated at FVPL. The embedded derivatives separated from the host were carried at fair value in the trading portfolio with changes in fair value recognised in the statement of profit or loss.

Financial assets are classified based on the business model and SPPI assessments.

Repurchase and reverse repurchase agreements and securities lending

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the statement of financial position and, in case the transferee has the right by contract or custom to sell or repledge them, reclassified as securities pledged under sale and repurchase agreements. The corresponding liability is presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as investment securities or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest revenue and accrued over the life of repo agreements using the effective interest method.

Securities lent to counterparties are retained in the statement of financial position. Securities borrowed are not recorded in the statement of financial position, unless these are sold to third parties, in which case the purchase and sale are recorded within gains less losses from trading securities in the statement of profit or loss. The obligation to return them is recorded at fair value as a trading liability.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to customers, amounts due to the Central Bank of the Republic of Azerbaijan and government organizations, amounts due to credit institutions and debt securities issued. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in profit or loss when the borrowings are derecognised as well as through the amortization process.

If the Bank purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is recognised in profit or loss.

Leases

The Bank applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The Bank recognises lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

Right-of-use assets

The Bank recognises right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Unless the Bank is reasonably certain to obtain ownership of the leased asset at the end of the lease term, the recognised right-of-use assets are depreciated on a straight-line basis over the shorter of its estimated useful life and the lease term. Right-of-use assets are subject to impairment.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Leases (continued)

Lease liabilities

At the commencement date of the lease, the Bank recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in-substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Bank and payments of penalties for terminating a lease, if the lease term reflects the Bank exercising the option to terminate. The variable lease payments that do not depend on an index or a rate are recognised as expense in the period on which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Bank uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the in-substance fixed lease payments or a change in the assessment to purchase the underlying asset.

Short-term leases and leases of low-value assets

The Bank applies the short-term lease recognition exemption to its short-term leases (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value (i.e., below USD 5 thousand). Lease payments on short-term leases and leases of low-value assets are recognised as expense on a straight-line basis over the lease term.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. The right of set-off must not be contingent on a future event and must be legally enforceable in all of the following circumstances:

- ▶ The normal course of business;
- ▶ The event of default; and
- ▶ The event of insolvency or bankruptcy of the entity and all of the counterparties.

These conditions are not generally met in master netting agreements, and the related assets and liabilities are presented gross in the statement of financial position.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.

The Bank derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI. Restructuring of impaired loans does not result in derecognition of financial instrument. When assessing whether or not to derecognise a loan to a customer, amongst others, the Bank considers the following factors:

- ▶ Change in currency of the loan;
- ▶ Change in counterparty;
- ▶ If the modification is such that the instrument would no longer meet the SPPI criterion.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, presented within interest income calculated using EIR in the statement of profit or loss, to the extent that an impairment loss has not already been recorded.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

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

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

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank’s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank’s continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank’s continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Write-off

Financial assets are written off either partially or in their entirety only when the Bank has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense. A write-off constitutes a derecognition event.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or 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, and the difference in the respective carrying amounts is recognised in profit or loss.

Taxation

The current income tax expense is calculated in accordance with the regulations of the Republic of Azerbaijan.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting date.

Azerbaijan also has various operating taxes that are assessed on the Bank’s activities. These taxes are included as a component of general and administrative expenses.

Current and deferred taxes are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity, respectively.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Property and equipment

Equipment is carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

The carrying values of equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Following initial recognition at cost, premises are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Any revaluation surplus is credited to the revaluation reserve for property and equipment included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss, in which case the increase is recognised in profit or loss. A revaluation deficit is recognised in profit or loss, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

An annual transfer from the revaluation reserve for property and equipment to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original cost. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	<u>Years</u>
Premises	20
Leasehold improvements	10
Computers and other office equipment	5
Furniture, fixtures, vehicles and others	5

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

Costs related to repairs and renewals are charged when incurred and included in general and administrative expenses, unless they qualify for capitalization.

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be finite. Intangible assets with finite lives are amortised over the useful economic lives of 1 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, and 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 obligation can be made.

Retirement and other employee benefit obligations

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

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Share capital

Share capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued and other contributions made by shareholders are recognised as additional paid-in capital.

Dividends

Dividends are recognised as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the financial statements are authorised for issue.

Contingencies

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

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Interest and similar income and expense

The Bank calculates interest income on debt financial assets measured at amortized cost or at FVOCI by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets. EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest revenue or expense.

When a financial asset becomes credit-impaired, the Bank calculates interest revenue by applying the effective interest rate to the net amortised cost of the financial asset. If the financial assets cures and is no longer credit-impaired, the Bank reverts to calculating interest revenue on a gross basis.

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates interest income by calculating the credit-adjusted EIR and applying that rate to the amortised cost of the asset. The credit-adjusted EIR is the interest rate that, at original recognition, discounts the estimated future cash flows (including credit losses) to the amortised cost of the POCI assets.

Fees and commissions

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

- ▶ Income earned from the provision of service is recognized as revenue as the service are provided (for example, servicing plastic card operations, settlement operations, cash operations and others);
- ▶ Income which forms an integral part of the effective interest rate of a financial instrument is recognized as an adjustment to the effective interest rate and recorded in 'interest income'.

Customer loyalty programs

The Bank offers a number customer loyalty programs. Accounting for such programs varies depending on who is identified as the customer, and whether the Bank acts as an agent or as a principal under the contract. For point-based programs, the Bank generally recognized a liability for the accumulated points that are expected to be utilized by the customers, which is reversed to profit or loss as the points expire. Cashbacks on plastic card transactions reduce fee and commission income.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

Dividend income

Revenue is recognized when the Bank's right to receive the payment is established.

Foreign currency translation

The financial statements are presented in Azerbaijani manat, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the statement of profit or loss as net gains (losses) from foreign currency translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the CBAR exchange rate on the date of the transaction are included in gains from dealing operations.

The Bank used the following official exchange rates at 31 December in the preparation of these financial statements:

	<u>2022</u>	<u>2021</u>
1 US dollar	AZN 1.7000	AZN 1.7000
1 euro	AZN 1.8114	AZN 1.9265

Standards issued but not yet effective

The new and amended standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these new and amended standards and interpretations, if applicable, when they become effective.

IFRS 17 Insurance Contracts

In May 2017, the IASB issued IFRS 17 *Insurance Contracts* (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 *Insurance Contracts* (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in IFRS 4, which are largely based on grandfathering previous local accounting policies, IFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects. The core of IFRS 17 is the general model, supplemented by:

- ▶ A specific adaptation for contracts with direct participation features (the variable fee approach);
- ▶ A simplified approach (the premium allocation approach) mainly for short-duration contracts.

IFRS 17 is effective for reporting periods beginning on or after 1 January 2023, with comparative figures required. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17. This standard is not applicable to the Bank.

Amendments to IAS 1: Classification of Liabilities as Current or Non-current

In January 2020, the IASB issued amendments to paragraphs 69 to 76 of IAS 1 to specify the requirements for classifying liabilities as current or non-current. The amendments clarify:

- ▶ What is meant by a right to defer settlement;
- ▶ That a right to defer must exist at the end of the reporting period;
- ▶ That classification is unaffected by the likelihood that an entity will exercise its deferral right;
- ▶ That only if an embedded derivative in a convertible liability is itself an equity instrument would the terms of a liability not impact its classification.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

The amendments are effective for annual reporting periods beginning on or after 1 January 2023 and must be applied retrospectively. The Bank is currently assessing the impact the amendments will have on its financial statements for periods beginning on or after 1 January 2023.

Definition of Accounting Estimates - Amendments to IAS 8

In February 2021, the IASB issued amendments to IAS 8, in which it introduces a definition of 'accounting estimates'. The amendments clarify the distinction between changes in accounting estimates and changes in accounting policies and the correction of errors. Also, they clarify how entities use measurement techniques and inputs to develop accounting estimates.

The amendments are effective for annual reporting periods beginning on or after 1 January 2023 and apply to changes in accounting policies and changes in accounting estimates that occur on or after the start of that period. Earlier application is permitted as long as this fact is disclosed.

The amendments are not expected to have a material impact on the Bank's financial statements.

Disclosure of Accounting Policies - Amendments to IAS 1 and IFRS Practice Statement 2

In February 2021, the IASB issued amendments to IAS 1 and IFRS Practice Statement 2 Making Materiality Judgements, in which it provides guidance and examples to help entities apply materiality judgements to accounting policy disclosures. The amendments aim to help entities provide accounting policy disclosures that are more useful by replacing the requirement for entities to disclose their 'significant' accounting policies with a requirement to disclose their 'material' accounting policies and adding guidance on how entities apply the concept of materiality in making decisions about accounting policy disclosures.

The amendments to IAS 1 are applicable for annual periods beginning on or after 1 January 2023 with earlier application permitted. Since the amendments to the Practice Statement 2 provide non-mandatory guidance on the application of the definition of material to accounting policy information, an effective date for these amendments is not necessary.

The Bank is currently revisiting their accounting policy information disclosures to ensure consistency with the amended requirements.

Deferred Tax related to Assets and Liabilities arising from a Single Transaction - Amendments to IAS 12

In May 2021, the Board issued amendments to IAS 12, which narrow the scope of the initial recognition exception under IAS 12, so that it no longer applies to transactions that give rise to equal taxable and deductible temporary differences.

The amendments should be applied to transactions that occur on or after the beginning of the earliest comparative period presented. In addition, at the beginning of the earliest comparative period presented, a deferred tax asset (provided that sufficient taxable profit is available) and a deferred tax liability should also be recognised for all deductible and taxable temporary differences associated with leases and decommissioning obligations.

The Bank is currently assessing the impact of the amendments.

(Amounts presented are in thousands of Azerbaijani manats)

4. Significant accounting judgments and estimates

Estimation uncertainty

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgments and estimates are as follows:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 27.

Impairment losses on financial assets

The measurement of impairment across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- ▶ The Bank's internal credit grading model, which assigns PDs to the individual grades;
- ▶ The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment;
- ▶ The segmentation of financial assets when their ECL is assessed on a collective basis;
- ▶ Development of ECL models, including the various formulae and the choice of inputs;
- ▶ Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs;
- ▶ Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

More details are provided in Notes 8 and 26.

Leases – estimating the incremental borrowing rate

The Bank cannot readily determine the interest rate implicit in the lease, therefore, it uses its incremental borrowing rate (IBR) to measure lease liabilities. The IBR is the rate of interest that the Bank would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The IBR therefore reflects what the Bank 'would have to pay', which requires estimation when no observable rates are available (for example, when the Bank does not enter into financing transactions) or when they need to be adjusted to reflect the terms and conditions of the lease (for example, when leases are not in the Bank's functional currency).

The Bank estimates the IBR using observable inputs (such as market interest rates) when available and is required to make certain entity-specific estimates (such as the Bank's credit rating).

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management believes that as at 31 December 2022 and 2021 its interpretation of the relevant legislation is appropriate and that the Bank's tax position will be sustained.

(Amounts presented are in thousands of Azerbaijani manats)

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	<u>2022</u>	<u>2021</u>
Cash on hand	784,132	689,219
Current accounts with the CBAR	577,825	1,779,540
Current accounts with other credit institutions	164,958	108,281
Reverse repurchase agreements up to 90 days	34,682	24,145
Cash in transit	-	6,700
Cash and cash equivalents	<u>1,561,597</u>	<u>2,607,885</u>

As at 31 December 2022, current accounts with other credit institutions consist of non-interest-bearing correspondent accounts balances with resident and non-resident banks in the amount of AZN 8,759 (2021: AZN 19,100) and AZN 156,199 (2021: AZN 89,181), respectively.

Cash equivalents in amount of AZN 759,741 are allocated to Stage 1 and cash equivalents in amount of AZN 17,724 are allocated to Stage 2 (2021: All cash equivalents were allocated to Stage 1). The ECL relating to cash equivalents of the Bank rounds to zero in both years.

