“Yapi Kredi Bank Azerbaijan” CJSC

International Financial Reporting Standards Financial Statements and Independent Auditor’s Report

31 December 2020

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Independent Auditor's Report

To the Shareholders and Management Board of Yapi Kredi Bank Azerbaijan CJSC:

Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of CJSC "Yapi Kredi Bank Azerbaijan" (the "Bank") as at 31 December 2020, and the Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

What we have audited

The Bank's financial statements comprise:

- the statement of financial position as at 31 December 2020;
- the statement of profit or loss and other comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include significant accounting policies and other explanatory information.

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 financial statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

Responsibilities of management and those charged with governance for the financial statements

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

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

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

We communicate with 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.

PricewaterhouseCoopers Audit Azerbaijan LLC

Baku, the Republic of Azerbaijan

31 May 2021

Yapi Kredi Bank Azerbaijan CJSC
Statement of Financial Position
(Amounts expressed in thousands of Azerbaijani Manats)

	Notes	31 December 2020	31 December 2019
ASSETS			
Cash and cash equivalents	7	183,540	202,396
Investments in debt securities	10	23,096	36,536
Amounts due from credit institutions	8	11,460	20,986
Loans to customers	9	125,683	160,678
Property and equipment	11	4,102	3,874
Intangible assets	12	7,677	7,890
Right of use assets	13	5,912	5,751
Other assets	15	7,835	8,936
TOTAL ASSETS		**369,305**	**447,047**
LIABILITIES			
Amounts due to credit institutions	1	11,972	10,051
Amounts due to customers	17	249,563	330,609
Deferred income tax liabilities	1	1,717	2,116
Other liabilities	15	11,376	12,922
TOTAL LIABILITIES		**274,628**	**355,698**
EQUITY			
Share capital	18	55,381	55,381
Retained earnings		39,296	35,968
TOTAL EQUITY		**94,677**	**91,349**
TOTAL LIABILITIES AND EQUITY		**369,305**	**447,047**

Signed and authorized for release on behalf of the Management Board of the Bank on 31 May 2021:

Yapi Kredi Bank Azerbaijan Closed Joint Stock Company
YAPI KREDİ BANK AZƏRBAYCAN

Cenk Yüksel
Chief Executive Officer / General Director

Matanat Gasimova
Chief Accountant

Ramin Saftarov
Chief of Financial Reporting Department

(Amounts expressed in thousands of Azerbaijani Manats)

	Notes	2020	2019
Interest income calculated using the effective interest method	20	21,668	26,388
Interest expense	20	(2,050)	(3,416)
Net margin on interest and similar income		**19,618**	**22,972**
Credit loss allowance	9	(284)	(637)
Net margin on interest and similar income after credit loss allowance		**19,334**	**22,335**
Fee and commission income	21	8,706	10,529
Fee and commission expense	21	(4,715)	(5,572)
Gains less losses from modification of financial assets		(131)	-
Gains less losses from trading in foreign currencies		3,709	3,645
Net losses from currency translation differences		(29)	(14)
Other income		15	48
Personnel, General and administrative expenses	22	(23,363)	(23,403)
Other impairment and provisions		(53)	37
Profit before tax		**3,473**	**7,605**
Income tax expense	14	(145)	(1,410)
PROFIT FOR THE YEAR		**3,328**	**6,195**
Other comprehensive income for the year		-	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**3,328**	**6,195**

(Amounts expressed in thousands of Azerbaijani Manats)

	Share Capital	Retained earnings	Total
Balance at 1 January 2019	**55,381**	**29,773**	**85,154**
Profit for the year	-	6,195	6,195
Total comprehensive income for the year	**-**	**6,195**	**6,195**
Balance at 31 December 2019	**55,381**	**35,968**	**91,349**
Profit for the year	-	3,328	3,328
Total comprehensive income for the year	**-**	**3,328**	**3,328**
Balance at 31 December 2020	**55,381**	**39,296**	**94,677**

(Amounts expressed in thousands of Azerbaijani Manats)

	Notes	2020	2019
Cash flows from operating activities			
Interest received		21,408	29,547
Interest paid		(2,216)	(3,716)
Fees and commissions received		8,837	10,585
Fees and commissions paid		(4,715)	(5,572)
Realized gains less losses from dealing in foreign currencies		3,709	3,645
Other income received		15	48
Personnel expenses paid		(9,394)	(9,340)
Other operating expenses paid		(7,848)	(7,558)
Cash flows from operating activities before changes in operating assets and liabilities		**9,796**	**17,639**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		9,251	40,001
Loans to customers		35,247	(17,357)
Other assets		526	(1,019)
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		1,921	2,781
Amounts due to customers		(80,880)	(4,141)
Other liabilities		(1,067)	393
Net cash (used in)/from operating activities before income tax		**(25,206)**	**38,297**
Income tax paid		(466)	(2,012)
Net cash (used in)/from operating activities		**(25,672)**	**36,285**
Cash flows from investing activities			
Proceeds from disposal of bonds		-	7,460
Purchase of property and equipment	11	(2,154)	(1,036)
Purchase of intangible assets	12	(2,299)	(2,205)
Net cash (used in)/from investing activities		**(4,453)**	**4,219**
Cash flows from financing activities			
Repayment of principal of lease liabilities		(2,162)	(2,320)
Net cash used in financing activities		**(2,162)**	**(2,320)**
Effect of exchange rates changes on cash and cash equivalents		(29)	(14)
Net (decrease)/increase in cash and cash equivalents		**(32,316)**	**38,170**
Cash and cash equivalents, beginning		**236,088**	**197,918**
Cash and cash equivalents, ending	7 ,10	**203,772**	**236,088**

As per Bank policy cash and cash equivalents include-notes issued by Central Bank of Azerbaijan Republic amounted AZN 20,232 (2019: AZN 33,692).

(Amounts expressed in thousands of Azerbaijani Manats)

1 Introduction

These financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2020 for Yapi Kredi Bank (the "Bank").

Yapi Kredi Bank Azerbaijan (the "Yapi Kredi Bank") was incorporated and is domiciled in the Republic of Azerbaijan. Yapi Kredi Bank Azerbaijan is a closed joint-stock company limited by shares and was set up in accordance with Azerbaijani regulations.

Principal activity. The Yapi Kredi Bank's principal business activity is commercial and retail banking operations within the Republic of Azerbaijan. The Yapi Kredi Bank has operated under a full banking license issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") since 11 January 2000 under registration number 243. The Yapi Kredi Bank participates in the state deposit insurance scheme, which was introduced by the Azeri Law, "Insurance of individual deposits in the Republic of Azerbaijan" dated 29 December 2006. The State Deposit Insurance Fund guarantees full repayment of deposits of individuals, annual interest rate not exceeding 12% for AZN, 2.5% for foreign currencies.

Registered address and place of business. The Bank's registered address and principal place of business is 73G Jalil Mammadguluzadeh street Baku, AZ1078, Azerbaijan.

The Bank has 8 branches (2019: 8 branches), 1 customer services unit (2019: 1 unit) within the Republic of Azerbaijan. The Bank had 247 employees at 31 December 2020 (2019: 245).

As at 31 December 2020 and 2019 the following shareholders owned the outstanding shares of the Bank:

Shareholder	%
Yapı ve Kredi Bankası A.Ş.	99.8
YK Yatirim Menkul Degerler A.Ş.	0.1
YK Lease A.Ş.	0.1
Total	100.0

Yapı ve Kredi Bankası A.Ş. ("YKB"), an entity established in Turkey, is the ultimate parent of the Bank. YKB's shares have been traded on the Istanbul Stock Exchange ("ISE") since 1987.
As of 31 December 2020, 30,03% of the shares of the Bank are publicly traded (31 December 2019 - 18,20%).

40,95% of the shares out of the remaining 69,97% is owned by Koç Financial Services. ("KFS") which is owned by Koç Group, 9,02% is owned by Koç Group directly and 20,00% is owned by UniCredit ("UCG"). Accordingly, the total direct and indirect shares of Koç Group stand at 49.99%

2 Operating Environment of the Bank

The Republic of Azerbaijan displays certain characteristics of an emerging market. Current and future growth and stability of the economy is largely dependent upon the effective implementation of economic, fiscal and monetary measures undertaken by government as well as crude oil prices and stability of Azerbaijani manats.

Following the sharp economic contraction in 2016 due to negative impact of the decline in oil prices and devaluations of national currency against major international currencies, the government accelerated reforms in support of long-term economic stability and sustainability. Based on the economic reforms involving institutional changes, inflation was stable at a low single-digit rate, the economic growth remained positively zoned, the exchange rate of the national currency was sustainable and positive trends emerged in the foreign sector.

Despite a number of ongoing fragilities in the systemic risks, the banking sector stability was safeguarded in parallel with lending recovery. The implementation of the Presidential Decree on "Additional measures on resolving problematic loans of individuals" has led to compensation of individuals and restructuring of defaulted loans of individuals helped to improve bad loan problem in the banking sector.

The international rating agencies have maintained credit ratings of Azerbaijan during 2020 with stable outlook. Moody's has evaluated Azerbaijan's economy as "Ba2" with stable outlook in its latest report from October 2020. Despite the spread of the coronavirus pandemic, the agency's rating of the current assessment of the country's resilience to external shocks is positive.

