

OJSC PASHA Bank

Consolidated financial statements

*Year ended 31 December 2021
together with independent auditor's report*

Contents

Independent auditor's report

Consolidated financial statements

Consolidated statement of financial position	1
Consolidated statement of profit or loss	2
Consolidated statement of comprehensive income	3
Consolidated statement of changes in equity	4
Consolidated statement of cash flows	5

Notes to the consolidated financial statements

1. Principal activities	6
2. Basis of preparation	6
3. Summary of accounting policies	7
4. Significant accounting judgements and estimates	21
5. Cash and cash equivalents	23
6. Amounts due from credit institutions	23
7. Investment securities	25
8. Loans to customers	27
9. Investment properties	30
10. Property and equipment	30
11. Intangible assets	31
12. Right-of-use assets and Lease liabilities	32
13. Other assets and liabilities	33
14. Amounts due to banks and government funds	34
15. Amounts due to customers	35
16. Debt securities issued	35
17. Subordinated debts	35
18. Derivative financial instruments	36
19. Taxation	36
20. Equity	38
21. Commitments and contingencies	38
22. Credit loss expense and other impairment and provisions	42
23. Net fee and commission income	43
24. Personnel, general and administrative expenses, write-down of repossessed collaterals	43
25. Risk management	44
26. Fair values measurement	56
27. Maturity analysis of assets and liabilities	59
28. Related party disclosures	59
29. Changes in liabilities arising from financing activities	61
30. Capital adequacy	61
31. Events after the reporting period	62



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Independent auditor's report

To the Shareholders and Supervisory Board of
OJSC PASHA Bank

Report on the audit of the consolidated financial statements

Opinion

We have audited the consolidated financial statements of OJSC PASHA Bank and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2021, and the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2021, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

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

Responsibilities of management and Audit Committee for the consolidated financial statements

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

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

Consolidated statement of financial position**As at 31 December 2021***(Figures in tables are in thousands of Azerbaijani manats)*

	Notes	2021	2020
Assets			
Cash and cash equivalents	5	1,325,411	1,200,544
Amounts due from credit institutions	6	602,608	456,425
Investment securities	7	1,883,364	1,649,436
Derivative financial assets	18	9,904	7,925
Loans to customers	8	3,027,305	2,608,818
Investment properties	9	19,126	34,981
Property and equipment	10	27,938	39,766
Intangible assets	11	39,467	45,619
Right-of-use assets	12	17,640	12,300
Current income tax assets	19	65	146
Deferred income tax assets	19	1,730	3,168
Other assets	13	53,625	52,583
Total assets		7,008,183	6,111,711
Liabilities			
Amounts due to banks and government funds	14	930,407	1,140,552
Amounts due to customers	15	5,181,851	4,091,379
Derivative Financial Liabilities	18	8,044	7,422
Lease liabilities	12	18,241	13,339
Debt securities issued	16	162,465	149,137
Other borrowed funds		8,586	4,058
Current income tax liabilities	19	11,802	12,798
Deferred income tax liabilities	19	2,894	9,342
Provision for guarantees and other commitments	21	11,024	10,546
Subordinated debts	17	45,103	27,165
Other liabilities	13	50,328	54,038
Total liabilities		6,430,745	5,519,776
Equity			
Share capital	20	354,512	354,512
Additional paid-in capital	20	343	343
Retained earnings		222,392	174,167
Other reserves	20	2,448	2,239
Net unrealised gain on investment securities	20	12,721	20,299
Foreign currency translation reserve	20	(56,362)	(27,822)
Total equity attributable to shareholders of the Bank		536,054	523,738
Non-controlling interests		41,384	68,197
Total equity		577,438	591,935
Total liabilities and equity		7,008,183	6,111,711

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

Taleh Kazimov

Chairman of the Executive Board

Bahruz Naghiyev

Chief Financial Officer

8 April 2022



The accompanying notes on pages 6 to 62 are an integral part of these consolidated financial statements.

Consolidated statement of profit or loss**For the year ended 31 December 2021***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Notes</i>	2021	2020
Interest income			
Loans to customers		231,864	191,169
Investment securities		75,743	59,579
Amounts due from credit institutions		6,056	7,085
Cash and cash equivalents		1,512	7,830
Interest revenue calculated using effective interest rate		315,175	265,663
Finance lease receivables		3,241	1,632
Other interest revenue		3,241	1,632
Interest expense			
Amounts due to customers		(37,616)	(35,987)
Amounts due to banks and government funds		(33,224)	(21,362)
Debt securities issued		(7,715)	(7,035)
Subordinated debts		(1,486)	(1,426)
Lease liabilities	12	(883)	(816)
Other borrowed funds		(363)	(442)
		(81,287)	(67,068)
Net interest income		237,129	200,227
Credit loss expense on financial assets	22	(24,687)	(22,061)
Net interest income after credit loss expense		212,442	178,166
Net fee and commission income	23	35,262	32,500
Net gains/(losses) from investment securities		3,131	(7)
Net gains/(losses) from foreign currencies:			
- dealing		31,868	22,864
- translation differences		(7,430)	8,574
- derivatives		8,887	4,307
Other income		3,519	1,018
Non-interest income		75,237	69,256
Personnel expenses	24	(68,388)	(69,277)
General and administrative expenses	24	(53,157)	(47,087)
Depreciation and amortisation	9, 10, 11, 12	(21,901)	(21,025)
Net gain/(loss) on modification of financial assets measured at amortised cost	8	1,398	(17)
Net losses on initial recognition of financial instruments	14	(3,778)	-
Reversal/(impairment) of miles under loyalty program		691	(691)
Reversal of impairment on Investment property		410	-
Impairment of license and digital products	11	(2,810)	(3,217)
Write-down of repossessed collaterals	24	(5,008)	(762)
Provision for credit related commitments and other assets	22	(1,030)	(596)
Other operating expenses		(631)	(89)
Non-interest expenses		(154,204)	(142,761)
Profit before income tax expense		133,475	104,661
Income tax expense	19	(31,158)	(25,178)
Profit for the year		102,317	79,483
Attributable to:			
- shareholders of the Bank		98,814	76,413
- non-controlling interests		3,503	3,070
		102,317	79,483

The accompanying notes on pages 6 to 62 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income**For the year ended 31 December 2021***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Notes</i>	2021	2020
Profit for the year		102,317	79,483
Other comprehensive income			
<i>Other comprehensive income to be reclassified to profit or loss in subsequent periods</i>			
Net change in fair value of investment securities at fair value through other comprehensive income	7	(8,955)	16,123
Changes in allowance for expected credit losses of investment securities at fair value through other comprehensive income	22	(518)	3,424
Net unrealised losses / gains on investment securities at fair value through other comprehensive income		(9,473)	19,547
Income tax relating to components of other comprehensive income	19	1,895	(3,916)
Foreign currency translation differences		(58,856)	(39,325)
Net other comprehensive loss to be reclassified to profit or loss in subsequent periods		(66,434)	(23,694)
Total comprehensive income for the year		35,883	55,789
Attributable to:			
- shareholders of the Bank		62,696	68,553
- non-controlling interests		(26,813)	(12,764)
		35,883	55,789

The accompanying notes on pages 6 to 62 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity**For the year ended 31 December 2021***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Attributable to shareholders of the Bank</i>								
	<i>Share capital</i>	<i>Additional paid-in capital</i>	<i>Retained earnings</i>	<i>Net unrealised gain/(loss) on investment securities</i>	<i>Other reserves</i>	<i>Foreign currency translation reserve</i>	<i>Total</i>	<i>Non-controlling interests</i>	<i>Total equity</i>
As at 1 January 2020	333,000	343	143,432	4,668	1,983	(4,331)	479,095	80,961	560,056
Profit for the year	-	-	76,413	-	-	-	76,413	3,070	79,483
Other comprehensive loss income/(loss) for the year	-	-	-	15,631	-	(23,491)	(7,860)	(15,834)	(23,694)
Total comprehensive income/(loss) for the year	-	-	76,413	15,631	-	(23,491)	68,553	(12,764)	55,789
Issue of share capital (Note 20)	21,512	-	-	-	-	-	21,512	-	21,512
Transfers to reserves	-	-	(256)	-	256	-	-	-	-
Dividends to shareholders of the Bank (Note 20)	-	-	(45,422)	-	-	-	(45,422)	-	(45,422)
As at 31 December 2020	354,512	343	174,167	20,299	2,239	(27,822)	523,738	68,197	591,935
Profit for the year	-	-	98,814	-	-	-	98,814	3,503	102,317
Other comprehensive loss for the year	-	-	-	(7,578)	-	(28,540)	(36,118)	(30,316)	(66,434)
Total comprehensive income/(loss) for the year	-	-	98,814	(7,578)	-	(28,540)	62,696	(26,813)	35,883
Transfers to reserves	-	-	(209)	-	209	-	-	-	-
Dividends to shareholders of the Bank (Note 20)	-	-	(50,380)	-	-	-	(50,380)	-	(50,380)
As at 31 December 2021	354,512	343	222,392	12,721	2,448	(56,362)	536,054	41,384	577,438

The accompanying notes on pages 6 to 62 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows**For the year ended 31 December 2021***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Notes</i>	2021	2020
Cash flows from operating activities			
Interest received		316,963	271,342
Interest paid		(76,953)	(63,339)
Fees and commissions received		83,216	60,430
Fees and commissions paid		(49,932)	(27,463)
Net gains from investment securities		2,446	-
Realised gains less losses from dealing in foreign currencies and foreign currency derivatives		36,046	25,140
Personnel expenses paid		(69,508)	(58,717)
General and administrative expenses paid		(50,322)	(48,798)
Other operating income received		4,759	2,767
Cash flows from operating activities before changes in operating assets and liabilities		196,715	161,362
<i>Net (increase)/decrease in operating assets</i>			
Amounts due from credit institutions		(159,007)	177,139
Loans to customers		(533,390)	(320,111)
Other assets		(16,099)	(5,334)
<i>Net increase/(decrease) in operating liabilities</i>			
Amounts due to banks and government funds		(219,965)	254,585
Amounts due to customers		1,172,439	253,498
Other borrowed funds		9,289	4,287
Other liabilities		(2,670)	(1,191)
Net cash flows from operating activities before income tax		447,312	524,235
Income tax paid		(35,133)	(16,258)
Net cash from operating activities		412,179	507,977
Cash flows from investing activities			
Proceeds from sale and redemption of investment securities		1,766,040	3,157,150
Purchase of investment securities		(2,010,538)	(3,640,801)
Proceeds from sale of investment property		2,000	-
Proceeds from sale of property and equipment		467	135
Purchase and prepayments for property and equipment		(7,986)	(5,607)
Acquisition of intangible assets		(7,070)	(5,292)
Net cash flows used in investing activities		(257,087)	(494,415)
Cash flows from financing activities			
Proceeds from issue of share capital	20	-	21,512
Proceeds from bonds issued	29	113,921	45,992
Redemption of bonds issued	29	(99,220)	(34,194)
Proceeds from subordinated debts	29	17,827	-
Finance lease paid	12	(7,021)	(6,847)
Dividends paid	20	(50,380)	(45,422)
Net cash used in financing activities		(24,873)	(18,959)
Effect of exchange rates changes on cash and cash equivalents		(5,426)	20,167
Effect of expected credit losses on cash and cash equivalents	22	74	(65)
Net increase in cash and cash equivalents		124,867	14,705
Cash and cash equivalents, beginning	5	1,200,544	1,185,839
Cash and cash equivalents, ending	5	1,325,411	1,200,544

The accompanying notes on pages 6 to 62 are an integral part of these consolidated financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

OJSC PASHA Bank (the "Bank") was established on 18 June 2007, as an open joint stock company under the laws of the Republic of Azerbaijan. The Bank operates under a banking licence No. 250 issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") on 28 November 2007.

The Bank and its subsidiaries (together – "the Group") accept deposits from the public and extend credit, transfer payments, exchange currencies and provide other banking services to its commercial and private customers.

As at 31 December 2021, the Bank has six service points (2020: six), three branches (2020: three) in Azerbaijan and two subsidiaries (2020: two), JSC PASHA Bank Georgia located in the Republic of Georgia and PASHA Yatirim Bankasi A.Ş. (the "Subsidiaries") located in the Republic of Turkey. The Bank's registered legal address is 15 Yusif Mammadaliyev Street, Baku, AZ1005, Azerbaijan.

As at 31 December 2021 and 2020, the following shareholders owned the outstanding shares of the Bank:

Shareholder	2021, (%)	2020, (%)
PASHA Holding LLC	57	57
Bless LLC	28	–
Mr. Arif Pashayev	10	10
Mr. Mir Jamal Pashayev	5	5
Ador LLC	–	28
Total	100	100

As at 31 December 2021 and 2020, the Group is ultimately owned by Mrs. Leyla Aliyeva, Mrs. Arzu Aliyeva, Mr. Arif Pashayev and Mr. Mir Jamal Pashayev, who exercise collective control over the Group.

PASHA Bank Georgia JSC, a wholly – owned subsidiary, is located in the Republic of Georgia, operating in the banking sector, with registered and paid up share capital of GEL 35,000 thousand as at 31 December 2013. In March 2014 share capital of subsidiary was increased and amounted to GEL 103,000 thousand as at 31 December 2021 and 2020. PASHA Bank Georgia JSC operates under a banking licence issued by the National Bank of Georgia (the "NBG") on 17 January 2013. Legal address of the PASHA Bank Georgia JSC is 37M, Ilia Chavchavadze Avenue, 0179, Tbilisi, Georgia.

TAIB Yatirim Bank A.Ş. was incorporated in 1987 as an investment bank in Turkey with the permission of the Council of Ministers decision No. 6224 which allows the transfer of the banks' net profit after statutory liabilities and in case of liquidation the transfer of capital to foreign shareholders. On 27 January 2015, the Bank acquired 79.47% of the voting common shares of TAIB Yatirim Bank A.Ş. and it was renamed to PASHA Yatirim Bankasi A.Ş. at the registration of the Bank as shareholder. In March 2015, investment in share capital of the subsidiary was increased by TRY 175,000 thousand to TRY 255,000 thousand increasing ownership in subsidiary to 99.92%. On 6 June 2018, share capital of subsidiary was increased by TRY 245,000 thousand to TRY 500,000 thousand. The increase was made based on decision of Supervisory Board of the Bank, according to which newly issued shares were acquired by PASHA Holding Ltd. As a result, the Bank's shares in the subsidiary decreased from 99.92% to 50.96% and PASHA Holding Ltd became a new non-controlling shareholder with ownership of 49% since 6 June 2018. Head office of PASHA Yatirim Bankasi A.Ş. is located in Istanbul. The activities of the bank are regulated by the Central Bank of the Republic of Turkey (the "CBRT").

OJSC PASHA Bank and its subsidiaries (together – "the Group") were consolidated in these financial statements.

