OJSC PASHA Bank

Separate financial statements

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

Contents

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working world

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Independent auditor's report

To the Shareholders and Supervisory Board of
OJSC PASHA Bank

Report on the audit of the financial statements

Opinion

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

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the separate financial statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' 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 separate financial statements

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

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

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

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Auditor's responsibilities for the audit of the separate financial statements

Our objectives are to obtain reasonable assurance about whether the separate financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these separate financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the separate financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the separate financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the separate financial statements, including the disclosures, and whether the separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Ernst & Young Holdings (CIS) B.V.

31 May 2022

Baku, Azerbaijan

Separate 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	1,285,419	1,147,235
Amounts due from credit institutions	6	540,649	411,620
Investment securities	7	1,803,328	1,590,102
Loans to customers	8	2,552,877	2,108,184
Derivative financial assets	17	7,994	7,654
Investments in subsidiaries	12	127,006	149,363
Investment properties		–	1,590
Property and equipment	9	14,211	15,818
Intangible assets	10	31,035	30,002
Right-of-use assets	11	14,603	7,631
Other assets	13	49,734	47,192
Total assets		**6,426,856**	**5,516,391**
Liabilities			
Amounts due to banks and government funds	14	667,710	886,295
Amounts due to customers	15	5,057,851	3,966,289
Derivative financial liabilities	17	7,847	6,760
Lease liabilities	11	14,795	7,831
Current income tax liabilities	18	11,101	12,250
Deferred income tax liabilities	18	1,949	6,895
Provision for guarantees and other commitments	20	10,011	8,141
Subordinated debts	16	36,809	18,923
Other liabilities	13	42,350	43,915
Total liabilities		**5,850,423**	**4,957,299**
Equity			
Share capital	19	354,512	354,512
Retained earnings		208,817	184,265
Net unrealised gain on investment securities	19	13,104	20,315
Total equity		**576,433**	**559,092**
Total liabilities and equity		**6,426,856**	**5,516,391**

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

Javid Gouliyev — Acting Chairman of the Executive Board

Bahruz Naghiyev — Chief Financial Officer

31 May 2022

Azərbaycan Respublikası Açıq Səhmdar Cəmiyyəti PAŞA Bank Open Joint Stock Company Azerbaijan Republic

The accompanying notes on pages 6 to 54 are an integral part of these separate financial statements.

Separate statement of profit or loss

For the year ended 31 December 2021

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2021*	*2020*
Interest income			
Loans to customers		182,105	149,362
Investment securities		69,991	54,387
Cash and cash equivalents		508	6,828
Amounts due from credit institutions		5,710	7,094
Interest revenue calculated using effective interest rate		**258,314**	**217,671**
Interest expense			
Amounts due to customers		(33,292)	(31,449)
Amounts due to banks and government funds		(18,310)	(12,006)
Lease liabilities	11	(658)	(482)
Subordinated debt		(621)	(561)
Amounts due to the debt securities issued		–	(1,497)
Other borrowed funds		–	–
		(52,881)	**(45,995)**
Net interest income		**205,433**	**171,676**
Credit loss expense on financial assets	21	(20,271)	(16,303)
Net interest income after credit loss expense		**185,162**	**155,373**
Net fee and commission income	22	33,270	31,023
Net gains from investment securities		2,446	–
Net gains/(losses) from foreign currencies:			
- Dealing		26,539	27,859
- translation differences		(1,245)	739
- foreign currency derivatives		3,492	3,037
Other income		2,687	293
Non-interest income		**67,189**	**62,951**
Personnel expenses	23	(54,605)	(53,926)
General and administrative expenses	23	(46,168)	(38,386)
Depreciation and amortisation	9, 10, 11	(17,606)	(16,291)
Net gain arising on modification of loans to customers	8	1,427	126
Net losses on initial recognition of financial instruments	13	(3,778)	–
Impairment of digital products	10	–	(1,482)
Impairment of Investment in subsidiaries	12	(22,357)	–
Reversal / (impairment) of miles under loyalty program		691	(691)
Reversal of impairment on investment property		410	–
Write-down of repossessed collaterals	23	(5,008)	(762)
Provision for credit related commitments and other assets	21	(1,818)	(81)
Other operating expenses		(111)	
Non-interest expenses		**(148,923)**	**(111,493)**
Profit before income tax expense		**103,428**	**106,831**
Income tax expense	18	(28,496)	(22,863)
Profit for the year		**74,932**	**83,968**

The accompanying notes on pages 6 to 54 are an integral part of these separate financial statements.

Separate statement of comprehensive income

For the year ended 31 December 2021

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2021	2020
Profit for the year		**74,932**	**83,968**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Net change in fair value of investment securities at fair value through other comprehensive income	7	(8,490)	16,313
Changes in allowance for expected credit losses of investment securities at fair value through other comprehensive income	7, 21	(524)	3,332
Net unrealised gains on investment securities at fair value through other comprehensive income		**(9,014)**	**19,645**
Income tax relating to components of other comprehensive income	18	1,803	(3,929)
Net other comprehensive income to be reclassified to profit or loss in subsequent periods		**(7,211)**	**15,716**
Total comprehensive income for the year		**67,721**	**99,684**

The accompanying notes on pages 6 to 54 are an integral part of these separate financial statements.

Separate statement of changes in equity

For the year ended 31 December 2021

(Figures in tables are in thousands of Azerbaijani manats)

	Share capital	*Retained earnings*	*Net unrealised gains on investment securities*	*Total equity*
As at 1 January 2020	**333,000**	**145,719**	**4,599**	**483,318**
Profit for the year	–	83,968	–	**83,968**
Other comprehensive income for the year	–	–	15,716	**15,716**
Total comprehensive income for the year	**–**	**83,968**	**15,716**	**99,684**
Issue of share capital (Note 19)	21,512	–	–	**21,512**
Dividends to shareholders of the Bank (Note 19)	–	(45,422)	–	**(45,422)**
As at 31 December 2020	**354,512**	**184,265**	**20,315**	**559,092**
Profit for the year	–	74,932	–	**74,932**
Other comprehensive loss for the year	–	–	(7,211)	**(7,211)**
Total comprehensive income for the year	**–**	**74,932**	**(7,211)**	**67,721**
Dividends to shareholders of the Bank (Note 19)	–	(50,380)	–	**(50,380)**
As at 31 December 2021	**354,512**	**208,817**	**13,104**	**576,433**

The accompanying notes on pages 6 to 54 are an integral part of these separate financial statements.

Separate statement of cash flows

For the year ended 31 December 2021

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2021	2020
Cash flows from operating activities			
Interest received		260,903	224,519
Interest paid		(51,560)	(42,933)
Fees and commissions received		79,864	58,454
Fees and commissions paid		(48,839)	(26,785)
Net gains from investment securities		2,446	–
Realised gains less losses from dealing in foreign currencies and foreign currency derivatives		30,778	30,171
Personnel expenses paid		(55,865)	(45,020)
General and administrative expenses paid		(42,741)	(40,029)
Other operating income received		981	89
Cash flows from operating activities before changes in operating assets and liabilities		**175,967**	**158,466**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		(140,817)	167,893
Loans to customers		(492,260)	(281,535)
Other assets		(15,871)	(5,520)
Net increase/(decrease) in operating liabilities			
Amounts due to banks and government funds		(242,219)	244,847
Amounts due to customers		1,166,868	271,240
Other liabilities		(3,506)	(620)
Net cash flows from operating activities before income tax		**448,162**	**554,771**
Income tax paid		(32,788)	(14,500)
Net cash from operating activities		**415,374**	**540,271**
Cash flows from investing activities			
Proceeds from sale and redemption of investment securities		1,757,279	3,138,931
Purchase of investment securities		(1,976,785)	(3,604,032)
Proceeds from sale of investment property		2,000	–
Proceeds from sale of property and equipment		221	115
Purchase and prepayments for property and equipment		(7,504)	(5,220)
Acquisition of intangible assets		(5,324)	(4,118)
Net cash flows used in investing activities		**(230,113)**	**(474,324)**
Cash flows from financing activities			
Proceeds from issue of share capital	19	–	21,512
Dividends paid	19	(50,380)	(45,422)
Proceeds from issue of subordinated debt	28	17,827	–
Finance lease paid	12	(5,461)	(5,055)
Net cash used in financing activities		**(38,014)**	**(28,965)**
Effect of exchange rates changes on cash and cash equivalents		(9,093)	19,747
Effect of expected losses on cash and cash equivalents	5	30	(30)
Net increase in cash and cash equivalents		**138,184**	**56,699**
Cash and cash equivalents, beginning	5	1,147,235	1,090,536
Cash and cash equivalents, ending	5	**1,285,419**	**1,147,235**