Thanks to the economic reforms initiated after the devaluation of 2016, involving institutional changes; between 2017-2019 period, inflation was stable at a low single-digit rate, the exchange rate of the national currency was stable and the economic growth remained positive.

On 12 March 2020, the World Health Organisation declared the outbreak of COVID-19 a global pandemic. In response to the pandemic, the Azerbaijani authorities implemented numerous measures attempting to contain the spreading and impact of COVID-19, such as travel bans and restrictions, quarantines, shelter-in-place orders and limitations on business activity, including closures. The above measures were gradually relaxed and reinforced again effective December 2020. These measures have, among other things, restricted economic activity in Azerbaijan and have negatively impacted, and could continue to negatively impact businesses, market participants, clients of the Bank, as well as the Azerbaijan and global economy for an unknown period of time.

Alongside the COVID-19 outbreak, renewed hostilities began on 27 September 2020 between Azerbaijan and Armenia over Nagorno-Karabakh and Armenian-occupied territories surrounding Nagorno-Karabakh. Azerbaijan introduced martial law along with curfew and made several territorial gains over the following six weeks. An armistice agreement was signed on 09 November, 2020, which ended all hostilities in the Nagorno-Karabakh region and surrounding territories therein from 10 November 2020.

The ongoing effects of the political and economic situation are difficult to predict, but they may have further effects on the economy of Azerbaijan, which may lead to a deterioration of the State finances, volatility of financial markets, illiquidity on capital markets, higher inflation and a depreciation of the national currency against major foreign currencies.

Central Bank has relaxed some capital and provisioning requirements to mitigate the negative effects of the pandemic on the banking sector; which is still in a recovery and development period.

The Bank's Management is monitoring these developments in the current environment and taking precautionary measures as it considers necessary in order to ensure the sustainability and development of the Bank's business in the foreseeable future.

2 Operating Environment of the Bank (Continued)

The Bank's Management is taking necessary measures to ensure sustainability of the Bank's operations and support its customers and employees consider listing the measures taken, for example:

- "Office healthcare group" was created;
- Starting from 18.03.2020 employees have been permitted working through VPN access;
- The working permissions were registered in the governmental electronic portal;
- The front office working hours were decreased at some points;
- The average number of employees working at the office was 101 or 46%, home 146 or 59% during the period of 29 March 2020 – 31 December 2020;
- 50% discount was applied to the standard commissions on intra-country payments (AZIPS&XOHKS) and POS operations starting from September 2020;
- As a result of pandemic impact 15 loans (4 business and 11 retail), with the total amount of AZN 687 were restructured;
- In order to direct and encourage customers was imposed zero commission to the IB/MB channel during the quarantine period, between 31 March 2020 and 4 May 2020;
- The online credit card application system has been improved (April 2020);
- Credit card interest rates were updated in July 2020.

However, the future effects of the current economic situation are difficult to predict and management's current expectations and estimates could differ from actual results.

3 Significant Accounting Policies

Basis of preparation. These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated. Refer to Note 5.

Financial instruments – key measurement terms. *Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the quantity held by the entity. This is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

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

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

3 Significant Accounting Policies (Continued)

Amortised cost ("AC") is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any allowance for expected credit losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related items in the statement of financial position.

The effective interest method is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the gross carrying amount of the financial instrument.

The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date, except for the premium or discount, which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

Financial instruments – initial recognition. Financial instruments at FVTPL are initially recorded at fair value. All other financial instruments are initially recorded at fair value adjusted for transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets. After the initial recognition, an ECL allowance is recognised for financial assets measured at AC and investments in debt instruments measured at FVOCI, resulting in an immediate accounting loss.

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

Financial assets – classification and subsequent measurement – measurement categories. The Bank classifies financial assets in the following measurement categories: FVTPL, FVOCI and AC. The classification and subsequent measurement of debt financial assets depends on: (i) the Bank's business model for managing the related assets portfolio and (ii) the cash flow characteristics of the asset.

Financial assets – classification and subsequent measurement – business model. The business model reflects how the Bank manages the assets in order to generate cash flows – whether the Bank's objective is: (i) solely to collect the contractual cash flows from the assets ("hold to collect contractual cash flows",) or (ii) to collect both the contractual cash flows and the cash flows arising from the sale of assets ("hold to collect contractual cash flows and sell") or, if neither of (i) and (ii) is applicable, the financial assets are classified as part of "other" business model and measured at FVTPL.

Business model is determined for a group of assets (on a portfolio level) based on all relevant evidence about the activities that the Bank undertakes to achieve the objective set out for the portfolio available at the date of the assessment. Factors considered by the Bank in determining the business model include the purpose and composition of a portfolio, past experience on how the cash flows for the respective assets were collected, how risks are assessed and managed, how the assets' performance is assessed. Refer to Note 4 for critical judgements applied by the Bank in determining the business models for its financial assets.

Financial assets – classification and subsequent measurement – cash flow characteristics. Where the business model is to hold assets to collect contractual cash flows or to hold contractual cash flows and sell, the Bank assesses whether the cash flows represent solely payments of principal and interest ("SPPI").

3 Significant Accounting Policies (Continued)

Where the contractual terms introduce exposure to risk or volatility that is inconsistent with a basic lending arrangement, the financial asset is classified and measured at FVTPL. The SPPI assessment is performed on initial recognition of an asset and it is not subsequently reassessed. Refer to Note 4 for critical judgements applied by the Bank in performing the SPPI test for its financial assets.

Financial assets – reclassification. Financial instruments are reclassified only when the business model for managing the portfolio as a whole changes. The reclassification has a prospective effect and takes place from the beginning of the first reporting period that follows after the change in the business model. The Bank did not change its business model during the current and comparative period and did not make any reclassifications.

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

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

The Bank applies a three stage model for impairment, based on changes in credit quality since initial recognition. A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial assets in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that results from default events possible within the next 12 months or until contractual maturity, if shorter ("12 Months ECL"). If the Bank identifies a significant increase in credit risk ("SICR") since initial recognition, the asset is transferred to Stage 2 and its ECL is measured based on ECL on a lifetime basis, that is, up until contractual maturity but considering expected prepayments, if any ("Lifetime ECL"). Refer to Note 1 for a description of how the Bank determines when a SICR has occurred. If the Bank determines that a financial asset is credit-impaired, the asset is transferred to Stage 3 and its ECL is measured as a Lifetime ECL. The Bank's definition of credit impaired assets and definition of default is explained in Note 1 .

As an exception, for certain financial instruments, such as credit cards, that may include both a loan and an undrawn commitment component, the Bank measures expected credit losses over the period that the Bank is exposed to credit risk, that is, until the expected credit losses would be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period. This is because contractual ability to demand repayment and cancel the undrawn commitment does not limit the exposure to credit losses to such contractual notice period.

Financial assets – write-off. Financial assets are written-off, in whole or in part, when the Bank exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a dercognition event. The Bank may write-off financial assets that are still subject to enforcement activity when the Bank seeks to recover amounts that are contractually due, however, there is no reasonable expectation of recovery.

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

3 Significant Accounting Policies (Continued)

Financial assets – modification. The Bank sometimes renegotiates or otherwise modifies the contractual terms of the financial assets. The Bank assesses whether the modification of contractual cash flows is substantial considering, among other, the following factors: any new contractual terms that substantially affect the risk profile of the asset (eg profit share or equity-based return), significant change in interest rate, change in the currency denomination, new collateral or credit enhancement that significantly affects the credit risk associated with the asset or a significant extension of a loan when the borrower is not in financial difficulties.

If the modified terms are substantially different, the rights to cash flows from the original asset expire and the Bank derecognises the original financial asset and recognises a new asset at its fair value. The date of renegotiation is considered to be the date of initial recognition for subsequent impairment calculation purposes, including determining whether a SICR has occurred. The Bank also assesses whether the new loan or debt instrument meets the SPPI criterion. Any difference between the carrying amount of the original asset derecognised and fair value of the new substantially modified asset is recognised in profit or loss, unless the substance of the difference is attributed to a capital transaction with owners.

In a situation where the renegotiation was driven by financial difficulties of the counterparty and inability to make the originally agreed payments, the Bank compares the original and revised expected cash flows to assets whether the risks and rewards of the asset are substantially different as a result of the contractual modification. If the risks and rewards do not change, the modified asset is not substantially different from the original asset and the modification does not result in derecognition. The Bank recalculates the gross carrying amount by discounting the modified contractual cash flows by the original effective interest rate, and recognises a modification gain or loss in profit or loss.

Financial liabilities – measurement categories. Financial liabilities are classified as subsequently measured at AC, except for (i) financial liabilities at FVTPL: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in securities), contingent consideration recognised by an acquirer in a business combination and other financial liabilities designated as such at initial recognition and (ii) financial guarantee contracts and loan commitments.

Financial liabilities – derecognition. Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

Modifications of liabilities that do not result in extinguishment are accounted for as a change in estimate using a cumulative catch up method, with any gain or loss recognised in profit or loss, unless the economic substance of the difference in carrying values is attributed to a capital transaction with owners.