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	<u>2022</u>	<u>2021</u>
Obligatory reserve with the CBAR	261,538	30,350
Loans to credit institutions	79,049	78,244
Block accounts with other credit institutions	33,071	51,262
Time deposits with credit institutions	5,026	68,315
Other amounts from credit institutions	13,740	26,696
Amounts due from credit institutions	<u>392,424</u>	<u>254,867</u>

As at 31 December 2022, blocked accounts with credit institutions in amount of AZN 26,608 (2021: 43,529) mainly represented funds blocked by three (2021: three) non-resident credit institutions against letters of guarantee issued to eight (2021: eleven) customers. In addition, funds are blocked by two (2021: two) non-resident credit institutions in amount of AZN 6,463 (2021: AZN 7,733) on behalf of Master Card Incorporated and Visa incorporated.

As at 31 December 2022, loans to credit institutions include AZN 79,049 (2021: AZN 78,244) issued to one non-resident and two resident banks and seven resident non-bank credit institutions (2021: one non-resident bank and two resident banks and two resident non-bank credit institutions).

As at 31 December 2022, time deposits with credit institutions consist of interest bearing short-term deposits placed in one resident bank (2021: one non-resident bank) in the amount of AZN 5,026 (2021: AZN 68,315).

As at 31 December 2022, credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at 4% of the previous month average balances of certain liabilities in AZN and 5% of the previous month average balances of certain liabilities in foreign currencies respectively, attracted from customers by the credit institutions. This is an increase from the previous rates of 0.5% and 1% respectively, which were in effect until 6 June 2022 when the CBAR made the decision to increase the rates. It should be noted that the Bank's ability to withdraw such deposit is restricted by statutory legislation.

Amounts due from credit institutions in amount of AZN 391,900 are allocated to Stage 1 and Amounts due from credit institutions in amount of AZN 524 are allocated to Stage 2 (2021: All Amounts due from credit institutions were allocated to Stage 1). The ECL relating to Amounts due from credit institutions of the Bank rounds to zero in both years.

(Amounts presented are in thousands of Azerbaijani manats)

7. Investment securities

Investment securities comprise:

	<u>2022</u>	<u>2021</u>
Debt securities at amortized cost		
Notes issued by the Ministry of Finance of the Republic of Azerbaijan	1,341,613	752,237
Notes issued by the CBAR	399,613	16,559
Corporate bonds	371,662	222,344
US Treasury bills	84,952	-
Reverse repurchase agreements for more than 90 days	20,819	-
Less - allowance for impairment	(6,336)	(2,995)
	<u>2,212,323</u>	<u>988,145</u>
Debt securities at FVOCI		
Notes issued by the Azerbaijan Mortgage Fund	216,720	134,779
US Treasury notes	82,272	-
	<u>298,992</u>	<u>134,779</u>
Equity securities at FVOCI		
Corporate shares	11,108	11,464
	<u>11,108</u>	<u>11,464</u>
Investment securities	<u>2,522,423</u>	<u>1,134,388</u>

An analysis of changes in the gross carrying amounts and associated ECLs in relation to debt securities at amortized cost during the year ended 31 December 2022 is as follows:

<i>Debt securities at amortised cost</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at 1 January 2022	991,140	-	-	991,140
New assets originated or purchased	1,601,315	-	-	1,601,315
Assets repaid	(373,796)	-	-	(373,796)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	(2,691)	-	2,691	-
As at 31 December 2022	<u>2,215,968</u>	<u>-</u>	<u>2,691</u>	<u>2,218,659</u>

<i>Debt securities at amortised cost</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECLs as at 1 January 2022	(2,995)	-	-	(2,995)
New assets originated or purchased	(1,321)	-	-	(1,321)
Assets repaid	668	-	-	668
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	3	-	(3)	-
Impact on period end ECL of exposures transferred between stages during the period	-	-	(2,688)	(2,688)
As at 31 December 2022	<u>(3,645)</u>	<u>-</u>	<u>(2,691)</u>	<u>(6,336)</u>

An analysis of changes in the gross carrying values and associated ECLs in relation to securities at FVOCI during the year ended 31 December 2022 is as follows:

<i>Debt securities at FVOCI</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at 1 January 2022	134,779	-	-	134,779
New assets originated or purchased	269,033	-	-	269,033
Assets sold	(104,820)	-	-	(104,820)
As at 31 December 2022	<u>298,992</u>	<u>-</u>	<u>-</u>	<u>298,992</u>

(Amounts presented are in thousands of Azerbaijani manats)

7. Investment securities (continued)

<i>Debt securities at FVOCI</i>	Stage 1	Stage 2	Stage 3	Total
ECLs as at 1 January 2022	(312)	–	–	(312)
New assets originated or purchased	(238)	–	–	(238)
Assets sold	274	–	–	274
As at 31 December 2022	(276)	–	–	(276)

An analysis of changes in the gross carrying amounts and associated ECLs in relation to debt securities at amortized cost during the year ended 31 December 2021 is as follows:

<i>Debt securities at amortised cost</i>	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2021	938,087	–	–	938,087
New assets originated or purchased	513,974	–	–	513,974
Assets repaid	(460,921)	–	–	(460,921)
As at 31 December 2021	991,140	–	–	991,140

<i>Debt securities at amortised cost</i>	Stage 1	Stage 2	Stage 3	Total
ECLs as at 1 January 2021	(2,150)	–	–	(2,150)
New assets originated or purchased	(1,178)	–	–	(1,178)
Assets repaid	333	–	–	333
As at 31 December 2021	(2,995)	–	–	(2,995)

An analysis of changes in the gross carrying values and associated ECLs in relation to securities at FVOCI during the year ended 31 December 2021 is as follows:

<i>Debt securities at FVOCI</i>	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2021	37,663	–	–	37,663
New assets originated or purchased	134,882	–	–	134,882
Assets sold	(37,766)	–	–	(37,766)
As at 31 December 2021	134,779	–	–	134,779

<i>Debt securities at FVOCI</i>	Stage 1	Stage 2	Stage 3	Total
ECLs as at 1 January 2021	(105)	–	–	(105)
New assets originated or purchased	(312)	–	–	(312)
Assets sold	105	–	–	105
As at 31 December 2021	(312)	–	–	(312)

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers

Concentration of loans to customers

Loans to customers comprise:

	<u>2022</u>	<u>2021</u>
Government-related entities	260,941	366,613
Corporate loans	484,257	343,562
Loans to individuals – consumer loans	1,820,221	1,583,502
Loans to individuals – mortgage loans	418,325	292,540
Loans to individuals – entrepreneurs	168,269	60,233
Gross loans to customers at amortised cost	3,152,013	2,646,450
Less: allowance for loan impairment	(123,732)	(127,021)
Loans to customers at amortised cost	3,028,281	2,519,429

Loans are extended to the following types of customers:

	<u>2022</u>	<u>2021</u>
Individuals	2,238,546	1,876,042
Private entities	484,257	343,562
Government related entities	260,941	366,613
Individual entrepreneurs	168,269	60,233
Loans to customers, gross	3,152,013	2,646,450

Loans are made principally in the following industry sectors:

	<u>2022</u>	<u>2021</u>
Individuals	2,238,546	1,876,042
Trade and services	327,449	245,092
Manufacturing	303,700	332,750
Construction	133,942	112,532
Agriculture and food processing	48,250	22,619
Telecommunication	25,972	34,522
Transport	14,714	9,089
Other	59,440	13,804
Loans to customers, gross	3,152,013	2,646,450

As at 31 December 2022, the Bank had a concentration of loans represented by AZN 387,360 or 12% of gross loan portfolio (2021: AZN 490,402 or 19%) due from twelve (2021: twelve) largest borrowers of the Bank. An allowance of AZN 3,192 (2021: AZN 5,082) was recognized against these loans.

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost

An analysis of changes in the gross carrying value and corresponding ECL in relation to Government related loans during the year ended 31 December 2022 is as follows:

Government related entities	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2022	324,875	41,623	115	366,613
New assets originated or purchased	8,934	-	-	8,934
Assets derecognized or repaid (excluding write-offs)	(72,927)	(41,623)	(56)	(114,606)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	(36)	36	-	-
Transfers to Stage 3	-	-	-	-
As a 31 December 2022	260,846	36	59	260,941
Government related entities	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2022	(1,991)	(1,798)	(60)	(3,849)
<i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i>				
New assets originated or purchased	(935)	-	-	(935)
Assets derecognized or repaid (excluding write-offs)	570	1,798	7	2,375
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	1	(1)	-	-
Transfers to Stage 3	-	-	-	-
Impact on period end ECL of exposures transferred between stages during the period	-	(1)	-	(1)
Changes to inputs used for ECL calculations	68	-	10	78
<i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i>				
Unwinding of discount (recognised in interest income)	-	-	(6)	(6)
As at 31 December 2022	(2,287)	(2)	(49)	(2,338)

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to corporate loans during the year ended 31 December 2022 is as follows:

Corporate loans	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2022	252,761	72,158	18,643	343,562
New assets originated or purchased	359,666	-	-	359,666
Assets derecognized or repaid (excluding write-offs)	(170,381)	(33,989)	(9,774)	(214,144)
Transfers to Stage 1	4,185	(3,824)	(361)	-
Transfers to Stage 2	(51,162)	51,162	-	-
Transfers to Stage 3	(3,598)	-	3,598	-
Recoveries	-	-	366	366
Amounts written off	-	-	(5,193)	(5,193)
As at 31 December 2022	391,471	85,507	7,279	484,257
Corporate loans	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2022	(6,857)	(3,097)	(8,158)	(18,112)
<i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i>				
New assets originated or purchased	(9,322)	-	-	(9,322)
Assets derecognized or repaid (excluding write-offs)	3,764	2,226	1,616	7,606
Transfers to Stage 1	(1,086)	863	223	-
Transfers to Stage 2	3,604	(3,604)	-	-
Transfers to Stage 3	514	-	(514)	-
Impact on period end ECL of exposures transferred between stages during the period	906	(641)	(2,231)	(1,966)
Changes to inputs used for ECL calculations	629	200	(559)	270
<i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i>				
Unwinding of discount (recognised in interest income)	-	-	(422)	(422)
Recoveries	-	-	(366)	(366)
Amounts written off	-	-	5,193	5,193
As at 31 December 2022	(7,848)	(4,053)	(5,218)	(17,119)

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Loans to individuals – consumer loans during the year ended 31 December 2022 is as follows:

Loans to individuals – consumer loans	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2022	1,086,703	427,576	69,223	1,583,502
New assets originated or purchased	1,317,927	–	–	1,317,927
Assets derecognized or repaid (excluding write-offs)	(741,256)	(253,329)	(20,960)	(1,015,545)
Transfers to Stage 1	131,229	(126,072)	(5,157)	–
Transfers to Stage 2	(99,160)	103,561	(4,401)	–
Transfers to Stage 3	(56,841)	(17,285)	74,126	–
Unwinding of discount	146	517	991	1,654
Changes to contractual cash flows due to modifications not resulting in derecognition	(266)	(627)	(1,041)	(1,934)
Recoveries	–	–	6,783	6,783
Amounts written off	–	–	(72,166)	(72,166)
As at 31 December 2022	1,638,482	134,341	47,398	1,820,221
Loans to individuals – consumer loans	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2022	(11,481)	(33,245)	(52,284)	(97,010)
<i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i>				
New assets originated or purchased	(34,424)	–	–	(34,424)
Assets derecognized or repaid (excluding write-offs)	1,318	7,803	14,463	23,584
Transfers to Stage 1	(12,015)	8,620	3,395	–
Transfers to Stage 2	17,816	(20,761)	2,945	–
Transfers to Stage 3	1,386	13,932	(15,318)	–
Impact on period end ECL of exposures transferred between stages during the period	9,269	(3,243)	(46,968)	(40,942)
Changes to inputs used for ECL calculations	(1,057)	(2,357)	(108)	(3,522)
<i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i>				
Unwinding of discount (recognised in interest income)	–	–	(4,786)	(4,786)
Recoveries	–	–	(6,783)	(6,783)
Amounts written off	–	–	72,166	72,166
As at 31 December 2022	(29,188)	(29,251)	(33,278)	(91,717)

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Loans to individuals – mortgage loans during the year ended 31 December 2022 is as follows:

