

**“FINCA AZERBAIJAN”  
LIMITED LIABILITY NON-BANKING  
CREDIT ORGANIZATION**

**International Financial Reporting Standards  
Financial Statements and  
Independent Auditors' Report  
For the Year Ended December 31, 2019**

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

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## **INDEPENDENT AUDITORS' REPORT**

To the Founder and the Management Board of “FINCA Azerbaijan” Limited Liability Non-Banking Credit Organization (the “Company”):

### ***Opinion***

We have audited the financial statements of “FINCA Azerbaijan” Limited Liability Non-Banking Credit Organization (the “Company”), which comprise the statement of financial position as at December 31, 2019, statement of profit or loss and other 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 statement of financial position as at December 31, 2019, 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 Company 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.

### ***Responsibilities of Management and Those Charged with Governance 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 Company'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 Company or to cease operations, or have no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company'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 Company'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 Company'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 Company 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 those charged with governance 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*

March 10, 2020  
Baku, the Republic of Azerbaijan

**“FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION**

**STATEMENT OF FINANCIAL POSITION  
AS AT DECEMBER 31, 2019**

*(in thousands of US dollars, unless otherwise indicated)*

	Notes	December 31, 2019	December 31, 2018
<b>ASSETS:</b>			
Cash and cash equivalents	6	7,722	1,881
Loans to customers, net	7	7,155	2,252
Property, equipment and intangible assets	8	142	81
Right-of-use assets	9	351	-
Deferred income tax assets	16	323	397
Other assets	10	270	298
		<u>15,963</u>	<u>4,909</u>
<b>Total assets</b>			
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES:</b>			
Borrowed funds	11	4,138	-
Lease liabilities	12	355	-
Other liabilities	13, 17	476	433
		<u>4,969</u>	<u>433</u>
<b>Total liabilities</b>			
<b>EQUITY:</b>			
Share capital		4,205	4,205
Retained earnings		28,342	21,824
Translation reserves		(21,553)	(21,553)
		<u>10,994</u>	<u>4,476</u>
<b>Total equity</b>			
<b>TOTAL LIABILITIES AND EQUITY</b>		<u>15,963</u>	<u>4,909</u>

**On behalf of the Management Board:**

**Timothy Tarrant**  
Chief Executive Officer

March 10, 2020  
Baku, the Republic of Azerbaijan



**Muhammad Mobeen Yaqoob**  
Deputy Director

March 10, 2020  
Baku, the Republic of Azerbaijan

The notes on pages 8-63 form an integral part of these financial statements.

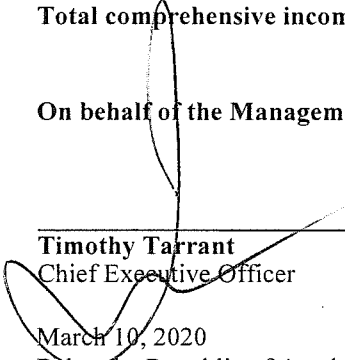
**“FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION**

**STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME  
FOR THE YEAR ENDED DECEMBER 31, 2019**

*(in thousands of US dollars, unless otherwise indicated)*

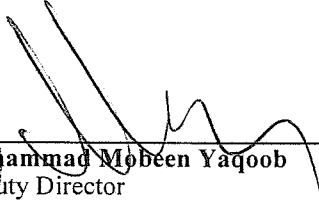
	Notes	Year ended December 31, 2019	Year ended December 31, 2018
Interest income	14	1,016	569
Interest expense	14	(34)	(566)
<b>Net interest income before recovery of expected credit losses</b>		<b>982</b>	<b>3</b>
Recovery of expected credit losses	7	7,224	2,628
<b>Net interest income</b>		<b>8,206</b>	<b>2,631</b>
Administrative and other operating expenses	15, 17	(2,928)	(2,744)
Fair value gain on loans to customers and borrowed funds at initial measurement	7, 11	1,355	-
Loss from change in fair value of repossessed collaterals		(39)	-
Net gain on foreign exchange operations		-	5
Other (expense)/income, net		(2)	15
Net non-interest loss		(1,614)	(2,724)
<b>Profit/(loss) before income tax</b>		<b>6,592</b>	<b>(93)</b>
Income tax (expense)/benefit	16	(74)	176
<b>Net profit for the year</b>		<b>6,518</b>	<b>83</b>
<b>Total comprehensive income for the year</b>		<b>6,518</b>	<b>83</b>

**On behalf of the Management Board:**

  
**Timothy Tarrant**  
Chief Executive Officer

March 10, 2020  
Baku, the Republic of Azerbaijan



  
**Muhammad Mubeen Yaqoob**  
Deputy Director

March 10, 2020  
Baku, the Republic of Azerbaijan

The notes on pages 8-63 form an integral part of these financial statements.

**“FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION**

**STATEMENT OF CHANGES IN EQUITY  
FOR THE YEAR ENDED DECEMBER 31, 2019**

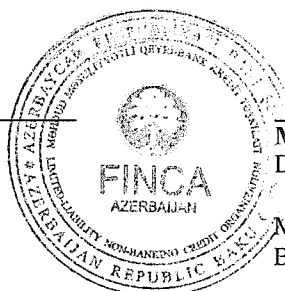
*(in thousands of US dollars, unless otherwise indicated)*

	Share capital	Retained earnings	Translation reserve	Total equity
January 1, 2018	3,705	21,741	(21,553)	3,893
Total comprehensive income for the year	-	83	-	83
Increase in share capital	500	-	-	500
<b>December 31, 2018</b>	<b>4,205</b>	<b>21,824</b>	<b>(21,553)</b>	<b>4,476</b>
Total comprehensive income for the year	-	6,518	-	6,518
<b>December 31, 2019</b>	<b>4,205</b>	<b>28,342</b>	<b>(21,553)</b>	<b>10,994</b>

On behalf of the Management Board:

**Timothy Tarrant**  
Chief Executive Officer

March 10, 2020  
Baku, the Republic of Azerbaijan



**Muhammad Mobeen Yaqoob**  
Deputy Director

March 10, 2020  
Baku, the Republic of Azerbaijan

The notes on pages 8-63 form an integral part of these financial statements.

**“FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION**

**STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2019**

*(in thousands of US dollars, unless otherwise indicated)*

	Notes	Year ended December 31, 2019	Year ended December 31, 2018
<b>Cash flows from operating activities:</b>			
Profit/(loss) before income tax		6,592	(93)
Adjustments for:			
Recovery of expected credit losses	7	(7,224)	(2,628)
Depreciation and amortization	8, 9, 15	203	48
Net change in accrued interest		(110)	741
Loss/(gain) from disposal of property, equipment and intangible assets		18	(15)
Fair value gain on loans to customers and borrowed funds at initial measurement	7, 11	(1,355)	-
Loss from change in fair value of repossessed collaterals		39	-
Net gain on foreign exchange operations		-	(5)
		<u>          </u>	<u>          </u>
<b>Cash outflow from operating activities before changes in operating assets and liabilities</b>		<b><u>(1,837)</u></b>	<b><u>(1,952)</u></b>
Changes in operating assets and liabilities			
Loans to customers, net		2,655	7,862
Other assets		(62)	436
Other liabilities		43	(629)
		<u>          </u>	<u>          </u>
<b>Cash inflow from operating activities before taxation and interest</b>		<b><u>799</u></b>	<b><u>5,717</u></b>
Income tax paid		-	(1,947)
		<u>          </u>	<u>          </u>
<b>Net cash inflow from operating activities</b>		<b><u>799</u></b>	<b><u>3,770</u></b>
<b>Cash flows from investing activities:</b>			
Purchase of property and equipment and intangible assets		(135)	(19)
Proceeds from disposal of property and equipment and intangible assets		-	21
		<u>          </u>	<u>          </u>
<b>Net cash (outflow)/inflow from investing activities</b>		<b><u>(135)</u></b>	<b><u>2</u></b>
<b>Cash flows from financing activities:</b>			
Proceeds from borrowed funds	11	5,295	-
Repayment of borrowed funds	11	-	(6,540)
Transaction cost paid on borrowed funds	11	(26)	-
Repayment of principal portion on lease liabilities	12	(92)	-
Proceeds from issue of ordinary shares		-	500
		<u>          </u>	<u>          </u>
<b>Net cash inflow/(outflow) from financing activities</b>		<b><u>5,177</u></b>	<b><u>(6,040)</u></b>



**“FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION**

**STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued)**  
*(in thousands of US dollars, unless otherwise indicated)*

	Notes	Year ended December 31, 2019	Year ended December 31, 2018
Effect of exchange rate changes on the balance of cash and cash equivalents held in foreign currencies		-	5
Net increase/(decrease) in cash and cash equivalents		5,841	(2,263)
Cash and cash equivalents, beginning of the year	6	1,881	4,144
Cash and cash equivalents, end of the year	6	<u>7,722</u>	<u>1,881</u>

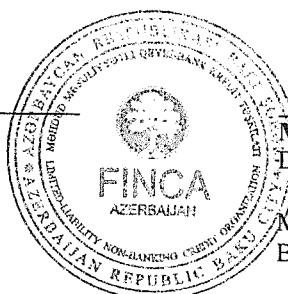
Interest paid and received by the Company during the year ended December 31, 2019 amounted to USD 34 thousand and USD 907 thousand, respectively.

Interest paid and received by the Company during the year ended December 31, 2018 amounted to nil and USD 743 thousand, respectively.

On behalf of the Management Board:

**Timothy Tarrant**  
Chief Executive Officer

March 10, 2020  
Baku, the Republic of Azerbaijan



**Muhammad Mobeen Yaqoob**  
Deputy Director

March 10, 2020  
Baku, the Republic of Azerbaijan

The notes on pages 8-63 form an integral part of these financial statements.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019

(in thousands of US dollars, unless otherwise indicated)

### 1. INTRODUCTION

#### Company and its principal activity

“FINCA Azerbaijan” LLC (the “Company”) was incorporated in the Republic of Azerbaijan in 1998. Until November 19, 1999 it was registered as a representative office of FINCA International Inc. in Azerbaijan. On November 19, 1999 the Company was registered with the Azerbaijan Ministry of Justice and obtained the status of a legal entity. The Company was reregistered to comply with the regulations of the Central Bank of the Republic of Azerbaijan, in accordance with which only legal entities can perform lending activities on the territory of Azerbaijan. The new entity obtained a license for lending activities from the Central Bank of Azerbaijan on February 29, 2000. The address of the Company’s registered office is 44 Jafar Jabbarly Street, Baku AZ1065, Azerbaijan.

The Company’s objective is to provide financial services including loans to representatives of micro, small and medium sized businesses in the Republic of Azerbaijan and also to individuals and groups of individuals engaged in sales and small-scale productive micro enterprises.

As at December 31, 2019 and 2018 the Company had 15 and 4 branches respectively operating in the Republic of Azerbaijan. The Company had an average of 142 employees during 2019 (2018: 118 employees).

The Company is a subsidiary of FINCA Microfinance Coöperatief U.A., which has a registered office in the Netherlands. The ultimate controlling party of the Company is FINCA International Inc., a not-for-profit corporation, incorporated in New York, United States of America. In October 2010, FINCA International Inc. formed FINCA Microfinance Holding Company LLC (“FMH”) to become a 100% owned holding company.

As at December 31, 2019 and 2018 the following shareholders owned the Company:

<b>Shareholder of the Company (Shareholder of the first level)</b>	<b>December 31, 2019, %</b>	<b>December 31, 2018, %</b>
FINCA Microfinance Coöperatief U.A.	100.00	100.00
<b>Total</b>	<b>100.00</b>	<b>100.00</b>
	<b>December 31, 2019, %</b>	<b>December 31, 2018, %</b>
<b>Ultimate shareholders of the Company</b>		
FINCA International, Inc.	62.64	62.64
International Finance Corporation	14.38	14.38
Kreditanstalt für Wiederaufbau	8.94	8.94
FMO (Nederlandse Financierings Maatschappij voor Ontwikkelingslanden N.V.)	7.31	7.31
Triple Jump, acting for ASN-NOVIB FONDS	1.68	1.68
Credit Suisse Microfinance Fund Management Company, acting for responsibility Global Microfinance Fund	2.98	2.98
Triodos Investment Management, representing: (i) Triodos Custody B.V. in its capacity as custodian of Triodos Fair Share Fund; and (ii) Triodos SICAV II – Triodos Microfinance Fund	2.07	2.07
<b>Total</b>	<b>100.00</b>	<b>100.00</b>

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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### **Operating Environment of the Company**

The Company’s operations are conducted in the Republic of Azerbaijan. Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks. The future stability of the Azerbaijan’s economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Government as well as crude oil prices and stability of Azerbaijani Manat.

