

**“BANK VTB (AZERBAIJAN)”
OPEN JOINT STOCK COMPANY**

**International Financial Reporting Standards
Financial Statements and
Independent Auditors’ Report**
For the Year Ended December 31, 2022

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022

The following statement is made with a view to distinguishing the respective responsibilities of the management and those of the independent auditors in relation to the financial statements of "Bank VTB (Azerbaijan)" Open Joint Stock Company (the "Bank").

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Bank as at December 31, 2022, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgements and estimates that are reasonable and prudent;
- Stating whether IFRS has been followed, subject to any material departures disclosed and explained in the financial statements; and
- Preparing the financial statements on a going concern basis, unless it is inappropriate to presume that the Bank will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Bank;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Bank, and which enable them to ensure that the financial statements of the Bank comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Bank; and
- Detecting and preventing fraud, errors and other irregularities.

The financial statements for the year ended December 31, 2022 were authorized for issue on April 7, 2023 by the Management Board of the Bank.

On behalf of the Management Board:

Mr. Iqor Okayev
Chairman of the Management Board

April 7, 2023
Baku, the Republic of Azerbaijan

Mr. Yusif Mammadov
Chief Accountant

April 7, 2023
Baku, the Republic of Azerbaijan

INDEPENDENT AUDITORS' REPORT

To the Shareholders, Supervisory Board and Management of "Bank VTB (Azerbaijan)" Open Joint Stock Company:

Opinion

We have audited the financial statements of "Bank VTB (Azerbaijan)" Open Joint Stock Company (the "Bank"), which comprise the statement of financial position as at December 31, 2022, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended and notes to the financial statements, including a summary of significant accounting policies.

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

Basis for Opinion

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

Emphasis of Matter

Without qualifying our opinion, we draw your attention to Note 19 to the financial statements, which describes the fact that "Bank VTB" PJSC and its subsidiaries, including the Bank are exposed to numerous sanctions imposed by majority of western countries as at December 31, 2022 and the date of issue of these financial statements. The main impact of the imposed sanctions affected the Bank's functionality on transactions with US dollar and Euro, as well as restrictions on Bank's plastic cards and blockage of SWIFT system. The management took number of measures as described in Note 19, to minimize negative impacts of the sanctions and maintain the sustainability of business operations of the Bank.

Other matter

The financial statements of the Bank for the year ended December 31, 2021 were audited by another auditor, who expressed an unqualified opinion on those financial statements.

As a part of the audit of the financial statements for the year ended December 31, 2022, we also audited the adjustments described in Note 5 that were applied to the financial statements for the year ended December 31, 2021. We were not engaged to audit the financial statements of the Bank for the year ended December 31, 2021 other than with respect to the adjustments, if any, accordingly, we do not express an opinion or any other form of assurance on those financial statements taken as a whole.

Responsibilities of Management and Audit Committee for the Financial Statements

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

In preparing the 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 have no realistic alternative but to do so.

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

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 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 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 auditors' report to the related disclosures in the 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 auditors' 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 financial statements, including the disclosures, and whether the 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.

Baker Tilly Azerbaijan

April 7, 2023
Baku, the Republic of Azerbaijan

"BANK VTB (AZERBAIJAN)" OPEN JOINT STOCK COMPANY

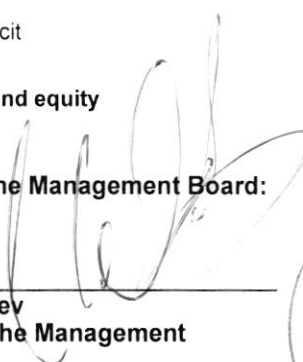
STATEMENT OF FINANCIAL POSITION

AS AT DECEMBER 31, 2022

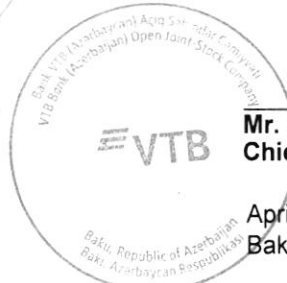
(Figures in tables are in thousands of Azerbaijani Manats)

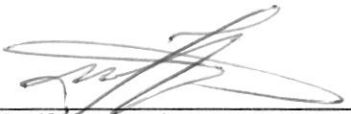
	Notes	December 31, 2022	December 31, 2021
Assets			
Cash and cash equivalents	6, 27	34,595	44,409
Mandatory reserves with the Central Bank of the Republic of Azerbaijan		4,193	477
Amounts due from credit institutions	7, 27	13,407	509
Investment securities	8	24,768	4,534
Derivative financial assets	9, 27	3	182
Loans to customers	10	163,404	181,764
Property and equipment	11	2,622	1,704
Intangible assets	12	6,625	5,544
Right-of-use assets	13	2,236	658
Deferred income tax asset	14	-	621
Other assets	15	5,322	10,407
Total assets		257,175	250,809
Liabilities			
Amounts due to banks and other credit institutions	16,27	50,186	51,366
Amounts due to customers	17,27	99,135	103,142
Current income tax liability		2,284	-
Lease liabilities	13	2,256	734
Deferred income tax liability	14	2,827	-
Other liabilities	15	5,949	5,911
Total liabilities		162,637	161,153
Equity			
Share capital	18	315,815	315,815
Accumulated deficit		(221,277)	(226,159)
Total equity		94,538	89,656
Total liabilities and equity		257,175	250,809

On behalf of the Management Board:


Mr. Iqor Okayev
 Chairman of the Management

April 7, 2023
 Baku, the Republic of Azerbaijan




Mr. Yusif Mammadov
 Chief Accountant

April 7, 2023
 Baku, the Republic of Azerbaijan

The notes on pages 8 to 58 form an integral part of these financial statements.

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

STATEMENT OF COMPEHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2022

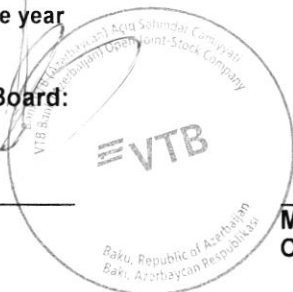
(Figures in tables are in thousands of Azerbaijani Manat)

	Notes	Year ended December 31, 2022	Year ended December 31, 2021
Interest income calculated using effective interest rate		24,637	19,830
Interest expense		(8,509)	(5,492)
Net interest income	21, 27	16,128	14,338
Credit loss reversal/(expense) and other impairment provisions	20	11,783	(3,014)
Net interest income after credit loss reversal/(expense)		27,911	11,324
Fee and commission income	22	2,803	4,055
Fee and commission expense	22	(1,527)	(2,535)
Net losses on derecognition of financial assets measured at fair value		(182)	(180)
Net (losses)/gains arising on initial recognition of financial instruments and loan modification		(1,180)	5,493
Net gains from foreign currencies:			
- dealing	27	8,094	2,196
- translation differences		1,151	416
Government grants		-	126
Other income		914	484
Non-interest income		10,073	10,055
Operating expenses	23	(27,370)	(20,484)
Profit before income tax benefit		10,614	895
Income tax (expense)/benefit	14	(5,732)	1,390
Net profit for the year		4,882	2,285
Other comprehensive income for the year		-	-
Total comprehensive income for the year		4,882	2,285

On behalf of the Management Board:

Mr. Iqor Okayev
Chairman of the Management

April 7, 2023
Baku, the Republic of Azerbaijan



Mr. Yusif Mammadov
Chief Accountant

April 7, 2023
Baku, the Republic of Azerbaijan

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“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2022**

(Figures in tables are in thousands of Azerbaijani Manat)

	<i>Share capital</i>	<i>Accumulated deficit</i>	<i>Total equity</i>
January 1, 2021	315,815	(228,444)	87,371
Total comprehensive income for the year	-	2,285	2,285
December 31, 2021	315,815	(226,159)	89,656
Total comprehensive income for the year	-	4,882	4,882
December 31, 2022	315,815	(221,277)	94,538

On behalf of the Management Board:

Mr. Iqor Okayev
Chairman of the Management

April 7, 2023
Baku, the Republic of Azerbaijan

Mr. Yusif Mammadov
Chief Accountant

April 7, 2023
Baku, the Republic of Azerbaijan

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"BANK VTB (AZERBAIJAN)" OPEN JOINT STOCK COMPANY

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2022 (Figures in tables are in thousands of Azerbaijani Manat)

	<i>Notes</i>	Year ended December 31, 2022	Year ended December 31, 2021
Cash flows from operating activities			
Interest received		24,151	18,573
Interest paid		(8,229)	(3,823)
Fees and commissions received		2,803	4,034
Fees and commissions paid		(1,527)	(3,068)
Realised gains less losses from dealing in foreign currencies		8,094	2,194
Other operating income received		627	225
Personnel expenses paid		(14,654)	(9,506)
Other operating expenses paid		(9,584)	(4,980)
Government grant received in relation to operating activities		-	126
Cash flows from operating activities before changes in operating assets and liabilities		1,681	3,775
<i>Net (increase)/decrease in operating assets</i>			
Amounts due from credit institutions		(12,930)	(201)
Mandatory reserves with the Central Bank of the Republic of Azerbaijan		(3,716)	(6)
Loans to customers		27,030	(58,738)
Other assets		4,016	406
<i>Net increase/(decrease) in operating liabilities</i>			
Amounts due to banks and other credit institutions		121	23,210
Amounts due to customers		618	17,963
Other liabilities		932	(2,847)
Net cash from/(used in) operating activities before income tax		17,752	(16,438)
Net cash from/(used in) operating activities		17,752	(16,438)
Cash flows from investing activities			
Payments for purchase of investment securities		(26,669)	(45,851)
Proceeds from sale and redemption of investment securities		6,614	55,836
Proceeds from sale of property and equipment		17	-
Payments for purchase of property and equipment		(1,572)	(365)
Payments for purchase of intangible assets		(1,961)	(2,506)
Net cash (used in)/from investing activities		(23,571)	7,114
Cash flows from financing activities			
Proceeds from borrowings	28	-	-
Repayment of borrowings	28	(2,184)	(2,121)
Lease liabilities paid	13	(830)	(774)
Net cash used in financing activities		(3,014)	(2,895)
Effect of exchange rates changes on cash and cash equivalents		(981)	96
Net decrease in cash and cash equivalents		(9,814)	(12,123)
Cash and cash equivalents, beginning	6	44,409	56,532
Cash and cash equivalents, ending	6	34,595	44,409

On behalf of the Management Board:

Mr. Iqor Okayev
Chairman of the Management

April 7, 2023
Baku, the Republic of Azerbaijan

Mr. Yusif Mammadov
Chief Accountant

April 7, 2023
Baku, the Republic of Azerbaijan

The notes on pages 8 to 58 form an integral part of these financial statements.

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022

(Figures in tables are in thousands of Azerbaijani Manat)

1. Principal activities

“Bank VTB (Azerbaijan)” Open Joint Stock Company (the “Bank”) was formed as “AF-Bank” OJSC on December 14, 1993, under the laws of the Republic of Azerbaijan. The Bank operates under a general banking license number 162 issued by the Central Bank of the Republic of Azerbaijan (the “CBAR”) on October 22, 1993.

