# STATE CONTRACT CORPORATION OF THE REPUBLIC OF AZERBAIJAN "AZERKONTRAKT" OPEN JOINT-STOCK COMPANY

**Special-Purpose Financial Statements and Independent Auditors' Report**
For the Year Ended December 31, 2022

## STATE CONTRACT CORPORATION OF THE REPUBLIC OF AZERBAIJAN "AZERKONTRAKT" OPEN JOINT-STOCK COMPANY

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

The following statement is made with a view to distinguishing respective responsibilities of the management and those of the independent auditors in relation to the special-purpose financial statements of State Contract Corporation of the Republic of Azerbaijan "Azerkontrakt" Open Joint-Stock Company (the "Company").

Management is responsible for the preparation of the special-purpose financial statements that present fairly the financial position of the Company as at December 31, 2022, the results of its operations, changes in equity and cash flows for the year then ended, in accordance with the basis of accounting as described in Note 3 to these special-purpose financial statements.

In preparing the special-purpose financial statements, management is responsible for:

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

Management is also responsible for:

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

The special-purpose financial statements for the year ended December 31, 2022 were authorized for issue on May 22, 2023 by the Management of the Company.

**On behalf of the Management:**

Azərbaycan Respublikasi Dövlət Kontrakt Korporasiyasi «AZƏRKONTRAKT» Səhmdar Cəmiyyəti

**Guladdin Dadashov**
**Deputy Director**

May 22, 2023
Baku, the Republic of Azerbaijan

**Shahnisa Nuriyeva**
**ActingHead of Finance Division**

May 22, 2023
Baku, the Republic of Azerbaijan

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## INDEPENDENT AUDITORS' REPORT

To the Management of the State Contract Corporation of the Republic of Azerbaijan "Azerkontrakt" Open Joint-Stock Company:

### *Opinion*

We have audited the special-purpose financial statements of State Contract Corporation of the Republic of Azerbaijan "Azerkontrakt" Open Joint-Stock Company (the "Company"), which comprise the special-purpose statement of financial position as at December 31, 2022 and the special-purpose statements of profit or loss and other comprehensive income, special-purpose statements of changes in equity and special-purpose statements of cash flows for the year then ended and notes to the special-purpose financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying special-purpose financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2022 and its financial performance and its cash flows for the year then ended December 31, 2022 in accordance with the basis of accounting as described in Note 3 to special-purpose financial statements.

### *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 Special-Purpose 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 the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### *Emphasis of Matter – Basis of Accounting and Restriction on Distribution and Use*

We draw attention to Note 3 to the special-purpose financial statements, which describes the basis of accounting. The special-purpose financial statements are prepared to assist the Company in evaluation of the financial position and operational results of the Company. As a result, the special-purpose financial statements may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

### *Responsibilities of Management and Those Charged with Governance for the Special-Purpose Financial Statements*

Management is responsible for the preparation and fair presentation of the special-purpose financial statements in accordance with the basis of accounting as described in Note 3 to these special-purpose financial statements and for such internal control as management determines is necessary to enable the preparation of special-purpose financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the special-purpose 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.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

***Auditors' Responsibilities for the Audit of the Special-Purpose Financial Statements***

Our objectives are to obtain reasonable assurance about whether the special-purpose 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 special-purpose 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 special-purpose 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 special-purpose 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 special-purpose financial statements, including the disclosures, and whether the special-purpose 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

May 22, 2023
Baku, the Republic of Azerbaijan

## STATE CONTRACT CORPORATION OF THE REPUBLIC OF AZERBAIJAN "AZERKONTRAKT" OPEN JOINT-STOCK COMPANY

### SPECIAL-PURPOSE STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2022
*(In Azerbaijani Manats)*

| | Notes | Year ended December 31, 2022 | Year ended December 31, 2021 |
|---|---|---|---|
| Revenue from sales of natural gas | 8 | 1,674,714,984 | 1,200,043,556 |
| **Operating expenses** | | | |
| Cost of natural gas | | (1,408,609,477) | (1,025,813,907) |
| Transportation expenses | | (74,645,875) | (59,393,046) |
| Cost of delivery of natural gas into underground gas storage | | (13,677,899) | (15,416,624) |
| Cost of taking of natural gas from underground gas storage | | (11,276,986) | (4,023,950) |
| Losses related to underground gas storage | | (7,261,374) | (5,667,953) |
| Losses on transportation | | (4,793,219) | (3,608,201) |
| Technological consumption | | (1,948,934) | (3,076,673) |
| Employee related expenses | | (1,157,683) | (64,909) |
| Transit fees | | (59,112) | (3,115,710) |
| **Total operating expenses** | | **(1,523,430,559)** | **(1,120,180,973)** |
| **Other income/(expenses)** | | | |
| Income from transportation of natural gas | | 34,774,305 | 25,623,036 |
| Interest income | | 1,361,374 | - |
| Interest expense | | (825,038) | (745,403) |
| Other income/(expenses), net | 9 | (1,377,729) | (370,390) |
| **Profit before income tax** | | **185,217,337** | **104,369,826** |
| Income tax expense | 10 | (37,113,668) | (20,873,965) |
| **Net profit for the year** | | **148,103,669** | **83,495,861** |
| **TOTAL COMPREHENSIVE INCOME FOR THE YEAR** | | **148,103,669** | **83,495,861** |

**On behalf of the Management:**

**Guladdin Dadashov**
**Deputy Director**

May 22, 2023
Baku, the Republic of Azerbaijan

**Shahnisa Nuriyeva**
**Acting Head of Finance Division**

May 22, 2023
Baku, the Republic of Azerbaijan

Azərbaycan Respublikası Dövlət Kontrakt Korporasiyası «AZƏRKONTRAKT» Səhmdar Cəmiyyəti

The selected explanatory notes on pages 8 to 38 form an integral part of these special-purpose financial statements.

## STATE CONTRACT CORPORATION OF THE REPUBLIC OF AZERBAIJAN "AZERKONTRAKT" OPEN JOINT-STOCK COMPANY

### SPECIAL-PURPOSE STATEMENT OF FINANCIAL POSITION AS AT DECEMBER 31, 2022

*(In Azerbaijani Manats)*

| | Notes | December 31, 2022 | December 31, 2021 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets:** | | | |
| Cash and cash equivalents | 11 | 205,903,189 | 91,897,090 |
| Trade receivables | 12 | 76,069,182 | 37,854,374 |
| Advances paid to suppliers | 13 | 34,747,582 | 438,153 |
| Inventories | 14 | 185,409,430 | 182,226,113 |
| Other current assets | 15 | 70,209,494 | 45,912,576 |
| **Total current assets** | | **572,338,877** | **358,328,306** |
| **Non-current assets** | | | |
| Property and equipment | 16 | 346,389 | - |
| Deferred tax assets | 10 | 15,345 | 49,158 |
| **Total non-current assets** | | **361,734** | **49,158** |
| **TOTAL ASSETS** | | **572,700,611** | **358,377,464** |
| **LIABILITIES AND EQUITY** | | | |
| LIABILITIES: | | | |
| **Current liabilities:** | | | |
| Trade and other payables | 17 | 341,092,046 | 181,188,165 |
| Borrowings | 18 | - | 93,684,403 |
| **Total current liabilities** | | **341,092,046** | **274,872,568** |
| **TOTAL LIABILITIES** | | **341,092,046** | **274,872,568** |
| **EQUITY:** | | | |
| Share capital | 19 | 13,538,682 | 13,538,682 |
| Other capital | 20 | (13,538,682) | (13,538,682) |
| Retained earnings | | 231,608,565 | 83,504,896 |
| **Total equity** | | **231,608,565** | **83,504,896** |
| **TOTAL LIABILITIES AND EQUITY** | | **572,700,611** | **358,377,464** |