The accompanying notes on pages 6 to 54 are an integral part of these separate financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

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

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

As at 31 December 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. Jamal Pashayev	5	5
Ador Ltd.	–	28
Total	**100**	**100**

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

2. Basis of preparation

General

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

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

The Bank is the parent entity of JSC PASHA Bank Georgia and PASHA Yatirim Bankasi A.S. and consolidated financial statements of OJSC PASHA Bank prepared in accordance with IFRS have been issued separately on 8 April 2022. Copy of consolidated financial statements is available at official legal address of the Bank. The separate financial statements are prepared for the purposes of the Bank's performance monitoring and performance management.

Effect of COVID-19 pandemic

Following rapid spread of COVID-19 pandemic in 2020 many governments, which continued in 2021, including the Government of the Republic of Azerbaijan has 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.

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies

Changes in accounting policies

The Bank applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2021. The Bank 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 Bank has not received COVID-19-related rent concessions, but plans to apply the practical expedient if it becomes applicable within allowed period of application.

Fair value measurement

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

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

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

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

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

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

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

Financial assets and liabilities

Initial recognition

Date of recognition

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Financial assets and liabilities (continued)

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

- Amortised cost;
- FVOCI;
- FVPL.

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

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

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

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

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

The details of these conditions are outlined below.

Business model assessment

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

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

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

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

The SPPI test

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Financial assets and liabilities (continued)

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

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

Debt instruments at FVOCI

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

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

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

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

Equity instruments at FVOCI

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

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

Financial guarantees, letters of credit and undrawn loan commitments

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

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

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

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

Performance guarantees

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Financial assets and liabilities (continued)

Reclassification of financial assets and liabilities

The Bank does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank changes the business model for managing financial assets. Financial liabilities are never reclassified. The Bank did not reclassify any of its financial assets and liabilities in 2020 and 2019.

Cash and cash equivalents

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

Repurchase and reverse repurchase agreements

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

Securities purchased under agreements to resell ("reverse repo") are recorded as separate account on the separate statement of financial position if material or as cash and cash equivalents or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

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

Derivative financial instruments

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

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to banks and government funds, other borrowed funds, debt securities issued, subordinated debt and amounts due to customers.

After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the borrowings are derecognised as well as through the amortisation process. If the Bank purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is recognised in profit or loss.

Leases

i. Bank as a lessee

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

Right-of-use assets

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

Lease liabilities

At the commencement date of the lease, the Bank recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in-substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Bank and payments of penalties for terminating a lease, if the lease term reflects the Bank exercising the option to terminate. The variable lease payments that do not depend on an index or a rate are recognised as expense in the period on which the event or condition that triggers the payment occurs. In calculating the present value of lease payments, the Bank uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the in-substance fixed lease payments or a change in the assessment to purchase the underlying asset.

Short-term leases and leases of low-value assets

The Bank applies the short-term lease recognition exemption to its short-term leases (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value (i.e., below USD 5000). Lease payments on short-term leases and leases of low-value assets are recognised as expense on a straight-line basis over the lease term.

ii. Finance – Bank as a lessor

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Offsetting of financial instruments

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

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

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

Renegotiated loans

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

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

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

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

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

Write-off

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

Financial liabilities

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

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

Taxation

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

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

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

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively.

Property and equipment

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

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

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

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

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Investments in subsidiaries

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

Investment property

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

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

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

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

Repossessed collateral

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

Intangible assets

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

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

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

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

Provisions

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Retirement and other employee benefit obligations

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

Share capital

Share capital

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

Dividends

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

Contingencies

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

Recognition of income and expenses

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

Interest and similar income and expense

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

The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest revenue or expense.

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

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates interest revenue by calculating the credit-adjusted EIR and applying that rate to the amortised cost of the asset. The credit-adjusted EIR is the interest rate that, at original recognition, discounts the estimated future cash flows (including credit losses) to the amortised cost of the POCI assets. Interest revenue on all financial assets at FVPL is recognised using the contractual interest rate in "Other interest revenue" in the separate statement of profit or loss.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Recognition of income and expenses (continued)

Fee and commission income

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

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

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

Fee income from providing transaction services

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

Customer loyalty programs

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

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

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

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

Dividend income

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

Foreign currency translation

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Foreign currency translation (continued)

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

	2021	*2020*
1 US dollar	AZN 1.7000	AZN 1.7000
1 euro	AZN 1.9265	AZN 2.089

Standards issued but not yet effective

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

IFRS 17 Insurance Contracts

In May 2017, the IASB issued IFRS 17 *Insurance Contracts* (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 *Insurance Contracts* (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply. 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 Bank is currently in the process of assessing the impact of adopting IFRS 17 on its financial statements.

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Standards issued but not yet effective (continued)

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 Bank.

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 Bank 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 Bank 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 Bank.

Definition of Accounting Estimates – Amendments to IAS 8

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

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Standards issued but not yet effective (continued)

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

4. Significant accounting judgments and estimates

Judgements

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

Determining the lease term of contracts with renewal options

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

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

Estimation uncertainty

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

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 25.

Impairment losses on financial assets

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

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

More details are provided in Notes 8 and 24.

(Figures in tables are in thousands of Azerbaijani manats)

4. Significant accounting judgments and estimates (continued)

Estimation uncertainty (continued)

Impairment of digital products

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

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

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

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

Net realisable value of repossessed collaterals

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

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

The carrying amount of repossessed collaterals at 31 December 2021 was AZN 10,647 thousand (31 December 2020: AZN 16,105 thousand). More details are provided in Note 13.

Leases – estimating the incremental borrowing rate

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

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

Taxation

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

(Figures in tables are in thousands of Azerbaijani manats)

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2021	*2020*
Cash on hand	81,981	62,674
Current accounts with the CBAR	1,068,050	581,308
Current accounts with other credit institutions	77,928	80,499
Time deposits with credit institutions up to 3 months	56,960	399,317
Reverse repurchase agreements with credit institutions up to 3 months	500	23,467
Less: allowance for impairment	–	(30)
Cash and cash equivalents	**1,285,419**	**1,147,235**

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 3,838 thousand (31 December 2020: AZN 609 thousand) and AZN 74,090 thousand (31 December 2020: AZN 79,890 thousand), respectively.

As at 31 December 2021, the Bank placed AZN 56,960 thousand in time deposits with two non-resident banks maturing through January 2022 (31 December 2020: AZN 399,317 thousand with CBAR and six non-resident banks maturing through March 2021.

As at 31 December 2021 and 2020, all balances of cash equivalents are allocated to Stage 1.

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2021	*2020*
Time deposits with credit institutions for more than 3 months	321,537	236,936
Loans to banks	45,209	37,133
Obligatory reserve with the CBAR	27,445	24,287
Restricted deposits	147,262	113,707
	541,453	412,063
Less: allowance for impairment	(804)	(443)
Amounts due from credit institutions	**540,649**	**411,620**

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).

As at 31 December 2021, the Bank had outstanding amount of AZN 37,070 thousand (31 December 2020: AZN 28,995 thousand) of secured loans issued to four resident commercial bank (31 December 2020: three resident commercial banks) and AZN 8,139 thousand (31 December 2020: AZN 8,138 thousand) of unsecured loans issued to one non-resident commercial banks (31 December 2020: one non-resident commercial banks) with contractual maturity through December 2025 (31 December 2020: December 2025).