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

The Bank participates in the state deposit insurance scheme, which was introduced by the law on “Insurance of individual deposits in the Republic of Azerbaijan” dated December 29, 2006. Insurance covers Bank’s liabilities to individual depositors in case of business failure and revocation of the CBAR banking license.

On October 27, 2007, two companies registered in Cyprus – “Balmwell Limited” LLC and “Nies Ventures Limited” LLC acquired 99.8% of the Bank from its former shareholders. On July 31, 2008 and on November 9, 2009, “Bank VTB” PJSC (Russian Federation) (Parent) and “Ata Holding” OJSC acquired 51% and 48.99% of the Bank, respectively, from “Nies Ventures Limited” LLC and “Balmwell Limited” LLC. On October 13, 2017, VTB 24 (subsidiary of “Bank VTB” PJSC) acquired 48.99% of the Bank from “Ata Holding” OJSC. During 2018 “Bank VTB” PJSC acquired 48.99% of the Bank from VTB 24 and currently owns 99.99% of the Bank.

The Bank had 4 branches (2021: 4 branches) within the Republic of Azerbaijan. The Bank had 384 employees as at December 31, 2022 (December 31, 2021: 376). The Bank’s registered legal address is 38, Khatai Avenue, Baku, the Republic of Azerbaijan.

As at December 31, 2022 and 2021 the following shareholders owned the share capital of the Bank:

Shareholders	December 31, 2022, %	December 31, 2021, %
“Bank VTB” PJSC (Russian Federation)	99.99	99.99
Mr. Adigozel Agayev	0.01	0.01
Total	100.00	100.00

As at the date of these financial statements, the ultimate controlling party of the Bank is the government of the Russian Federation through “Bank VTB” PJSC (Russian Federation).

2. Basis of preparation

General

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

The Bank maintains its accounting records in accordance with the laws and regulations of the Republic of Azerbaijan. These financial statements are based on those accounting records, as adjusted and reclassified to comply with IFRS.

These financial statements have been prepared under the historical cost convention except for derivative financial instruments which have been measured at fair value.

The Azerbaijani manat (“AZN”), which is the national currency of the Republic of Azerbaijan, is the reporting and functional currency of the Bank. Transactions in other currencies are treated as transactions in foreign currencies. These financial statements are presented in thousands of AZN except for share amounts and unless otherwise indicated.

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022 (Continued) (Figures in tables are in thousands of Azerbaijani Manat)

The summary of principal accounting policies applied in the preparation of these financial statements is set out below in Note 3. These policies have been consistently applied to all the periods presented, unless otherwise stated.

3. Summary of accounting policies

Several amendments effective since January 1, 2022 were applied but do not have an impact on the financial statements of the Bank.

Fair value measurement

The Bank measures financial instruments, such as derivatives, at fair value at each balance sheet date. Fair values of financial instruments measured at amortized cost are disclosed in Note 24.

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, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs. All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

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

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

Financial assets and liabilities

Initial recognition

Date of recognition

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

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022 (Continued) (Figures in tables are in thousands of Azerbaijani Manat)

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

Measurement categories of financial assets and liabilities

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

- Amortized cost;
- FVOCI;
- FVPL.

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

Financial liabilities, other than loan commitments and financial guarantees, are measured at Amortized 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 amortized cost

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

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

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 realized 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.

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022 (Continued) (Figures in tables are in thousands of Azerbaijani Manat)

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 amortization of the premium/discount).

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

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

Financial guarantees, letters of credit and undrawn loan commitments

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

Financial guarantees are initially recognized 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 recognized less cumulative amortization recognized in the statement of profit or loss and other comprehensive income, 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.

Reclassification of financial assets and liabilities

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

Cash and cash equivalents

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

Mandatory reserves with the Central Bank of the Republic of Azerbaijan

Mandatory cash balances in AZN and foreign currency held with the CBAR represent non-interest bearing mandatory reserve deposits, which are not available to finance the Bank's day-to-day operations, and hence are not considered as part of cash and cash equivalents for the purpose of the statement of cash flows.

Amounts due from credit institutions

Amounts due from other institutions are recorded when the Bank advances money to counterparty banks with no intention of trading the resulting receivable, which is due on fixed or determinable dates. Amounts due from credit institutions are carried at amortized cost less allowance for expected credit losses.

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022 (Continued) *(Figures in tables are in thousands of Azerbaijani Manat)*

Investment securities

After initial measurement investment securities (including short-term notes issued by the CBAR) are subsequently measured at amortized cost. Amortized cost is calculated by taking into account any discount or premium on funds, and costs that are an integral part of the effective interest rate (EIR).

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. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of comprehensive income as net gains/(losses) from trading securities or net gains/(losses) from foreign currencies dealing, 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.

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

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 other credit institutions, due to customers' and subordinated debts. After initial recognition, borrowings are subsequently measured at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the borrowings are derecognized as well as through the amortization process.

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

Leases

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

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022 (Continued) (Figures in tables are in thousands of Azerbaijani Manat)

Right-of-use assets

The Bank recognizes 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 recognized, 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 recognized right-of-use assets are depreciated on a straight-line basis over the shorter of its estimated useful life (3-4 years) and the lease term. Right-of-use assets are subject to impairment.

Lease liabilities

At the commencement date of the lease, the Bank recognizes 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 recognized as expense in the period on which the event or condition that triggers the payment occurs.

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

Short-term leases and leases of low-value assets

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

Offsetting of financial instruments

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

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

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

Renegotiated loans

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

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The Bank derecognizes a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognized as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognized loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI. Restructuring of impaired loans does not result in derecognition of financial instrument, unless there is a change in contractual currency of the loan on renegotiation along with a substantial change in interest rate. When assessing whether or not to derecognize 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 separate line in the statement of profit or loss and other comprehensive income, to the extent that an impairment loss has not already been recorded.

Financial assets

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

- The rights to receive cash flows from the asset have expired;
- The 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 “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 recognized to the extent of the Bank’s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

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

Write-off

Financial assets are written off either partially or in their entirety only when the Bank has no realistic expectation of recovering the financial assets and as a result – stopped pursuing their 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 derecognized 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 recognized in the statement of profit or loss and other comprehensive income.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022 (Continued) (Figures in tables are in thousands of Azerbaijani Manat)

Taxation

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

Deferred income 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 utilized. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting date.

In addition, there are various operating taxes in Azerbaijan such as VAT, property tax, withholding tax and others which become relevant as a result of the Bank's operations. These taxes are included as a component operating expenses.

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

	2022 (years)	2021 (years)
Leasehold improvements	over the term of the underlying lease	over the term of the underlying lease
Computer equipment	6-7	6-7
Furniture and fixtures	5	5
Motor vehicles	6-7	6-7
Other property and equipment	5	5

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

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

Intangible assets

Intangible assets include computer software and licenses. Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic lives of 3 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortization periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022 (Continued) (Figures in tables are in thousands of Azerbaijani Manat)

Provisions

Provisions are recognized 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.

Repossessed collateral

In certain circumstances, collateral is repossessed following the foreclosure on loans that are in default. Repossessed collateral is measured in accordance with IAS 2 *Inventories* at the lower of cost and net realizable value and reported within “Other assets”.

Share capital

Ordinary shares are 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 recognized as additional paid-in capital.

Dividends

Dividends are recognized 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 authorized for issue.

Contingencies

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

Recognition of income and expenses

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

Interest and similar income and expense

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

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

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates interest income by calculating the credit-adjusted EIR and applying that rate to the amortized 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 amortized cost of the POCI assets.

Fee and commission income

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

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 as respective performance obligations are satisfied. These fees include commission income and asset management, custody and other management and advisory fees. 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 recognized as an adjustment to the effective interest rate on the loan.

Fee income from providing transaction services

Fees include commission income for provision of the following services: cash withdrawals, consulting, settlement operations, documentary operations and fees charged for transactions with plastic cards and etc. These fees or components of fees are linked to a certain performance and are recognized after fulfilling the corresponding criteria.

Foreign currency translation

The financial statements are presented in Azerbaijani manats, 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 recognized in the statement of comprehensive income as net gain/(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 net gain/(losses) from foreign currencies-dealing. The official CBAR exchange rates at December 31, 2022 and 2021 were as follows:

	December 31, 2022	December 31, 2021
USD/AZN	1.7000	1.7000
GBP/AZN	2.0477	2.2925
EUR/AZN	1.8114	1.9265
RUB/AZN	0.0230	0.0229

Foreign exchange revaluation of expected credit loss allowance of loans denominated in foreign currency

Allowance for impairment of loans denominated in foreign currency is accounted for in the same currency as the loans, which they are made for. Gains and losses from the revaluation of previously recognized allowance for loan impairment denominated in foreign currencies is included in ‘net losses/gains from foreign currencies - translation differences’ in the statement of comprehensive income.

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Government grants and government assistance

Government grants are recognized where there is reasonable assurance that the grant will be received and all the related conditions will be complied with. Where the grant relates to an expense item, it is recognized as income in the same periods as the respective expenses it is intended to compensate on a systematic basis. Where the grant relates to an asset, it is recognized as deferred income and released to income in equal amounts over the expected useful life of the related asset.

Government loans provided at below market interest rates are recognized in accordance with IFRS 9. The benefit of the government loan is measured at the inception of the loan as the difference between the cash received and the amount at which the loan is initially recognized in the statement of financial position. This benefit is accounted for in accordance with IAS 20.

A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs is recognized in a separate line of the statement of profit or loss and other comprehensive income for the period in which it becomes receivable.

Adoption of new and revised standards and interpretations

In the current year, the Bank has adopted all of the applicable new and revised Standards and Interpretations issued by the IASB and the IFRIC of the IASB that are relevant to its operations and effective for annual reporting periods ending on December 31, 2022.

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 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. At the same time, the Board decided to clarify existing guidance in IFRS 3 for contingent assets that would not be affected by replacing the reference to the Framework for the Preparation and Presentation of Financial Statements.

Property, Plant and Equipment: Proceeds before Intended Use – Amendments to IAS 16. In May 2020, the IASB issued Property, Plant and Equipment – Proceeds before Intended Use, which prohibits entities deducting from the cost of an item of property, plant and equipment, any proceeds from selling 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.

Onerous Contracts – Costs of Fulfilling a Contract – Amendments to IAS 37 – In May 2020, the IASB issued amendments to IAS 37 to specify which costs an entity needs to include when assessing whether a contract is onerous or loss-making. The amendments apply a “directly related cost approach”. The costs that relate directly to a contract to provide goods or services include 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.

