OJSC PASHA Bank

Separate financial statements

Year ended 31 December 2022
with independent auditor's report

Contents

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Independent auditor's report

To the Shareholders and Supervisory Board of
OJSC PASHA Bank

Opinion

We have audited the separate financial statements of OJSC PASHA Bank (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 separate financial position of the Bank as at 31 December 2022, and its separate financial performance and separate 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) 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 the 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.

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.

31 March 2023

Baku, Azerbaijan

Separate statement of financial position

As at 31 December 2022

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2022	2021
Assets			
Cash and cash equivalents	5	3,176,024	1,285,419
Amounts due from credit institutions	6	500,315	540,649
Investment securities	7	1,764,134	1,803,328
Loans to customers	8	2,728,154	2,552,877
Derivative financial assets	17	9,968	7,994
Investments in subsidiaries	12	109,179	127,006
Property and equipment	9	12,567	14,211
Intangible assets	10	26,482	31,035
Right-of-use assets	11	14,991	14,603
Deferred income tax assets	18	17,174	–
Other assets	13	74,427	49,734
Total assets		**8,433,415**	**6,426,856**
Liabilities			
Amounts due to banks and government funds	14	596,225	667,710
Amounts due to customers	15	7,028,896	5,057,851
Derivative financial liabilities	17	9,425	7,847
Lease liabilities	11	15,206	14,795
Current income tax liabilities	18	21,244	11,101
Deferred income tax liabilities	18	–	1,949
Provision for guarantees and other commitments	20	9,727	10,011
Subordinated debts	16	106,437	36,809
Other liabilities	13	47,256	42,350
Total liabilities		**7,834,416**	**5,850,423**
Equity			
Share capital	19	354,512	354,512
Retained earnings		249,822	208,817
Net unrealised (losses)/gains on investment securities	19	(5,335)	13,104
Total equity		**598,999**	**576,433**
Total liabilities and equity		**8,433,415**	**6,426,856**

Signed and authorised for release on behalf of the Executive Board of the Bank:

Javid Gouliyev — Chairman of the Executive Board

Murad Suleymanov — Chief Financial Officer

31 March 2023

The accompanying notes on pages 6 to 57 are an integral part of these separate financial statements.

Separate statement of profit or loss

For the year ended 31 December 2022

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2022	2021
Interest income			
Loans to customers		220,904	181,721
Investment securities		67,459	69,991
Cash and cash equivalents		12,775	508
Amounts due from credit institutions		10,606	5,710
Interest revenue calculated using effective interest rate		**311,744**	**257,930**
Finance lease receivables		483	384
Other interest revenue		**312,227**	**258,314**
Interest expense			
Amounts due to customers		(32,266)	(33,292)
Amounts due to banks and government funds		(15,309)	(18,310)
Lease liabilities	11	(1,215)	(658)
Subordinated debt		(4,289)	(621)
		(53,079)	**(52,881)**
Net interest income		**259,148**	**205,433**
Credit loss expense on financial assets	21	(45,061)	(20,271)
Net interest income after credit loss expense		**214,087**	**185,162**
Net fee and commission income	22	39,562	33,270
- fee and commission income		111,269	79,312
- fee and commission expense		(71,707)	(46,042)
Net (losses)/gains from investment securities		(13,899)	2,446
Net gains from foreign currencies	23	46,452	28,786
Other income		4,965	2,687
Non-interest income		**77,080**	**67,189**
Personnel expenses	24	(62,096)	(54,605)
General and administrative expenses	24	(46,546)	(46,168)
Depreciation and amortisation	9, 10, 11	(18,690)	(17,606)
Net (loss)/gain arising on modification of loans to customers	8	(988)	1,427
Net losses on initial recognition of financial instruments	14	–	(3,778)
Impairment and write-down	25	(35,170)	(26,264)
Provision for credit related commitments and other assets	21	(9,646)	(1,818)
Other operating expenses		–	(111)
Non-interest expenses		**(173,136)**	**(148,923)**
Profit before income tax expense		**118,031**	**103,428**
Income tax expense	18	(32,712)	(28,496)
Profit for the year		**85,319**	**74,932**

The accompanying notes on pages 6 to 57 are an integral part of these separate financial statements.

Separate statement of comprehensive income

For the year ended 31 December 2022

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2022*	*2021*
Profit for the year		**85,319**	**74,932**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Net change in fair value of investment securities at fair value through other comprehensive income	7	(63,457)	(8,490)
Reclassification of cumulative loss on disposal of debt instruments at fair value through other comprehensive income to profit or loss		13,899	–
Changes in allowance for expected credit losses of investment securities at fair value through other comprehensive income	21	26,509	(524)
Net unrealised losses on investment securities at fair value through other comprehensive income		**(23,049)**	**(9,014)**
Income tax relating to components of other comprehensive income	18	4,610	1,803
Net other comprehensive loss to be reclassified to profit or loss in subsequent periods		**(18,439)**	**(7,211)**
Total comprehensive income for the year		**66,880**	**67,721**

The accompanying notes on pages 6 to 57 are an integral part of these separate financial statements.

Separate statement of changes in equity

For the year ended 31 December 2022

(Figures in tables are in thousands of Azerbaijani manats)

	Share capital	*Retained earnings*	*Net unrealised gains/(losses) on investment securities*	*Total equity*
As at 1 January 2021	**354,512**	**184,265**	**20,315**	**559,092**
Profit for the year	–	74,932	–	**74,932**
Other comprehensive loss for the year	–	–	(7,211)	**(7,211)**
Total comprehensive income for the year	**–**	**74,932**	**(7,211)**	**67,721**
Dividends to shareholders of the Bank (Note 19)	–	(50,380)	–	**(50,380)**
As at 31 December 2021	**354,512**	**208,817**	**13,104**	**576,433**
Profit for the year	–	85,319	–	**85,319**
Other comprehensive loss for the year	–	–	(18,439)	**(18,439)**
Total comprehensive income for the year	**–**	**85,319**	**(18,439)**	**66,880**
Dividends to shareholders of the Bank (Note 19)	–	(44,314)	–	**(44,314)**
As at 31 December 2022	**354,512**	**249,822**	**(5,335)**	**598,999**

The accompanying notes on pages 6 to 57 are an integral part of these separate financial statements.

Separate statement of cash flows

For the year ended 31 December 2022

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2022*	*2021*
Cash flows from operating activities			
Interest received		319,484	260,903
Interest paid		(53,938)	(51,560)
Fees and commissions received		110,363	79,864
Fees and commissions paid		(72,849)	(48,839)
Net gains from investment securities		–	2,446
Realised gains less losses from dealing in foreign currencies and foreign currency derivatives		46,604	30,778
Personnel expenses paid		(59,771)	(55,865)
General and administrative expenses paid		(49,291)	(42,741)
Other operating income received		3,049	981
Cash flows from operating activities before changes in operating assets and liabilities		**243,651**	**175,967**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		42,886	(140,817)
Loans to customers		(233,869)	(492,260)
Other assets		(27,048)	(15,871)
Net increase/(decrease) in operating liabilities			
Amounts due to banks and government funds		(68,787)	(242,219)
Amounts due to customers		2,000,390	1,166,868
Other liabilities		(16)	(3,506)
Net cash flows from operating activities before income tax		**1,957,207**	**448,162**
Income tax paid		(37,079)	(32,788)
Net cash from operating activities		**1,920,128**	**415,374**
Cash flows from investing activities			
Proceeds from sale and redemption of investment securities		3,245,727	1,757,279
Purchase of investment securities		(3,271,183)	(1,976,785)
Proceeds from sale of investment property		–	2,000
Proceeds from sale of property and equipment		–	221
Purchase and prepayments for property and equipment		(1,915)	(7,504)
Acquisition of intangible assets		(2,978)	(5,324)
Investment in subsidiary	12	(14,060)	–
Net cash flows used in investing activities		**(44,409)**	**(230,113)**
Cash flows from financing activities			
Dividends paid	19	(44,314)	(50,380)
Proceeds from subordinated debts	30	68,681	17,827
Principal repayments of lease liability		(6,125)	(5,461)
Net cash used in financing activities		**18,242**	**(38,014)**
Effect of exchange rates changes on cash and cash equivalents		(3,356)	(9,093)
Effect of expected losses on cash and cash equivalents	21	–	30
Net increase in cash and cash equivalents		**1,890,605**	**138,184**
Cash and cash equivalents, beginning	5	1,285,419	1,147,235
Cash and cash equivalents, ending	5	**3,176,024**	**1,285,419**

The accompanying notes on pages 6 to 57 are an integral part of these separate financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

OJSC PASHA Bank ("the Bank") was established on 18 June 2007 as an open joint stock company under the laws of the Republic of Azerbaijan. The Bank operates under a banking licence number 250 issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") on 28 November 2007.

The Bank accepts deposits from the public and extends credit, transfers payments, exchanges currencies and provides other banking services to its commercial and private customers.

As at 31 December 2022 and 2021 the Bank has six service points, three branches in Azerbaijan and two subsidiaries, JSC PASHA Bank Georgia located in the Republic of Georgia and PASHA Yatirim Bankasi A.Ş. (the "Subsidiaries") located in the Republic of Turkey.

The Bank's registered legal address is 15 Yusif Mammadaliyev Street, Baku, AZ1005, Azerbaijan.

As at 31 December 2022 and 2021, the following shareholders owned the outstanding shares of the Bank:

Shareholders	***Ownership percentage (%)***
PASHA Holding LLC	57
Bless LLC	28
Mr. Arif Pashayev	10
Mr. Mir Jamal Pashayev	5
Total	**100**

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.

2. Basis of preparation

General

These separate financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The Azerbaijani manat is the functional and presentation currency of OJSC PASHA 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 is required to maintain its records and prepare its financial statements in Azerbaijani manat and in accordance with IFRS. These separate financial statements are presented in thousands of Azerbaijani manat ("AZN"), except per share amounts and when otherwise indicated. The separate financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies, for certain investment securities at FVOCI and derivative financial instruments which have been measured at fair value.

The Bank is the parent entity of JSC PASHA Bank Georgia and PASHA Yatirim Bankasi A.S. and consolidated financial statements of OJSC PASHA Bank prepared in accordance with IFRS have been issued separately on 9 March 2023. Copy of consolidated financial statements is available at official legal address of the Bank. The separate financial statements are prepared for the purposes of the Bank's performance monitoring and performance management.

3. Summary of significant accounting policies

Changes in accounting policies

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

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 separate 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 recognizes 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 separate 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.

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 separate 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 consolidated 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 separate financial statements of the Bank.

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 separate 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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

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 separate 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 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.

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 separate 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 separate 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 labiality. 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 market place.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Financial assets and liabilities (continued)

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 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 and investment securities at amortised 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).

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Financial assets and liabilities (continued)

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 separate 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.

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 separate 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 recognised 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. Provision for Performance guarantees are measured in accordance with IFRS 9.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Financial assets and liabilities (continued)

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 and 2021.

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 with due on demand or up to 3 months from the date of origination and that are free from contractual encumbrances.

Amounts due from credit institutions

Amounts due from credit institutions include amounts due only from CBAR and commercial banks. The Bank considers non-banking credit organizations as customers and loans to non-banking credit organizations are included in loans to customers.

Amounts due to banks and government funds

Amounts due to credit institutions include deposits and loans placed by commercial banks and the government funds.

Repurchase and reverse repurchase agreements

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the separate statement of financial position and, in case the transferee has the right by contract or custom to sell or re-pledge 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 separate account on the separate statement of financial position if material or as cash and cash equivalents or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

Securities lent to counterparties are retained in the separate statement of financial position. Securities borrowed are not recorded in the separate 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 separate statement of profit or loss. The obligation to return them is recorded at fair value as a trading liability.