The Azerbaijan’s economy has been negatively impacted by decline of oil prices and devaluation of Azerbaijani Manat during 2015. This resulted in reduced access to capital, a higher cost of capital, inflation and uncertainty regarding economic growth. In response to these challenges, Azerbaijani government announced plans to accelerate reforms and support financial system. On December 6, 2016 President of the Republic of Azerbaijan approved “Strategic road maps for the national economy and main economic sectors of Azerbaijan”. The road maps cover 2016-2020 development strategy, long-term outlook up to 2025 and vision beyond.

Furthermore, during 2018 the government continued its monetary policy with respect to stability of Azerbaijani Manat as well as allocated foreign currency resources which stabilized Azerbaijani Manat. This policy continued in 2019 with the aim of maintaining macroeconomic stability.

On February 28, 2019, the President of the Republic of Azerbaijan signed a decree “On the additional measures related to the solution of problematic loans of individuals in the Republic of Azerbaijan” (“the Decree”). According to the Decree the increase in loan balances denominated in foreign currency resulted from devaluations of the national currency on February 21, 2015 and December 21, 2015 with total exposure up to USD 10 thousand in all banks had to be compensated by the government and CBAR had to provide loans to the banks with 0.1% interest rate and for 5 years under the state guarantee in order to restructure loans to individuals with overdue days more than 360 as at the date of the Decree and issued starting January 1, 2012 till the date of the Decree with exposure of up to USD 10 thousand or AZN 17 thousand.

The Company received compensation for such problematic loans from the government in the amount of USD 6,881 thousand during the year ended December 31, 2019. Additionally, the Company obtained loan from CBAR under favorable conditions in the amount of USD 5,295 thousand with 0.1% for 5 years and restructured the overdue loans in the amount of USD 6,895 thousand under the Decree.

The Company’s management is monitoring changes in macroeconomic environment and taking precautionary measures it considers necessary in order to support the sustainability and development of the Company’s business in the foreseeable future.

International credit rating agencies regularly evaluate credit rating of the Republic of Azerbaijan. Fitch and S&P evaluated rating of the Republic of Azerbaijan as “BB+”. Moody’s Investors Service set “Ba2” credit rating for the country.

The future economic growth of the Republic of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory and political developments. The Management is unable to predict, all developments in the economic environment which would have an impact on the Company’s operations and consequently what effect, if any, they could have on the financial position of the Company. The management is currently performing sensitivity analyses under different oil prices scenarios and elaborating relevant action plans for mainlining sustainability of the business.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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### 2. SIGNIFICANT ACCOUNTING POLICIES

#### **Statement of Compliance**

These financial statements for the year ended December 31, 2019 have been prepared in accordance with International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board (“IASB”) and Interpretations issued by the International Financial Reporting Interpretations Committee (“IFRIC”).

#### **Going concern**

These financial statements have been prepared on the assumption that the Company is a going concern and will continue in operation for the foreseeable future.

Management views the Company as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations of the Republic of Azerbaijan. Accordingly, assets and liabilities are recorded on the basis that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. Some financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the Company’s ability to continue as a going concern, and standards regarding matters to be considered and disclosures to be made in connection with going concern.

Management’s assessment of the going concern assumption involves making a judgment, at a particular point in time, about the future outcome of events or conditions which are inherently uncertain.

#### **Other basis of presentation criteria**

These financial statements are presented in thousands of US dollars (“USD”), unless otherwise indicated. These financial statements have been prepared under the historical cost convention, except measurement at fair value of certain financial instruments.

The Company maintains its accounting records in accordance with the laws of the Republic of Azerbaijan. These financial statements have been prepared from the statutory accounting records and have been adjusted to conform to IFRS. These adjustments include certain reclassifications to reflect the economic substance of underlying transactions including reclassifications of certain assets and liabilities, income and expenses to appropriate financial statement captions.

#### **Offsetting**

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liability simultaneously. Income and expense is not offset in the statement of profit or loss unless required or permitted by an accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Company.

#### **Financial instruments - key measurement terms.**

Depending on their classification financial instruments are carried at fair value or amortized cost as described below.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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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 best evidence of fair value is the price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the number of instruments held by the entity. This is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Valuation techniques such as discounted cash flow models or models based on recent arm's length transactions or consideration of financial data of the investees are used to measure fair value of certain financial instruments for which external market pricing information is not available. Fair value measurements are analyzed by level in the fair value hierarchy as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based on solely observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period. Refer to Note 18.

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

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

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

### **Initial recognition of financial instruments**

A financial asset or financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by either observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention (“regular way” purchases and sales) are recorded at trade date, which is the date when the Company commits to deliver a financial instrument. All other purchases and sales are recognized when the entity becomes a party to the contractual provisions of the instrument.

### **Classification of financial instruments**

A financial asset is classified as measured at: amortized cost, fair value through other comprehensive income (“FVOCI”) or fair value through profit or loss (“FVPL”).

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- 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.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- 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.

On initial recognition of an equity investment that is not held for trading, the Company may irrevocably elect to present subsequent changes in fair value in other comprehensive income. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVPL.

In addition, on initial recognition, the Company may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI at FVPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

### **Business model assessment**

The Company makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management’s strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realizing cash flows through the sale of the assets;

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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- how the performance of the portfolio is evaluated and reported to the Company’s management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Company’s stated objective for managing the financial assets is achieved and how cash flows are realized.

### **Assessment whether contractual cash flows are solely payments of principal and interest**

For the purposes of this assessment, “principal” is defined as the fair value of the financial asset on initial recognition. ‘Interest’ is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Company considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Company considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Company’s claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

### **Reclassification of financial assets**

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Company changes its business model for managing financial assets. The reclassification has a prospective effect.

### **Financial assets impairment – credit loss allowance for ECL**

The Company assesses, on a forward-looking basis, the ECL for debt instruments measured at AC and FVOCI and for the exposures arising from loan commitments and financial guarantee contracts. The Company measures ECL and recognizes credit loss allowance at each reporting date. The measurement of ECL reflects: (i) an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, (ii) time value of money and (iii) all reasonable and supportable information that is available without undue cost and effort at the end of each reporting period about past events, current conditions and forecasts of future conditions.

Debt instruments measured at AC are presented in the statement of financial position net of the allowance for ECL. For loan commitments and financial guarantees, a separate provision for ECL is recognized as a liability in the statement of financial position. For debt instruments at FVOCI, changes in amortized cost, net of allowance for ECL, are recognized in profit or loss and other changes in carrying value are recognized in OCI as gains less losses on debt instruments at FVOCI.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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The Company applies a three stage model for impairment, based on changes in credit quality since initial recognition. A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial assets in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that results from default events possible within the next 12 months or until contractual maturity, if shorter (“12 months ECL”). If the Company identifies SICR since initial recognition, the asset is transferred to Stage 2 and its ECL is measured based on ECL on a lifetime basis, that is, up until contractual maturity but considering expected prepayments, if any (“Lifetime ECL”). Refer to Note 21 for a description of how the Company determines when a SICR has occurred. If the Company determines that a financial asset is credit-impaired, the asset is transferred to Stage 3 and its ECL is measured as a Lifetime ECL. The Company’s definition of credit impaired assets and definition of default is explained in Note 21. For financial assets that are purchased or originated credit-impaired (“POCI Assets”), the ECL is always measured as a Lifetime ECL. POCI assets are financial assets that are credit-impaired upon initial recognition, such as impaired loans acquired. Note 21 provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Company incorporates forward-looking information in the ECL models.

### **Presentation of allowance for ECL in the statement of financial position**

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortized cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision;
- where a financial instrument includes both a drawn and an undrawn component, and the Company cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Company presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- debt instruments measured at FVOCI: no loss allowance is recognized in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognized in the fair value reserve.

### **Derecognition of financial assets**

The Company derecognizes financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expire or (b) the Company has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement whilst (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all the risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

### **Cash and cash equivalents**

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at AC because: (i) they are held for collection of contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL. Features mandated solely by legislation, such as the bail-in legislation in certain countries, do not have an impact on the SPPI test, unless they are included in contractual terms such that the feature would apply even if the legislation is subsequently changed.



# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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### **Loans to customers, net**

Loans to customers are recorded when the Company advances money to purchase or originate a loan due from a customer. Based on the business model and the cash flow characteristics, the Company classifies loans and advances to customers into one of the following measurement categories:

- (i) AC: loans that are held for collection of contractual cash flows and those cash flows represent SPPI and loans that are not voluntarily designated at FVTPL, and
- (ii) FVTPL: loans that do not meet the SPPI test or other criteria for AC or FVOCI are measured at FVTPL.

### **Write-off**

Financial assets are written off when the Company has no reasonable expectations of recovering the financial asset (either in its entirety or a portion of it). This is the case when the Company determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. A write-off constitutes a derecognition event. The Company may apply enforcement activities to financial assets written off. Recoveries resulting from the Company's enforcement activities will result in gain from reversal of ECL.

### **Financial liabilities and equity**

#### **Classification as debt or equity**

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

#### **Equity instruments**

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Company are recognized at the proceeds received, net of direct issue costs.

Repurchase of the Company's own equity instruments is recognized and deducted directly in equity. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Company's own equity instruments.

#### **Financial liabilities**

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in profit or loss.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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### **Borrowed funds**

Borrowed funds are initially recognized at cost, being the fair value of the consideration received, net of issue costs associated with the borrowing. After initial recognition, interest-bearing borrowings are subsequently measured at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any issue costs, and any discount or premium on settlement. Gains and losses are recognized in the income statement when the liabilities are derecognized or impaired, as well as through the amortization process.

### **IFRS 16 “Leases”**

IFRS 16 “Leases” replaces IAS 17 “Leases” along with three Interpretations (IFRIC 4 “Determining whether an Arrangement contains a Lease”, SIC 15 “Operating Leases-Incentives” and SIC 27 “Evaluating the Substance of Transactions Involving the Legal Form of a Lease”). The Company has elected not to include initial direct costs in the measurement of the right-of-use asset for operating leases in existence at the date of initial application of IFRS 16, being January 1, 2019. At this date, the Company has also elected to measure the right-of-use assets at an amount equal to the lease liability adjusted for any prepaid or accrued lease payments that existed at the date of transition. Prior periods have not been restated.

For contracts in place at the date of initial application, the Company has elected to apply the definition of a lease from IAS 17 and IFRIC 4 and has not applied IFRS 16 to arrangements that were previously not identified as lease under IAS 17 and IFRIC 4.

Instead of performing an impairment review on the right-of-use assets at the date of initial application, the Company has relied on its historic assessment as to whether leases were onerous immediately before the date of initial application of IFRS 16.

On transition, for leases previously accounted for as operating leases with a remaining lease term of less than 12 months and for leases of low-value assets the Company has applied the optional exemptions to not recognize right-of-use assets but to account for the lease expense on a straight-line basis over the remaining lease term.

For those leases previously classified as finance leases, the right-of-use asset and lease liability are measured at the date of initial application at the same amounts as under IAS 17 immediately before the date of initial application.

On transition to IFRS 16 the weighted average incremental borrowing rate applied to lease liabilities recognized under IFRS 16 was weighted average margin for government T-bills with maturity 3 years+3%.

The Company has benefited from the use of hindsight for determining lease term when considering options to extend and terminate leases.

The management of the Company utilized certain judgement in determination of lease terms, based on past history.

### **Property and equipment**

Property and equipment are stated at cost less accumulated depreciation and impairment losses.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) (in thousands of US dollars, unless otherwise indicated)

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At each reporting date the Company assesses whether there is any indication of impairment of property and equipment. If such indication exists, the Company estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. Where the carrying amount of property and equipment is greater than their estimated recoverable amount, it is written down to their recoverable amount and the difference is charged as an impairment loss to the statement of profit or loss.

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and recorded as gain/(loss) in the statement of profit or loss.

Repairs and maintenance are charged to the statement of profit or loss when the expense is incurred.

Depreciation is recognized so as to write off the cost of assets less their residual values over their useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following annual rates:

Furniture and office equipment	20-33%
Computer equipment	33%
Vehicles	20%
Other assets	20%
Right-of-use assets	over the term of the underlying lease

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

### **Intangible assets**

Intangible assets include investment into software license and its customization.

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortization and impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives. The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite useful lives that are acquired separately are carried at cost less accumulated impairment losses.

***De-recognition of intangible assets.*** An intangible asset is derecognized on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from de-recognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, and are recognized in profit or loss when the asset is derecognized.

***Impairment of tangible and intangible assets other than goodwill.*** At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). When it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

### **Repossessed collateral**

The Company obtains collateral in respect of customer liabilities where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Company a claim on these assets for both existing and future customer liabilities.

In certain circumstances, assets are repossessed following the foreclosure on loans that are in default. Repossessed collateral is initially recognized at an amount equal to the carrying amount of a loan for which it was pledged. Repossessed assets are measured at the lower of carrying amount and fair value less costs to sell.