2. Basis of preparation

General

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

The Azerbaijani manat is the functional and presentation currency of OJSC PASHA Bank as the majority of the transactions are denominated, measured, or funded in Azerbaijani manat. Transactions in other currencies are treated as transactions in foreign currencies. The Group is required to maintain its records and prepare its financial statements in Azerbaijani manat and in accordance with IFRS. These consolidated financial statements are presented in thousands of Azerbaijani manat ("AZN"), except per share amounts and unless otherwise indicated. The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies, for certain investment securities at FVOCI and derivative financial instruments which have been measured at fair value.

(Figures in tables are in thousands of Azerbaijani manats)

2. Basis of preparation (continued)

Effect of COVID-19 pandemic

Following the rapid spread of COVID-19 pandemic in 2020, which continued in 2021, many governments, including the Government of the Republic of Azerbaijan, the Government of the Republic of Turkey and the Government of the Republic of Georgia have introduced various measures to combat the outbreak, including travel restrictions, quarantines, closure of business and other venues and lockdown of certain areas. These measures have affected the global supply chain, demand for goods and services, as well as scale of business activity. It is expected that pandemic itself as well as the related public health and social measures may influence the business of the entities in a wide range of industries.

Support measures were introduced by the Government and the Central Bank of Azerbaijan to counter the economic downturn caused by the COVID-19 pandemic. These measures include, among others, subsidized lending to affected industries and individuals and easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources and to help customers avoid liquidity shortages as a result of the COVID-19 containment measures.

Support measures were introduced by the Government of the Republic of Georgia and NBG to counter the economic downturn caused by the COVID-19 pandemic. These measures include, among others, subsidized lending to affected industries and individuals, payment holidays and easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources and to help customers avoid liquidity shortages as a result of the COVID-19 containment measures.

The Government of the Republic of Turkey, the CBRT and The Banking Regulation and Supervision Agency (hereafter, "BRSA") have announced measures and incentives, due to the spread of the virus in Europe, and in Turkey. The CBRT cut its policy rate and announced liquidity measures. The government has also announced the economic stability package. In this context, the Credit Guarantee Fund limit was increased twice. Within the fiscal package, deferral options for tax and debt payments were also announced.

The Group continues to assess pandemic effect and changing micro- and macroeconomic conditions on its activities, financial position and financial results.

3. Summary of accounting policies

Changes in accounting policies

The Group applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2021. The Group has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective.

COVID-19-Related Rent Concessions beyond 30 June 2021 Amendments to IFRS 16

On 28 May 2020, the IASB issued *COVID-19-Related Rent Concessions – amendment to IFRS 16 Leases*. The amendments provide relief to lessees from applying IFRS 16 guidance on lease modification accounting for rent concessions arising as a direct consequence of the COVID-19 pandemic. As a practical expedient, a lessee may elect not to assess whether a COVID-19 related rent concession from a lessor is a lease modification. A lessee that makes this election accounts for any change in lease payments resulting from the COVID-19 related rent concession the same way it would account for the change under IFRS 16, if the change were not a lease modification.

The amendment was intended to apply until 30 June 2021, but as the impact of the COVID-19 pandemic is continuing, on 31 March 2021, the IASB extended the period of application of the practical expedient to 30 June 2022. The amendment applies to annual reporting periods beginning on or after 1 April 2021. However, the Group has not received COVID-19-related rent concessions, but plans to apply the practical expedient if it becomes applicable within allowed period of application.

Basis of consolidation

Subsidiaries, which are those entities which are controlled by the Group, are consolidated. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if, and only if, the Group has:

- ▶ Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee);
- ▶ Exposure, or rights, to variable returns from its involvement with the investee;
- ▶ The ability to use its power over the investee to affect its returns.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Basis of consolidation (continued)

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- ▶ The contractual arrangement(s) with the other vote holders of the investee;
- ▶ Rights arising from other contractual arrangements;
- ▶ The Group's voting rights and potential voting rights.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All intra-group transactions, balances and unrealised gains on transactions between group companies are eliminated in full; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses are attributed to the non-controlling interests even if that results in a deficit balance.

If the Group loses control over a subsidiary, it derecognises the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests, the cumulative translation differences, recorded in equity; recognises the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in profit or loss and reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss.

Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interests in the acquiree. For each business combination, the acquirer measures the non-controlling interests in the acquiree that are present ownership interests either at fair value or at the proportionate share of the acquiree's identifiable net assets and other components of non-controlling interests at their acquisition date fair value. Acquisition costs incurred are expensed.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value as at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the acquirer is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability, will be recognised in accordance with IFRS 9 either in profit or loss or as change to other comprehensive income. If the contingent consideration is classified as equity, it shall not be remeasured until it is finally settled within equity.

Goodwill is initially measured at cost being the excess of the consideration transferred over the acquiree's net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Fair value measurement

The Group measures financial instruments carried at FVPL and FVOCI at fair value at each balance sheet date.

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

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

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

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

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

Financial assets and liabilities

Initial recognition

Date of recognition

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

Initial measurement

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

Measurement categories of financial assets and liabilities

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

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

The Group only measures amounts due from credit institutions, loans to customers and investment securities at amortised cost if both of the following conditions are met:

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

The details of these conditions are outlined below.

Business model assessment

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

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

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

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

The SPPI test

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

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

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

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

Debt instruments at FVOCI

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

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

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

Equity instruments at FVOCI

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

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

Financial guarantees, letters of credit and undrawn loan commitments

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

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

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

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

Performance guarantees

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Performance guarantees do not transfer credit risk. The risk under performance guarantee contracts is the possibility that the failure to perform the contractual obligation by another party occurs. Provision for Performance guarantees are measured in accordance with IFRS 9.

Reclassification of financial assets and liabilities

The Group does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Group changes the business model for managing financial assets. Financial liabilities are never reclassified. The Group did not reclassify any of its financial assets and liabilities in 2021 and 2020.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the CBAR, NBS and CBRT, excluding obligatory reserves, and amounts due from credit institutions with due on demand or up to 3 months from the date of origination and that are free from contractual encumbrances.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Repurchase and reverse repurchase agreements

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the consolidated statement of financial position and, in case the transferee has the right by contract or custom to sell or re-pledge them, reclassified as securities pledged under sale and repurchase agreements. The corresponding liability is presented within amounts due to credit institutions or customers.

Securities purchased under agreements to resell ("reverse repo") are recorded on the consolidated statement of financial position as cash and cash equivalents or investment securities as appropriate depending on their contractual term. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

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

Derivative financial instruments

In the normal course of business, the Group enters into various derivative financial instruments including futures, forwards, swaps and options in the foreign exchange and capital markets. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative.

Gains and losses resulting from these instruments are included in the consolidated statement of profit or loss as net gains/(losses) from financial instruments at fair value through profit or loss or net gains/(losses) from foreign currencies, depending on the nature of the instrument.

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

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

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

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to banks and government funds, other borrowed funds, debt securities issued, subordinated debts and amounts due to customers. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the borrowings are derecognised as well as through the amortisation process.

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Leases

i. Group as a lessee

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

Right-of-use assets

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

Lease liabilities

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

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

Short-term leases and leases of low-value assets

The Group applies the short-term lease recognition exemption to its short-term leases (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value (i.e., below USD 5,000). Lease payments on short-term leases and leases of low-value assets are recognised as expense on a straight-line basis over the lease term.

ii. Finance – Group as a lessor

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

Offsetting of financial instruments

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Renegotiated loans

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

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

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

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

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Write-off

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

Financial liabilities

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Taxation

The current income tax expense is calculated in accordance with the regulations of the Republic of Azerbaijan and of the countries in which the Group has offices and branches and where its subsidiaries are located.

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

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

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

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

Property and equipment

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

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

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

	<u>Years</u>
Buildings	20-50
Furniture and fixtures	4-10
Computers and other equipment	3-10
Vehicles	4-5
Other equipment	3-15
Leasehold improvements	2-7

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end. Costs related to repairs and renewals are charged when incurred and included in general and administrative expenses, unless they qualify for capitalization.

Investment properties

Investment properties held are land and building with a useful life up to 50 years or a part of building held to earn rental income or for capital appreciation and which is not used by the Group or held for the sale in the ordinary course of business. Property that is being constructed or developed or redeveloped for future use as investment property is also classified as investment property.

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Investment properties (continued)

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

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

Repossessed collaterals

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

Intangible assets

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

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

Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

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

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

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

Retirement and other employee benefit obligations

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

Share capital

Share capital

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Share capital (continued)

Dividends

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

Contingencies

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

Recognition of income and expenses

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

Interest and similar income and expense

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

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

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

Interest revenue on all financial assets at FVPL is recognised using the contractual interest rate in "Other interest revenue" in the consolidated statement of profit or loss.

Fee and commission income

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

Fee income from providing transaction services

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

Customer loyalty programs

The Group offers a number customer loyalty programs. Accounting for such programs varies depending on who is identified as the customer, and whether the Group acts as an agent or as a principal under the contract.

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

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

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

Dividend income

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

Foreign currency translation

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

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

The Group used the following official exchange rates at 31 December 2021 and 2020, in the preparation of these financial statements:

	<u>2021</u>	<u>2020</u>
1 US dollar	AZN 1.7000	AZN 1.7000
1 Euro	AZN 1.9265	AZN 2.0890
1 Georgian lari	AZN 0.5489	AZN 0.5193
1 Turkish lira	AZN 0.1329	AZN 0.2305

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Standards issued but not yet effective

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

IFRS 17 Insurance Contracts

In May 2017, the IASB issued IFRS 17 *Insurance Contracts* (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 *Insurance Contracts* (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply. IFRS 17 introduces new accounting requirements for banking products with insurance features that may affect the determination of which instruments or which components thereof will be in the scope of IFRS 9 or IFRS 17.

Credit cards and similar products that provide insurance coverage: most issuers of these products will be able to continue with their existing accounting treatment as a financial instrument under IFRS 9. IFRS 17 excludes from its scope credit card contracts (and other similar contracts that provide credit or payment arrangements) that meet the definition of an insurance contract if, and only if, the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.

When the insurance coverage is provided as part of the contractual terms of the credit card, the issuer is required to:

- ▶ Separate the insurance coverage component and apply IFRS 17 to it;
- ▶ Apply other applicable standards (such as IFRS 9, IFRS 15 *Revenue from Contracts with Customers* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) to the other components.

Loan contracts that meet the definition of insurance but limit the compensation for insured events to the amount otherwise required to settle the policyholder's obligation created by the contract: Issuers of such loans – e.g. a loan with waiver on death – have an option to apply IFRS 9 or IFRS 17. The election would be made at a portfolio level and would be irrevocable.

IFRS 17 is effective for reporting periods beginning on or after 1 January 2023, with comparative figures required. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17.

The Group is currently in the process of assessing the impact of adopting IFRS 17 on its consolidated financial statements.

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

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

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

The amendments are effective for annual reporting periods beginning on or after 1 January 2023 and must be applied retrospectively. The Group is currently assessing the impact the amendments will have on current practice and whether existing loan agreements may require renegotiation.

Reference to the Conceptual Framework – Amendments to IFRS 3

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

The Board also added an exception to the recognition principle of IFRS 3 to avoid the issue of potential 'day 2' gains or losses arising for liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 *Levies*, if incurred separately.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

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*.

The amendments are effective for annual reporting periods beginning on or after 1 January 2022 and apply prospectively. The amendments are not expected to have a material impact on the Group.

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 recognises the proceeds from selling such items, and the costs of producing those items, in profit or loss.

The amendment is effective for annual reporting periods beginning on or after 1 January 2022 and must be applied retrospectively to items of property, plant and equipment made available for use on or after the beginning of the earliest period presented when the entity first applies the amendment.

The amendments are not expected to have a material impact on the Group.

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.

The amendments are effective for annual reporting periods beginning on or after 1 January 2022. The Group will apply these amendments to contracts for which it has not yet fulfilled all its obligations at the beginning of the annual reporting period in which it first applies the amendments.

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

As part of its 2018-2020 annual improvements to IFRS standards process the IASB issued 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.

The amendment is effective for annual reporting periods beginning on or after 1 January 2022 with earlier adoption permitted. The Group will apply the amendments 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.

The amendments are not expected to have a material impact on the Group.

Definition of Accounting Estimates – Amendments to IAS 8

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

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

The amendments are not expected to have a material impact on the Group.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

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

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

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

4. Significant accounting judgements and estimates

Judgements

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

Determining the lease term of contracts with renewal options

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

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

Estimation uncertainty

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

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 26.

Impairment losses on financial assets

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

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Significant accounting judgements and estimates (continued)

Estimation uncertainty (continued)

More details are provided in Notes 8 and 25.

Impairment of banking license

The recoverable amount of banking license is measured annually, irrespective of whether there is any indication that it may be impaired. This requires an estimation of the value in use of the cash-generating unit. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The Group reviews and validates at the end of each reporting period its decision to classify the useful life of an intangible asset as indefinite. If events and circumstances no longer support an indefinite useful life, the change from indefinite to finite life is accounted for as a change in accounting estimate under IAS 8, which requires such changes to be recognised prospectively.

Furthermore, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. The carrying amount of banking license at 31 December 2021 was AZN 4,729 thousand (31 December 2020: AZN 11,836 thousand), more details are provided in Note 11.

Impairment of digital products

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

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

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

The carrying amount of digital products at 31 December 2021 was AZN 10,191 thousand (31 December 2020: AZN 12,845 thousand). More details are provided in Note 11.

Net realisable value of repossessed collaterals

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

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

The carrying amount of repossessed collaterals at 31 December 2021 was AZN 10,853 thousand (31 December 2020: AZN 16,211 thousand). More details are provided in Note 13.

(Figures in tables are in thousands of Azerbaijani manats)

4. Significant accounting judgements and estimates (continued)

Estimation uncertainty (continued)

Leases – estimating the incremental borrowing rate

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

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

Taxation

Tax legislation in Azerbaijan, Turkey and Georgia is subject to varying interpretations, and changes can occur frequently. Management believes that as at 31 December 2021 and 2020 its interpretation of the relevant legislation is appropriate and that the Group's tax position will be sustained.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	<u>2021</u>	<u>2020</u>
Cash on hand	84,590	65,515
Current accounts with the CBAR, the NBG and the CBRT	1,069,209	587,649
Current accounts with other credit institutions	93,282	87,432
Time deposits with credit institutions up to 3 months	77,841	431,262
Reverse repurchase agreements with credit institutions up to 3 months	500	28,771
Less: allowance for impairment	(11)	(85)
Cash and cash equivalents	<u>1,325,411</u>	<u>1,200,544</u>

Current accounts with other credit institutions consist of non-interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 4,230 thousand (31 December 2020: AZN 1,160 thousand) and AZN 89,052 thousand (31 December 2020: AZN 86,272 thousand), respectively.

As at 31 December 2021, the Group placed AZN 77,841 thousand in time deposits with one resident and six non-resident banks maturing through January 2022 (31 December 2020: AZN 431,262 thousand in time deposits with CBAR and fifteen non-resident banks maturing through March 2021).