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 separate statement of profit or loss 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.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Derivative financial instruments (continued)

Derivatives embedded in liabilities and non-financial host contacts 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 separate statement of profit or loss.

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

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 banks and government funds, other borrowed funds, debt securities issued, subordinated debt and amounts due to customers.

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 amortisation 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

Bank as a lessee

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.

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 5000). 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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Leases (continued)

Finance − Bank as a lessor

The Bank recognises lease receivables at value equal to the net investment in the lease, starting from the date of commencement of the lease term. Finance income is based on a pattern reflecting a constant periodic rate of return on the net investment outstanding. Initial direct costs are included in the initial measurement of the lease receivables.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the separate 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 separate 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 revenue calculated using EIR in the separate statement of profit or loss, to the extent that an impairment loss has not already been recorded.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

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 tax 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.

Property and equipment

Property and equipment are 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 property and equipment when that cost is incurred if the recognition criteria are met.

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

Depreciation of an asset, including construction in progress, begins when it is ready and available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	20
Furniture and fixtures	4
Computers and other equipment	4
Vehicles	4
Other equipment	5
Leasehold improvements	7

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Property and equipment (continued)

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.

Investments in subsidiaries

Investment in subsidiaries are two subsidiaries of the Bank with 100.00% and 50.96% ownership interest which are accounted at cost (Note 12).

Investment property

Investment property is land or building or a part of building held to earn rental income or for capital appreciation and which is not used by the Bank or held for the sale in the ordinary course of business. Property that is being constructed or developed or redeveloped for future use as investment property is also classified as investment property.

Investment property is initially recognised at cost, including transaction costs, and subsequently is stated at cost less accumulated depreciation and any accumulated impairment losses. For disclosure purposes investment property is re-measured at fair value reflecting market conditions at the end of the reporting period. Fair value of the Bank's investment property is determined on the base of various sources including reports of independent appraisers, who hold a recognised and relevant professional qualification and who have recent experience in valuation of property of similar location and category.

Earned rental income is recorded in the income statement within income arising from non-banking activities. Gains and losses resulting from changes in the fair value of investment property are recorded in the separate statement of profit or loss and presented within income or expense arising from non-banking activities.

Subsequent expenditure is capitalized only when it is probable that future economic benefits associated with it will flow to the Bank and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to premises and equipment, and its carrying amount at the date of reclassification becomes its deemed cost to be subsequently depreciated.

Repossessed collateral

Repossessed collaterals represent non-financial assets acquired by the Bank in settlement of overdue loans. These assets are initially recognised at cost when acquired and included within Other assets. Upon legal collection, the collateral is held at a lower of cost and net realisable value, to be sold within a reasonable timeframe. The Bank regularly reviews the realization possibility and price and adjusts the balance in cases where cost exceeds net realizable value.

Intangible assets

Intangible assets include internally developed digital products, other licenses and computer software.

Intangible assets are measured on initial recognition measured at cost, once capitalization criteria is met, less accumulated amortisation and provisions for impairment. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Internally generated assets not fully completed as of reporting date, however meeting capitalisation criteria, are recognised as "Intangible assets in-progress". Bank divides the process of generation of the asset into a research phase and a development phase, after which the cost related internally developed products is capitalised. Only development costs for internally generated asset are capitalised, which are subject to meeting specific criteria, as demonstration of technical feasibility, the effectiveness of performance initially intended by the management and provision of future cash benefit.

Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of acquired intangible assets are assessed to be indefinite. Acquired intangible assets with definite lives are amortised over the useful economic lives of up to 10 years. The amortization period for the digital products is set at period of 5-10 years at the outset with subsequent reassessment of remaining life at the end of each year. The amortization of internally developed digital products starts when an asset is available for use in the condition necessary to operate as intended by management.

Intangible assets with indefinite useful lives are not amortised and assessed for impairment at least at each financial year-end whenever there is an indication that the intangible asset may be impaired.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

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.

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 is 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 separate 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 separate 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 and expense is recognised.

Interest and similar income and expense

The Bank calculates interest revenue 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 revenue 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.Interest revenue on all financial assets at FVPL is recognised using the contractual interest rate in “Other interest revenue” in the separate statement of profit or loss.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Recognition of income and expenses (continued)

Fee and commission income

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

Fee income earned from services that are provided over a certain period of time

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income on guarantees and letters of credit. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

Fee income from providing transaction services

Fees arising from negotiating or participating in the negotiation of a transaction for a third party − such as where the Bank's performance obligation is the arrangement of the acquisition of shares or other securities − are recognised on completion of the underlying transaction. Fees or components of fees that are linked to certain performance obligations are recognised after fulfilling the corresponding criteria. When the contract provides for a variable consideration, fee and commission income is only recognised to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognised will not occur until the uncertainty associated with the variable consideration is subsequently resolved. Revenue is recognised when the Bank's right to receive the payment is established.

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.

The Bank has launched a loyalty program for its customers with incentives to sell their banking cards, which is a new product with conditions and a set of privileges unique to the Miles & Smiles Frequent Flyer Programme. According the programme the Bank is a principal that obtains control of specified number of miles, so that is an only an inventory risk owner, as well as determines conversion rate of miles. Thus, the nature of Bank's promise is a performance obligation to provide the specified miles to the customer, which are initially bought from airlines.

The Bank assesses active miles as inventory in the form of materials to be consumed in the rendering of services. At each reporting period and recognises them at lower cost and net realizable value.

The Bank generally recognises a liability for the accumulated miles that are expected to be utilized by the customers, which is reversed to profit or loss as the points expire. Thus, the revenues from rendering services using loyalty program are allocated to the obligation to satisfy the loyalty points i.e. miles and deferred until those points are accrued to customers individual airline accounts, so that transfers control of miles.

Dividend income

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

Foreign currency translation

The separate financial statements are presented in AZN, 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 current year profit as gains less losses from foreign currencies − 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 less losses from dealing in foreign currencies.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Foreign currency translation (continued)

The Bank used the following official exchange rates at 31 December 2022 and 2021, in the preparation of these financial statements:

	2022	***2021***
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. The Bank is currently in the process of assessing the impact of adopting IFRS 17 on its separate financial statements.

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.

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 current practice and whether existing loan agreements may require renegotiation.

Reference to the Conceptual Framework – Amendments to IFRS 3

In May 2020, the IASB issued Amendments to IFRS 3 *Business Combinations – Reference to the Conceptual Framework*. The amendments are intended to replace a reference to the *Framework for the Preparation and Presentation of Financial Statements*, issued in 1989, with a reference to the *Conceptual Framework for Financial Reporting* issued in March 2018 without significantly changing its requirements.

The Board also added an exception to the recognition principle of IFRS 3 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 or IFRIC 21 *Levies*, if incurred separately.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Standards issued but not yet effective (continued)

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.

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.

4. Significant accounting judgments and estimates

Judgements

In the process of applying the Bank's accounting policies, management has made the following judgments, apart from those involving estimates, which have the most significant effect on the amounts recognised in the financial statements:

Determining the lease term of contracts with renewal options

The Bank determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised.

The Bank has the option, under some of its leases to lease the assets for additional terms of three to five years. The Bank applies judgement in evaluating whether it is reasonably certain to exercise the option to renew. That is, it considers all relevant factors that create an economic incentive for it to exercise the renewal. After the commencement date, the Bank reassesses the lease term if there is a significant event or change in circumstances that is within its control and affects its ability to exercise (or not to exercise) the option to renew (e.g., a change in business strategy).

Estimation uncertainty

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognized 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.

(Figures in tables are in thousands of Azerbaijani manats)

4. Significant accounting judgments and estimates (continued)

Estimation uncertainty

Impairment losses on financial assets

The measurement of impairment losses 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 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.

Impairment losses and fair value assessment of Russian investment securities

Russia-Ukraine conflict that started on 24 February 2022 and triggered a series of sanctions against Russian government and companies, restricting their ability to settle their obligations to foreign creditors. This required the Bank to reassess its views used in estimation of impairment losses and fair value estimation of Russian investment securities held at FVOCI. The Bank exercised judgement in determining the key assumptions used in ECL and fair value estimation. As at 31 December 2022, the fair value and related ECL of Russian investment securities were AZN 34,174 thousand (31 December 2021: AZN 73,898 thousand) and AZN 27,735 thousand (31 December 2021: AZN 59 thousand), respectively. More details are provided in Notes 26 and 27.

Impairment of digital products

At the end of each reporting period the Bank assesses an impairment trigger of each digital product. If any such indication exists, the Bank estimates the recoverable amount of the asset. The recoverable amount is the higher of the asset's fair value less costs of disposal and its value in use. At each reporting date the Bank assesses whether the product still complies with the predetermined needs of the Bank and whether the value in use corresponds with the carrying value. The impairment assessment requires an estimation of the value in use of the cash-generating unit.

Estimating the value in use requires the Bank to make an estimate of the expected future cash flows from each cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. Thus, in the measuring value in use the Bank:

- Bases cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of particular digital product;
- Bases cash flow projections on the most recent financial budgets/forecasts approved by management. Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified. Only remaining useful life of a product should be taken into account;
- Estimates cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified;
- Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases attributable to general inflation.

The carrying amount of digital products at 31 December 2022 was AZN 7,858 thousand (31 December 2021: AZN 10,191 thousand). More details are provided in Note 10.

(Figures in tables are in thousands of Azerbaijani manats)

4. Significant accounting judgments and estimates (continued)

Estimation uncertainty (continued)

Net realisable value of repossessed collaterals

The net realisable value of repossessed collaterals is measured each reporting period, to ensure that the collaterals are held at a lower of cost or net realizable value.

The Bank developed a strategy for realization of these assets within current year. If no sale of the assets is observed within current year then valuation of net realizable value of the subject assets is performed under more scrutiny and conservatism. Each property is valued separately based on the available market data.

The carrying amount of repossessed collaterals at 31 December 2022 was AZN 6,934 thousand (31 December 2021: AZN 10,647 thousand). More details are provided in Note 13.

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 do 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 occasionally. 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.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2022	*2021*
Cash on hand	88,837	81,981
Current accounts with the CBAR	1,834,417	1,068,050
Current accounts with other credit institutions	739,340	77,928
Time deposits with credit institutions up to 3 months	510,428	56,960
Reverse repurchase agreements with credit institutions up to 3 months	3,002	500
Less: allowance for impairment	−	−
Cash and cash equivalents	**3,176,024**	**1,285,419**

Current accounts with other credit institutions consist of non-interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 6,619 thousand (31 December 2021: AZN 3,838 thousand) and AZN 732,721 thousand (31 December 2021: AZN 74,090 thousand), respectively.

As at 31 December 2022, the Bank placed AZN 510,428 thousand in time deposits with CBAR, four resident and two non-resident banks maturing through January 2023 (31 December 2021: AZN 56,960 thousand in time deposits with two non-resident banks maturing through January 2022).

As at 31 December 2021 and 2022, all balances of cash equivalents are allocated to Stage 1.

(Figures in tables are in thousands of Azerbaijani manats)

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2022	*2021*
Time deposits with credit institutions for more than 3 months	70,879	321,537
Loans to banks	37,127	45,209
Obligatory reserve with the CBAR	266,420	27,445
Restricted deposits	129,108	147,262
	503,534	**541,453**
Less: allowance for impairment	(3,219)	(804)
Amounts due from credit institutions	**500,315**	**540,649**

As at 31 December 2022, time deposits with credit institutions mature between April 2023 and December 2024 (31 December 2021: between January 2022 and August 2023).

As at 31 December 2022, the Bank had outstanding amount of AZN 15,007 thousand (31 December 2021: AZN 37,070 thousand) of secured loans issued to one resident commercial bank (31 December 2021: four resident commercial banks) and AZN 22,120 thousand (31 December 2021: AZN 8,139 thousand) of unsecured loans issued to one resident and one non-resident commercial banks (31 December 2021: one non-resident commercial banks) with contractual maturity through December 2025 (31 December 2021: December 2025).