IFRS 1 “First-time Adoption of International Financial Reporting Standards” – Subsidiary as a first-time adopter. As part of its 2018-2020 annual improvements to the IFRS standards process, the IASB issued an amendment to IFRS 1 “First-time Adoption of International Financial Reporting Standards”. The amendment permits a subsidiary that elects to apply paragraph D16(a) of IFRS 1 to measure cumulative translation differences using the amounts reported by the parent, based on the parent’s date of transition to IFRS. This amendment is also applied to an associate or joint venture that elects to apply paragraph D16 (a) of IFRS 1.

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IFRS 9 Financial Instruments – Fees in the “10 percent” test for derecognition of financial liabilities.

As part of its 2018-2020 annual improvements to the IFRS standards process the IASB issued an amendment to IFRS 9. 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. An entity applies the amendment to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment.

“IAS 41 Agriculture” – Taxation in fair value measurements. As part of its 2018-2020 annual improvements to the IFRS standards process the IASB issued an amendment to IAS 41 Agriculture. 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.

Unless otherwise disclosed, the new standards did not have a material effect on the financial statements of the Bank.

4. Significant accounting judgments and estimates

Standards and interpretations issued but not yet effective

At the date of authorization of these financial statements, other than the Standards and Interpretations adopted by the Bank in advance of their effective dates, the following Interpretations were in issue but not yet effective. The Bank intends to adopt these new and amended standards and interpretations, if applicable, when they become effective.

IFRS 17 “Insurance contracts” – was issued in May 2017 and replaced IFRS 4 “Insurance contracts”. The new standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. An entity shall apply IFRS 17 “Insurance Contracts” to insurance contracts, including reinsurance contracts, it issues; reinsurance contracts it holds; and investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

IFRS 17 is effective for annual reporting periods beginning on or after January 1, 2023. Earlier application is permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments have also been applied. This standard is not applicable to the Company.

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 January 1, 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.

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 January 1, 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.

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Deferred Tax related to Assets and Liabilities arising from a Single Transaction - Amendments to IAS 12 - In May 2021, the Board issued amendments to IAS 12, which narrow the scope of the initial recognition exception under IAS 12, so that it no longer applies to transactions that give rise to equal taxable and deductible temporary differences.

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

IASB has issued “**Lease Liability in a Sale and Leaseback (Amendments to IFRS 16)**” with amendments that clarify how a seller-lessee subsequently measures sale and leaseback transactions that satisfy the requirements in IFRS 15 to be accounted for as a sale. **Lease Liability in a Sale and Leaseback (Amendments to IFRS 16)** requires a seller-lessee to subsequently measure lease liabilities arising from a leaseback in a way that it does not recognize any amount of the gain or loss that relates to the right of use it retains. The new requirements do not prevent a seller-lessee from recognizing in profit or loss any gain or loss relating to the partial or full termination of a lease. The amendments are effective for annual reporting periods beginning on or after January 1, 2024. Earlier application is permitted.

On October 2022, IASB has published “**Non-current Liabilities with Covenants (Amendments to IAS 1)**” to clarify how conditions with which an entity must comply within twelve months after the reporting period affect the classification of a liability. According to the amendment, only covenants with which an entity is required to comply on or before the reporting date affect the classification of a liability as current or non-current. In addition, an entity has to disclose information in the notes that enables users of financial statements to understand the risk that non-current liabilities with covenants could become repayable within twelve months. The amendments are effective for annual reporting periods beginning on or after January 1, 2024.

IFRS 10 “Consolidated Financial Statements” and IAS 28 (amendments) Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognized in the parent’s profit or loss only to the extent of the unrelated investors’ interests in that associate or joint venture.

Similarly, gains and losses resulting from the remeasurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognized in the former parent’s profit or loss only to the extent of the unrelated investors’ interests in the new associate or joint venture. The effective date of the amendments has yet to be set by the IASB; however, earlier application of the amendments is permitted.

Unless otherwise disclosed, the new standards are not expected to have a material effect on the financial statements of the Bank.

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.

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Impairment losses on financial assets

The measurement of impairment losses both under IFRS 9 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

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

The amount of allowance for loan impairment recognized in the statement of financial position at December 31, 2022 was AZN 19,220 thousand (2021: AZN 22,926 thousand). More details are provided in Notes 10 and 24.

Management monitors market value of collateral on a regular basis. Management uses its experienced judgment and independent opinion to adjust the fair value to reflect the current circumstances. The amount and collateral required depend on the assessment of credit risk of the counterparty.

Initial recognition of related party transactions

In the normal course of business, the Bank enters into transactions with its related parties. IFRS 9 requires initial recognition of financial instruments based on their fair values. Judgment is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgment is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

More details are provided in Note 27.

Leases - estimating the incremental borrowing rate

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

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

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Taxation

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

Deferred income tax assets and liabilities

Deferred income tax assets are recorded to the extent that realization of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are probable in the future are based on medium term business plan prepared by management and extrapolated results thereafter. The business plans are based on management expectations that are believed to be reasonable under the circumstances.

Deferred income tax liability in the amount of AZN 2,827 thousand was recognized in the statement of financial position as at December 31, 2022 and deferred income tax asset in the amount of AZN 621 thousand was recognized in the statement of financial position as at December 31, 2021.

5. Prior period reclassifications/restatements

During the year ended December 31, 2022, the Management detected certain errors and made certain reclassifications in the financial statements for the year ended December 31, 2021.

The effect of reclassifications on the statement of comprehensive income and statement of cash flow for the year ended December 31, 2021 are presented in the tables below:

Statement of comprehensive income:	As previously reported December 31, 2021	Effect of reclassifications	As reclassified December 31, 2021
Operating expenses	(20,525)	41	(20,484)
Credit loss reversal/(expense) and other impairment provisions	(3,233)	219	(3,014)
Fee and commission expense	(2,275)	(260)	(2,535)

Statement of cash flows:	As previously reported December 31, 2021	Effect of reclassifications	As reclassified December 31, 2021
Operating expenses	(9,766)	260	(9,506)
Fee and commission expense	(2,808)	(260)	(3,068)

6. Cash and cash equivalents

Cash and cash equivalents comprise:

	December 31, 2022	December 31, 2021
Cash on hand	6,972	7,841
Current accounts with the CBAR	25,671	24,902
Current accounts with other banks	1,952	11,666
Cash and cash equivalents	34,595	44,409

Current accounts with other banks consist of non-interest-bearing correspondent account balances with resident and non-resident banks in the amount of AZN 12 thousand (December 31, 2021: AZN 494 thousand) and AZN 1,940 thousand (December 31, 2021: AZN 11,172 thousand), respectively.

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Current accounts with non-resident banks are mainly concentrated in Russia and denominated in RUB, USD and EUR.

All balances of cash equivalents are allocated to Stage 1. The ECL relating to cash equivalents of the Bank rounds to zero.

7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	December 31, 2022	December 31, 2021
Deposits with banks	12,420	-
Loans to credit institutions	969	201
Blocked accounts with banks	428	313
	<u>13,817</u>	<u>514</u>
Less: allowance for expected credit loss	(410)	(5)
Amounts due from credit institutions	<u>13,407</u>	<u>509</u>

As at December 31, 2022, accrued interest income included in amounts due from credit institutions amounted to AZN 4 thousand (December 31, 2021: nil).

8. Investment securities

Investment securities comprise:

	December 31, 2022	December 31, 2021
Notes issued by the Ministry of Finance of the Republic of Azerbaijan	10,620	4,534
Notes issued by the CBAR	14,148	-
Investment Securities	<u>24,768</u>	<u>4,534</u>

All investment securities are measured at amortized cost and are allocated to Stage 1. The ECL relating to investment securities of the Bank rounds to zero.

	December 31, 2022	December 31, 2021
Notes issued by the Ministry of Finance of the Republic of Azerbaijan	-	4,534
Trading securities pledged under sale and repurchase agreements	<u>-</u>	<u>4,534</u>

As at December 31, 2022, accrued interest income included in investment securities amounted to AZN 293 thousand (December 31, 2021: AZN 114 thousand).

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9. Derivative financial instruments

The table below shows the fair value of derivative financial instruments, recorded as asset (2021: asset), together with their notional amounts.

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

	December 31, 2022			December 31, 2021		
	Notional amount	Fair values		Notional amount	Fair value	
<i>Foreign exchange contracts</i>		Asset	Liability		Asset	Liability
Swap – foreign	-	-	-	6,460	175	-
Forward – foreign	1,700	3	-	5,440	7	-
Total derivative assets		3	-		182	-

Forwards

Forwards contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customized contracts transacted in the over-the-counter market.

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.

10. Loans to customers

Loans to customers comprise:

	December 31, 2022	December 31, 2021
Small business lending	29,561	36,076
Corporate lending	42,526	83,776
Consumer lending	110,265	84,317
Auto lending	272	521
Gross loans to customers	182,624	204,690
Less: allowance for expected credit loss	(19,220)	(22,926)
Net loans to customers	163,404	181,764

As at December 31, 2022, the Bank had a concentration of loans represented by AZN 39,075 due from ten (December 31, 2021: ten) largest third-party borrowers (21% of gross loan portfolio) (December 31, 2021: AZN 71,681 thousand or 35% of gross loan portfolio). An allowance of AZN 4,946 thousand (December 31, 2021: AZN 7,046 thousand) was recognized against these loans.

As at December 31, 2022, accrued interest income included in loans to customers amounted to AZN 1,666 thousand (December 31, 2021: AZN 1,366 thousand).

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Loans have been extended to the following types of customers:

	December 31, 2022	December 31, 2021
Individuals	110,537	84,838
Private companies	52,488	96,926
Individual entrepreneurs	19,599	22,926
Gross loans to customers	182,624	204,690

Loans are made principally within the Republic of Azerbaijan in the following industry sectors:

	December 31, 2022	December 31, 2021
Individuals	110,537	84,838
Services	32,942	62,960
Trading enterprises	17,937	22,904
Credit Institutions	11,392	16,158
Manufacturing	6,310	4,123
Transport	3,326	3,606
Construction	180	7,288
Agriculture and food processing	-	1,710
Energy	-	1,103
Gross loans to customers	182,624	204,690

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

<i>Small business lending</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at January 1, 2022	12,195	-	23,881	36,076
New assets originated or purchased	14,903	27	210	15,140
Assets repaid	(7,946)	-	(19,401)	(27,347)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	(324)	(324)
Unwinding of discount	-	-	(96)	(96)
Amounts written off	-	-	(6,347)	(6,347)
Recovery	-	-	12,459	12,459
Gross carrying value as at December 31, 2022	19,152	27	10,382	29,561

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<i>Small business lending</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at January 1, 2022	349	7	8,738	9,094
<i>Movements with impact on credit loss allowance charge/(reversal) in profit or loss</i>				
New assets originated or purchased	345	10	210	565
Assets repaid	(254)	(7)	(7,895)	(8,156)
Changes due to modifications not resulting in derecognition	-	-	(100)	(100)
Changes to inputs used for ECL calculations	-	-	2,357	2,357
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Impact on period end ECL of exposures transferred between stages during the period	-	-	(324)	(324)
<i>Movements without impact on credit loss allowance charge/(reversal) in profit or loss</i>				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	-	-	96	96
Amounts written off	-	-	(6,347)	(6,347)
Recovery	-	-	12,459	12,459
ECL as at December 31, 2022	440	10	9,194	9,644