Cash and cash equivalents. Cash and cash equivalents are short-term items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents include cash on hand, amounts due from the CBAR, excluding obligatory reserves, and unrestricted balances on correspondent accounts including overnight deposits and deposits with original maturities of less than three months. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents, both in the statement of financial position and for the purposes of the statement of cash flows. Cash and cash equivalents are carried at AC because: (i) they are held for collection of contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL. Notes from CBAR represent cash and cash equivalents.

Mandatory cash balances with the CBAR. Mandatory cash balances with the CBAR are carried at AC and represent non-interest bearing mandatory reserve deposits, which are not available to finance the Bank's day to day operations, and hence are not considered as part of cash and cash equivalents for the purposes of the statement of cash flows.

Due from credit institutions. Amounts due from credit institutions are recorded when the Bank advances money to counterparty banks. Amounts due from credit institutions are carried at AC when: (i) they are held for the purposes of collecting contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL.

Investments in debt securities. Based on the business model and the cash flow characteristics, the Bank classifies investments in debt securities as carried at AC, FVOCI or FVTPL. Debt securities are carried at AC if they are held for collection of contractual cash flows and where those cash flows represent SPPI, and if they are not voluntarily designated at FVTPL in order to significantly reduce an accounting mismatch.

3 Significant Accounting Policies (Continued)

Debt securities are carried at FVOCI if they are held for collection of contractual cash flows and for selling, where those cash flows represent SPPI, and if they are not designated at FVTPL. Interest income from these assets is calculated using the effective interest method and recognised in profit or loss. An impairment allowance estimated using the expected credit loss model is recognised in profit or loss for the year. All other changes in the carrying value are recognised in OCI. When the debt security is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from OCI to profit or loss.

Investments in debt securities are carried at FVTPL if they do not meet the criteria for AC or FVOCI. The Bank may also irrevocably designate investments in debt securities at FVTPL on initial recognition if applying this option significantly reduces an accounting mismatch between financial assets and liabilities being recognised or measured on different accounting bases.

Notes Issued by Central Bank of the Republic of Azerbaijan (CBAR) and Other Bonds. Notes from CBAR have original maturity less than one month and represents cash and cash equivalents. Other investments in debt securities are measured at amortised cost.

Loans to customers. Loans to customers are recorded when the Bank advances money to purchase or originate a loan due from a customer. Based on the business model and the cash flow characteristics, the Bank classifies loans to customers into one of the following measurement categories: (i) AC: loans that are held for collection of contractual cash flows and those cash flows represent SPPI and loans that are not voluntarily designated at FVTPL, and (ii) FVTPL: loans that do not meet the SPPI test or other criteria for AC or FVOCI are measured at FVTPL.

Impairment allowances are determined based on the forward-looking ECL models. Note 1 provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Bank incorporates forward-looking information in the ECL models.

Repossessed collateral. Repossessed collateral represents financial and non-financial assets acquired by the Bank in settlement of overdue loans. The assets are initially recognised at fair value when acquired and included in premises and equipment, other financial assets, investment properties or inventories within other assets depending on their nature and the Bank's intention in respect of recovery of these assets. The Bank measures a repossessed collateral at the lower of its carrying amount and fair value less costs to sell. The Bank recognizes an impairment loss for any initial or subsequent write-down of the asset to fair value less costs to sell if events or changes in circumstance indicate that their carrying amount may be impaired.

Loan commitments. The Bank issues commitments to provide loans. These commitments are irrevocable or revocable only in response to a material adverse change. Such commitments are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At the end of each reporting period, the commitments are measured at (i) the remaining unamortised balance of the amount at initial recognition, plus (ii) the amount of the loss allowance determined based on the expected credit loss model, unless the commitment is to provide a loan at a below market interest rate, in which case the measurement is at the higher of these two amounts. The carrying amount of the loan commitments represents a liability. For contracts that include both a loan and an undrawn commitment and where the Bank cannot separately distinguish the ECL on the undrawn loan component from the loan component, the ECL on the undrawn commitment is recognised together with the loss allowance for the loan. To the extent that the combined ECLs exceed the gross carrying amount of the loan, they are recognised as a liability.

Financial guarantees. Financial guarantees require the Bank to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. Financial guarantees are initially recognised in "Other liabilities" at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the guarantee. At the end of each reporting period, the guarantees are measured at the higher of (i) the amount of the loss allowance for the guaranteed exposure determined based on the expected loss model and (ii) the remaining unamortised balance of the amount at initial recognition. In addition, an ECL loss allowance is recognised for fees receivable that are recognised in the statement of financial position as an asset.

3 Significant Accounting Policies (Continued)

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

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

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

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

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

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

	Years
Leasehold improvements	4-15
Furniture and fixtures	4-5
Computers and office equipment	4
Motor vehicles	4

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

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

Intangible assets. Intangible assets other than goodwill include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic lives of 1 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Amortization periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

Accounting for leases by the Bank as a lessee from 1 January 2019. The Bank leases office premises, apartments, cars and ATMs. Leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Bank. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is recognised at cost and depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

3 Significant Accounting Policies (Continued)

Liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- variable lease payment that are based on an index or a rate;
- amounts expected to be payable by the lessee under residual value guarantees;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option,
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the lessee's incremental borrowing rate is used, being the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability;
- any lease payments made at or before the commencement date less any lease incentives received;
- any initial direct costs, and
- restoration costs.

In determining the lease term, management of the Bank considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended or not terminated.

The assessment is reviewed if a significant event or a significant change in circumstances occurs which affects this assessment and that is within the control of the lessee.

Due to other credit institutions. Amounts due to other banks are recorded when money or other assets are advanced to the Bank by counterparty banks. The non-derivative liability is carried at AC.

Amounts due to customers. Amounts due to customers are non-derivative liabilities to individuals, state or corporate customers and are carried at AC.

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

Share Capital. Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity.

Any excess of the fair value of consideration received over the par value of shares issued is recognized as additional paid-in capital.

Presentation of statement of financial position in order of liquidity. The Bank does not have a clearly identifiable operating cycle and therefore does not present current and non-current assets and liabilities separately in the statement of financial position. Instead, assets and liabilities are presented in order of their liquidity. Refer to Note 23 for analysis of financial instruments by expected maturity.

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

3 Significant Accounting Policies (Continued)

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

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Bank to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Bank does not designate loan commitments as financial liabilities at FVTPL.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for (i) financial assets that have become credit impaired (Stage 3), for which interest revenue is calculated by applying the effective interest rate to their AC, net of the ECL provision.

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

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

Fee and commission income is recognised over time on a straight line basis as the services are rendered, when the customer simultaneously receives and consumes the benefits provided by the Bank's performance. Loan commitment fees for loans that are likely to be drawn down and other credit related

fees are deferred (together with any incremental costs) and recognized as an adjustment to the effective interest rate on the loan.

- *Fee income from providing transaction services*

Fee and commission income is recognised at a point in time when the Bank satisfies its performance obligation, usually upon execution of the underlying transaction. The amount of fee or commission received or receivable represents the transaction price for the services identified as distinct performance obligations. Fees arising from negotiating or participating in the negotiation of a transaction for a third party are recognized on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

Sales and purchases of foreign currencies and currency conversion. The Bank sells and purchases foreign currencies in the cash offices and through the bank accounts, as well as exchanges foreign currencies. The transactions are performed at the exchange rates established by the Bank, which are different from the official spot exchange rates at the particular dates. The differences between the official rates and Bank rates are recognised as gains less losses from trading in foreign currencies at a point in time when a particular performance obligation is satisfied.

Foreign currency translation. The financial statements are presented in Azerbaijani Manat, 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 the statement of profit or loss and other comprehensive income as net gains (losses) from foreign currency 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/ losses from dealing operations.

(Amounts expressed in thousands of Azerbaijani Manats)

3 Significant Accounting Policies (Continued)

The Bank used the following official exchange rates at 31 December 2020 and 2019 in the preparation of these financial statements:

	2020	2019
1 US dollar	AZN 1.7000	AZN 1.7000
1 EUR	AZN 2.0890	AZN 1.9035

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies

The Bank makes estimates and assumptions that affect the amounts recognised in the financial statements, and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

ECL measurement. Measurement of ECLs is a significant estimate that involves determination of methodology, models and data inputs. Details of ECL measurement methodology are disclosed in Note 23 . The following components have a major impact on credit loss allowance: definition of default, SICR, probability of default ("PD"), exposure at default ("EAD"), and loss given default ("LGD"), as well as models of macro-economic scenarios. The Bank regularly reviews and validates the models and inputs to the models to reduce any differences between expected credit loss estimates and actual credit loss experience.

A 15% increase or decrease in PD estimates would result in an increase or decrease in total expected credit loss allowances of AZN 173 thousand at 31 December 2020 (31 December 2019: increase or decrease of AZN 189 thousand). A 15% increase or decrease in LGD estimates would result in an increase or decrease in total expected credit loss allowances of AZN 638 thousand at 31 December 2020 (31 December 2019: increase or decrease of AZN 611 thousand).