All balances of cash equivalents are allocated to Stage 1.

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	<u>2021</u>	<u>2020</u>
Time deposits with credit institutions for more than 3 months	323,240	234,386
Loans to banks	37,070	28,995
Obligatory reserve with the CBAR, the NBG and the CBRT	90,195	79,292
Restricted deposits	152,964	114,237
	<u>603,469</u>	<u>456,910</u>
Less: allowance for impairment	(861)	(485)
Amounts due from credit institutions	<u>602,608</u>	<u>456,425</u>

As at 31 December 2021, time deposits with credit institutions mature between January 2022 and August 2023 (31 December 2020: between January 2021 and April 2023).

(Figures in tables are in thousands of Azerbaijani manats)

6. Amounts due from credit institutions (continued)

As at 31 December 2021, the Bank had outstanding amount of AZN 37,070 thousand of secured loans issued to four resident commercial banks with contractual maturity through September 2023 (31 December 2020: AZN 28,995 thousand of secured loans issued to three resident commercial banks with a contractual maturity through March 2021).

Credit institutions in the Republic of Azerbaijan are required to maintain a mandatory reserve rates (with restriction on withdrawal) a non-interest earning cash deposit (obligatory reserve) with the CBAR at the level of 0.5% (2020: 0.5%) and 1.0% (2020: 1.0%) of the previous month average of funds attracted from customers by a credit institution in AZN and foreign currencies, respectively.

Credit institutions in the Republic of Georgia are required to maintain a mandatory interest earning cash deposit with the NBS at the level of 5.0% (2020: 5.0%) and 25.0% (2020: 25.0%) of the average of funds attracted from customers and non-resident financial institutions for the appropriate two-week period in GEL and foreign currencies, respectively.

Credit institutions in the Turkish Republic are required to maintain a mandatory reserve rates for deposits with the CBRT in the range of 3.0% and 8.0% (2020: 1.0 and 6.0%) and 5.0% and 25.0% (2020: 7.0 and 21.0%) of average of funds attracted from customers by a credit institution in TL and foreign currencies, respectively.

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

	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2021	442,929	-	13,981	456,910
New assets originated or purchased	378,770	-	-	378,770
Assets repaid	(230,467)	-	-	(230,467)
Foreign exchange adjustments	(1,744)	-	-	(1,744)
At 31 December 2021	589,488	-	13,981	603,469

	Stage 1	Stage 2	Stage 3	Total
ECL allowance as at 1 January 2021	(485)	-	-	(485)
New assets originated or purchased	(787)	-	-	(787)
Assets repaid	365	-	-	365
Foreign exchange adjustments	46	-	-	46
At 31 December 2021	(861)	-	-	(861)

An analysis of changes in gross carrying value and corresponding ECL allowance on amounts due from credit institutions during the year ended 31 December 2020 is as follows:

	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2020	610,741	14,214	-	624,955
New assets originated or purchased	282,192	-	-	282,192
Assets repaid	(445,794)	(233)	-	(446,027)
Transfers to Stage 3	-	(13,981)	13,981	-
Foreign exchange adjustments	(4,210)	-	-	(4,210)
At 31 December 2020	442,929	-	13,981	456,910

	Stage 1	Stage 2	Stage 3	Total
ECL allowance as at 1 January 2020	(561)	-	-	(561)
New assets originated or purchased	(293)	-	-	(293)
Assets repaid	363	-	-	363
Foreign exchange adjustments	6	-	-	6
At 31 December 2020	(485)	-	-	(485)

As at 31 December 2021 and 31 December 2020, credit-impaired loan in the amount of AZN 13,981 thousand is full covered with a real estate property pledged under mortgage agreement.

(Figures in tables are in thousands of Azerbaijani manats)

7. Investment securities

Investment securities comprise:

	<u>2021</u>	<u>2020</u>
Debt securities at FVOCI		
Bonds of the Ministry of Finance of the Republic of Azerbaijan	616,722	553,787
Azerbaijan Mortgage Fund bonds	592,843	531,372
Corporate bonds	216,142	139,453
US treasury bonds	142,186	4,445
Certificate of deposits	93,741	94,216
Bonds of financial institutions	70,659	76,641
Other foreign governments' bonds	58,187	44,216
Notes issued by the Central Bank of Azerbaijan Republic	16,563	151,318
	<u>1,807,043</u>	<u>1,595,448</u>
Debt securities at FVOCI		
	<u>1,807,043</u>	<u>1,595,448</u>
Equity securities at FVOCI		
Corporate Shares	3,021	1,765
	<u>3,021</u>	<u>1,765</u>
Equity securities at FVOCI		
	<u>3,021</u>	<u>1,765</u>
Equity securities at FVTPL		
Mutual funds participation certificate	2,785	1,707
	<u>2,785</u>	<u>1,707</u>
Equity securities at FVTPL		
	<u>2,785</u>	<u>1,707</u>
Debt securities at amortized cost		
Bonds of financial institutions	28,871	27,284
Other foreign governments' bonds	28,234	13,234
Corporate bonds	14,159	10,619
	<u>71,264</u>	<u>51,137</u>
Less: allowance for impairment	(749)	(621)
	<u>70,515</u>	<u>50,516</u>
Debt securities at amortized cost		
	<u>70,515</u>	<u>50,516</u>

As at 31 December 2020, debt securities at FVOCI in total amount of AZN 150,000 thousand are pledged as collateral for repurchase agreement with National Depository Centre of Azerbaijan (Note 14). The net investment securities balance after offset would have been AZN 1,499,436 thousand if net-off rights were exercised. As at 31 December 2021 investment are free from liens and encumbrances.

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

Debt securities at FVOCI	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2021	1,595,448	-	-	1,595,448
New assets originated or purchased	253,692	-	-	253,692
Assets repaid or sold	(29,256)	-	-	(29,256)
Unwinding of discount (recognised in interest income)	(98)	-	-	(98)
Fair value decrease	(8,955)	-	-	(8,955)
Foreign exchange adjustments	(3,788)	-	-	(3,788)
At 31 December 2021	<u>1,807,043</u>	<u>-</u>	<u>-</u>	<u>1,807,043</u>
Debt securities at FVOCI	Stage 1	Stage 2	Stage 3	Total
ECL allowance as at 1 January 2021	(4,246)	-	-	(4,246)
New assets originated or purchased	(1,567)	-	-	(1,567)
Assets repaid or sold	2,097	-	-	2,097
Changes to models and inputs used for ECL calculations	(12)	-	-	(12)
Foreign exchange adjustments	35	-	-	35
At 31 December 2021	<u>(3,693)</u>	<u>-</u>	<u>-</u>	<u>(3,693)</u>

(Figures in tables are in thousands of Azerbaijani manats)

7. Investment securities (continued)

<i>Debt securities at FVOCI</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at 1 January 2020	1,105,195	583	-	1,105,778
New assets originated or purchased	703,635	-	-	703,635
Assets repaid or sold	(229,013)	(488)	-	(229,501)
Unwinding of discount (recognised in interest income)	117	(10)	-	107
Fair value increase	16,123	-	-	16,123
Foreign exchange adjustments	(609)	(85)	-	(694)
At 31 December 2020	1,595,448	-	-	1,595,448

<i>Debt securities at FVOCI</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL allowance as at 1 January 2020	(828)	(5)	-	(833)
New assets originated or purchased	(3,654)	-	-	(3,654)
Assets repaid or sold	226	4	-	230
Foreign exchange adjustments	10	1	-	11
At 31 December 2020	(4,246)	-	-	(4,246)

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

<i>Debt securities at amortised cost</i>	<i>Stage 1</i>
Gross carrying value as at 1 January 2021	51,137
New assets originated	48,893
Assets repaid	(3,886)
Unwinding of discount (recognised in interest revenue)	735
Foreign exchange and other movements	(25,615)
At 31 December 2021	71,264

<i>Debt securities at amortised cost</i>	<i>Stage 1</i>
ECL as at 1 January 2021	(621)
New assets originated	(379)
Assets repaid	2
Changes to models and inputs used for ECL calculation	(32)
Foreign exchange and other movements	281
At 31 December 2021	(749)

<i>Debt securities at amortised cost</i>	<i>Stage 1</i>
Gross carrying value as at 1 January 2020	38,812
New assets originated	28,697
Assets repaid	(15,252)
Unwinding of discount (recognised in interest revenue)	55
Foreign exchange and other movements	(1,175)
At 31 December 2020	51,137

<i>Debt securities at amortised cost</i>	<i>Stage 1</i>
ECL as at 1 January 2020	(426)
New assets originated	(513)
Assets repaid	240
Changes to models and inputs used for ECL calculation	(3)
Foreign exchange and other movements	81
At 31 December 2020	(621)

(Figures in tables are in thousands of Azerbaijani manats)

8. Loans to customers

Loans to customers comprise:

	<u>2021</u>	<u>2020</u>
Legal entities	2,808,078	2,441,171
Individuals	315,391	241,685
Loans to customers (gross)	3,123,469	2,682,856
Less: allowance for impairment	(96,164)	(74,038)
Loans to customers (net)	3,027,305	2,608,818

Loans are made in the following industry sectors:

	<u>2021</u>	<u>2020</u>
Trade and services	1,460,654	1,221,601
Manufacturing	360,062	340,344
Construction	328,149	262,752
Individuals	315,391	241,685
Transport and telecommunication	201,356	119,733
Agriculture and food processing	154,859	161,293
Non-banking credit organizations	119,700	118,482
Energy	70,896	74,818
Mining	41,706	41,679
Real estate management	30,759	41,300
Leasing	25,616	29,624
Other	14,321	29,545
Total loans (gross)	3,123,469	2,682,856

As at 31 December 2021, loans granted to top 16 customers (2020: 9 customers) which individually exceeded 5% of the Group's equity, amounted to AZN 1,027,958 thousand (2020: AZN 773,133 thousand).

Finance lease receivables

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

	<u>Not later than 1 year</u>	<u>Later than 1 year and not later than 5 years</u>	<u>Later than 5 years</u>
Gross investment in finance leases	18,533	38,267	-
Unearned future finance income on finance leases	(3,051)	(4,077)	-
Net investment in finance leases	15,482	34,190	-

The analysis of finance lease receivables at 31 December 2020 is as follows:

	<u>Not later than 1 year</u>	<u>Later than 1 year and not later than 5 years</u>	<u>Later than 5 years</u>
Gross investment in finance leases	10,763	16,740	4,104
Unearned future finance income on finance leases	(2,177)	(4,277)	(220)
Net investment in finance leases	8,586	12,463	3,884

(Figures in tables are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

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

	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2021	1,434,825	1,087,661	160,370	2,682,856
New assets originated or purchased	1,907,613	-	-	1,907,613
Assets repaid (excluding write-offs)	(968,978)	(276,456)	(25,121)	(1,270,555)
Transfers to Stage 1	192,947	(190,568)	(2,379)	-
Transfers to Stage 2	(393,695)	409,907	(16,212)	-
Transfers to Stage 3	(45,837)	(49,316)	95,153	-
Amounts written off	-	-	(7,130)	(7,130)
Recovery	-	-	5,975	5,975
Foreign exchange adjustments	(179,666)	(11,850)	(3,774)	(195,290)
At 31 December 2021	1,947,209	969,378	206,882	3,123,469
	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2021	(14,034)	(32,547)	(27,457)	(74,038)
New assets originated or purchased	(47,855)	-	-	(47,855)
Assets repaid	6,330	7,952	8,527	22,809
Transfers to Stage 1	(4,146)	3,926	220	-
Transfers to Stage 2	13,281	(16,393)	3,112	-
Transfers to Stage 3	21,562	7,057	(28,619)	-
Impact on period end ECL of exposures transferred between stages during the period	2,328	850	(7,491)	(4,313)
Unwinding of discount (recognised in interest revenue)	-	-	(4,123)	(4,123)
Changes to models and inputs used for ECL calculations	1,435	3,753	(277)	4,911
Amounts written off	-	-	7,130	7,130
Recovery	-	-	(5,975)	(5,975)
Foreign exchange adjustments	1,142	1,904	2,244	5,290
At 31 December 2021	(19,957)	(23,498)	(52,709)	(96,164)

* The effect of recovery on consolidated statement of profit or loss is included within Assets repaid line. See Note 22.

An analysis of changes in the gross carrying value and corresponding ECL during the year ended 31 December 2020 is as follows:

	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 1 January 2020	1,603,196	598,092	162,621	2,363,909
New assets originated or purchased	1,578,324	-	-	1,578,324
Assets repaid (excluding write-offs)	(941,818)	(273,708)	(21,708)	(1,237,234)
Transfers to Stage 1	55,388	(55,387)	(1)	-
Transfers to Stage 2	(825,745)	825,772	(27)	-
Transfers to Stage 3	(23,541)	(8,161)	31,702	-
Amounts written off	-	-	(11,400)	(11,400)
Foreign exchange adjustments	(10,979)	1,053	(817)	(10,743)
At 31 December 2020	1,434,825	1,087,661	160,370	2,682,856

(Figures in tables are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2020	(12,102)	(21,090)	(33,729)	(66,921)
New assets originated or purchased	(33,796)	-	-	(33,796)
Assets repaid	8,458	8,076	10,384	26,918
Transfers to Stage 1	(836)	836	-	-
Transfers to Stage 2	17,354	(17,377)	23	-
Transfers to Stage 3	8,577	897	(9,474)	-
Impact on period end ECL of exposures transferred between stages during the period	652	(5,346)	(3,840)	(8,534)
Unwinding of discount (recognised in interest revenue)	-	-	(3,478)	(3,478)
Changes to models and inputs used for ECL calculations	(3,129)	190	(15)	(2,954)
Amounts written off	-	-	11,400	11,400
Foreign exchange adjustments	788	1,267	1,272	3,327
At 31 December 2020	(14,034)	(32,547)	(27,457)	(74,038)

Modified and restructured loans

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

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

The table below includes assets that were modified during the year, with the related modification gain / (loss) suffered by the Group.

	2021	2020
Loans modified during the period		
Amortised cost before modification	164,957	384,428
Net modification gain/(loss)	1,398	(17)

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

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

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

The Group calculates LGD rate of certain Legal entities in Stage 3 using discounted value of collaterals. As at 31 December 2021, maximum exposure of such individually assessed loans amounted to AZN 179,185 thousand (31 December 2020: AZN 133,131 thousand) for which ECL of AZN 38,443 thousand (31 December 2020: AZN 15,453 thousand) was created. If these loans were not collateralized, ECL amount for these loans would be AZN 83,796 thousand (31 December 2020: AZN 91,955 thousand) based on collective assessment.

(Figures in tables are in thousands of Azerbaijani manats)

9. Investment properties

The movements in investment properties were as follows:

	2021	2020
Opening balance at 1 January	34,981	43,302
Disposals	(1,590)	
Amortisation for the period	(188)	(181)
Foreign translation difference	(14,077)	(8,140)
Closing balance	<u>19,126</u>	<u>34,981</u>

In 2011, the Group acquired land for the amount of AZN 2,000 thousand as investment property which is held for long-term appreciation in value. As at 31 December 2020, the fair value of this investment property amounted to AZN 1,590 thousand. During 2021, the Group sold the land for AZN 2,500 thousand.