**On behalf of the Management:**

**Guladdin Dadashov**
**Deputy Director**

May 22, 2023
Baku, the Republic of Azerbaijan

**Shahnisa Nuriyeva**
**Acting Head of Finance Division**

May 22, 2023
Baku, the Republic of Azerbaijan

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## STATE CONTRACT CORPORATION OF THE REPUBLIC OF AZERBAIJAN "AZERKONTRAKT" OPEN JOINT-STOCK COMPANY

### SPECIAL-PURPOSE STATEMENT OF CHANGES IN EQUITY
### FOR THE YEAR ENDED DECEMBER 31, 2022
*(In Azerbaijani Manats)*

| | Share capital | Other capital | Retained earnings | Total equity |
|---|---|---|---|---|
| **January 1, 2021** | **13,538,682** | **(13,538,682)** | **9,035** | **9,035** |
| Total comprehensive income for the year | - | - | 83,495,861 | 83,495,861 |
| **December 31, 2021** | **13,538,682** | **(13,538,682)** | **83,504,896** | **83,504,896** |
| Total comprehensive income for the year | - | - | 148,103,669 | 148,103,669 |
| **December 31, 2022** | **13,538,682** | **(13,538,682)** | **231,608,565** | **231,608,565** |

**On behalf of the Management:**

**Guladdin Dadashov**
**Deputy Director**

May 22, 2023
Baku, the Republic of Azerbaijan

**Shahnisa Nuriyeva**
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May 22, 2023
Baku, the Republic of Azerbaijan

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## STATE CONTRACT CORPORATION OF THE REPUBLIC OF AZERBAIJAN "AZERKONTRAKT" OPEN JOINT-STOCK COMPANY

### SPECIAL-PURPOSE STATEMENT OF CASH FLOWS
### FOR THE YEAR ENDED DECEMBER 31, 2022
*(In Azerbaijani Manats)*

| | Notes | Year ended December 31, 2022 | Year ended December 31, 2021 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Profit before income tax | | 185,217,337 | 104,369,826 |
| Adjustments to reconcile profit before income tax to net cash flows: | | | |
| Interest income | | (1,361,374) | - |
| Depreciation charge | 16 | 91,141 | - |
| Interest expense | | 825,038 | 745,403 |
| **Operating cash flows before working capital changes:** | | **184,772,142** | **105,115,229** |
| Working capital adjustments: | | | |
| Change in trade receivables | | (38,214,808) | (37,846,456) |
| Change in advances paid to suppliers | | (34,309,429) | (438,153) |
| Change in inventories | | (3,183,317) | (182,226,113) |
| Change in other current assets | | (24,296,918) | (45,912,576) |
| Change in trade and other payables | | 163,740,647 | 160,266,101 |
| **Cash generated from operating activities:** | | **248,508,317** | **(1,041,968)** |
| Income tax paid | | (40,916,621) | - |
| **Net cash inflow/(outflow) from operating activities** | | **207,591,696** | **(1,041,968)** |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Purchase of property and equipment | | (437,530) | - |
| Interest received on current accounts | | 1,361,374 | - |
| **Net cash from investing activities** | | **923,844** | **-** |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Proceeds from borrowings | 18 | - | 93,500,000 |
| Repayments of borrowings | 18 | (93,500,000) | - |
| Interest paid on borrowings | 18 | (1,009,441) | (561,000) |
| **Net cash (outflow)/inflow in financing activities** | | **(94,509,441)** | **92,939,000** |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | | 114,006,099 | 91,897,032 |
| **CASH AND CASH EQUIVALENTS,** ***beginning of the year*** | **11** | **91,897,090** | **58** |
| **CASH AND CASH EQUIVALENTS,** ***end of the year*** | **11** | **205,903,189** | **91,897,090** |

**On behalf of the Management:**

Azərbaycan Respublikası Dövlət Kontrakt Korporasiyası «AZƏRKONTRAKT» Səhmdar Cəmiyyəti

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May 22, 2023
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The selected explanatory notes on pages 8 to 38 form an integral part of these special-purpose financial statements.

## 1. CORPORATE INFORMATION

### The Company and its principal activities

State Contract Corporation "Azerkontrakt" Open Joint Stock Company (hereinafter – "Company") was established on the basis of the former Ministry of Material Resources and Ministry of Trade, with 100% state-owned shares, by the Decree of the President of the Republic of Azerbaijan No. 519 dated December 17, 1996.

Until January 1, 2021, activities of the Company consisted of the following:

- Material and technical support of the state needs of the Republic of Azerbaijan, strategically important production and construction programs, organization of interstate economic relations in this field;
- Assisting enterprises and organizations, regardless of the form of ownership, in the development of direct relations on the purchase and sale of products;
- Studying the demand of the internal consumer market of the Republic of Azerbaijan for production-technical products and basic consumer goods and giving recommendations to the central executive authorities;
- Helping the development of industry and increasing the efficiency of production by providing raw materials and materials, as well as attracting foreign investments, bank loans and other financial resources for this purpose;
- Providing marketing, transportation, rental, leasing, information and other services to enterprises and organizations, as well as to the population, regardless of the form of ownership.

According to the Decision No. 513 of the Cabinet of Ministers of the Republic of Azerbaijan dated December 28, 2020, starting from January 1, 2021, the purchase of natural gas from suppliers in the domestic market, organization of its transportation, sale to domestic distributors and consumers entrusted to the Company.

The purchase price of natural gas is fixed based on the contracts signed with suppliers (price of natural gas purchased from "Azneft" Production Union is derived from tariffs set by the Tariff Council of the Republic of Azerbaijan), while transportation costs and revenues are derived from tariffs set by the Tariff Council of the Republic of Azerbaijan.

The list of suppliers for purchase of natural gas consisted of the followings:

- "Azneft" Production Union
- "Azerbaijan Gas Supply Company" Limited
- "Umid Babek Operating Company"
- "Bahar Energy Operating Company"
- "Gobustan Operating Company"
- "Petro Hong Kong Pirsaat Oil" Limited

The list of customers for sales of natural gas consisted of the followings:

- "Azerenerji" OJSC
- "Azerigas" Production Union
- The Nakhchivan Autonomous Republic Gas Export Institution

During the year ended December 31, 2022, 318,244 $m^3$ (or AZN 32,881 VAT excluded) of the gas in the monetary terms of volumes that should be transferred to the Company by the "Gas Export" Entity of State Oil Company of the Azerbaijan Republic ("SOCAR") were used for the internal needs of that entity and the value has not been paid to the Company (2021: 316,379 $m^3$ or AZN 22,881 VAT excluded).

The ultimate controlling party of the Company is the Cabinet of Ministers of the Republic of Azerbaijan.

**Legal address of the Company**

The Company's registered address is Yasamal district, Shafayet Mehdiyev street 82/83, AZ1141 Baku, the Republic of Azerbaijan.