<i>Loans to individuals – mortgage loans</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at 1 January 2022	290,653	1,383	504	292,540
New assets originated or purchased	154,030	–	–	154,030
Assets derecognized or repaid (excluding write-offs)	(27,995)	(35)	(200)	(28,230)
Transfers to Stage 1	1,153	(960)	(193)	–
Transfers to Stage 2	(19,029)	19,049	(20)	–
Transfers to Stage 3	(821)	(298)	1,119	–
Amounts written off	–	–	(15)	(15)
As at 31 December 2022	397,991	19,139	1,195	418,325
<i>Loans to individuals – mortgage loans</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2022	(1,035)	(181)	(117)	(1,333)
<i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i>				
New assets originated or purchased	(420)	–	–	(420)
Assets derecognized or repaid (excluding write-offs)	126	6	55	187
Transfers to Stage 1	(159)	118	41	–
Transfers to Stage 2	260	(262)	2	–
Transfers to Stage 3	10	49	(59)	–
Impact on period end ECL of exposures transferred between stages during the period	157	(201)	(175)	(219)
Changes to inputs used for ECL calculations	600	2	–	602
<i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i>				
Unwinding of discount (recognised in interest income)	–	–	(7)	(7)
Amounts written off	–	–	15	15
As at 31 December 2022	(461)	(469)	(245)	(1,175)

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Loans to individuals – entrepreneurs loans during the year ended 31 December 2022 is as follows:

<i>Loans to individuals – entrepreneurs</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at 1 January 2022	50,186	4,801	5,246	60,233
New assets originated or purchased	140,584	–	–	140,584
Assets derecognized or repaid (excluding write-offs)	(28,480)	(3,275)	(712)	(32,467)
Transfers to Stage 1	308	(308)	–	–
Transfers to Stage 2	(11,152)	11,203	(51)	–
Transfers to Stage 3	(961)	–	961	–
Recoveries	–	–	68	68
Amounts written off	–	–	(149)	(149)
As at 31 December 2022	150,485	12,421	5,363	168,269
<i>Loans to individuals – entrepreneurs</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2022	(2,727)	(772)	(3,218)	(6,717)
<i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i>				
New assets originated or purchased	(6,356)	–	–	(6,356)
Assets derecognized or repaid (excluding write-offs)	1,733	467	615	2,815
Transfers to Stage 1	(43)	43	–	–
Transfers to Stage 2	921	(960)	39	–
Transfers to Stage 3	82	–	(82)	–
Impact on period end ECL of exposures transferred between stages during the period	39	(705)	(415)	(1,081)
Changes to inputs used for ECL calculations	112	86	(45)	153
<i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i>				
Unwinding of discount (recognised in interest income)	–	–	(278)	(278)
Recoveries	–	–	(68)	(68)
Amounts written off	–	–	149	149
As at 31 December 2022	(6,239)	(1,841)	(3,303)	(11,383)

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Government related loans during the year ended 31 December 2021 is as follows:

Government related entities	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2021	360,011	3,345	299	363,655
New assets originated or purchased	55,392	-	-	55,392
Assets derecognized or repaid (excluding write-offs)	(48,965)	(3,285)	(184)	(52,434)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	(41,563)	41,563	-	-
Transfers to Stage 3	-	-	-	-
As at 31 December 2021	324,875	41,623	115	366,613

Government related entities	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2021	(3,410)	(994)	(241)	(4,645)
<i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i>				
New assets originated or purchased	(389)	-	-	(389)
Assets derecognized or repaid (excluding write-offs)	1,176	143	184	1,503
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	850	(850)	-	-
Transfers to Stage 3	-	-	-	-
Impact on period end ECL of exposures transferred between stages during the period	-	(97)	-	(97)
Changes to inputs used for ECL calculations	(218)	-	3	(215)
<i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i>				
Unwinding of discount (recognised in interest income)	-	-	(6)	(6)
As at 31 December 2021	(1,991)	(1,798)	(60)	(3,849)

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to corporate loans during the year ended 31 December 2021 is as follows:

Corporate loans	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2021	114,515	76,053	23,218	213,786
New assets originated or purchased	249,073	–	–	249,073
Assets derecognized or repaid (excluding write-offs)	(89,363)	(19,788)	(13,415)	(122,566)
Transfers to Stage 1	6,241	(6,241)	–	–
Transfers to Stage 2	(25,016)	25,091	(75)	–
Transfers to Stage 3	(2,689)	(2,957)	5,646	–
Recoveries	–	–	3,512	3,512
Amounts written off	–	–	(243)	(243)
As at 31 December 2021	252,761	72,158	18,643	343,562

Corporate loans	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2021	(2,442)	(5,380)	(11,670)	(19,492)
<i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i>				
New assets originated or purchased	(9,507)	–	–	(9,507)
Assets derecognized or repaid (excluding write-offs)	1,635	2,351	8,632	12,618
Transfers to Stage 1	(891)	891	–	–
Transfers to Stage 2	2,833	(2,875)	42	–
Transfers to Stage 3	687	1,068	(1,755)	–
Impact on period end ECL of exposures transferred between stages during the period	708	(306)	(413)	(11)
Changes to inputs used for ECL calculations	120	1,154	962	2,236
<i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i>				
Unwinding of discount (recognised in interest income)	–	–	(687)	(687)
Recoveries	–	–	(3,512)	(3,512)
Amounts written off	–	–	243	243
As at 31 December 2021	(6,857)	(3,097)	(8,158)	(18,112)

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Loans to individuals – consumer loans during the year ended 31 December 2021 is as follows:

Loans to individuals – consumer loans	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2021	913,848	383,145	42,331	1,339,324
New assets originated or purchased	1,082,784	–	–	1,082,784
Assets derecognized or repaid (excluding write-offs)	(585,378)	(224,069)	(13,977)	(823,424)
Transfers to Stage 1	53,413	(51,909)	(1,504)	–
Transfers to Stage 2	(325,440)	330,218	(4,778)	–
Transfers to Stage 3	(52,573)	(10,408)	62,981	–
Unwinding of discount	9	1,029	650	1,688
Changes to contractual cash flows due to modifications not resulting in derecognition	40	(430)	(853)	(1,243)
Recoveries	–	–	3,964	3,964
Amounts written off	–	–	(19,591)	(19,591)
As at 31 December 2021	1,086,703	427,576	69,223	1,583,502
Loans to individuals – consumer loans	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2021	(11,362)	(26,248)	(31,161)	(68,771)
<i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i>				
New assets originated or purchased	(31,164)	–	–	(31,164)
Assets derecognized or repaid (excluding write-offs)	6,801	13,982	9,735	30,518
Transfers to Stage 1	(3,719)	2,730	989	–
Transfers to Stage 2	23,185	(26,283)	3,098	–
Transfers to Stage 3	979	2,352	(3,331)	–
Impact on period end ECL of exposures transferred between stages during the period	2,822	(1,011)	(43,344)	(41,533)
Changes to inputs used for ECL calculations	977	1,233	(1,371)	839
<i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i>				
Unwinding of discount (recognised in interest income)	–	–	(2,526)	(2,526)
Recoveries	–	–	(3,964)	(3,964)
Amounts written off	–	–	19,591	19,591
As at 31 December 2021	(11,481)	(33,245)	(52,284)	(97,010)

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Loans to individuals – mortgage loans during the year ended 31 December 2021 is as follows:

<i>Loans to individuals – mortgage loans</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at 1 January 2021	226,299	1,823	1,174	229,296
New assets originated or purchased	83,486	–	–	83,486
Assets derecognized or repaid (excluding write-offs)	(19,663)	(450)	(20)	(20,133)
Transfers to Stage 1	1,695	(1,111)	(584)	–
Transfers to Stage 2	(1,045)	1,121	(76)	–
Transfers to Stage 3	(119)	–	119	–
Recoveries	–	–	(109)	(109)
As at 31 December 2021	290,653	1,383	504	292,540
<i>Loans to individuals – mortgage loans</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2021	(1,318)	(890)	(772)	(2,980)
<i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i>				
New assets originated or purchased	(645)	–	–	(645)
Assets derecognized or repaid (excluding write-offs)	134	225	(6)	353
Transfers to Stage 1	(996)	582	414	–
Transfers to Stage 2	21	(69)	48	–
Transfers to Stage 3	8	–	(8)	–
Impact on period end ECL of exposures transferred between stages during the period	875	(85)	(19)	771
Changes to inputs used for ECL calculations	886	56	165	1,107
<i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i>				
Unwinding of discount (recognised in interest income)	–	–	(48)	(48)
Recoveries	–	–	109	109
As at 31 December 2021	(1,035)	(181)	(117)	(1,333)

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Loans to individuals – entrepreneurs loans during the year ended 31 December 2021 is as follows:

<i>Loans to individuals – entrepreneurs</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at 1 January 2021	5,785	5,136	5,064	15,985
New assets originated or purchased	52,702	–	–	52,702
Assets derecognized or repaid (excluding write-offs)	(3,677)	(4,392)	(683)	(8,752)
Transfers to Stage 1	16	(16)	–	–
Transfers to Stage 2	(4,186)	4,258	(72)	–
Transfers to Stage 3	(454)	(185)	639	–
Recoveries	–	–	345	345
Amounts written off	–	–	(47)	(47)
As at 31 December 2021	50,186	4,801	5,246	60,233
<i>Loans to individuals – entrepreneurs</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2021	(341)	(875)	(3,426)	(4,642)
<i>Movements with impact on credit loss allowance (charge)/reversal in profit or loss</i>				
New assets originated or purchased	(3,474)	–	–	(3,474)
Assets derecognized or repaid (excluding write-offs)	217	797	644	1,658
Transfers to Stage 1	(3)	3	–	–
Transfers to Stage 2	810	(872)	62	–
Transfers to Stage 3	130	65	(195)	–
Impact on period end ECL of exposures transferred between stages during the period	3	24	(38)	(11)
Changes to inputs used for ECL calculations	(69)	86	333	350
<i>Movements without impact on credit loss allowance (charge)/reversal in profit or loss</i>				
Unwinding of discount (recognised in interest income)	–	–	(300)	(300)
Recoveries	–	–	(345)	(345)
Amounts written off	–	–	47	47
As at 31 December 2021	(2,727)	(772)	(3,218)	(6,717)

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Modified and restructured loans

The Bank derecognizes a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognized as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognized loans are classified as Stage 1 for ECL measurement purposes.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, to the extent that an impairment loss has not already been recorded.

The table below includes Stage 2 and 3 assets that were modified during the period, with the related modification loss suffered by the Bank.

	<u>2022</u>	<u>2021</u>
Loans modified during the period		
Amortised cost before modification	70,904	50,442
Net modification loss	(1,934)	(1,243)

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- ▶ For corporate lending, charges over real estate properties and vehicles, third party guarantees;
- ▶ For retail lending, mortgages over residential properties.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

The Bank calculates LGD rate of several corporate and small lending loans in Stage 3 using discounted value of collaterals. As at 31 December 2022, maximum exposure of such loans amounted to AZN 2,934 (2021: AZN 17,158) for which ECL of AZN 1,475 (2021: AZN 5,448) was recognized. If these loans were not collateralized, ECL amount for these loans would be AZN 2,379 (2021: AZN 14,314) based on collective assessment.

(Amounts presented are in thousands of Azerbaijani manats)

9. Property and equipment

The movements in property and equipment were as follows:

	<i>Premises</i>	<i>Leasehold improvements</i>	<i>Computers and other office equipment</i>	<i>Furniture, fixtures, vehicles and others</i>	<i>Total</i>
Cost or revaluation					
1 January 2021	5,381	12,517	23,164	98,088	139,150
Additions	550	4,486	4,990	11,866	21,892
Disposals	(179)	(59)	(7,435)	(9,080)	(16,753)
Effect of revaluation	(86)	-	-	-	(86)
31 December 2021	5,666	16,944	20,719	100,874	144,203
Additions	-	7,146	3,341	17,608	28,095
Disposals	-	(973)	(4,096)	(8,377)	(13,446)
Effect of revaluation	625	-	-	-	625
31 December 2022	6,291	23,117	19,964	110,105	159,477
Accumulated depreciation and impairment					
1 January 2021	(5)	(3,593)	(14,801)	(59,513)	(77,912)
Depreciation charge	(323)	(1,430)	(2,783)	(11,744)	(16,280)
Disposals	21	33	5,291	7,190	12,535
Effect of revaluation	307	-	-	-	307
31 December 2021	-	(4,990)	(12,293)	(64,067)	(81,350)
Depreciation charge	(283)	(1,963)	(2,827)	(13,094)	(18,167)
Disposals	-	462	3,903	8,036	12,401
Effect of revaluation	283	-	-	-	283
31 December 2022	-	(6,491)	(11,217)	(69,125)	(86,833)
Net book value					
31 December 2020	5,376	8,924	8,363	38,575	61,238
31 December 2021	5,666	11,954	8,426	36,807	62,853
31 December 2022	6,291	16,626	8,747	40,980	72,644

As at 31 December 2022, property and equipment amounting to AZN 45,579 (2021: AZN 45,418) were fully depreciated but in use.