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

<i>Corporate lending</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at January 1, 2022	73,439	-	10,337	83,776
New assets originated or purchased	24,026	1,738	-	25,764
Assets repaid	(62,525)	-	(4,653)	(67,178)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	(1,595)	(1,595)
Unwinding of discount	-	-	-	-
Recovery	-	-	1,759	1,759
Amounts written off	-	-	-	-
Gross carrying value as at December 31, 2022	34,940	1,738	5,848	42,526

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Corporate lending	Stage 1	Stage 2	Stage 3	Total
ECL as at January 1, 2022	683	-	4,284	4,967
<i>Movements with impact on credit loss allowance charge/(reversal) in profit or loss</i>				
New assets originated or purchased	439	91	-	530
Assets repaid	(670)	-	(8,440)	(9,110)
Changes due to modifications not resulting in derecognition	-	-	(575)	(575)
Changes to inputs used for ECL calculations	5	-	200	205
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Impact on period end ECL of exposures transferred between stages during the period	-	-	4,521	4,521
<i>Movements without impact on credit loss allowance charge/(reversal) in profit or loss</i>				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	-	-	-	-
Recovery	-	-	1,759	1,759
Amounts written off	-	-	-	-
ECL as at December 31, 2022	457	91	1,749	2,297

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

Consumer lending	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at January 1, 2022	78,212	720	5,385	84,317
New assets originated or purchased	52,583	1,140	1,324	55,047
Assets repaid	(26,216)	(210)	(2,880)	(29,306)
Transfers to Stage 1	230	(136)	(94)	-
Transfers to Stage 2	(770)	774	(4)	-
Transfers to Stage 3	(2,673)	(362)	3,035	-
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	-	-
Unwinding of discount	-	-	(22)	(22)
Recovery	-	-	229	229
Amounts written off	-	-	-	-
Gross carrying value as at December 31, 2022	101,366	1,926	6,973	110,265

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Consumer lending	Stage 1	Stage 2	Stage 3	Total
ECL as at January 1, 2022	3,421	378	4,569	8,368
<i>Movements with impact on credit loss allowance charge/(reversal) in profit or loss</i>				
New assets originated or purchased	1,454	461	879	2,794
Assets repaid	(1,749)	(144)	(2,286)	(4,179)
Changes to inputs used for ECL calculations	(587)	(1)	(1,039)	(1,627)
Transfers to Stage 1	141	(64)	(77)	-
Transfers to Stage 2	(44)	74	(30)	-
Transfers to Stage 3	(215)	(191)	406	-
Impact on period end ECL of exposures transferred between stages during the period	(137)	302	1,401	1,566
<i>Movements without impact on credit loss allowance charge/(reversal) in profit or loss</i>				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)			22	22
Recovery			229	229
Amounts written off	-	-	-	-
ECL as at December 31, 2022	2,284	815	4,074	7,173

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

Auto lending	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at January 1, 2022	28	4	489	521
New assets originated or purchased	-	-	-	-
Assets repaid	22	(4)	(545)	(527)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	(49)	-	49	-
Unwinding of discount	-	-	(1)	(1)
Recovery	-	-	279	279
Amounts written off	-	-	-	-
Gross carrying value as at December 31, 2022	1	-	271	272

Auto lending	Stage 1	Stage 2	Stage 3	Total
ECL as at January 1, 2022	7	2	488	497
<i>Movements with impact on credit loss allowance charge/(reversal) in profit or loss</i>				
New assets originated or purchased	-	-	-	-
Assets repaid	(6)	(2)	(520)	(528)
Changes to inputs used for ECL calculations			(96)	(96)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	(1)	-	1	-
Impact on period end ECL of exposures transferred between stages during the period	-	-	(47)	(47)
<i>Movements without impact on credit loss allowance charge/(reversal) in profit or loss</i>				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	-	-	1	1
Recovery	-	-	279	279
Amounts written off	-	-	-	-
ECL as at December 31, 2022	-	-	106	106

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

<i>Small business lending</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at January 1, 2021	6,415	97	38,007	44,519
New assets originated or purchased	12,454	-	-	12,454
Contractual interest receivable	-	-	10	10
Assets repaid	(3,707)	(38)	(10,257)	(14,002)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	(2,965)	(59)	3,024	-
Changes to contractual cash flows due to modifications not resulting in derecognition	(3)	-	(2,040)	(2,043)
Unwinding of discount	1	-	1,777	1,778
Amounts written off	-	-	(6,821)	(6,821)
Foreign exchange	-	-	181	181
Gross carrying value as at December 31, 2021	12,195	-	23,881	36,076

<i>Small business lending</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at January 1, 2021	362	35	14,773	15,170
<i>Movements with impact on credit loss allowance charge/(reversal) in profit or loss</i>				
New assets originated or purchased	432	-	-	432
Contractual interest receivable	-	-	8	8
Assets repaid	(238)	(16)	(3,099)	(3,353)
Changes due to modifications not resulting in derecognition	-	-	(67)	(67)
Changes to inputs used for ECL calculations	(76)	3	1,200	1,127
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	(131)	(15)	146	-
Impact on period end ECL of exposures transferred between stages during the period	-	-	2,415	2,415
<i>Movements without impact on credit loss allowance charge/(reversal) in profit or loss</i>				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	-	-	2	2
Amounts written off	-	-	(6,821)	(6,821)
Foreign exchange	-	-	181	181
ECL as at December 31, 2021	349	7	8,738	9,094

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

<i>Corporate lending</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at January 1, 2021	54,383	-	14,387	68,770
New assets originated or purchased	61,657	-	-	61,657
Contractual interest receivable	-	-	15	15
Assets repaid	(41,731)	-	(4,558)	(46,289)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	(870)	-	870	-
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	(163)	(163)
Unwinding of discount	-	-	15	15
Amounts written off	-	-	(229)	(229)
Gross carrying value as at December 31, 2021	73,439	-	10,337	83,776

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Corporate lending	Stage 1	Stage 2	Stage 3	Total
ECL as at January 1, 2021	1,286	-	6,276	7,562
<i>Movements with impact on credit loss allowance charge/(reversal) in profit or loss</i>				
New assets originated or purchased	1,079	-	-	1,079
Contractual interest receivable	-	-	12	12
Assets repaid	(1,483)	-	(2,590)	(4,073)
Changes due to modifications not resulting in derecognition	-	-	(74)	(74)
Changes to inputs used for ECL calculations	(3)	-	190	187
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	(196)	-	196	-
Impact on period end ECL of exposures transferred between stages during the period	-	-	500	500
<i>Movements without impact on credit loss allowance charge/(reversal) in profit or loss</i>				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	-	-	3	3
Amounts written off	-	-	(229)	(229)
ECL as at December 31, 2021	683	-	4,284	4,967

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

Consumer lending	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at January 1, 2021	30,279	1,334	2,832	34,445
New assets originated or purchased	56,341	-	-	56,341
Contractual interest receivable	-	-	2,965	2,965
Assets repaid	(7,909)	(140)	(1,105)	(9,154)
Transfers to Stage 1	1,171	(575)	(596)	-
Transfers to Stage 2	(661)	670	(9)	-
Transfers to Stage 3	(1,004)	(551)	1,555	-
Changes to contractual cash flows due to modifications not resulting in derecognition	(5)	-	-	(5)
Unwinding of discount	-	-	401	401
Amounts written off	-	(18)	(658)	(676)
Gross carrying value as at December 31, 2021	78,212	720	5,385	84,317

Consumer lending	Stage 1	Stage 2	Stage 3	Total
ECL as at January 1, 2021	907	755	2,387	4,049
<i>Movements with impact on credit loss allowance charge/(reversal) in profit or loss</i>				
New assets originated or purchased	3,246	-	-	3,246
Contractual interest receivable	-	-	2,755	2,755
Assets repaid	(361)	(36)	(1,033)	(1,430)
Changes to inputs used for ECL calculations	(82)	(43)	17	(108)
Transfers to Stage 1	736	(329)	(407)	-
Transfers to Stage 2	(107)	115	(8)	-
Transfers to Stage 3	(198)	(307)	505	-
Impact on period end ECL of exposures transferred between stages during the period	(720)	241	801	322
<i>Movements without impact on credit loss allowance charge/(reversal) in profit or loss</i>				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	-	-	210	210
Amounts written off	-	(18)	(658)	(676)
ECL as at December 31, 2021	3,421	378	4,569	8,368

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

Auto lending	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at January 1, 2021	76	34	304	414
New assets originated or purchased	7	-	-	7
Contractual interest receivable	-	-	245	245
Assets repaid	(48)	(30)	-	(78)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	(7)	-	7	-
Amounts written off	-	-	(67)	(67)
Gross carrying value as at December 31, 2021	28	4	489	521

Auto lending	Stage 1	Stage 2	Stage 3	Total
ECL as at January 1, 2021	16	23	270	309
<i>Movements with impact on credit loss allowance charge/(reversal) in profit or loss</i>				
New assets originated or purchased	3	-	-	3
Contractual interest receivable	-	-	245	245
Assets repaid	(5)	(15)	-	(20)
Changes to inputs used for ECL calculations	(6)	(6)	33	21
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	(1)	-	1	-
Impact on period end ECL of exposures transferred between stages during the period	-	-	6	6
<i>Movements without impact on credit loss allowance charge/(reversal) in profit or loss</i>				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	-	-	-	-
Amounts written off	-	-	(67)	(67)
ECL as at December 31, 2021	7	2	488	497

Modified and restructured loans

The Bank derecognizes a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognized as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognized loans are classified as Stage 1 for ECL measurement purposes, 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 Stage 3 assets that were modified during the period, with the related modification loss suffered by the Bank.

Loans modified during the period	2022	2021
Amortized cost before modification	9,160	10,663
Net modification loss	(333)	(2,207)

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Collateral and other credit enhancements

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

- For corporate and small business lending: charges over real estate and trade receivables, third party guarantees;
- For consumer lending: cash, charges over credited consumer appliances, third party guarantees and mortgages over residential properties;
- For auto lending: cash, liens over vehicles and third-party guarantees.

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

The Bank calculates LGD rate of several corporate and small business lending loans in Stage 3 using discounted value of collaterals. As at December 31, 2022, maximum exposure of such loans amounted to AZN 15,903 thousand (December 31, 2021: AZN 33,934 thousand) for which ECL of AZN 10,944 thousand (December 31, 2021: AZN 12,852 thousand) was created. If these loans were not collateralized, ECL amount for these loans would be AZN 15,903 thousand (December 31, 2021: AZN 32,972 thousand).