Customer relief measures. The Bank implemented relief measures stipulated in the law passed in April 2020 in response to the spread of COVID-19. However, such measures were not in the form of blanket maratorias and borrowers had to opt-in for its debt restructuring following procedure for such restructurings established by the Bank in March 2020 and April of 2020 following the pandemic. Individuals and SMEs that are negatively affected by the virus and lost more than 30% of their income can apply for payment holidays for up to six months, which have to be granted by the Bank. The Bank concluded that generally such applications provide evidence of a significant increase in credit risk of the loan, unless observable mitigating factors (*affected industry, government subsidy, and customer creditworthiness*) are identified. Additional metrics were considered for stage determination for COVID impacted portfolio, such as "credit history" and "days past due" status as of restructuring date, payment behaviour of borrowers before and after lockdown.

The Bank offered payment holidays and temporary reduction in interest rates on certain consumer loans. The Bank concluded that these measures result in contractual modification of the respective loans. Since payment holidays did not cover concession on interest charged to borrowers, the Bank did not incur significant modification loss in the period ended 30 December 2020.

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

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

Initial recognition of related party transactions. In the normal course of business, the Bank enters into transactions with its related parties. IFRS 9 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. Terms and conditions of related party balances are disclosed in Note 25.

Credit exposure on revolving credit facilities (e.g. credit cards, overdrafts). For certain loan facilities, the Bank's exposure to credit losses may extend beyond the maximum contractual period of the facility. This exception applies to certain revolving credit facilities, which include both a loan and an undrawn commitment component and where the Bank's contractual ability to demand repayment and cancel the undrawn component in practice does not limit its exposure to credit losses.

For such facilities, the Bank measures ECLs over the period that the Bank is exposed to credit risk and ECLs are not mitigated by credit risk management actions. Application of this exception requires judgement. Management applied its judgement in identifying the facilities, both retail and commercial, to which this exception applies. The Bank applied this exception to facilities with the following characteristics:

(a) there is no fixed term or repayment structure, (b) the contractual ability to cancel the contract is not in practice enforced as a result of day-to-day management of the credit exposure and the contract may only be cancelled when the Bank becomes aware of an increase in credit risk at the level of an individual facility, and (c) the exposures are managed on a collective basis. Further, the Bank applied judgement in determining a period for measuring the ECL, including the starting point and the expected end point of the exposures.

The Bank considered historical information and experience about: (a) the period over which the Bank is exposed to credit risk on similar facilities, including when the last significant modification of the facility occurred and that therefore determines the starting point for assessing SICR, (b) the length of time for related defaults to occur on similar financial instruments following a SICR and (c) the credit risk management actions (eg the reduction or removal of undrawn limits), prepayment rates and other factors that drive expected maturity. In applying these factors, the Bank segments the portfolios of revolving facilities into sub-groups and applies the factors that are most relevant based on historical data and experience as well as forward-looking information.

Significant increase in credit risk ("SICR"). In order to determine whether there has been a significant increase in credit risk, the Bank compares the risk of a default occurring over the life of a financial instrument at the end of the reporting date with the risk of default at the date of initial recognition. The assessment considers relative increase in credit risk rather than achieving a specific level of credit risk at the end of the reporting period. The Bank considers all reasonable and supportable forward looking information available without undue cost and effort, which includes a range of factors, including behavioural aspects of particular customer portfolios. The Bank identifies behavioural indicators of increases in credit risk prior to delinquency and incorporated appropriate forward looking information into the credit risk assessment, either at an individual instrument, or on a portfolio level. Refer to Note 24 .

Should ECL on all loans and advances to customers be measured at lifetime ECL (that is, including those that are currenty in Stage 1 measured at 12-months ECL), the expected credit loss allowance would be higher by AZN 2,673 thousand as of 31 December 2020 (31 December 2019: higher by AZN 2,190 thousand).

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

Business model assessment. The business model drives classification of financial assets. Management applied judgement in determining the level of aggregation and portfolios of financial instruments when performing the business model assessment. When assessing sales transactions, the Bank considers their historical frequency, timing and value, reasons for the sales and expectations about future sales activity. Sales transactions aimed at minimising potential losses due to credit deterioration are considered consistent with the "hold to collect" business model. Other sales before maturity, not related to credit risk management activities, are also consistent with the "hold to collect" business model, provided that they are infrequent or insignificant in value, both individually and in aggregate. The Bank assesses significance of sales transactions by comparing the value of the sales to the value of the portfolio subject to the business model assessment over the average life of the portfolio. In addition, sales of financial asset expected only in stress case scenario, or in response to an isolated event that is beyond the Bank's control, is not recurring and could not have been anticipated by the Bank, are regarded as incidental to the business model objective and do not impact the classification of the respective financial assets.

The "hold to collect and sell" business model means that assets are held to collect the cash flows, but selling is also integral to achieving the business model's objective, such as, managing liquidity needs, achieving a particular yield, or matching the duration of the financial assets to the duration of the liabilities that fund those assets.

The residual category includes those portfolios of financial assets, which are managed with the objective of realising cash flows primarily through sale, such as where a pattern of trading exists. Collecting contractual cash flow is often incidental for this business model.

Assessment whether cash flows are solely payments of principal and interest ("SPPI"). Determining whether a financial asset's cash flows are solely payments of principal and interest required judgement.

The time value of money element may be modified, for example, if a contractual interest rate is periodically reset but the frequency of that reset does not match the tenor of the debt instrument's underlying base interest rate, for example a loan pays three months interbank rate but the rate is reset every month. The effect of the modified time value of money was assessed by comparing relevant instrument's cash flows against a benchmark debt instrument with SPPI cash flows, in each period and cumulatively over the life of the instrument. The assessment was done for all reasonably possible scenarios, including reasonably possible financial stress situation that can occur in financial markets. In case of a scenario with cash flows that significantly differ from the benchmark, the assessed instrument's cash flows are not SPPI and the instrument is then carried at FVTPL.

The Bank identified and considered contractual terms that change the timing or amount of contractual cash flows. The SPPI criterion is met if a loan allows early settlement and the prepayment amount substantially represents principal and accrued interest, plus a reasonable additional compensation for the early termination of the contract. The asset's principal is the fair value at initial recognition less subsequent principal repayments, ie instalments net of interest determined using the effective interest method. As an exception to this principle, the standard also allows instruments with prepayment features that meet the following condition to meet SPPI: (i) the asset is originated at a premium or discount, (ii) the prepayment amount represents contractual par amount and accrued interest and a reasonable additional compensation for the early termination of the contract, and (ii) the fair value of the prepayment feature is immaterial at initial recognition.

Modification of financial assets. When financial assets are contractually modified (e.g. renegotiated), the Bank assesses whether the modification is substantial and should result in derecognition of the original asset and recognition of a new asset at fair value. This assessment is based primarily on qualitative factors, described in the relevant accounting policy and it requires significant judgment. In particular, the Bank applies judgment in deciding whether credit impaired renegotiated loans should be derecognised and whether the new recognised loans should be considered as credit impaired on initial recognition. The derecognition assessment depends on whether the risks and rewards, that is, the variability of expected (rather than contractual) cash flows, change as a result of such modifications. Management determined that risks and rewards did not change as a result of modifying such loans and therefore in substantially all such modifications, the loans were neither derecognised nor reclassified out of the credit-impaired stage.

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

Write-off policy. Financial assets are written-off, in whole or in part, when the Bank exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. Determining the cash flows for which there is no reasonable expectation of recovery requires judgement. Management considered the following indicators that there is no reasonable expectation of recovery: liquidation or bankruptcy proceedings as well as decision of the court.

Initial recognition of related party transactions. In the normal course of business the Group enters into transactions with its related parties. IFRS 9 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. Terms and conditions of related party balances are disclosed in Note 25.

5 Adoption of New or Revised Standards and Interpretations

Amendments to the Conceptual Framework for Financial Reporting (issued on 29 March 2018 and effective for annual periods beginning on or after 1 January 2020). The revised Conceptual Framework includes a new chapter on measurement; guidance on reporting financial performance; improved definitions and guidance - in particular the definition of a liability; and clarifications in important areas, such as the roles of stewardship, prudence and measurement uncertainty in financial reporting.

Definition of a business – Amendments to IFRS 3 (issued on 22 October 2018 and effective for acquisitions from the beginning of annual reporting period that starts on or after 1 January 2020). The amendments revise definition of a business. A business must have inputs and a substantive process that together significantly contribute to the ability to create outputs. The new guidance provides a framework to evaluate when an input and a substantive process are present, including for early stage companies that have not generated outputs. An organised workforce should be present as a condition for classification as a business if are no outputs. The definition of the term 'outputs' is narrowed to focus on goods and services provided to customers, generating investment income and other income, and it excludes returns in the form of lower costs and other economic benefits. It is also no longer necessary to assess whether market participants are capable of replacing missing elements or integrating the acquired activities and assets. An entity can apply a 'concentration test'. The assets acquired would not represent a business if substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets).