As at 31 December 2022, property and equipment contained items in warehouse amounting to AZN 3,933 (2021: AZN 2,714).

The Bank engaged an independent appraiser, "KONEKO" LLC, to determine the revalued amount of its premises as at 31 December 2022 and 2021. Revalued amount is determined by reference to market-based evidence. The valuation method used was comparison analysis. The revaluation gain amounting to AZN 910 (2021: gain AZN 221) has been recognized within other comprehensive income.

If the premises were measured using the cost model, the carrying amounts would be as follows:

	2022	2021
Cost	8,031	8,031
Accumulated depreciation	(5,388)	(4,986)
Net carrying amount	2,643	3,045

(Amounts presented are in thousands of Azerbaijani manats)

10. Intangible assets

The movements in intangible assets were as follows:

	License	Computer software	Total
Cost			
1 January 2021	16,480	18,985	35,465
Additions	7,456	1,563	9,019
Disposals	(2,493)	(138)	(2,631)
31 December 2021	21,443	20,410	41,853
Additions	6,254	4,754	11,008
Disposals	(6,430)	(1,541)	(7,971)
31 December 2022	21,267	23,623	44,890
Accumulated amortization			
1 January 2021	(5,846)	(5,945)	(11,791)
Amortisation charge	(5,034)	(2,047)	(7,081)
Disposals	2,493	138	2,631
31 December 2021	(8,387)	(7,854)	(16,241)
Amortisation charge	(7,343)	(3,077)	(10,420)
Disposals	6,430	1,541	7,971
31 December 2022	(9,300)	(9,390)	(18,690)
Net book value			
31 December 2020	10,634	13,040	23,674
31 December 2021	13,056	12,556	25,612
31 December 2022	11,967	14,233	26,200

11. Right of use assets and lease liability

The movements in right-of-use assets were as follows:

	2022	2021
As at 1 January	34,034	36,819
Additions	6,684	5,002
Lease modification	3,238	(299)
Depreciation expense	(8,924)	(7,488)
As at 31 December	35,032	34,034

The movements in lease liability were as follows:

	2022	2021
As at 1 January	38,954	40,749
Additions	6,684	5,002
Lease modifications	2,852	(677)
Interest expense	4,571	4,441
Payments	(12,030)	(10,561)
As at 31 December	41,031	38,954

(Amounts presented are in thousands of Azerbaijani manats)

12. Taxation

The corporate income tax expense comprises:

	<u>2022</u>	<u>2021</u>
Current tax charge	(92,251)	(49,155)
Deferred benefit/(charge) – origination of temporary differences	3,816	(17,132)
Less: deferred tax recognised in other comprehensive income	35	91
Income tax expense	(88,400)	(66,196)

Deferred tax related to items charged or credited to other comprehensive income during the year is as follows:

	<u>2022</u>	<u>2021</u>
Net gains on debt instruments designated at fair value through OCI	104	–
Net gains on equity instruments designated at fair value through OCI	43	(47)
Revaluation of premises	(182)	(44)
Income tax charged to other comprehensive income	(35)	(91)

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

	<u>2022</u>	<u>2021</u>
Profit before income tax expense	404,086	306,655
Statutory tax rate	20%	20%
Theoretical income tax expense at the statutory rate	(80,817)	(61,331)
Tax effect of items which are not deductible or assessable for taxation purposes		
Non-deductible expenses	(7,615)	(4,850)
Other	32	(15)
Income tax expense	(88,400)	(66,196)

Deferred tax assets and liabilities as at 31 December and their movements for the respective years comprise:

	<u>Origination and reversal of temporary differences</u>			<u>Origination and reversal of temporary differences</u>			
	<u>2020</u>	<u>In the statement of profit or loss</u>	<u>In other comprehensive income</u>	<u>2021</u>	<u>In the statement of profit or loss</u>	<u>In other comprehensive income</u>	<u>2022</u>
Tax effect of deductible temporary differences							
Amounts due from credit institutions	144	(144)	–	–	583	–	583
Investment securities	–	–	–	–	105	147	252
Intangible assets	28	(28)	–	–	–	–	–
Provision for credit related commitments and other impairment	1,229	(914)	–	315	(315)	–	–
Amounts due to customers	–	812	–	812	(136)	–	676
Right of use assets	965	124	–	1,089	192	–	1,281
Other liabilities	9,034	(1,099)	–	7,935	832	–	8,767
Deferred tax assets	11,400	(1,249)	–	10,151	1,261	147	11,559
Cash and cash equivalents	(190)	190	–	–	–	–	–
Amounts due from credit institutions	–	(221)	–	(221)	221	–	–
Investment securities	(553)	574	(47)	(26)	26	–	–
Intangible assets	–	(82)	–	(82)	(146)	–	(228)
Provision for credit related commitments and other impairment	–	–	–	–	(338)	–	(338)
Loans to customers	(32,227)	(13,645)	–	(45,872)	3,171	–	(42,701)
Property and equipment	(2,363)	(1,197)	(44)	(3,604)	548	(182)	(3,238)
Lease liability	(179)	74	–	(105)	99	–	(6)
Other assets	(936)	(1,898)	–	(2,834)	(991)	–	(3,825)
Deferred tax liabilities	(36,448)	(16,205)	(91)	(52,744)	2,590	(182)	(50,336)
Net deferred income tax (liabilities)/asset	(25,048)	(17,454)	(91)	(42,593)	3,851	(35)	(38,777)

(Amounts presented are in thousands of Azerbaijani manats)

13. Credit loss expense and other impairment and provisions

The table below shows the ECL charges on financial instruments recorded in the statement of profit or loss for the year ended 31 December 2022:

	Note	Stage 1	Stage 2	Stage 3	Total
Investment securities	8	(614)	–	(2,691)	(3,305)
Loans to customers at amortised cost	9	(21,932)	3,477	(43,063)	(61,518)
Other financial assets	15	12	1	347	360
Credit loss on financial assets		(22,534)	3,478	(45,407)	(64,463)
Financial guarantees	22	832	(120)	(723)	(11)
Letters of credit	22	(79)	43	–	(36)
Undrawn loan commitments	22	(485)	881	(504)	(108)
Credit related commitments		268	804	(1,227)	(155)
Total credit loss expense		(22,266)	4,282	(46,634)	(64,618)

The table below shows the ECL charges on financial instruments recorded in the statement of profit or loss for the year ended 31 December 2021:

	Note	Stage 1	Stage 2	Stage 3	Total
Investment securities	8	(1,052)	–	–	(1,052)
Loans to customers at amortised cost	9	(5,218)	(4,706)	(25,169)	(35,093)
Other financial assets	15	447	186	(832)	(199)
Credit loss on financial assets		(5,823)	(4,520)	(26,001)	(36,344)
Financial guarantees	22	(406)	592	(13,562)	(13,376)
Letters of credit	22	–	93	–	93
Undrawn loan commitments	22	1,592	2,043	1,328	4,963
Credit-related commitments		1,186	2,728	(12,234)	(8,320)
Total credit loss expense		(4,637)	(1,792)	(38,235)	(44,664)

The movements in other impairment allowances and provisions were as follows:

	Performance guarantees	Total
1 January 2021	(3,028)	(3,028)
Charge	(8,965)	(8,965)
31 December 2021	(11,993)	(11,993)
Reversal for the year	404	404
<i>Movements without impact on (Provision)/reversal of provision for credit related commitments and other impairment in profit or loss</i>		
Payment for issued letter of performance guarantee	9,510	9,510
31 December 2022	(2,079)	(2,079)

(Amounts presented are in thousands of Azerbaijani manats)

14. Other assets and liabilities

Other assets comprise:

	2022	2021
Other financial assets		
Funds in settlement	116,381	61,165
Derivative financial assets	15,972	7,160
Receivable from local budget	12,590	22,002
Accrued commission	2,747	4,856
Less: allowance for impairment of other assets	(4,029)	(4,414)
Total other financial assets	143,661	90,769
Other non-financial assets		
Prepaid rent and other deferred expenses	49,099	6,613
Repossessed collateral	10,420	8,723
Prepayments	8,113	6,465
Spare parts	214	285
Total other non-financial assets	67,846	22,086
Other assets	211,507	112,855

During 2022, the Bank has entered into a 20-year lease agreement with a related party for a new head office premise with the commencement date at the end of December 2023. To secure this lease, the Bank was required to make an upfront payment. As at 31 December 2022, prepaid rent and other deferred expenses includes prepaid rental fee for a 5-year period for the new head office in the amount of AZN 38,213.

An analysis of changes in the ECLs for other financial assets for 31 December 2022 is, as follows:

	Stage 1	Stage 2	Stage 3	Total
ECL at 1 January 2022	(15)	(37)	(4,362)	(4,414)
Reversal/(charge) for the period	12	1	347	360
Amounts written-off	-	-	25	25
As at 31 December 2022	(3)	(36)	(3,990)	(4,029)

An analysis of changes in the ECLs for other financial assets for 31 December 2021 is as follows:

	Stage 1	Stage 2	Stage 3	Total
ECL at 1 January 2021	(462)	(223)	(6,035)	(6,720)
Reversal/(charge) for the period	447	186	(832)	(199)
Amounts written-off	-	-	2,505	2,505
As at 31 December 2021	(15)	(37)	(4,362)	(4,414)

Other liabilities comprise:

	2022	2021
Other financial liabilities		
Funds in settlement	18,313	23,607
Provision for financial guarantees and other credit related commitments	10,566	24,676
Accrued expenses	8,510	7,997
Total other financial liabilities	37,389	56,280
Other non-financial liabilities		
Payables to employees	45,341	36,152
Deferred revenue	11,834	7,827
Contract liabilities	11,709	12,455
Payables to local budget	11,355	11,791
Taxes other than income tax	2,187	2,041
Provision for performance guarantees	2,079	11,993
Total other non-financial liabilities	84,505	82,259
Other liabilities	121,894	138,539

(Amounts presented are in thousands of Azerbaijani manats)

14. Other assets and liabilities (continued)

The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset or liability, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of the credit risk.

	31 December 2022			31 December 2021		
	Notional amount	Fair values		Notional amount	Fair value	
		Asset	Liability		Asset	Liability
Foreign exchange contracts						
Swaps – domestic	325,530	15,972	–	253,498	7,160	–
Total derivative assets		15,972			7,160	–

15. Amounts due to customers

Amounts due to customers comprise:

	2022	2021
Legal entities		
Current accounts	4,089,591	3,780,220
Term deposits	298,665	270,709
Individuals		
Current accounts	1,205,998	729,963
Term deposits	563,792	547,705
Amounts due to customers	6,158,046	5,328,597
Held as security against guarantees and letters of credit (Note 22)	(31,077)	(67,414)

At 31 December 2022, the Bank had amounts due to ten (2021: ten) largest customers with aggregate balance of AZN 2,527,056 or 41% of total amounts due to customers (2021: AZN 2,386,241 or 45%).

An analysis of customer accounts by economic sector follows:

	2022		2021	
	Amount	%	Amount	%
Individuals	1,769,790	29%	1,277,668	24%
Construction	1,226,926	20%	923,250	17%
Trade and services	1,126,641	18%	653,760	12%
Insurance	720,277	12%	903,615	18%
Energy	596,994	10%	800,618	15%
Education	237,850	4%	206,998	4%
Transportation & Communication	158,066	2%	170,431	3%
Agriculture	139,061	2%	163,476	3%
Manufacturing	116,562	2%	172,998	3%
Other	65,879	1%	55,783	1%
Amounts due to customers	6,158,046	100%	5,328,597	100%

16. Debt securities issued

As at 31 December 2022, the Bank had one class of bonds in USD amounting to AZN 59,578 issued in December 2020 and maturing on 24 December 2027 (2021: 24 December 2027). The issuance was conducted through private placement on Baku Stock Exchange, and the bonds were delisted after being purchased by counterparties. The Bank is not obliged to comply with any financial or non-financial covenants in relation to these debt securities.