11. Property and equipment

The movements in property and equipment were as follows:

	<i>Leasehold improvements</i>	<i>Computer equipment</i>	<i>Furniture and fixtures</i>	<i>Motor vehicles</i>	<i>Other property and equipment</i>	<i>Total</i>
Cost						
January 1, 2021	1,637	4,300	2,128	755	183	9,003
Additions	37	229	15	6	39	326
Disposals	-	-	-	(135)	-	(135)
Write-offs	-	(53)	-	-	(2)	(55)
December 31, 2021	1,674	4,476	2,143	626	220	9,139
Additions	530	538	444	15	45	1,572
Disposals	-	(115)	(98)	-	(6)	(219)
December 31, 2022	2,204	4,899	2,489	641	259	10,492
Accumulated depreciation						
January 1, 2021	(1,637)	(3,391)	(1,604)	(457)	(118)	(7,207)
Disposals	-	-	-	135	-	135
Write-off	-	53	-	-	2	55
Depreciation charge	(5)	(199)	(119)	(74)	(21)	(418)
December 31, 2021	(1,642)	(3,537)	(1,723)	(396)	(137)	(7,435)
Disposals	-	111	93	-	-	204
Depreciation charge	(30)	(247)	(177)	(76)	(109)	(639)
December 31, 2022	(1,672)	(3,673)	(1,807)	(472)	(246)	(7,870)
Net book value						
December 31, 2021	32	939	420	230	83	1,704
December 31, 2022	532	1,226	682	169	13	2,622

As at December 31, 2022, property and equipment amounting to AZN 6,405 thousand (December 31, 2021: AZN 6,218 thousand) were fully depreciated.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022 (Continued) (Figures in tables are in thousands of Azerbaijani Manat)

12. Intangible assets

	<i>Licenses</i>	<i>Computer software</i>	<i>Total</i>
Cost			
January 1, 2021	2,490	3,140	5,630
Additions	696	2,544	3,240
December 31, 2021	3,186	5,684	8,870
Additions	79	1,882	1,961
Write-off	(276)	-	(276)
December 31, 2022	2,989	7,566	10,555
Accumulated amortization			
January 1, 2021	(1,348)	(990)	(2,338)
Amortization charge	(627)	(361)	(988)
December 31, 2021	(1,975)	(1,351)	(3,326)
Write-off	276	-	276
Amortization charge	(267)	(613)	(880)
December 31, 2022	(1,966)	(1,964)	(3,930)
Net book value			
December 31, 2021	1,211	4,333	5,544
December 31, 2022	1,023	5,602	6,625

As at December 31, 2022, intangible assets amounting to AZN 1,638 thousand (December 31, 2021: AZN 1,431 thousand) were fully amortized.

13. Right of use assets and lease liability

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

	2022	2021
As at January 1,	658	1,315
Additions	2,214	-
Depreciation expense	(636)	(657)
As at December 31,	2,236	658

The movements in lease liability were as follows:

	2022	2021
As at January 1,	734	1,402
Additions	2,214	-
Interest expense	138	106
Payments	(830)	(774)
As at December 31,	2,256	734

14. Taxation

The corporate income tax (expense)/benefit comprises:

	December 31, 2022	December 31, 2021
Current year income tax expense	(2,284)	-
Adjustments in respect of current income tax of previous years	-	1,569
Deferred tax expense	(3,448)	(179)
Income tax (expense)/benefit	(5,732)	1,390

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Azerbaijani legal entities have to file individual corporate income tax declarations. Standard corporate income tax rate for companies (including banks) is 20% for 2022 and 2021.

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:

	Year ended December 31, 2022	Year ended December 31, 2021
Profit before tax	10,614	895
Statutory tax rate	20%	20%
Theoretical income tax expense at the statutory rate	(2,123)	(179)
Revision of prior year tax estimations	1,267	-
Adjustments in respect of current income tax of previous years	-	1,569
Tax effect of permanent differences	(433)	(77)
Change in unrecognized deferred tax asset	42,069	98
Tax loss carried forward unrecognized	(46,512)	-
Other	-	(21)
Income tax (expense)/benefit	(5,732)	1,390

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

	2020	Origination and reversal of temporary differences in statement of profit or loss and other comprehensive income	2021	Origination and reversal of temporary differences in statement of profit or loss and other comprehensive income	2022
Tax effect of deductible temporary differences					
Tax losses carried forward	47,534	(1,022)	46,512	(46,512)	-
Property and equipment	482	(398)	84	(56)	28
Intangible assets	-	116	116	(30)	86
Other assets	(523)	73	(450)	577	127
Lease liabilities	281	(133)	148	316	464
Other liabilities	133	15	148	(58)	90
Deferred tax assets	47,907	(1,349)	46,558	(45,763)	795
Loans to customers	(4,043)	748	(3,295)	219	(3,076)
Amounts due from credit institutions	(38)	14	(24)	15	(9)
Amounts due to credit institutions	(560)	179	(381)	291	(90)
Derivative financial assets	(36)	-	(36)	36	-
Right-of-use assets	(263)	131	(132)	(315)	(447)
Deferred tax liabilities	(4,940)	1,072	(3,868)	246	(3,622)
Unrecognized deferred tax asset	(42,167)	98	(42,069)	42,069	-
Net deferred income tax (liability)/asset	800	(179)	621	(3,448)	(2,827)

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022 (Continued) (Figures in tables are in thousands of Azerbaijani Manat)

15. Other assets and liabilities

Other assets comprise:

	December 31, 2022	December 31, 2021
Amounts in the course of settlement	717	2,333
Other financial receivables	24	22
Total other financial assets	741	2,355
Prepayment for purchase of property, equipment and intangible assets	124	139
Other prepayments	1,193	819
Repossessed collateral	3,036	6,786
Other non-financial assets	228	308
Total other non-financial assets	4,581	8,052
Other assets	5,322	10,407

Other liabilities comprise:

	December 31, 2022	December 31, 2021 (reclassified)
Funds in settlement	1,727	1,648
Payable for professional services	4	43
Other financial liabilities	2	7
Total other financial liabilities	1,733	1,698
Payable to employees	2,326	2,576
Deferred income	945	575
Taxes payable, other than income tax	765	892
Provision for credit related commitments	180	164
Other non-financial liabilities	-	6
Total other non-financial liabilities	4,216	4,213
Other liabilities	5,949	5,911

16. Amounts due to banks and other credit institutions

Amounts due to banks and other credit institutions comprise:

	December 31, 2022	December 31, 2021
Long term loans due to the Central Bank of the Republic of Azerbaijan	5,147	7,331
Amount due to Azerbaijan Mortgage and Credit Guarantee Fund	38,000	27,268
Current accounts of other banks	4,137	926
Long-term Loans from Entrepreneurship Development Fund	2,902	254
Short-term loans from resident banks	-	11,000
Payables under repurchase agreement for up to 30 days	-	4,587
Amounts due to banks and other credit institutions	50,186	51,366

As at December 31, 2022, accrued interest expenses included in Amounts due to banks and other credit institutions amounted to AZN 115 thousand (December 31, 2021: AZN 129 thousand).

Long term loans due to the Central Bank of the Republic of Azerbaijan are funds provided in accordance with the Presidential Decree on additional measures for resolution of the issues relating to non-performing loans of individuals in the Republic of Azerbaijan, which was signed on February 28, 2019. The loans mature in 2024-2025 (December 31, 2021: 2024-2025) and bear contractual interest rate of 0.1% p.a (December 31, 2021: 0.1% p.a.).

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As at December 31, 2021, the Bank attracted short-term deposits from four resident banks comprising AZN 11,000 thousand maturing through December 2022 and with interest rates ranging between 7% and 8% p.a. In 2016, the Bank signed a credit agreement with the Azerbaijan Mortgage Fund for granting long-term mortgage loans to individuals. Name of the fund was changed to Azerbaijan Mortgage and Credit Guarantee Fund in 2018. Under this program, funds are made available to the Bank at interest rates between 1.0% and 4.0% p.a. (December 31, 2021: 1% and 4% p.a.) and mature in 2023-2047 (December 31, 2021: 2022-2046). The Bank is obliged to make these funds to issue loans to eligible borrowers at rates not higher than 8.0% p.a.

Current accounts include accounts in amount of AZN 4,135 thousand (December 31, 2021: AZN 74 thousand) from Parent and AZN 2 thousand (December, 2021: AZN 851 thousand) from entities under common control.

In 2021, the Bank signed a credit agreement with Entrepreneurship Development Fund of the Republic of Azerbaijan, a program under the Ministry of Economy of the Republic of Azerbaijan, for financing of small and medium sized enterprises. Under this program, funds are made available to the Bank at an interest rate of 1.0% p.a. and mature in 2025. The Bank uses these funds to issue loans to eligible borrowers at rates not higher than 7.0% p.a.

As at December 31, 2021, the Bank entered into repurchase agreement and borrowed funds amounting to AZN 4,587. The Bank pledged its investment securities as collateral in National Depository Center of Azerbaijan.

17. Amounts due to customers

The amounts due to customers comprise:

	December 31, 2022	December 31, 2021
Current accounts	43,290	48,550
Term deposits	55,845	54,592
Amounts due to customers	99,135	103,142
Held as security against guarantees and letters of credit (Note 19)	(59)	(459)

As at December 31, 2022, customer accounts of AZN 40,283 thousand or 41% (December 31, 2021: AZN 46,422 thousand or 45%) were due to ten (December 31, 2021: ten) largest customers.

The average interest rate on term deposits of individual customers outstanding as at December 31, 2022 is 10.0% p.a. (December 31, 2021: 9.0% p.a.), while the average interest rate on term deposits of legal entities outstanding as at December 31, 2022 was 9.21% p.a. (December 31, 2021: 7.0% p.a.).

As at December 31, 2022, accrued interest expenses included in amounts due to customers amounted to AZN 953 thousand (December 31, 2021: AZN 797 thousand).

As at December 31, 2022 deposits secured by the Azerbaijan Deposit Insurance Fund included in current accounts and deposits from customers in the amount of AZN 50,134 thousand (December 31, 2021: AZN 34,997 thousand).

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022 (Continued) (Figures in tables are in thousands of Azerbaijani Manat)

An analysis of amounts due to customers by economic sector is as follows:

	December 31, 2022	December 31, 2021
Individuals	52,805	54,575
Service	35,829	14,198
Trading	5,675	15,315
Insurance	3,387	14,980
Transportation	844	1,336
Public organizations	290	566
Manufacturing	242	1,877
Other	63	295
Amounts due to customers	99,135	103,142

18. Equity

As at December 31, 2022 and 2021, the Bank's share capital is represented by ordinary shares which were registered at State Securities Committee of the Republic of Azerbaijan on December 29, 2017, thus, authorized, issued and fully paid up capital comprised of 1,579,075,000 ordinary shares with nominal amount of 0.2 AZN per ordinary share. Each ordinary share carries one vote.