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.

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

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

(Figures in tables are in thousands of Azerbaijani manats)

6. Amounts due from credit institutions (continued)

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

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	**555,399**	**14,214**	**–**	**569,613**
New assets originated or purchased	243,646	–	–	243,646
Assets repaid	(400,963)	(233)	–	(401,196)
Transfers to Stage 3	–	(13,981)	13,981	–
At 31 December 2020	**398,082**	**–**	**13,981**	**412,063**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL allowance as at 1 January 2020	**(530)**	**–**	**–**	**(530)**
New assets originated or purchased	(224)	–	–	(224)
Assets repaid	311	–	–	311
At 31 December 2020	**(443)**	**–**	**–**	**(443)**

7. Investment securities

Investment securities comprise:

	2021	*2020*
Debt securities at FVOCI		
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	616,722	553,787
AMF bonds	592,843	531,372
Corporate bonds	216,031	137,920
US treasury bonds	142,186	4,445
Certificate of deposits	93,741	94,216
Bonds of financial institutions	70,262	76,064
Foreign government bonds	44,418	32,308
Notes issued by the CBAR	16,563	151,318
Turkey Govemment Bonds	8,559	8,672
Debt securities at FVOCI	**1,801,325**	**1,590,102**

	2021	*2020*
Equity securities at FVOCI		
Corporate Shares	2,003	–
Equity securities at FVOCI	**2,003**	**–**

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 15). The net investment securities balance after offset would have been AZN 1,440,102 thousand if net-off rights were exercised.

(Figures in tables are in thousands of Azerbaijani manats)

7. Investment securities (continued)

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*
Gross carrying value as at 1 January 2021	**1,590,102**
New assets originated or purchased	243,353
Assets repaid	(23,640)
Fair value increase	(8,490)
At 31 December 2021	**1,801,325**

Debt securities at FVOCI	*Stage 1*
ECL as at 1 January 2020	**(4,140)**
New assets originated or purchased	(1,530)
Assets repaid	2,054
At 31 December 2020	**(3,616)**

Debt securities at FVOCI	*Stage 1*
Gross carrying value as at 1 January 2020	**1,103,159**
New assets originated or purchased	697,164
Assets repaid	(226,534)
Fair value decrease	16,313
At 31 December 2020	**1,590,102**

Debt securities at FVOCI	*Stage 1*
ECL as at 1 January 2020	**(808)**
New assets originated or purchased	(3,533)
Assets repaid	201
At 31 December 2020	**(4,140)**

8. Loans to customers

Loans to customers comprise:

	2021	*2020*
Legal entities	2,330,600	1,926,899
Individuals	301,404	236,516
Loans to customers (gross)	**2,632,004**	**2,163,415**
Less: allowance for impairment	(79,127)	(55,231)
Loans to customers (net)	**2,552,877**	**2,108,184**

(Figures in tables are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Loans are made in the following industry sectors:

	2021	*2020*
Trade and services	1,366,781	1,121,802
Manufacturing	317,062	301,315
Individuals	301,404	236,516
Construction	221,248	151,222
Transport and telecommunication	170,018	99,112
Agriculture and food processing	152,466	158,765
Mining	41,706	34,750
Non-banking credit organizations	37,688	25,954
Leasing	12,571	22,781
Energy	7,503	9,830
Other	3,557	1,368
Total loans (gross)	**2,632,004**	**2,163,415**

As at 31 December 2021, loans granted to top 15 customers (31 December 2020: 9 customers) which individually exceeded 5% of the Bank's equity, amounted to AZN 967,026 thousand (31 December 2020: AZN 739,307 thousand).

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

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

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

(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 2020 is as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2020	**1,151,751**	**567,578**	**151,985**	**1,871,314**
New assets originated or purchased	1,004,451	–	–	**1,004,451**
Assets repaid (excluding write-offs)	(430,210)	(255,386)	(15,710)	**(701,306)**
Transfers to Stage 1	53,009	(53,008)	(1)	–
Transfers to Stage 2	(765,061)	765,088	(27)	–
Transfers to Stage 3	(21,425)	(6,408)	27,833	–
Amounts written off	–	–	(11,044)	**(11,044)**
At 31 December 2020	**992,515**	**1,017,864**	**153,036**	**2,163,415**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2020	**(7,049)**	**(15,781)**	**(26,938)**	**(49,768)**
New assets originated or purchased	(21,683)	–	–	**(21,683)**
Assets repaid	6,821	5,222	8,589	**20,632**
Transfers to Stage 1	(787)	787	–	–
Transfers to Stage 2	8,652	(8,675)	23	–
Transfers to Stage 3	7,266	190	(7,456)	–
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	(3,499)	70	(15)	**(3,444)**
Amounts written off	–	–	11,044	**11,044**
At 31 December 2020	**(9,627)**	**(23,533)**	**(22,071)**	**(55,231)**

Modified and restructured loans

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

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

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

	2021	*2020*
Loans modified during the period		
Amortised cost before modification	134,161	306,144
Net modification gain	1,427	126

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

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

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.

(Figures in tables are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Collateral and other credit enhancements (continued)

The Bank 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 173,095 thousand (31 December 2020: AZN 133,131 thousand) for which ECL of AZN 35,135 thousand (31 December 2020: AZN 15,453 thousand) was created. If these loans were not collateralized, ECL amount for these loans would be AZN 81,055 thousand (31 December 2020: AZN 91,955 thousand) based on collective assessment.

9. Property and equipment

The movements in property and equipment were as follows:

	Land	*Buildings*	*Furniture and fixtures*	*Computers and other equipment*	*Vehicles*	*Other equipment*	*Leasehold improve-ments*	*Total*
Cost								
31 December 2019	**300**	**5,407**	**17,381**	**11,481**	**1,312**	**351**	**2,494**	**38,726**
Additions	–	–	3,999	1,253	745	4	100	6,101
Disposals	–	–	(691)	(450)	(209)	–	–	(1,350)
31 December 2020	**300**	**5,407**	**20,689**	**12,284**	**1,848**	**355**	**2,594**	**43,477**
Additions	–	–	4,080	962	214	–	–	5,256
Disposals	–	–	(105)	(4,952)	(339)	–	–	(5,396)
Transfers	–	–	491	(491)	–	–	–	-
31 December 2021	**300**	**5,407**	**25,155**	**7,803**	**1,723**	**355**	**2,594**	**43,337**
Accumulated depreciation								
31 December 2019	–	(1,615)	(11,080)	(8,172)	(1,053)	(309)	(1,480)	(23,709)
Depreciation charge	–	(270)	(3,046)	(1,437)	(171)	(17)	(272)	(5,213)
Disposals	–	–	605	450	208	–	–	1,263
31 December 2020	–	**(1,885)**	**(13,521)**	**(9,159)**	**(1,016)**	**(326)**	**(1,752)**	**(27,659)**
Depreciation charge	–	(270)	(3,578)	(1,304)	(335)	(13)	(273)	(5,773)
Disposals	–	–	94	3,873	339	–	–	4,306
Transfers	–	–	(491)	491	–	–	–	-
31 December 2021	–	**(2,155)**	**(17,496)**	**(6,099)**	**(1,012)**	**(339)**	**(2,025)**	**(29,126)**
Net book value								
31 December 2021	**300**	**3,252**	**7,659**	**1,704**	**711**	**16**	**569**	**14,211**
31 December 2020	**300**	**3,522**	**7,168**	**3,125**	**832**	**29**	**842**	**15,818**
31 December 2019	**300**	**3,792**	**6,301**	**3,309**	**259**	**42**	**1,014**	**15,017**

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)

10. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Digital products*	*Total*
Cost				
31 December 2019	**16,032**	**12,426**	**14,980**	**43,438**
Additions	2,759	625	5,412	8,796
Disposals	(1,024)	(64)	–	(1,088)
31 December 2020	**17,767**	**12,987**	**20,392**	**51,146**
Additions	4,688	3,574	–	8,262
Disposals	(335)	(153)	–	(488)
31 December 2021	**22,120**	**16,408**	**20,392**	**58,920**
Accumulated amortization				
31 December 2019	**(6,641)**	**(3,834)**	**(3,723)**	**(14,198)**
Amortisation charge	(2,916)	(1,243)	(2,342)	(6,501)
Disposals	970	67	–	1,037
Impairment	–	–	(1,482)	(1,482)
31 December 2020	**(8,587)**	**(5,010)**	**(7,547)**	**(21,144)**
Amortisation charge	(2,933)	(1,423)	(2,652)	(7,008)
Disposals	139	128	–	267
Impairment	–	–	–	–
31 December 2021	**(11,381)**	**(6,305)**	**(10,199)**	**(27,885)**
Net book value				
31 December 2021	**10,739**	**10,103**	**10,193**	**31,035**
31 December 2020	**9,180**	**7,977**	**12,845**	**30,002**
31 December 2019	**9,391**	**8,592**	**11,257**	**29,240**

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.