(Amounts presented are in thousands of Azerbaijani manats)

17. Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations

Amounts due to the CBAR and government organizations comprise:

	<u>2022</u>	<u>2021</u>
Azerbaijan Mortgage and Credit Guarantee Fund	276,006	234,260
Educational Student Credit Fund	90,463	79,865
Entrepreneurship Development Fund of the Republic of Azerbaijan	34,530	21,887
Agency for Agro Credit and Development	1,857	2,171
Central Bank of the Republic of Azerbaijan	1,080	1,620
Amounts due to the CBAR and government organizations	<u>403,936</u>	<u>339,803</u>

In 2005, the Bank signed a credit agreement with National Fund for Support of Entrepreneurship, a program under the Ministry of Economic Development of the Republic of Azerbaijan, for financing of small and medium sized enterprises. Name of the fund was change to Entrepreneurship Development Fund of the Republic of Azerbaijan in 2018. Under this program, funds are made available to the Bank at an interest rate of 1% p.a. (2021: 1% p.a.) and mature during 2023-2031 (2021: 2022-2026). The Bank uses these funds to issue loans to eligible borrowers at rates not higher than 7% p.a.

In 2016, the Bank signed a credit agreement with the Azerbaijan Mortgage Fund OJSC for granting long-term mortgage loans to individuals. Name of the fund was change to Azerbaijan Mortgage and Credit Guarantee Fund OJSC in 2018. Under this program, funds are made available to the Bank at interest rates between 1% and 4% p.a. (2021: 1% and 4% p.a.) and mature in 2023-2052 (2021: 2022-2051). The Bank is obliged to make these funds to issue loans to eligible borrowers at rates not higher than 8.0% p.a.

In 2018, the Bank signed a credit agreement with the Agency for Agro Credit and Development, a program under the Ministry of Agriculture of the Republic of Azerbaijan, for financing enterprises in agriculture sector. Under this program, funds are made available to the Bank at interest rates 2% and 3% p.a. (2021: 2% p.a.) and mature in 2023-2027 (2021: 2022-2026). The Bank is obliged to make these funds to issue loans to eligible borrowers at rates not higher than 7% p.a. (2021: 7% p.a.).

In 2021, the Bank signed a credit agreement with Educational Student Credit Fund, a program under the Ministry of Education of the Republic of Azerbaijan, for financing students' education fees. Educational Student Credit Fund was created by the decree of the President of Azerbaijan Republic in 2021 and the charter of this fund is AZN 90,463 (2021: AZN 79,865) which has been transferred to the Fund's current account at the Bank as at 31 December 2022. Under this program, loans terms and interest rates will be defined by the Fund. The Bank will finance loans of eligible students and the Fund will subsequently transfer financed amount to the Bank. The Fund will bear all credit risks associated with those loans.

18. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	<u>2022</u>	<u>2021</u>
Current accounts	15,900	7,199
Time deposits from financial institutions	2,769	817
Amounts due to credit institutions	<u>18,669</u>	<u>8,016</u>

19. Subordinated loan

At 31 December 2022, the Bank had a subordinated loan from one resident bank with balance of AZN 8,521 (2021: 8,521) denominated in USD.

(Amounts presented are in thousands of Azerbaijani manats)

20. Equity

As at 31 December 2022, the Bank's share capital is represented by ordinary and preference shares. Ordinary shares were registered at State Securities Committee of the Republic of Azerbaijan on 17 July 2014, thus, authorized, issued and fully paid up capital comprised of 16,614,205 ordinary shares with nominal amount of 12.39 Azerbaijani manat per ordinary share as at 31 December 2022 (2021:15,000,000). Each ordinary share carries one vote.

On 12 October 2022, in accordance with the decision of shareholders, the Bank authorized to issue ordinary shares with nominal amount of 12.39 for the total amount of AZN 20,000, which were fully paid by the shareholders by the end of 2022. The share capital of the Bank was contributed by shareholders in Azerbaijani manat and they are entitled to dividends and any capital distribution in Azerbaijani manat. As at 31 December 2022, the balance of share capital is AZN 265,850 (2021: AZN 245,850).

According to the decision of the General Shareholders' Meeting held on 14 March 2022, the Bank declared dividends in respect of the year ended 31 December 2021 in the amount of AZN 144,273 on ordinary shares and in the amount of AZN 9,000 on preference shares (both amounts include 10% withholding tax to be paid on behalf of shareholders). The dividends were fully paid during 2022.

According to the decision of the General Shareholders' Meeting held on 1 April 2021, the Bank declared dividends in respect of the year ended 31 December 2020 in the amount of AZN 152,330 on ordinary shares and in the amount of AZN 7,015 on preference shares (both amounts include 10% withholding tax to be paid on behalf of shareholders). The dividends were fully paid during 2021, along with the dividends of AZN 11,600 that were declared in 2020 but paid in 2021.

All amounts include 10% withholding tax to be paid on behalf of shareholders.

Revaluation reserve for premises

The revaluation reserve is used to record increases in the fair value of premises and decreases to the extent that such decrease relates to an increase on the same asset previously recognised in equity.

Unrealised gains on investment securities

This reserve records fair value changes on investment securities designated at FVOCI.

21. Commitments and contingencies

Operating environment

The Bank conducts all of its operations in the Republic of Azerbaijan. The economy of Azerbaijan is particularly sensitive to oil and gas prices. During recent years, the Azerbaijani Government has initiated major economic and social reforms to accelerate the transition to a more balanced economy and reduce dependence on the oil and gas sector.

The disruption of the global supply chains, conflict between the Russian Federation and Ukraine as well as rising consumer demand for goods led to significant inflationary pressures to the global economy in 2022, including soaring commodity prices. During 2022, oil and gas prices reached multi-year highs, contributing to significant trade surplus, and increased foreign currency inflows into the Azerbaijani economy. The prices declined towards the end of the year, but still remained high compared to previous few years. These global trends contributed to inflationary pressures in the country.

With inflation at multi-decade highs in many countries, policymakers in advanced economies have pivoted toward tightening of their monetary policies through reduction of their balance sheets and aggressive interest rate hikes. In the event of global recession, which might be triggered by such tightening, demand for hydrocarbons will fall, which would negatively impact Azerbaijan economy.

During 2021 and 2022, the CBAR continued to maintain stability of the Azerbaijani manat, which was kept flat at 1.7000 for 1 USD throughout the period. During 2022, the CBAR continued to tighten its monetary policy, and, as a result, refinancing rate reached 8.25% as at 31 December 2022 (31 December 2021: 7.25%).

During 2022, global rating agencies have revised up growth forecast for Azerbaijan and upgraded Azerbaijani Government's credit rating by one notch. The upgrade reflects the effectiveness of economic policy in recent years, expressed in better fiscal management and greater ability to absorb future disruptions during the post pandemic period. Fiscal performance remains strong and is improving faster than expected, thanks to prudent fiscal management amid economic recovery and high hydrocarbon prices.

(Amounts presented are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Operating environment (continued)

The Bank's management is monitoring economic developments in the current environment and taking precautionary measures it considers necessary in order to support the sustainability and development of the Bank's business in the foreseeable future. The Bank considers its current liquidity position to be sufficient for its sustainable functioning. The Bank monitors its liquidity position on a daily basis.

Legal

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank.

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within the Republic of Azerbaijan suggest that the tax authorities may be taking a more assertive position in their interpretation and application of this legislation and assessments. It is therefore possible that transactions and activities of the Bank that have not been challenged in the past may be challenged at any time in the future. As a result, significant additional taxes, penalties and interest may be assessed by the relevant authorities. Fiscal periods remain open and subject to review by the tax authorities for a period of three calendar years immediately preceding the year in which the decision to conduct a tax review is taken. The last tax audit covered first half of 2017.

Management's interpretation of the relevant legislation as at 31 December 2022 is appropriate and the Bank's tax, currency and customs positions will be sustained.

Insurance

The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions.

Compliance with the CBAR ratios

The CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2022, the Bank was in compliance with these ratios except for:

- ▶ Maximum credit exposure of a bank per a single borrower or a group of related borrowers that should not exceed 10 percent of the bank's Tier 1 capital on unsecured loan. As at 31 December 2022, the Bank's ratio was 12.48% (2021: 13.90%).

The breach of this ratio was caused by investment made for government related projects.

Throughout the year the Bank submitted information regarding these breaches to the CBAR on a monthly basis and no sanctions were imposed on the Bank. Management believes that the Bank will not face any sanctions against the Bank in the future.

Financial commitments and contingencies

The Bank provides guarantees and letters of credit to customers with primary purpose of ensuring that funds are available to a customer as required. Guarantees and standby letters of credit represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorizing a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralized by the underlying shipments of goods, to which they relate, or cash deposits and, therefore, carry less risk than a direct borrowing.

(Amounts presented are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

As at 31 December, the Bank's financial commitments and contingencies comprised the following:

	<u>2022</u>	<u>2021</u>
Credit related commitments		
Undrawn loan commitments	912,857	855,603
Financial guarantees	584,476	350,726
Letters of credit	33,741	64,821
Performance guarantees	166,513	173,719
Less: provisions for ECL for credit related commitments	(10,566)	(24,676)
Less: provisions for performance guarantees (Note 14)	(2,079)	(11,993)
Commitments and contingencies (before deducting collateral)	1,684,942	1,408,200
Less: cash held as security against guarantees and letters of credit (Note 16)	(31,077)	(67,414)
Commitments and contingencies	<u>1,653,865</u>	<u>1,340,786</u>

An analysis of changes in the ECLs during the year ended 31 December 2022 is as follows:

<i>Financial guarantees</i>	<u>Stage 1</u>	<u>Stage 2</u>	<u>Stage 3</u>	<u>Total</u>
ECLs as at 1 January 2022	(1,543)	(233)	(13,589)	(15,365)
New exposures	(759)	-	-	(759)
Exposures derecognised or matured (excluding write-offs)	651	196	-	847
Transfers to Stage 1	(254)	45	209	-
Transfers to Stage 2	362	(362)	-	-
Transfers to Stage 3	6	-	(6)	-
Impact on period end ECL of exposures transferred between stages during the period	244	(25)	(41)	178
Changes to inputs used for ECL calculations	582	26	(885)	(277)
<i>Movements without impact on (Provision)/reversal of provision for credit related commitments and other impairment in profit or loss</i>				
Payment for issued letter guarantee	-	-	14,265	14,265
Aa at 31 December 2022	<u>(711)</u>	<u>(353)</u>	<u>(47)</u>	<u>(1,111)</u>
Undrawn loan commitments	<u>Stage 1</u>	<u>Stage 2</u>	<u>Stage 3</u>	<u>Total</u>
ECLs as at 1 January 2022	(4,771)	(3,706)	(790)	(9,267)
New exposures	(5,942)	-	-	(5,942)
Exposures derecognised or matured (excluding write-offs)	2,607	1,512	222	4,341
Transfers to Stage 1	(1,493)	1,473	20	-
Transfers to Stage 2	1,916	(1,927)	11	-
Transfers to Stage 3	531	7	(538)	-
Impact on period end ECL of exposures transferred between stages during the period	1,284	(564)	(44)	676
Changes to inputs used for ECL calculations	612	380	(175)	817
As at 31 December 2022	<u>(5,256)</u>	<u>(2,825)</u>	<u>(1,294)</u>	<u>(9,375)</u>

(Amounts presented are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

<i>Letters of credit</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECLs as at 1 January 2022	-	(44)	-	(44)
New exposures	(80)	-	-	(80)
Exposures derecognised or matured (excluding write-offs)	-	44	-	44
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	1	(1)	-	-
Transfers to Stage 3	-	-	-	-
Impact on period end ECL of exposures transferred between stages during the period	-	-	-	-
As at 31 December 2022	(79)	(1)	-	(80)

An analysis of changes in the ECLs during the year ended 31 December 2021 is as follows:

<i>Financial guarantees</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECLs as at 1 January 2021	(1,137)	(825)	(27)	(1,989)
New exposures	(1,559)	-	-	(1,559)
Exposures derecognised or matured (excluding write-offs)	526	536	27	1,089
Transfers to Stage 1	(96)	96	-	-
Transfers to Stage 2	137	(137)	-	-
Transfers to Stage 3	209	61	(270)	-
Impact on period end ECL of exposures transferred between stages during the period	81	(11)	(13,319)	(13,249)
Changes to inputs used for ECL calculations	296	47	-	343
As at 31 December 2021	(1,543)	(233)	(13,589)	(15,365)