Credit institutions in the Republic of Azerbaijan are required to maintain a non-interest earning cash deposit (obligatory reserve with restriction on withdrawal) with the CBAR at the level of 4.0% (2021: 0.5%) and 5.0% (2021: 1.0%) of the previous month average of funds attracted from customers by a credit institution in AZN and foreign currencies, respectively.

An analysis of changes in gross carrying value and corresponding ECL allowance on amounts due from credit institutions during the year ended 31 December 2022 is as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2022	**527,472**	**–**	**13,981**	**541,453**
New assets originated or purchased	71,901	–	–	**71,901**
Assets repaid	(109,820)			**(109,820)**
Transfers to Stage 3	(3,429)	–	3,429	**–**
At 31 December 2022	**486,124**	**–**	**17,410**	**503,534**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL allowance as at 1 January 2022	**(804)**	**–**	**–**	**(804)**
New assets originated or purchased	(240)	–	–	**(240)**
Assets repaid	613		48	**661**
Transfers to Stage 3	24	–	(24)	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	(2,836)	**(2,836)**
At 31 December 2022	**(407)**	**–**	**(2,812)**	**(3,219)**

An analysis of changes in gross carrying value and corresponding ECL allowance on amounts due from credit institutions during the year ended 31 December 2021 is as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2021	**398,082**	**–**	**13,981**	**412,063**
New assets originated or purchased	342,366	–	–	**342,366**
Assets repaid	(212,976)	–	–	**(212,976)**
At 31 December 2021	**527,472**	**–**	**13,981**	**541,453**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL allowance as at 1 January 2021	**(443)**	**–**	**–**	**(443)**
New assets originated or purchased	(661)	–	–	**(661)**
Assets repaid	300	–	–	**300**
At 31 December 2021	**(804)**	**–**	**–**	**(804)**

(Figures in tables are in thousands of Azerbaijani manats)

7. Investment securities

Investment securities comprise:

	2022	*2021*
Debt securities at FVOCI		
Azerbaijan Mortgage Fund bonds	567,829	592,843
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	423,416	616,722
Notes of the Central Bank of Azerbaijan Republic	182,446	16,563
Corporate bonds	86,572	216,031
Bonds of financial institutions	30,510	70,262
Certificate of deposits	16,920	93,741
Foreign government bonds	3,561	44,418
US treasury bonds	1,735	142,186
Turkey Government Bonds	–	8,559
Debt securities at FVOCI	**1,312,989**	**1,801,325**

	2022	*2021*
Equity securities at FVOCI		
Corporate Shares	2,003	2,003
Equity securities at FVOCI	**2,003**	**2,003**

	2022	*2021*
Debt securities at amortised cost		
Bonds of the Ministry of Finance of the Republic of Azerbaijan	285,378	–
Notes of the Central Bank of Azerbaijan Republic	164,287	–
	449,665	**–**
Less: allowance for impairment	(523)	–
Debt securities at amortised cost	**449,142**	**–**

An analysis of changes in the gross carrying values and associated ECLs in relation to debt securities at FVOCI is as follows:

Debt securities at FVOCI	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2022	**1,801,325**	**–**	**–**	**1,801,325**
New assets originated or purchased	333,951	–	–	**333,951**
Assets repaid or sold	(758,304)	(465)	(61)	**(758,830)**
Transfers to Stage 2	(40,729)	40,729	–	**–**
Transfers to Stage 3	(22,267)	–	22,267	**–**
Change in fair value	(35,161)	(11,909)	(16,387)	**(63,457)**
At 31 December 2022	**1,278,815**	**28,355**	**5,819**	**1,312,989**

Debt securities at FVOCI	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL allowance as at 1 January 2022	**(3,616)**	**–**	**–**	**(3,616)**
New assets originated or purchased	(417)	–	–	**(417)**
Assets repaid or sold	1,067	–	–	**1,067**
Transfers to Stage 2	63	(63)	–	**–**
Transfers to Stage 3	12	–	(12)	**–**
Changes to models and inputs used for ECL calculations	501	–	–	**501**
Impact on period end ECL of exposures transferred between stages during the period	–	(9,677)	(17,983)	**(27,660)**
At 31 December 2022	**(2,390)**	**(9,740)**	**(17,995)**	**(30,125)**

(Figures in tables are in thousands of Azerbaijani manats)

7. Investment securities (continued)

Debt securities at FVOCI	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2021	**1,590,102**	**–**	**–**	**1,590,102**
New assets originated or purchased	243,353	–	–	**243,353**
Assets repaid or sold	(23,640)	–	–	**(23,640)**
Change in fair value	(8,490)	–	–	**(8,490)**
At 31 December 2021	**1,801,325**	**–**	**–**	**1,801,325**

Debt securities at FVOCI	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL allowance as at 1 January 2021	**(4,140)**	**–**	**–**	**(4,140)**
New assets originated or purchased	(1,530)	–	–	**(1,530)**
Assets repaid or sold	2,054	–	–	**2,054**
At 31 December 2021	**(3,616)**	**–**	**–**	**(3,616)**

Debt securities at amortised cost	***Stage 1***
Gross carrying value as at 1 January 2022	**–**
New assets originated	449,665
At 31 December 2022	**449,665**

Debt securities at amortised cost	***Stage 1***
ECL as at 1 January 2022	**–**
New assets originated	(523)
At 31 December 2022	**(523)**

8. Loans to customers

Loans to customers comprise:

	2022	***2021***
Legal entities	2,357,475	2,330,600
Individuals	468,298	301,404
Loans to customers (gross)	**2,825,773**	**2,632,004**
Less: allowance for impairment	(97,619)	(79,127)
Loans to customers (net)	**2,728,154**	**2,552,877**

Loans are made in the following industry sectors:

	2022	***2021***
Trade and services	1,323,935	1,366,781
Individuals	468,298	301,404
Manufacturing	301,718	317,062
Transport and telecommunication	226,435	170,018
Construction	177,755	221,248
Agriculture and food processing	153,127	152,466
Energy	74,663	7,503
Non-banking credit organizations	64,951	37,688
Mining	34,009	41,706
Rental services	–	12,571
Other	882	3,557
Total loans (gross)	**2,825,773**	**2,632,004**

As at 31 December 2022, loans granted to top 11 customers (31 December 2021: 15 customers) which individually exceeded 5% of the Bank's equity, amounted to AZN 862,722 thousand (31 December 2021: AZN 967,026 thousand).

(Figures in tables are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Finance lease receivables

Included in loans to legal entities are finance lease receivables. The analysis of finance lease receivables at 31 December 2022 is as follows:

	Not later than 1 year	*Between 1 and 2 years*	*Between 2 and 3 years*	*Between 3 and 4 years*	*Between 4 and 5 years*	*Later than 5 years*
Gross investment in finance leases	10,290	5,750	–	–	–	–
Unearned future finance income on finance leases	(274)	(68)	–	–	–	–
Net investment in finance leases	**10,016**	**5,682**	**–**	**–**	**–**	**–**

Included in loans to legal entities are finance lease receivables. The analysis of finance lease receivables at 31 December 2021 is as follows:

	Not later than 1 year	*Between 1 and 2 years*	*Between 2 and 3 years*	*Between 3 and 4 years*	*Between 4 and 5 years*	*Later than 5 years*
Gross investment in finance leases	8,188	14,988	–	–	–	–
Unearned future finance income on finance leases	(502)	(380)	–	–	–	–
Net investment in finance leases	**7,686**	**14,608**	**–**	**–**	**–**	**–**

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

	Stage 1	*Stage 2*	*Stage 3*	*POCI*	*Total*
Gross carrying value as at 1 January 2022	**1,539,591**	**900,606**	**191,807**	**–**	**2,632,004**
New assets originated or purchased	1,497,573	–	–	7,025	**1,504,598**
Assets repaid (excluding write-offs)	(749,545)	(420,325)	(135,040)	–	**(1,304,910)**
Transfers to Stage 1	110,640	(110,640)	–	–	**–**
Transfers to Stage 2	(526,490)	527,365	(875)	–	**–**
Transfers to Stage 3	(54,157)	(18,692)	72,849	–	**–**
Amounts written off	–	–	(8,118)	–	**(8,118)**
Recovery	–	–	3,138	–	**3,138**
Changes to contractual cash flows due to modifications not resulting in derecognition	415	(2,581)	1,227	–	**(939)**
At 31 December 2022	**1,818,027**	**875,733**	**124,988**	**7,025**	**2,825,773**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2022	**(15,833)**	**(17,249)**	**(46,045)**	**(79,127)**
New assets originated or purchased	(7,084)	–	–	**(7,084)**
Assets repaid	5,354	5,147	23,279	**33,780**
Transfers to Stage 1	(6,345)	6,345	–	**–**
Transfers to Stage 2	1,618	(2,217)	599	**–**
Transfers to Stage 3	422	1,239	(1,661)	**–**
Impact on period end ECL of exposures transferred between stages during the period	5,491	(8,990)	(42,672)	**(46,171)**
Unwinding of discount (recognised in interest revenue)	–	–	(7,858)	**(7,858)**
Changes to models and inputs used for ECL calculations	(616)	634	3,843	**3,861**
Amounts written off			8,118	**8,118**
Recovery	–	–	(3,138)	**(3,138)**
At 31 December 2022	**(16,993)**	**(15,091)**	**(65,535)**	**(97,619)**

(Figures in tables are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Finance lease receivables (continued)

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

	Stage 1	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2021	**995,685**	**1,017,864**	**149,866**	**2,163,415**
New assets originated or purchased	1,223,041	–	–	**1,223,041**
Assets repaid (excluding write-offs)	(499,179)	(232,796)	(21,786)	**(753,761)**
Transfers to Stage 1	166,879	(166,617)	(262)	**–**
Transfers to Stage 2	(308,195)	313,302	(5,107)	**–**
Transfers to Stage 3	(38,640)	(31,147)	69,787	**–**
Amounts written off	–	–	(6,666)	**(6,666)**
Recovery	–	–	5,975	**5,975**
At 31 December 2021	**1,539,591**	**900,606**	**191,807**	**2,632,004**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2021	**(9,627)**	**(23,533)**	**(22,071)**	**(55,231)**
New assets originated or purchased	(37,390)	–	–	**(37,390)**
Assets repaid	3,996	5,085	7,250	**16,331**
Transfers to Stage 1	(3,683)	3,560	123	**–**
Transfers to Stage 2	8,382	(10,575)	2,193	**–**
Transfers to Stage 3	18,708	3,632	(22,340)	**–**
Impact on period end ECL of exposures transferred between stages during the period	2,328	850	(7,491)	**(4,313)**
Unwinding of discount (recognised in interest revenue)	–	–	(4,123)	**(4,123)**
Changes to models and inputs used for ECL calculations	1,453	3,732	(277)	**4,908**
Amounts written off			6,666	**6,666**
Recovery	–	–	(5,975)	**(5,975)**
At 31 December 2021	**(15,833)**	**(17,249)**	**(46,045)**	**(79,127)**

Modified and restructured loans

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.

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 assets that were modified during the period, with the related modification gain suffered by the Bank.

	2022	*2021*
Loans modified during the period		
Amortised cost before modification	376,257	134,161
Net modification gain	(988)	1,427

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 commercial lending, charges over real estate properties, cash, securities, inventory and trade receivables;
- For retail lending, mortgages over residential properties and life endowment insurance account;
- Guarantees from parent company for both commercial and retail lending.