## 2. OPERATING ENVIRONMENT OF THE COMPANY

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

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

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

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

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

## 3. SIGNIFICANT ACCOUNTING POLICIES

### Introduction

The financial year of the Company ends on the last day of December. The special-purpose financial statements of the Company have been prepared based on financial reporting framework adjusted to IFRS, except for the application and disclosure requirements of "IFRS 10 – Consolidated Financial Statements" (consolidated financial statements are not required under special-purpose financial reporting framework.) and valuation and disclosure of related financial statement elements - investment in subsidiaries and other capital and required for disclosure of comparative information. Investment in subsidiaries are excluded from special-purpose financial statements through other capital under special-purpose reporting framework.

### Going concern

These special-purpose 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 judgement, at a particular point in time, about the future outcome of events or conditions which are inherently uncertain.

The principal accounting policies are set out below:

### Current versus non-current classification

The Company presents assets and liabilities in the special-purpose financial statements based on current/non-current classification. An asset is current when it is:

- Expected to be realized or intended to be sold or consumed in the normal operating cycle;
- Held primarily for the purpose of trading;
- Expected to be realized within twelve months after the reporting period; or
- Cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

All other assets are classified as non-current.

A liability is current when:

- It is expected to be settled in the normal operating cycle;
- It is held primarily for the purpose of trading;
- It is due to be settled within twelve months after the reporting period; or
- There is no unconditional right to defer the settlement of the liability for at least twelve months after the reporting period.

The Company classifies all other liabilities as non-current.

Deferred tax assets and liabilities are classified as non-current assets and liabilities.

**Revenue from Contracts with Customers**

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers.

The core principle of IFRS 15 is that the Company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the Standard introduces a 5-step approach to revenue recognition:

Step 1: Identify the contract(s) with a customer.
Step 2: Identify the performance obligations in the contract.
Step 3: Determine the transaction price.
Step 4: Allocate the transaction price to the performance obligations in the contract.
Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognizes revenue when or as a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer.

Substantially all of the Company revenues are derived from rates authorized by the Tariff Council of the Republic of Azerbaijan through its tariffs. Tariff rates represent the transaction prices. Performance obligations created under these tariff based sales include commodity (the cost of natural gas sold to customers) and delivery (transporting natural gas through distribution system to customers). The delivery of natural gas to customers results in the satisfaction of the Company's respective performance obligations over time. All customers are billed monthly based on consumptions as measured by metered usage. Revenue is recognized as bills are issued for natural gas that has been delivered or transported.

**Other income and expenses**

Other income and expenses are recognized on an accrual basis.

**Employee benefits**

Wages, salaries, contributions to the State Pension Fund of the Republic of Azerbaijan, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services and food) are accrued in the year in which the associated services are rendered by the employees of the Company.

**Financial instruments**

Financial assets and financial liabilities are recognized in the Company's statement of financial position when the Company becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

**Financial assets**

All regular-way purchases or sales of financial assets are recognized and derecognized on a trade date basis. All recognized financial assets are measured subsequently in their entirety at either amortized cost or fair value, depending on the classification of the financial assets.

*Classification of financial assets*

Debt instruments that meet the following conditions are measured subsequently at amortized cost:

- the financial asset is held within a business model whose objective is to hold financial assets in order 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.

Debt instruments that meet the following conditions are measured subsequently at fair value through other comprehensive income (FVTOCI):

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

By default, all other financial assets are measured subsequently at fair value through profit or loss (FVTPL).

Despite the foregoing, the Company may make the following irrevocable election/designation at initial recognition of a financial asset:

- the Company may irrevocably elect to present subsequent changes in fair value of an equity investment in other comprehensive income if certain criteria are met; and
- the Company may irrevocably designate a debt investment that meets the amortized cost or FVTOCI criteria as measured at FVTPL if doing so eliminates or significantly reduces an accounting mismatch.

*Amortized cost and effective interest method*

The effective interest method is a method of calculating the amortized cost of a debt instrument and of allocating interest income over the relevant period. For financial assets other than purchased or originated credit-impaired financial assets (i.e. assets that are credit impaired on initial recognition), the effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) excluding expected credit losses, through the expected life of the debt instrument, or, where appropriate, a shorter period, to the gross carrying amount of the debt instrument on initial recognition.

For purchased or originated credit-impaired financial assets, a credit adjusted effective interest rate is calculated by discounting the estimated future cash flows, including expected credit losses, to the amortized cost of the debt instrument on initial recognition.

The amortized cost of a financial asset is the amount at which the financial asset is measured at initial recognition minus the principal repayments, plus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount, adjusted for any loss allowance. The gross carrying amount of a financial asset is the amortized cost of a financial asset before adjusting for any loss allowance.

Interest income is recognized using the effective interest method for debt instruments measured subsequently at amortized cost and at FVTOCI.

For financial assets other than purchased or originated credit-impaired financial assets, interest income is calculated by applying the effective interest rate to the gross carrying amount of a financial asset, except for financial assets that have subsequently become credit-impaired. For financial assets that have subsequently become credit-impaired, interest income is recognized by applying the effective interest rate to the amortized cost of the financial asset. If, in subsequent reporting periods, the credit risk on the credit-impaired financial instrument improves so that the financial asset is no longer credit-impaired, interest income is recognized by applying the effective interest rate to the gross carrying amount of the financial asset.

The Company's majority of financial assets were classified as financial assets measured subsequently at amortized cost. The Company's financial liabilities were classified as financial liabilities measured subsequently at amortized cost. The Company does not choose to classify any financial liabilities as measured at fair value through profit or loss.

*Impairment of financial assets*

The Company applies the expected credit loss model to financial assets measured at amortized cost or at fair value through other comprehensive income.

The allowance for expected credit losses for a financial asset is measured at an amount equal to the lifetime expected credit losses if the credit risk on that financial asset has increased significantly since initial recognition.

If, at the reporting date, the credit risk on a financial asset has not increased significantly since initial recognition, the allowance for expected credit losses for that financial asset (except trade receivables, where the simplified approach is elected) is measured at an amount equal to 12-month expected credit losses. For trade receivables, whether they contain a significant financing component or not, measurement based on lifetime expected credit losses are applied (simplified approach).

The Company utilizes an internal model to assess expected credit losses. The model was developed in accordance with IFRS 9 and designed to assess the credit risk exposure of counterparties considering the characteristics of financial assets by assigning a scoring system to counterparties. Assigned score is returning PD (Probability of Default) on an individual basis. Move of the asset from one score band to a lower score band is considered significant increase in credit risk among other criteria.

**Fair value measurement**

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

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

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

The Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the special-purpose financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

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

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

**De-recognition of financial assets**

The Company derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

**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*

All financial liabilities are measured subsequently at amortized cost using the effective interest method or at FVTPL.

Financial liabilities are classified as at FVTPL when the financial liability is (i) contingent consideration of an acquirer in a business combination, (ii) held for trading or (iii) it is designated as at FVTPL.

Financial liabilities that are not (i) contingent consideration of an acquirer in a business combination, (ii) held-for-trading, or (iii) designated as at FVTPL, are measured subsequently at amortized cost using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or (where appropriate) a shorter period, to the amortized cost of financial liability.

Trade payables are accrued when the counterparty performed its obligations under the contract and are carried at amortized cost using the effective interest method.

**De-recognition of financial liabilities**

The Company removes a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished – i.e. when the obligation specified in the contract is discharged or cancelled or expires.

An exchange between an existing borrower and lender of debt instruments with substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 percent different from the discounted present value of the remaining cash flows of the original financial liability. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognized as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortized over the remaining term of the modified liability.