### **Taxation**

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of profit or loss because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized.

Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

### **Recognition of interest income and expense**

Interest income and expense are recorded for debt instruments measured at amortized cost or at FVOCI on an accrual basis using the effective interest method. This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents.

## **“FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued)** *(in thousands of US dollars, unless otherwise indicated)*

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Commitment fees received by the Company to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Company will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Company does not designate loan commitments as financial liabilities at FVTPL.

For financial assets that are originated or purchased credit-impaired, the effective interest rate is the rate that discount the expected cash flows (including the initial expected credit losses) to the fair value on initial recognition (normally represented by the purchase price). As a result, the effective interest is credit-adjusted.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

- i) financial assets that have become credit-impaired (Stage 3), for which interest revenue is calculated by applying the effective interest rate to their AC (net of the ECL provision); and
- ii) financial assets that are purchased or originated credit-impaired, for which the original credit-adjusted effective interest rate is applied to the AC.

#### **Recognition of fee and commission income**

Loan origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in profit or loss over the remaining period of the loan commitment. Where a loan commitment expires without resulting in a loan, the loan commitment fee is recognized in profit or loss on expiry. Loan servicing fees are recognized as revenue as the services are provided. All other commissions are recognized when services are provided.

#### **Retirement and other benefit obligations**

In accordance with the requirements of the legislation of the Republic of Azerbaijan state pension system provides for the calculation of current payments by the employer as a percentage of current total payments to staff. This expense is charged in the period the related salaries are earned. Upon retirement all retirement benefit payments are made by pension funds selected by employees. The Company does not have any pension arrangements separate from the state pension system of the Republic of Azerbaijan. In addition, the Company has no post-retirement benefits or other significant compensated benefits requiring accrual.

#### **Operating taxes**

The Republic of Azerbaijan also has various other taxes, which are assessed on the Company's activities. These taxes are included as a component of operating expenses in the statement of profit or loss.

#### **Provisions**

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) (in thousands of US dollars, unless otherwise indicated)

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The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

### Foreign currency translation

Transactions in foreign currencies are translated to the respective functional currencies of the Company at exchange rates at the dates of the transactions.

The results and financial position of the Company are translated into the presentation currency as follows:

- a) Assets and liabilities for each statement of financial position are translated at the closing rate at the end of the respective reporting period;
- b) Income and expenses are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions);
- c) Components of equity are translated at the historic rate; and
- d) All resulting exchange differences are recognized in other comprehensive income.

When control over a foreign operation is lost, the previously recognized exchange differences on translation to a different presentation currency are reclassified from other comprehensive income to profit or loss for the year as part of the gain or loss on disposal.

The exchange rates at the year-end used by the Company in the preparation of the financial statements are as follows:

	December 31, 2019	December 31, 2018
AZN 1/USD	0.5882	0.5882
EUR /USD	1.1197	1.1452
AZN 1/USD (average rate for the year)	0.5882	0.5882

### 3. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY UNDER GOING CONCERN BASIS

The preparation of the Company’s financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the reporting date and the reported amount of income and expenses during the period ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The following estimates and judgments are considered important to the portrayal of the Company’s financial condition.

Judgements that have the most significant effect on the amounts recognized in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

# **“FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION**

## **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued)** *(in thousands of US dollars, unless otherwise indicated)*

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### **Fair value of restructured loans to customers and borrowing from CBAR under below market rate originated under the Decree**

As disclosed in Note 1 to the financial statements, the Company obtained borrowings from CBAR in the amount of USD 5,295 thousand with 0.1% annual interest rate and restructured the loans to the costumers in the amount of USD 6,895 thousand with interest rate of 1% under the Decree. Terms and conditions both for borrowings and loans originated under this Decree did not match the normal market conditions as at the initial recognition therefore the Company recognized these financial instruments at fair value utilizing the market rate for similar financial instruments. The market rate used for discounting the similar loans was 24% and 7.5% for borrowings received from CBAR.

### **Measurement of ECL allowance**

Measurement of ECLs is a significant estimate that involves determination of methodology, models and data inputs. Details of ECL measurement methodology are disclosed in Note 21. The following components have a major impact on credit loss allowance: definition of default, SICR, probability of default (“PD”), exposure at default (“EAD”), and loss given default (“LGD”), as well as models of macro-economic scenarios.

The Company regularly reviews and validates the models and inputs to the models to reduce any differences between expected credit loss estimates and actual credit loss experience. For details of ECL measurement including incorporation of forward-looking information refers to Note 21.

### **Significant increase in credit risk (“SICR”)**

In order to determine whether there has been a significant increase in credit risk, the Company compares the risk of a default occurring over the life of a financial instrument at the end of the reporting date with the risk of default at the date of initial recognition. The assessment considers relative increase in credit risk rather than achieving a specific level of credit risk at the end of the reporting period. The Company considers all reasonable and supportable forward looking information available without undue cost and effort, which includes a range of factors, including behavioral aspects of particular customer portfolios. The Company identifies behavioral indicators of increases in credit risk prior to delinquency and incorporated appropriate forward looking information into the credit risk assessment, either at an individual instrument, or on a portfolio level. Refer to Note 21.

### **Modification and derecognition of financial assets**

A modification of a financial asset occurs when the contractual terms governing the cash flows of a financial asset are renegotiated or otherwise modified between initial recognition and maturity of the financial asset. A modification affects the amount and/or timing of the contractual cash flows either immediately or at a future date.

The Company renegotiates loans to customers in financial difficulty to maximize collection and minimize the risk of default. Loan terms are modified in cases where although the borrower made all reasonable efforts to pay under the original contractual terms, there is a high risk of default or default has already happened and the borrower is expected to be able to meet the revised terms. The revised terms in most of the cases include an extension of the maturity of the loan, changes to the timing of the cash flows of the loan (principal and interest repayment), reduction in the amount of cash flows due (principal and interest forgiveness) and amendments to other terms. When a financial asset is modified, the Company assesses whether this modification results in derecognition. In accordance with the Company’s policy a modification results in derecognition when it gives rise to substantially different terms. To determine if the modified terms are substantially different from the original contractual terms the Company considers the following:

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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- Quantitative assessment is performed to compare the present value of the remaining contractual cash flows under the original terms with the contractual cash flows under the revised terms, both amounts discounted at the original EIR. If the difference in present value is greater than 10% the Company deems the arrangement is substantially different leading to derecognition.

If the terms are substantially different, the Company derecognizes the original financial asset and recognizes a ‘new’ asset at fair value and recalculates a new EIR for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Company recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognizes a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original EIR (or credit-adjusted EIR for purchased or originated credit-impaired financial assets).

The Company derecognizes a financial asset only when the contractual rights to the asset’s cash flows expire (including expiry arising from modification with substantially different terms), or when the financial asset and substantially all the risks and rewards of ownership of the asset are transferred to another entity. If the Company neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Company recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Company retains substantially all the risks and rewards of ownership of a transferred financial asset, the Company continues to recognize the financial asset.

### **Valuation of lease liabilities and right of use assets**

The application of IFRS 16 requires to make judgements of right-of-use assets and lease liabilities. In determining the lease term, the Company considers all facts and circumstances that create an economic incentive to exercise renewal options (or not to exercise termination options). Assessing whether a contract includes a lease also requires judgement. Estimates are required to determine the appropriate discount rate used to measure lease liabilities.

### **Recoverability of deferred income tax assets**

The management of the Company created valuation allowance against deferred income tax asset in the amount of USD 865 thousand and USD 218 thousand as at December 31, 2019 and 2018. The carrying value of deferred income tax assets amounted to USD 323 thousand and USD 397 thousand as at December 31, 2019 and 2018 respectively.

The management of the Company is confident that the carrying amount of deferred income tax asset will be fully realized in the future.

## **4. ADOPTION OF NEW AND REVISED STANDARDS AND INTERPRETATIONS**

In the current year, the Company 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 ended in December 31, 2019.

**IFRIC 23 “Uncertainty over Income Tax Treatments”** – addresses the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. It specifically considers:



# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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- whether tax treatments should be considered collectively;
- assumptions for taxation authorities' examinations;
- the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- the effect of changes in facts and circumstances.

**Annual Improvements to IFRS Standards 2015-2017 Cycle** – contains amendments to four International Financial Reporting Standards (IFRSs) as result of the IASB's annual improvements project.

Standard	Subject of amendment
IFRS 3 “Business Combinations” and IFRS 11 “Joint Arrangements”	The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it re-measures previously held interests in that business. The amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not re-measure previously held interests in that business.
IAS 12 “Income Taxes”	The amendments clarify that all income tax consequences of dividends (i.e. distribution of profits) should be recognized in profit or loss, regardless of how the tax arises.
IAS 23 “Borrowing Costs”	The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalization rate on general borrowings.

**Amendments to IAS 19 “Employee Benefits Plan Amendment, Curtailment or Settlement”** – The amendments clarify that the past service cost (or of the gain or loss on settlement) is calculated by measuring the defined benefit liability (asset) using updated assumptions and comparing benefits offered and plan assets before and after the plan amendment (or curtailment or settlement) but ignoring the effect of the asset ceiling (that may arise when the defined benefit plan is in a surplus position). IAS 19 is now clear that the change in the effect of the asset ceiling that may result from the plan amendment (or curtailment or settlement) is determined in a second step and is recognized in the normal manner in other comprehensive income.

The paragraphs that relate to measuring the current service cost and the net interest on the net defined benefit liability (asset) have also been amended. An entity will now be required to use the updated assumptions from this re-measurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. In the case of the net interest, the amendments make it clear that for the period post plan amendment, the net interest is calculated by multiplying the net defined benefit liability (asset) as re-measured under IAS 19.99 with the discount rate used in the re-measurement (also taking into account the effect of contributions and benefit payments on the net defined benefit liability (asset)).

The amendments are applied prospectively. They apply only to plan amendments, curtailments or settlements that occur on or after the beginning of the annual period in which the amendments to IAS 19 are first applied.

**Amendments to IAS 28 “Investments in Associations and Joint Ventures”** – The IASB has published amendments to IAS 28 regarding the long-term interest in associates and joint Ventures. According to the amendment the entity should apply IFRS 9 to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) (in thousands of US dollars, unless otherwise indicated)

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**Amendments to IFRS 9 “Financial Instruments”** – The IASB have published amendments to IFRS 9 regarding prepayment features with negative compensation and modifications of financial liabilities.

*Prepayment Features with Negative Compensation* amends the existing requirement of IFRS 9 regarding termination rights in order to allow measurement at amortized cost even in the case of negative compensation payments. The IASB also clarifies that the entity recognizes any adjustment to the amortized cost of the financial liability arising from a modification or exchange in profit or loss at the date of modification or exchange.

**IFRS 16 “Leases”**, which specifies how and IFRS reporter recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16’s approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

The Company has chosen the application of IFRS 16 in accordance with IFRS 16:C5 (b), i.e., retrospectively, with the cumulative effect of initially applying the Standard recognized at the date of initial application. Consequently, the Company will not restate the comparative information instead will recognize the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings at the date of initial application.

In contrast to lessee accounting, IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. The Company might be affected by application of new standard as a Lessee. IFRS 16 may change how the Company accounts for leases previously classified as operating leases under IAS 17, which were off balance sheet. On initial application of IFRS 16, for all leases (except as noted below), the Company adopts to:

- a. Recognize right of use assets and lease liabilities in the statement of financial position, initially measured at the present value of the future lease payments;
- b. Recognize depreciation of right of use assets and interest on lease liabilities in the statement of profit or loss and other comprehensive income;
- c. Separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the cash flow statement.

Lease incentives (e.g. rent free period) are recognized as part of the measurement of the right of use assets and lease liabilities whereas under IAS 17 they resulted in the recognition of a lease liability incentive, amortized as a reduction of rental expenses on a straight-line basis.

Under IFRS 16, right of use assets are tested for impairment in accordance with IAS 36 *Impairment of Assets*. This will replace the previous requirement to recognize a provision for onerous lease contracts.

For short-term leases (lease term of 12 months or less) and leases of low value assets (such as personal computers and office furniture), the Company opted to recognize a lease expense on a straight line basis as permitted by IFRS 16.

The Company has evaluated the effects of application of this standard and made changes on its financial statements.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

The following is a reconciliation of total operating lease commitments at December 31, 2018 to the lease liabilities recognized at January 1, 2019:

	<b>December 31, 2019</b>
Total operating lease commitments disclosed at December 31, 2018	281
Discounted using incremental borrowing rate	<u>(36)</u>
Total lease liabilities recognized under IFRS 16 at January 1, 2019	<u><u>245</u></u>

The effect of adoption IFRS 16 on the financial statements as at January 1, 2019 was as follows:

	Carrying value as at December 31, 2018	Re- measurement	Carrying value per IFRS 16 as at January 1, 2019
Right-of-use assets	-	270	270
Lease liability	-	(245)	(245)
Other assets	26	(25)	1

### 5. STANDARDS AND INTERPRETATIONS ISSUED AND NOT YET ADOPTED

At the date of authorization of these financial statements, other than the Standards and Interpretations adopted by the Company in advance of their effective dates, the following Interpretations were in issue but not yet effective.