(Figures in tables are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Collateral and other credit enhancements

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 certain Legal entities in Stage 3 using discounted value of collaterals. As at 31 December 2022, maximum exposure of such individually assessed loans amounted to AZN 113,225 thousand (31 December 2021: AZN 173,095 thousand) for which ECL of AZN 53,243 thousand (31 December 2021: AZN 35,135 thousand) was created. If these loans were not collateralized, ECL amount for these loans would be AZN 80,298 thousand (31 December 2021: AZN 81,055 thousand) based on collective assessment.

9. Property and equipment

The movements in property and equipment were as follows:

	Land	*Buildings*	*Furniture and fixtures*	*Computers and other equipment*	*Vehicles*	*Other equipment*	*Leasehold improve-ments*	*Total*
Cost								
1 January 2021	**300**	**5,407**	**20,689**	**12,284**	**1,848**	**355**	**2,594**	**43,477**
Additions	–	–	4,080	962	214	–	–	**5,256**
Disposals	–	–	(105)	(4,952)	(339)	–	–	**(5,396)**
Transfers	–	–	491	(491)	–	–	–	**–**
31 December 2021	**300**	**5,407**	**25,155**	**7,803**	**1,723**	**355**	**2,594**	**43,337**
Additions	–	–	2,765	664	280	16	–	**3,725**
Disposals	–	–	(309)	(100)	–	–	–	**(409)**
31 December 2022	**300**	**5,407**	**27,611**	**8,367**	**2,003**	**371**	**2,594**	**46,653**
Accumulated depreciation								
1 January 2021	**–**	**(1,885)**	**(13,521)**	**(9,159)**	**(1,016)**	**(326)**	**(1,752)**	**(27,659)**
Depreciation charge	–	(270)	(3,578)	(1,304)	(335)	(13)	(273)	**(5,773)**
Disposals	–	–	94	3,873	339	–	–	**4,306**
Transfers	–	–	(491)	491	–	–	–	**–**
31 December 2021	**–**	**(2,155)**	**(17,496)**	**(6,099)**	**(1,012)**	**(339)**	**(2,025)**	**(29,126)**
Depreciation charge	–	(271)	(3,588)	(855)	(304)	(12)	(270)	**(5,300)**
Disposals	–	–	240	100	–	–	–	**340**
31 December 2022	**–**	**(2,426)**	**(20,844)**	**(6,854)**	**(1,316)**	**(351)**	**(2,295)**	**(34,086)**
Net book value								
31 December 2022	**300**	**2,981**	**6,767**	**1,513**	**687**	**20**	**299**	**12,567**
31 December 2021	**300**	**3,252**	**7,659**	**1,704**	**711**	**16**	**569**	**14,211**

As at 31 December 2022, property and equipment amounting to AZN 22,392 thousand (31 December 2021: AZN 16,278 thousand) were fully depreciated but in use.

(Figures in tables are in thousands of Azerbaijani manats)

10. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Digital products*	*Total*
Cost				
1 January 2021	**17,767**	**12,987**	**20,392**	**51,146**
Additions	4,688	3,574	–	**8,262**
Disposals	(335)	(153)	–	**(488)**
31 December 2021	**22,120**	**16,408**	**20,392**	**58,920**
Additions	2,759	510	–	**3,269**
Disposals	(86)	(836)	–	**(922)**
Transfers	(544)	544	–	**–**
31 December 2022	**24,249**	**16,626**	**20,392**	**61,267**
Accumulated amortization				
1 January 2021	**(8,587)**	**(5,010)**	**(7,547)**	**(21,144)**
Amortisation charge	(2,933)	(1,423)	(2,652)	**(7,008)**
Disposals	139	128	–	**267**
31 December 2021	**(11,381)**	**(6,305)**	**(10,199)**	**(27,885)**
Amortisation charge	(3,600)	(1,307)	(2,333)	**(7,240)**
Disposals	86	254	–	**340**
Transfers	227	(227)	–	**–**
31 December 2022	**(14,668)**	**(7,585)**	**(12,532)**	**(34,785)**
Net book value				
31 December 2022	**9,581**	**9,041**	**7,860**	**26,482**
31 December 2021	**10,739**	**10,103**	**10,193**	**31,035**

As at 31 December 2022, intangible assets amounting to AZN 6,537 thousand (31 December 2021: AZN 4,952 thousand) were fully amortised but in use.

Digital products represent the Bank's internally developed software that is being used starting from 2019 and acquired digital lending tool that is being used starting from 2020. As at 31 December 2022 and 2021, recoverable amount of cash generating unit have been determined based on value in use method. The valuation is based on discounted cashflow information which is regularly updated in line with the most recent projections and forecasts.

11. Right-of-use assets and Lease liabilities

The leases of the Bank are represented by buildings used as office premises. The movement in right-of-use assets and lease liabilities during the year ended 31 December 2022 were as follows:

	Right-of-use assets	*Lease liabilities*
As at 1 January 2022	**14,603**	**14,795**
Additions	3,177	3,177
Lease modifications	3,440	3,440
Disposals	(79)	(81)
Depreciation expense	(6,150)	–
Interest expense	–	1,215
Payments	–	(7,340)
As at 31 December 2022	**14,991**	**15,206**

	Right-of-use assets	*Lease liabilities*
As at 1 January 2021	**7,631**	**7,831**
Additions	4,600	4,600
Lease modifications	7,352	7,352
Disposals	(155)	(185)
Depreciation expense	(4,825)	–
Interest expense	–	658
Payments	–	(5,461)
As at 31 December 2021	**14,603**	**14,795**

(Figures in tables are in thousands of Azerbaijani manats)

11. Right-of-use assets and Lease liabilities (continued)

Future lease payments for each of the next five years for the year ended 31 December 2022 and 2021 are as follows:

	2022	*2021*
Within one year	6,662	6,225
Between 1 and 2 years	7,911	8,367
Between 2 and 3 years	2,945	1,122
Between 3 and 4 years	–	1,029
Between 4 and 5 years	–	–
Total future lease payments	**17,518**	**16,743**

12. Investments in subsidiaries

Investments in subsidiaries comprise the following:

	2022	*2021*
PASHA Yatirim Bankasi A.S.	47,262	79,149
PASHA Bank Georgia JSC	61,917	47,857
	109,179	**127,006**

In July 2013, the Bank made a prepayment of AZN 41,971 thousand for the purpose of acquisition of TAIB Yatirim Bank under Share Sale and Purchase agreement. On 27 January 2015, the acquisition process has completed and the Bank acquired 79.47% of the voting common shares of the bank. TAIB Yatirim Bank A.Ş. was renamed to Pasha Yatirim Bankasi A.Ş. at the registration of the Bank as shareholder. In March 2015, investment in share capital of the subsidiary was increased by TRY 175,000 thousand (AZN 58,433 thousand) to TRY 255,000 thousand (AZN 85,057 thousand). Also, there was share registration fee expenses in the amount of AZN 1,102 thousand which was capitalized. On 6 June 2018, share capital of subsidiary was increased by TRY 245,000 thousand (AZN 101,602 thousand) to TRY 500,000 thousand (AZN 186,658 thousand). The increase was made based on decision of Supervisory Board of the Bank, according to which newly issued shares were acquired by Pasha Holding LLC. As a result, the Bank's shares in the subsidiary decreased from 99.92% to 50.96% and Pasha Holding LLC became a new non-controlling shareholder with ownership of 49.00% since 6 June 2018. Head office of PASHA Yatirim Bankasi A.Ş. is located in Istanbul. The activities of the bank are regulated by the Central Bank of the Republic of Turkey (the "CBRT").

During 2022 devaluation of TRY further continued, the Bank reassessed value in use of its investment in PASHA Yatirim Bankasi A.Ş. The remeasurement lead to impairment of investment in subsidiary in the amount of AZN 31,887 thousand (31 December 2021 AZN 22,357 thousand).

PASHA Bank Georgia JSC, a wholly-owned subsidiary, is located in the Republic of Georgia, operating in the banking sector, with registered and paid up share capital of GEL 35,000 thousand (AZN 16,615 thousand) as of 31 December 2013. In March 2014 share capital of subsidiary was increased by GEL 68,000 thousand (AZN 30,866 thousand) and amounted to GEL 103,000 thousand. In March 2022 share capital of subsidiary was increased by GEL 26,000 thousand (AZN 14,060 thousand) and amounted to GEL 129,000 thousand (AZN 61,541 thousand) as at 31 December 2022 (31 December 2021 AZN 47,481 thousand).

In December 2019, the Bank granted subordinated debt of USD 5,000 thousand (AZN 8,500 thousand) to PASHA Bank Georgia JSC. The fair value measurement of subordinated debt lead to total loss of AZN 376 thousand by the Bank. The loss has been accounted as a cost of investment in the subsidiary, which amounted to AZN 61,917 thousand as of 31 December 2022 and AZN 47,857 thousand 2021. PASHA Bank Georgia JSC operates under a banking licence issued by the National Bank of Georgia (the "NBG") on 17 January 2013.

(Figures in tables are in thousands of Azerbaijani manats)

13. Other assets and liabilities

Other assets comprise:

	2022	*2021*
Other financial assets		
Settlements on money transfers	53,135	27,699
Accrued commission receivable on guarantees and letters of credit	1,675	1,759
Other	67	5
	54,877	**29,463**
Less-allowance for impairment of other financial assets	(945)	(358)
Total other financial assets	**53,932**	**29,105**
Other non-financial assets		
Repossessed collaterals	6,552	10,647
Deferred expenses	5,371	2,513
Purchased miles under loyalty programme	2,998	3,788
Prepayments for acquisition of property, equipment and intangible assets	1,152	2,301
Other	4,422	1,380
	20,495	**20,629**
Total other assets	**74,427**	**49,734**

All balances of other financial assets are allocated to Stage 1.

The repossessed collaterals are represented by non-financial assets acquired by the Bank in settlement of overdue loans. The repossessed collaterals are recorded at a lower of cost and net realizable value as at the end of year.

Other liabilities comprise:

	2022	*2021*
Other financial liabilities		
Accrued expenses	8,049	10,962
Settlements on money transfer	4,959	209
Other	1,110	784
	14,118	**11,955**
Other non-financial liabilities		
Payable to employees	28,761	26,140
Deferred income	2,302	2,684
Taxes, other than income tax	2,075	1,571
	33,138	**30,395**
Total other liabilities	**47,256**	**42,350**

14. Amounts due to banks and government funds

Amounts due to banks and government funds comprise:

	2022	*2021*
Entrepreneurship Development Fund of the Republic of Azerbaijan	208,738	273,940
Long-term deposits from banks	164,495	184,961
Azerbaijan Mortgage and Credit Guarantee Fund	103,654	82,674
Long-term loans from banks	47,609	50,085
Correspondent accounts with other banks	46,265	22,887
Agro Credit and Development Agency	12,128	12,923
Short-term deposits from banks	3,438	11,568
Amount due to IT Development Fund	538	1,067
Other	9,360	27,605
Amounts due to banks and government funds	**596,225**	**667,710**

(Figures in tables are in thousands of Azerbaijani manats)

14. Amounts due to banks and government funds (continued)

As at 31 December 2022, Entrepreneurship Development Fund of the Republic of Azerbaijan had current account amounting to AZN 2,629 thousand (31 December 2021: AZN 25,317 thousand) and time deposits amounting to AZN 0 thousand (31 December 2021: AZN 13,089 thousand maturing through April 2022 with interest rate of 6.5%). The Bank had loans received from the Entrepreneurship Development Fund of the Republic of Azerbaijan amounting to AZN 206,109 thousand (31 December 2021: AZN 235,534 thousand), maturing through September 2032 (31 December 2021: through June 2030) and bearing interest rate of 1.0% (31 December 2021: 1.0%). The loans were acquired for the purposes of assistance in gradually improving entrepreneurship environment in Azerbaijan under the government program. The loans have been granted to local entrepreneurs at interest rate not higher than 6.0% (31 December 2021: not higher than 6.0%).