**Offset of financial assets and liabilities**

Financial assets and liabilities are offset and reported net on the statement of financial position when the Company has a legally enforceable right to set off the recognized amounts and the Company intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. In accounting for a transfer of a financial asset that does not qualify for de-recognition, the Company does not offset the transferred asset and the associated liability.

**Cash and cash equivalents**

Cash and cash equivalents in the statement of financial position comprise cash at banks and on hand and short-term highly liquid deposits with a maturity of three months or less, that are readily convertible to a known amount of cash and subject to an insignificant risk of changes in value, but exclude any restricted cash.

Restricted balances are excluded from cash and cash equivalents for the purposes of the cash flow statement. Restricted cash is not available for use by the Company and therefore is not considered highly liquid, for example, cash set aside to cover rehabilitation obligations. Balances restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date are included in other non-current assets.

**Trade receivables**

Trade receivables are carried at amortized cost using the effective interest method. The Company uses a provision matrix to calculate expected credit losses for trade receivables. The provision rates are based on days past due for groupings of various customer segments that have similar loss patterns (i.e., by geography, product type, customer type and rating, and coverage by letters of credit and other forms of credit insurance).

The provision matrix is initially based on the Company's historical observed default rates. The Company will calibrate the matrix to adjust the historical credit loss experience with forward-looking information. For instance, if forecast economic conditions (i.e., gross domestic product) are expected to deteriorate over the next year which can lead to an increased number of defaults in the manufacturing sector, the historical default rates are adjusted. At every reporting date, the historical observed default rates are updated and changes in the forward-looking estimates are analyzed. Where applicable, the Company relies on default rates derived from external rates of counterparties.

The assessment of the correlation between historically observed default rates, forecast economic conditions and expected credit losses is a significant estimate. The amount of expected credit losses is sensitive to changes in circumstances and forecast economic conditions.

The Company's historical credit loss experience and forecast of economic conditions may also not be representative of the customer's actual default in the future.

**Advances paid to suppliers**

Advances paid to suppliers are carried at cost less provision for impairment. An advances paid to suppliers is classified as non-current when the goods or services relating to the advances to suppliers are expected to be obtained after one year, or when the advances paid to suppliers relates to an asset which will itself be classified as non-current upon initial recognition.

Advances paid to suppliers to acquire assets are transferred to the carrying amount of the asset once the Company has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Company. Other advances paid to suppliers are written off to profit and loss accounts when the goods or services relating to the advances paid to suppliers are received. If there is an indication that the assets, goods or services relating to an advances paid to suppliers will not be received, the carrying value of the advances paid to suppliers is written down accordingly and a corresponding impairment loss is recognized in profit and loss accounts.

**Inventories**

Natural gas in storage is recorded at average cost. Natural gas storage injections are priced at the purchase cost at the time of injection and storage withdrawals are priced at the weighted average cost of the reporting month.

At the yearend the natural gas in storage are stated at the lower of cost and net realizable value. Cost comprises the direct purchase costs, excluding cost of transportation and lost and unaccounted for gas which occur after the inventory is ready for its intended use or sale. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated cost of completion and selling expenses.

Lost and unaccounted for gas is the difference between the gas measured into the distribution system and gas measured out of the utility system or otherwise accounted for. These differences are due to the fact that changes in pressure and temperature cause large changes in volume. Lost and unaccounted for gas is not necessarily gas leaked into the air.

### *VAT deposit account*

The Value Added Tax ("VAT") deposit account system is a system introduced in 2008 by the State Tax Service under the Ministry of Economy of the Republic of Azerbaijan which aims prevention of VAT misuse. From January 1, 2008 on the basis of amendments to the Tax Code, the amount of VAT refund is considered the tax amount which is paid, according to the submitted electronic invoices to the taxpayer's VAT deposit account in the framework of transactions carried out in this account.

### Property and equipment

Property and equipment are carried at historical cost less accumulated depreciation and any recognized impairment loss.

The depreciation method is reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a reducing balance basis at the following annual prescribed rates:

| | |
|---|---|
| Furniture and equipment | 20% |
| Computer and equipment | 20% |

Depreciation is calculated on a reducing balance method.

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

At the end of each reporting period, the Company reviews the carrying amounts of its property and equipment 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). Where 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.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit and loss accounts, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a /cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit and loss accounts, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

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 and loss accounts.

**Trade and other payables**

Trade and other payables are accrued when the counterparty performed its obligations under the contract and are carried at amortized cost using the effective interest method.

**Taxation**

***Income taxes***

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

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

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the special-purpose financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method.

Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such 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 tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each reporting date 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 is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the statement of profit or loss and other comprehensive income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the statement of financial position if:

- The Company has a legally enforceable right to set off current income tax assets against current income tax liabilities; and
- Deferred income tax assets and the deferred income tax liability relate to income taxes levied by the same taxation authority on the same taxable entity.

***Property tax***

Except for cases when the property has been insured at a value exceeding its residual value and the property tax is then calculated on the market value, the taxable base for resident legal entities and non-resident legal entities with a permanent establishment is the average annual residual value of their fixed assets. Thus, an average annual residual value of fixed assets owned by such legal entities is subject to a property tax at the rate of 1%. At the same time, the taxable base in respect of resident and non-resident individuals comprises of buildings and their parts, as well as resident individuals' water and air transportation means, where the property tax rate varies depending on the type of asset owned.

The reporting period is a calendar year. Legal entities, owning the fixed assets, have to file the tax return no later than March 31 of the year following the reporting period. The property taxpayer legal entities remit the tax by way of advances (20% of the last year's property tax) by the 15th of the second month of each quarter with the final balancing payment due no later than the filing deadline mentioned above.

The Republic of Azerbaijan also has various other taxes, which are assessed on the Company's activities. These taxes are included in the statement of comprehensive income.

***Value-added tax***

The difference of output VAT and claimable input VAT is payable to the state budget within 20 days following the reporting month. Output value-added tax related to sales is payable to tax authorities on the earlier of: (a) when the receivables from customers are paid or (b) when the goods or services are provided to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT electronic invoice. VAT related to sales and purchases is recognized in the statement of financial position in the total amount and disclosed separately as an asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

**Advances received from customers**

Advances received from customers refer to an item that will initially be recorded as a liability. Advances received from customers are initially recorded at the fair value of consideration received plus any directly attributable transaction costs, and subsequently are carried at amortized cost.

By the support of this module the taxpayer pays the amount of VAT indicated on the VAT electronic invoices to the VAT sub-account of another taxpayer. At the same time tax obligations to the state budget regarding all kinds of taxes and VAT amounts on the import transactions payable to the State Customs Committee, can be paid by taxpayers through the VAT deposit account.

Information about paid amounts is transferred by the Ministry of Taxes to the Main State Treasury ("MST") and then to the Central Bank of the Republic of Azerbaijan ("CBRA"). CBRA on the basis of information submitted by the Main State Treasury ensures the transformation of amounts to the relevant local treasury authorities. The State Tax Services ensures the inclusion of amounts which is noted in the submitted information to the taxpayer's personal score sheet. The current system is connected with the Automated Tax Information System of the Ministry of Taxes. At the same time, online exchange of information was organized with the MST and CBRA.

Implementation of the VAT deposit account makes it possible to timely control payments and refunded VAT amounts. Taxpayers who have tax debts can only transfer these amounts to the state budget.

Taxpayers can make payments to the state budget without visiting banks, to the VAT sub-account of other taxpayers and to the customs committee through the deposit account. The State Tax Service under the Ministry of Economy of the Republic of Azerbaijan automatically controls all transactions carried out through the VAT deposit account using special software.