In accordance with Azerbaijan legislation, the shareholders of the Bank should have the following rights: elect and be elected to its management and executive bodies, collect information related to the activity of the Bank, familiarize with annual reports and accounts once a year, request holding the General Meeting of Shareholders, request amendments to the agenda of the General Meeting of Shareholders of the Bank, request audit of the activity of the Bank and in case of termination of Bank's activity, receive a distribution of Bank's assets remained after settlements with creditors and payment of calculated but unpaid dividends.

19. Commitments and contingencies

Operating environment

The Bank's operations are conducted in the Republic of Azerbaijan. The Bank is exposed to the economic and financial markets of Azerbaijan which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in Azerbaijan.

Azerbaijan economy also has a significant exposure to level of international energy prices. Crude oil prices increased in the first half of the year because of supply concerns however starting from the second half of the year oil prices generally decreased as concerns about a possible economic recession reduced demand. The Brent crude oil spot price averaged USD 100 per barrel in 2022. Strong oil prices supported economic growth of the country.

The depreciation of Azerbaijani Manat in 2015-2016 years has led to significant uncertainties in business environment, therefore government took all required actions to keep the exchange rate stable over the past 5 years. As a result, continuous fluctuation in global oil prices did not affect the local currency and therefore did not increase the uncertainty in the business environment. The COVID-19 coronavirus pandemic has affected businesses significantly in 2020, however, after a successful vaccination campaign of the government majority of businesses steadily returned to their normal activities during 2021 and the first half of 2022. The sustainability of the cease-fire arrangement over the Karabakh region also improves the business environment as there are number of government-led projects to attract investment and develop the territories released from occupation.

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(Figures in tables are in thousands of Azerbaijani Manat)

GDP reached AZN 133.8 billion (USD 78.7 billion) in 2022 with 4.6% growth compared to 2021. During 2022 foreign trade turnover of the Republic of Azerbaijan reached about USD 52.69 billion of which export equaled to USD 38.15 billion and import equaled to USD 14.54 billion according to the statistics of State Custom Committee.

The government continued its monetary policy with respect to the stability of Azerbaijani Manat as well as allocated foreign currency resources which stabilized Azerbaijani Manat. This policy continued in nine months of 2022 with the aim of maintaining macroeconomic stability. The Central Bank of the Republic of Azerbaijan has changed the refinancing rate several times during the period and the range was between 7.25% - 8.25% with a steady increase in rates.

On June 6, 2022 the Central Bank has increased minimum reserve deposit rates to 4% and 5% for national and foreign currencies, respectively.

On December 28, 2022 the Central Bank has increased minimum reserve deposit rates to 5% and 6% for national and foreign currencies, respectively effective from January 2023.

Inflation rate increased from 6.7% in December 2021 to 13.9% in December 2022.

By the end of December 2022 number of active plastic cards increased to a historic high of 13,257 thousand compared to 11,040 thousand in 2021.

During 2022 proportion of foreign currency deposits of individuals dropped to 39.2% from 41% in 2021.

International credit rating agencies regularly evaluate the credit rating of the Republic of Azerbaijan. Fitch and S&P evaluated the rating of the Republic of Azerbaijan as “BB+”. Moody’s Investors Service set a “Ba1” credit rating for the country.

In February 2022, due to the conflict between the Russian Federation and Ukraine, numerous sanctions have been announced by majority of western countries against the Russian Federation. A number of countries have and continue to impose sanctions against Russian government entities, state-owned enterprises and entities and individuals linked to Russia anywhere in the world including “Bank VTB” PJSC (Russian Federation) and “Bank VTB (Azerbaijan)” OJSC.

The main impact of the imposed sanctions affected the Bank’s functionality on transactions with US dollar and euro, as well as restrictions on the Bank’s payment cards outside the Republic of Azerbaijan and blockage of SWIFT system.

In order to minimize the negative impact of the sanctions on the Bank’s operations, the Bank implemented FMTS system (Financial Message Transfer System) which is considered as alternative for SWIFT system. FMTS system makes money transfer possible between Russian Federation and countries which are connected to this system. Furthermore, the Bank has a “Transit” system in place, which also allows transfer of funds between members of the VTB Group. The system of urgent money transfers (“Contact”) is in active mode and has not been blocked. Individual customers can transfer funds from Azerbaijan to the CIS countries and vice versa by using “Contact” system.

Due to the termination of payment card servicing by Visa and Mastercard, plastic card operations abroad are no longer possible. However, the cards are functioning within the borders of the Republic of Azerbaijan.

In terms of liquidity, the Bank has faced a considerable outflow of customer funds during the period from February 24, 2022 to March 2, 2022 and has fulfilled all the obligations. Prudential liquidity norm set by the CBAR (minimum of 30%) was met since the Bank’s liquidity ratio was 52.58% as at March 31, 2022.

As at March 31, 2022, the Bank’s total capital adequacy ratio, as per report submitted to the CBAR, was 38.34%.

Since the beginning of the recent geopolitical crisis, the Bank has attracted funds in the amount of AZN 7,500 thousand from Russian-resident individuals (for a term of 1 year). The Bank expects that the inflows of funds from the Parent’s customers will continue. As part of the normal course of business, considerable financial inflows are expected from local entrepreneurs with businesses in Russian Federation.

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The Bank conducts its operations predominantly in Azerbaijan. The Bank’s exposure to European and US financial markets is insignificant.

The Bank has insignificant RUB open currency position.

The Bank has not faced any considerable decrease in the quality of its loan portfolio after February 24, 2022, and customers continue to fulfil their loan obligations to the Bank in a timely manner.

Legal

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

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management’s interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within the Republic of Azerbaijan suggest that the tax authorities may be taking a more assertive position in their interpretation and application of this legislation and assessments. It is therefore possible that transactions and activities of the Bank that have not been challenged in the past may be challenged at any time in the future. As a result, significant additional taxes, penalties and interest may be assessed by the relevant authorities. Fiscal periods remain open and subject to review by the tax authorities for a period of three calendar years immediately preceding the year in which the decision to conduct a tax review is taken. The last tax audit of the Bank covered the period from 2018 to 2020.

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

Commitments and contingencies

As of December 31, the Bank’s commitments and contingencies comprised the following:

	December 31, 2022	December 31, 2021
<i>Credit related commitments</i>		
Guarantees	13,056	20,030
Undrawn loan commitments	18,370	18,268
Less: provisions for ECL for credit related commitments	(180)	(164)
Commitments and contingencies (before deducting collateral)	31,246	38,134
Less: cash held as security against guarantees and letters of credit (Note 17)	(59)	(459)
Commitments and contingencies	31,187	37,675

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

<i>Financial guarantees</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECLs as at January 1, 2022	123	-	-	123
New exposures	106	-	-	106
Exposures derecognized or matured	(121)	-	-	(121)
Changes to models and inputs used for ECL	4	-	-	4
At December 31, 2022	112	-	-	112
<i>Undrawn loan commitments</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECLs as at January 1, 2022	40	1	-	41
New exposures	38	-	-	38
Exposures derecognized or matured	(1)	-	-	(1)
New remeasurement of ECL	(10)	-	-	(10)
At December 31, 2022	67	1	-	68

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2022 (Continued) (Figures in tables are in thousands of Azerbaijani Manat)

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

<i>Financial guarantees</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECLs as at January 1, 2021	193	-	-	193
New exposures	118	-	-	118
Exposures derecognized or matured	(183)	-	-	(183)
Changes to models and inputs used for ECL	(5)	-	-	(5)
At December 31, 2021	123	-	-	123

<i>Undrawn loan commitments</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECLs as at January 1, 2021	178	12	-	190
New exposures	28	-	-	28
Exposures derecognized or matured	(182)	-	-	(182)
Transfers to stage 1	11	(11)	-	-
New remeasurement of ECL	5	-	-	5
At December 31, 2021	40	1	-	41

Expected credit loss allowance on credit-related commitments is recorded within other non-financial liabilities balance.

Compliance with the CBAR ratios

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

20. Credit loss reversal and other impairment provisions

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

	<i>Note</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Loans to customers	10	1,279	(529)	11,454	12,204
Amounts due from credit institutions	7	(405)	-	-	(405)
Credit loss reversal/(expense) on financial assets		874	(529)	11,454	11,799
Financial guarantees	19	11	-	-	11
Undrawn loan commitments	19	(27)	-	-	(27)
Credit related commitments		(16)	-	-	(16)
Total credit loss reversal		858	(529)	11,454	11,783

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

	<i>Note</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Loans to customers	10	(1,889)	408	(1,752)	(3,233)
Credit loss (expense)/reversal on financial assets		(1,889)	408	(1,752)	(3,233)
Financial guarantees	19	70	-	-	70
Undrawn loan commitments	19	138	11	-	149
Credit related commitments		208	11	-	219
Total credit loss expense		(1,681)	419	(1,752)	(3,014)

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21. Net interest income

Net interest income comprises:

	Year ended December 31, 2022	Year ended December 31, 2021
Interest income on loans to customers	23,429	19,054
Interest income on investment securities	661	524
Interest income on guarantees	327	28
Interest income on cash and cash equivalents	220	224
Interest income on financial assets recorded at amortized cost	24,637	19,830
Interest expense on due to customers	(7,274)	(3,873)
Interest expense on due to credit institutions	(1,097)	(1,513)
Interest expense on lease liabilities	(138)	(106)
Interest expense on financial liabilities recorded at amortized cost	(8,509)	(5,492)
Net interest income	16,128	14,338

22. Fee and commission income and expense

Fee and commission income and expense comprises:

	Year ended December 31, 2022	Year ended December 31, 2021 (reclassified)
Settlements operations	1,148	1,810
Plastic card operations	620	1,263
Cash operations	377	372
Documentary operations	334	299
Agency fee	277	166
Consulting and expert operations	47	145
Fee and commission income	2,803	4,055
Plastic card operations	(657)	(1,671)
Settlements operations	(453)	(435)
Cash operations	(54)	(14)
Agency fee	(363)	(415)
Fee and commission expense	(1,527)	(2,535)

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23. Operating expenses

Operating expenses comprise:

	Year ended December 31, 2022	Year ended December 31, 2021 (reclassified)
Salaries and bonuses	(11,663)	(11,483)
Social security costs	(2,066)	(1,958)
Other employment expenses	(302)	(340)
Personnel expenses	(14,031)	(13,781)
Collector fee	(3,000)	(191)
Depreciation and amortization	(2,155)	(2,063)
Fines, penalties and forfeits	(1,736)	-
Change in fair value of repossessed collateral	(1,676)	-
Software cost	(1,073)	(727)
Marketing and advertising	(707)	(470)
Legal and consultancy	(446)	(1,075)
Communications	(305)	(343)
Charity expenses	(292)	(36)
Deposit insurance	(272)	(139)
Security	(246)	(233)
Occupancy and rent	(236)	(209)
Repair and maintenance of property and equipment	(229)	(189)
Representative expenses	(206)	(186)
Office supplies	(180)	(213)
Operating taxes	(144)	(135)
Utilities	(107)	(90)
Transportation cost	(85)	(47)
Business travel and related	(53)	(25)
Other expenses	(191)	(332)
Other operating expenses	(13,339)	(6,703)
Total operating expenses	(27,370)	(20,484)

24. 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 and 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 Bank’s 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.