**IFRS 3 Business Combinations. Amendment of the definition of “Business”** – The amendments will help companies determine whether an acquisition made is of a business or a group of assets.

The amended definition emphasizes that the output of a business is to provide goods and services to customers, whereas the previous definition focused on returns in the form of dividends, lower costs or other economic benefits to investors and others. Distinguishing between a business and a group of assets is important because an acquirer recognizes goodwill only when acquiring a business.

According to the amendment new definition a “business” is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

Companies are required to apply the amended definition of a business to acquisitions that occur on or after January 1, 2020. Earlier application is permitted.

**New definition of “Material”** – The IASB has issued amendments to its definition of material to make it easier for companies to make materiality judgements. The updated definition amends IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS Standards. According to the new definition, information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

The changes are effective from January 1, 2020. Earlier application is permitted.

IASB has published “**Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)**” as a first reaction to the potential effects the IBOR reform could have on financial reporting. The changes in Interest Rate Benchmark Reform will:

- modify specific hedge accounting requirements so that entities would apply those hedge accounting requirements assuming that the interest rate benchmark on which the hedged cash flows and cash flows from the hedging instrument are based will not be altered as a result of interest rate benchmark reform;
- are mandatory for all hedging relationships that are directly affected by the interest rate benchmark reform;
- are not intended to provide relief from any other consequences arising from interest rate benchmark reform (if a hedging relationship no longer meets the requirements for hedge accounting for reasons other than those specified by the amendments, discontinuation of hedge accounting is required); and
- require specific disclosures about the extent to which the entities’ hedging relationships are affected by the amendments.

The amendments are to be effective for annual periods beginning on or after January 1, 2020 and must be applied retrospectively. Early application is permitted.

**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.

**Amendments to IAS 1 to clarify the classification of liabilities** – In January 2020 the IASB has issued “**Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)**” providing a more general approach to the classification of liabilities under IAS 1 based on the contractual arrangements in place at the reporting date. The amendments in Classification of Liabilities as Current or Non-Current (Amendments to IAS 1) affect only the presentation of liabilities in the statement of financial position — not the amount or timing of recognition of any asset, liability income or expenses, or the information that entities disclose about those items.

The amendments are effective for annual reporting periods beginning on or after January 1, 2022 and are to be applied retrospectively. Earlier application is permitted.

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**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 re-measurement 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.

**6. CASH AND CASH EQUIVALENTS**

	December 31, 2019	December 31, 2018
Cash on hand	6	8
Current accounts with resident banks	4,704	1,586
Term placements with resident banks	2,942	-
Current accounts with non-resident banks	-	239
Cash in transit	70	48
<b>Total cash and cash equivalents</b>	<b>7,722</b>	<b>1,881</b>

For the purpose of ECL measurement cash and cash equivalents balances are included in Stage 1. The ECL for these balances represents an insignificant amount; therefore the Company did not recognize any credit loss allowance for cash and cash equivalents.

**7. LOANS TO CUSTOMERS**

	December 31, 2019	December 31, 2018
Agriculture loans	4,256	1,175
Service loans	1,879	810
Trade loans	1,479	1,432
Other loans	175	149
<b>Gross loans to customers</b>	<b>7,789</b>	<b>3,566</b>
Less: allowance for expected credit loss	(634)	(1,314)
<b>Total loans to customers, net</b>	<b>7,155</b>	<b>2,252</b>

As at December 31, 2019 and 2018, all loans are granted to customers operating in the Republic of Azerbaijan, which represents a significant geographical concentration in one region.

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As disclosed in Note 1 to the financial statements, the Company received compensation from the government in the amount of USD 6,881 thousand for the problematic loans under the Decree during the year ended December 31, 2019. Additionally, the Company restructured loans in amount of USD 6,895 thousand under the Decree with 1% of interest and 5 years of maturity. Before restructuring these loans were either written off or presented in Stage 3. The restructured loans were also granted with 1 year of grace period for payment of principal amount as stipulated in the Decree. As the modification of terms of these loans were substantially different from their original conditions, the Company applied derecognition approach regarding these loans. These loans were recognized as new loans at initial recognition with fair value of USD 225 thousand taking into account prevailing market rate of 24% and classified as POCI. The Company recognized gain in the amount of USD 225 thousand from modification and at initial recognition of these loans.

For the purpose of excepted credit loss, the Company groups its loans into small and large customers. The following tables disclose the movements in the gross carrying amounts of loans to customers between the beginning and the end of the reporting periods:

	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL)	Stage 3 (lifetime ECL-impaired)	Purchased or originated credit- impaired (POCI)	Total
<i>Large loans to customers</i>					
<b>As at January 1, 2019</b>	<b>4</b>	<b>1,006</b>	<b>1,967</b>	<b>-</b>	<b>2,977</b>
Transfer from Stage 1 to Stage 2	(472)	472	-	-	-
Transfer from Stage 2 to Stage 1	765	(765)	-	-	-
Transfer from Stage 2 to Stage 3	-	(406)	406	-	-
Transfer from Stage 3 to Stage 2	-	36	(36)	-	-
New financial instruments originated or purchased	4,676	80	1,655	120	6,531
Other movements	(1,253)	(362)	(2,720)	-	(4,335)
Write-offs	-	-	(734)	-	(734)
<b>As at December 31, 2019</b>	<b>3,720</b>	<b>61</b>	<b>538</b>	<b>120</b>	<b>4,439</b>

**“FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION**

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	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL)	Stage 3 (lifetime ECL-impaired)	Purchased or originated credit- impaired (POCI)	Total
<i>Small loans to customers</i>					
<b>As at January 1, 2019</b>	<b>141</b>	<b>160</b>	<b>288</b>	<b>-</b>	<b>589</b>
Transfer from Stage 1 to Stage 2	(232)	232	-	-	-
Transfer from Stage 2 to Stage 1	217	(217)	-	-	-
Transfer from Stage 2 to Stage 3	-	(77)	77	-	-
Transfer from Stage 3 to Stage 2	-	7	(7)	-	-
New financial instruments originated or purchased	6,063	10	619	105	6,797
Other movements	(3,070)	(65)	(825)	-	(3,960)
Write-offs	-	-	(76)	-	(76)
<b>As at December 31, 2019</b>	<b>3,119</b>	<b>50</b>	<b>76</b>	<b>105</b>	<b>3,350</b>

	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL)	Stage 3 (lifetime ECL-impaired)	Total
<i>Large loans to customers</i>				
<b>As at January 1, 2018</b>	<b>577</b>	<b>4,411</b>	<b>2,570</b>	<b>7,558</b>
Transfer from Stage 1 to Stage 2	(152)	152	-	-
Transfer from Stage 2 to Stage 1	79	(79)	-	-
Transfer from Stage 2 to Stage 3	-	(1,354)	1,354	-
Transfer from Stage 3 to Stage 2	-	16	(16)	-
New financial instruments originated or purchased	186	1,066	229	1,481
Other movements	(686)	(3,206)	(1,071)	(4,963)
Write-offs	-	-	(1,099)	(1,099)
<b>As at December 31, 2018</b>	<b>4</b>	<b>1,006</b>	<b>1,967</b>	<b>2,977</b>

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	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL)	Stage 3 (lifetime ECL-impaired)	Total
<i>Small loans to customers</i>				
<b>As at January 1, 2018</b>	<b>222</b>	<b>1,412</b>	<b>726</b>	<b>2,360</b>
Transfer from Stage 1 to Stage 2	(39)	39	-	-
Transfer from Stage 2 to Stage 1	13	(13)	-	-
Transfer from Stage 2 to Stage 3	-	(406)	406	-
Transfer from Stage 3 to Stage 2	-	8	(8)	-
New financial instruments originated or purchased	187	321	39	547
Other movements	(242)	(1,201)	(336)	(1,779)
Write-offs	-	-	(539)	(539)
<b>As at December 31, 2018</b>	<b>141</b>	<b>160</b>	<b>288</b>	<b>589</b>

The following tables disclose the movements in the credit loss allowance amounts of loans to customers between the beginning and the end of the reporting periods:

	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL)	Stage 3 (lifetime ECL-impaired)	Purchased or originated credit- impaired (POCI)	Total
<i>Large loans to customers</i>					
<b>As at January 1, 2019</b>	<b>-</b>	<b>182</b>	<b>975</b>	<b>-</b>	<b>1,157</b>
Transfer from Stage 1 to Stage 2	(68)	100	-	-	32
Transfer from Stage 2 to Stage 1	85	(136)	-	-	(51)
Transfer from Stage 2 to Stage 3	-	(133)	155	-	22
Transfer from Stage 3 to Stage 2	-	7	(24)	-	(17)
New financial instruments originated or purchased	91	8	362	-	461
Other movements	(48)	(16)	(1,181)	-	(1,245)
Recoveries of loans previously written-off	-	-	911	-	911
Unwinding of discount	-	-	12	-	12
Write-offs	-	-	(734)	-	(734)
<b>As at December 31, 2019</b>	<b>60</b>	<b>12</b>	<b>476</b>	<b>-</b>	<b>548</b>



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	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL)	Stage 3 (lifetime ECL-impaired)	Purchased or originated credit- impaired (POCI)	Total
<i>Small loans to customers</i>					
<b>As at January 1, 2019</b>	<b>1</b>	<b>24</b>	<b>132</b>	<b>-</b>	<b>157</b>
Transfer from Stage 1 to Stage 2	(13)	23	-	-	10
Transfer from Stage 2 to Stage 1	13	(27)	-	-	(14)
Transfer from Stage 2 to Stage 3	-	(21)	27	-	6
Transfer from Stage 3 to Stage 2	-	1	(4)	-	(3)
New financial instruments originated or purchased	42	-	28	-	70
Other movements	(24)	2	(648)	-	(670)
Recoveries of loans previously written-off	-	-	601	-	601
Unwinding of discount	-	-	5	-	5
Write-offs	-	-	(76)	-	(76)
<b>As at December 31, 2019</b>	<b>19</b>	<b>2</b>	<b>65</b>	<b>-</b>	<b>86</b>

	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL)	Stage 3 (lifetime ECL-impaired)	Total
<i>Large loans to customers</i>				
<b>As at January 1, 2018</b>	<b>13</b>	<b>742</b>	<b>1,066</b>	<b>1,821</b>
Transfer from Stage 1 to Stage 2	(7)	15	-	8
Transfer from Stage 2 to Stage 1	3	(14)	-	(11)
Transfer from Stage 2 to Stage 3	-	(424)	501	77
Transfer from Stage 3 to Stage 2	-	4	(7)	(3)
New financial instrument originated or purchased	3	69	65	137
Other movements	(12)	(210)	(2,048)	(2,270)
Recoveries of loans previously written-off	-	-	2,441	2,441
Unwinding of discount (recognized in interest income)	-	-	56	56
Write-offs	-	-	(1,099)	(1,099)
<b>As at December 31, 2018</b>	<b>-</b>	<b>182</b>	<b>975</b>	<b>1,157</b>

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	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL)	Stage 3 (lifetime ECL-impaired)	Total
<i>Small loans to customers</i>				
<b>As at January 1, 2018</b>	<u>4</u>	<u>169</u>	<u>265</u>	<u>438</u>
Transfer from Stage 1 to Stage 2	(1)	2	-	1
Transfer from Stage 2 to Stage 1	-	(3)	-	(3)
Transfer from Stage 2 to Stage 3	-	(105)	135	30
Transfer from Stage 3 to Stage 2	-	2	(4)	(2)
New financial instrument originated or purchased	2	13	3	18
Other movements	(4)	(54)	(552)	(610)
Recoveries of loans previously written-off	-	-	824	824
Unwinding of discount (recognized in interest income)	-	-	-	-
Write-offs	-	-	(539)	(539)
<b>As at December 31, 2018</b>	<u>1</u>	<u>24</u>	<u>132</u>	<u>157</u>

The tables below show the credit quality analysis of the Company’s loans to customers as at December 31, 2019 and 2018. Explanation of the terms 12-month ECL and lifetime ECL is disclosed in Note 21. Credit quality in the table below is based on the scale developed internally by the Company. The scale is described in Note 21.