Use of balances in the VAT deposit account is restricted and can be used only for transactions connected with VAT and other applicable taxes.

The Republic of Azerbaijan also has various other taxes, which are assessed on the Company's activities. These taxes are included in the statement of profit or loss and other comprehensive income.

**Foreign currency translation**

Functional currency of the Company is the currency of the primary economic environment in which the entity operates. The Company's functional currency AZN is the national currency of the Republic of Azerbaijan.

Monetary assets and liabilities are translated into entity's functional currency at the official exchange rate of the Central Bank of the Republic of Azerbaijan ("CBRA") at the respective reporting dates.

Foreign exchange gains and losses resulting from the settlement of the transactions and from the translation of monetary assets and liabilities into each entity's functional currency at year-end official exchange rates of the CBRA are recognized in the statement of profit or loss and other comprehensive income.

Translation at year-end rates does not apply to non-monetary items, including equity investments. Effects of exchange rate changes on the fair value of equity securities are recorded as part of the fair value gain or loss.

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

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| AZN/USD | 1.7000 | 1.7000 |

**Contingent liabilities and assets**

Contingent liabilities are not recognized in the special-purpose financial statements. They are disclosed in the notes to the special-purpose financial statements unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized in the special-purpose financial statements but disclosed when an inflow of economic benefits is probable.

**Reclassifications**

Certain reclassifications have been made to the notes to the financial consolidated statements for the year ended December 31, 2021 to conform to the presentation as at December 31, 2022, as the current year presentation provides better view of notes.

## 4. CRITICAL ACCOUNTING ESTIMATE AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The preparation of the IFRS special-purpose financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and disclosure of contingent liabilities during the reporting period.

As a result of the uncertainties inherent in business activities, many items in special-purpose financial statements cannot be measured with precision but can only be estimated. Estimation involves judgments based on the latest information available when the special-purpose financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising beyond the control of the Company. Such changes are reflected in the assumptions made by the Company when they occur.

The most significant estimates relate to the net realisable value of inventory, losses on natural gas reserves, recoverability of VAT, recoverability of receivable for transportation services of natural gas, fair value measurement of financial instruments and current tax. Actual results could differ from these estimates.

**Judgments**

In the process of applying the Company's accounting policies, the management has made the following judgments, apart from those involving estimates, which have the most significant effect on the amounts recognized in IFRS special-purpose financial statements.

**Net realizable value of inventory**

Provision for net realizable value of inventory is accrued based on the Company's assessment of inventory items. Write-down of inventories become necessary if they are damaged, obsolete of their selling price decreased. Inventory write-down occurs based on assessment of obsoleteness and usefulness of the inventories by the management of the Company at the year-end.

**Losses on natural gas reserves**

The Company assesses the losses of natural gas reserves. There are two types of losses, which are assessed by the Company. These include losses on transportation and technological consumption during the transportation of natural gas.

- Losses on natural gas reserves in underground gas storage occurs when the natural gas reserves are delivered into the underground gas storage, are held there and are taken from the underground gas storage.
- Losses on transportation and technological consumption occur in the process of transporting natural gas.

Both types of losses excluded from cost of natural gas due to they are incurred after the purchased natural gas is ready for its intended sale.

In response to the Company's request to the Tariff Council of the Republic of Azerbaijan to assess the losses of natural gas resources, it was indicated that the costs of technological consumption and losses, as well as the costs of the Underground Gas Storage such as technological loss, gas extraction, geological gas losses, are included in the storage tariff. The management believes that in future periods, upon signing an agreement with the relevant parties, the above-mentioned losses will be attributed to the storage tariff.

**Recoverability of VAT**

At each reporting date the Company assesses the recoverability of VAT arising on purchase of goods and services. The Company can only receive these amounts through an offset against future VAT liability or collection from the tax authorities. In assessing the recoverability of the VAT receivable, the Company considers information from the internal financial department regarding projected VAT liability, correspondence with government tax authorities, and historical recovery experience.

The actual amount of VAT recovery could differ materially from the Company's estimate and this could materially impact operating results.

**Recoverability of receivable for transportation services of natural gas**

As at December 31, 2022, the Company had receivable for transportation of natural gas from "Azerigas" Production Union in the amount of AZN 71,268,862 (December 31, 2021: AZN 30,235,182). The management assumes that this amount is recoverable and will be received during the short-term period or will be agreed trilaterally with "Azerigas" Production Union and Gas Export Entity of SOCAR for mutual settlement with the payable of the same amount to Gas Export Entity of SOCAR.

**Fair value measurement of financial instruments**

A number of the Company's accounting policies and disclosures require the measurement of fair values, for both financial and non-financial assets and liabilities.

The Company has an established control framework with respect to the measurement of fair values.

When measuring the fair value of an asset or a liability, the Company uses market observable data as far as possible. Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation methods as follows.

- *Level 1:* quoted prices (unadjusted) in active markets for identical assets or liabilities;
- *Level 2:* inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);
- *Level 3:* inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

**Current taxes**

Azerbaijani tax legislation is subject to varying interpretations and changes occur frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Company may not coincide with that of the Management. As a result, tax authorities may challenge transactions and the Company may be assessed additional taxes, penalties and interest, which can be significant. Periods remain open to review by the tax authorities with respect to tax liabilities for three calendar years preceding the year of review. Under certain circumstances, reviews may cover longer periods.

## 5. 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 the year ended December 31, 2022.

In May 2020, the IASB issued **Amendments to IFRS 3 "Business Combinations" – Reference to the Conceptual Framework.** The amendments are intended to replace a reference to the Framework for the Preparation and Presentation of Financial Statements, issued in 1989, with reference to the Conceptual Framework for Financial Reporting issued in March 2018 without significantly changing its requirements. The Board also added an exception to the recognition principle of IFRS 3 to avoid the issue of potential "2 days" gains or losses arising for liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 Levies, if incurred separately. At the same time, the Board decided to clarify existing guidance in IFRS 3 for contingent assets that would not be affected by replacing the reference to the Framework for the Preparation and Presentation of Financial Statements.

**Property, Plant and Equipment: Proceeds before Intended Use – Amendments to IAS 16.** In May 2020, the IASB issued Property, Plant and Equipment – Proceeds before Intended Use, which prohibits entities deducting from the cost of an item of property, plant and equipment, any proceeds from selling items produced while bringing that asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Instead, an entity recognizes the proceeds from selling such items, and the costs of producing those items, in profit or loss.

**Onerous Contracts – Costs of Fulfilling a Contract – Amendments to IAS 37** – In May 2020, the IASB issued amendments to IAS 37 to specify which costs an entity needs to include when assessing whether a contract is onerous or loss-making. The amendments apply a "directly related cost approach". The costs that relate directly to a contract to provide goods or services include both incremental costs and an allocation of costs directly related to contract activities. General and administrative costs do not relate directly to a contract and are excluded unless they are explicitly chargeable to the counterparty under the contract.

**IFRS 1 "First-time Adoption of International Financial Reporting Standards"** – Subsidiary as a first-time adopter. As part of its 2018-2020 annual improvements to the IFRS standards process, the IASB issued an amendment to IFRS 1 "First-time Adoption of International Financial Reporting Standards".

The amendment permits a subsidiary that elects to apply paragraph D16(a) of IFRS 1 to measure cumulative translation differences using the amounts reported by the parent, based on the parent's date of transition to IFRS. This amendment is also applied to an associate or joint venture that elects to apply paragraph D16 (a) of IFRS 1.