Definition of material – Amendments to IAS 1 and IAS 8 (issued on 31 October 2018 and effective for annual periods beginning on or after 1 January 2020). The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS. In addition, the explanations accompanying the definition have been improved. Finally, the amendments ensure that the definition of material is consistent across all IFRS Standards. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Interest rate benchmark reform – Amendments to IFRS 9, IAS 39 and IFRS 7 (issued on 26 September 2019 and effective for annual periods beginning on or after 1 January 2020). The amendments were triggered by replacement of benchmark interest rates such as LIBOR and other inter-bank offered rates ('IBORs'). The amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by the IBOR reform.

5 Adoption of New or Revised Standards and Interpretations (Continued)

COVID-19-Related Rent Concessions Amendment to IFRS 16 (Issued on 28 May 2020 and effective for annual periods beginning on or after 1 June 2020). The amendment provides lessees with relief in the form of an optional exemption from assessing whether a rent concession related to COVID-19 is a lease modification. Lessees can elect to account for rent concessions in the same way as if they were not lease modifications. The practical expedient only applies to rent concessions occurring as a direct consequence of the COVID-19 pandemic and only if all of the following conditions are met: the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change; any reduction in lease payments affects only payments due on or before 30 June 2021; and there is no substantive change to other terms and conditions of the lease.

6 New Accounting Pronouncements

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2021 or later, and which the Bank has not early adopted.

IFRS 17 "Insurance Contracts" (issued on 18 May 2017 and effective for annual periods beginning on or after 1 January 2023). IFRS 17 replaces IFRS 4, which has given companies dispensation to carry on accounting for insurance contracts using existing practices. As a consequence, it was difficult for investors to compare and contrast the financial performance of otherwise similar insurance companies. IFRS 17 is a single principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds. The standard requires recognition and measurement of groups of insurance contracts at: (i) a risk-adjusted present value of the future cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information; plus (if this value is a liability) or minus (if this value is an asset) (ii) an amount representing the unearned profit in the group of contracts (the contractual service margin). Insurers will be recognising the profit from a group of insurance contracts over the period they provide insurance coverage, and as they are released from risk. If a group of contracts is or becomes loss-making, an entity will be recognising the loss immediately.

Amendments to IFRS 17 and an amendment to IFRS 4 (issued on 25 June 2020 and effective for annual periods beginning on or after 1 January 2023). The amendments include a number of clarifications intended to ease implementation of IFRS 17, simplify some requirements of the standard and transition. The amendments relate to eight areas of IFRS 17, and they are not intended to change the fundamental principles of the standard. The following amendments to IFRS 17 were made:

- *Effective date:* The effective date of IFRS 17 (incorporating the amendments) has been deferred by two years to annual reporting periods beginning on or after 1 January 2023; and the fixed expiry date of the temporary exemption from applying IFRS 9 in IFRS 4 has also been deferred to annual reporting periods beginning on or after 1 January 2023.
- *Expected recovery of insurance acquisition cash flows:* An entity is required to allocate part of the acquisition costs to related expected contract renewals, and to recognise those costs as an asset until the entity recognises the contract renewals. Entities are required to assess the recoverability of the asset at each reporting date, and to provide specific information about the asset in the notes to the financial statements.
- *Contractual service margin attributable to investment services*: Coverage units should be identified, considering the quantity of benefits and expected period of both insurance coverage and investment services, for contracts under the variable fee approach and for other contracts with an 'investment-return service' under the general model. Costs related to investment activities should be included as cash flows within the boundary of an insurance contract, to the extent that the entity performs such activities to enhance benefits from insurance coverage for the policyholder.

6 New Accounting Pronouncements (Continued)

- *Reinsurance contracts held – recovery of losses:* When an entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous underlying contracts to a group, an entity should adjust the contractual service margin of a related group of reinsurance contracts held and recognise a gain on the reinsurance contracts held. The amount of the loss recovered from a reinsurance contract held is determined by multiplying the loss recognised on underlying insurance contracts and the percentage of claims on underlying insurance contracts that the entity expects to recover from the reinsurance contract held. This requirement would apply only when the reinsurance contract held is recognised before or at the same time as the loss is recognised on the underlying insurance contracts.
- *Other amendments:* Other amendments include scope exclusions for some credit card (or similar) contracts, and some loan contracts; presentation of insurance contract assets and liabilities in the statement of financial position in portfolios instead of groups; applicability of the risk mitigation option when mitigating financial risks using reinsurance contracts held and non-derivative financial instruments at fair value through profit or loss; an accounting policy choice to change the estimates made in previous interim financial statements when applying IFRS 17; inclusion of income tax payments and receipts that are specifically chargeable to the policyholder under the terms of an insurance contract in the fulfilment cash flows; and selected transition reliefs and other minor amendments.

Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – Amendments to IFRS 10 and IAS 28 (issued on 11 September 2014 and effective for annual periods beginning on or after a date to be determined by the IASB). These amendments address an inconsistency between the requirements in IFRS 10 and those in IAS 28 in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognised when a transaction involves a business. A partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if these assets are held by a subsidiary.

Classification of liabilities as current or non-current – Amendments to IAS 1 (issued on 23 January 2020 and effective for annual periods beginning on or after 1 January 2022). These narrow scope amendments clarify that liabilities are classified as either current or non-current, depending on the rights that exist at the end of the reporting period. Liabilities are non-current if the entity has a substantive right, at the end of the reporting period, to defer settlement for at least twelve months. The guidance no longer requires such a right to be unconditional. Management's expectations whether they will subsequently exercise the right to defer settlement do not affect classification of liabilities. The right to defer only exists if the entity complies with any relevant conditions as of the end of the reporting period. A liability is classified as current if a condition is breached at or before the reporting date even if a waiver of that condition is obtained from the lender after the end of the reporting period. Conversely, a loan is classified as non-current if a loan covenant is breached only after the reporting date. In addition, the amendments include clarifying the classification requirements for debt a company might settle by converting it into equity. 'Settlement' is defined as the extinguishment of a liability with cash, other resources embodying economic benefits or an entity's own equity instruments. There is an exception for convertible instruments that might be converted into equity, but only for those instruments where the conversion option is classified as an equity instrument as a separate component of a compound financial instrument.

Classification of liabilities as current or non-current, deferral of effective date – Amendments to IAS 1 (issued on 15 July 2020 and effective for annual periods beginning on or after 1 January 2023). The amendment to IAS 1 on classification of liabilities as current or non-current was issued in January 2020 with an original effective date 1 January 2022. However, in response to the Covid-19 pandemic, the effective date was deferred by one year to provide companies with more time to implement classification changes resulting from the amended guidance.

6 New Accounting Pronouncements (Continued)

Proceeds before intended use, Onerous contracts – cost of fulfilling a contract, Reference to the Conceptual Framework – narrow scope amendments to IAS 16, IAS 37 and IFRS 3, and Annual Improvements to IFRSs 2018-2020 – amendments to IFRS 1, IFRS 9, IFRS 16 and IAS 41 (issued on 14 May 2020 and effective for annual periods beginning on or after 1 January 2022). The amendment to IAS 16 prohibits an entity from deducting from the cost of an item of PPE any proceeds received from selling items produced while the entity is preparing the asset for its intended use. The proceeds from selling such items, together with the costs of producing them, are now recognised in profit or loss. An entity will use IAS 2 to measure the cost of those items. Cost will not include depreciation of the asset being tested because it is not ready for its intended use. The amendment to IAS 16 also clarifies that an entity is 'testing whether the asset is functioning properly' when it assesses the technical and physical performance of the asset. The financial performance of the asset is not relevant to this assessment. An asset might therefore be capable of operating as intended by management and subject to depreciation before it has achieved the level of operating performance expected by management.

The amendment to IAS 37 clarifies the meaning of 'costs to fulfil a contract'. The amendment explains that the direct cost of fulfilling a contract comprises the incremental costs of fulfilling that contract; and an allocation of other costs that relate directly to fulfilling. The amendment also clarifies that, before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets used in fulfilling the contract, rather than on assets dedicated to that contract.

IFRS 3 was amended to refer to the 2018 Conceptual Framework for Financial Reporting, in order to determine what constitutes an asset or a liability in a business combination. Prior to the amendment, IFRS 3 referred to the 2001 Conceptual Framework for Financial Reporting. In addition, a new exception in IFRS 3 was added for liabilities and contingent liabilities. The exception specifies that, for some types of liabilities and contingent liabilities, an entity applying IFRS 3 should instead refer to IAS 37 or IFRIC 21, rather than the 2018 Conceptual Framework. Without this new exception, an entity would have recognised some liabilities in a business combination that it would not recognise under IAS 37. Therefore, immediately after the acquisition, the entity would have had to derecognise such liabilities and recognise a gain that did not depict an economic gain. It was also clarified that the acquirer should not recognise contingent assets, as defined in IAS 37, at the acquisition date.

The amendment to IFRS 9 addresses which fees should be included in the 10% test for derecognition of financial liabilities. Costs or fees could be paid to either third parties or the lender. Under the amendment, costs or fees paid to third parties will not be included in the 10% test.