<i>Undrawn loan commitments</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECLs as at 1 January 2021	(6,363)	(5,749)	(2,118)	(14,230)
New exposures	(6,282)	-	-	(6,282)
Exposures derecognised or matured (excluding write-offs)	2,120	2,911	1,953	6,984
Transfers to Stage 1	(1,426)	1,338	88	-
Transfers to Stage 2	3,100	(3,157)	57	-
Transfers to Stage 3	674	33	(707)	-
Impact on period end ECL of exposures transferred between stages during the period	1,281	(26)	(69)	1,186
Changes to inputs used for ECL calculations	2,125	944	6	3,075
As at 31 December 2021	(4,771)	(3,706)	(790)	(9,267)

<i>Letters of credit</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECLs as at 1 January 2021	-	(137)	-	(137)
New exposures	(44)	-	-	(44)
Exposures derecognised or matured (excluding write-offs)	-	142	-	142
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	44	(44)	-	-
Transfers to Stage 3	-	-	-	-
Impact on period end ECL of exposures transferred between stages during the period	-	(5)	-	(5)
As at 31 December 2021	-	(44)	-	(44)

(Amounts presented are in thousands of Azerbaijani manats)

22. Net fee and commission income

Net fee and commission income comprises:

	<u>2022</u>	<u>2021</u>
Servicing plastic card operations	177,920	133,424
Settlement operations	26,060	17,818
Cash operations	27,203	20,948
Guarantees and commitments	14,544	10,293
Other	6,951	6,553
Fee and commission income	<u>252,678</u>	<u>189,036</u>
Servicing plastic card operations	(56,180)	(43,267)
Settlement operations	(17,105)	(14,279)
Cash operations	(4,785)	(8,092)
Guarantees and commitments	(655)	(1,434)
Other	(7,741)	(3,934)
Fee and commission expense	<u>(86,466)</u>	<u>(71,006)</u>
Net fee and commission income	<u>166,212</u>	<u>118,030</u>

23. Other operating income

As at 31 December 2022, other operating income of AZN 17,351 (2021: AZN 13,886) primarily comprise income from online payment services for utilities and telecommunication, income from plastic card campaigns and other individually insignificant items.

24. Personnel expenses

Personnel expenses comprise:

	<u>2022</u>	<u>2021</u>
Salaries and bonuses	(136,291)	(109,714)
Social security costs	(24,513)	(18,774)
Other employee related expenses	(3,603)	(2,542)
Personnel expenses	<u>(164,407)</u>	<u>(131,030)</u>

25. General and administrative expenses

General and administrative expenses comprise:

	<u>2022</u>	<u>2021</u>
Sponsorship	(23,571)	(15,077)
Repair and maintenance of property and equipment	(17,619)	(11,997)
Legal and consultancy	(15,002)	(13,369)
Communications	(13,881)	(10,070)
Marketing and advertising	(13,029)	(8,923)
Deposit Insurance Fund expenses	(12,060)	(7,926)
Security	(4,676)	(3,974)
Representation expenses	(4,498)	(3,405)
Office supplies	(4,112)	(3,718)
Occupancy and rent	(2,069)	(2,491)
Utilities	(1,919)	(1,712)
Insurance on properties and equipment	(1,877)	(1,456)
Business travel and related expenses	(1,119)	(866)
Transportation and vehicle maintenance	(657)	(663)
Taxes other than income tax	(629)	(583)
Expenses on Equipment rent	(6)	(147)
Other	(9,128)	(3,865)
General and administrative expenses	<u>(125,852)</u>	<u>(90,242)</u>

Other expenses mainly include expenses related to plastic card orders and manufacturing.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management

Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk. It is also subject to operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Risk management structure

The Supervisory Board is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Supervisory Board

The Supervisory Board is responsible for the overall risk management approach and for approving the risk strategies and principles.

Audit Committee

The Audit Committee has the overall responsibility for the establishment and development of the audit mission and strategy. It is responsible for the fundamental audit issues and monitoring Internal Audit's activities.

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Bank.

Risk Committee

The Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Risk Management

The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Bank Treasury

Bank Treasury is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

Internal Audit

Risk management processes throughout the Bank are audited annually by the internal audit function that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting systems

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risks types and activities.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Introduction (continued)

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Management Board, the Risk Committee, and the head of each business division. The report includes aggregate credit exposure, hold limit exceptions and liquidity ratios. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Management Board receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

For all levels throughout the Bank, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

A daily briefing is given to the Management Board and all other relevant employees of the Bank on the utilization of market limits and liquidity, plus any other risk developments.

Risk mitigation

Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry.

In order to avoid excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the statement of financial position.

Credit-related commitments risks

The Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

The maximum exposure to credit risk for the components of the statement of financial position, before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

Where financial instruments are recorded at fair value, the carrying value represents the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 8.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

Impairment assessment

The Bank calculates ECL based on several probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. The mechanics of the ECL calculations are outlined below and the key elements are as follows:

PD	The <i>Probability of Default</i> is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.
EAD	The <i>Exposure at Default</i> is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.
LGD	The <i>Loss Given Default</i> is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12mECL). The 12mECL is the portion of LTECL that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Both LTECL and 12mECL are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments.

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. Based on the above process, the Bank groups its loans into Stage 1, Stage 2, Stage 3 and POCI, as described below:

Stage 1:	When loans are first recognized, the Bank recognizes an allowance based on 12mECL. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.
Stage 2:	When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECL. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.
Stage 3:	Loans considered credit-impaired. The Bank records an allowance for the LTECL.
POCI:	Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and interest revenue is subsequently recognised based on a credit-adjusted EIR. ECL are only recognised or released to the extent that there is a subsequent change in the lifetime expected credit losses.

Definition of default and cure

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Bank considers amounts due from banks defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikelihood to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

Such events include:

- ▶ Default and Credit-impaired assets:
 - ▶ Loans with principal amount and/or accrued interest and/or any of other payment overdue by more than 90 days from the date specified in the contract;
 - ▶ 2 times within three years restructured loans that have been overdue (in principal amount and/or accrued interest and/or any of other payment) less than 30 days from the date specified in the contract at the moment of each particular restructuring;
 - ▶ “Non-healthy” restructured loans that were PAR 30 at the moment of restructuring; (originally in Stage 3), when NPV loss restructuring is more than 10%;
 - ▶ Any loan considered by management as non-performing (except non-performing loans that meet Stage 2 criteria);
 - ▶ Retail loans, residential mortgages and private banking retail loans that have been restructured according to the following conditions:
 - ▶ All restructurings with more than 90 days overdue;
 - ▶ For those who have been restructured more than once, if the status of the previous restructured loan was Stage 3 or Stage 2 restructuring at the time of the last restructuring;
 - ▶ Transfer of liabilities under the loan of the borrower to another individual (excluding mortgage loans);
 - ▶ Full or partial forgiveness of accrued interest or principal;
 - ▶ Restructuring of the term of the new loan for a period longer than 7 years (excluding mortgage loans).
- ▶ Granting a grace period of more than 3 (three) months to the loan payment schedule;
- ▶ Existing of information that borrower will/has enter bankruptcy, insolvency or a similar condition;
- ▶ Default (according to IRB and External Rating);
- ▶ Default on other financial instruments of the same borrower.

It is the Bank’s policy to consider a financial instrument as ‘cured’ and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

Internal rating and PD estimation process

The Bank’s Risk Department operates its internal rating models. The Bank runs separate models for its key portfolios in which its corporate customers are rated based on Moody’s model. Small and medium enterprises are scored from 1 to 20 using internal grades. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilise supplemental external information that could affect the borrower’s behaviour. Where practical, they also build on information from the national and international external rating agencies. PDs, incorporating forward looking information and the IFRS 9 stage classification of the exposure, are assigned for each grade. This is repeated for each economic scenario as appropriate.

The Bank uses specific variables to determine the PD base rates for consumer lending products such as unsecured personal loans, credit cards, and overdrafts. These variables include borrower attributes such as credit history, transaction volumes of customers with debit cards issued by the Bank, workplace, region of residence, age, and gender. The selection and weighting of these variables is based on statistical analysis of historical data and expert judgment, ensuring that the PD model accurately predicts the probability of default for different types of borrowers.

Treasury and interbank relationships

The Bank’s treasury and interbank relationships and counterparties comprise financial services institutions, banks, broker-dealers, exchanges and clearing-houses. For these relationships, the Bank analyses publicly available information such as financial information and other external data, e.g., the external ratings, and assigns the internal rating, as shown in the table below.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

Corporate and small business lending

For corporate loans, the borrowers are assessed by specialised credit risk employees of the Bank. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as:

- ▶ Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance;
- ▶ Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies;
- ▶ Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates;
- ▶ Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

The complexity and granularity of the rating techniques varies based on the exposure of the Bank and the complexity and size of the customer. Some of the less complex small business loans are rated within the Bank's models for retail products.

Consumer lending and residential mortgages

The Bank has implemented modifications to its calculation of Expected Credit Losses (ECL) for its retail loan portfolio. The modifications include the adoption of a new Probability of Default (PD) model and updates to the staging and recovery criteria for restructured retail loans. The new PD model incorporates a more comprehensive and detailed approach, accounting for a wider range of financial and borrower-specific factors, while the updated staging and recovery criteria consider more specific restructuring conditions. Given the intricacy of these modifications and the uncertainty surrounding their impact in the future, the Bank has determined that it is impracticable to estimate the effect of the changes at this time. The Bank has complied with the disclosure requirements of IAS 8 by disclosing this fact in its financial statements.

Consumer lending comprises unsecured cash loans, credit card loans and overdrafts. The Bank categorizes these loans into three groups for internal management purposes - non-pension, pension, and street. These categories have specific variables, such as credit history, transaction volumes of customers with debit cards issued by the Bank, workplace, region of residence, age, and gender of borrowers, which are used to determine base PD rates. These variables are critical in evaluating the risk of a borrower defaulting on a loan, and they are used to calculate the ECL. The final selection of variables for a predictive model is based on their economic and statistical significance and their relationship with the likelihood of default. Economic significance refers to the practical importance of the variable in predicting a default, while statistical significance is the degree to which the variable is associated with the probability of default. A strong relationship indicates a significant impact on default likelihood, while a moderate relationship indicates a relatively smaller impact.

Residential mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by debt to income (DTI) and payment to income (PTI) ratios. Other key inputs into the models are GDP growth, changes in personal income/salary levels, personal indebtedness.

The Bank's internal credit rating grades are as follows:

Internal rating for consumer loans is based on overdue days. High grade rating is used for local currency balances of the Central Bank of Azerbaijan Republic and the Ministry of Finance of the Republic of Azerbaijan.

Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too. To calculate the EAD for a Stage 1 loan, the Bank assesses the possible default events within 12 months for the calculation of the 12mECL. For Stage 2, Stage 3 financial assets, the exposure at default is considered for events over the lifetime of the instruments.

The Bank determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding the multiple scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of Bank's models.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

Loss given default

For corporate lending assets, LGD values are assessed at least quarterly by account managers and reviewed and approved by the Bank.

The credit risk assessment is based on a standardized LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The Bank segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type) as well as borrower characteristics.

Where appropriate, further recent data is used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in, collateral values including property prices for mortgages, commodity prices, payment status or other factors that are indicative of losses in the group.

LGD rates are estimated for the Stage 1, Stage 2, Stage 3 and POCI segment of each asset class.

Significant increase in credit risk

The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Bank assesses whether there has been a significant increase in credit risk since initial recognition.

The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming restructured due to credit event. In certain cases, the Bank may also consider that events explained in "Definition of default" section above are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

When estimating ECLs on a collective basis for a group of similar assets, the Bank applies the same principles for assessing whether there has been a significant increase in credit risk since initial recognition.

Grouping financial assets measured on a collective basis

Dependent on the factors below, the Bank calculates ECLs either on a collective or on an individual basis.

Asset classes where the Bank calculates ECL on an individual basis include:

- ▶ PD for all corporate and small business lending;
- ▶ LGD for Stage 3 corporate and small business lending which are above predetermined threshold and are collateralized.

Asset classes where the Bank calculates ECL on a collective basis include:

- ▶ PD and LGD for all retail consumer and mortgages lending;
- ▶ LGD for all corporate and small business lending which are in Stage 1 and Stage 2;
- ▶ LGD for corporate and small business lending which are in Stage 3, neither are above predetermined threshold nor are collateralized.