**IFRS 9 "Financial Instruments" – Fees in the "10 percent" test for derecognition of financial liabilities.** As part of its 2018-2020 annual improvements to the IFRS standards process the IASB issued an amendment to IFRS 9. The amendment clarifies the fees that an entity includes when assessing whether the terms of a new or modified financial liability are substantially different from the terms of the original financial liability. These fees include only those paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf. An entity applies the amendment to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment.

**IAS 41 "Agriculture" – Taxation in fair value measurements.** As part of its 2018-2020 annual improvements to the IFRS standards process the IASB issued an amendment to IAS 41 "Agriculture". The amendment removes the requirement in paragraph 22 of IAS 41 that entities exclude cash flows for taxation when measuring the fair value of assets within the scope of IAS 41.

Unless otherwise disclosed, the new standards did not have a material effect on the special-purpose financial statements of the Company.

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

At the date of authorization of these special-purpose 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. The Company intends to adopt these new and amended standards and interpretations, if applicable, when they become effective.

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

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

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

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

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

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

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

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

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

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

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

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

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

## 7. BALANCES AND TRANSACTIONS WITH RELATED PARTIES

Related parties are defined in IAS 24 "Related Party Disclosures". Parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. The Company's immediate parent is the State Customs Committee of Azerbaijan Republic, which is fully controlled by the Government of the Republic of Azerbaijan.

The Company applied the exemption in paragraph 25 of IAS 24 "Related Party Disclosures" regarding the disclosure requirement for government related entities.

A reporting entity is exempt from the disclosure requirements of paragraph 18 of IAS 24 "Related Party Disclosures" in relation to related party transactions and outstanding balances, including commitments, with:

a) a government that has control or joint control of, or significant influence over, the reporting entity; and
b) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.

The nature of transactions with government related entities include purchase of electricity, gas, petrol and receiving other services and sale of natural gas.

Total compensations to key management personnel for the year ended December 31, 2022 was AZN 156,617 (2021: AZN 8,373).

## 8. REVENUES

Revenue by companies comprises:

| | Year ended December 31, 2022 | Year ended December 31, 2021 |
|---|---|---|
| Revenue from "Azerenerji" OJSC | 804,929,297 | 587,907,121 |
| Revenue from "Azerigas" Production Union | 776,101,014 | 590,046,703 |
| Revenue from SOCAR (for gas exchanged to Gazprom Schweiz AG) | 65,067,767 | - |
| Revenue from the Nakhchivan Autonomous Republic Gas Export Institution | 28,548,400 | 22,089,732 |
| Revenue from other companies | 68,506 | - |
| **Total revenues** | **1,674,714,984** | **1,200,043,556** |

Wholesale prices of natural gas are regulated by the Tariff Council of the Republic of Azerbaijan. The prices were changed twice by the Tariff Council of the Republic of Azerbaijan during the year ended December 31, 2021. The wholesale price of natural gas per thousand cubic meter was AZN 75 for "Azerigas" PU and Gas Operation Service of Nakhchivan Autonomous Republic and AZN 120 for "Azerenerji" OJSC from January 1, 2021 to June 30, 2021, AZN 110 for "Azerigas" PU and Gas Operation Service of Nakhchivan Autonomous Republic and AZN 130 for "Azerenergy" OJSC from July 1, 2021 to October 31, 2021, AZN 118 for "Azerigas" PU and Gas Operation Service of Nakhchivan Autonomous Republic and AZN 165 for "Azerenergy" OJSC from November 1, 2021.

According to the natural gas exchange agreement No. AZ-CH-2021 dated July 23, 2021, signed between Gazprom Schweiz AG Company of the Russian Federation and the Company, natural gas exchanged with Russian Federation in the volume of 326,532,396 $m^3$ (AZN 30,483,635) during the year ended December 31, 2021. During the year ended December 31, 2022, 101,384,412 $m^3$ of the natural gas was returned to the Company and 225,147,984 $m^3$ of the natural gas was purchased by SOCAR for the amount of AZN 65,067,767.

## 9. OTHER INCOME/EXPENSES, NET

Other income/expenses, net comprise:

| | Year ended December 31, 2022 | Year ended December 31, 2021 |
|---|---|---|
| Bank charges | 756,326 | 286,691 |
| Donation fee to "YASHAT" Foundation | 200,000 | - |
| Professional fees | 188,784 | 13,335 |
| Depreciation of property and equipment | 91,141 | - |
| Expertise expense | 41,192 | 36,770 |
| Custom fee | 16,825 | 45,355 |
| Other income and expenses, net | 83,461 | (11,761) |
| **Total other income/expenses, net** | **1,377,729** | **370,390** |

## 10. INCOME TAXES

The Company measures and records its current income tax payable and its tax bases related to assets and liabilities in accordance with the statutory tax regulation of the country where the Company operates, which differs from IFRS.

The Company is subject to certain permanent tax differences due to 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, 2022 and December 31, 2021 relate mostly to different methods/timing of income and expense recognition as well as to temporary differences generated by taxation bases differences for certain assets.

Relationships between tax expenses and accounting profit for the year ended December 31, 2022 and December 31, 2021 are explained as follows:

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| **Deductible temporary differences:** | | |
| Trade receivables | 76,727 | 76,727 |
| Borrowings | - | 184,403 |
| **Total deductible temporary differences** | **76,727** | **261,130** |
| **Taxable temporary differences:** | | |
| Inventories | - | (15,338) |
| **Total taxable temporary differences** | **-** | **(15,338)** |
| Net deductible temporary differences | 76,727 | 245,792 |
| **Deferred tax asset at 20%** | **15,345** | **49,158** |

| | Year ended December 31, 2022 | Year ended December 31, 2021 |
|---|---|---|
| **Profit before income tax** | **185,217,337** | **104,369,826** |
| Statutory tax rates | 20% | 20% |
| Theoretical tax at the statutory tax rate | (37,043,467) | (20,873,965) |
| Tax effect of permanent differences | (70,201) | - |
| **Income tax expense** | **(37,113,668)** | **(20,873,965)** |
| Current income tax expense | (37,079,855) | (20,885,748) |
| Change in deferred tax asset | (33,813) | 11,783 |
| **Income tax expense** | **(37,113,668)** | **(20,873,965)** |

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| **Deferred tax asset** | | |
| **Beginning of the year** | **49,158** | **37,375** |
| Change in the deferred tax asset for the year (charged)/credited to profit and loss accounts | (33,813) | 11,783 |
| **End of the year** | **15,345** | **49,158** |

## 11. CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise:

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| Cash in bank accounts | 205,903,189 | 91,897,090 |
| **Total cash and cash equivalents** | **205,903,189** | **91,897,090** |

As at December 31, 2022, all bank accounts are held at "Kapital Bank" OJSC and "International Bank of Azerbaijan" OJSC, and as at December 31, 2021, all bank accounts are held only at "Kapital Bank" OJSC.

There were no restrictions on the use of cash and cash equivalents as at December 31, 2022 and December 31, 2021.

The geographical concentration of the Company's cash and cash equivalents was the Republic of Azerbaijan.

According to the contract signed by the Company with the "Internation Bank of Azerbaijan" OJSC on March 3, 2022 if the balance in the bank account exceeds AZN 20,000,000, up to 1.1% interest is calculated on the balance.