As at 31 December 2021, the Group has a real estate classified as investment property amounting to AZN 19,126 thousand with fair value of AZN 21,397 thousand (2020: AZN 35,267 thousand).

10. Property and equipment

The movements in property and equipment were as follows:

	Land	Buildings	Furniture and fixtures	Computers and other equipment	Vehicles	Other equipment	Leasehold improve- ments	Total
Cost								
31 December 2019	17,082	16,568	20,135	15,061	2,099	1,155	5,340	77,440
Additions	-	1	4,058	1,517	755	41	127	6,499
Disposals	-	-	(705)	(464)	(210)	(30)	(115)	(1,524)
Transfers	-	-	(140)	242	-	-	(102)	-
Foreign currency translation difference	(3,248)	(2,160)	(408)	(527)	(130)	(129)	(342)	(6,944)
31 December 2020	<u>13,834</u>	<u>14,409</u>	<u>22,940</u>	<u>15,829</u>	<u>2,514</u>	<u>1,037</u>	<u>4,908</u>	<u>75,471</u>
Additions	-	28	4,090	1,412	214	4	-	5,748
Disposals	-	-	(546)	(5,505)	(454)	(90)	(441)	(7,036)
Transfers	-	-	491	(491)	-	-	-	-
Foreign currency translation difference	(5,730)	(3,822)	(226)	(264)	(145)	(117)	106	(10,198)
31 December 2021	<u>8,104</u>	<u>10,615</u>	<u>26,749</u>	<u>10,981</u>	<u>2,129</u>	<u>834</u>	<u>4,573</u>	<u>63,985</u>
Accumulated depreciation								
31 December 2019	(2,746)	(3,133)	(11,782)	(10,227)	(1,322)	(488)	(1,706)	(31,404)
Depreciation charge	-	(410)	(3,423)	(1,964)	(297)	(111)	(807)	(7,012)
Disposals	-	-	611	456	208	5	46	1,326
Transfers	-	-	-	(13)	-	-	13	-
Foreign currency translation difference	531	301	113	311	44	30	55	1,385
31 December 2020	<u>(2,215)</u>	<u>(3,242)</u>	<u>(14,481)</u>	<u>(11,437)</u>	<u>(1,367)</u>	<u>(564)</u>	<u>(2,399)</u>	<u>(35,705)</u>
Depreciation charge	-	(411)	(3,917)	(1,811)	(436)	(96)	(712)	(7,383)
Disposals	-	-	307	4,301	447	43	160	5,258
Transfers	-	-	(491)	491	-	-	-	-
Foreign currency translation difference	938	623	60	102	60	26	(26)	1,783
31 December 2021	<u>(1,277)</u>	<u>(3,030)</u>	<u>(18,522)</u>	<u>(8,354)</u>	<u>(1,296)</u>	<u>(591)</u>	<u>(2,977)</u>	<u>(36,047)</u>
Net book value								
31 December 2021	<u>6,827</u>	<u>7,585</u>	<u>8,227</u>	<u>2,627</u>	<u>833</u>	<u>243</u>	<u>1,596</u>	<u>27,938</u>
31 December 2020	<u>11,619</u>	<u>11,167</u>	<u>8,459</u>	<u>4,392</u>	<u>1,147</u>	<u>473</u>	<u>2,509</u>	<u>39,766</u>
31 December 2019	<u>14,336</u>	<u>13,435</u>	<u>8,353</u>	<u>4,834</u>	<u>777</u>	<u>667</u>	<u>3,634</u>	<u>46,036</u>

As at 31 December 2021, property and equipment amounting to AZN 16,278 thousand (31 December 2020: AZN 15,169 thousand) were fully depreciated but in use.

(Figures in tables are in thousands of Azerbaijani manats)

11. Intangible assets

The movements in intangible assets were as follows:

	<u>Goodwill</u>	<u>Banking license</u>	<u>Licenses</u>	<u>Computer software</u>	<u>Digital products</u>	<u>Total</u>
Cost						
31 December 2019	3,642	26,595	16,122	18,465	14,980	79,804
Additions	-	-	2,760	1,801	5,412	9,973
Disposals	-	-	(1,026)	(369)	-	(1,395)
Foreign currency translation difference	-	(3,233)	(12)	(975)	-	(4,220)
31 December 2020	3,642	23,362	17,844	18,922	20,392	84,162
Additions	-	-	4,718	5,297	-	10,015
Disposals	-	-	(336)	(602)	-	(938)
Foreign currency translation difference	-	(5,012)	6	(1,138)	-	(6,144)
31 December 2021	3,642	18,350	22,232	22,479	20,392	87,095
Accumulated amortization						
31 December 2019	(3,642)	(9,886)	(6,696)	(5,436)	(3,723)	(29,383)
Amortisation charge	-	-	(2,924)	(2,421)	(2,342)	(7,687)
Disposals	-	-	971	372	-	1,343
Impairment	-	(1,735)	-	-	(1,482)	(3,217)
Foreign currency translation difference	-	95	7	299	-	401
31 December 2020	(3,642)	(11,526)	(8,642)	(7,186)	(7,547)	(38,543)
Amortisation charge	-	-	(2,944)	(2,650)	(2,654)	(8,248)
Disposals	-	-	139	576	-	715
Impairment	-	(2,810)	-	-	-	(2,810)
Foreign currency translation difference	-	715	(3)	546	-	1,258
31 December 2021	(3,642)	(13,621)	(11,450)	(8,714)	(10,201)	(47,628)
Net book value						
31 December 2021	-	4,729	10,782	13,765	10,191	39,467
31 December 2020	-	11,836	9,202	11,736	12,845	45,619
31 December 2019	-	16,709	9,426	13,029	11,257	50,421

As at 31 December 2021, intangible assets amounting to AZN 4,952 thousand (31 December 2020: AZN 2,928 thousand) were fully amortized but in use.

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

Impairment testing of intangible assets with indefinite lives

Banking license acquired through business combination with indefinite lives has been allocated to one individual cash-generating unit for impairment testing which is PASHA Yatirim Bankasi A.Ş.

The carrying amount of the banking license acquired allocated to the cash-generating units is AZN 4,729 thousand (31 December 2020: AZN 11,836 thousand).

Key assumptions used in value in use calculation

As at 31 December 2021 and 2020, recoverable amount of cash generating unit have been determined based on value in use method. The valuation is based on the information about historical and prospective financials and strategic initiatives of the PASHA Yatirim Bankasi A.S. and other third party information available on the market.

(Figures in tables are in thousands of Azerbaijani manats)

11. Intangible assets (continued)

Key assumptions used in value in use calculation (continued)

The calculation of value in use is most sensitive to the following assumptions:

- ▶ Financial performance (including current and forecasted results);
- ▶ Cost of equity;
- ▶ ROE (including current and forecasted results);
- ▶ Growth rate of loan portfolio;
- ▶ GDP growth rate in Turkey;
- ▶ Leverage ratio;
- ▶ Period of discounted cash flow of 8 years;
- ▶ Long term inflation growth rate of 5.0% (2020: 5.0%).

The following rates are used by the Group for calculation of Cost of Equity:

		2021	2020
Cost of equity calculation			
US Risk-Free Rate	a	1.5%	0.9%
US Market risk premium	b	8.5%	7.6%
Country risk premium	c	0.1%	0.1%
Beta	d	0.24	0.39
Cost of equity USD	$e = (a + b * d + c)$	3.6%	4.0%
USA inflation rate	f	6.2%	1.2%
Turkey inflation rate	j	21.3%	14.0%
Cost of equity TRY	$h = (1 + e) * ((1 + j) / (1 + f)) - 1$	18.4%	17.2%

As a result of the valuation, recoverable amount of cash generating unit amounted to 77,378 AZN thousand (2020: AZN 143,020 thousand). Accordingly, the license was partially impaired by amount of AZN 2,810 thousand (2020: AZN 1,735 thousand). As at December 2021 and 2020, the impairment loss was mainly due to increase in cost of equity.

Sensitivity for reasonably possible increase in discount rate by 1% (from 18.4% to 19.4%) (31 December 2020: from 17.2% to 18.2%) would result in additional impairment of AZN 4,729 thousand (31 December 2020: AZN 13,051 thousand) under the same assumption of the long-term Return on Equity.

The period of discounted cash flow model is based on the sensible and justifiable assumptions. Long-term growth rate is kept at a steady 5% (2020: 5%) rate in all periods.

12. Right-of-use assets and lease liabilities

The movement in right-of-use assets and lease liabilities during the year ended 31 December 2021 were as follows:

	<i>Right-of-use assets</i>	<i>Lease liabilities</i>
As at 1 January 2021	12,300	13,339
Additions	4,600	4,600
Lease modifications	7,434	7,434
Disposals and write offs	(779)	(944)
Depreciation expense	(6,082)	-
Interest expense	-	883
Payments	-	(7,021)
Rent concessions	-	(52)
Foreign currency translation difference	167	2
As at 31 December 2021	17,640	18,241

(Figures in tables are in thousands of Azerbaijani manats)

12. Right-of-use assets and lease liabilities (continued)

	<i>Right-of-use assets</i>	<i>Lease liabilities</i>
As at 1 January 2020	9,142	9,537
Additions	10,508	10,508
Disposals and write offs	(705)	-
Depreciation expense	(6,145)	-
Interest expense	-	816
Payments	-	(6,847)
Rent concessions	-	(81)
Foreign currency translation difference	(500)	(594)
As at 31 December 2020	12,300	13,339

13. Other assets and liabilities

Other assets comprise:

	<i>2021</i>	<i>2020</i>
Other financial assets		
Settlements on money transfers	27,772	22,511
Clearance cheque accounts	2,695	4,342
Accrued commission receivable on guarantees and letters of credit	1,774	1,736
Other	101	3
	32,342	28,592
Less: allowance for impairment of other financial assets	(358)	(410)
Total other financial assets	31,984	28,182
Other non-financial assets		
Reposessed collateral	10,853	16,211
Deferred expenses	2,833	2,846
Purchased miles under loyalty programme	3,788	2,807
Other prepayments	1,836	1,888
Prepayments for acquisition of property, equipment and intangible assets	2,301	644
Taxes, other than income tax	30	5
	21,641	24,401
Other assets	53,625	52,583

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

As at 31 December 2021 and 2020, clearance cheque accounts consist of receivables from other banks for which cheques stand as collateral.

As at 31 December 2021 deferred expenses of AZN 1,552 thousand (31 December 2020: AZN 1,536 thousand) related to long term software support.

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

Other liabilities comprise:

	<i>2021</i>	<i>2020</i>
Other financial liabilities		
Settlements on money transfer	1,287	4,930
Clearance cheque accounts	2,695	4,342
Accrued expenses	11,348	10,724
Other	1,255	889
	16,585	20,885
Other non-financial liabilities		
Payable to employees	28,676	30,463
Deferred income	3,059	1,436
Taxes, other than income tax	1,995	1,242
Other	13	12
	33,743	33,153
Other liabilities	50,328	54,038

(Figures in tables are in thousands of Azerbaijani manats)

14. Amounts due to banks and government funds

Amounts due to banks and government funds comprise:

	2021	2020
Long-term deposits from banks	319,961	324,822
Entrepreneurship Development Fund of the Republic of Azerbaijan	273,940	385,654
Short-term deposits from banks	108,000	94,942
Azerbaijan Mortgage and Credit Guarantee Fund	82,674	47,360
Long-term loans from banks	59,394	8,971
Correspondent accounts with other banks	22,711	69,392
Agro Credit and Development Agency	12,923	8,674
Loans from the National Bank of Georgia	10,992	7,790
Deposits from the Ministry of Finance of Georgia	5,762	5,710
Repurchase agreements	5,378	159,635
State Agency on Mandatory Health Insurance	4,305	4,065
Amount due to IT Development Fund	1,067	2,686
Short-term loans from banks	-	9,290
Other	23,300	11,561
Amounts due to banks and government funds	930,407	1,140,552

As at 31 December 2021, the Group attracted long-term deposits from two resident and one non-resident commercial banks comprising AZN 319,961 thousand (31 December 2020: AZN 324,822 thousand) maturing through September 2023 with interest rate ranging between 0.1% and 4.3% p.a. (31 December 2020: August 2023 with interest rate ranging between 0.3% and 4.3% p.a.).

As at 31 December 2021, Entrepreneurship Development Fund of the Republic of Azerbaijan had current account amounting to AZN 25,317 thousand (31 December 2020: AZN 95,174 thousand) and time deposits amounting to AZN 13,089 thousand (31 December 2020: AZN 30,083 thousand) maturing through April 2022 with interest rate of 6.5%. The Group had loans received from the Entrepreneurship Development Fund of the Republic of Azerbaijan amounting to AZN 235,534 thousand (31 December 2020: AZN 260,397 thousand), maturing through June 2030 (31 December 2020: through June 2030) and bearing interest rate of 1.0% (31 December 2020: 1.0% p.a.). The loans were acquired for the purposes of assistance in gradually improving entrepreneurship environment in Azerbaijan under the government program. The loans have been granted to local entrepreneurs at interest rate not higher than 6.0% p.a. (31 December 2020: not higher than 6.0% p.a.).

As at 31 December 2021, the Group attracted short-term deposits from four resident and fifteen non-resident commercial banks (31 December 2020: non-residents) comprising AZN 108,000 thousand (31 December 2020: AZN 94,942 thousand) maturing through November 2022 (31 December 2020: April 2021) and with interest rates ranging between 0.01% and 19.0% p.a. (31 December 2020: ranging between 0.01% and 18.5% p.a.).

As at 31 December 2021, the Group had loans refinanced from the Azerbaijan Mortgage and Credit Guarantee Fund amounting to AZN 67,181 thousand (31 December 2020: AZN 37,118 thousand), maturing through January 2051 (31 December 2020: through November 2050) and bearing interest rate of 1.0% and 4.0% p.a. (31 December 2020: 1.0% and 4.0% p.a.). The loans have been granted to borrowers at interest rate not higher than 8.0% p.a. (31 December 2020: not higher than 8.0%). Also, the Group had short-term deposit from the Azerbaijan Mortgage and Credit Guarantee Fund amounting AZN 15,493 thousand (31 December 2020: AZN 10,242 thousand), maturing through June 2022 (31 December 2020: October 2021) with interest rate ranging between 5.0% and 5.5% p.a. (31 December: ranging between 6.5% and 7.5% p.a.).

As at 31 December 2021, the Group received long-term loan from one resident and one non resident commercial banks (31 December 2020: one resident commercial bank) comprising AZN 59,394 thousand (31 December 2020: 8,971 thousand), maturing through August 2026 (31 December 2020: through August 2022) and with interest rates ranging between 3.0% p.a and 11.00% p.a (31 December 2020: 4.0% p.a.). A fair value loss of AZN 3,778 thousand arose on initial recognition of the loan from the resident bank.