	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL)	Stage 3 (lifetime ECL- impaired)	Purchased or originated credit- impaired (POCI)	Total
<i>Large loans to customers</i>					
Current	3,697	-	7	30	3,734
Past due 1-30 days	23	35	2	18	78
Past due 31-60 days	-	15	2	11	28
Past due 61-90 days	-	11	2	4	17
Past due more than 90 days	-	-	525	57	582
<b>Total gross loans to customers</b>	<u>3,720</u>	<u>61</u>	<u>538</u>	<u>120</u>	<u>4,439</u>
Less: Expected credit losses	(60)	(12)	(476)	-	(548)
<b>Total net loans to customers as at December 31, 2019</b>	<u>3,660</u>	<u>49</u>	<u>62</u>	<u>120</u>	<u>3,891</u>

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	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL)	Stage 3 (lifetime ECL- impaired)	Purchased or originated credit- impaired (POCI)	Total
<i>Small loans to customers</i>					
Current	3,115	-	-	24	3,139
Past due 1-30 days	4	34	1	10	49
Past due 31-60 days	-	8	1	4	13
Past due 61-90 days	-	8	1	6	15
Past due more than 90 days	-	-	73	61	134
<b>Total gross loans to customers</b>	<b>3,119</b>	<b>50</b>	<b>76</b>	<b>105</b>	<b>3,350</b>
Less: Expected credit losses	(19)	(2)	(65)	-	(86)
<b>Total net loans to customers as at December 31, 2019</b>	<b>3,100</b>	<b>48</b>	<b>11</b>	<b>105</b>	<b>3,264</b>

	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL)	Stage 3 (lifetime ECL- impaired)	Total
<i>Large loans to customers</i>				
Current	4	574	-	578
Past due 1-30 days	-	245	-	245
Past due 31-60 days	-	99	-	99
Past due 61-90 days	-	88	44	132
Past due more than 90 days	-	-	1,923	1,923
<b>Total gross loans to customers</b>	<b>4</b>	<b>1,006</b>	<b>1,967</b>	<b>2,977</b>
Less: Expected credit losses	-	(182)	(975)	(1,157)
<b>Total net loans to customers as at December 31, 2018</b>	<b>4</b>	<b>824</b>	<b>992</b>	<b>1,820</b>

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	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL)	Stage 3 (lifetime ECL- impaired)	Total
<i>Small loans to customers</i>				
Current	140	67	-	207
Past due 1-30 days	1	52	-	53
Past due 31-60 days	-	28	-	28
Past due 61-90 days	-	13	-	13
Past due more than 90 days	-	-	288	288
<b>Total gross loans to customers</b>	<b>141</b>	<b>160</b>	<b>288</b>	<b>589</b>
Less: Expected credit losses	(1)	(24)	(132)	(157)
<b>Total net loans to customers as at December 31, 2018</b>	<b>140</b>	<b>136</b>	<b>156</b>	<b>432</b>

*Collateralization of loans.* The table below summarizes carrying value of loans to customers analyzed by type of collateral obtained by the Company:

	December 31, 2019	December 31, 2018
Unsecured loans	2,727	632
Loans collateralized by guarantee	4,889	2,309
Loans collateralized by pledge of inventories	92	282
Loans collateralized by pledge of real estate	41	235
Loans collateralized by pledge equipment	20	55
Loans collateralized by pledge of motor vehicles	16	44
Loans collateralized by households	4	9
<b>Gross loans to customers</b>	<b>7,789</b>	<b>3,566</b>
Less: allowance for expected credit loss	(634)	(1,314)
<b>Total loans to customers, net</b>	<b>7,155</b>	<b>2,252</b>

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**8. PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS**

	Furniture and office equipment	Computer equipment	Other assets	Total property and Equipment	Intangible assets	Total property, equipment and intangible assets
<b>At initial cost</b>						
<b>January 1, 2018</b>	551	539	179	1,269	2,273	3,542
Additions	-	18	-	18	1	19
Disposals	(198)	(81)	(62)	(341)	-	(341)
<b>December 31, 2018</b>	353	476	117	946	2,274	3,220
Additions	20	96	15	131	4	135
Disposals	(124)	(160)	(24)	(308)	(166)	(474)
<b>December 31, 2019</b>	249	412	108	769	2,112	2,881
<b>Accumulated depreciation</b>						
<b>January 1, 2018</b>	498	506	151	1,155	2,271	3,426
Depreciation charge	14	18	13	45	3	48
Eliminated on disposals	(193)	(80)	(62)	(335)	-	(335)
<b>December 31, 2018</b>	319	444	102	865	2,274	3,139
Depreciation charge	19	29	7	55	1	56
Eliminated on disposals	(111)	(160)	(19)	(290)	(166)	(456)
<b>December 31, 2019</b>	227	313	90	630	2,109	2,739

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	Furniture and office equipment	Computer equipment	Other assets	Total property and equipment	Intangible assets	Total property, equipment and intangible assets
<b>Net book value</b>						
<b>As at December 31, 2019</b>	<u>22</u>	<u>99</u>	<u>18</u>	<u>139</u>	<u>3</u>	<u>142</u>
<b>As at December 31, 2018</b>	<u>34</u>	<u>32</u>	<u>15</u>	<u>81</u>	<u>-</u>	<u>81</u>

As at December 31, 2019 and 2018 included in property, equipment and intangible assets were fully depreciated assets totalling USD 2,612 thousand and USD 2,963 thousand, respectively.

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**9. RIGHT-OF-USE ASSETS**

	Office buildings	Total right-of- use assets
At initial cost		
January 1, 2019	<u>270</u>	<u>270</u>
Additions	<u>228</u>	<u>228</u>
December 31, 2019	<u>498</u>	<u>498</u>
Accumulated depreciation		
January 1, 2019	<u>-</u>	<u>-</u>
Depreciation charge	<u>(147)</u>	<u>(147)</u>
December 31, 2019	<u>(147)</u>	<u>(147)</u>
Net book value		
December 31, 2019	<u><u>351</u></u>	<u><u>351</u></u>
January 1, 2019	<u><u>270</u></u>	<u><u>270</u></u>

**10. OTHER ASSETS**

Other assets comprise:

	December 31, 2019	December 31, 2018
<b>Other financial assets:</b>		
Settlement receivables	46	-
Other financial assets	<u>-</u>	<u>11</u>
<b>Total other financial assets</b>	<u>46</u>	<u>11</u>
<b>Other non-financial assets:</b>		
Prepayments for services	97	53
Prepaid taxes other than income tax	75	117
Reposessed collaterals*	52	91
Prepaid rents	<u>-</u>	<u>26</u>
<b>Total other non-financial assets</b>	<u>224</u>	<u>287</u>
<b>Total other assets</b>	<u>270</u>	<u>298</u>

\*As at December 31, 2019 and 2018, the fair value of reposessed collaterals approximates to USD 52 thousand and USD 91 thousand, respectively. During the year ended December 31, 2019 the Company recognized loss on change of fair value of reposessed collaterals in the amount of USD 39 thousand (2018: nil).

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	December 31, 2019	December 31, 2018
Residential property	42	71
Business property	<u>10</u>	<u>20</u>
<b>Total repossessed collaterals</b>	<b><u>52</u></b>	<b><u>91</u></b>

Management of the Company intends to sell these assets, however no active program to locate a buyer and complete plan have been initiated as at the date of report.

**11. BORROWED FUNDS**

	December 31, 2019	December 31, 2018
Loan from Central Bank of the Republic of Azerbaijan	<u>4,138</u>	<u>-</u>
<b>Total borrowed funds</b>	<b><u>4,138</u></b>	<b><u>-</u></b>

The Company received borrowings from CBAR in the amount of USD 5,295 thousand with annual interest rate of 0.1% per annum for 5 years under the Decree. The interest rate of borrowings received from the CBAR for the purpose of financing the restructured loans were below market rate as at the date of origination, therefore the Company recognized gain in the amount of USD 1,131 thousand at initial recognition of these borrowings. The fair value of these borrowings at initial recognition was USD 4,164 thousand.

In accordance with the agreement signed between the Company and the Ministry of Finance of Azerbaijan who act as a guarantor on behalf of the Republic of Azerbaijan, the Company paid a guarantee fee in the amount of 0.5% of received borrowings.

A reconciliation of the opening and closing amounts of borrowed funds with relevant cash and non-cash changes from financing activities is stated below:

	Amount
<b>January 1, 2018</b>	<b>5,973</b>
<b>Cash flows</b>	
Repayment	<u>(6,540)</u>
<b>Non-cash changes</b>	
Interest expense	566
Other changes	<u>1</u>
<b>December 31, 2018</b>	<b><u>-</u></b>
<b>Cash flows</b>	
Proceeds	5,295
Transaction costs paid	<u>(26)</u>
<b>Non-cash changes</b>	
Fair value adjustment at initial recognition	<u>(1,131)</u>
<b>December 31, 2019</b>	<b><u>4,138</u></b>



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**12. LEASE LIABILITIES**

	December 31, 2019	January 1, 2019	December 31, 2018
Current lease liabilities	182	80	-
Non-current lease liabilities	<u>173</u>	<u>165</u>	<u>-</u>
<b>Total lease liabilities</b>	<b><u>355</u></b>	<b><u>245</u></b>	<b><u>-</u></b>

Future minimum lease payments as at January 1, 2019 were as follows:

	Minimum lease payments due		
	Within one year	One to five years	Total
Lease payments	104	177	281
Finance charges	<u>(24)</u>	<u>(12)</u>	<u>(36)</u>
<b>Net present value as at January 1, 2019</b>	<b><u>80</u></b>	<b><u>165</u></b>	<b><u>245</u></b>

Future minimum lease payments as at December 31, 2019 were as follows:

	Minimum lease payments due		
	Within one year	One to five years	Total
Lease payments	211	192	403
Finance charges	<u>(29)</u>	<u>(19)</u>	<u>(48)</u>
<b>Net present value as at December 31, 2019</b>	<b><u>182</u></b>	<b><u>173</u></b>	<b><u>355</u></b>

A reconciliation of the opening and closing amounts of lease liabilities with relevant cash and non-cash changes from financing activities is stated below:

	Amount
<b>January 1, 2019</b>	<b>245</b>
<b>Cash flows</b>	
Repayment of principal	(92)
Interest paid	<u>(34)</u>
<b>Non-cash changes</b>	
New leases	202
Interest expense	<u>34</u>
<b>December 31, 2019</b>	<b><u>355</u></b>

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**13. OTHER LIABILITIES**

Other liabilities comprise:

	December 31, 2019	December 31, 2018
<b>Other financial liabilities:</b>		
Payable to employees	232	140
Professional service fee payable	100	112
Service fee payable to a related party	45	23
Compensation payables to customers	22	-
Severance payable to employees	-	24
Others	14	3
	<u>413</u>	<u>302</u>
<b>Total other financial liabilities</b>		
<b>Other non-financial liabilities:</b>		
Taxes other than income tax payable	11	81
Others	52	50
	<u>63</u>	<u>131</u>
<b>Total other non-financial liabilities</b>		
<b>Total other liabilities</b>	<u>476</u>	<u>433</u>

**14. NET INTEREST INCOME**

	Year ended December 31, 2019	Year ended December 31, 2018
<b>Interest income on financial assets recorded at amortized cost</b>		
- interest income from loans to customers	962	569
- interest income from deposit placed with bank	54	-
	<u>1,016</u>	<u>569</u>
<b>Total interest income on financial assets recorded at amortized</b>		
<b>Interest expense on financial liabilities recorded at amortized cost</b>		
- interest expense on lease liabilities	(34)	-
- interest expense on borrowed funds	-	(566)
	<u>(34)</u>	<u>(566)</u>
<b>Total interest expense on financial liabilities recorded at amortized cost</b>		
<b>Net interest income</b>	<u>982</u>	<u>3</u>

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**15. ADMINISTRATIVE AND OTHER OPERATING EXPENSES**

Administrative and other operating expenses comprise the following items:

	Year ended December 31, 2019	Year ended December 31, 2018
Wages and salaries	1,447	967
Allowances, incentives and other benefits	412	481
Compulsory social security obligations	275	355
Depreciation and amortization	203	48
Professional fees	157	491
Consumables and office supply	89	18
IT professional fees	79	77
Communication expenses	69	55
Business trip expenses	54	39
Marketing expenses	41	8
Bank charges	39	45
Taxes, other than income tax	22	3
Vehicle running costs	13	5
Rent expenses	1	139
Others	27	13
	<u>2,928</u>	<u>2,744</u>
<b>Total administrative and other operating expenses</b>	<b><u>2,928</u></b>	<b><u>2,744</u></b>

**16. INCOME TAXES**

The Company measures and records its current income tax payable and its tax bases in its assets and liabilities in accordance with the tax regulations of the Republic of Azerbaijan where the Company operates, which may differ from IFRS.

The Company is subject to certain permanent tax differences due to the non-tax deductibility of certain expenses and certain income being treated as non-taxable for tax purposes.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

Temporary differences as at December 31, 2019 and 2018 relate mostly to different methods/timing of income and expense recognition as well as to temporary differences generated by tax – book bases’ differences for certain assets.

The tax rate used for the reconciliations below is the corporate tax rate of 20% payable by corporate entities in the Republic of Azerbaijan on taxable profits (as defined) under tax law in that jurisdiction.