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Management Board

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

Risk Committee

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

Risk Management

The Risk Management Unit is responsible for implementing and maintaining risk related procedures to ensure an independent control process. In addition, Risk Management Unit is responsible for monitoring compliance with risk principles, policies and limits, across the Bank.

Risk Controlling

The Risk Controlling Unit is responsible for monitoring compliance with risk principles, policies and limits, across the Bank. Each business group has a decentralized unit which is responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This unit also ensures the complete capture of the risks in risk measurement and reporting systems.

Bank Treasury

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

Internal audit

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

Risk measurement and reporting systems

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worst 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 risk types and activities.

Information compiled from all the businesses is examined and processed in order to analyze, 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. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis.

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

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Risk mitigation

As part of its overall risk management, the Bank uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions.

The Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration

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

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

Credit risk

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

Derivative financial instruments

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

Credit-related commitments risks

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

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

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

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 9.

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:

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

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

The Bank has established a 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, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. 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.

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

Stage 1:	When loans are first recognized, the Bank recognizes an allowance based on 12mECL. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.
Stage 2:	When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECL. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.
Stage 3:	Loans considered credit-impaired. The Bank records an allowance for the LTECL.
POCI:	Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and interest income is subsequently recognized based on a credit-adjusted EIR. ECL are only recognized 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 credit institutions defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

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

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- Internal rating of the borrower indicating default or near-default;
- The borrower is deceased;
- If the borrower's status “PD” (Problematic Delinquency);
- A material decrease in the borrower's turnover or the loss of a major customer;
- A covenant breach not waived by the Bank;
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy;
- Debtor's listed debt or equity suspended at the primary exchange because of rumors or facts about financial difficulties.

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 independent Credit Risk Department operates its internal rating models. The Bank runs separate models for its key portfolios in which its corporate and small and medium business customers are rated from 1 to 100 using internal grades. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilize supplemental external information that could affect the borrower's behavior. 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.

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.

Corporate and small business lending

For corporate loans, the borrowers are assessed by specialized 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 realized and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention.
- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies, independent analyst reports, publicly traded bond prices or press releases and articles.
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

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

Consumer lending and residential mortgages

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 primarily rated by days past due. Other key input into the models is GDP growth.

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

Credit risk grades	Description
High grade	Acceptable risk level assets by internal probability of default calculation viewed as target segment by the Bank in context of loan portfolio growth. Specific lending transactions could be ranked in this category on the basis of expected loss assessment (as the basic parameter of quantitative evaluation of risk in this segment). High grade is generally attached to counterparties with excellent financial performance or sovereign risk, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.
Standard grade	Higher-level risk assets ranked untargeted by the Bank in context of new loans, by internal probability of default calculation. Standard grade is generally attached to counterparties with stable financial performance, having no changes in the terms and conditions of loan agreements and overdue in principal and interest up to 30 days.
Sub-standard grade	High-risk assets exposed to substantial credit risk factors or assets ranked unacceptable by the Bank in context of new loans, by internal probability of default calculation. This category may also include loans the Bank was forced to restructure. Such loans are currently serviced in accordance with the schedule but criteria for Default status rescinding for them were not yet met because not enough time has passed since restructuring or significant part of loan was not yet repaid under the terms of restructured loan. Standard grade is generally attached to counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and no overdue in principal and interest.
Impaired	The Bank defines non-performing loans (NPL) as lifetime ECL credit-impaired financial assets with contractual principal and (or) interest payments overdue more than 90 days and POCI loans with principal and (or) interest payments becoming overdue more than 90 days after the date of initial recognition. Loans with no contractual payments until maturity, grace period on principal and or interest payments, as well as restructured loans are not considered NPL unless amounts due contractually become more than 90 days overdue. Impaired grade is generally attached to counterparties with unsatisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

It is the Bank’s policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank’s rating policy. The attributable risk ratings are assessed and updated regularly.

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 and POCI 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.

Loss given default

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

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 realized from any collateral held.

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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, wider range of collateral types) as well as borrower characteristics.

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

LGD rates are estimated for the Stage 1, Stage 2, Stage 3 and POCI segment of each asset class. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries. These are repeated for each economic scenario as appropriate.

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 12m ECL or LTECL, the Bank assesses whether there has been a significant increase in credit risk since initial recognition.

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

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

Grouping financial assets measured on a collective basis

Dependent on the factors below, the Bank calculates ECLs either on a collective or on an individual basis. Asset classes where the Bank calculates ECL on an individual basis include:

- Stage 3 assets, regardless of the class of financial assets;
- Stage 3 corporate lending portfolio;
- The treasury and interbank relationships (such as amounts due from credit institutions, cash equivalents and debt investment securities at Amortized cost and FVOCI);
- Exposures that have been classified as POCI when the original loan was derecognized and a new loan was recognized as a result of a credit driven debt restructuring.
- If the borrower’s status “PD” (Problematic Delinquency).

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

- The smaller and more generic balances of the Bank’s small business lending;
- Stage 1, 2 and 3 retail mortgages and consumer lending and Stage 1 and stage 2 corporate lending portfolio;
- Purchased POCI exposures managed on a collective basis.

The Bank groups these exposures into smaller homogeneous portfolios, based on a combination of internal and external characteristics of the loans, for example internal grade, overdue bucket, product type, loan-to-value ratios, or borrower’s industry.

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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;
- Inflation;
- Central Bank base rates;
- Foreign exchange rates.
- Real estate price.

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.

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 statement of financial position, based on the Bank's credit rating system.

	Note		High grade	Standard grade	Sub-standard grade	Impaired	Total
December 31, 2022							
Cash and cash equivalents, except for cash on hand	6	Stage 1	25,671	1,952	-	-	27,623
Investment securities	8	Stage 1	24,768	-	-	-	24,768
Amounts due from credit institutions	7	Stage 1	-	13,817	-	-	13,817
Loans to customers:	10						
- Small business lending		Stage 1	-	19,152	-	-	19,152
		Stage 2	-	-	27	-	27
		Stage 3	-	-	-	10,382	10,382
- Corporate lending		Stage 1	-	34,940	-	-	34,940
		Stage 2	-	-	1,738	-	1,738
		Stage 3	-	-	-	5,848	5,848
- Consumer lending		Stage 1	-	101,366	-	-	101,366
		Stage 2	-	-	1,926	-	1,926
		Stage 3	-	-	-	6,973	6,973
- Auto lending		Stage 1	-	1	-	-	1
		Stage 2	-	-	-	-	-
		Stage 3	-	-	-	271	271
Undrawn loan commitments	19	Stage 1	-	18,370	-	-	18,370
Financial guarantees	19	Stage 1	-	13,056	-	-	13,056
Other financial assets	15	Stage 1	-	741	-	-	741
Total			50,439	203,395	3,691	23,474	280,999

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	Note		High grade	Standard grade	Sub-standard grade	Impaired	Total
December 31, 2021							
Cash and cash equivalents, except for cash on hand	6	Stage 1	24,902	11,666	-	-	36,568
Investment securities	8	Stage 1	4,534	-	-	-	4,534
Amounts due from credit institutions	7	Stage 1	-	514	-	-	514
Loans to customers:	10						
- Small business lending		Stage 1	-	12,195	-	-	12,195
		Stage 2	-	-	-	-	-
		Stage 3	-	-	-	23,881	23,881
- Corporate lending		Stage 1	-	73,439	-	-	73,439
		Stage 2	-	-	-	-	-
		Stage 3	-	-	-	10,337	10,337
- Consumer lending		Stage 1	-	78,212	-	-	78,212
		Stage 2	-	271	449	-	720
		Stage 3	-	-	-	5,385	5,385
- Auto lending		Stage 1	-	28	-	-	28
		Stage 2	-	-	4	-	4
		Stage 3	-	-	-	489	489
Undrawn loan commitments	19	Stage 1	-	17,653	-	-	17,653
		Stage 2	-	-	615	-	615
Financial guarantees	19	Stage 1	-	20,030	-	-	20,030
Other financial assets	15	Stage 1	-	2,355	-	-	2,355
Total			29,436	216,363	1,068	40,092	286,959

See Note 10 for more detailed information with respect to the allowance for impairment of loans to customers. ECLs for financial guarantees and letters of credit are assessed in a similar manner as for loans.

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

	December 31, 2022				December 31, 2021			
	Azerbaijan	OECD	CIS and other foreign banks	Total	Azerbaijan	OECD	CIS and other foreign banks	Total
Assets								
Cash and cash equivalents	32,656	-	1,939	34,595	33,237	2,171	9,001	44,409
Mandatory reserve with the CBAR	4193	-	-	4,193	477	-	-	477
Amounts due from credit institutions	987	-	12,420	13,407	509	-	-	509
Investment securities	24,768	-	-	24,768	4,534	-	-	4,534
Loans to customers	163,404	-	-	163,404	181,764	-	-	181,764
Derivative financial assets	-	-	3	3	-	-	182	182
Other financial assets	710	-	31	741	2,355	-	-	2,355
	226,718	-	14,393	241,111	222,876	2,171	9,183	234,230
Liabilities								
Amounts due to banks and other credit institutions	(46,049)	-	(4,137)	(50,186)	(50,440)	-	(926)	(51,366)
Amounts due to customers	(99,135)	-	-	(99,135)	(103,142)	-	-	(103,142)
Lease liabilities	(2,256)	-	-	(2,256)	(734)	-	-	(734)
Other financial liabilities	(1,652)	-	(81)	(1,733)	(1,480)	-	(218)	(1,698)
	(149,092)	-	(4,218)	(153,310)	(155,796)	-	(1,144)	(156,940)
Net assets	77,626	-	10,175	87,801	67,080	2,171	8,039	77,290

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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 assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can assess to meet liquidity needs. In addition, the Bank maintains a cash deposit (mandatory reserve) with the CBAR, the amount of which depends on the level of customer funds attracted.

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

	December 31, 2022 (unaudited)	December 31, 2021 (unaudited)
Instant Liquidity Ratio	98.62%	58.45%

Analysis of financial liabilities by remaining contractual maturities

The tables below summarize the maturity profile of the Bank’s financial liabilities at December 31, 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.

As at December 31, 2022	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to banks and other credit institutions	4,633	1,069	6,560	59,862	72,124
Amounts due to customers	57,150	22,213	26,092	54	105,509
Lease liabilities	128	639	2,125	-	2,892
Other financial liabilities	1,733	-	-	-	1,733
Total undiscounted financial liabilities	63,644	23,921	34,777	59,916	182,258

As at December 31, 2021	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to banks and other credit institutions	6,973	12,794	17,863	27,495	65,125
Amounts due to customers	55,977	37,520	15,331	-	108,828
Lease liabilities	181	374	251	-	806
Other financial liabilities	1,698	-	-	-	1,698
Total undiscounted financial liabilities	64,829	50,688	33,445	27,495	176,457

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

	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total</i>
2022	31,426	-	-	-	31,426
2021	38,298	-	-	-	38,298

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 realize an equivalent amount of assets within the same period of time. There is a significant concentration as of December 31, 2022 of deposits from individuals and entities that represents about 63% of total portfolio (December 31, 2021: 86%) in the period less than one year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. Management believes that this level of funding will remain with the Bank for 5 the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realize 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 due to customers are term deposits of individuals. In accordance with the legislation of the Republic of Azerbaijan, the Bank is obliged to repay such deposits upon demand of a depositor.