As at 31 December 2021, the Group had loans received from the Agro Credit and Development Agency amounting to AZN 12,923 thousand (31 December 2020: AZN 8,674 thousand), maturing through December 2026 (31 December 2020: October 2025) and bearing interest rate between 2.0% and 4.0% p.a. (31 December 2020: 2.0% and 3.6% p.a.). The loans have been granted to local entrepreneurs at interest rate of 7.0% p.a. (31 December 2020: 7.0%).

As at 31 December 2021, the Group had loans from National Bank of Georgia amounting to AZN 10,992 thousand (31 December 2020: AZN 7,790 thousand) maturing through January 2022 (31 December 2020: January 2021) and with interest rates 11.0% p.a (31 December 2020: 8% p.a.).

As at 31 December 2021, the Group had deposit from Ministry of Finance of Georgia amounting to AZN 5,762 thousand (31 December 2020: AZN 5,710 thousand) maturing through January 2028 (31 December 2020: January 2028) and with interest rates ranging between 9.9% and 11.00% p.a. (31 December 2020: 9.3% and 9.9% p.a.).

(Figures in tables are in thousands of Azerbaijani manats)

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

As at 31 December 2021, the Group had loans refinanced from the IT Development Fund amounting to AZN 1,067 thousand (31 December 2020: AZN 2,686 thousand), maturing through June 2024 (31 December 2020: through June 2024) and bearing interest rate of 1.0% p.a. (31 December 2020: 1.0% p.a.). The loans have been granted to local entrepreneurs at interest rate of 5.0% p.a.

As at 31 December 2021, State Agency on Mandatory Health Insurance had a current account amounting AZN 4,305 thousand (31 December 2020: AZN 4,065 thousand).

15. Amounts due to customers

The amounts due to customers include the following:

	<u>2021</u>	<u>2020</u>
Demand deposits	3,647,812	2,703,609
Time deposits	1,534,039	1,387,770
Amounts due to customers	<u>5,181,851</u>	<u>4,091,379</u>
Held as security against guarantees issued (Note 21)	51,317	35,831

An analysis of customer accounts by economic sector is as follows:

	<u>2021</u>	<u>2020</u>
Individuals	1,651,084	1,319,453
Trade and services	1,119,964	1,008,833
Mining	502,764	115,975
Investment holding companies	453,777	474,794
Manufacturing	382,238	257,349
Transport and communication	360,886	265,064
Construction	250,994	216,402
Energy	131,830	96,214
Insurance	121,780	149,301
Public organizations	68,939	55,062
Agriculture	29,197	37,157
Non banking credit organizations	23,573	29,379
Hotel business	16,137	10,958
Other	68,688	55,438
Amounts due to customers	<u>5,181,851</u>	<u>4,091,379</u>

As at 31 December 2021, customer deposits included balances with thirteen (31 December 2020: nine) largest customers comprised AZN 2,757,218 thousand or 53% of the total customer deposits portfolio (31 December 2020: AZN 1,906,386 thousand or 47% of the total customer deposits portfolio).

As at 31 December 2021, deposits of the customers in the amount of AZN 628,246 thousand (31 December 2020: AZN 665,025 thousand) are pledged as collateral for loans to customers in the amount of AZN 769,964 thousand (31 December 2020: AZN 714,493). The net amounts due to customers balance after offset would have been AZN 4,553,605 thousand (31 December 2020: AZN 3,426,354 thousand) if net-off rights were exercised.

16. Debt securities issued

As at 31 December 2021, PASHA Yatirim Bankasi A.S. had issued interest-bearing bonds with carrying amount of AZN 162,465 thousand (31 December 2020: AZN 149,137 thousand) maturing in February 2023 (31 December 2020: February 2023). Bonds issued by the bank as at 31 December 2021, bear annual interest rates ranging from 1.8% to 18.4% p.a. (31 December 2020: from 1.8% to 4.9% p.a.).

17. Subordinated debts

As of 31 December 2021, the amount of subordinated debts represent USD denominated subordinated loan of AZN 45,103 thousand (31 December 2020: AZN 27,165 thousand) borrowed by the Group maturing through August 2024 and December 2028 (31 December 2020: August 2024 and December 2025).

(Figures in tables are in thousands of Azerbaijani manats)

18. Derivative financial instruments

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

	2021			2020		
	Notional amount	Fair values		Notional amount	Fair value	
		Asset	Liability		Asset	Liability
Interest rate contracts						
Forwards and swaps – foreign	39,828	102	(183)	76,535	157	(333)
Foreign exchange contracts						
Forwards and swaps – foreign	356,704	1,868	(7,801)	340,160	6,468	(736)
Forwards and swaps – domestic	334,764	7,835	(60)	409,071	861	(6,353)
Options – domestic	54,474	99	-	18,318	437	-
Futures – domestic	-	-	-	4,614	2	-
Total derivative assets/ (liabilities)		9,904	(8,044)		7,925	(7,422)

Foreign and domestic in the table above stand for counterparties where foreign means non-Azerbaijani entities and domestic means Azerbaijani entities.

As at 31 December 2021 and 2020, the Group has positions in the following types of derivatives:

Forwards and futures

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

Swaps

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

Options

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

19. Taxation

The corporate income tax expense comprises:

	2021	2020
Current tax charge	(34,532)	(31,667)
Deferred tax credit – origination and reversal of temporary differences	5,269	2,573
Less: deferred tax recognised in other comprehensive income	(1,895)	3,916
Income tax expense	(31,158)	(25,178)

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

	2021	2020
Net loss/(gains) on investment securities FVOCI	1,895	(3,916)
Income tax charged to other comprehensive income	1,895	(3,916)

(Figures in tables are in thousands of Azerbaijani manats)

19. Taxation (continued)

Current income tax assets of AZN 65 thousand as at 31 December 2021 (31 December 2020: AZN 146 thousand) represents cumulative amount of income tax prepaid by the Group.

Current income tax liabilities of AZN 11,802 thousand as at 31 December 2021 (31 December 2020: AZN 12,798 thousand) represents cumulative amount of income tax payable of the Group.

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

	2021	2020
Profit before income tax expense	133,475	104,661
Statutory tax rate	20%	20%
Theoretical tax expense at the statutory rate	(26,695)	(20,932)
Tax effect of non-deductible expenses	(3,301)	(1,851)
Tax rate change effects	39	(311)
Effect of difference in tax rate in foreign country	(749)	(740)
Tax effect of tax-exempt income	75	44
Unrecognised tax losses carried forward	(556)	-
Expired tax losses carried forward, not recognized previously	358	(1,670)
Other	(329)	282
Income tax expense	(31,158)	(25,178)

Deferred tax assets and liabilities as at 31 December 2021 and 2020 and their movements for the respective years comprise:

	Origination and reversal of temporary differences			Origination and reversal of temporary differences			2021		
	2019	In the statement of profit or loss	In other compre- hensive income	Translation difference	2020	In the statement of profit or loss		In other compre- hensive income	Translation difference
Tax effect of deductible temporary differences									
Tax losses carried forward	-	-	-	-	-	358	-	13	371
Subordinated debt	-	5	-	-	5	22	-	-	27
Amounts due from credit institutions	10	10	-	(3)	17	3	-	(6)	14
Amounts due to banks and government funds	-	-	-	-	-	751	-	2	753
Loans to customers	2,114	(213)	-	(398)	1,503	789	-	(852)	1,440
Investment securities	101	41	21	(23)	140	(56)	94	47	225
Investment properties	2,734	(206)	-	(502)	2,026	(112)	-	(792)	1,122
Property and equipment	-	15	-	138	153	15	-	4	172
Right of use assets	118	232	-	(27)	323	185	-	26	534
Intangible assets	373	(68)	-	35	340	(198)	-	-	142
Other assets	-	13	-	(1)	12	1	-	-	13
Derivative financial liabilities	-	1,352	-	-	1,352	(1,404)	-	55	3
Lease liabilities	1,238	329	-	-	1,567	1,393	-	-	2,960
Other liabilities	3,869	1,703	-	(82)	5,490	(663)	-	(70)	4,757
Deferred tax asset	10,557	3,213	21	(863)	12,928	1,084	94	(1,573)	12,533
Amounts due from credit institutions	(1,933)	(939)	-	-	(2,872)	293	-	-	(2,579)
Derivative financial assets	(42)	(1,480)	-	2	(1,520)	1,088	-	129	(303)
Investment securities	(1,018)	645	(3,937)	12	(4,298)	(104)	1,801	-	(2,601)
Loans to customers	(8,641)	7,126	-	23	(1,492)	1,296	-	(29)	(225)
Property and equipment	(543)	(175)	-	(9)	(727)	(248)	-	380	(595)
Intangible assets	(75)	7	-	9	(59)	(14)	-	(4)	(77)
Other assets	(1,628)	(243)	-	-	(1,871)	889	-	(1)	(983)
Lease liabilities	(87)	(114)	-	17	(184)	(259)	-	(20)	(463)
Right of use assets	(1,198)	(328)	-	-	(1,526)	(1,395)	-	-	(2,921)
Amounts due to banks and government funds	(5)	(38)	-	5	(38)	38	-	-	-
Amounts due to customers	-	-	-	-	-	-	-	-	-
Provision for guarantees and letters of credit	(616)	(1,532)	-	-	(2,148)	144	-	-	(2,004)
Banking license	(3,342)	347	-	628	(2,367)	562	-	859	(946)
Deferred tax liabilities	(19,128)	3,276	(3,937)	687	(19,102)	2,290	1,801	1,314	(13,697)
Net deferred tax assets/(liabilities)	(8,571)	6,489	(3,916)	(176)	(6,174)	3,374	1,895	(259)	(1,164)

(Figures in tables are in thousands of Azerbaijani manats)

19. Taxation (continued)

Deferred taxes in the consolidated statement of financial position as at 31 December 2021 and 2020 can be reconciled as follows:

	<u>2021</u>	<u>2020</u>
Deferred tax assets	1,730	3,168
Deferred tax liabilities	<u>(2,894)</u>	<u>(9,342)</u>
Net deferred tax liabilities	<u>(1,164)</u>	<u>(6,174)</u>

20. Equity

On 24 June 2020 Shareholders of the Group approved an issue of 646 ordinary shares. Total consideration received for these shares was comprised of cash for the total amount of AZN 21,512 thousand. This share issue was registered by State Tax Service under the Ministry of Economy of the Republic of Azerbaijan.

As at 31 December 2021 and 31 December 2020, the Bank's authorized, issued and fully paid capital amounted to AZN 354,512 thousand comprising of 10,646 ordinary shares (31 December 2020: AZN 10,646 thousand) with a par value of AZN 33,300 per ordinary share. Each ordinary share entitles one vote to the shareholder.

On 24 April 2020 Shareholders of the Bank declared dividends totalling AZN 45,422 thousand on ordinary shares (AZN 4,542 per share) which was paid as at 31 December 2020.

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

Additional paid-in capital

As at 31 December 2021 and 2020, additional paid-in capital of AZN 343 thousand represents gain from fair value measurement of subordinated debts of AZN 8,531 thousand, borrowed from entities under common control.

Foreign currency translation reserve

Foreign currency translation reserve is used to record exchange difference arising from the translation of the financial statements of foreign subsidiaries.

Other reserves

Other reserves consist of first and second legal reserves in accordance with the Turkish Commercial Code. The first legal reserve is appropriated out of the statutory profits at the rate of 5%, until the total reserve reaches a maximum of 20% of the entity's share capital. The second legal reserve is appropriated at the rate of 10% of all distributions in excess of 5% of the entity's share capital. The first and second legal reserves are not available for distribution unless they exceed 50% of the share capital but may be used to absorb losses in the event that the reserve is exhausted.

As of 31 December 2021, other reserves amounted to AZN 2,448 thousand (31 December 2020: AZN 2,239 thousand).

Unrealised gains on investment securities

This reserve records fair value changes on investment securities at FVOCI which amounted to AZN 12,721 thousand (31 December 2020: AZN 20,299 thousand).

21. Commitments and contingencies

Operating environment

During 2020, the global economy was negatively impacted by the spread of the coronavirus pandemic (COVID-19).

During March-August 2020, the increasingly restrictive lockdown measures to combat COVID-19 in many countries significantly reduced economic activity and aggregate spending levels. Social distancing and quarantine measures resulted in the closure of retail, transport, travel, catering, hotel, entertainment and many other businesses. International trade was also significantly reduced. Finally, oil prices tumbled to historic lows but fully recovered by the end of the period.

However, during 2021, increased worldwide vaccination resulted in softened quarantine restrictions, which in turn positively affected the global economy. Effect on economies in which the Group operates is presented as follows.

(Figures in tables are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Operating environment (continued)

The Republic of Azerbaijan

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

During 2021 the oil prices have been increasing and had reached its 7-year maximum as at 31 December 2021. This resulted in considerable increase of USD inflow into the economy, which added stability to the local currency.

During 2020 and 2021, the CBAR continued to ease monetary conditions while maintaining the stability of the Azerbaijani manat, which was kept flat at 1.7000 for 1 USD throughout the period. As a result, the CBAR refinancing rate was reduced from 7.25% to 6.25% during 2020 and remained flat since then. During the second half of 2021, the CBAR increased refinancing rate due to the increased inflation rates worldwide, and as a result, refinancing rate became 7.25% as at 31 December 2021.

A support package was introduced by the Government and CBAR to counter the economic downturn caused by the pandemic. These measures include, but are not limited to, subsidized lending to affected industries, payments to unemployed individuals and easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources and help customers avoid liquidity shortages as a result of the COVID-19 containment measures. On 23 April 2020, the CBAR decided to temporarily reduce the minimum required capital adequacy ratio from 12% to 11% for banks of system importance, which include the Bank, and from 10% to 9% for all other banks and keep it at these levels until July 2021. Since July 2021, the required minimum ratios were set back at pre-pandemic levels (12% and 10%, respectively).

With the start of vaccination of Azerbaijani population on 16 January 2021 the Azerbaijani Government decided to gradually eliminate the special strict quarantine regime measures introduced in the previous year to combat the COVID-19 outbreak, such as travel restrictions, closure of business and other venues, lockdowns of certain areas throughout the country. Despite this relief of strict quarantine regime for preventing coronavirus, CBAR decided to prolong easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources.

The Republic of Georgia

According to Georgia's socio-economic development strategy, the economic policy of Georgia is based on the principles of fast and efficient economic growth driven by development of the real sector of economy, implementation of economic policies that would facilitate inclusive economic growth and rational use of natural resources, ensuring environmental safety and sustainability. Georgia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Georgian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The level of inflation reached 13.9% year-on-year in December 2021, largely reflecting utility price increases, higher commodity prices and elevated input costs. NBG has increased its refinancing rate several times during the year ended 31 December 2021 to reach 10.5%. Inflation has significantly exceeded the target and will remain high in the short run. Together with the exhaustion of the one-off factors and strict monetary policy stance, inflation is forecasted to start a return to its target from the second quarter of 2022.