11. 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:

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

(Figures in tables are in thousands of Azerbaijani manats)

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

	Right-of-use assets	*Lease liabilities*
As at 1 January 2020	**5,992**	**6,188**
Additions	6,216	6,216
Depreciation expense	(4,577)	–
Interest expense	–	482
Payments	–	(5,055)
As at 31 December 2020	**7,631**	**7,831**

12. Investments in subsidiaries

Investments in subsidiaries comprise the following:

	2021	*2020*
PASHA Yatirim Bankasi A.S.	79,149	101,506
PASHA Bank Georgia JSC	47,857	47,857
	127,006	**149,363**

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

Due to significant devaluation of TRY in 2021, the Bank reassessed fair value of its investment in PASHA Yatirim Bankasi A.Ş. The remeasurement lead to impairment of investment in subsidiary by AZN 22,357 thousand (31 December 2020: nil).

PASHA Bank Georgia JSC, a wholly-owned subsidiary, is located in the Republic of Georgia, operating in the banking sector, with registered and paid up share capital of GEL 35,000 thousand (AZN 16,615 thousand) as of 31 December 2013. In March 2014 share capital of subsidiary was increased by GEL 68,000 thousand (AZN 30,866 thousand) and amounted to GEL 103,000 thousand (AZN 47,481 thousand) as at 31 December 2021 and 2020.

In December 2019, the Bank granted subordinated debt of USD 5,000 thousand (AZN 8,500 thousand) to PASHA Bank Georgia JSC. The fair value measurement of subordinated debt lead to total loss of AZN 376 thousand by the Bank. The loss has been accounted as a cost of investment in the subsidiary, which amounted to AZN 47,857 thousand as of 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.

(Figures in tables are in thousands of Azerbaijani manats)

13. Other assets and liabilities

Other assets comprise:

	2021	*2020*
Other financial assets		
Settlements on money transfers	27,699	22,511
Accrued commission receivable on guarantees and letters of credit	1,759	1,736
Other	5	–
	29,463	**24,247**
Less-allowance for impairment of other financial assets	(358)	(410)
Total other financial assets	**29,105**	**23,837**
Other non-financial assets		
Repossessed collaterals	10,647	16,105
Deferred expenses	2,513	2,522
Prepayments for acquisition of property, equipment and intangible assets	2,301	644
Purchased miles under loyalty programme	3,788	2,807
Other	1,380	1,277
	20,629	**23,355**
Other assets	**49,734**	**47,192**

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

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

Other liabilities comprise:

	2021	*2020*
Other financial liabilities		
Settlements on money transfer	209	3,892
Accrued expenses	10,962	10,003
Other	784	859
	11,955	**14,754**
Other non-financial liabilities		
Payable to employees	26,140	27,102
Deferred income	2,684	1,160
Taxes, other than income tax	1,571	899
	30,395	**29,161**
Other liabilities	**42,350**	**43,915**

14. Amounts due to banks and government funds

Amounts due to banks and government funds comprise:

	2021	*2020*
Entrepreneurship Development Fund of the Republic of Azerbaijan	273,940	385,654
Long-term deposits from banks	184,961	192,124
Azerbaijan Mortgage and Credit Guarantee Fund	82,674	47,360
Long-term loans from banks	50,085	–
Correspondent accounts with other banks	22,887	69,582
Agro Credit and Development Agency	12,923	8,674
Short-term deposits from banks	11,568	13,173
State Agency on Mandatory Health Insurance	4,305	4,065
Amount due to IT Development Fund	1,067	2,686
Repurchase agreements	–	151,416
Other amount	23,300	11,561
Amounts due to banks and government funds	**667,710**	**886,295**

(Figures in tables are in thousands of Azerbaijani manats)

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

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% p.a. (31 December 2020: maturing through March 2021 with interest rate of 4.0% p.a.).

The Bank 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% p.a. (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 Bank attracted long-term deposits from two resident commercial banks comprising AZN 184,961 thousand maturing on September 2023 with interest rates 0.1% and 4.0% p.a. (31 December 2020: from three resident commercial bank comprising AZN 192,124 thousand matured on December 2022 with interest rate 0.3% and 4.0% p.a.).

As at 31 December 2021, the Bank 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 Bank 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 2020:interest rate ranging between 6.5% and 7.5% p.a.).

As at 31 December 2021, the Bank received long-term loans from one resident and one non resident banks comprising AZN 50,085 thousands maturing through August 2026 and with interest rate ranging between 3.00% and 11.00% p.a.

As at 31 December 2021, the Bank 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% p.a.).

As at 31 December 2021, the Bank attracted short-term deposits from two resident commercial banks (31 December 2020: two resident commercial banks) comprising AZN 11,568 thousand (31 December 2020: AZN 13,173 thousand) maturing on August 2022 (31 December 2020: September 2021) and with interest rate ranging between 3.0% and 12.0% p.a. (31 December 2020: 12.0% p.a.).

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

As at 31 December 2021, the Bank 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. (31 December 2020: 5.0% p.a.).

15. Amounts due to customers

The amounts due to customers include the following:

	2021	*2020*
Demand deposits	3,611,577	2,664,045
Time deposits	1,446,274	1,302,244
Amounts due to customers	**5,057,851**	**3,966,289**
Held as security against guarantees issued (Note 20)	40,775	18,263

(Figures in tables are in thousands of Azerbaijani manats)

15. Amounts due to customers (continued)

An analysis of customer accounts by economic sector follows:

	2021	*2020*
Individuals	1,629,724	1,294,695
Trade and services	1,085,190	976,986
Mining	502,536	115,145
Investment holding companies	453,777	474,794
Manufacturing	382,179	252,850
Transport and communication	357,899	264,765
Construction	242,145	208,818
Energy	123,178	90,488
Insurance	84,090	113,236
Public organizations	68,939	55,062
Agriculture	29,185	37,005
Hotel business	16,137	10,958
Non-banking credit organizations	15,183	17,480
Other	67,689	54,007
Amounts due to customers	**5,057,851**	**3,966,289**

As at 31 December 2021, customer deposits included balances with thirteen (31 December 2020: nine) largest customers comprised AZN 2,757,218 thousand or 55% of the total customer deposits portfolio (31 December 2020: AZN 1,906,386 thousand or 48% of the total customer deposits portfolio).

16. Subordinated debts

As of 31 December 2021, subordinated debts represent USD denominated subordinated loans of AZN 36,809 (31 December 2020: AZN 18,923) borrowed by the Bank maturing through August 2024 and December 2028 (31 December 2020: August 2024).