As at 31 December 2022, the Bank attracted long-term deposits from two resident commercial banks comprising AZN 164,495 thousand maturing on November 2025 with interest rates 0.1% and 4.3% (31 December 2021: from two resident commercial banks comprising AZN 184,961 thousand matured on September 2023 with interest rate 0.1% and 4.0%).

As at 31 December 2022, the Bank had loans refinanced from the Azerbaijan Mortgage and Credit Guarantee Fund amounting to AZN 92,596 thousand (31 December 2021: AZN 67,181 thousand), maturing through October 2052 (31 December 2021: through January 2051) and bearing interest rate of 1.0% and 4.0% (31 December 2021: 1.0% and 4.0%). The loans have been granted to borrowers at interest rate not higher than 8.0% (31 December 2021: not higher than 8.0%). Also, the Bank had short-term deposit from the Azerbaijan Mortgage and Credit Guarantee Fund amounting AZN 11,058 thousand (31 December 2021: AZN 15,493 thousand), maturing through August 2023 (31 December 2021: June 2022) with interest rate ranging between 5.0% and 9% (31 December 2021: ranging between 5.0% and 5.5%)

As at 31 December 2022, the Bank received long-term loans from one resident and one non resident banks comprising AZN 47,609 thousands maturing through August 2026 and with interest rate ranging between 3.0% and 10.5% (31 December 2021: from one non-resident commercial bank comprising AZN 50,085 thousand matured on August 2026 with interest rate 3.0% and 11.0%). During 2021, a fair value loss of AZN 3,778 thousand arose on initial recognition of the loan from the resident bank.

As at 31 December 2022, the Bank had loans received from the Agro Credit and Development Agency amounting to AZN 12,128 thousand (31 December 2021: AZN 12,923 thousand), maturing through September 2027 (31 December 2021: December 2026) and bearing interest rate between 2.0% and 4.0% (31 December 2021: 2.0% and 4.0%). The loans have been granted to local entrepreneurs at interest rate of 7.0% (31 December 2021: 7.0%).

As at 31 December 2021, the Bank attracted short-term deposits from one resident commercial bank (31 December 2021: two resident commercial banks) comprising AZN 3,438 thousand (31 December 2021: AZN 11,568 thousand) maturing on February 2023 (31 December 2021: August 2022) and with interest rate ranging between 3.0% (31 December 2021: 3.0% and 12.0%).

As at 31 December 2022, the Bank had loans refinanced from the IT Development Fund amounting to AZN 538 thousand (31 December 2021: AZN 1,067 thousand), maturing through June 2024 (31 December 2021: through June 2024) and bearing interest rate of 1.0% (31 December 2021: 1.0%). The loans have been granted to local entrepreneurs at interest rate of 5.0%.

15. Amounts due to customers

The amounts due to customers include the following:

	2022	***2021***
Demand deposits	5,395,892	3,611,577
Time deposits	1,633,004	1,446,274
Amounts due to customers	**7,028,896**	**5,057,851**
Held as security against guarantees issued (Note 20)	50,050	40,775

(Figures in tables are in thousands of Azerbaijani manats)

15. Amounts due to customers (continued)

An analysis of customer accounts by economic sector follows:

	2022	*2021*
Trade and services	1,850,004	1,085,190
Individuals	1,562,706	1,629,724
Mining	1,009,901	502,536
Transport and communication	842,454	357,899
Investment holding companies	506,153	453,777
Manufacturing	473,837	382,179
Energy	175,012	123,178
Insurance	166,757	84,090
Construction	151,231	242,145
Public organizations	85,528	68,939
Agriculture	45,496	29,185
Hotel business	37,621	16,137
Non-banking credit organizations	15,538	15,183
Other	106,658	67,689
Amounts due to customers	**7,028,896**	**5,057,851**

As at 31 December 2022, customer deposits included balances with fourteen (31 December 2021: thirteen) largest customers comprised AZN 4,352,437 thousand or 62% of the total customer deposits portfolio (31 December 2021: AZN 2,757,218 thousand or 55% of the total customer deposits portfolio).

As at 31 December 2022, deposits of the customers in the amount of AZN 546,040 thousand (31 December 2021: AZN 628,246 thousand) are pledged as collateral for loans to customers in the amount of AZN 848,748 thousand (31 December 2021: AZN 769,964). The net amounts due to customers balance after offset would have been AZN 6,482,856 thousand (31 December 2021: AZN 4,429,605 thousand) if net-off rights were exercised.

16. Subordinated debts

As of 31 December 2022, subordinated debts represent USD denominated subordinated loans of AZN 106,437 (31 December 2021: AZN 36,809) borrowed by the Bank maturing through August 2027 and April 2029 (31 December 2021: August 2024 and December 2028).

17. Derivative financial instruments

The Bank enters into derivative financial instruments for trading purposes. 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, 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.

	2022			*2021*		
	Notional amount	***Fair values***		***Notional amount***	***Fair value***	
		Asset	***Liability***		***Asset***	***Liability***
Foreign exchange contracts						
Futures – foreign	45,126	1,218	–			
Futures − domestic	45,154	–	(1,191)	–	–	–
Options – domestic	40,726	53	–	54,474	99	–
Forwards and swaps – foreign	295,495	1,657	(6,606)	319,664	60	(7,787)
Forwards and swaps − domestic	313,641	7,040	(1,628)	334,764	7,835	(60)
Total derivative assets/ (liabilities)		**9,968**	**(9,425)**		**7,994**	**(7,847)**

(Figures in tables are in thousands of Azerbaijani manats)

17. Derivative financial instruments (continued)

As at 31 December 2022 and 2021, the Bank has positions in the following types of derivatives:

Forwards and futures

Forwards and futures contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Futures contracts are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements.

Swaps

Swaps are contractual agreements between two parties to exchange movements in interest and foreign currency rates and equity indices, and (in the case of credit default swaps) to make payments with respect to defined credit events based on specified notional amounts.

Options

Options are contractual agreements that convey the right, but not the obligation, for the purchaser either to buy or sell a specific amount of a financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

18. Taxation

The corporate income tax expense comprises:

	2022	*2021*
Current tax charge	(47,225)	(31,639)
Deferred tax credit − origination and reversal of temporary differences	19,123	4,946
Less: deferred tax recognised in other comprehensive income	(4,610)	(1,803)
Income tax expense	**(32,712)**	**(28,496)**

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

	2022	*2021*
Net loss on investment securities at FVOCI	4,610	1,803
Income tax credited of other comprehensive income	**4,610**	**1,803**

Current income tax liabilities of AZN 21,244 thousand as at 31 December 2021 (31 December 2021: AZN 11,101 thousand) represents cumulative amount of income tax payable of the Bank.

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:

	2022	*2021*
Profit before income tax expense	**118,031**	**103,428**
Statutory tax rate	20%	20%
Theoretical tax expense at the statutory rate	**(23,606)**	**(20,686)**
Tax effect of non-deductible expenses	(2,792)	(3,009)
Unrecognized deferred income tax for impairment of investments in subsidiaries	(6,377)	(4,471)
Other	63	(330)
Income tax expense	**(32,712)**	**(28,496)**

(Figures in tables are in thousands of Azerbaijani manats)

18. Taxation (continued)

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

		Origination and reversal of temporary differences			*Origination and reversal of temporary differences*		
	1 January 2021	*In the statement of profit or loss*	*In other comprehensive income*	*31 December 2021*	*In the statement of profit or loss*	*In other comprehensive income*	*31 December 2022*
Tax effect of deductible temporary differences							
Amounts due to banks and government agencies	–	755	–	755	(234)	–	521
Investment property	82	(82)	–	–	–	–	–
Property and equipment	126	(48)	–	78	(78)	–	–
Intangible assets	340	(198)	–	142	(137)	–	5
Derivative financial liabilities	1,352	(1,352)	–	–	316	–	316
Loans to customers	–	392	–	392	9,054	–	9,446
Investment securities	–	–	–	–	–	3,500	3,500
Lease liabilities	1,567	1,393	–	2,960	81	–	3,041
Provision for credit related commitments	–	–	–	–	249	–	249
Derivative financial assets	–	59	–	59	(59)	–	–
Other liabilities	4,983	(279)	–	4,704	957	–	5,661
Deferred tax assets	**8,450**	**640**	**–**	**9,090**	**10,149**	**3,500**	**22,739**
Tax effect of taxable temporary differences							
Amounts due from credit institutions	(2,872)	293	–	(2,579)	1,377	–	(1,202)
Investment securities	(4,250)	(105)	1,803	(2,552)	1,442	1,110	–
Loans to customers	(1,180)	1,180	–	–	–	–	–
Derivative financial assets	(1,497)	1,497	–	–	(405)	–	(405)
Amounts due to customers	–	–	–	–	(131)	–	(131)
Other assets	(1,872)	889	–	(983)	287	–	(696)
Right-of-use assets	(1,526)	(1,395)	–	(2,921)	(77)	–	(2,998)
Property and equipment	–	–	–	–	(133)	–	(133)
Provision for credit related commitments	(2,148)	144	–	(2,004)	2,004	–	–
Deferred tax liabilities	**(15,345)**	**2,503**	**1,803**	**(11,039)**	**4,364**	**1,110**	**(5,565)**
Net deferred tax (liabilities)/assets	**(6,895)**	**3,143**	**1,803**	**(1,949)**	**14,513**	**4,610**	**17,174**

19. Equity

As at 31 December 2022 and 2021, the Bank's authorized, issued and fully paid capital amounted to AZN 354,512 thousand comprising of 10,646 ordinary shares with a par value of AZN 33,300 per ordinary share. Each ordinary share entitles one vote to the shareholder.

On 3 May 2021 Shareholders of the Bank declared dividends totalling AZN 50,380 thousand on ordinary shares (AZN 4,733 per share) which was paid as at 31 December 2021.

On 20 April 2022 and 2 September 2022 Shareholders of the Bank declared dividends totalling AZN 44,314 thousand on ordinary shares (AZN 4,163 per share) which was paid as at 31 December 2022.

Unrealised gains/losses on investment securities

This reserve records fair value changes on investment securities at FVOCI which amounted to loss of AZN 5,335 thousand as at 31 December 2022 (31 December 2021: gain of AZN 13,104 thousand).

(Figures in tables are in thousands of Azerbaijani manats)

20. Commitments and contingencies

Operating environment

The disruption of the global supply chains, conflict between the Russian Federation and Ukraine (Note 4) as well as rising consumer demand for goods lead to significant inflationary pressures to the global economy in 2022, including soaring commodity prices. Effect on economies in which the Bank operates is presented as follows.

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.

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 8.3% as at 31 December 2022 (31 December 2021: 7.3%).

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.

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

Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which 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 Azerbaijan suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years proceding the year of review.

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

(Figures in tables are in thousands of Azerbaijani manats)

20. Commitments and contingencies (continued)

Compliance with CBAR ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2022 and 2021, the Bank was in compliance with these ratios except for the followings:

- Ratio of the share in one legal entity which should not exceed 10% of total capital. As at 31 December 2022, the Bank's ratio was 18.4% (31 December 2021: 24.0%). This breach was caused by investment injections to the subsidiaries of the Bank.
- Ratio of maximum credit exposure of a bank per a single borrower or a group of related borrowers on unsecured loan that should not exceed 10% of Tier 1 capital. As at 31 December 2022, the Bank's ratio was 12.3% (31 December 2021: 13.4%). This breach was caused by the issuance of the specific loans for government related projects.
- Ratio of maximum credit exposure to one related party legal entity of the bank or their representatives should not exceed 10% of total capital. As at 31 December 2022, the Bank's ratio was 14.8% (31 December 2021: 19.3%). This breach was caused by issuance of cash covered loans to related parties.
- Ratio of maximum credit exposure of total related party loans of the bank or their representatives should not exceed 20% of total capital. As at 31 December 2022, the Bank's ratio was 30.1% (31 December 2021: 42.8%). This breach was caused by issuance of cash covered loans to related parties.