In line with the overall developments in the Georgian banking sector, PASHA Bank Georgia has also suffered from the effects of the economic downturn caused by COVID-19 with deterioration of the performance and credit risk of the borrowers operating in the vulnerable sectors. This has resulted in the number of restructured loans and significant increase in the ECL rates across all portfolio segments, compared to the average rates existing in the pre-pandemic periods. Nevertheless, the roll out of the vaccination program by the government, the positive economic outlook for 2021 and the ongoing modifications of the customer's loan facilities has allowed the bank to obtain certain improvements on the quality of its portfolios and recognize reversal of provisions in the reporting period. Despite the negative effect of the pandemic the management maintains strong liquidity positions supported by the NBG's measures to strengthen banking sector resilience amidst the crisis, reasonable NPL levels due to timely restructuring actions and continued support from PASHA Bank Azerbaijan.

Although the management of the bank is strongly committed to the further expansion of the bank on the Georgian market in line with the approved strategic plans, the major medium-term focus amidst the persisting uncertainties related to COVID-19 developments is to restore and preserve sufficient retained earnings to ensure strong platform for future growth and development.

(Figures in tables are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Operating environment (continued)

The Republic of Turkey

Various measures have been taken in Turkey in order to prevent the transmission of the virus and it is still being taken. In addition to these measures, economic measures are also taken to minimize the economic impact of the virus outbreak on individuals and businesses. After an initial shock from COVID-19 (the economy shrunk a record 9.9% in the second quarter of 2020), Turkey's GDP grew by 1.8% in 2020. GDP growth has continued into 2021 with a 7% increase in the first quarter. Turkey responded to COVID-19 with a large economic stimulus program and in fiscal terms, Turkey's COVID-19 stimulus package amounted to nearly 12% of GDP when including tax deferrals and contingent liabilities. Turkey's support was overwhelmingly provided through the banking sector and was not realized as direct fiscal costs on the budget, but as contingent liabilities to the government in future.

As at 31 December 2021, inflation in Turkey increased sharply which is largely attributable to the decision of the CBRT to cut the interest rate incrementally by 5% from September to December despite fears of rising inflation following high levels of government spending to support the economy through the COVID-19 pandemic. The CBRT's decision to cut the policy rate has further created pressure on Turkish Lira (TL) which devaluated against main currencies and thus falling against AZN by 42% over 2021.

In the announcement published by the Public Oversight Accounting and Auditing Standards Authority on 20 January 2022, it is stated that TAS 29 Financial Reporting in Hyperinflationary Economies does not apply to the Turkish Financial Reporting Standards (TFRS) financial statements as of 31 December 2021, since the cumulative change in the general purchasing power of the last three years according to Consumer Price Index (CPI) is 74.41%. In this respect, IFRS financial statements as of 31 December 2021 are not adjusted while taking explanations of Public Oversight Accounting and Auditing Standards Authority into account for inflation in accordance with TAS 29.

Legal

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

Taxation

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

Management believes that its interpretation of the relevant legislation as at 31 December 2020 is appropriate and that the Group's tax, currency and customs positions will be sustained.

Insurance

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

Compliance with the Regulators' ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2021 and 2020, the Bank was in compliance with these ratios except for the followings:

- a) Ratio of the share in one legal entity which should not exceed 10% of total capital. As at 31 December 2021, the Bank's ratio was 23.98% (31 December 2020: 27.39%).
- b) Ratio of the total share in other legal entities which should not exceed 40% of total capital. As at 31 December 2021, the Bank has no breach (31 December 2020: 40.29%).
- c) Ratio of maximum credit exposure of a bank per a single borrower or a group of related borrowers on unsecured loan that should not exceed 10%. As at 31 December 2021, the Bank's ratio was 13.42% (31 December 2020: 15.19%).
- d) Ratio of maximum credit exposure to one related party legal entity of the bank or their representatives should not exceed 10% of the capital. As at 31 December 2021, the Bank's ratio was 19.28% (31 December 2020: 22.02%).
- e) Ratio of maximum credit exposure of total related party loans of the bank or their representatives should not exceed 20% of the capital. As at 31 December 2021, the Bank's ratio was 42.81% (31 December 2020: 44.33%).

(Figures in tables are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Compliance with the Regulators' ratios (continued)

The breach of the first ratio was caused by investment injections to the subsidiaries of the Bank.

The breach of the third ratio was caused by the issuance of the specific loans for government related projects.

The breach of the last two ratios was caused by issuance of cash covered loans to related parties.

NBG requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2021 and 2020, PASHA Bank Georgia was in compliance with these ratios except for the following:

- Ratio of maximum credit exposure of a bank to a single borrower should not exceed 15% of regulatory capital. As at 31 December 2021, the Bank's ratio was 17.52% (31 December 2020: 17.54%).
- Ratio of exposure to a single related party which should not exceed 5% of regulatory capital. As at 31 December 2021, the Bank's ratio was 5.87% (31 December 2020: 0.30%).
- Ratio of exposure to group of related borrowers loan that should not exceed 25% of regulatory capital. As at 31 December 2021, the Bank's ratio was 26.57% (31 December 2020: 22.36%).

The Group introduced the recovery plan to NBG and received the waiver that allows PASHA Bank Georgia to become in compliance with the above mentioned ratios by the end of June 2022. These breaches do not lead to any regulatory punishment, because of the waivers granted by the NBG.

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

Financial commitments and contingencies

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

Financial commitments and contingencies comprise:

	<u>2021</u>	<u>2020</u>
Credit-related commitments		
Guarantees issued	291,260	322,306
Unused credit lines	340,472	331,549
Letters of credit	34,981	24,698
	<u>666,713</u>	<u>678,553</u>
Operating lease commitments		
Not later than 1 year	61	72
Later than 1 year but not later than 5 years	2	20
	<u>63</u>	<u>92</u>
Performance guarantees	386,318	264,351
Less: provisions for ECL for credit related commitments	(6,119)	(7,316)
Less: provisions for performance guarantees	(4,905)	(3,230)
Commitments and contingencies (before deducting collateral)	<u>1,042,070</u>	<u>932,450</u>
Less: cash held as security against guarantees issued (Note 15)	(51,317)	(35,831)
Commitments and contingencies	<u>990,753</u>	<u>896,619</u>

(Figures in tables are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

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

	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2021	(2,456)	(4,676)	(184)	(7,316)
New exposures	(4,876)	(11)	-	(4,887)
Exposures derecognised or matured (excluding write-offs)	1,851	3,311	70	5,232
Transfers to Stage 1	(425)	391	34	-
Transfers to Stage 2	2,386	(2,443)	57	-
Transfers to Stage 3	108	3	(111)	-
Impact on period end ECL of exposures transferred between stages during the period	331	(425)	(104)	(198)
Changes to inputs used for ECL calculations	287	159	-	446
Foreign exchange adjustments	407	197	-	604
At 31 December 2021	(2,387)	(3,494)	(238)	(6,119)

An analysis of changes in the ECLs during the year ended 31 December 2020 is as follows:

	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2020	(3,984)	(4,095)	(273)	(8,352)
New exposures	(2,895)	-	-	(2,895)
Exposures derecognised or matured (excluding write-offs)	2,286	1,056	273	3,615
Transfers to Stage 1	(1,176)	1,176	-	-
Transfers to Stage 2	1,882	(1,882)	-	-
Transfers to Stage 3	66	-	(66)	-
Impact on period end ECL of exposures transferred between stages during the period	1,090	(1,289)	(118)	(317)
Changes to inputs used for ECL calculations	154	11	-	165
Foreign exchange adjustments	121	347	-	468
At 31 December 2020	(2,456)	(4,676)	(184)	(7,316)

22. Credit loss expense and other impairment and provisions

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

	Note	Stage 1	Stage 2	Stage 3	Total
Cash and cash equivalents		74	-	-	74
Amounts due from credit Institutions	6	(422)	-	-	(422)
Investment securities at FVOCI	7	518	-	-	518
Investment securities at amortised cost	7	(409)	-	-	(409)
Loans to customers	8	(7,065)	7,145	(24,528)	(24,448)
Credit loss on financial assets		(7,304)	7,145	(24,528)	(24,687)
Credit related commitments	21	(338)	985	(54)	593
Total credit loss expense		(7,642)	8,130	(24,582)	(24,094)

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

(Figures in tables are in thousands of Azerbaijani manats)

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

The table below shows the ECL charges on financial instruments recorded in the consolidated statement of profit or loss for the year ended 31 December 2020:

	<i>Note</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Cash and cash equivalents		(65)	-	-	(65)
Due from credit institutions	6	70	-	-	70
Investment securities at FVOCI	7	(3,428)	4	-	(3,424)
Investment securities at amortised cost	7	(276)	-	-	(276)
Loans to customers	8	(2,720)	(12,724)	(2,922)	(18,366)
Credit loss on financial assets		(6,419)	(12,720)	(2,922)	(22,061)
Credit related commitments	21	1,407	(928)	89	568
Total credit loss expense		(5,012)	(13,648)	(2,833)	(21,493)

The movements in provisions for ECL for credit related commitments and performance guarantees were as follows:

	<i>Other financial assets</i>	<i>Performance guarantees</i>	<i>Total</i>
1 January 2020	(315)	(2,198)	(2,513)
Charge	(132)	(1,032)	(1,164)
Recoveries of amounts previously written off	37	-	37
31 December 2020	(410)	(3,230)	(3,640)
Credit/(charge)	52	(1,675)	(1,623)
31 December 2021	(358)	(4,905)	(5,263)

23. Net fee and commission income

Net fee and commission income comprise:

	<i>2021</i>	<i>2020</i>
Servicing plastic card operations	41,458	26,162
Settlements operations	20,993	15,544
Guarantees and letters of credit	14,791	14,643
Cash operations	4,905	4,010
Other	890	772
Fee and commission income	83,037	61,131
Servicing plastic card operations	(36,106)	(19,598)
Settlements operations	(8,699)	(3,763)
Guarantees and letters of credit	(1,631)	(2,176)
Cash operations	(1,199)	(979)
Securities operations	(22)	(180)
Other	(118)	(1,935)
Fee and commission expense	(47,775)	(28,631)
Net fee and commission income	35,262	32,500

24. Personnel, general and administrative expenses, write-down of repossessed collaterals

Personnel expenses comprise:

	<i>2021</i>	<i>2020</i>
Salaries and bonuses	(56,635)	(58,124)
Social security costs	(8,001)	(7,430)
Other employee related expenses	(3,752)	(3,723)
Personnel expenses	(68,388)	(69,277)

(Figures in tables are in thousands of Azerbaijani manats)

24. Personnel, general and administrative expenses, write-down of repossessed collaterals (continued)

General and administrative expenses comprise:

	2021	2020
Charity and sponsorship	(10,347)	(12,940)
Professional services	(9,587)	(10,373)
Insurance	(7,222)	(5,060)
Software cost	(6,829)	(5,075)
Stationery and loyalty miles	(5,632)	(1,896)
Advertising costs	(2,680)	(2,703)
Communications	(2,162)	(1,383)
Utilities	(1,816)	(1,667)
Repair and maintenance	(1,513)	(856)
Taxes, other than income tax	(1,490)	(1,436)
Security expenses	(947)	(993)
Transportation and business trip expenses	(866)	(250)
Membership fees	(641)	(745)
Entertainment	(612)	(497)
Operating leases	(349)	(569)
Printing expenses	(34)	(25)
Other expenses	(430)	(619)
General and administrative expenses	(53,157)	(47,087)
	2021	2020
Write-down of repossessed collaterals	(5,008)	(762)

As at 31 December 2021, the Group written-down one repossessed collateral held on balance since 2015 in full (AZN 2,371 thousand) and one repossessed collateral held on balance since 2017 by half (AZN 2,752 thousand).

25. Risk management

Introduction

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

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

Risk management structure

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

Supervisory Board

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

Audit Committee

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

Executive Board

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

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Introduction (continued)

Risk Committee

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

Risk Management

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

Bank Treasury

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

Internal Audit

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

Risk measurement and reporting systems

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

The Group also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

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

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

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

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

Risk mitigation

Group actively uses collateral to reduce its credit risks.

Excessive risk concentration

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

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

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk

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

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

Derivative financial instruments

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

Credit-related commitments risks

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

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

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

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

Impairment assessment

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk (continued)

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

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

Definition of default and cure

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

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

Such events include:

- ▶ Default and Credit-impaired assets:
 - ▶ Loans with principal amount and/or accrued interest and/or any of other payment overdue by more than 90 days from the date specified in the contract;
 - ▶ 2 times within three years restructured loans that have been overdue (in principal amount and/or accrued interest and/or any of other payment) less than 30 days from the date specified in the contract at the moment of each particular restructuring;
 - ▶ "Non-healthy" restructured loans that were PAR 30 at the moment of restructuring; (originally in Stage 3), when NPV loss restructuring is more than 10%;
 - ▶ Any loan considered by management as non-performing (except non-performing loans that meet Stage 2 criteria).
- ▶ Existing of information that borrower will/has enter bankruptcy, insolvency or a similar condition.
- ▶ Default (according to IRB and External Rating).
- ▶ Default on other financial instruments of the same borrower.

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

Internal rating and PD estimation process

The Group's Risk Department operates its internal rating models. The Group runs separate models for its key portfolios in which its corporate borrowers are rated based on Moody's model. Small and medium enterprises and consumer loans are scored from 1 to 20 and from 1 to 4 using internal grades, respectively. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilise supplemental external information that could affect the borrower's behaviour. Where practical, they also build on information from the national and international external rating agencies. PDs, incorporating forward looking information and the IFRS 9 stage classification of the exposure, are assigned for each grade. This is repeated for each economic scenario as appropriate.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk (continued)

Treasury and interbank relationships

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

Corporate and small business lending

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

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

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

Consumer lending

Consumer lending comprises unsecured personal loans, credit cards and overdrafts. These products along with residential mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by debt to income (DTI) and payment to income (PTI) ratios. Other key inputs into the models are GDP growth, changes in personal income/salary levels, personal indebtedness.

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

<i>Internal rating grade for SME</i>	<i>Moody's based internal/external ratings for Corporate and Financial institutions</i>	<i>Internal rating description</i>
1	Aaa	High grade
2-4	Aa1 to Aa3	
5-7	A1 to A3	
8-10	Baa1 to Baa3	Standard grade
11-13	Ba1 to Ba3	
14-16	B1 to B3	
17-19	Caa1 to Caa3	Sub-standard grade
20	Ca	
Default	C	

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

Exposure at default

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

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

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk (continued)

Loss given default

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

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

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

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

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

Significant increase in credit risk

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

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

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

Grouping financial assets measured on a collective basis

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

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

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

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

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

Forward-looking information and multiple economic scenarios

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

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

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk (continued)

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

The Group obtains the forward-looking information from third party sources (external rating agencies, governmental bodies e.g. central Groups, and international financial institutions). Experts of the Group's Credit Risk Department determine the weights attributable to the multiple scenarios with the values of the key forward looking economic variables/assumptions used in each of the economic scenarios for the ECL calculations.