17. Derivative financial instruments

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

	2021			*2020*		
	Notional amount	*Fair values*		*Notional amount*	*Fair value*	
		Asset	*Liability*		*Asset*	*Liability*
Foreign exchange contracts						
Futures – domestic	–	–	–	4,614	2	–
Options – domestic	54,474	99	–	18,318	437	–
Forwards and swaps – foreign	319,664	60	(7,787)	295,295	6,354	(407)
Forwards and swaps – domestic	334,764	7,835	(60)	409,071	861	(6,353)
Total derivative assets/ (liabilities)		**7,994**	**(7,847)**		**7,654**	**(6,760)**

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

Forwards and futures

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

Swaps

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

(Figures in tables are in thousands of Azerbaijani manats)

17. Derivative financial instruments (continued)

Options

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

18. Taxation

The corporate income tax expense comprises:

	2021	*2020*
Current tax charge	(31,639)	(29,555)
Deferred tax credit – origination and reversal of temporary differences	4,946	2,763
Less: deferred tax recognised in other comprehensive income	(1,803)	3,929
Income tax expense	**(28,496)**	**(22,863)**

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

	2021	*2020*
Net loss/(gains) on investment securities at FVOCI	1,803	(3,929)
Income tax credited of other comprehensive income	**1,803**	**(3,929)**

Current income tax liabilities of AZN 11,101 thousand as at 31 December 2021 (31 December 2020: AZN 12,250 thousand) represents cumulative amount of income tax payable of the Bank.

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

	2021	*2020*
Profit before income tax expense	**103,428**	**106,831**
Statutory tax rate	20%	20%
Theoretical tax expense at the statutory rate	**(20,686)**	**(21,366)**
Tax effect of non-deductible expenses	(7,480)	(1,778)
Other	(330)	281
Income tax expense	**(28,496)**	**(22,863)**

(Figures in tables are in thousands of Azerbaijani manats)

18. Taxation (continued)

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

		Origination and reversal of temporary differences			*Origination and reversal of temporary differences*		
	1 January 2020	*In the statement of profit or loss*	*In other comprehensive income*	*31 December 2020*	*In the statement of profit or loss*	*In other comprehensive income*	*31 December 2021*
Tax effect of deductible temporary differences							
Amounts due to banks and government agencies	–	–	–	–	755	–	755
Investment property	82	–	–	82	(82)	–	–
Property and equipment	139	(13)	–	126	(48)	–	78
Intangible assets	408	(68)	–	340	(198)	–	142
Derivative financial liabilities	–	1,352	–	1,352	(1,352)	–	–
Loans to customers	–	–	–	–	392	–	392
Lease liabilities	1,238	329	–	1,567	1,393	–	2,960
Derivative financial assets	–	–	–	–	59	–	59
Other liabilities	3,438	1,545	–	4,983	(279)	–	4,704
Deferred tax assets	**5,305**	**3,145**	**–**	**8,450**	**640**	**–**	**9,090**
Tax effect of taxable temporary differences							
Amounts due from credit institutions	(1,933)	(939)	–	(2,872)	293	–	(2,579)
Investment securities	(987)	666	(3,929)	(4,250)	(105)	1,803	(2,552)
Loans to customers	(8,567)	7,387	–	(1,180)	1,180	–	–
Derivative financial assets	(34)	(1,463)	–	(1,497)	1,497	–	–
Other assets	(1,628)	(244)	–	(1,872)	889	–	(983)
Right-of-use assets	(1,198)	(328)	–	(1,526)	(1,395)	–	(2,921)
Provision for credit related commitments	(616)	(1,532)	–	(2,148)	144	–	(2,004)
Deferred tax liabilities	**(14,963)**	**3,547**	**(3,929)**	**(15,345)**	**2,503**	**1,803**	**(11,039)**
Net deferred tax (liabilities)/assets	**(9,658)**	**6,692**	**(3,929)**	**(6,895)**	**3,143**	**1,803**	**(1,949)**

19. Equity

On 24 June 2020 Shareholders of the Bank 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, the Bank's authorized, issued and fully paid capital amounted to AZN 354,512 thousand (31 December 2020: 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 (31 December 2020: AZN 33,300 thousand). 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.

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.

Unrealised gains on investment securities

This reserve records fair value changes on investment securities at FVOCI which amounted to AZN 13,104 thousand as at 31 December 2021 (31 December 2020: AZN 20,315 thousand).

(Figures in tables are in thousands of Azerbaijani manats)

20. 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 Bank operates is presented as follows.

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.

Legal

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

Taxation

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

Management believes that its interpretation of the relevant legislation as at 31 December 2021 is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Insurance

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

(Figures in tables are in thousands of Azerbaijani manats)

20. Commitments and contingencies (continued)

Compliance with CBAR ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 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%).

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.

Financial commitments and contingencies

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

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

	2021	*2020*
Credit-related commitments		
Guarantees issued	211,735	250,314
Unused credit lines	325,948	313,007
Letters of credit	37,833	24,064
	575,516	**587,385**
Performance guarantees	384,926	259,891
Less: provisions for ECL for credit related commitments	(10,011)	(8,141)
Commitments and contingencies (before deducting collateral)	**950,431**	**839,135**
Less: cash held as security against guarantees issued (Note 15)	(40,775)	(18,263)
Commitments and contingencies	**909,656**	**820,872**

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

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

(Figures in tables are in thousands of Azerbaijani manats)

20. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

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

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2020	(3,282)	(2,439)	(273)	(5,994)
New exposures	(1,959)	–	–	(1,959)
Exposures derecognised or matured (excluding write-offs)	2,002	1,048	273	3,323
Transfers to Stage 1	(1,169)	1,169	–	–
Transfers to Stage 2	1,420	(1,420)	–	–
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	(16)	52	–	36
At 31 December 2020	(1,848)	(2,879)	(184)	(4,911)

21. Credit loss expense and other impairment and provisions

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

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

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.

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

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Cash and cash equivalents	5	(30)	–	–	(30)
Due from credit Institutions	6	87	–	–	87
Investment securities at FVOCI	7	(3,332)	–	–	(3,332)
Loans to customers	8	(2,578)	(7,752)	(2,699)	(13,029)
Credit loss on financial assets		**(5,852)**	**(7,752)**	**(2,699)**	**(16,303)**
Credit related commitments	21	1,434	(440)	89	1,083
Total credit loss expense		**(4,418)**	**(8,192)**	**(2,610)**	**(15,220)**

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

	Other financial assets	*Performance guarantees*	*Total*
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)
Charge	52	(1,675)	(1,623)
Recoveries of amounts previously written off	–	–	–
31 December 2021	(358)	(4,905)	(5,263)

(Figures in tables are in thousands of Azerbaijani manats)

22. Net fee and commission income

Net fee and commission income comprise:

	2021	*2020*
Servicing plastic card operations	41,207	26,042
Settlements operations	18,894	15,113
Guarantees and letters of credit	13,714	13,337
Cash operations	4,727	3,839
Other	770	555
Fee and commission income	**79,312**	**58,886**
Servicing plastic card operations	(35,565)	(19,389)
Settlements operations	(7,752)	(3,400)
Guarantees and letters of credit	(1,682)	(2,191)
Cash operations	(951)	(798)
Securities operations	(22)	(180)
Other	(70)	(1,905)
Fee and commission expense	**(46,042)**	**(27,863)**
Net fee and commission income	**33,270**	**31,023**

23. Personnel, general and administrative expenses

Personnel expenses comprise:

	2021	*2020*
Salaries and bonuses	(43,911)	(43,868)
Social security costs	(7,568)	(6,980)
Other employee related expenses	(3,126)	(3,078)
Total personnel expenses	**(54,605)**	**(53,926)**

General and administrative expenses comprise:

	2021	*2020*
Charity and sponsorship	(10,301)	(12,885)
Professional services	(7,245)	(6,585)
Insurance	(7,030)	(4,909)
Software cost	(6,011)	(4,424)
Stationery and loyalty miles	(5,540)	(1,786)
Advertising costs	(1,986)	(1,524)
Communications	(1,719)	(928)
Repair and maintenance	(1,452)	(814)
Utilities	(1,405)	(1,208)
Taxes, other than income tax	(1,244)	(1,208)
Security expenses	(910)	(934)
Transportation and business trip expenses	(675)	(125)
Entertainment	(507)	(436)
Membership fees	(63)	(229)
Printing expenses	(34)	(25)
Operating leases	–	(87)
Other expenses	(46)	(279)
Total general and administrative expenses	**(46,168)**	**(38,386)**

	2021	*2020*
Write-down of repossessed collaterals	(5,008)	(762)

As at 31 December 2021, the Bank 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).