## 12. TRADE RECEIVABLES

Trade receivables comprise:

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| Trade receivables from the customers | 4,800,320 | 7,619,192 |
| Receivables from transportation services of natural gas | 71,268,862 | 30,235,182 |
| **Total trade receivables** | **76,069,182** | **37,854,374** |

The geographical concentration of the Company's trade receivables was the Republic of Azerbaijan.

## 13. ADVANCES PAID TO SUPPLIERS

Advances paid to suppliers comprise:

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| Advances paid to suppliers for the purchase of natural gas | 34,747,582 | 438,153 |
| **Total advances paid to suppliers** | **34,747,582** | **438,153** |

## 14. INVENTORIES

Inventories comprise:

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| Natural gas reserves in underground gas storage | 184,759,280 | 151,060,535 |
| Natural gas reserves in foreign countries | 650,150 | 31,165,578 |
| **Total inventories** | **185,409,430** | **182,226,113** |

From April 1, 2021, the Company has been using underground gas storage in order to provide consumers with uninterrupted natural gas. The volume of natural gas reserves belonging to Company in underground gas storage was 2,030,851,575 $m^3$ as at December 31, 2022 (December 31, 2021: 1,702,957,644 $m^3$).

The Company held natural gas reserves (residual gas) in foreign country, Iran Islamic Republic in the amount of AZN 650,150 as at December 31, 2022 (December 31, 2021: the Russian Federation and Iran Islamic Republic in the amount of AZN 30,483,635 and AZN 681,943, respectively).

According to the natural gas exchange agreement No. AZ-CH-2021 dated July 23, 2021, signed between the Company and Gazprom Schweiz AG Company of the Russian Federation, natural gas exchanged with Russian Federation in the volume of 326,532,396 $m^3$ (AZN 30,483,635) on the territory of the Russian Federation as at December 31, 2021. In the volume of 101,384,412 $m^3$ of the natural gas was returned to the Company and according to the Agreement dated December 23, 2022 signed between the Company and SOCAR on the right (claim), the value of natural gas in the amount of 225,147,984 $m^3$ or AZN 65,067,767 was purchased by the Company.

In order to supply the Nakhchivan Autonomous Republic of the Republic of Azerbaijan with natural gas, as at December 31, 2022 8,412,720 $m^3$ (December, 2021: 9,010,479 $m^3$) of natural gas reserves were stored in the pipeline in the territory of the Islamic Republic of Iran within the scope of the natural gas SWOP contract concluded between the National Iranian Gas Export Company (NIGEC) of the Islamic Republic of Iran and the State Oil Company of the Azerbaijan Republic "Azerigas" PU on August 5, 2004.

## 15. OTHER CURRENT ASSETS

Other current assets comprise:

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| VAT deposit account | 41,247,927 | 37,074,987 |
| Input VAT | 28,961,567 | 8,837,589 |
| **Total other current assets** | **70,209,494** | **45,912,576** |

## 16. PROPERTY AND EQUIPMENT

Property and equipment comprise:

| | Furniture and equipment | Computers and related equipment | CIP | Total |
|---|---|---|---|---|
| **Initial cost** | | | | |
| **January 1, 2022** | - | - | - | - |
| Additions | 249,830 | 176,154 | 11,546 | 437,530 |
| **December 31, 2022** | **249,830** | **176,154** | **11,546** | **437,530** |
| **Accumulated depreciation** | | | | |
| **January 1, 2022** | - | - | - | - |
| Depreciation charge for the year | (49,966) | (41,175) | - | (91,141) |
| **December 31, 2022** | **(49,966)** | **(41,175)** | - | **(91,141)** |
| **Net book value** | | | | |
| **December 31, 2022** | **199,864** | **134,979** | **11,546** | **346,389** |
| **December 31, 2021** | - | - | - | - |

As at December 31, 2022 and 2021, included in property and equipment, there were neither any assets with restrictions on title nor any assets that were pledged as security for liabilities.

## 17. TRADE AND OTHER PAYABLES

Trade and other payables comprise:

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| Trade payables | 266,654,935 | 130,388,845 |
| **Total financial payables** | **266,654,935** | **130,388,845** |
| Tax payables | 60,150,656 | 43,249,589 |
| Advances received from customers | 3,151,753 | 2,094,891 |
| VAT output | 11,134,702 | 5,454,840 |
| **Total trade and other payables** | **341,092,046** | **181,188,165** |

The geographical concentration of the Company's trade and other payables was the Republic of Azerbaijan.

## 18. BORROWINGS

Borrowings comprise:

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| "International Bank of Azerbaijan" OJSC | - | 40,880,467 |
| "Kapital Bank" OJSC | - | 40,880,467 |
| "Azer-Turk Bank" OJSC | - | 11,923,469 |
| **Total borrowings** | **-** | **93,684,403** |

On October 21, 2021, the Company entered into a credit agreement in the amount of USD 55,000,000 with an annual interest rate of 1% under guarantee of Ministry of Finance of the Republic of Azerbaijan, maturing on October 21, 2022 with "Kapital Bank" OJSC, "International Bank of Azerbaijan" OJSC and "Azer-Turk Bank" OJSC. As at December 31, 2022, there was no outstanding amount (December 31, 2021: AZN 93,684,403).

According to the additional agreement signed on October 21, 2022, the loan repayment period was extended until February 28, 2023. The contractual obligations were pre-fulfilled on December 27, 2022.

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

| | Amount |
|---|---|
| **January 1, 2022** | **93,684,403** |
| **Cash flows** | |
| Repayments of borrowings | (93,500,000) |
| Interest paid on borrowings | (1,009,441) |
| **Non-cash changes** | |
| Interest expense | 825,038 |
| **December 31, 2022** | - |

| | Amount |
|---|---|
| **January 1, 2021** | - |
| **Cash flows** | |
| Proceeds from borrowings | 93,500,000 |
| Interest paid on borrowings | (561,000) |
| **Non-cash changes** | |
| Interest expense | 745,403 |
| **December 31, 2021** | **93,684,403** |

The geographical concentration of the Company's borrowings were the Republic of Azerbaijan.

## 19. SHARE CAPITAL

The nominal value of the registered amount of the Company's issued share capital as at December 31, 2022 and 2021 was AZN 13,538,682.

The total authorized number of ordinary shares was 6,769,341 shares, with a par value of AZN 2 per share as at December 31, 2022 and 2021.

## 20. OTHER CAPITAL

Under the special-purpose financial reporting framework, the subsidiaries are not included in the special-purpose financial statements. The cost of subsidiaries in the amount of AZN 13,538,682 were excluded from the special-purpose financial statements through the other capital.

## 21. COMMITMENTS AND CONTINGENCIES

**Legal proceedings**

In the normal course of business, the Company might receive claims from customers and counterparties. The Management expects that no material un-accrued losses will be incurred and accordingly no provision has been made in these special-purpose financial statements.

**Tax legislation**

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

Recent events within the Republic of Azerbaijan suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged.

As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review.

Under certain circumstances, reviews may cover longer periods. The Management believes that its interpretation of the relevant legislation is appropriate and the Company's tax will be sustained.

## 22. RISK MANAGEMENT POLICIES

Management of risk is fundamental to the Company's business and is an essential element of its operations. The main risks inherent to the Company's operations are those related to:

- Credit risk;
- 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. Through the risk management framework, the Company manages the following risks:

**Credit risk**

The Company is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

**Maximum exposure**

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

**Geographical concentration**

Assets, liabilities and credit-related commitments have been based on the country, in which the counterparty is located. Balances with counterparties located in the Republic of Azerbaijan actually outstanding to/from companies of these counterparties are allocated to the caption "The Republic of Azerbaijan".