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

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group internal credit ratings. The table below shows the credit quality by class of asset for loan-related lines in the consolidated statement of financial position, based on the Group's credit rating system for the year ended 31 December 2021.

	Note		High grade	Standard grade	Sub-standard grade	Impaired	Total
Cash and cash equivalents, except for cash on hand	5	Stage 1	1,174,681	66,151	-	-	1,240,832
Amounts due from credit institutions	6	Stage 1	183,754	405,734	-	-	589,488
		Stage 3	-	-	-	13,981	13,981
Loans to customers	8	Stage 1	127,726	1,665,217	154,266	-	1,947,209
		Stage 2	418,567	167,862	382,949	-	969,378
		Stage 3	-	-	-	206,882	206,882
Investment securities:	7						
- Measured at FVOCI		Stage 1	1,522,268	284,775	-	-	1,807,043
- Measured at amortised cost		Stage 1	-	71,264	-	-	71,264
Unused credit lines	21	Stage 1	30,860	262,634	20,108	-	313,602
		Stage 2	165	9,527	16,787	-	26,479
		Stage 3	-	-	-	391	391
Letters of credit	21	Stage 1	2,888	26,915	2,628	-	32,431
		Stage 2	-	-	2,550	-	2,550
Guarantees issued	21	Stage 1	227	236,955	14,839	-	252,021
		Stage 2	971	2,435	35,580	-	38,986
		Stage 3	-	-	-	253	253
Other financial assets	13	Stage 1	-	32,342	-	-	32,342
Total			3,462,107	3,231,811	629,707	221,507	7,545,132

The table below shows the credit quality by class of asset for loan-related lines in the consolidated statement of financial position, based on the Group's credit rating system for the year ended 31 December 2020.

	Note		High grade	Standard grade	Sub-standard grade	Impaired	Total
Cash and cash equivalents, except for cash on hand	5	Stage 1	1,071,046	64,068	-	-	1,135,114
Amounts due from credit institutions	6	Stage 1	195,288	242,640	5,001	-	442,929
		Stage 3	-	-	-	13,981	13,981
Loans to customers	8	Stage 1	159,506	1,118,096	157,223	-	1,434,825
		Stage 2	424,006	243,909	419,746	-	1,087,661
		Stage 3	-	-	-	160,370	160,370
Investment securities	7						
- Measured at FVOCI		Stage 1	1,381,311	213,502	635	-	1,595,448
		Stage 2	-	-	-	-	-
- Measured at amortised cost		Stage 1	-	51,137	-	-	51,137
Unused credit lines	21	Stage 1	7,556	287,079	6,787	-	301,422
		Stage 2	34	18,271	11,531	-	29,836
		Stage 3	-	-	-	291	291
Letters of credit	21	Stage 1	5,560	12,117	958	-	18,635
		Stage 2	1,921	3,791	351	-	6,063
Guarantees issued	21	Stage 1	90	228,284	6,549	-	234,923
		Stage 2	170	45,315	40,695	-	86,180
		Stage 3	-	-	-	1,203	1,203
Other financial assets	13	Stage 1	-	28,592	-	-	28,592
Total			3,246,488	2,556,801	649,476	175,845	6,628,610

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk (continued)

See Note 8 for more detailed information with respect to the allowance for impairment of loans to customers.

Financial guarantees, unused credit lines and letters of credit are assessed and a provision for expected credit losses is calculated in similar manner as for loans adjusted to credit conversion factor. See Note 21.

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

	2021				2020			
	The Republic of Azerbaijan	OECD countries	CIS and other non-OECD countries	Total	The Republic of Azerbaijan	OECD countries	CIS and other non-OECD countries	Total
Financial assets								
Cash and cash equivalents	1,158,302	117,765	49,344	1,325,411	729,598	447,786	23,160	1,200,544
Amounts due from credit institutions	67,364	415,349	119,895	602,608	53,520	372,133	30,772	456,425
Investment securities	1,323,448	367,081	192,835	1,883,364	1,309,287	219,764	120,385	1,649,436
Derivative financial assets	7,934	1,868	102	9,904	1,300	6,468	157	7,925
Loans to customers	2,556,361	247,500	223,444	3,027,305	2,108,201	270,324	230,293	2,608,818
Other financial assets	29,105	2,715	164	31,984	23,838	4,344	-	28,182
	5,142,514	1,152,278	585,784	6,880,576	4,225,744	1,320,819	404,767	5,951,330
Financial liabilities								
Amounts due to banks and government funds	810,755	38,995	80,657	930,407	1,038,127	29,301	73,124	1,140,552
Amounts due to customers	5,104,166	12,635	65,050	5,181,851	4,013,918	15,818	61,643	4,091,379
Other borrowed funds	2,073	6,513	-	8,586	-	4,058	-	4,058
Derivative financial liabilities	60	7,802	182	8,044	6,354	736	332	7,422
Debt securities issued	153,924	8,541	-	162,465	149,137	-	-	149,137
Subordinated debts	45,103	-	-	45,103	27,165	-	-	27,165
Lease liabilities	14,795	72	3,374	18,241	7,831	41	5,467	13,339
Other financial liabilities	11,954	3,312	1,319	16,585	14,927	4,629	1,329	20,885
	6,142,830	77,870	150,582	6,371,282	5,257,459	54,583	141,895	5,453,937
Net assets/(liabilities)	(1,000,316)	1,074,408	435,202	509,294	(1,031,715)	1,266,236	262,872	497,393

Liquidity risk and funding management

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

The Group maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. In addition, the Group maintains obligatory reserves with the CBAR, NBS and Banking Regulation and Supervision Agency ("BRSA"), the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank on a standalone basis based on certain liquidity ratios established by the CBAR. As at 31 December, these ratios were as follows:

	2021, %	2020, %
Instant Liquidity Ratio (30% is the minimum required by the CBAR) (assets receivable or realisable within one day/liabilities repayable on demand)	61	66

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Liquidity risk and funding management (continued)

The liquidity position is assessed and managed by the PASHA Bank Georgia primarily on a standalone basis, based on the certain liquidity ratios established by the NBG.

	2021, %	2020, %
Liquidity Coverage Ratio (100% is the minimum required by the NBG for foreign currency and 75% is the minimum required by the NBG for national currency) (high-quality liquid assets / net cash outflow)		
Foreign currency	251	160
Combined	222	140
	2021, %	2020, %
Net Stable Funding Ratio (stable ratio is required by the NBG) (available amount of stable funding/the required amount of stable funding)	114	127
	2021, %	2020, %
Average Liquidity Ratio (is not requirement since 1 January 2021, remains for monitoring purposes) (average volume of liquid assets / average volume of liquid liabilities)	47	39

As at 31 December 2021, liquidity ratio of PASHA Yatirim Bankasi A.S. on a standalone basis based on requirements established by the BRSA was 210% (31 December 2020: 223%). Minimum required level of liquidity by BRSA is 100%.

Analysis of financial liabilities by remaining contractual maturities

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

<i>Financial liabilities</i>	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total 2021</i>
As at 31 December 2021					
Amounts due to banks and government funds	208,004	321,873	349,963	115,817	995,657
Amounts due to customers	3,825,685	407,386	921,614	94,287	5,248,972
Other borrowed funds	7,856	783	-	-	8,639
Debt securities issued	9,922	105,888	52,023	-	167,833
Subordinated debts	310	2,251	35,670	19,276	57,507
Gross settled derivative financial instruments:					
- Contractual amounts payable	82,896	346,647	-	-	429,543
- Contractual amounts receivable	(87,151)	(349,161)	-	-	(436,312)
Lease liabilities	1,764	5,856	12,811	-	20,431
Other financial liabilities	16,585	-	-	-	16,585
Total undiscounted financial liabilities	4,065,871	841,523	1,372,081	229,380	6,508,855

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)**Liquidity risk and funding management (continued)**

<i>Financial liabilities</i>	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total 2020</i>
As at 31 December 2020					
Amounts due to banks and government funds	411,336	151,695	520,447	102,084	1,185,562
Amounts due to customers	2,804,818	501,225	767,868	129,942	4,203,853
Other borrowed funds	4,058	195	-	-	4,253
Debt securities issued	1,290	46,308	109,025	-	156,623
Subordinated debts	140	1,141	23,628	7,442	32,351
Net settled derivative financial liabilities	334	-	-	-	334
Gross settled derivative financial instruments:					
- Contractual amounts payable	47,057	36,970	343,551	-	427,578
- Contractual amounts receivable	(47,358)	(39,716)	(343,956)	-	(431,030)
Lease liabilities	1,539	4,617	5,589	2,412	14,157
Other financial liabilities	20,885	-	-	-	20,885
Total undiscounted financial liabilities	3,244,099	702,435	1,426,152	241,880	5,614,566

The table below shows the contractual expiry by maturity of the Group's credit related commitments.

	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Maturity undefined</i>	<i>Total</i>
As at 31 December 2021	400,653	188,613	77,447	-	-	666,713
As at 31 December 2020	390,667	199,097	88,789	-	-	678,553

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

The Group's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant concentration of deposits from organizations of related parties in the period of one year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Group.

This level of funding will remain with the Group for the foreseeable future and that in the event of withdrawal of funds, the Group would be given sufficient notice so as to realise its liquid assets to enable repayment. Management believes that this level of funding will remain with the Group for the foreseeable future and that in the event of withdrawal of funds, the Group would be given sufficient notice so as to realise its liquid assets to enable repayment.

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

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

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss.

The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. The Group manages exposures to market risk based of sensitivity analysis. The Group has no significant concentration of market risk.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)**Market risk (continued)***Interest rate risk*

Interest rate risk arises from the possibility that changes in interest rates will affect the fair values of financial instruments. The sensitivity of current year profit is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2021. The Group does not have substantial amount of floating rate non-trading financial instruments as at 31 December 2021 and 2020.

Currency risk

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

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

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

	AZN	USD	EUR	GEL	TRY	Other	Total 2021
Financial assets							
Cash and cash equivalents	843,814	306,886	135,447	8,939	1,007	29,318	1,325,411
Amounts due from credit institutions	58,237	414,743	110,204	1	344	19,079	602,608
Investment securities	1,037,459	793,591	29,847	15,936	6,531	-	1,883,364
Derivative financial assets	147	2,064	-	73	1,808	5,812	9,904
Loans to customers	1,368,300	919,624	496,984	58,040	87,453	96,904	3,027,305
Other financial assets	20,305	7,265	1,445	162	2,705	102	31,984
Total financial assets	3,328,262	2,444,173	773,927	83,151	99,848	151,215	6,880,576
The effect of derivatives	15,100	200,863	124,652	1,700	-	84,455	426,770
Financial liabilities							
Amounts due to banks and government funds	450,721	225,200	111,619	18,402	30,742	93,723	930,407
Amounts due to customers	2,632,619	1,871,303	600,214	21,354	5,179	51,182	5,181,851
Other borrowed funds	-	3,369	5,194	-	23	-	8,586
Derivative financial liabilities	-	2,050	4	178	-	5,812	8,044
Debt securities issued	-	147,494	6,430	-	8,541	-	162,465
Subordinated debts	-	45,103	-	-	-	-	45,103
Lease liabilities	14,592	3,577	-	-	72	-	18,241
Other financial liabilities	5,940	3,854	3,242	219	3,286	44	16,585
Total financial liabilities	3,103,872	2,301,950	726,703	40,153	47,843	150,761	6,371,282
The effect of derivatives	-	43,350	203,610	11,645	10,620	89,775	359,000
Net position after the effect of derivatives	239,490	299,736	(31,734)	33,053	41,385	(4,866)	577,064

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)**Currency risk (continued)**

As at 31 December 2020, the Group had the following exposure to foreign currency exchange rate risk:

	AZN	USD	EUR	GEL	TRY	Other	Total 2020
Financial assets							
Cash and cash equivalents	391,387	570,750	214,314	4,347	6,848	12,898	1,200,544
Trading securities	-	-	-	-	-	-	-
Amounts due from credit institutions	36,940	250,304	149,535	-	488	19,158	456,425
Investment securities	1,013,840	601,959	9,748	16,843	7,046	-	1,649,436
Derivative financial assets	892	6,253	6	128	114	532	7,925
Loans to customers	1,146,285	815,756	416,926	48,717	92,769	88,365	2,608,818
Other financial assets	19,540	2,866	1,283	3	4,345	145	28,182
Total financial assets	2,608,884	2,247,888	791,812	70,038	111,610	121,098	5,951,330
The effect of derivatives	19,172	191,902	170,020	4,424	2,745	89,452	477,715
Financial liabilities							
Amounts due to banks and government funds	621,499	282,838	104,625	13,500	29,558	88,532	1,140,552
Amounts due to customers	1,689,100	1,750,401	598,537	17,557	4,145	31,639	4,091,379
Other borrowed funds	-	1,181	-	-	2,877	-	4,058
Derivative financial liabilities	-	6,703	-	160	27	532	7,422
Debt securities issued	-	142,398	6,739	-	-	-	149,137
Subordinated debts	-	27,165	-	-	-	-	27,165
Lease liabilities	7,422	5,758	-	118	41	-	13,339
Other financial liabilities	13,240	1,077	1,495	448	4,582	43	20,885
Total financial liabilities	2,331,261	2,217,521	711,396	31,783	41,230	120,746	5,453,937
The effect of derivatives	-	86,452	181,641	10,709	5,253	86,928	370,983
Net position after the effect of derivatives	296,795	135,817	68,795	31,970	67,872	2,876	604,125

Currency risk sensitivity

The tables below indicate the currencies to which the Group had significant exposure at 31 December on its monetary assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Azerbaijani manats, with all other variables held constant on the consolidated statement of profit or loss and equity. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for specified changes in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Group where the denomination of the loan is in a currency other than the currency of the lender or the borrower. A negative amount in the table reflects a potential net reduction in the consolidated statement of profit or loss or equity, while a positive amount reflects a net potential increase. Impact on profit before tax based on assets value as at 31 December 2021 and 2020:

	2021		2020	
	USD/AZN +20%	USD/AZN -3%	USD/AZN +20%	USD/AZN -3%
Impact on profit before tax	59,947	(8,992)	27,163	(4,075)
	2021		2020	
	EUR/AZN +21%	EUR/AZN -9%	EUR/AZN +22%	EUR/AZN -10%
Impact on profit before tax	(6,664)	2,856	15,135	(6,880)
	2021		2020	
	GEL/AZN +15%	GEL/AZN -15%	GEL/AZN +15%	GEL/AZN -15%
Impact on Other Comprehensive Income	4,958	(4,958)	4,796	(4,796)
	2021		2020	
	TRY/AZN +15%	TRY/AZN -20%	TRY/AZN +15%	TRY/AZN -17%
Impact on Other Comprehensive Income	6,208	(8,277)	10,181	(11,538)

(Figures in tables are in thousands of Azerbaijani manats)