Throughout the year the Bank submitted information regarding these breaches to the regulator on a monthly basis. The Bank is in continuous discussions with the CBAR to agree the remediation measures for each of these breaches. No sanctions have been imposed on the Bank in relation to these breaches as at 31 December 2022. Management believes that the Bank will not face any sanctions in the foreseeable future in respect of these breaches.

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.

The Bank's commitments and contingencies comprised the following as of 31 December:

	2022	*2021*
Credit-related commitments		
Guarantees issued	192,728	211,735
Unused credit lines	325,837	325,948
Letters of credit	16,057	37,833
	534,622	**575,516**
Performance guarantees	424,707	384,926
Less: provisions for ECL for credit related commitments	(9,727)	(10,011)
Commitments and contingencies (before deducting collateral)	**949,602**	**950,431**
Less: cash held as security against guarantees issued (Note 15)	(50,050)	(40,775)
Commitments and contingencies	**899,552**	**909,656**

(Figures in tables are in thousands of Azerbaijani manats)

20. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

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:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2022	**(1,486)**	**(3,382)**	**(238)**	**(5,106)**
New exposures	(3,938)	–	–	**(3,938)**
Exposures derecognised or matured (excluding write-offs)	862	912	224	**1,998**
Transfers to Stage 1	(711)	711	–	**–**
Transfers to Stage 2	560	(560)	–	**–**
Transfers to Stage 3	2,442	1,208	(3,650)	**–**
Impact on period end ECL of exposures transferred between stages during the period	661	(589)	(8,472)	**(8,400)**
Changes to inputs used for ECL calculations	(120)	(125)	(4)	**(249)**
Amounts paid/Conversion into loan	–	–	9,343	**9,343**
At 31 December 2022	**(1,730)**	**(1,825)**	**(2,797)**	**(6,352)**

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:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2021	**(1,848)**	**(2,879)**	**(184)**	**(4,911)**
New exposures	(3,271)	–	–	**(3,271)**
Exposures derecognised or matured (excluding write-offs)	877	1,857	70	**2,804**
Transfers to Stage 1	(375)	341	34	**–**
Transfers to Stage 2	2,386	(2,443)	57	**–**
Transfers to Stage 3	108	3	(111)	**–**
Impact on period end ECL of exposures transferred between stages during the period	331	(425)	(104)	**(198)**
Changes to inputs used for ECL calculations	306	164	–	**470**
At 31 December 2021	**(1,486)**	**(3,382)**	**(238)**	**(5,106)**

21. Credit loss expense and other impairment and provisions

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

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Cash and cash equivalents		–	–	–	**–**
Amounts due from credit Institutions	6	397	–	(2,812)	**(2,415)**
Investment securities at FVOCI	7	1,226	(9,740)	(17,995)	**(26,509)**
Investment securities at amortised cost	7	(523)	–	–	**(523)**
Loans to customers	8	(1,160)	2,158	(16,612)	**(15,614)**
Credit loss on financial assets		**(60)**	**(7,582)**	**(37,419)**	**(45,061)**
Credit related commitments	20	(244)	1,557	(11,902)	**(10,589)**
Total credit loss expense		**(304)**	**(6,025)**	**(49,321)**	**(55,650)**

Allowance for impairment of other assets is deducted from the carrying amounts of the related assets. Provision for ECL for credit related commitments are recorded in liabilities.

(Figures in tables are in thousands of Azerbaijani manats)

21. Credit loss expense and other impairment and provisions (continued)

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

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Cash and cash equivalents		30	–	–	**30**
Amounts due from credit Institutions	6	(361)	–	–	**(361)**
Investment securities at FVOCI	7	524	–	–	**524**
Loans to customers	8	(6,206)	6,284	(20,542)	**(20,464)**
Credit loss on financial assets		**(6,013)**	**6,284**	**(20,542)**	**(20,271)**
Credit related commitments	20	362	(503)	(54)	**(195)**
Total credit loss expense		**(5,651)**	**5,781**	**(20,596)**	**(20,466)**

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

	Other financial assets	*Performance guarantees*	*Total*
1 January 2021	**(410)**	**(3,230)**	**(3,640)**
Credit/(charge)	52	(1,675)	**(1,623)**
31 December 2021	**(358)**	**(4,905)**	**(5,263)**
Credit/(charge)	(587)	1,530	**943**
31 December 2022	**(945)**	**(3,375)**	**(4,320)**

22. Net fee and commission income

Net fee and commission income comprise:

	2022	*2021*
Servicing plastic card operations	65,724	41,207
Settlements operations	22,432	18,894
Guarantees and letters of credit	16,594	13,714
Cash operations	5,823	4,727
Other	696	770
Fee and commission income	**111,269**	**79,312**
Servicing plastic card operations	(58,712)	(35,565)
Settlements operations	(9,066)	(7,752)
Guarantees and letters of credit	(2,945)	(1,682)
Cash operations	(832)	(951)
Securities operations	(110)	(22)
Other	(42)	(70)
Fee and commission expense	**(71,707)**	**(46,042)**
Net fee and commission income	**39,562**	**33,270**

23. Net gains from foreign currencies

Net gains from foreign currencies comprise:

	2022	*2021*
Dealing	43,846	26,539
Translation differences	(548)	(1,245)
Operations with foreign currency derivatives	3,154	3,492
Total net gains from foreign currencies	**46,452**	**28,786**

(Figures in tables are in thousands of Azerbaijani manats)

24. Personnel, general and administrative expenses

Personnel expenses comprise:

	2022	*2021*
Salaries and bonuses	(49,217)	(43,911)
Social security costs	(8,926)	(7,568)
Other employee related expenses	(3,953)	(3,126)
Total personnel expenses	**(62,096)**	**(54,605)**

General and administrative expenses comprise:

	2022	*2021*
Software cost	(8,483)	(6,011)
Charity and sponsorship	(8,020)	(10,301)
Insurance	(7,696)	(7,030)
Professional services	(5,040)	(7,245)
Loyalty miles	(4,732)	(4,385)
Advertising costs	(2,732)	(1,986)
Communications	(2,013)	(1,719)
Taxes, other than income tax	(1,697)	(1,244)
Utilities	(1,639)	(1,405)
Repair and maintenance	(1,246)	(1,452)
Security expenses	(1,036)	(910)
Stationery	(954)	(1,155)
Transportation and business trip expenses	(630)	(675)
Entertainment	(485)	(507)
Membership fees	(91)	(63)
Printing expenses	(43)	(34)
Other expenses	(9)	(46)
Total general and administrative expenses	**(46,546)**	**(46,168)**

25. Impairment and write-down

Impairment and write-down for the year ended 31 December comprise the following:

	2022	*2021*
Impairment of Investment in subsidiaries (Note 12)	(31,887)	(22,357)
Write-down of repossessed collaterals	(3,283)	(5,008)
Reversal of write-down of miles under loyalty program	–	691
Reversal of impairment on investment property	–	410
Total impairment and write-down	**(35,170)**	**(26,264)**

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, the latter being subdivided into trading and non-trading risks. 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.

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Introduction (continued)

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.

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.

Executive Board

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

Asset-Liability Management Committee (ALCO)

An ALCO is responsible for managing the Bank's assets and liabilities to ensure that the Bank maintains healthy financial position and meets its financial objectives.

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, which 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.

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 Supervisory 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 Executive Board and all other relevant employees of the Bank on the utilisation of market limits and liquidity, plus any other risk developments.

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Introduction (continued)

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 or geographical location.

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 and customer's deposit 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 separate 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 separate statement of financial position, including derivatives, 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 below. The effect of collateral and other risk mitigation techniques is shown in Note 8.

(Figures in tables 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 *Probability of Default* 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 *Exposure at Default* 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 *Loss Given Default* 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 recognised, the Bank recognises 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 unlikeliness 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.

(Figures in tables 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).
- 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 and consumer loans are scored from 1 to 20 and from 1 to 4 using internal grades, respectively. 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.

Impairment assessment of Russian investment securities

As at 31 December 2022, ECL for Russian investment securities is estimated based on qualitative and quantitative factors for Stage determination:

- Presence/absence of sanctions imposed on investment security issuer and ownership structure of the issuer;
- Coupons’ collection and overdue days on latest coupon;
- Technical ability of the Bank to recover the payments timely.

The Bank estimates PD using a pre-default (Ca) rating, whereas LGD is based on historical recovery rates.

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.

(Figures in tables 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

Consumer lending comprises unsecured personal loans, credit cards and overdrafts. These products along with 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 grade for SME	*Moody's based internal/external ratings for Corporate and Financial institutions*	*Internal rating description*
1	Aaa	
2-4	Aa1 to Aa3	High grade
5-7	A1 to A3	
8-10	Baa1 to Baa3	
11-13	Ba1 to Ba3	Standard grade
14-16	B1 to B3	
17-19	Caa1 to Caa3	Sub-standard grade
20	Ca	
Default	C	Impaired

Internal rating for loans is based on quantitative and qualitive factors. High grade rating is used for Central Bank, Ministry of Finance of the Republic of Azerbaijan and other cash covered financial assets.

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.

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

Loss given default

For corporate lending assets, LGD values are assessed semi-annually.

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.

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.

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.

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, the account becoming restructured due to credit event, or credit rating downgrade. 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 consumer 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;
- Inflation;
- Monetary policy rate;
- Dynamics of real and nominal effective exchange rates;
- Real estate price.

(Figures in tables 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 groups, and international financial institutions). Experts of the Bank's Credit Risk Department determine the weights attributable to the multiple scenarios with the values of the key forward looking economic variables/assumptions used in each of the economic scenarios for the ECL calculations.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank internal credit ratings. The table below shows the credit quality by class of asset for loan-related lines in the separate statement of financial position, based on the Bank's credit rating system for the year ended 31 December 2022.

31 December 2022	***Note***		***High grade***	***Standard grade***	***Sub-standard grade***	***Impaired***	***Total***
Cash and cash equivalents, except for cash on hand	5	Stage 1	2,839,240	237,446	10,501	–	**3,087,187**
Amounts due from credit institutions	6	Stage 1	360,710	121,381	4,033	–	**486,124**
		Stage 3	–	–	–	17,410	**17,410**
Loans to customers	8	Stage 1	114,668	1,450,121	253,238	–	**1,818,027**
		Stage 2	426,734	178,487	270,512	–	**875,733**
		Stage 3	–	–	–	124,988	**124,988**
		POCI	–	–	–	7,025	**7,025**
Investment securities							
- Measured at FVOCI	7	Stage 1	1,175,425	103,390	–	–	**1,278,815**
		Stage 2	–	–	28,355	–	**28,355**
		Stage 3	–	–	5,819	–	**5,819**
- Measured at amortised cost		Stage 1	449,665	–	–	–	**449,665**
Unused credit lines	20	Stage 1	31,443	206,237	72,660	–	**310,340**
		Stage 2	562	4,293	9,821	–	**14,676**
		Stage 3	–	–	–	821	**821**
Letters of credit	20	Stage 1	–	11,357	2,251	–	**13,608**
		Stage 2	–	2,332	117	–	**2,449**
Guarantees issued	20	Stage 1	1,101	158,372	9,435	–	**168,908**
		Stage 2	–	2,030	17,777	–	**19,807**
		Stage 3	–	–	–	4,013	**4,013**
Other financial assets	13	Stage 1	–	54,877	–	–	**54,877**
Total			**5,399,548**	**2,530,323**	**678,700**	**160,076**	**8,768,647**

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

The table below shows the credit quality by class of asset for loan-related lines in the separate statement of financial position, based on the Bank's credit rating system for the year ended 31 December 2021.