The geographical concentration of the Company's financial assets and liabilities was disclosed in the relevant notes.

**Liquidity risk**

Liquidity risk is defined as the risk when the maturity of financial assets and liabilities does not match. Liquidity risk is managed by the Finance Department of the Company. The liquidity management of the Company requires considering the level of liquid assets necessary to settle obligations as they fall due; maintaining access to a range of funding sources; maintaining funding contingency plans and monitoring balance sheet liquidity ratio.

The liquidity risk of the Company's financial assets and liabilities as at December 31, 2022 is set out below:

| | Up to 1 month | 1 month to 3 months | 3 months to 1 year | Total |
|---|---|---|---|---|
| **FINANCIAL ASSETS** | | | | |
| Cash and cash equivalents | 205,903,189 | - | - | 205,903,189 |
| Trade receivables | 76,069,182 | - | - | 76,069,182 |
| **Total financial assets** | **281,972,371** | **-** | **-** | **281,972,371** |
| **FINANCIAL LIABILITIES** | | | | |
| Trade and other payables | 266,654,935 | - | - | 266,654,935 |
| **Total financial liabilities** | **266,654,935** | **-** | **-** | **266,654,935** |
| Liquidity gap | 15,317,436 | - | - | 15,317,436 |
| **Cumulative liquidity gap** | **15,317,436** | **15,317,436** | **15,317,436** | |

The liquidity risk of the Company's financial assets and liabilities as at December 31, 2021 is set out below:

| | Up to 1 month | 1 month to 3 months | 3 months to 1 year | Total |
|---|---|---|---|---|
| **FINANCIAL ASSETS** | | | | |
| Cash and cash equivalents | 91,897,090 | - | - | 91,897,090 |
| Trade receivables | 37,854,374 | - | - | 37,854,374 |
| **Total financial assets** | **129,751,464** | - | - | **129,751,464** |
| **FINANCIAL LIABILITIES** | | | | |
| Trade and other payables | 130,388,845 | - | - | 130,388,845 |
| Borrowings | 184,403 | - | 93,500,000 | 93,684,403 |
| **Total financial liabilities** | **130,573,248** | - | **93,500,000** | **224,073,248** |
| Liquidity gap | (821,784) | - | (93,500,000) | (94,321,784) |
| **Cumulative liquidity gap** | **(821,784)** | **(821,784)** | **(94,321,784)** | |

As there is no outstanding balance in borrowings as at December 31, 2022, there is no liquidity risk of the Company's financial assets and liabilities in accordance with IFRS 7.

The liquidity risk of the Company's financial assets and liabilities in accordance with IFRS 7 as at December 31, 2021 are set out below:

| | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | Total |
|---|---|---|---|---|
| Financial liabilities | | | | |
| Borrowings | 263,818 | 151,144 | 94,020,038 | 94,435,000 |
| **Total potential future payments for financial liabilities** | **263,818** | **151,144** | **94,020,038** | **94,435,000** |

## 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 currency risk of the Company's financial assets and liabilities as at December 31, 2022 is set out below:

| | AZN | USD | Total |
|---|---|---|---|
| **FINANCIAL ASSETS** | | | |
| Cash and cash equivalents | 205,903,189 | - | 205,903,189 |
| Trade receivables | 76,069,182 | - | 76,069,182 |
| **TOTAL FINANCIAL ASSETS** | **281,972,371** | **-** | **281,972,371** |
| **FINANCIAL LIABILITIES** | | | |
| Trade and other payables | 188,783,063 | 77,871,872 | 266,654,935 |
| **TOTAL FINANCIAL LIABILITIES** | **188,783,063** | **77,871,872** | **266,654,935** |
| **OPEN CURRENCY POSITION** | **93,189,308** | **(77,871,872)** | **15,317,436** |

The currency risk of the Company's financial assets and liabilities as at December 31, 2021 is set out below:

| | AZN | USD | Total |
|---|---|---|---|
| **FINANCIAL ASSETS** | | | |
| Cash and cash equivalents | 91,897,090 | - | 91,897,090 |
| Trade receivables | 37,854,374 | - | 37,854,374 |
| **TOTAL FINANCIAL ASSETS** | **129,751,464** | **-** | **129,751,464** |
| **FINANCIAL LIABILITIES** | | | |
| Trade and other payables | 43,536,943 | 86,851,902 | 130,388,845 |
| Borrowings | - | 93,684,403 | 93,684,403 |
| **TOTAL FINANCIAL LIABILITIES** | **43,536,943** | **180,536,305** | **224,073,248** |
| **OPEN CURRENCY POSITION** | **86,214,521** | **(180,536,305)** | **(94,321,784)** |

## 23. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price.

The estimated fair values of financial instruments have been determined by the Company using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. The

Republic of Azerbaijan continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets.

Market quotations may be outdated or reflect distress sale transactions and therefore not represent fair values of financial instruments. Management has used all available market information in estimating the fair value of financial instruments.

The fair value of financial assets and liabilities recognized at cost or amortized cost in the statement of financial position is presented below:

| | December 31, 2022 | | December 31, 2021 | |
|---|---|---|---|---|
| | **Carrying value** | **Fair value** | **Carrying value** | **Fair value** |
| Cash and cash equivalents | 205,903,189 | 205,903,189 | 91,897,090 | 91,897,090 |
| Trade receivables | 76,069,182 | 76,069,182 | 37,854,374 | 37,854,374 |
| Borrowings | - | - | 93,684,403 | 93,684,403 |
| Trade and other payables | 266,654,935 | 266,654,935 | 130,388,845 | 130,388,845 |

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

| | | | Fair value measurement using | | | |
|---|---|---|---|---|---|---|
| | **Financial instrument classification** | **Date of Valuation** | **Quoted prices in active markets (Level 1)** | **Significant observable inputs (Level 2)** | **Significant unobservable inputs (Level 3)** | **Total** |
| **Assets for which fair values are disclosed** | | | | | | |
| Cash and cash equivalents | Financial assets at amortized cost | December 31, 2022 | 205,903,189 | - | - | 205,903,189 |
| Trade receivables | Financial assets at amortized cost | December 31, 2022 | - | - | 76,069,182 | 76,069,182 |
| **Liabilities for which fair values are disclosed** | | | | | | |
| Trade and other payables | Financial liabilities at amortized cost | December 31, 2022 | - | - | 266,654,935 | 266,654,935 |

| | | | Fair value measurement using | | | |
|---|---|---|---|---|---|---|
| | **Financial instrument classification** | **Date of valuation** | **Quoted prices in active markets (Level 1)** | **Significant observable inputs (Level 2)** | **Significant unobservable inputs (Level 3)** | **Total** |
| **Assets for which fair values are disclosed** | | | | | | |
| Cash and cash equivalents | Financial assets at amortized cost | December 31, 2021 | 91,897,090 | - | - | 91,897,090 |
| Trade receivables | Financial assets at amortized cost | December 31, 2021 | - | - | 37,854,374 | 37,854,374 |
| **Liabilities for which fair values are disclosed** | | | | | | |
| Trade and other payables | Financial liabilities at amortized cost | December 31, 2021 | - | - | 130,388,845 | 130,388,845 |
| Borrowings | Financial liabilities at amortized cost | December 31, 2021 | - | - | 93,684,403 | 93,684,403 |