26. Fair values measurement

Fair value hierarchy

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

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

For the purpose of fair value disclosures, the Group's has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy:

	Date of valuation	Fair value measurement using			Total
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Assets measured at fair value					
Investment securities – at FVOCI	31 December 2021	417,927	1,392,137	–	1,810,064
Investment securities – at FVTPL	31 December 2021	356	2,429	–	2,785
Derivative financial assets	31 December 2021	–	9,904	–	9,904

Assets for which fair values are disclosed

	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Cash and cash equivalents	31 December 2021	1,325,411	–	–	1,325,411
Amounts due from credit institutions	31 December 2021	–	602,608	–	602,608
Investment securities measured at amortised cost	31 December 2021	47,652	2,930	20,604	71,186
Loans to customers	31 December 2021	–	–	3,018,272	3,018,272
Investment properties	31 December 2021	–	–	19,126	19,126
Other financial assets	31 December 2021	–	–	31,984	31,984

	Date of valuation	Fair value measurement using			Total
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2021	–	8,044	–	8,044

Liabilities for which fair values are disclosed

	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Amounts due to banks and government funds	31 December 2021	–	918,349	–	918,349
Amounts due to customers	31 December 2021	–	–	5,181,042	5,181,042
Debt securities issued	31 December 2021	–	162,812	–	162,812
Other borrowed funds	31 December 2021	–	–	8,586	8,586
Subordinated debts	31 December 2021	–	–	45,103	45,103
Other financial liabilities	31 December 2021	–	–	16,585	16,585

(Figures in tables are in thousands of Azerbaijani manats)

26. Fair values measurement (continued)

Fair value hierarchy (continued)

	Date of valuation	Fair value measurement using			Total
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Assets measured at fair value					
Investment securities – at FVOCI	31 December 2020	213,771	1,383,442	-	1,597,213
Investment securities – at FVTPL	31 December 2020	339	1,368	-	1,707
Derivative financial assets	31 December 2020	-	7,925	-	7,925
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2020	1,200,544	-	-	1,200,544
Amounts due from credit institutions	31 December 2020	-	456,425	-	456,425
Investment securities measured at amortised cost	31 December 2020	28,041	-	24,399	52,440
Loans to customers	31 December 2020	-	-	2,599,116	2,599,116
Investment properties	31 December 2020	-	-	36,857	36,857
Other financial assets	31 December 2020	-	-	28,182	28,182

	Date of valuation	Fair value measurement using			Total
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2020	-	7,422	-	7,422
Liabilities for which fair values are disclosed					
Amounts due to banks and government funds	31 December 2020	-	1,154,532	-	1,154,532
Amounts due to customers	31 December 2020	-	-	4,089,046	4,089,046
Debt securities issued	31 December 2020	-	149,971	-	149,971
Other borrowed funds	31 December 2020	-	-	4,058	4,058
Subordinated debt	31 December 2020	-	-	27,165	27,165
Other financial liabilities	31 December 2020	-	-	20,885	20,885

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

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

	Carrying value 2021	Fair value 2021	Unrecognized gain/(loss) 2021	Carrying value 2020	Fair value 2020	Unrecognized gain/(loss) 2020
Financial assets						
Cash and cash equivalents	1,325,411	1,325,411	-	1,200,544	1,200,544	-
Amounts due from credit institutions	602,608	602,608	-	456,425	456,425	-
Investment securities measured at amortised cost	70,515	71,186	671	50,516	52,440	1,924
Loans to customers	3,027,305	3,018,272	(9,033)	2,608,818	2,599,116	(9,702)
Other financial assets	31,984	31,984	-	28,182	28,182	-
Financial liabilities						
Amounts due to banks and government funds	930,407	918,349	12,058	1,140,552	1,154,532	(13,980)
Amounts due to customers	5,181,851	5,181,042	809	4,091,379	4,089,046	2,333
Other borrowed funds	8,586	8,586	-	4,058	4,058	-
Subordinated debts	45,103	45,103	-	27,165	27,165	-
Debt securities issued	162,465	162,812	(347)	149,137	149,971	(834)
Other financial liabilities	16,585	16,585	-	20,885	20,885	-
Total unrecognised change in unrealised fair value			4,158			(20,259)

(Figures in tables are in thousands of Azerbaijani manats)

26. Fair values measurement (continued)

Valuation techniques and assumptions

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

Assets for which fair value approximates carrying value

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

Derivatives

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

Investment securities

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

Financial assets and financial liabilities carried at amortized cost

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

(Figures in tables are in thousands of Azerbaijani manats)

27. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 25 "Risk management" for the Group's contractual undiscounted repayment obligations.

	2021			2020		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Cash and cash equivalents	1,325,411	-	1,325,411	1,200,544	-	1,200,544
Amounts due from credit institutions	516,112	86,496	602,608	389,433	66,992	456,425
Investment securities	376,046	1,507,318	1,883,364	532,697	1,116,739	1,649,436
Derivative financial assets	9,904	-	9,904	765	7,160	7,925
Loans to customers	1,572,824	1,454,481	3,027,305	1,097,540	1,511,278	2,608,818
Investment properties	-	19,126	19,126	-	34,981	34,981
Property and equipment	-	27,938	27,938	-	39,766	39,766
Intangible assets	-	39,467	39,467	-	45,619	45,619
Right-of-use assets	-	17,640	17,640	-	12,300	12,300
Current income tax assets	65	-	65	146	-	146
Deferred income tax assets	-	1,730	1,730	-	3,168	3,168
Other assets	53,399	226	53,625	52,564	19	52,583
Total assets	3,853,761	3,154,422	7,008,183	3,273,689	2,838,022	6,111,711
Amounts due to banks and government funds	512,635	417,772	930,407	559,230	581,322	1,140,552
Amounts due to customers	4,203,610	978,241	5,181,851	3,236,380	854,999	4,091,379
Other borrowed funds	8,586	-	8,586	4,058	-	4,058
Debt securities issued	111,763	50,702	162,465	43,223	105,914	149,137
Derivative financial liabilities	8,044	-	8,044	662	6,760	7,422
Current income tax liability	11,802	-	11,802	12,798	-	12,798
Deferred income tax liabilities	-	2,894	2,894	-	9,342	9,342
Subordinated debts	-	45,103	45,103	-	27,165	27,165
Lease liabilities	6,514	11,727	18,241	4,769	8,570	13,339
Provision for credit related guarantees and other assets	11,024	-	11,024	10,546	-	10,546
Other liabilities	47,300	3,028	50,328	52,613	1,425	54,038
Total liabilities	4,921,278	1,509,467	6,430,745	3,924,279	1,595,497	5,519,776
Net assets	(1,067,517)	1,644,955	577,438	(650,590)	1,242,525	591,935

Negative gap is due to significant concentration of amounts due to customers represented by related parties in the period of one year. Management believes that this level of funding will remain with the Group for the foreseeable future and that in the event of withdrawal of funds, the Group would be given sufficient notice so as to realise its liquid assets to enable repayment.

28. Related party disclosures

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

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties. Other related parties include entities which are associates of the entities under common control or shareholders.

(Figures in tables are in thousands of Azerbaijani manats)

28. Related party disclosures (continued)

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

	2021					2020				
	Share-Holders/ Ultimate owners	Entities under common control	Key manage- ment personnel	Other	Total	Share-Holders/ Ultimate owners	Entities under common control	Key manage- ment personnel	Other	Total
Cash and cash equivalents	-	609	-	-	609	-	1,113	-	-	1,113
Loans outstanding at 1 January, gross	-	647,313	3,415	43,213	693,941	-	453,485	5,018	35,338	493,841
Loans issued during the year	-	128,270	7,101	87,080	222,451	-	238,840	7,359	240,412	486,611
Loan repayments during the year	-	(95,608)	(8,026)	(107,694)	(211,328)	-	(70,732)	(9,052)	(232,517)	(312,301)
Interest accrual	-	2,302	21	-	2,323	-	1,828	23	189	2,040
Foreign currency translation difference	-	(13,928)	772	227	(12,929)	-	23,892	67	(209)	23,750
Loans outstanding at 31 December, gross	-	668,349	3,283	22,826	694,458	-	647,313	3,415	43,213	693,941
Less: allowance for impairment at 31 December	-	(3,729)	(12)	(309)	(4,050)	-	(4,711)	(153)	(424)	(5,288)
Loans outstanding at 31 December, net	-	664,620	3,271	22,517	690,408	-	642,602	3,262	42,789	688,653
Interest income on loans	-	29,519	330	3,855	33,704	-	23,070	399	5,518	28,987
Other assets	-	275	-	-	275	-	681	-	129	810
Amounts due to banks and government funds	-	89,324	-	1,390	90,714	-	86,347	-	-	86,347
Time Deposits	87,995	673,803	6,550	28,268	796,616	88,075	494,709	11,810	22,469	617,063
Demand deposits	623,328	309,521	7,400	357,966	1,298,215	253,348	271,695	2,901	426,652	954,596
Subordinated debts	18,923	12,739	850	-	32,512	18,923	8,242	-	-	27,165
Debt securities issued	78,749	51,868	-	-	130,617	99,587	37,824	-	-	137,411
Other liabilities	12	7,904	-	487	8,403	-	6,903	-	495	7,398
Lease liabilities	-	8,100	-	-	8,100	-	5,345	-	-	5,345
Derivative financial liabilities	-	61	-	-	61	-	6,760	-	-	6,760
Derivative financial assets	-	7,786	-	-	7,786	-	-	-	-	-
Paid-in capital	-	343	-	-	343	-	343	-	-	343
Guarantees issued	-	22,292	-	15,382	37,674	-	11,294	-	49,189	60,483
Letters of credit issued	-	2,995	-	6,894	9,889	-	1,016	-	9,874	10,890
Other Borrowed Funds	-	-	50	-	50	-	-	-	-	-
Unused credit lines	-	30,536	772	33,235	64,543	-	6,933	636	41,967	49,536
Investment securities	-	2,003	-	-	2,003	-	-	-	-	-
Interest income (except loans)	-	4	-	-	4	-	18	-	-	18
Interest expense	(6,496)	(15,160)	(482)	(2,719)	(24,857)	(6,093)	(15,388)	(270)	(1,930)	(23,681)
Fee and commission income	209	9,417	94	3,530	13,250	193	6,887	59	2,220	9,359
Fee and commission expense	(3)	(7,706)	(1)	(641)	(8,351)	-	(5,894)	-	(72)	(5,966)
Net gains/(losses) from foreign currencies: dealing	416	3,265	32	1,724	5,437	408	3,190	52	2,055	5,705
Net gains/(losses) from foreign currencies: translation differences	581	(9,895)	-	-	(9,314)	(4,703)	15,061	-	-	10,358
Net gains/(losses) from foreign currencies: operations with foreign currency derivatives	-	14,059	-	-	14,059	-	1,988	-	-	1,988
Other operating expenses	(23)	(3,920)	-	10	(3,933)	-	(2,166)	-	-	(2,166)
Other income	-	467	-	-	467	-	433	-	-	433
Loss on initial recognition of financial assets at fair value	-	(3,778)	-	-	(3,778)	-	-	-	-	-

As at 31 December 2021, the Group has guarantees from its parent received as a collateral in respect of loans issued to borrowers in the amount of AZN 332,320 thousand (2020: AZN 161,062 thousand) and the Group incurred guarantee fee in the amount of AZN 1,763 (2020: AZN 2,201) thousand which was accounted as a part of effective interest rate.

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

	2021	2020
Salaries and other benefits	(19,206)	(12,695)
Social security costs	(2,635)	(1,595)
Total key management compensation	(21,841)	(14,290)

(Figures in tables are in thousands of Azerbaijani manats)

29. Changes in liabilities arising from financing activities

	Note	Debt securities issued	Subordinated debts	Total liabilities from financing activities
Carrying amount at 31 December 2019		136,031	27,111	163,142
Proceeds from issue		45,992	-	45,992
Redemption		(34,194)	-	(34,194)
Fair value adjustment		-	32	32
Foreign currency translation		1,132	88	1,220
Other		176	(66)	110
Carrying amount at 31 December 2020	16, 17	149,137	27,165	176,302
Proceeds from issue		113,921	17,827	131,748
Redemption		(99,220)	-	(99,220)
Fair value adjustment		-	145	145
Foreign currency translation		(1,798)	(6)	(1,804)
Other		425	(28)	397
Carrying amount at 31 December 2021	16, 17	162,465	45,103	207,568

30. Capital adequacy

The Group maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the ratios established by the CBAR, NBG and BRSA.

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

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

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

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum capital adequacy ratio of 6% (2020: 6%) and 12% (2020: 11%) for Tier 1 Capital and Total Capital, respectively, based on its guidelines.

In January 2020 the CBAR increased the minimum capital adequacy ratio for Total Capital from 11% to 12%. However, as part of the stimulus measures to combat economic downturn caused by the COVID-19 pandemic, CBAR decided on 23 April 2020 to temporarily reduce it back to 11% and keep it at 11% until April 2021.

	2021	2020
Tier 1 capital	417,676	384,363
Tier 2 capital	156,891	135,495
Less: deductions from capital	(151,305)	(149,301)
Total regulatory capital	423,262	370,557
Risk-weighted assets	3,161,218	2,387,253
Capital adequacy ratio (Tier 1)	13.2%	16.1%
Capital adequacy ratio (Total Capital)	13.4%	15.5%

NBG capital adequacy ratio

The NBG requires banks to maintain a minimum total capital adequacy ratio of 15.08% (31 December 2020: 14.3%) and Tier 1 / Core Tier 1 Capital ratio of 6.8% (31 December 2020: 7.8%) of risk-weighted assets, computed based on Basel III requirements. As at 31 December 2021 the PASHA Bank Georgia's capital adequacy ratio on this basis was 18.7% (31 December 2020: 21.5%) and Tier 1 / Core Tier 1 Capital ratio was 13.7% (31 December 2020: 14.0%).

(Figures in tables are in thousands of Azerbaijani manats)

30. Capital adequacy (continued)

BRSA capital adequacy ratio

The BRSA requires banks to maintain a minimum total capital adequacy ratio of 8.0% (31 December 2020: 8.0%) of risk-weighted assets for regulatory capital. Capital adequacy standard ratio of PASHA Yatirim Bankasi is calculated in accordance with BRSA. As at 31 December 2021 the bank's capital adequacy ratio was 17.4% (31 December 2020: 26.3%).

31. Events after the reporting period

Subsequent to year end, in February 2022, due to the conflict between the Russian Federation and Ukraine, numerous sanctions have been announced by majority of western countries against the Russian Federation. These sanctions are targeted to have a negative economic impact on the Russian Federation.

As of 31 December 2021, the Bank's total exposure to Russian financial markets amounted to AZN 73,762 thousand, which comprised investment securities and current accounts. Currently, the Group is taking actions to minimize such exposure.

The Group's management is monitoring the economic situation in the current environment and taking precautionary measures it considers necessary in order to support the liquidity of the Group's assets in the foreseeable future.