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 and foreign exchanges. The Bank classifies exposures to market risk into non-trading portfolios. Non-trading positions are managed and monitored using sensitivity analysis. Except for the concentrations within foreign currency, the Bank has no significant concentration of market risk.

Currency risk

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

The tables below indicate the currencies to which the Bank had significant exposure at December 31, 2022 and 2021 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Azerbaijani manat, with all other variables held constant on the statement of comprehensive income (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on the statement of comprehensive income. A negative amount in the table reflects a potential net reduction in statement of comprehensive income or equity, while a positive amount reflects a net potential increase.

<i>Currency</i>	2022		2021	
	<i>Increase in currency rate in %</i>	<i>Effect on profit before tax</i>	<i>Increase in currency rate in %</i>	<i>Effect on profit before tax</i>
USD	10%	194	10%	717
RUB	10%	1	10%	17
EUR	10%	(4)	10%	24
GBP	10%	1	10%	8

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Currency	2022		2021	
	Decrease in currency rate in %	Effect on profit before tax	Decrease in currency rate in %	Effect on profit before tax
USD	(10%)	(194)	(10%)	(717)
RUB	(10%)	(1)	(10%)	(17)
EUR	(10%)	4	(10%)	(24)
GBP	(10%)	(1)	(10%)	(8)

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 a control framework and monitoring and responding to potential risks could be effective tools to manage the risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

25. Fair value measurements

Fair value hierarchy

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

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

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

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	Date of valuation	Fair value measurement using			Total
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Assets measured at fair value					
Derivative financial assets	December 31, 2022	-	3	-	3
Assets for which fair values are disclosed					
Cash and cash equivalents	December 31, 2022	34,595	-	-	34,595
Investment securities	December 31, 2022	-	24,591	-	24,591
Amounts due from credit institutions	December 31, 2022	-	-	13,407	13,407
Loans to customers	December 31, 2022	-	40,902	122,502	163,404
Other financial assets	December 31, 2022	-	-	741	741
Liabilities for which fair values are disclosed					
Amounts due to banks and other credit institutions	December 31, 2022	-	38,000	12,186	50,186
Amounts due to customers	December 31, 2022	-	-	99,135	99,135
Other financial liabilities	December 31, 2022	-	-	1,733	1,733

	Date of valuation	Fair value measurement using			Total
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Assets measured at fair value					
Derivative financial assets	December 31, 2021	-	182	-	182
Assets for which fair values are disclosed					
Cash and cash equivalents	December 31, 2021	44,409	-	-	44,409
Investment securities	December 31, 2021	-	4,534	-	4,534
Amounts due from credit institutions	December 31, 2021	-	-	509	509
Loans to customers	December 31, 2021	-	27,525	154,399	181,924
Other financial assets	December 31, 2021	-	-	2,355	2,355
Liabilities for which fair values are disclosed					
Amounts due to banks and other credit institutions	December 31, 2021	-	27,268	24,098	51,366
Amounts due to customers	December 31, 2021	-	-	103,240	103,240
Other financial liabilities	December 31, 2021	-	-	1,698	1,698

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

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

	December 31, 2022			December 31, 2021		
	Carrying value	Fair value	Unrecog- nized gain/(loss)	Carrying value	Fair value	Unrecog- nized gain/(loss)
Assets						
Cash and cash equivalents	34,595	34,595	-	44,409	44,409	-
Investment securities	24,768	24,591	177	4,534	4,534	-
Amounts due from credit institutions	13,407	13,407	-	509	509	-
Loans to customers	163,404	163,404	-	181,764	181,924	160
Other financial assets	741	741	-	2,355	2,355	-
Liabilities						
Amounts due to banks and other credit institutions	50,186	50,186	-	51,366	51,366	-
Amounts due to customers	99,135	99,135	-	103,142	103,240	(98)
Other financial liabilities	1,733	1,733	-	1,698	1,698	-
			<u>177</u>			<u>62</u>

Valuation techniques and assumptions

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

Assets for which fair value approximates carrying value

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

Financial assets and financial liabilities carried at amortized cost

Fair value of the quoted notes and bonds is based on price quotations at the reporting date. The fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and Amounts due to banks and credit institutions and other financial assets and liabilities, obligations under finance leases is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

26. 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 24 “Risk management” for the Bank's contractual undiscounted repayment obligations and how management addresses the negative maturity mismatch below for within one year.

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	December 31, 2022			December 31, 2021		
	<i>Within one year</i>	<i>More than one year</i>	<i>Total</i>	<i>Within one year</i>	<i>More than one year</i>	<i>Total</i>
Cash and cash equivalents	34,595	-	34,595	44,409	-	44,409
Investment securities	15,348	9,420	24,768	4,534	-	4,534
Mandatory reserves with the CBAR	4,193	-	4,193	477	-	477
Amounts due from credit institutions	13,407	-	13,407	509	-	509
Loans to customers	62,330	101,074	163,404	102,483	79,281	181,764
Property and equipment	-	2,622	2,622	-	1,704	1,704
Intangible assets	-	6,625	6,625	-	5,544	5,544
Right-of-use assets	-	2,236	2,236	-	658	658
Deferred income tax asset	-	-	-	-	621	621
Derivative financial assets	3	-	3	182	-	182
Other assets	2,165	3,157	5,322	3,621	6,786	10,407
Total assets	132,041	125,134	257,175	156,215	94,594	250,809
Amounts due to banks and other credit institutions	4,259	45,927	50,186	18,096	33,270	51,366
Amounts due to customers	75,535	23,600	99,135	90,969	12,173	103,142
Current income tax liability	2,284	-	2,284	-	-	-
Lease liabilities	484	1,772	2,256	496	238	734
Deferred income tax liability	-	2,827	2,827	-	-	-
Other liabilities	5,949	-	5,949	5,911	-	5,911
Total liabilities	88,511	74,126	162,637	115,472	45,681	161,153
Net assets	43,530	51,008	95,538	40,743	48,913	89,656

27. 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 affected on the same terms, conditions and amounts as transactions between unrelated parties.

The outstanding balances of related party transactions are as follows:

	2022			2021		
	<i>Parent</i>	<i>Entities under common control</i>	<i>Other related parties</i>	<i>Parent</i>	<i>Entities under common control</i>	<i>Other related parties</i>
Deposits at January 1,	-	-	517	-	-	54
Deposits received during the year	-	-	34	-	-	474
Deposits repaid during the year	-	-	(517)	-	-	(11)
Other movements	-	-	-	-	-	-
Deposits at December 31,	-	-	34	-	-	517
Current accounts at December 31,	-	-	153	-	-	-
Cash and cash equivalents	1,925	-	-	2,428	8,745	-
Amounts due to banks and other credit institutions	12,420	-	-	74	851	-
Derivative financial assets	3	-	-	7	175	-

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The income and expense arising from related party transactions are as follows:

	For the year ended December 31,					
	2022			2021		
	<i>Parent</i>	<i>Entities under common control</i>	<i>Other related parties</i>	<i>Parent</i>	<i>Entities under common control</i>	<i>Other related parties</i>
Interest income	120	-	-	6	16	-
Interest expense	109	-	-	-	-	(19)
Net (loss)/gain on dealing in foreign currencies	162	-	-	1,957	175	-

Compensation of key management personnel was comprised of the following:

	2022	2021
Salaries and other short-term benefits	1,430	1,039
Social security costs	250	171
Total key management personnel compensation	1,680	1,210

As at December 31, 2022 key management personnel of the Bank consisted of 5 members (2021: 4 members).

28. Changes in liabilities arising from financing activities

	Notes	Long term loans due to the CBAR	Total liabilities from financing activities
Carrying amount at December 31, 2020	15	9,578	9,578
Redemption		(2,121)	(2,121)
Reversal of credit loss allowance for loan exposures repaid by Azerbaijani Government on behalf of customers		(126)	(126)
Other		-	-
Carrying amount at December 31, 2021	15	7,331	7,331
Redemption		(2,184)	(2,184)
Other		-	-
Carrying amount at December 31, 2022		5,147	5,147

The “Other” line includes the effect of accrued but not yet paid interest. The Bank classifies interest paid within cash flows from operating activities.

29. Capital adequacy

The objectives of management when managing the Bank’s capital are (i) to comply with the capital requirements set by the CBAR, (ii) to safeguard the Bank’s ability to continue as a going concern and (iii) to maintain strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders’ value. Compliance with capital adequacy ratios set by the CBAR is monitored monthly with reports outlining their calculation reviewed and signed by the Bank’s Chairman of the Management Board and Chief Accountant. The other objectives of capital management are evaluated annually.

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 or return capital to shareholders. No changes were made in the objectives, policies and processes from the previous years.

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The CBAR requires each bank or banking group to: (a) hold the minimum level of share capital AZN 50,000; (b) maintain a ratio of total regulatory capital to the risk-weighted assets (the “total capital ratio”) at or above the prescribed minimum of 10% (2021: 10%) and (c) maintain a ratio of tier 1 capital to the risk-weighted assets (the “Tier 1 capital ratio”) at or above the prescribed minimum of 6% (2021: 6%).

As at December 31, 2022 and 2021, the Bank’s capital adequacy ratios, as per reports submitted to the CBAR, were as follows:

	December 31, 2022 (unaudited)	December 31, 2021 (unaudited)
Tier 1 capital	60,453	57,320
Tier 2 capital	13,142	5,860
Total regulatory capital	73,595	63,180
Risk weighted assets	187,905	184,450
Capital adequacy ratio (Tier 1)	32.17%	31.08%
Capital adequacy ratio (Total Capital)	39.17%	34.25%

30. Events after reporting period

Subsequent to year end, in March 2023, the Bank wrote off a pool of loans to individuals of AZN 2 million, which were issued before 2020 and had more than 150 overdue days.

The impact of sanctions against businesses linked to Russian government arisen from the conflict between Russian Federation and Ukraine and coming from February 2022 still remains. Plastic cards are functioning only within the borders of the Republic of Azerbaijan. The Bank conducts its operations predominantly in Azerbaijan. The Bank’s exposure to European and US financial markets is insignificant.

The restrictions over transactions with US dollar and euro, as well as blockage of SWIFT system, are still valid.

As at 31 March 2023, the Bank’s total capital adequacy ratio was calculated about 36%.

On March 29, 2023 the Central Bank of the Republic of Azerbaijan has increased the refinancing rate to 8.75%.