IFRS 1 allows an exemption if a subsidiary adopts IFRS at a later date than its parent. The subsidiary can measure its assets and liabilities at the carrying amounts that would be included in its parent's consolidated financial statements, based on the parent's date of transition to IFRS, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary. IFRS 1 was amended to allow entities that have taken this IFRS 1 exemption to also measure cumulative translation differences using the amounts reported by the parent, based on the parent's date of transition to IFRS. The amendment to IFRS 1 extends the above exemption to cumulative translation differences, in order to reduce costs for first-time adopters. This amendment will also apply to associates and joint ventures that have taken the same IFRS 1 exemption.

The requirement for entities to exclude cash flows for taxation when measuring fair value under IAS 41 was removed. This amendment is intended to align with the requirement in the standard to discount cash flows on a post-tax basis.

Interest rate benchmark (IBOR) reform – phase 2 amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 (issued on 27 August 2020 and effective for annual periods beginning on or after 1 January 2021). The Phase 2 amendments address issues that arise from the implementation of the reforms, including the replacement of one benchmark with an alternative one. The amendments cover the following areas:

(Amounts expressed in thousands of Azerbaijani Manats)

6 New Accounting Pronouncements (Continued)

- *Accounting for changes in the basis for determining contractual cash flows as a result of IBOR reform:* For instruments to which the amortised cost measurement applies, the amendments require entities, as a practical expedient, to account for a change in the basis for determining the contractual cash flows as a result of IBOR reform by updating the effective interest rate using the guidance in paragraph B5.4.5 of IFRS 9. As a result, no immediate gain or loss is recognised. This practical expedient applies only to such a change and only to the extent it is necessary as a direct consequence of IBOR reform, and the new basis is economically equivalent to the previous basis. Insurers applying the temporary exemption from IFRS 9 are also required to apply the same practical expedient. IFRS 16 was also amended to require lessees to use a similar practical expedient when accounting for lease modifications that change the basis for determining future lease payments as a result of IBOR reform.
- *End date for Phase 1 relief for non contractually specified risk components in hedging relationships:* The Phase 2 amendments require an entity to prospectively cease to apply the Phase 1 reliefs to a non-contractually specified risk component at the earlier of when changes are made to the non-contractually specified risk component, or when the hedging relationship is discontinued. No end date was provided in the Phase 1 amendments for risk components.
- *Additional temporary exceptions from applying specific hedge accounting requirements:* The Phase 2 amendments provide some additional temporary reliefs from applying specific IAS 39 and IFRS 9 hedge accounting requirements to hedging relationships directly affected by IBOR reform.
- *Additional IFRS 7 disclosures related to IBOR reform:* The amendments require disclosure of: (i) how the entity is managing the transition to alternative benchmark rates, its progress and the risks arising from the transition; (ii) quantitative information about derivatives and non-derivatives that have yet to transition, disaggregated by significant interest rate benchmark; and (iii) a description of any changes to the risk management strategy as a result of IBOR reform.

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Bank's financial statements.

7 Cash and Cash Equivalents

Cash and cash equivalents comprise:

	2020	2019
Cash on hand	20,009	24,381
Current accounts with the CBAR	44,329	67,271
Short-term deposits placed in the CBAR	14,703	18,033
Accounts with other credit institutions	104,942	92,932
Less credit loss allowance	(443)	(221)
Cash and cash equivalents	**183,540**	**202,396**

As at 31 December 2020, the Bank had short-term deposits placed in the CBAR amounting to AZN 14,688 (2019: AZN 17,940) maturing until 11 January 2021 (2019: 13 January 2020) with the annual interest rates of 5.76 – 6.01% p.a (2019: 5.76% p.a).

Current accounts with other credit institutions consist of interest bearing correspondent account balances with resident and non–resident banks of amounting AZN Nil (2019: AZN 5,088) and AZN 70,448 (2019: AZN 78,879), respectively.

(Amounts expressed in thousands of Azerbaijani Manats)

7 Cash and Cash Equivalents (Continued)

The table below discloses the credit quality of cash and cash equivalents balances based on credit risk grades at 31 December 2020. Refer to Note 23 for the description of the Bank's credit risk grading system.

	Cash balances with the CBAR, excluding mandatory reserves	Accounts with other credit institutions	Total
- Excellent	-	91,302	91,302
- Good	59,032	13,640	72,672
Less credit loss allowance	(222)	(221)	(443)
Total cash and cash equivalents, excluding cash on hand	**58,810**	**104,721**	**163,531**

For the purpose of ECL measurement cash and cash equivalents balances are included in Stage 1. Refer to Note 1 for the ECL measurement approach.

The credit quality of cash and cash equivalents balances based on credit risk grades at 31 December 2019 is as follows:

	Cash balances with the CBAR, excluding mandatory reserves	Accounts with other credit institutions	Total
- Excellent	-	77,723	77,723
- Good	85,304	15,209	100,513
Less credit loss allowance	(143)	(78)	(221)
Total cash and cash equivalents, excluding cash on hand	**85,161**	**92,854**	**178,015**

As of 31 December 2020, the Bank had AZN 70,842 or 68% (2019: AZN 70,811 or 76%) of total amounts with other credit institutions placed with one counterparty (2019: one).

Information on related party balances is disclosed in Note 25

8 Amounts Due from Credit Institutions

Amounts due from credit institutions comprise:

	2020	2019
Short-term deposits placed in banks	9,712	18,639
Obligatory reserve with the CBAR	1,756	2,457
Amounts due from credit institutions (gross)	11,468	21,096
Less: allowance for impairment	(8)	(110)
Amounts due from credit institutions (net)	**11,460**	**20,986**

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR, the amount of which depends on the level of funds attracted by the credit institution. The Bank's ability to withdraw such deposit is significantly restricted by the statutory legislation.

(Amounts expressed in thousands of Azerbaijani Manats)

8 Amounts Due from Credit Institutions (Continued)

As at 31 December 2020, the Bank had short-term deposits placed in banks amounting to AZN 9,690 (2019: AZN 18,639) maturing in Feb-Aug 2021 (2019: Feb-May-Oct 2020), with the annual interest rates of 0.17-1.5% p.a (2019:3.0-7.5% p.a.).

Analysis by credit quality of amounts due from credit institutions outstanding at 31 December 2020, is as follows: Refer to Note 24 for the estimated fair value of each class of amounts due from credit institutions. Interest rate analysis of due from credit institutions is disclosed in Note 23. Information on related party balances is disclosed in Note 25:

	Stage 1 (12-months ECL)	Total
Placements with credit institutions		
- Good	11,468	11,468
Gross carrying amount	**11,468**	**11,468**
Credit loss allowance	(8)	(8)
Total due from credit institutions (carrying amount)	**11,460**	**11,460**

Analysis by credit quality of amounts due from credit institutions outstanding at 31 December 2019, is as follows:

	Stage 1 (12-months ECL)	Total
Placements with credit institutions		
- Excellent	-	-
- Good	21,096	21,096
Gross carrying amount	**21,096**	**21,096**
Credit loss allowance	(110)	(110)
Total due from credit institutions (carrying amount)	**20,986**	**20,986**

9 Loans to Customers

Loans to customers comprise:

	31 December 2020	31 December 2019
Gross carrying amount of loans to customers at AC	167,377	204,171
Less credit loss allowance	(41,694)	(43,493)
Total carrying amount of loans to customers at AC	**125,683**	**160,678**
Total loans to customers	**125,683**	**160,678**

As at 31 December 2020, out of the total amount of loans 26.3% (2019: 37.6%) are denominated in foreign currencies.

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

Gross carrying amount and credit loss allowance amount for loans to customers at AC by classes at 31 December 2020 and 31 December 2019 are disclosed in the table below:

	31 December 2020			31 December 2019		
	Gross carrying amount	**Credit loss allowance**	**Carrying amount**	**Gross carrying amount**	**Credit loss allowance**	**Carrying amount**
Loans to corporate / commercial customers	96,499	21,375	75,124	129,808	23,323	106,485
Loans to SME	15,326	8,230	7,096	14,946	8,310	6,636
Consumer Loans	41,535	10,692	30,843	49,096	10,241	38,855
Residential Mortgage loans	14,017	1,397	12,620	10,321	1,619	8,702
Total loans to customers at AC	**167,377**	**41,694**	**125,683**	**204,171**	**43,493**	**160,678**

More detailed explanation of classes of loans to legal entities is provided below:

- Loans to corporate / commercial customers – loans issued to commercial entities;
- Loans to SME – loans issued to small and medium-sized enterprises;
- Consumer Loans – loans issued to individuals for personal needs;
- Residential Mortgage loans - loans issued to individuals for mortgage purposes.

The following table discloses the changes in the credit loss allowance and gross carrying amount for loans to customers carried at amortised cost between the beginning and the end of the reporting period and comparative periods.