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	1,161,199	42,239	–	–	**1,203,438**
Amounts due from credit institutions	6	Stage 1	183,754	343,718	–	–	**527,472**
		Stage 3	–	–	–	13,981	**13,981**
Loans to customers	8	Stage 1	118,669	1,282,993	137,929	–	**1,539,591**
		Stage 2	418,514	134,156	347,936	–	**900,606**
		Stage 3	–	–	–	191,807	**191,807**
Investment securities	7	Stage 1	1,522,268	279,057	–	–	**1,801,325**
Unused credit lines	20	Stage 1	23,115	257,698	18,265	–	**299,078**
		Stage 2	165	9,527	16,787	–	**26,479**
		Stage 3	–	–	–	391	**391**
Letters of credit	20	Stage 1	2,888	12,339	2,628	–	**17,855**
		Stage 2	–	–	19,978	–	**19,978**
	20	Stage 1	226	158,552	14,537	–	**173,315**
Guarantees issued		Stage 2	971	2,374	34,822	–	**38,167**
		Stage 3	–	–	–	253	**253**
Other financial assets	13	Stage 1	–	29,463	–	–	**29,463**
Total			**3,431,769**	**2,552,116**	**592,882**	**206,432**	**6,783,199**

See Note 8 for more detailed information with respect to expected credit loss of loans to customers.

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. See Note 20.

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

	2022				*2021*			
	The Republic of Azerbaijan	*OECD countries*	*CIS and other non-OECD countries*	*Total*	*The Republic of Azerbaijan*	*OECD countries*	*CIS and other non-OECD countries*	*Total*
Financial assets								
Cash and cash equivalents	1,994,394	1,138,661	42,969	**3,176,024**	1,154,369	97,884	33,166	**1,285,419**
Amounts due from credit institutions	305,331	143,815	51,169	**500,315**	67,364	373,059	100,226	**540,649**
Derivative financial assets	7,093	2,875	–	**9,968**	7,934	60	–	**7,994**
Investment securities	1,711,305	1,735	51,094	**1,764,134**	1,321,844	311,735	169,749	**1,803,328**
Loans to customers	2,728,154	–	–	**2,728,154**	2,552,877	–	–	**2,552,877**
Other financial assets	54,877	–	–	**54,877**	29,463	–	–	**29,463**
	6,801,154	**1,287,086**	**145,232**	**8,233,472**	**5,133,851**	**782,738**	**303,141**	**6,219,730**
Financial liabilities								
Amounts due to banks and government funds	564,664	11,545	20,016	**596,225**	658,466	1,925	7,319	**667,710**
Amounts due to customers	7,028,896	–	–	**7,028,896**	5,057,851	–	–	**5,057,851**
Derivative financial liabilities	2,820	6,605	–	**9,425**	60	7,787	–	**7,847**
Subordinated debts	106,437	–	–	**106,437**	36,809	–	–	**36,809**
Lease liabilities	15,206	–	–	**15,206**	14,795	–	–	**14,795**
Other financial liabilities	14,118	–	–	**14,118**	11,955	–	–	**11,955**
	7,732,141	**18,150**	**20,016**	**7,770,307**	**5,779,936**	**9,712**	**7,319**	**5,796,967**
Net (liabilities)/assets	**(930,987)**	**1,268,936**	**125,216**	**463,165**	**(646,085)**	**773,026**	**295,822**	**422,763**

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

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 highly 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. As at 31 December 2022 and 2021, these ratios were as follows:

	2022, %	*2021, %*
Instant Liquidity Ratio (30% is the minimum required by the CBAR) (assets receivable or realisable within one day/liabilities repayable on demand)	82	61

Analysis of financial liabilities by remaining contractual maturities

The table below summarises 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.

Financial liabilities	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total 2022*
As at 31 December 2022					
Amounts due to banks and government funds	84,622	54,664	398,115	136,500	**673,901**
Amounts due to customers	5,520,645	1,232,603	318,300	–	**7,071,548**
Subordinated debt	2,275	4,829	31,094	102,483	**140,681**
Net settled derivative financial liabilities	1,191	–	–	–	**1,191**
Gross settled derivative financial instruments:					
- Contractual amounts payable	116,551	44,214	303,402	–	**464,167**
- Contractual amounts receivable	(118,543)	(46,948)	(303,372)	–	**(468,863)**
Lease liabilities	1,727	4,935	10,856	–	**17,518**
Other financial liabilities	14,118	–	–	–	**14,118**
Total undiscounted financial liabilities	**5,622,586**	**1,294,297**	**758,395**	**238,983**	**7,914,261**

Financial liabilities	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total 2021*
As at 31 December 2021					
Amounts due to banks and government funds	99,114	254,920	258,555	112,503	**725,092**
Amounts due to customers	3,779,264	379,146	866,987	94,287	**5,119,684**
Subordinated debt	310	1,389	24,374	19,276	**45,349**
Gross settled derivative financial instruments:					
- Contractual amounts payable	42,768	346,647	–	–	**389,415**
- Contractual amounts receivable	(45,439)	(349,161)	–	–	**(394,600)**
Lease liabilities	1,415	4,810	10,518	-	**16,743**
Other financial liabilities	11,955	–	–	–	**11,955**
Total undiscounted financial liabilities	**3,889,387**	**637,751**	**1,160,434**	**226,066**	**5,913,638**

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Liquidity risk and funding management (continued)

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies.

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Maturity undefined*	*Total*
As at 31 December 2022	361,425	141,298	29,180	–	–	**531,903**
As at 31 December 2021	375,666	158,740	20,433	–	–	**554,839**

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 deposits from organizations of related parties 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. 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 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.

Included in amounts due to customers are term deposits of individuals. In accordance with the legislation, the Bank is obliged to repay such deposits upon demand of a depositor.

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, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

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 manages exposures to market risk based of sensitivity analysis. The Bank has no significant concentration of market risk.

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.

The sensitivity of current year profit is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2022. The Bank does not have substantial amount of floating rate non-trading financial instruments as at 31 December 2022 and 2021.

Currency risk

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its statement of financial position and statement of cash flows.

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.

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Currency risk (continued)

As at 31 December 2022, the Bank had the following exposure to foreign currency exchange rate risk:

	AZN	*USD*	*EUR*	*Other*	*Total 2022*
Financial assets					
Cash and cash equivalents	905,377	1,989,427	244,649	36,571	**3,176,024**
Amounts due from credit institutions	153,086	237,952	92,226	17,051	**500,315**
Derivative financial assets	488	7,823	1,657	–	**9,968**
Investment securities	1,474,957	279,405	9,772	–	**1,764,134**
Loans to customers	1,546,200	871,076	228,747	82,131	**2,728,154**
Other financial assets	28,830	23,582	1,879	586	**54,877**
Total financial assets	**4,108,938**	**3,409,265**	**578,930**	**136,339**	**8,233,472**
The effect of derivatives	20,000	140,775	139,282	100,472	**400,529**
Financial liabilities					
Amounts due to banks and government funds	377,974	114,709	20,465	83,077	**596,225**
Amounts due to customers	3,367,299	3,063,748	543,539	54,310	**7,028,896**
Derivative financial liabilities	–	7,768	1,657	–	**9,425**
Subordinated debts	–	106,437	–	–	**106,437**
Lease liabilities	15,206	–	–	–	**15,206**
Other financial liabilities	10,055	2,505	1,430	128	**14,118**
Total financial liabilities	**3,770,534**	**3,295,167**	**567,091**	**137,515**	**7,770,307**
The effect of derivatives	–	97,506	140,429	101,678	**339,613**
Net financial position after the effect of derivatives	**358,404**	**157,367**	**10,692**	**(2,382)**	**524,081**

As at 31 December 2021 the Bank had the following exposure to foreign currency exchange rate risk:

	AZN	*USD*	*EUR*	*Other*	*Total 2021*
Financial assets					
Cash and cash equivalents	843,815	287,042	125,633	28,929	**1,285,419**
Amounts due from credit institutions	58,237	354,357	108,965	19,090	**540,649**
Derivative financial assets	147	2,035	–	5,812	**7,994**
Investment securities	1,037,459	738,451	27,418	–	**1,803,328**
Loans to customers	1,368,300	734,438	353,235	96,904	**2,552,877**
Other financial assets	20,663	7,249	1,445	106	**29,463**
Total financial assets	**3,328,621**	**2,123,572**	**616,696**	**150,841**	**6,219,730**
The effect of derivatives	15,100	165,824	124,652	84,455	**390,031**
Financial liabilities					
Amounts due to banks and government funds	450,747	103,015	20,179	93,769	**667,710**
Amounts due to customers	2,632,618	1,785,972	588,481	50,780	**5,057,851**
Derivative financial liabilities	–	2,035	–	5,812	**7,847**
Subordinated debts	–	36,809	–	–	**36,809**
Lease liabilities	14,592	203	–	–	**14,795**
Other financial liabilities	5,940	2,768	3,204	43	**11,955**
Total financial liabilities	**3,103,897**	**1,930,802**	**611,864**	**150,404**	**5,796,967**
The effect of derivatives	–	43,350	185,746	89,775	**318,871**
Net financial position after the effect of derivatives	**239,824**	**315,244**	**(56,262)**	**(4,883)**	**493,923**

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Currency risk (continued)

Currency risk sensitivity

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2019 and 2018 on its monetary assets and liabilities. 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 separate statement of profit or loss. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for specified changes in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Bank where the denomination of the loan is in a currency other than the currency of the lender or the borrower. The effect on equity does not differ from the effect on the separate statement of profit or loss. A negative amount in the table reflects a potential net reduction in the separate statement of profit or loss or equity, while a positive amount reflects a net potential increase. Impact on profit before tax based on assets value as at 31 December 2022 and 2021:

Impact on profit before tax based on assets value as at 31 December 2022 and 2021:

	2022		*2021*	
	USD/AZN +20%	***USD/AZN -3%***	***USD/AZN +20%***	***USD/AZN -3%***
Impact on profit before tax	31,473	(4,721)	63,049	(9,457)

	2022		*2021*	
	EUR/AZN +21%	***EUR/AZN -9%***	***EUR/AZN +22%***	***EUR/AZN -10%***
Impact on profit before tax	2,245	(962)	(12,378)	5,626

27. Fair value measurement

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’s 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:

		Fair value measurement using			
At 31 December 2022	***Date of valuation***	***Quoted prices in active markets (Level 1)***	***Significant observable inputs (Level 2)***	***Significant unobservable inputs (Level 3)***	***Total***
Assets measured at fair value					
Investment securities − at FVOCI	31 December 2022	94,293	1,220,699	−	**1,314,992**
Derivative financial assets	31 December 2022	−	9,968	−	**9,968**
Assets for which fair values are disclosed					
Investment securities measured at amortised cost	31 December 2022	−	448,584	−	**448,584**
Loans to customers	31 December 2022	−	−	2,711,406	**2,711,406**

(Figures in tables are in thousands of Azerbaijani manats)

27. Fair value measurement (continued)

Fair value hierarchy (continued)

At 31 December 2022	*Date of valuation*	*Fair value measurement using* Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	*Total*
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2022	−	9,425	−	**9,425**
Liabilities for which fair values are disclosed					
Amounts due to banks and government funds	31 December 2022	−	594,039	−	**594,039**
Amounts due to customers	31 December 2022	−	−	7,017,623	**7,017,623**
Subordinated debts	31 December 2022	−	−	106,437	**106,437**