(Figures in tables are in thousands of Azerbaijani manats)

24. Risk management

Introduction

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

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

Risk management structure

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

Supervisory Board

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

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 Bank.

Risk Committee

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

Risk Management

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

Bank Treasury

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

Internal audit

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

Risk measurement and reporting systems

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

24. Risk management (continued)

Introduction (continued)

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 Bank.

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

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

Risk mitigation

Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration

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

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

Credit risk

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

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

Derivative financial instruments

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

Credit-related commitments risks

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

24. Risk management (continued)

Credit risk (continued)

Impairment assessment

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

PD — The *Probability of Default* is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.

EAD — The *Exposure at Default* is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.

LGD — The *Loss Given Default* is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

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

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

Stage 1: When loans are first recognised, the Bank recognises an allowance based on 12mECL. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.

Stage 2: When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECL. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.

Stage 3: Loans considered credit-impaired. The Bank records an allowance for the LTECL.

POCI: Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and interest revenue is subsequently recognised based on a credit-adjusted EIR. ECL are only recognised or released to the extent that there is a subsequent change in the lifetime expected credit losses.

Definition of default and cure

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

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

24. Risk management (continued)

Credit risk (continued)

Such events include:

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

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

Internal rating and PD estimation process

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

Treasury and interbank relationships

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

Corporate and small business lending

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

24. Risk management (continued)

Credit risk (continued)

Consumer lending

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

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

Internal rating grade for SME	*Moody's based internal/external ratings for Corporate and Financial institutions*	*Internal rating description*
1	Aaa	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	Impaired

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

Exposure at default

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

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

Loss given default

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

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

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

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

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

Significant increase in credit risk

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

(Figures in tables are in thousands of Azerbaijani manats)

24. Risk management (continued)

Credit risk (continued)

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

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

Grouping financial assets measured on a collective basis

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

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

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

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

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

Forward-looking information and multiple economic scenarios

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

24. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets

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

31 December 2021	*Note*		*High grade*	*Standard grade*	*Sub-standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	5	Stage 1	1,161,199	42,239	–	–	**1,203,438**
Amounts due from credit institutions	6	Stage 1	183,754	343,718	–	–	**527,472**
		Stage 3	–	–	–	13,981	**13,981**
Loans to customers	8	Stage 1	118,669	1,282,993	137,929	–	**1,539,591**
		Stage 2	418,514	134,156	347,936	–	**900,606**
		Stage 3	–	–	–	191,807	**191,807**
Investment securities	7	Stage 1	1,522,268	279,057	–	–	**1,801,325**
Unused credit lines	20	Stage 1	23,115	257,698	18,265	–	**299,078**
		Stage 2	165	9,527	16,787	–	**26,479**
		Stage 3	–	–	–	391	**391**
Letters of credit	20	Stage 1	2,888	12,339	2,628	–	**17,855**
		Stage 2	–	–	19,978	–	**19,978**
Guarantees issued	20	Stage 1	226	158,552	14,537	–	**173,315**
		Stage 2	971	2,374	34,822	–	**38,167**
		Stage 3	–	–	–	253	**253**
Other financial assets	13	Stage 1	–	29,463	–	–	**29,463**
Total			**3,431,769**	**2,552,116**	**592,882**	**206,432**	**6,783,199**

The table below shows the credit quality by class of asset for loan-related lines in the separate statement of financial position, based on the Bank's credit rating system for the year ended 31 December 2019.

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	1,063,188	21,403	–	–	**1,084,591**
Amounts due from credit institutions	6	Stage 1	195,288	197,793	5,001	–	**398,082**
		Stage 2	–	–	–	13,981	**13,981**
Loans to customers	8	Stage 1	153,759	756,935	81,821	–	**992,515**
		Stage 2	423,959	228,483	365,422	–	**1,017,864**
		Stage 3	–	–	–	153,036	**153,036**
Investment securities	7	Stage 1	1,383,076	207,026	–	–	**1,590,102**
Unused credit lines	20	Stage 1	3,914	277,307	1,659		**282,880**
		Stage 2	34	18,271	11,531	–	**29,836**
		Stage 3	–	–	–	291	**291**
Letters of credit	20	Stage 1	5,560	11,405	1,036	–	**18,541**
		Stage 2	1,921	3,791	351	–	**6,063**
Guarantees issued	20	Stage 1	90	173,602	6,259	–	**179,951**
		Stage 2	170	43,010	25,980	–	**69,160**
		Stage 3	–	–	–	1,203	**1,203**
Other financial assets	13	Stage 1	–	24,247	–	–	**24,247**
Total			**3,230,959**	**1,963,273**	**499,060**	**168,511**	**5,861,803**

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

Financial guarantees, letters of credit and loan commitments are assessed and a provision for expected credit losses is calculated in similar manner as for loans. See Note 20.

(Figures in tables are in thousands of Azerbaijani manats)

24. Risk management (continued)

Credit risk (continued)

The geographical concentration of the Bank'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	1,154,369	97,884	33,166	**1,285,419**	729,047	408,948	9,240	**1,147,235**
Amounts due from credit institutions	67,364	373,059	100,226	**540,649**	53,520	340,797	17,303	**411,620**
Derivative financial assets	7,934	60	–	**7,994**	1,300	6,354	–	**7,654**
Investment securities	1,321,844	311,735	169,749	**1,803,328**	1,309,287	184,434	96,381	**1,590,102**
Loans to customers	2,552,877	–	–	**2,552,877**	2,108,184	–	–	**2,108,184**
Other financial assets	29,463	–	–	**29,463**	24,247	–	–	**24,247**
	5,133,851	**782,738**	**303,141**	**6,219,730**	**4,225,585**	**940,533**	**122,924**	**5,289,042**
Financial liabilities								
Amounts due to banks and government funds	658,466	1,925	7,319	**667,710**	881,888	282	4,125	**886,295**
Amounts due to customers	5,057,851	–	–	**5,057,851**	3,966,289	–	–	**3,966,289**
Derivative financial liabilities	60	7,787	–	**7,847**	6,354	406	–	**6,760**
Subordinated debts	36,809	–	–	**36,809**	18,923	–	–	**18,923**
Lease liabilities	14,795	–	–	**14,795**	7,831	–	–	**7,831**
Other financial liabilities	11,955	–	–	**11,955**	14,754	–	–	**14,754**
	5,779,936	**9,712**	**7,319**	**5,796,967**	**4,896,039**	**688**	**4,125**	**4,900,852**
Net (liabilities)/assets	**(646,085)**	**773,026**	**295,822**	**422,763**	**(670,454)**	**939,845**	**118,799**	**388,190**

Liquidity risk and funding management

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

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. In addition, the Bank maintains obligatory reserves with the CBAR, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank based on certain liquidity ratios established by the CBAR. As at 31 December 2021 and 2020, 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)

24. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2019 and 2018 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

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

Financial liabilities	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total 2020*
As at 31 December 2020					
Amounts due to banks and government funds	309,951	130,919	378,399	98,800	**918,069**
Amounts due to customers	2,730,316	462,944	734,563	96,637	**4,024,460**
Subordinated debt	140	421	20,606	–	**21,167**
Gross settled derivative financial instruments:					
- Contractual amounts payable	9,189	36,970	343,551	–	**389,710**
- Contractual amounts receivable	(10,116)	(39,716)	(343,956)	–	**(393,788)**
Lease liabilities	1,324	3,971	3,232	81	**8,608**
Other financial liabilities	14,754	–	–	–	**14,754**
Total undiscounted financial liabilities	**3,055,558**	**595,509**	**1,136,395**	**195,518**	**4,982,980**

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

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Total*
As at 31 December 2021	375,666	158,740	20,433	**554,839**
As at 31 December 2020	364,508	168,760	54,657	**587,925**

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

24. Risk management (continued)

Liquidity risk and funding management (continued)

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

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

Operational risk

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

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

Market risk

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

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments.