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	December 31, 2019	December 31, 2018
Deferred income tax assets/(liabilities) in relation to:		
Loans to customers, net	693	81
Tax loss carried forward	592	344
Other assets	134	137
Property and equipment and intangible assets	113	125
Other liabilities	81	28
Lease liabilities	71	-
Borrowed funds	(226)	-
Provision for tax losses	(200)	(100)
Right-of-use assets	(70)	-
Not recognized deferred tax asset	(865)	(218)
<b>Net deferred income tax asset</b>	<b>323</b>	<b>397</b>

When estimating the deductible difference for loans to customers the Company has analyzed the following circumstances:

- in accordance with tax legislation of the Republic of Azerbaijan impairment loss for a loan to customer is a non-deductible expense;
- losses arising from sale of loan to customer is a deductible expense;
- the Company plans to start selling its non-performing loans to third parties and it is currently developing respective strategies.

The effective tax rate reconciliation is as follows for the years ended December 31, 2019 and 2018:

	Year ended December 31, 2019	Year ended December 31, 2018
Profit/(loss) before income tax	6,592	(93)
Tax at the statutory tax rate (20%)	(1,318)	19
Change in not recognized deferred income tax assets	(647)	362
Tax effect of permanent differences	1,891	(205)
<b>Income tax (expense)/benefit</b>	<b>(74)</b>	<b>176</b>
Deferred income tax (expense)/benefit	(74)	176
<b>Income tax (expense)/benefit</b>	<b>(74)</b>	<b>176</b>
	<b>December 31, 2019</b>	<b>December 31, 2018</b>
<b>As at year beginning – deferred income tax assets</b>	<b>397</b>	<b>221</b>
Change in deferred income tax balances	(74)	176
<b>As at year end – deferred income tax assets</b>	<b>323</b>	<b>397</b>

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**17. TRANSACTIONS WITH RELATED PARTIES**

Related parties or transactions with related parties, as defined by IAS 24 “Related party disclosures”, represent:

- (a) Parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Company (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Company that gives them significant influence over the Company; and that have joint control over the Company;
- (b) Associates – enterprises on which the Company has significant influence and which is neither a subsidiary nor a joint venture of the investor;
- (c) Joint ventures in which the Company is a venture;
- (d) Members of key management personnel of the Company or its parent;
- (e) Close members of the family of any individuals referred to in (a) or (d);
- (f) Parties that are entities controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
- (g) Post-employment benefit plans for the benefit of employees of the Company, or of any entity that is a related party of the Company.

The Company’s policy does not allow issuing loans to employees, board members, their family members and close relatives, and other persons involved in the management, control or supervision of the Company. The Company had the following transactions outstanding as at December 31, 2019 and 2018 with related parties:

	December 31, 2019		December 31, 2018	
	Related party balances	Total category as per financial statements caption	Related party balances	Total category as per financial statements caption
<b>Other liabilities</b>		476		433
- Parent	45		23	

Included in the statement of comprehensive income for the years ended December 31, 2019 and 2018 are the following amounts which arose due to transactions with related parties:

	Year ended December 31, 2019		Year ended December 31, 2018	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
<b>Key management personnel compensation</b>		2,134		1,803
- short-term employee benefits	450		768	

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	Year ended December 31, 2019		Year ended December 31, 2018	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
<b>Administrative and other operating expenses (excluding staff related costs)</b>		794		941
<i>- the Parent</i>	108		99	

**18. COMMITMENTS AND CONTINGENCIES**

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk in order to meet the needs of its customers. These instruments, involving varying degrees of credit risk, are not reflected in the statement of financial position.

The Company’s uses the same credit control and management policies in undertaking off-balance sheet commitments as it does for on-balance operations.

The Company is received from customers and counterparties. Management is of the opinion that no material un-accrued losses will be incurred and accordingly no provision has been made in these financial statements.

**Taxation** – Laws and regulations affecting business in the Republic of Azerbaijan continue to change rapidly. Management’s interpretation of such legislation as applied to the activity of the Company may be challenged by the relevant regional authorities. Recent events suggest that the tax authorities are taking a more assertive position in their interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. Fiscal periods generally remain open to tax audit by the authorities in respect of taxes for three calendar years preceding the year of tax audit. Under certain circumstances reviews may cover longer periods.

The taxation system in the Republic of Azerbaijan continues to evolve and is characterized by frequent changes in legislation, official pronouncements and court decisions, which are sometimes contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities who have the authority to impose severe fines, penalties and interest charges. A tax year remains open for review by the tax authorities during the three subsequent calendar years; however, under certain circumstances a tax year may remain open longer. Recent events within the Azerbaijan Republic suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation.

These circumstances may create tax risks in Azerbaijan that are substantially more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Azerbaijan tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on the financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) (in thousands of US dollars, unless otherwise indicated)

### 19. FAIR VALUE OF FINANCIAL INSTRUMENT

IFRS defines fair value as 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.

#### Fair value hierarchy

The Company measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements:

- **Level 1:** quoted market price (unadjusted) in an active market for an identical instrument.
- **Level 2:** inputs other than quotes prices included within Level 1 that are observable either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- **Level 3:** inputs that are unobservable. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument’s valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

As at December 31, 2019 and 2018 the Company had no financial instruments measured at fair value.

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorized.

	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)	
<b>Assets for which fair values are disclosed</b>					
Cash and cash equivalents	December 31, 2019	7,722	-	-	7,722
Loans to customers, net	December 31, 2019	-	-	7,155	7,155
Other financial assets	December 31, 2019	-	-	46	46
<b>Liabilities for which fair values are disclosed</b>					
Borrowed funds	December 31, 2019	-	-	4,138	4,138
Lease liabilities	December 31, 2019	-	-	355	355
Other financial liabilities	December 31, 2019	-	-	413	413

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

	Date of valuation	Quoted prices in active markets (Level 1)	Fair value measurement using		Total
			Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
<b>Assets for which fair values are disclosed</b>					
Cash and cash equivalents	December 31, 2018	1,881	-	-	1,881
Loans to customers, net	December 31, 2018	-	-	2,252	2,252
Other financial assets	December 31, 2018	-	-	11	11
<b>Liabilities for which fair values are disclosed</b>					
Other financial liabilities	December 31, 2018	-	-	302	302

### 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 Company'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.

### Assets and liabilities 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, without a specific maturity and variable rate financial instruments.

### Fixed and variable rate financial instruments

For quoted debt instruments the fair values are determined based on quoted market prices. The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

## 20. CAPITAL RISK MANAGEMENT

The Company manages its capital to ensure that the Company will be able to continue as a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance. According to the verdict # 01/2 para 4.3.1 of the Central Bank of the Republic of Azerbaijan dated on January 21, 2015 and the requirement of the Financial Markets Supervision Chamber, the Company has to meet the minimum regulatory total capital requirement of AZN 300 thousand.

Management's focus in respect of the Company's capital management has the following objectives: ensuring the Company's ability to operate as a going concern and maintain balances in order to comply with covenants of lenders and investors. This is exercised daily in respect of the projected and actual data and on the basis of monthly reports with the corresponding calculations that are verified and signed by the management board and chief accountant of the Company.



# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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### 21. RISK MANAGEMENT POLICIES

Management of risk is fundamental to the Company’s banking business and is an essential element of the Company’s operations.

The main risks inherent to the Company’s operations are those related to:

- Credit exposures;
- Liquidity risk;
- Market risk.

The Company recognizes that it is essential to have efficient and effective risk management processes in place. To enable this, the Company has established a risk management framework, whose main purpose is to protect the Company from risk and allow it to achieve its performance objectives.

**Structure of risk management.** The Management Board is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

**Management board.** The Management Board is responsible for the overall risk management approach and for approving the risk strategies and principles.

**Audit committee.** On a quarterly basis, the Audit Committee examines reports related to risk issues presented by Internal Audit and follows measures undertaken by the management to resolve discovered issues. The Audit Committee is also involved in discussion of findings discovered by external auditors.

**Other Committees.** In order to provide additional measures in terms of risk management, permanent working committees are created within the Company:

- Asset and Liability Management Committee (“ALMC”) – the committee reviews every month the projected liquidity for the following 12 months. Liquidity forecasts are based on expected loan disbursement levels, expected funding plans and other expected cash movements. ALMC takes decisions related to new borrowings, sets open currency position and counterparty limits for operations with banks and financial institutions, monitors covenants with lenders, examines issues related to maturities of assets and liabilities, and gives recommendations to the Finance Department concerning the elimination of divergences.
- Credit Departments – the departments evaluate quality of loans of the Company and prepares recommendations concerning allowances for impairment and provisions. Credit Department supervises the realization of methodology concerning credit risk management, takes measures towards credit risk minimization and makes decisions concerning operations bearing credit risk. This department places credit limits for branches, performs analysis and controls credit risk.

**Finance department.** Finance department is responsible for day-to-day management of assets and liabilities of the Company, computation and planning of liquidity position of the Company, redistribution of cash and cash equivalents between operating sites of the Company. The Finance Department controls the application of limits and liquidity ratios set by ALMC and the implementation of decisions taken by ALMC in regard to liquidity risk optimisation.

**Internal audit.** Internal Audit performs an independent review of the risk management process, informs management about the revealed shortcomings, and gives appropriate recommendations concerning the improvement of the risk management process.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) (in thousands of US dollars, unless otherwise indicated)

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**Risk measurement and reporting systems.** The choice of the risk management method depends on risk factors, which determine the relative importance or probability of the risks, which may adversely affect the financial position of the Company. The Company not only analyses and measures each risk separately, but also determines the level of cumulative risks. Thus, for each kind of risk, the following methods of risk measurement are applied:

- credit risk analysis of a credit portfolio and credit risk ratios;
- off-balance sheet risk;
- interest-rate risk maturity and interest rate gap analysis of assets and liabilities;
- liquidity risk gap analysis of payments in local and foreign currencies; analysis of liquidity ratios, determination of liquidity reserve;
- currency risk gap analysis of payments in foreign currency; analysis of currency position;
- operational risk for all operations having impact on the Company’s financial position, systems assuring separation of activities (such as initiation, execution and control) necessary for the finalisation of operations have been implemented.

Risk measurement methods reflect expected loss, which the Company might incur when performing its activities. Every month, based on the analysis of the separate risks, the Finance Department prepares conclusions concerning the current state of the risks, and their main drivers.

In particular, at the monthly ALMC, the status of the interest rate, liquidity, currency, and other market risks are reported.

The status of functional risks (operational – technological, legal, strategic, reputation risk) is also reported to Management Board each month. These reports are examined at the Management Board and Audit Committee meetings held each quarter.

**Risk mitigation.** The Company uses the following methods, *inter alia*, for risk minimisation:

- Reception of guarantees and collateral for credit risk mitigation;
- Diversification – selection of assets, which are not connected between each other.

### **Credit risk**

#### **Credit risk measurement for loans to customers**

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. For risk management reporting purposes, the Company considers and consolidates loan size as an element of credit risk exposure. The Company measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring ECL under IFRS 9.

#### **Expected credit loss measurement**

IFRS 9 outlines a ‘three-stage’ model for impairment based on changes in credit quality since initial recognition as summarized below:

- A financial instrument that is not credit-impaired on initial recognition is classified in ‘Stage 1’ and has its credit risk continuously monitored by the Company;

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## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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- If a significant increase in credit risk (SICR) since initial recognition is identified, the financial instrument is moved to ‘Stage 2’ but is not yet deemed to be credit-impaired;
- If the financial instrument is credit-impaired, the financial instrument is then moved to ‘Stage 3’;
- Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis;
- A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information;
- Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition. Their ECL is always measured on a lifetime basis (Stage 3).

### **Significant increase in credit risk**

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Company considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Company’s historical experience and expert credit assessment and including forward-looking information. The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- The remaining lifetime PD as at the reporting date; with
- The remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

The Company uses three criteria for determining whether there has been a significant increase in credit risk:

- Quantitative test based on movement in PD;
- Forbearance status; and
- A backstop of 30 days past due.

“Forbearance” occurs upon restructuring, i.e. prolongation in payment terms of payment of interest or principal arising from a deterioration of a borrower’s financial condition such that it is not the same as it was at the time of loan origination and a borrower has applied for a change in the payment schema of the loan. Restructuring only occurs when the appropriate division of the Company is reasonably confident that a borrower is able to service the renewed payment schedule.

Multiple economic scenarios form the basis of determining the PD at initial recognition and at subsequent reporting dates. Different economic scenarios will lead to a different PD. It is the weighting of these different scenarios that forms the basis of a weighted average PD that is used to determine whether credit risk has significantly increased. Forward-looking information includes the future prospects of Azerbaijan economy obtained from economic expert reports, financial analysts, governmental bodies, relevant think-tanks and other similar organizations, as well as consideration of various internal and external sources of actual and forecast economic information.