Forward-looking information and multiple economic scenarios

In its ECL models, the Bank relies on a broad range of forward-looking information as economic inputs, such as:

- ▶ GDP growth rates;
- ▶ NPL rates;
- ▶ Consumption growth rates;
- ▶ Inflation;
- ▶ Unemployment rate;
- ▶ Monetary policy rate;
- ▶ Dynamics of real and nominal effective exchange rates;
- ▶ Real estate price.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

The Bank obtains the forward-looking information from third party sources (external rating agencies, governmental bodies e.g. central banks, and international financial institutions). Experts of the Bank's Credit Risk Department determine the weights attributable to the multiple scenarios. The tables show the values of the key forward looking economic variables/ assumptions used in each of the economic scenarios for the ECL calculations. The figures for "Subsequent years" represent a long-term average and so are the same for each scenario as at 31 December 2022.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank's internal credit ratings, as described above. The table below shows the credit quality by class of asset for loan-related lines in the statement of financial position, based on the Bank's credit rating system.

31 December 2022	Note		High grade	Standard grade	Sub-standard grade	Impaired	Total
Cash and cash equivalents, except for cash on hand and in transit	5	Stage 1	436,449	323,292	–	–	759,741
		Stage 2	–	–	17,724	–	17,724
Amounts due from credit institutions	6	Stage 1	264,014	125,141	2,745	–	391,900
		Stage 2	–	–	524	–	524
Loans to customers at amortised cost	8						
- Government related entities		Stage 1	–	235,346	25,500	–	260,846
		Stage 2	–	6	30	–	36
		Stage 3	–	–	–	59	59
- Corporate loans		Stage 1	–	333,660	57,811	–	391,471
		Stage 2	–	30,477	55,030	–	85,507
		Stage 3	–	–	–	7,279	7,279
- Loans to individuals – consumer loans		Stage 1	–	1,638,353	129	–	1,638,482
		Stage 2	–	113,177	21,164	–	134,341
		Stage 3	–	–	–	47,398	47,398
- Loans to individuals – mortgage loans		Stage 1	–	397,038	953	–	397,991
		Stage 2	–	17,863	1,276	–	19,139
		Stage 3	–	–	–	1,195	1,195
- Loans to individuals – entrepreneurs		Stage 1	–	143,621	6,864	–	150,485
		Stage 2	–	5,118	7,303	–	12,421
		Stage 3	–	–	–	5,363	5,363
Debt securities at amortised cost	7	Stage 1	1,387,037	828,931	–	–	2,215,968
		Stage 3	–	–	–	2,691	2,691
Debt securities at FVOCI	7	Stage 1	298,992	–	–	–	298,992
Financial guarantees	21	Stage 1	–	380,552	145,284	–	525,836
		Stage 2	–	15,460	43,047	–	58,507
		Stage 3	–	–	–	133	133
Undrawn loan commitments	21	Stage 1	–	831,197	7,947	–	839,144
		Stage 2	–	51,786	16,855	–	68,641
		Stage 3	–	–	–	5,072	5,072
Letters of credit	21	Stage 1	–	11,123	15,138	–	26,261
		Stage 2	–	112	7,368	–	7,480
Total			2,386,492	5,482,253	432,692	69,190	8,370,627

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

31 December 2021	Note		High grade	Standard grade	Sub-standard grade	Impaired	Total
Cash and cash equivalents, except for cash on hand	5	Stage 1	1,383,985	527,981	-	-	1,911,966
Amounts due from credit institutions	6	Stage 1	93,494	158,172	3,201	-	254,867
Loans to customers at amortised cost	8						
- Government related entities		Stage 1	-	290,755	34,120	-	324,875
		Stage 2	-	655	40,968	-	41,623
		Stage 3	-	-	-	115	115
- Corporate loans		Stage 1	-	202,418	50,343	-	252,761
		Stage 2	-	5,122	67,036	-	72,158
		Stage 3	-	-	-	18,643	18,643
- Loans to individuals – consumer loans		Stage 1	-	1,086,537	166	-	1,086,703
		Stage 2	-	412,016	15,560	-	427,576
		Stage 3	-	-	-	69,223	69,223
- Loans to individuals – mortgage loans		Stage 1	-	289,929	724	-	290,653
		Stage 2	-	1,161	222	-	1,383
		Stage 3	-	-	-	504	504
- Loans to individuals – entrepreneurs		Stage 1	-	48,584	1,602	-	50,186
		Stage 2	-	1,406	3,395	-	4,801
		Stage 3	-	-	-	5,246	5,246
Debt securities at amortised cost	7	Stage 1	773,828	217,312	-	-	991,140
Debt securities at FVOCI	7	Stage 1	134,779	-	-	-	134,779
Financial guarantees	21	Stage 1	-	257,893	64,149	-	322,042
		Stage 2	-	2,084	11,931	-	14,015
		Stage 3	-	-	-	14,669	14,669
Undrawn loan commitments	21	Stage 1	-	717,706	31,627	-	749,333
		Stage 2	-	86,526	15,393	-	101,919
		Stage 3	-	-	-	4,351	4,351
Letters of credit	21	Stage 1	-	57,874	-	-	57,874
		Stage 2	-	6,947	-	-	6,947
Total			<u>2,386,086</u>	<u>4,371,078</u>	<u>340,437</u>	<u>112,751</u>	<u>7,210,352</u>

More detailed information with respect to the allowance for impairment of loans to customers is provided in Note 8.

Financial guarantees, letters of credit and loan commitments are assessed and a provision for expected credit losses is calculated in similar manner as for loans.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

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

	2022				2021			
	Azerbaijan	OECD	CIS and other countries	Total	Azerbaijan	OECD	CIS and other countries	Total
Assets								
Cash and cash equivalents	1,405,397	101,433	54,767	1,561,597	2,518,704	49,127	40,054	2,607,885
Amounts due from credit institutions	345,446	18,573	28,405	392,424	120,872	101,058	32,937	254,867
Investment securities	2,143,669	369,242	9,512	2,522,423	973,556	142,967	17,865	1,134,388
Loans to customers	3,027,076	379	826	3,028,281	2,517,479	273	1,677	2,519,429
Other financial assets	131,069	9,695	2,897	143,661	73,584	15,530	1,655	90,769
	7,052,657	499,322	96,407	7,648,386	6,204,195	308,955	94,188	6,607,338
Liabilities								
Amounts due to customers	6,082,472	22,449	53,125	6,158,046	5,290,123	20,878	17,596	5,328,597
Amounts due to the Central Bank of the Republic of Azerbaijan, and government organizations	403,936	-	-	403,936	339,803	-	-	339,803
Debt Securities issued	59,578	-	-	59,578	59,578	-	-	59,578
Subordinated loan	8,521	-	-	8,521	8,521	-	-	8,521
Amounts due to credit institutions	17,587	13	1,069	18,669	7,628	14	374	8,016
Other financial liabilities	37,283	31	75	37,389	56,280	-	-	56,280
	6,609,377	22,493	54,269	6,686,139	5,761,933	20,892	17,970	5,800,795
Net assets	443,280	476,829	42,138	962,247	442,262	288,063	76,218	806,543

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high-grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. In addition, the Bank maintains obligatory reserves with the CBAR, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank based on certain liquidity ratios established by the CBAR. The CBAR requires banks to maintain instant liquidity ratio of more than 30%. As at 31 December, these ratios were as follows:

	2022, %	2021, %
Instant Liquidity Ratio (assets receivable or realisable within one day / liabilities repayable on demand)	49.83	61.31

Analysis of financial liabilities by remaining contractual maturities

The table below summarizes the maturity profile of the Bank's financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Liquidity risk and funding management (continued)

As at 31 December 2022	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations	106,634	26,200	96,618	254,012	483,464
Amounts due to credit institutions	17,485	1,062	122	8	18,677
Amounts due to customers	5,466,443	527,549	205,569	38	6,199,599
Debt Securities issued	1,076	2,996	75,403	-	79,475
Lease liability	3,050	8,999	28,558	10,869	51,476
Subordinated loan	149	383	10,010	-	10,542
Other financial liabilities	37,389	-	-	-	37,389
Total undiscounted financial liabilities	5,632,226	567,189	416,280	264,927	6,880,622
As at 31 December 2021					
Financial liabilities					
Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations	89,700	22,935	81,559	210,386	404,580
Amounts due to credit institutions	7,379	-	639	-	8,018
Amounts due to customers	4,681,608	476,229	216,688	-	5,374,525
Debt Securities issued	1,076	2,996	15,980	63,428	83,480
Lease liability	2,947	8,537	25,153	14,822	51,459
Subordinated loan	149	383	10,520	-	11,052
Other financial liabilities	56,280	-	-	-	56,280
Total undiscounted financial liabilities	4,839,139	511,080	350,539	288,636	5,989,394

The table below shows the contractual expiry by maturity of the Bank's credit related commitments. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
2022	1,127,552	323,195	80,327	-	1,531,074
2021	925,449	304,494	41,207	-	1,271,150

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The Bank's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant concentration of amounts due to customers represented by government organizations in the period of one year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. This level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than three months in the tables above.

(Amounts presented are in thousands of Azerbaijani manats)

26. Risk management (continued)

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. The Bank does not have any significant equity, corporate fixed income, or derivatives holdings.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Management Board has set limits on positions by currency based on the CBAR regulations. Positions are monitored on a daily basis.

The Assets and Liabilities Management Committee controls currency risk by management of the open currency position on the estimated basis of AZN devaluation and other macroeconomic indicators, which gives the Bank an opportunity to minimize losses from significant currency rates fluctuations toward its national currency. The Treasury Department performs daily monitoring of the Bank's open currency position with the aim to match the requirements of the CBAR.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Azerbaijani manats, with all other variables held constant on the statement of profit or loss. The effect on equity does not differ from the effect on profit or loss. A negative amount in the table reflects a potential net reduction in profit or loss or equity, while a positive amount reflects a net potential increase.

Impact on profit before tax based on net assets value as at 31 December:

	31 December 2022		31 December 2021	
USD	+20%/-3%	106,091 / (15,914)	+20%/-3%	67,879 / (10,182)
EUR	+21%/-9%	13,920 / (5,966)	+21%/-9%	1,713 / (734)

Operational risk

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

(Amounts presented are in thousands of Azerbaijani manats)

27. Fair value measurements

Fair value hierarchy

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

- ▶ Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- ▶ Level 2: 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.