The sensitivity of current year profit is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2019. The Bank does not have substantial amount of floating rate non-trading financial instruments as at 31 December 2019 and 2018.

Currency risk

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

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

(Figures in tables are in thousands of Azerbaijani manats)

24. Risk management (continued)

Currency risk (continued)

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

	AZN	*USD*	*EUR*	*Other*	*Total 2021*
Financial assets					
Cash and cash equivalents	843,815	287,042	125,633	28,929	**1,285,419**
Amounts due from credit institutions	58,237	354,357	108,965	19,090	**540,649**
Derivative financial assets	147	2,035	–	5,812	**7,994**
Investment securities	1,037,459	738,451	27,418	–	**1,803,328**
Loans to customers	1,368,300	734,438	353,235	96,904	**2,552,877**
Other financial assets	20,663	7,249	1,445	106	**29,463**
Total financial assets	**3,328,621**	**2,123,572**	**616,696**	**150,841**	**6,219,730**
The effect of derivatives	15,100	165,824	124,652	84,455	**390,031**
Financial liabilities					
Amounts due to banks and government funds	450,747	103,015	20,179	93,769	**667,710**
Amounts due to customers	2,632,618	1,785,972	588,481	50,780	**5,057,851**
Derivative financial liabilities	–	2,035	–	5,812	**7,847**
Subordinated debts	–	36,809	–	–	**36,809**
Lease liabilities	14,592	203	–	–	**14,795**
Other financial liabilities	5,940	2,768	3,204	43	**11,955**
Total financial liabilities	**3,103,897**	**1,930,802**	**611,864**	**150,404**	**5,760,158**
The effect of derivatives	–	43,350	185,746	89,775	**318,871**
Net financial position after the effect of derivatives	**239,824**	**315,244**	**(56,262)**	**(4,883)**	**530,732**

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

	AZN	*USD*	*EUR*	*Other*	*Total 2020*
Financial assets					
Cash and cash equivalents	391,385	541,242	202,033	12,575	**1,147,235**
Amounts due from credit institutions	36,940	208,494	147,028	19,158	**411,620**
Derivative financial assets	892	6,230	–	532	**7,654**
Investment securities	1,013,840	567,882	8,380	–	**1,590,102**
Loans to customers	1,146,285	613,447	260,087	88,365	**2,108,184**
Other financial assets	19,950	2,866	1,283	148	**24,247**
Total financial assets	**2,609,292**	**1,940,161**	**618,811**	**120,778**	**5,289,042**
The effect of derivatives	19,172	116,992	168,562	89,452	**394,178**
Financial liabilities					
Amounts due to banks and government funds	621,526	153,399	22,666	88,704	**886,295**
Amounts due to customers	1,689,099	1,660,862	585,201	31,127	**3,966,289**
Derivative financial liabilities	–	6,228	–	532	**6,760**
Subordinated debts	–	18,923	–	–	**18,923**
Lease liabilities	7,422	409	–	–	**7,831**
Other financial liabilities	13,240	644	828	42	**14,754**
Total financial liabilities	**2,331,287**	**1,840,465**	**608,695**	**120,405**	**4,900,852**
The effect of derivatives	–	81,362	164,830	86,928	**333,120**
Net financial position after the effect of derivatives	**297,177**	**135,326**	**13,848**	**2,897**	**449,248**

(Figures in tables are in thousands of Azerbaijani manats)

24. Risk management (continued)

Currency risk (continued)

Currency risk sensitivity

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2019 and 2018 on its monetary assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Azerbaijani manats, with all other variables held constant on the separate statement of profit or loss. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for specified changes in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Bank where the denomination of the loan is in a currency other than the currency of the lender or the borrower. The effect on equity does not differ from the effect on the separate statement of profit or loss. A negative amount in the table reflects a potential net reduction in the separate statement of profit or loss or equity, while a positive amount reflects a net potential increase. Impact on profit before tax based on assets value as at 31 December 2021 and 2020:

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	63,049	(9,457)	27,065	(4,060)

	2021		*2020*	
	EUR/AZN +22%	*EUR/AZN -10%*	*EUR/AZN +22%*	*EUR/AZN -10%*
Impact on profit before tax	(12,378)	5,626	3,047	(1,385)

25. Fair value measurement

Fair value hierarchy

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

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

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

		Fair value measurement using			
At 31 December 2021	*Date of valuation*	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Investment securities – at FVOCI	31 December 2021	412,209	1,391,119	–	**1,803,328**
Derivative financial assets	31 December 2021	–	7,994	–	**7,994**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2021	1,285,419	–	–	**1,285,419**
Amounts due from credit institutions	31 December 2021	–	540,649	–	**540,649**
Loans to customers	31 December 2021	–	–	2,545,768	**2,545,768**
Other financial assets	31 December 2021	–	–	29,105	**29,105**

(Figures in tables are in thousands of Azerbaijani manats)

25. Fair value measurement (continued)

Fair value hierarchy (continued)

At 31 December 2021	*Date of valuation*	*Fair value measurement using* Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	*Total*
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2021	–	7,847	–	**7,847**
Liabilities for which fair values are disclosed					
Amounts due to banks and government funds	31 December 2021	–	654,863	–	**654,863**
Amounts due to customers	31 December 2021	–	–	5,057,047	**5,057,047**
Subordinated debts	31 December 2021	–	–	36,809	**36,809**
Other financial liabilities	31 December 2021	–	–	11,955	**11,955**

At 31 December 2020	*Date of valuation*	*Fair value measurement using* Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	*Total*
Assets measured at fair value					
Investment securities – at FVOCI	31 December 2020	208,426	1,381,676	–	**1,590,102**
Derivative financial assets	31 December 2020	–	7,654	–	**7,654**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2020	1,147,235	–	–	**1,147,235**
Amounts due from credit institutions	31 December 2020	–	408,443	–	**408,443**
Loans to customers	31 December 2020	–	–	2,100,214	**2,100,214**
Investment property	31 December 2020	–	–	1,590	**1,590**
Other financial assets	31 December 2020	–	–	23,837	**23,837**

At 31 December 2020	*Date of valuation*	*Fair value measurement using* Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	*Total*
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2020	–	6,760	–	**6,760**
Liabilities for which fair values are disclosed					
Amounts due to banks and government funds	31 December 2020	–	899,180	–	**899,180**
Amounts due to customers	31 December 2020	–	–	3,963,956	**3,963,956**
Subordinated debt	31 December 2020	–	–	18,923	**18,923**
Other financial liabilities	31 December 2020	–	–	14,754	**14,754**

(Figures in tables are in thousands of Azerbaijani manats)

25. Fair value measurement (continued)

Fair value hierarchy (continued)

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

	Carrying value 2021	*Fair value 2021*	*Unrecognised gain/(loss) 2021*	*Carrying value 2020*	*Fair value 2020*	*Unrecognised gain/(loss) 2020*
Financial assets						
Cash and cash equivalents	1,285,419	1,285,419	–	1,147,235	1,147,235	–
Amounts due from credit institutions	540,649	540,649	–	411,620	408,443	(3,177)
Loans to customers	2,552,877	2,545,768	(7,109)	2,108,184	2,100,214	(7,970)
Other financial assets	29,105	29,105	–	23,837	23,837	–
Financial liabilities						
Amounts due to banks and government funds	667,710	654,863	12,847	886,295	899,180	(12,885)
Amounts due to customers	5,057,851	5,057,047	804	3,966,289	3,966,289	2,333
Subordinated debts	36,809	36,809	–	18,923	18,923	–
Other financial liabilities	11,955	11,955	–	14,754	14,754	–
Total unrecognised change in unrealised fair value			**6,542**			**(21,699)**

Valuation techniques and assumptions

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

Assets for which fair value approximates carrying value

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

Derivatives

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

Investment securities

Investment securities valued using a valuation technique or pricing models primarily consist of 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 debt and other financial assets and liabilities is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

(Figures in tables are in thousands of Azerbaijani manats)

26. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 24 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2021			*2020*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	1,285,419	–	**1,285,419**	1,147,235	–	**1,147,235**
Amounts due from credit institutions	445,959	94,690	**540,649**	344,586	67,034	**411,620**
Investment securities	343,827	1,459,501	**1,803,328**	523,986	1,066,116	**1,590,102**
Loans to customers	1,340,347	1,212,530	**2,552,877**	800,754	1,307,430	**2,108,184**
Derivative financial assets	7,994	–	**7,994**	494	7,160	**7,654**
Investment property	–	–	**–**	–	1,590	**1,590**
Property and equipment	–	14,211	**14,211**	–	15,818	**15,818**
Intangible assets	–	31,035	**31,035**	–	30,002	**30,002**
Right-of-use assets	–	14,603	**14,603**	–	7,631	**7,631**
Investment in subsidiaries	–	127,006	**127,006**	–	149,363	**149,363**
Other assets	49,734	–	**49,734**	47,192	–	**47,192**
Total assets	**3,473,280**	**2,953,576**	**6,426,856**	**2,864,247**	**2,652,144**	**5,516,391**
Amounts due to banks and government funds	342,083	325,627	**667,710**	431,261	455,034	**886,295**
Amounts due to customers	4,132,182	925,669	**5,057,851**	3,170,499	795,790	**3,966,289**
Derivative financial liabilities	7,847	–	**7,847**	–	6,760	**6,760**
Current income tax liabilities	11,101	–	**11,101**	12,250	–	**12,250**
Deferred income tax liabilities	–	1,949	**1,949**	–	6,895	**6,895**
Provision for credit related commitments	10,011	–	**10,011**	8,141	–	**8,141**
Subordinated debts	–	36,809	**36,809**	–	18,923	**18,923**
Lease liabilities	5,253	9,542	**14,795**	4,769	3,062	**7,831**
Other liabilities	39,666	2,684	**42,349**	42,755	1,160	**43,915**
Total liabilities	**4,548,143**	**1,302,280**	**5,850,423**	**3,669,675**	**1,287,624**	**4,957,299**
Net assets	**(1,074,863)**	**1,651,296**	**576,433**	**(805,428)**	**1,364,520**	**559,092**

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 Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

27. Related party disclosures

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

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be 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)

27. 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*	*Sub-sidiaries*	*Total*	*Share-holders / Ultimate owners*	*Entities under common control*	*Key manage-ment personnel*	*Other*	*Sub-sidiaries*	*Total*
Cash and cash equivalents	–	220	–	–	4,557	**4,777**	–	562	–	–	4,337	**4,899**
Amounts due from credit institutions	–	–	–	–	8,139	**8,139**	–	–	–	–	10,688	**10,688**
Loans outstanding at 1 January, gross	–	**583,240**	**3,396**	**43,213**	–	**629,849**	–	**393,035**	**5,014**	**35,338**	–	**433,387**
Loans issued during the year	–	128,270	6,859	87,079	–	**222,208**	–	238,801	5,431	240,412	–	**484,644**
Loan repayments during the year	–	(95,608)	(7,945)	(107,694)	–	**(211,247)**	–	(68,376)	(7,189)	(232,517)	–	**(308,082)**
Interest accrual	–	1,753	21	–	–	**1,774**	–	1,692	23	189	–	**1,904**
Foreign currency translation difference	–	(10,991)	775	227	–	**(9,989)**	–	18,088	117	(209)	–	**17,996**
Loans outstanding at 31 December, gross	–	**606,664**	**3,106**	**22,825**	–	**632,595**	–	**583,240**	**3,396**	**43,213**	–	**629,849**
Less: allowance for impairment at 31 December	–	(2,976)	(12)	(309)	–	**(3,297)**	–	(3,808)	(152)	(424)	–	**(4,384)**
Loans outstanding at 31 December, net	–	**603,688**	**3,094**	**22,516**	–	**629,298**	–	**579,432**	**3,244**	**42,789**	–	**625,465**
Interest income on loans and amounts due from credit institutions	–	25,768	319	3,855	-	**29,942**	–	20,170	368	5,518	573	**26,629**
Interest income (except loans)	–	–	–	–	443	**443**	–	–	–	–	–	–
Amounts due to banks and government funds	–	79,937	–	–	178	**80,115**	–	74,823	–	–	196	**75,019**
Time deposits	87,995	627,827	1,831	28,268	–	**745,921**	88,075	448,837	7,087	22,469	–	**566,468**
Demand deposits	623,328	307,533	7,143	357,966	–	**1,295,970**	253,348	271,505	2,901	426,652	–	**954,406**
Subordinated debt	18,923	4,445	850	–	–	**24,218**	18,923	–	–	–	–	**18,923**
Derivative financial liabilities	–	61	–	–	–	**61**	–	6,760	–	–	–	**6,760**
Derivative financial assets	–	7,786	–	–	–	**7,786**	–	–	–	–	–	–
Right of use assets	–	–	–	–	–	–	–	5,248	–	–	–	**5,248**
Lease liabilities	–	(8,100)	–	–	–	**(8,100)**	–	5,345	–	–	–	**5,345**
Other Assets	–	275	–	–	–	**275**	–	681	–	129	–	**810**
Other liabilities	12	7,902	–	483	–	**8,397**	372	6,730	–	495	–	**7,597**
Investment securities	–	2,003	–	–	–	**2,003**	–	–	–	–	–	–
Guarantees issued	–	22,256	–	15,382	–	**37,638**	–	11,275	–	49,189	–	**60,464**
Letters of credit issued	–	2,995	–	6,894	–	**9,889**	–	1,016	–	9,874	–	**10,890**
Unused credit lines	–	30,536	772	33,235	–	**64,543**	–	6,933	636	41,967	–	**49,536**
Interest expense	(3,506)	(10,862)	(302)	(2,511)	–	**(17,181)**	(3,697)	(10,924)	(100)	(1,930)	–	**(16,651)**
Fee and commission: income	208	9,311	94	2,458	2	**12,073**	193	6,806	59	2,220	3	**9,281**
Fee and commission: expense	–	(7,689)	(1)	(60)	(136)	**(7,886)**	–	(5,887)	–	(72)	(138)	**(6,097)**
Net gains 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: derivatives	–	14,059	–	–	–	**14,059**	–	(873)	–	–	–	**(873)**
Net gains/(losses) from foreign currencies: translation differences	581	(9,895)	–	–	–	**(9,314)**	(4,703)	15,061	–	–	–	**10,358**
Other operating expenses	(23)	(3,706)	–	–	–	**(3,729)**	–	(1,960)	–	–	–	**(1,960)**
Other income	–	17	–	–	–	**17**	–	–	–	–	26	**26**
Loss on initial recognition of financial assets at fair value	–	(3,778)	–	–	–	**(3,778)**	–	–	–	–	–	–

As at 31 December 2021, the Bank has guarantees from its parent received as a collateral in respect of loans issued to borrowers in the amount of AZN 332,320 thousand (31 December 2020: AZN 161,062 thousand) and the Bank 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	(15,713)	(10,002)
Social security costs	(2,593)	(1,550)
Total key management compensation	**(18,306)**	**(11,552)**

(Figures in tables are in thousands of Azerbaijani manats)

28. Changes in liabilities arising from financing activities

	Note	*Subordinated debt*	*Total liabilities from financing activities*
Carrying amount at 31 December 2020	16	**18,923**	**18,923**
Proceeds from issue		17,827	17,827
Other		59	59
Carrying amount at 31 December 2021	16	**36,809**	**36,809**

29. Capital adequacy

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

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

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

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

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum capital adequacy ratio of 6% (2020: 6.0%) and 11% (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%

30. 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. As of the date of this financial statements, the Bank considers this exposure as a credit impaired and assessing expected losses, and taking actions to minimize such losses.

The Bank'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 Bank's assets in the foreseeable future.

On 31 March 2022, the Bank made an additional investment in JSC PASHA Bank Georgia through contribution of AZN 14,060 thousand.