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

	Credit loss allowance				Gross carrying amount			
	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total
Loans to corporate / commercial customers								
At 31 December 2019	**378**	**2,015**	**20,930**	**23,323**	**88,321**	**7,732**	**33,755**	**129,808**
Movements with impact on credit loss allowance charge for the period:								
Transfers:								
- to lifetime (from Stage 1 to Stage 2)	(107)	964	-	857	(11,476)	11,476	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	(9)	(52)	953	892	(1,729)	(2,859)	4,588	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	-	-	-	-	-	-	-	-
New originated or purchased	217	136	-	353	33,766	446	-	34,212
Derecognized during the period	(77)	-	(1,406)	(1,483)	(16,122)	(5)	(2,565)	(18,692)
Changes in accrued interest	-	-	-	-	-	-	2,683	2,683
Partial derecognition	(153)	(226)	(513)	(892)	(46,449)	(904)	(2,364)	(49,717)
Modification of contractual cash flows	(18)	138	-	120	-	-	-	-
Total movements with impact on credit loss allowance charge for the period	**(147)**	**960**	**(966)**	**(153)**	**(42,010)**	**8,154**	**2,342**	**(31,514)**
Movements without impact on credit loss allowance charge for the period:								
Write-offs	-	-	(1,795)	(1,795)	-	-	(1,795)	(1,795)
At 31 December 2020	**231**	**2,975**	**18,169**	**21,375**	**46,311**	**15,886**	**34,302**	**96,499**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

	Credit loss allowance				Gross carrying amount			
	Stage 1 (12-months ECL)	**Stage 2 (lifetime ECL for SICR)**	**Stage 3 (lifetime ECL for credit im-paired)**	**Total**	**Stage 1 (12-months ECL)**	**Stage 2 (lifetime ECL for SICR)**	**Stage 3 (lifetime ECL for credit im-paired)**	**Total**
Loans to corporate / commercial customers								
At 31 December 2018	**379**	**347**	**21,942**	**22,668**	**60,645**	**11,462**	**34,751**	**106,858**
Movements with impact on credit loss allowance charge for the period:								
Transfers:								
- to lifetime (from Stage 1 to Stage 2)	(429)	429	-	-	(3,040)	3,040	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	-	(101)	101	-	-	(101)	101	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	-	-	-	-	-	-	-	-
New originated or purchased	707	1,584	1,743	4,034	80,607	4,587	3,243	88,437
Derecognized during the period	(247)	(243)	(872)	(1,362)	(47,707)	(11,219)	(1,638)	(60,564)
Other movements	(32)	(1)	(241)	(274)	(2,184)	(37)	274	(1,947)
Total movements with impact on credit loss allowance charge for the period	**(1)**	**1,668**	**731**	**2,398**	**27,676**	**(3,,730)**	**1,980**	**25,926**
Movements without impact on credit loss allowance charge for the period:								
Write-offs	-	-	(1,743)	(1,743)	-	-	(2,976)	(2,976)
At 31 December 2019	**378**	**2,015**	**20,930**	**23,323**	**88,321**	**7,732**	**33,755**	**129,808**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

	Credit loss allowance				Gross carrying amount			
	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit impaired)	Total	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit impaired)	Total
Loans to SME								
At 31 December 2019	**14**	**21**	**8,275**	**8,310**	**2,240**	**49**	**12,657**	**14,946**
Movements with impact on credit loss allowance charge for the period:								
Transfers:								
- to lifetime (from Stage 1 to Stage 2)	(11)	17	-	6	(1,797)	1,797	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	-	(5)	65	60	-	(85)	85	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	-	-	-	-	-	-	-	-
New originated or purchased	8	-	9	17	737	1	9	747
Derecognised during the period	-	-	(98)	(98)	(38)	(3)	(210)	(251)
Changes in accrued interest	-	-	-	-	-	-	579	579
Partial derecognition	(6)	(22)	-	(28)	(429)	(44)	(165)	(638)
Modification of contractual cash flows	8	-	12	20	-	-	-	-
Total movements with impact on credit loss allowance charge for the period	**(1)**	**(10)**	**(12)**	**(23)**	**(1,527)**	**1,666**	**298**	**437**
Movements without impact on credit loss allowance charge for the period:								
Write-offs	-	-	(57)	(57)	-	-	(57)	(57)
At 31 December 2020	**13**	**11**	**8,206**	**8,230**	**713**	**1,715**	**12,898**	**15,326**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

	Credit loss allowance				Gross carrying amount			
	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total
Loans to SME								
At 31 December 2018	**20**	**34**	**9,007**	**9,061**	**3,237**	**1,499**	**14,711**	**19,447**
Movements with impact on credit loss allowance charge for the period:								
Transfers:								
- to lifetime (from Stage 1 to Stage 2)	(34)	34	-	-	(92)	92	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	-	(14)	14	-	-	(737)	737	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	-	-	-	-	-	-	-	-
New originated or purchased	5	-	9	14	829	-	16	845
Derecognised during the period	(24)	(20)	(661)	(705)	(1,529)	(805)	(1,152)	(3,486)
Other movements	47	(13)	265	299	(205)	-	54	(151)
Total movements with impact on credit loss allowance charge for the period	**(6)**	**(13)**	**(373)**	**(392)**	**(997)**	**(1,450)**	**(345)**	**(2,792)**
Movements without impact on credit loss allowance charge for the period:								
Write-offs	-	-	(359)	(359)	-	-	(1,709)	(1,709)
At 31 December 2019	**14**	**21**	**8,275**	**8,310**	**2,240**	**49**	**12,657**	**14,946**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

	Credit loss allowance				Gross carrying amount			
	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total
Consumer loans								
At 31 December 2019	**1,439**	**109**	**8,693**	**10,241**	**37,613**	**1,866**	**9,617**	**49,096**
Movements with impact on credit loss allowance charge for the period:								
Transfers:								
- to lifetime (from Stage 1 to Stage 2)	(26)	392	-	366	(7,570)	7,570	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	-	(84)	837	753	(2)	(1,471)	1,473	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	18	(265)	(3)	(250)	4,604	(4,600)	(4)	-
New originated or purchased	386	15	-	401	25,567	144	-	25,711
Derecognised during the period	(26)	(10)	(238)	(274)	(5,417)	(189)	(297)	(5,903)
Changes in accrued interest	-	-	-	-	-	-	564	564
Partial derecognition	(1,657)	(94)	1,524	(227)	(27,239)	(1,997)	1,612	(27,624)
Modification of contractual cash flows	-	(7)	(2)	(9)	-	-	-	-
Total movements with impact on credit loss allowance charge for the period	**(1,305)**	**(53)**	**2,118**	**760**	**(10,057)**	**(543)**	**3,348**	**(7,252)**
Movements without impact on credit loss allowance charge for the period:								
Write-offs	-	-	(309)	(309)	-	-	(309)	(309)
At 31 December 2020	**134**	**56**	**10,502**	**10,692**	**27,556**	**1,323**	**12,656**	**41,535**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

	Credit loss allowance				Gross carrying amount			
	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total
Consumer loans								
At 31 December 2018	**245**	**51**	**12,928**	**13,224**	**39,896**	**1,041**	**14,650**	**55,587**
Movements with impact on credit loss allowance charge for the period:								
Transfers:								
- to lifetime (from Stage 1 to Stage 2)	(12)	12	-	-	(1,224)	1,224	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	(4)	(15)	19	-	(309)	(244)	553	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	5	(5)	-	-	241	(241)	-	-
New originated or purchased	1,305	60	128	1,493	16,607	430	224	17,261
Derecognised during the period	(40)	(18)	(2,242)	(2,300)	(13,323)	(460)	(2,818)	(16,601)
Other movements	(60)	24	(544)	(580)	(4,275)	116	(1,167)	(5,326)
Total movements with impact on credit loss allowance charge for the period	**1,194**	**58**	**(2,639)**	**(1,387)**	**(2,283)**	**825**	**(3,208)**	**(4,666)**
Movements without impact on credit loss allowance charge for the period:								
Write-offs	-	-	(1,596)	(1,596)	-	-	(1,825)	(1,825)
At 31 December 2019	**1,439**	**109**	**8,693**	**10,241**	**37,613**	**1,866**	**9,617**	**49,096**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

	Credit loss allowance				Gross carrying amount			
	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit Im-paired)	Total	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit Im-paired)	Total
Residential mortgage loans								
At 31 December 2019	**66**	**2**	**1,551**	**1,619**	**7,682**	**176**	**2,463**	**10,321**
Movements with impact on credit loss allowance charge for the period:								
Transfers:								
- to lifetime (from Stage 1 to Stage 2)	(1)	3	-	2	(1,606)	1,606	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	-	-	35	35	(62)	(17)	79	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	2	(2)	(51)	(51)	1,443	(1,336)	(107)	-
New originated or purchased	8	-	8	16	4,795	99	11	4,905
Derecognised during the period	-	-	(55)	(55)	(206)	(68)	(110)	(384)
Changes in accrued interest	-	-	-	-	-	-	115	115
Partial derecognition	(56)	(2)	(77)	(135)	(739)	(26)	(141)	(906)
Modification of contractual cash flows	-	-	-	-	-	-	-	-
Total movements with impact on credit loss allowance charge for the period	**(47)**	**(1)**	**(140)**	**(188)**	**3,625**	**258**	**(153)**	**3,730**
Movements without impact on credit loss allowance charge for the period:								
Write-offs	-	-	(34)	(34)	-	-	(34)	(34)
At 31 December 2020	**19**	**1**	**1,377**	**1,397**	**11,307**	**434**	**2,276**	**14,017**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