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

	<i>Date of valuation</i>	<i>Fair value measurement using</i>			<i>Total</i>
		<i>Quoted prices in active markets (Level 1)</i>	<i>Significant observable inputs (Level 2)</i>	<i>Significant unobservable inputs (Level 3)</i>	
Assets measured at fair value					
Investment securities – debt securities at FVOCI	31 December 2022	82,272	216,720	–	298,992
Investment securities – equity securities at FVOCI	31 December 2022	8,105	–	3,003	11,108
Derivative financial assets at FVPL – Currency swaps	31 December 2022	–	15,972	–	15,972
Property and equipment – premises	31 December 2022	–	6,291	–	6,291
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2022	1,561,597	–	–	1,561,597
Investment securities measured at amortised cost	31 December 2022	516,510	793,590	880,858	2,190,958
Amounts due from credit institutions	31 December 2022	–	–	392,424	392,424
Loans to customers	31 December 2022	–	448,426	2,595,390	3,043,816
Other financial assets (excluding derivative financial assets)	31 December 2022	–	–	127,689	127,689

*(Amounts presented are in thousands of Azerbaijani manats)***27. Fair value measurements (continued)****Fair value hierarchy (continued)**

	<i>Date of valuation</i>	<i>Fair value measurement using</i>			<i>Total</i>
		<i>Quoted prices in active markets (Level 1)</i>	<i>Significant observable inputs (Level 2)</i>	<i>Significant unobservable inputs (Level 3)</i>	
Liabilities for which fair values are disclosed					
Amounts due to customers	31 December 2022	-	5,295,589	861,737	6,157,326
Amounts due to the CBAR and government organizations	31 December 2022	-	400,999	2,712	403,711
Amounts due to credit institutions	31 December 2022	-	15,900	2,769	18,669
Debt securities issued	31 December 2022	-	59,578	-	59,578
Subordinated loan	31 December 2022	-	-	8,521	8,521
Other financial liabilities	31 December 2022	-	-	37,389	37,389

	<i>Date of valuation</i>	<i>Fair value measurement using</i>			<i>Total</i>
		<i>Quoted prices in active markets (Level 1)</i>	<i>Significant observable inputs (Level 2)</i>	<i>Significant unobservable inputs (Level 3)</i>	
Assets measured at fair value					
Investment securities – debt securities at FVOCI	31 December 2021	-	134,779	-	134,779
Investment securities – equity securities at FVOCI	31 December 2021	8,461	-	3,003	11,464
Derivative financial assets at FVPL – Currency swaps	31 December 2021	-	7,160	-	7,160
Property and equipment – premises	31 December 2021	-	5,765	-	5,765
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2021	2,607,885	-	-	2,607,885
Amounts due from credit institutions	31 December 2021	-	-	254,867	254,867
Investment securities measured at amortized cost	31 December 2021	190,735	705,263	89,830	985,828
Loans to customers	31 December 2021	-	313,709	2,224,027	2,537,736
Other financial assets (excluding derivative financial assets)	31 December 2021	-	-	83,609	83,609

	<i>Date of valuation</i>	<i>Fair value measurement using</i>			<i>Total</i>
		<i>Quoted prices in active markets (Level 1)</i>	<i>Significant observable inputs (Level 2)</i>	<i>Significant unobservable inputs (Level 3)</i>	
Liabilities for which fair values are disclosed					
Amounts due to customers	31 December 2021	-	4,510,116	817,537	5,327,653
Amounts due to the CBAR and government organizations	31 December 2021	-	336,012	3,488	339,500
Amounts due to credit institutions	31 December 2021	-	7,199	817	8,016
Debt securities issued	31 December 2021	-	59,578	-	59,578
Subordinated loan	31 December 2021	-	-	8,521	8,521
Other financial liabilities	31 December 2021	-	-	56,280	56,280

(Amounts presented are in thousands of Azerbaijani manats)

27. Fair value measurements (continued)

Fair value hierarchy (continued)

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2022	Fair value 2022	Unrealized gain/(loss)	Carrying value 2021	Fair value 2021	Unrealized gain/(loss)
Financial assets						
Cash and cash equivalents	1,561,597	1,561,597	-	2,607,885	2,607,885	-
Amounts due from credit institutions	392,424	392,424	-	254,867	254,867	-
Investment securities – debt securities at amortized cost	2,212,323	2,190,958	(21,365)	988,145	985,828	(2,317)
Loans to customers	3,028,281	3,043,816	15,535	2,519,429	2,537,736	18,307
Other financial assets(excluding derivative financial assets)	127,689	127,689	-	83,609	83,609	-
Financial liabilities						
Amounts due to customers	6,158,046	6,157,326	720	5,328,597	5,327,653	944
Amounts due to the CBAR and government organizations	403,936	403,711	225	339,803	339,500	303
Amounts due to credit institutions	18,669	18,669	-	8,016	8,016	-
Debt securities issued	59,578	59,578	-	59,578	59,578	-
Subordinated loan	8,521	8,521	-	8,521	8,521	-
Other financial liabilities	37,389	37,389	-	56,280	56,280	-
Total unrecognized change in unrealized fair value			(4,885)			17,237

Valuation techniques and assumptions

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short-term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and savings accounts without a specific maturity.

Derivatives

Derivatives valued using a valuation technique with market observable inputs are mainly interest rate swaps, currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves. Derivatives valued using a valuation technique with significant non-market observable inputs are primarily long dated option contracts. These derivatives are valued using the binomial models. The models incorporate various non-observable assumptions, which include market rate volatilities.

Investment securities

Investment securities valued using a valuation technique or pricing models primarily consist of unquoted equity and debt securities. These securities are valued using models which sometimes only incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

Financial assets and financial liabilities carried at amortized cost

Fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to the CBAR and government organizations, and credit institutions and other financial assets and liabilities is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

(Amounts presented are in thousands of Azerbaijani manats)

28. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 26 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2022			2021		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Cash and cash equivalents	1,561,597	–	1,561,597	2,607,885	–	2,607,885
Amounts due from credit institutions	25,169	367,255	392,424	99,352	155,515	254,867
Investment in subsidiary	–	31,360	31,360	–	8,540	8,540
Investment securities	1,256,222	1,266,201	2,522,423	486,517	647,871	1,134,388
Loans to customers	1,184,077	1,844,204	3,028,281	924,101	1,595,328	2,519,429
Property and equipment	–	72,644	72,644	–	62,853	62,853
Intangible assets	–	26,200	26,200	–	25,612	25,612
Right of use assets	–	35,032	35,032	–	34,034	34,034
Current income tax assets	–	–	–	5,535	–	5,535
Other assets	162,408	49,099	211,507	112,965	–	112,965
Total	4,189,473	3,691,995	7,881,468	4,236,355	2,529,753	6,766,108
Amounts due to customers	5,974,409	183,637	6,158,046	5,137,095	191,502	5,328,597
Amounts due to the CBAR and government organizations	125,547	278,389	403,936	106,553	233,250	339,803
Amounts due to credit institutions	18,546	123	18,669	7,378	638	8,016
Debt securities issued	78	59,500	59,578	78	59,500	59,578
Subordinated loan	21	8,500	8,521	21	8,500	8,521
Lease liability	10,667	30,364	41,031	8,590	30,364	38,954
Deferred income tax liabilities	–	38,777	38,777	–	42,593	42,593
Current tax liabilities	47,066	–	47,066	–	–	–
Other liabilities	121,894	–	121,894	138,539	–	138,539
Total	6,298,228	599,290	6,897,518	5,398,254	566,347	5,964,601
Net	(2,108,755)	3,092,705	983,950	(1,161,899)	1,963,406	801,507

The matching and controlled mismatching of the maturities of assets and liabilities is fundamental to management of the Bank. An unmatched position potentially enhances profitability and leverage, but can also increase the risk of unexpected losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest and exchange rates.

Management believes that in spite of a substantial portion of amounts due to customers being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Bank indicates that these amounts provide a long-term and stable source of funding for the Bank. The considerable part of amounts due to customers that is comprised of large number of individually insignificant accounts demonstrate the behaviour of a long-term financing, if taken as a whole. The Bank considers it to be unlikely that unusually large number of customers will withdraw their funds in a short time span.

The customers who hold the largest current account deposits with the Bank have a long established history as the Bank's customers. Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

The CBAR's minimum liquidity norm for banks of 30% (the Bank's actual ratio is 49%) is a reasonable precautionary measure taken by the regulator, which is based on the nature and established normal business practice in banking industry. The Bank has a reasonably high headroom above the minimum required liquidity ratio.

Although the Bank holds considerable amounts of investment securities maturing in more than one year, the Bank is able to sell a substantial portion of such securities on an open market in case of urgent liquidity needs.

The Bank has established Treasury Department and Asset Liabilities Management Committee, which are responsible for overseeing the Bank's liquidity on day-to-day basis.

(Amounts presented are in thousands of Azerbaijani manats)

29. Related party disclosures

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

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.

The volumes of related party transactions, outstanding balances at the year-end, and related expense and income for the year are as follows:

	2022				2021			
	Share-holders / ultimate owners	Entities under common control	Other related parties	Key management personnel	Share-holders / ultimate owners	Entities under common control	Other related parties	Key management personnel
Loans outstanding at 1 January, gross	-	58,741	18,753	8,368	-	55,791	6,697	3,867
Loans issued during the year	-	32,837	33,198	12,544	-	25,393	20,216	11,543
Loan repayments during the year	-	(40,601)	(30,786)	(11,654)	-	(22,484)	(8,619)	(7,085)
Other movements	-	(110)	161	30	-	41	459	43
Loans outstanding at 31 December, gross	-	50,867	21,326	9,288	-	58,741	18,753	8,368
Less: allowance for impairment at 31 December	-	(241)	(207)	(238)	-	(469)	(510)	(173)
Loans outstanding at 31 December, net	-	50,626	21,119	9,050	-	58,272	18,243	8,195
Due from Credit Institutions	-	69,118	-	-	-	83,232	-	-
Interest income due from Credit Institutions	-	4,135	-	-	-	697	-	-
Interest income on loans	-	6,723	2,185	711	-	6,800	1,551	532
Insurance premiums recognised as part of effective interest income under IFRS 9	-	21,292	-	-	-	29,317	-	-
Impairment reversal/(charge) for loans	-	228	303	(65)	-	190	(250)	(141)
Right-of-use asset	-	22,730	894	-	-	25,877	-	-
Depreciation of right-of-use assets	-	(4,471)	(166)	-	-	(4,617)	-	-
Other assets	-	97,951	35	-	-	4,610	35	-
Deposits at 1 January	1,279	1,248	10,082	34,694	1,201	2,736	-	34,452
Deposits received during the year	-	1,379	-	2,273	170	1,538	10,000	37,200
Deposits repaid during the year	-	(1,430)	-	(4,878)	(170)	(3,023)	-	(36,676)
Other movements	81	(2)	(4)	(46)	78	(3)	82	(282)
Deposits at 31 December	1,360	1,195	10,078	32,043	1,279	1,248	10,082	34,694
Current accounts at 31 December	215,734	55,914	3,066	9,055	10,417	24,477	5,144	12,217
Cash and cash equivalents	-	6,985	-	-	-	12,767	-	-
Investment Securities	-	38,201	-	-	-	29,032	-	-
Interest income on Investment securities	-	2,186	-	-	-	178	-	-
Lease liability	-	27,612	939	-	-	30,006	-	-
Interest expense on lease liability	-	(3,224)	(99)	-	-	(3,577)	-	-
Debt Securities issued	25,535	-	-	4,955	25,535	-	-	4,955
Interest expenses on debt securities issued	(1,697)	-	-	(310)	(1,697)	-	-	(310)
Other liabilities	-	1,401	-	-	-	-	-	-
Interest expense on deposits	(81)	(48)	(600)	(760)	-	1,313	-	-
General and administrative expenses	-	(14,470)	(15,206)	-	(81)	(80)	(82)	(768)
Personnel expenses	-	(1,566)	-	-	(35)	(7,252)	(9,684)	-
Commission Income	3	17,796	196	22	-	(1,268)	-	-
Commission expense	-	(10,252)	(1,927)	-	1	9,246	226	42
Net gains/(loss) from foreign currencies: dealing	1	705	896	42	-	(1,767)	(1,204)	-
Net gains/(losses) on initial recognition of financial instruments	-	-	-	-	-	498	127	12
Letters of credit and guarantees issued	-	18,841	9,464	-	-	12,642	5,114	-
Unused credit lines	-	2,730	2,479	1,018	-	6,231	3,747	2,038

(Amounts presented are in thousands of Azerbaijani manats)

29. Related party disclosures (continued)

The compensation of key management personnel is as follows:

	<u>2022</u>	<u>2021</u>
Salaries and other benefits	28,409	42,021
Social security costs	4,612	6,752
Total key management personnel compensation	<u>33,021</u>	<u>48,773</u>

As of 31 December 2022, the Bank has a guarantee from its parent received as collateral in respect of loans issued to borrowers in the amount of AZN 30,805 (2021: AZN 40,770).

30. Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored by the CBAR using the ratios established by the CBAR in supervising the Bank.

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

The CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum capital adequacy ratio of 6% (2021: 6%) and 12 % (2021: 12%) for Tier 1 Capital and Total Capital, respectively, based on its guidelines.

As at 31 December 2022 and 2021, the Bank's capital adequacy ratios on this basis were as follows:

	<u>2022</u>	<u>2021</u>
Tier 1 capital	449,552	403,453
Tier 2 capital	394,914	276,488
Less: deductions from capital	(42,822)	(20,004)
Total regulatory capital	<u>801,644</u>	<u>659,937</u>
Risk weighted assets	<u>4,733,425</u>	<u>4,253,202</u>
Capital adequacy ratio (Tier 1)	9.50%	9.49%
Capital adequacy ratio (Total Capital)	16.94%	15.52%

31. Events after the reporting period

According to the decision of the General Shareholders' Meeting held on 12 January 2023, the Bank declared and paid dividends in respect of the year ended 31 December 2022 in the amount of AZN 9,000 on preference shares (including 10% withholding tax to be paid on behalf of shareholders).