### **Definition of default**

Critical to the determination of ECL is the definition of default. The definition of default is used in measuring the amount of ECL and in the determination of whether the loss allowance is based on 12-month or lifetime ECL, as default is a component of the probability of default (PD) which affects both the measurement of ECLs and the identification of a significant increase in credit risk.

# “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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The Company considers the following as constituting an event of default:

- The contract is past due more than 90 days; or
- The credit obligations reflected in the contract is unlikely to be paid to the Company in full.

The definition of default is appropriately tailored to reflect different characteristics of different types of assets. When assessing if the borrower is unlikely to pay its credit obligation, the Company takes into account both qualitative and quantitative indicators. Quantitative indicators, such as overdue status and non-payment on another obligation of the same counterparty are key inputs in this analysis. The Company uses a variety of sources of information to assess default which are either developed internally or obtained from external sources.

The following diagram summarizes the impairment requirements under IFRS 9 (other than purchased or originated credit-impaired financial assets):

<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>
(Initial recognition)	(Significant increase in credit risk since initial recognition)	(Credit-impaired assets)
12-month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

Credit-impaired assets in Stage 3 undergo a probationary period of 6 months after the material credit obligations of the Contract are met before moving to Stage 2.

### **Write-off**

When periodic collective historical recovery analysis indicates that the Company does not expect significant additional recoveries after certain months in default (“MID”), it is the policy of the Company to write-off loans on a collective basis.

Amount outstanding on financial assets that were written off during the reporting period and are still subject to enforcement activity is USD 810 thousand.

### **Grouping with similar credit risk characteristics**

Financial assets are split into three segments for the purposes of PD calculation:

- Small (for loan amounts up to USD 2,000);
- Large (for loan amounts greater than USD 2,001).

The segments above reflect the level of assessment of client creditworthiness, with the large segment exhibiting a comparatively stricter assessment. The historical default rate is utilized as an indicator of strictness, such that the difference in default rates is maximized between the segments.

### **Rating Model**

All available information (product groups, industries, etc.) are used to derive internal ratings for each segment. In such a way groups with the same risk characteristics are created and used afterwards to adjust the PD curve of the segment.

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**Significant increase in credit risk**

The Company considers a financial instrument to have experienced a significant increase in credit risk when the remaining Lifetime PD at the reporting date has increased by 20%, compared to the residual Lifetime PD expected at the reporting date when the exposure was first recognized.

The following table shows the impact on the December 31, 2019 and 2018 ECL allowance of changing the PD thresholds for SICR. Increases in ECL (positive amounts) represent higher impairment allowances that would be recognized.

ECL sensitivity on the threshold for PD change	Actual threshold applied (%)	Change in threshold (+%)	Change in threshold (-%)	Impact on December 31, 2019 ECL		
				Lower threshold	No change	Higher threshold
SMALL	150				86	
LARGE	150				548	

ECL sensitivity on the threshold for PD change	Actual threshold applied (%)	Change in threshold (+%)	Change in threshold (-%)	Impact on December 31, 2018 ECL		
				Lower threshold	No change	Higher threshold
SMALL	200				157	
LARGE	200				1,157	

**Measurement of ECL**

The key inputs into the measurement of ECL are the term structure of the following variables:

- Probability of default (PD);
- Loss given default (LGD);
- Exposure at default (EAD).

These parameters are generally derived from internally developed statistical models and other historical data.

**Probability of default (PD)**

The PD represents the likelihood of a borrower defaulting on its financial obligation (as per “Definition of default and credit-impaired” above), either over the next 12 months (12M PD) or over the remaining lifetime (Lifetime PD) of the obligation.

The Lifetime PD is developed by applying a maturity profile to the current 12M PD. The maturity profile looks at how defaults develop on a portfolio from the point of initial recognition throughout the lifetime of the loans. The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and credit grade band. This is supported by historical analysis.

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Probability of Default is modeled by survival function, which is based on hazard rates.

Hazard rates are obtained by Cox proportional-hazards model, which is a semi-parametric model, it uses assumed simple form for effect of covariates and the exact value of free parameters is estimated with partial likelihood. The baseline is obtained by non-parametrical methods. A macroeconomic overlay can be directly included into the hazard function through a time-dependent variable. From obtained hazard rates, then Point-in-Time (“PiT”) PD is derived, i.e. marginal PDs assigned to a respective date.

Observation period for modeling cox hazard rates is 5 years.

Set out below are the changes to the ECL as at December 31, 2019 and 2018 that would result from reasonably possible changes in the macroeconomic parameter from the actual assumptions used in the Company’s economic variable assumptions.

		<b>2019</b>		
Macro parameter used		GDP		
% change of macro parameter for the sensitivity test		50%		
		+ 50%	No change	-50%
SMALL		85	86	87
LARGE		547	548	549
<b>Total</b>		<b>632</b>	<b>634</b>	<b>636</b>

		<b>2018</b>		
Macro parameter used		GDP		
% change of macro parameter for the sensitivity test		50%		
		+ 50%	No change	-50%
SMALL		157	157	158
LARGE		1,156	1,157	1,158
<b>Total</b>		<b>1,313</b>	<b>1,314</b>	<b>1,316</b>

**Loss given default (LGD)**

LGD is the magnitude of the likely loss if there is a default. The Company estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD model considers cash recoveries only. LGD is calculated on a discounted cash flow basis using the EIR as the discounting factor.

Secured loans utilize collateral values, whereas unsecured and guaranteed loans are using recovery rates.

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**Exposure at default (EAD)**

EAD is based on the amounts the Company expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD).

**Incorporation of forward-looking information**

The Company incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL.

The Company has identified and documented the key drivers of credit risk and credit losses for the portfolio using an analysis of historical data, has assessed the impact of macro-economic variables on PD and recovery rate. The macro-economic variable which was involved in the analysis is a real growth rate of GDP.

**Maximum exposure of credit risk.** The Company’s maximum exposure to credit risk varies significantly and is dependent on both individual risks and general market economy risks.

The following table presents the maximum exposure to credit risk of balance sheet and off balance sheet financial assets. For financial assets in the balance sheet, the maximum exposure is equal to the carrying amount of those assets prior to any offset or collateral. The Company’s maximum exposure to credit risk under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

Maximum exposure of credit risk table is as below:

	Maximum exposure	Collateral pledged	Net exposure
<b>December 31, 2019</b>			
Cash at banks	7,646	-	7,646
Loans to customers	7,155	-	7,155
Other financial assets	46	-	46
<b>December 31, 2018</b>			
Cash at banks	1,825	-	1,825
Loans to customers	2,252	-	2,252
Other financial assets	11	-	11

**Analysis of collateral and other credit enhancements**

The Company closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Company will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

	Gross carrying amount	Loss allowance	Amortized Cost	Fair value of collateral
<b>December 31, 2019</b>				
Loan portfolio in default (Stage 3)				
Small loans	76	(65)	11	-
Large loans	538	(476)	62	-
<b>Total</b>	<b>614</b>	<b>(541)</b>	<b>73</b>	<b>-</b>

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December 31, 2018	Gross carrying amount	Loss allowance	Amortized Cost	Fair value of collateral
Loan portfolio in default (Stage 3)				
Small loans	288	(132)	156	-
Large loans	<u>1,967</u>	<u>(975)</u>	<u>992</u>	<u>-</u>
<b>Total</b>	<b><u>2,255</u></b>	<b><u>(1,107)</u></b>	<b><u>1,148</u></b>	<b><u>-</u></b>

The following tables stratify credit exposures from loans to customers by ranges of loan-to-value (LTV) ratio. LTV is calculated as the ratio of the gross amount of the loan – or the amount committed for loan commitments – to the value of the collateral. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral.

The following table shows the distribution of LTV ratios for the Company’s credit-impaired portfolio of small loans:

Loan to Value (LTV) ratio	2019			
	Total loan portfolio		Credit impaired loan portfolio (stage 3)	
	Gross carrying amount	Loss allowance	Gross carrying amount	Loss allowance
No Collateral	<u>3,350</u>	<u>(86)</u>	<u>76</u>	<u>(65)</u>
<b>Total</b>	<b><u>3,350</u></b>	<b><u>(86)</u></b>	<b><u>76</u></b>	<b><u>(65)</u></b>

Loan to Value (LTV) ratio	2018			
	Total loan portfolio		Credit impaired loan portfolio (stage 3)	
	Gross carrying amount	Loss allowance	Gross carrying amount	Loss allowance
No Collateral	<u>589</u>	<u>(157)</u>	<u>288</u>	<u>(132)</u>
<b>Total</b>	<b><u>589</u></b>	<b><u>(157)</u></b>	<b><u>288</u></b>	<b><u>(132)</u></b>

The following table shows the distribution of LTV ratios for the Company’s credit-impaired portfolio of large loans:

Loan to Value (LTV) ratio	2019			
	Total loan portfolio		Credit impaired loan portfolio (stage 3)	
	Gross carrying amount	Loss allowance	Gross carrying amount	Loss allowance
No Collateral	<u>4,439</u>	<u>(548)</u>	<u>538</u>	<u>(476)</u>
<b>Total</b>	<b><u>4,439</u></b>	<b><u>(548)</u></b>	<b><u>538</u></b>	<b><u>(476)</u></b>



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	2018			
	Total loan portfolio		Credit impaired loan portfolio (stage 3)	
Loan to Value (LTV) ratio	Gross carrying amount	Loss allowance	Gross carrying amount	Loss allowance
No Collateral	2,977	(1,157)	1,967	(975)
<b>Total</b>	<b>2,977</b>	<b>(1,157)</b>	<b>1,967</b>	<b>(975)</b>

**Off-balance sheet risk.** The Company applies fundamentally the same risk management policies for off-balance sheet risks as it does for its on-balance sheet risks. In the case of commitments to lend, customers and counterparties will be subject to the same credit management policies as for loans and advances. Collateral may be sought depending on the strength of the counterparty and the nature of the transaction.

**Geographical concentration.** The geographical concentration of the Company’s financial assets and liabilities as at December 31, 2019 is set out below:

	The Republic of Azerbaijan	OECD countries	Non-OECD countries	Total
Cash and cash equivalents	7,722	-	-	7,722
Loans to customers, net	7,155	-	-	7,155
Other financial assets	46	-	-	46
<b>Total financial assets</b>	<b>14,923</b>	<b>-</b>	<b>-</b>	<b>14,923</b>
Borrowed funds	4,138	-	-	4,138
Lease liabilities	355	-	-	355
Other financial liabilities	304	107	2	413
<b>Total financial liabilities</b>	<b>4,797</b>	<b>107</b>	<b>2</b>	<b>4,906</b>
<b>Net position</b>	<b>10,126</b>	<b>(107)</b>	<b>(2)</b>	<b>10,017</b>

The geographical concentration of the Company’s financial assets and liabilities as at December 31, 2018 is set out below:

	The Republic of Azerbaijan	OECD countries	Non-OECD countries	Total
Cash and cash equivalents	1,642	239	-	1,881
Loans to customers, net	2,252	-	-	2,252
Other financial assets	11	-	-	11
<b>Total financial assets</b>	<b>3,905</b>	<b>239</b>	<b>-</b>	<b>4,144</b>
Borrowed funds	-	-	-	-
Other financial liabilities	202	76	24	302
<b>Total financial liabilities</b>	<b>202</b>	<b>76</b>	<b>24</b>	<b>302</b>
<b>Net position</b>	<b>3,703</b>	<b>163</b>	<b>(24)</b>	<b>3,842</b>

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## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) (in thousands of US dollars, unless otherwise indicated)

**Market risk.** Market risk is that the risk that the Company’s earnings or capital or its ability to meet business objectives will be adversely affected by changes in the level or volatility of market rates or prices.

Market risk covers interest rate risk, currency risk, credit spreads, commodity prices and equity prices that the Company is exposed to. There have been no changes as to the way the Company measures risk or to the risk it is exposed or the manner in which these risks are managed and measured.

The Company is exposed to interest rate risks as entities in the Company borrow funds at both fixed and floating rates. The risk is managed by the Company maintaining an appropriate mix between fixed and floating rate borrowings.

The ALMC also manages interest rate and market risks by matching the Company’s interest rate position, which provides the Company with a positive interest margin. The Finance Department conducts monitoring of the Company’s current financial performance, estimates the Company’s sensitivity to changes in interest rates and its influence on the Company’s profitability.

Some of the Company’s financial liabilities that bear interest are either variable or contain clauses enabling the interest rate to be changed at the option of the lender. The Company monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

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

The ALMC controls currency risk by management of the open currency position on the estimated basis of USD fluctuation and other macroeconomic indicators, which gives the Company an opportunity to minimize losses from significant currency rates fluctuations toward its national currency.

The Company is exposed to effects of fluctuation in the prevailing foreign currency exchange rates on its financial position and cash flows.