At 31 December 2021	*Date of valuation*	*Fair value measurement using* Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	*Total*
Assets measured at fair value					
Investment securities − at FVOCI	31 December 2021	412,209	1,391,119	−	**1,803,328**
Derivative financial assets	31 December 2021	−	7,994	−	**7,994**
Assets for which fair values are disclosed					
Loans to customers	31 December 2021	−	−	2,545,768	**2,545,768**

At 31 December 2021	*Date of valuation*	*Fair value measurement using* Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	*Total*
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2021	−	7,847	−	**7,847**
Liabilities for which fair values are disclosed					
Amounts due to banks and government funds	31 December 2021	−	654,863	−	**654,863**
Amounts due to customers	31 December 2021	−	−	5,057,047	**5,057,047**
Subordinated debts	31 December 2021	−	−	36,809	**36,809**

(Figures in tables are in thousands of Azerbaijani manats)

27. Fair value measurement (continued)

Fair value hierarchy (continued)

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 separate statement of financial position. For the remaining financial instruments, their carrying value approximates their fair value. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2022	*Fair value 2022*	*Unrecognised gain/(loss) 2022*	*Carrying value 2021*	*Fair value 2021*	*Unrecognised gain/(loss) 2021*
Financial assets						
Loans to customers	2,728,154	2,711,406	(16,748)	2,552,877	2,545,768	(7,109)
Investment securities measured at amortised cost	449,142	448,584	(558)	–	–	–
Financial liabilities						
Amounts due to banks and government funds	596,225	594,039	2,186	667,710	654,863	12,847
Amounts due to customers	7,028,896	7,017,623	11,273	5,057,851	5,057,047	804
Subordinated debts	106,437	106,437	–	36,809	36,809	–
Total unrecognised change in unrealised fair value			**(3,847)**			**6,542**

Valuation techniques and assumptions

The following describes the methodologies and assumptions used to determine fair values for assets and liabilities recorded at fair value in the financial statements and those items that are not measured at fair value in the separate statement of financial position, but whose fair value is disclosed.

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 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 counterparty, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the counterparty operates.

The Bank estimates a fair value of Russian investment securities using a two-step approach:

- Step One – direct observations which is focused on trades, executable levels and indicative quotes on the target investment security;
- Step Two – uses direct observations on comparable investment securities to derive a relative value price on the target investment security when direct market observations are insufficient.

To derive a final fair value, the results are then appropriately weighted and aggregated based on the relative strength of each observation.

(Figures in tables are in thousands of Azerbaijani manats)

27. Fair value measurement (continued)

Fair value hierarchy (continued)

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 banks and government funds, subordinated debt 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.

Transfers between levels of the fair value hierarchy

During the year ended 31 December 2022, the Bank transferred certain financial instruments from level 1 to level 2 of the fair value hierarchy. As at 31 December 2022, the fair value of the total assets transferred was AZN 26,698. The reason for this transfer is a significant decrease in the volume or level of activity in the market for Russian bonds, which has led to a change in the method used to determine their fair value, which is described above.

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	3,176,024	–	**3,176,024**	1,285,419	–	**1,285,419**
Amounts due from credit institutions	428,859	71,456	**500,315**	445,959	94,690	**540,649**
Investment securities	823,331	940,803	**1,764,134**	343,827	1,459,501	**1,803,328**
Loans to customers	1,429,137	1,299,017	**2,728,154**	1,340,347	1,212,530	**2,552,877**
Derivative financial assets	1,468	8,500	**9,968**	7,994	–	**7,994**
Property and equipment	–	12,567	**12,567**	–	14,211	**14,211**
Intangible assets	–	26,482	**26,482**	–	31,035	**31,035**
Right-of-use assets	–	14,991	**14,991**	–	14,603	**14,603**
Investment in subsidiaries	–	109,179	**109,179**	–	127,006	**127,006**
Deferred income tax assets	–	17,174	**17,174**	–	–	**–**
Other assets	74,427	–	**74,427**	49,734	–	**49,734**
Total assets	**5,933,246**	**2,500,169**	**8,433,415**	**3,473,280**	**2,953,576**	**6,426,856**
Amounts due to banks and government funds	117,803	478,422	**596,225**	342,083	325,627	**667,710**
Amounts due to customers	6,729,851	299,045	**7,028,896**	4,132,182	925,669	**5,057,851**
Derivative financial liabilities	1,162	8,263	**9,425**	7,847	–	**7,847**
Current income tax liabilities	21,244	–	**21,244**	11,101	–	**11,101**
Deferred income tax liabilities	–	–	**–**	–	1,949	**1,949**
Provision for credit related commitments	9,727	–	**9,727**	10,011	–	**10,011**
Subordinated debts	1,443	104,994	**106,437**	–	36,809	**36,809**
Lease liabilities	5,583	9,623	**15,206**	5,253	9,542	**14,795**
Other liabilities	44,954	2,302	**47,256**	39,666	2,684	**42,350**
Total liabilities	**6,931,767**	**902,649**	**7,834,416**	**4,548,143**	**1,302,280**	**5,850,423**
Net assets	**(998,521)**	**1,597,520**	**598,999**	**(1,074,863)**	**1,651,296**	**576,433**

(Figures in tables are in thousands of Azerbaijani manats)

28. Maturity analysis of assets and liabilities (continued)

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.

Negative gap is due to significant concentration of amounts due to customers represented by related parties in the period of one year and these customers 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 82%) 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 ALCO, which are responsible for overseeing the Bank's liquidity on day-to-day basis.

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. Other related parties include entities which are associates of the entities under common control or shareholders.

(Figures in tables are in thousands of Azerbaijani manats)

29. Related party disclosures (continued)

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***	***Key manage-ment personnel***	***Other***	***Sub-sidiaries***	***Total***	***Share-Holders/ Ultimate owners***	***Entities under common control***	***Key manage-ment personnel***	***Other***	***Sub-sidiaries***	***Total***
Cash and cash equivalents	–	339	–	–	4,783	**5,122**	–	220	–	–	4,557	**4,777**
Amounts due from credit institutions	–	–	–	–	8,139	**8,139**	–	–	–	–	8,139	**8,139**
Loans outstanding at 1 January, gross	**–**	**606,664**	**3,106**	**22,825**	**–**	**632,595**	**–**	**583,240**	**3,396**	**43,213**	**–**	**629,849**
Loans issued during the year	–	448,042	3,455	139,570	–	**591,067**	–	128,270	6,859	87,079	–	**222,208**
Loan repayments during the year	–	(568,987)	(3,408)	(108,414)	–	**(680,809)**	–	(95,608)	(7,945)	(107,694)	–	**(211,247)**
Interest accrual	–	–	41	352	–	**393**	–	1,753	21	–	–	**1,774**
Foreign currency translation difference	–	(5,778)	429	(2,050)	–	**(7,399)**	–	(10,991)	775	227	–	**(9,989)**
Loans outstanding at 31 December, gross	**–**	**479,941**	**3,623**	**52,283**	**–**	**535,847**	**–**	**606,664**	**3,106**	**22,825**	**–**	**632,595**
Less: allowance for impairment at 31 December	–	(2,832)	(36)	(3,233)	–	**(6,101)**	–	(2,976)	(12)	(309)	–	**(3,297)**
Loans outstanding at 31 December, net	**–**	**477,109**	**3,587**	**49,050**	**–**	**529,746**	**–**	**603,688**	**3,094**	**22,516**	**–**	**629,298**
Interest income on loans and amounts due from credit institutions	–	25,163	157	4,594	–	**29,914**	–	25,768	319	3,855	–	**29,942**
Interest income (except loans)	–	–	–	–	452	**452**	–	–	–	–	443	**443**
Amounts due to banks and government funds	–	55,640	–	–	250	**55,890**	–	79,937	–	–	178	**80,115**
Time deposits	85,973	430,686	322	28,915	–	**545,896**	87,995	627,827	1,831	28,268	–	**745,921**
Demand deposits	376,324	565,549	7,434	435,827	–	**1,385,134**	623,328	307,533	7,143	357,966	–	**1,295,970**
Subordinated debt	36,102	38,832	1,105	1,230	1,729	**78,998**	18,923	4,445	850	–	–	**24,218**
Derivative financial liabilities	–	5,041	–	–	–	**5,041**	–	61	–	–	–	**61**
Derivative financial assets		4,924				**4,924**		7,786				**7,786**
Lease liabilities	–	(11,725)	–	–	–	**(11,725)**	–	(8,100)	–	–	–	**(8,100)**
Other Assets	–	8,347	–	–	–	**8,347**	–	275	–	–	–	**275**
Other liabilities	53	8,271	–	693	–	**9,017**	12	7,902	–	483	–	**8,397**
Investment securities	–	2,003	–	–	–	**2,003**	–	2,003	–	–	–	**2,003**
Guarantees issued	–	71,714	–	8,022	–	**79,736**	–	22,256	–	15,382	–	**37,638**
Letters of credit issued	–	4,540	–	3,002	–	**7,542**	–	2,995	–	6,894	–	**9,889**
Unused credit lines	–	33,685	429	33,628	–	**67,742**	–	30,536	772	33,235	–	**64,543**
Interest expense	(998)	(12,861)	(33)	(28)	(80)	**(14,000)**	(3,506)	(10,862)	(302)	(2,511)	–	**(17,181)**
Fee and commission: income	168	11,837	23	1,780	2	**13,810**	208	9,311	94	2,458	2	**12,073**
Fee and commission: expense	–	(15,149)	–	(49)	(156)	**(15,354)**	–	(7,689)	(1)	(60)	(136)	**(7,886)**
Net gains from foreign currencies: dealing	1,375	3,969	7	1,950	(119)	**7,182**	416	3,265	32	1,724	–	**5,437**
Net gains/(losses) from foreign currencies: derivatives	–	6,242	–	239	–	**6,481**	–	14,059	–	–	–	**14,059**
Net gains/(losses) from foreign currencies: translation differences	(81)	(17,200)	–	–	–	**(17,281)**	581	(9,895)	–	–	–	**(9,314)**
Other operating expenses	–	(15)	(6,359)	–	–	(6,374)	(23)	(3,706)	–	–	–	**(3,729)**
Other income	–	–	–	–	–	**–**	–	17	–	–	–	**17**
Loss on initial recognition of financial assets at fair value	–	–	–	–	–	–	–	(3,778)	–	–	–	**(3,778)**

(Figures in tables are in thousands of Azerbaijani manats)

29. Related party disclosures (continued)

As at 31 December 2022, the Bank has guarantees from its parent received as a collateral in respect of loans issued to borrowers in the amount of AZN 135,975 thousand (2021: AZN 332,320 thousand) and the Bank incurred guarantee fee in the amount of AZN 1,470 (2021 AZN 1,763) thousand which was accounted as a part of effective interest rate.

Compensation to members of key management personnel was comprised of the following:

	2022	*2021*
Salaries and other benefits	(14,020)	(15,713)
Social security costs	(2,453)	(2,593)
Total key management compensation	**(16,473)**	**(18,306)**

30. Changes in liabilities arising from financing activities

	Note	*Subordinated debts*
Carrying amount at 1 January 2021		**18,923**
Proceeds from issue		17,827
Other		59
Carrying amount at 31 December 2021	16	**36,809**
Proceeds from issue		68,681
Other		947
Carrying amount at 31 December 2022	16	**106,437**

31. 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 using, among other measures, the ratios established by the CBAR.

During the past year, the Bank had complied in full with all its externally imposed capital requirements.

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 maximise 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.

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.

	2022	*2021*
Tier 1 capital	456,310	417,676
Tier 2 capital	259,748	156,891
Less: deductions from capital	(165,365)	(151,305)
Total regulatory capital	**550,693**	**423,262**
Risk-weighted assets	**3,214,522**	**3,161,218**
Capital adequacy ratio (Tier 1)	14.2%	13.2%
Capital adequacy ratio (Total Capital)	17.1%	13.4%