As at December 31, 2019, the Company’s exposure to foreign currency exchange rate risk is as follows:

	AZN	USD	EUR	Total
Cash and cash equivalents	6,688	1,034	-	7,722
Loans to customers, net	7,127	28	-	7,155
Other financial assets	46	-	-	46
<b>Total financial assets</b>	<b>13,861</b>	<b>1,062</b>	<b>-</b>	<b>14,923</b>
Borrowed funds	4,138	-	-	4,138
Lease liabilities	355	-	-	355
Other financial liabilities	399	14	-	413
<b>Total financial liabilities</b>	<b>4,892</b>	<b>14</b>	<b>-</b>	<b>4,906</b>
<b>OPEN POSITION</b>	<b>8,969</b>	<b>1,048</b>	<b>-</b>	<b>10,017</b>

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As at December 31, 2018, the Company’s exposure to foreign currency exchange rate risk is as follows:

	AZN	USD	EUR	Total
Cash and cash equivalents	401	1,478	2	1,881
Loans to customers, net	1,918	334	-	2,252
Other financial assets	11	-	-	11
<b>Total financial assets</b>	<b>2,330</b>	<b>1,812</b>	<b>2</b>	<b>4,144</b>
Borrowed funds	-	-	-	-
Other financial liabilities	202	100	-	302
<b>Total financial liabilities</b>	<b>202</b>	<b>100</b>	<b>-</b>	<b>302</b>
<b>OPEN POSITION</b>	<b>2,128</b>	<b>1,712</b>	<b>2</b>	<b>3,842</b>

The following table details the Company’s sensitivity to a 10% increase and decrease in the AZN against the relevant foreign currencies as at December 31, 2019 and 2018, respectively. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management’s assessment of the reasonably possible change in foreign exchange rates.

	2019	
	Effect on profit or loss before taxation	Effect on equity
USD appreciation by 10%	105	84
USD depreciation by 10%	(105)	(84)
	<u>          </u>	<u>          </u>
	2018	
	Effect on profit or loss before taxation	Effect on equity
USD appreciation by 10%	171	137
USD depreciation by 10%	(171)	(137)
	<u>          </u>	<u>          </u>

**Interest rate risk.** Interest rate risk arises from the possibility that changes in interest rates will affect the fair value of the financial instruments or the future cash flows on financial instruments. The Company’s interest rate policy is reviewed periodically by the Management Board in order to place and attract funds based on market conditions. Interest rate risk is managed principally through monitoring interest rate gaps.

The Company manages fair value interest rate risk through periodic estimation of potential losses that could arise from adverse changes in market conditions. The Finance Department conducts monitoring of the Company’s current financial performance, estimates the Company’s sensitivity to changes in fair value interest rates and its influence on the Company’s profitability.

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## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) *(in thousands of US dollars, unless otherwise indicated)*

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The sensitivity analyses below have been determined based on the exposure to interest rates for financial instruments at the end of the reporting period. A 50 (0.5%) basis points increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management’s assessment of the reasonably possible change in interest rates.

If interest rates had been 50 (0.5%) basis points higher/lower and all other variables were held constant, the Company’s:

	2019		2018	
	Effect on profit or loss before taxation	Effect on equity	Effect on profit or loss before taxation	Effect on equity
Interest rate increase on 0.5%	28	22	11	9
Interest rate decrease on 0.5%	(28)	(22)	(11)	(9)

**Limitations of sensitivity analysis.** The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Company’s view of possible near-term market changes that cannot be predicted with any certainty; and the assumption that all interest rates move in an identical fashion.

**Liquidity risk.** Liquidity risk refers to the availability of sufficient funds to meet financial commitments associated with financial instruments as they actually fall due. In order to manage liquidity risk, the Company performs daily monitoring of existing cash balances and monthly analysis of future expected cash flows on clients’ and other financial operations, which is a part of assets/liabilities management process.

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The table below shows the expected maturity analysis as at December 31, 2019:

	Up to 1 month	1 month to 3 months	3 month to 6 months	7 month to 1 year	1 year to 5 years	Maturity undefined/ Overdue	December 31, 2019 Total
<b>FINANCIAL ASSETS</b>							
Interest rate instruments	-	2,942	-	-	-	-	2,942
Cash and cash equivalents	382	3,421	566	1,256	1,342	188	7,155
Loans to customers, net							
<b>Total fixed interest bearing financial assets</b>	<b>382</b>	<b>6,363</b>	<b>566</b>	<b>1,256</b>	<b>1,342</b>	<b>188</b>	<b>10,097</b>
Non-interest bearing financial assets							
Cash and cash equivalents	4,780	-	-	-	-	-	4,780
Other financial assets	46	-	-	-	-	-	46
<b>Total non-interest bearing financial assets</b>	<b>4,826</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>4,826</b>
<b>Total financial assets</b>	<b>5,208</b>	<b>6,363</b>	<b>566</b>	<b>1,256</b>	<b>1,342</b>	<b>188</b>	<b>14,923</b>
<b>FINANCIAL LIABILITIES</b>							
Interest rate instruments	-	-	-	-	-	-	-
Borrowed funds	-	-	-	-	4,138	-	4,138
Lease liabilities	26	12	41	103	173	-	355
<b>Total fixed interest bearing financial liabilities</b>	<b>26</b>	<b>12</b>	<b>41</b>	<b>103</b>	<b>4,311</b>	<b>-</b>	<b>4,493</b>
Non-interest bearing financial liabilities							
Other financial liabilities	170	100	-	-	-	143	413
<b>Total non-interest bearing financial liabilities</b>	<b>170</b>	<b>100</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>143</b>	<b>413</b>
<b>Total financial liabilities and commitments</b>	<b>196</b>	<b>112</b>	<b>41</b>	<b>103</b>	<b>4,311</b>	<b>143</b>	<b>4,906</b>
Liquidity gap	5,012	6,251	525	1,153	(2,969)	45	10,017
<b>Cumulative liquidity gap</b>	<b>5,012</b>	<b>11,263</b>	<b>11,788</b>	<b>12,941</b>	<b>9,972</b>	<b>10,017</b>	

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The table below shows the expected maturity analysis as at December 31, 2018:

	Up to 1 month	1 month to 3 months	3 month to 6 months	7 month to 1 year	1 year to 5 years	Maturity undefined/ Overdue	December 31, 2018 Total
<b>FINANCIAL ASSETS</b>							
Interest rate instruments							
Loans to customers, net	128	168	257	319	401	979	2,252
<b>Total fixed interest bearing financial assets</b>	<b>128</b>	<b>168</b>	<b>257</b>	<b>319</b>	<b>401</b>	<b>979</b>	<b>2,252</b>
Non-interest bearing financial assets							
Cash and cash equivalents	1,881	-	-	-	-	-	1,881
Other financial assets	11	-	-	-	-	-	11
<b>Total non-interest bearing financial assets</b>	<b>1,892</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,892</b>
<b>Total financial assets</b>	<b>2,020</b>	<b>168</b>	<b>257</b>	<b>319</b>	<b>401</b>	<b>979</b>	<b>4,144</b>
<b>FINANCIAL LIABILITIES</b>							
Non-interest bearing financial liabilities							
Other financial liabilities	60	76	-	-	-	166	302
<b>Total non-interest bearing financial liabilities</b>	<b>60</b>	<b>76</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>166</b>	<b>302</b>
<b>Total financial liabilities and commitments</b>	<b>60</b>	<b>76</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>166</b>	<b>302</b>
Liquidity gap	1,960	92	257	319	401	813	3,842
<b>Cumulative liquidity gap</b>	<b>1,960</b>	<b>2,052</b>	<b>2,309</b>	<b>2,628</b>	<b>3,029</b>	<b>3,842</b>	

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**Maturity analysis of undiscounted financial liabilities.** The following tables detail the Company’s remaining contractual maturity for its financial liabilities with agreed repayment periods. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Company can be required to pay.

The tables include both interest and principal cash flows. To the extent that interest flows are floating rate, the undiscounted amount is derived from interest rate curves at the end of the reporting period. The contractual maturity is based on the earliest date on which the Company may be required to pay.

The table below shows the maturity analysis of undiscounted financial liabilities as at December 31, 2019:

FINANCIAL LIABILITIES	Up to 1 month	1 month to 3 months	3 month to 6 months	7 month to 1 year	1 year to 5 years	Maturity undefined	December 31, 2019 Total
Interest rate instruments	-	-	-	6	4,151	-	4,157
Borrowed funds	27	12	41	103	172	-	355
Lease liabilities	27	12	41	109	4,323	-	4,512
Total fixed interest bearing financial liabilities							
Non-interest bearing financial liabilities	170	100	-	-	-	143	413
Other financial liabilities	170	100	-	-	-	143	413
Total non-interest bearing financial liabilities	197	112	41	109	4,323	143	4,925
<b>Total financial liabilities and commitments</b>							

The table below shows the maturity analysis of undiscounted financial liabilities as at December 31, 2018:

FINANCIAL LIABILITIES	Up to 1 month	1 month to 3 months	3 month to 6 months	7 month to 1 year	1 year to 5 years	Maturity undefined	December 31, 2019 Total
Non-interest bearing financial liabilities	60	76	-	-	-	166	302
Other financial liabilities	60	76	-	-	-	166	302
Total non-interest bearing financial liabilities	60	76	-	-	-	166	302
<b>Total financial liabilities and commitments</b>							

## “FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued) (in thousands of US dollars, unless otherwise indicated)

**Credit ratings analysis.** The following table details credit ratings of financial assets held by the Company that are neither past due nor impaired:

December 31, 2019	BB-	B1	Ba3	Ba2	Not rated	Total
Cash at banks	6,577	34	744	-	291	7,646
Loans to customers, net	-	-	-	-	7,155	7,155
Other financial assets	-	-	-	46	-	46
December 31, 2018	AA-	B3	Ba3	Ba2	Not rated	Total
Cash at banks	239	52	1,499	-	35	1,825
Loans to customers, net	-	-	-	-	2,252	2,252
Other financial assets	-	-	-	-	11	11

The Company enters into numerous transactions where the counterparties are not rated by international rating agencies. The Company has developed internal models, which allow it to determine the rating of counterparties, which are comparable to rating of international rating agencies.

A model of the borrower’s scoring assessment has been developed in the Company to assess and decide on loans customers. The scoring model is developed relating to loan products and includes key performance indicators of borrowers: financial situation, relations with the borrower, management quality, target use, location, credit history, collateral, etc.

The scoring assessment based on the borrower’s parameters is one of the main factors for the decision-making process relating to loans.

A methodology of evaluation of borrowers is based on following criteria: education, occupancy, financial position, credit history, property owned by the borrower. Based on information obtained the maximum limit of a loan is calculated. The maximum limit of a loan is calculated using a ratio of debt pressure on a borrower.

Financial assets other than loans to customers are graded according to the current credit rating they have been issued by an internationally regarded agency such as Fitch, Standard & Poor’s and Moody’s be advised that rating titles and therefore rating meanings are different from agency to agency. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

**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 Company cannot expect to eliminate all operational risks, but it endeavors to manage these risks through a control framework and by monitoring and responding to potential risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes.

## 22. EVENTS AFTER THE REPORTING DATE

On January 31, 2020 the Central Bank of the Republic of Azerbaijan decided to reduce the refinancing rate from 7.50% to 7.25%, the ceiling of the interest rate corridor from 9.25% to 9.00% and the floor from 5.75% to 5.50%.



## **“FINCA AZERBAIJAN” LIMITED LIABILITY NON-BANKING CREDIT ORGANIZATION**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019 (Continued)** *(in thousands of US dollars, unless otherwise indicated)*

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In late 2019 the coronavirus outbreak occurred in Wuhan, China. The situation at December 31, 2019 was limited in number of reported cases and geography and therefore this event was considered as non-adjusted event for the financial reporting purposes under IFRS. However, after January 2020 the situation changed drastically, and in March 2020 the World Health Organization (WHO) announced that the coronavirus outbreak can be characterized as a pandemic.

Many governments, including the government of the Republic of Azerbaijan have introduced various measures to combat the outbreak, including travel restrictions, quarantines, closure of business and other venues and lockdown of certain area. These measures have affected the global supply chain as well as demand for goods and services and resulted in significant disruption to business operations and a significant increase in economic uncertainty, with more volatile asset prices and currency exchange rates, and a marked decline in long-term interest rates in developed economies. These government responses and their corresponding effects are still evolving.

In addition to slowdown in world economy, oil prices have declined dramatically after OPEC and Russia were unable to agree on production cuts at their March 2020 meeting. These events and conditions create a level of uncertainty and risk that companies may not have encountered before, and may result in significant financial reporting implications.

Currently, the management is working on action plans under different scenarios of future developments. The Company management estimates that if the current situation does not improve in the nearest future, the Company might go to certain loan restructuring with their customers.