	Credit loss allowance				Gross carrying amount			
	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total
Residential mortgage loans								
At 31 December 2018	**13**	**1**	**1,588**	**1,602**	**6,708**	**229**	**2,556**	**9,493**
Movements with impact on credit loss allowance charge for the period:								
Transfers:								
- to lifetime (from Stage 1 to Stage 2)	(1)	1	-	-	(89)	89	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	-	(1)	1	-	(51)	(55)	106	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	-	-	-	-	23	(23)	-	-
New originated or purchased	20	-	-	20	1,911	-	-	1,911
Derecognised during the period	(10)	-	(61)	(71)	(313)	(37)	(188)	(538)
Other movements	44	1	23	68	(507)	(27)	(11)	(545)
Total movements with impact on credit loss allowance charge for the period	**53**	**1**	**(37)**	**17**	**974**	**(53)**	**(93)**	**828**
Movements without impact on credit loss allowance charge for the period:								
Write-offs	-	-	-	-	-	-	-	-
At 31 December 2019	**66**	**2**	**1,551**	**1,619**	**7,682**	**176**	**2,463**	**10,321**

The credit loss allowance for loans to customers recognised in the period is impacted by a variety of factors. Details of ECL measurement are provided in Note 23. The main reasons for movements are as follows:

- Transfers between Stage 1, 2 and 3 due to balances experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent "step up" (or "step down") between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognised during the period, as well as releases for financial instruments derecognised in the period;
- Write-offs of allowances related to assets that were written off during the period.
- ;

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

Allowance for impairment of loans to customers

Information about collateral at 31 December 2020 is as follows:

	Corporate lending	Small business lending	Consumer lending	Residential mortgages	Total
Unsecured loans	15,121	2,642	40,498	374	58,635
Loans collateralized by:					
Real estate	72,370	12,503	467	13,592	98,932
Cash deposits	5,831	-	105	-	5,936
Other assets	3,303	177	394	-	3,874
Less impairment provisions	(21,375)	(8,230)	(10,692)	(1,397)	(41,694)
Total loans to customers	**75,250**	**7,092**	**30,772**	**12,569**	**125,683**

Information about collateral at 31 December 2019 is as follows:

	Corporate lending	Small business lending	Consumer lending	Residential mortgages	Total
Unsecured loans	13,812	1,724	48,138	277	63,951
Loans collateralized by:					
Real estate	89,553	13,040	351	10,044	112,988
Cash deposits	16,622	-	187	-	16,809
Other assets	9,820	182	419	-	10,421
Less impairment provisions	(23,322)	(8,310)	(10,240)	(1,619)	(43,491)
Total loans to customers	**106,485**	**6,636**	**38,855**	**8,702**	**160,678**

Other assets mainly include vehicles and equipment. The disclosure above represents the lower of the carrying value of the loan or collateral taken; the remaining part is disclosed within the unsecured exposures. The carrying value of loans was allocated based on liquidity of the assets taken as collateral.

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

Loans to customers and other financial assets with good financial position and good debt service are included in the standard grade. Sub-standard grade comprises loans below standard grade that had changes in the terms and conditions of loan agreements, but not individually impaired.

The following tables contain analyses of the credit risk exposure of loans to customers measured at AC and for which ECL allowance is recognised. The carrying amount of loans to customers below also represents the Bank's maximum exposure to credit risk on these loans.

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

Analysis by credit quality of loans outstanding at 31 December 2020 is as follows:

	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total
Corporate lending				
Less than 30 days	46,311	13,195	4,560	64,066
30 to 90 days overdue	-	2,684	-	2,684
91-180 days overdue	-	7	-	7
181 to 360 days overdue	-	-	44	44
Over 360 days overdue	-	-	29,826	29,826
Gross carrying amount	**46,311**	**15,886**	**34,430**	**96,627**
Credit loss allowance	(231)	(2,975)	(18,170)	(21,376)
Carrying amount	46,080	**12,911**	**16,260**	**75,251**
Small business lending				
Less than 30 days	713	1,715	183	2,611
30 to 90 days overdue	-	-	-	-
91-180 days overdue	-	-	-	-
181 to 360 days overdue	-	-	-	-
Over 360 days overdue	-	-	12,711	12,711
Gross carrying amount	**713**	**1,715**	**12,894**	**15,322**
Credit loss allowance	(13)	(11)	(8,206)	(8,230)
Carrying amount	**700**	**1,704**	**4,688**	**7,092**
Consumer lending				
Less than 30 days	27,063	447	2,593	30,103
30 to 90 days overdue	493	876	69	1,438
91-180 days overdue	-	-	124	124
181 to 360 days overdue	-	-	790	790
Over 360 days overdue	-	-	9,009	9,009
Gross carrying amount	**27,556**	**1,323**	**12,585**	**41,464**
Credit loss allowance	(134)	(63)	(10,495)	(10,692)
Carrying amount	**27,422**	**1,260**	**2,090**	**30,772**
Residential mortgage loans				
Less than 30 days	11,130	283	-	11,413
30 to 90 days overdue	178	151	2	331
91-180 days overdue	-	-	-	-
181 to 360 days overdue	-	-	-	-
Over 360 days overdue	-	-	2,222	2,222
Gross carrying amount	**11,308**	**434**	**2,224**	**13,966**
Credit loss allowance	(18)	(1)	(1,378)	(1,397)
Carrying amount	**11,290**	**433**	**846**	**12,569**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

Analysis by credit quality of loans outstanding at 31 December 2019 is as follows:

	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit impaired)	Total
Corporate lending				
Less than 30 days	88,321	5,370	-	93,691
30 to 90 days overdue	-	2,362	-	2,362
91-180 days overdue	-	-	3,340	3,340
181 to 360 days overdue	-	-	192	192
Over 360 days overdue	-	-	30,223	30,223
Gross carrying amount	**88,321**	**7,732**	**33,755**	**129,808**
Credit loss allowance	(378)	(2,015)	(20,930)	(23,323)
Carrying amount	**87,943**	**5,717**	**12,825**	**106,485**
Small business lending				
Less than 30 days	2,240	6	35	2,281
30 to 90 days overdue	-	43	-	43
91-180 days overdue	-	-	-	-
181 to 360 days overdue	-	-	707	707
Over 360 days overdue	-	-	11,915	11,915
Gross carrying amount	**2,240**	**49**	**12,657**	**14,946**
Credit loss allowance	(14)	(21)	(8,275)	(8,310)
Carrying amount	**2,226**	**28**	**4,382**	**6,636**
Consumer lending				
Less than 30 days	37,613	1,086	18	38,717
30 to 90 days overdue	-	780	14	794
91-180 days overdue	-	-	227	227
181 to 360 days overdue	-	-	437	437
Over 360 days overdue	-	-	8,921	8,921
Gross carrying amount	**37,613**	**1,866**	**9,617**	**49,096**
Credit loss allowance	(1,440)	(109)	(8,692)	(10,241)
Carrying amount	**36,173**	**1,757**	**925**	**38,855**
Residential mortgage loans				
Less than 30 days	7,682	9	-	7,691
30 to 90 days overdue	-	168	-	168
91-180 days overdue	-	-	28	28
181 to 360 days overdue	-	-	50	50
Over 360 days overdue	-	-	2,384	2,384
Gross carrying amount	**7,682**	**177**	**2,462**	**10,321**
Credit loss allowance	(67)	(2)	(1,550)	(1,619)
Carrying amount	**7,615**	**175**	**912**	**8,702**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

Impairment assessment. The main considerations for the loan impairment assessment are based on the information provided by the roll-rate model, which measures the movement of the past due amounts balances in various time brackets. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances. The Bank determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realizable value of collateral, the timing of the expected cash flows and expected recoverability of unsecured portion based on management estimates. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances. Allowances are assessed collectively for losses on loans to customers that are not individually significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review. The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment.

Impairment losses are estimated by taking into consideration the roll-rate model assessment. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for loans.

The primary factors that the Bank considers in determining whether a loan is impaired are its overdue status and realis ability of related collateral, if any. As a result, the Bank presents above an ageing analysis of loans that are individually determined to be impaired.

The financial effect of collateral is presented by disclosing collateral values separately for (i) those assets where collateral and other credit enhancements are equal to or exceed carrying value of the asset ("over-collateralised assets") and (ii) those assets where collateral and other credit enhancements are less than the carrying value of the asset ("under-collateralised assets").

The effect of collateral at 31 December 2020:

	Over-collateralized Assets		**Under-collateralized Assets**	
	Carrying value of the assets	**Fair value of collateral**	**Carrying value of the assets**	**Fair value of collateral**
Corporate lending	48,457	97,486	26,668	7,205
Small business lending	3,395	8,505	3,701	1,966
Consumer lending	850	2,258	29,992	146
Residential mortgages	12,619	24,867	1	-

The effect of collateral at 31 December 2019:

	Over-collateralised Assets		**Under-collateralised Assets**	
	Carrying value of the assets	**Fair value of collateral**	**Carrying value of the assets**	**Fair value of collateral**
Corporate lending	66,638	147,633	62,923	36,949
Small business lending	3,348	7,196	11,479	6,404
Consumer lending	736	2,511	48,678	356
Residential mortgages	9,094	16,971	1,275	695

9 Loans to Customers (Continued)

The following table provides information on carrying value of loans, for which the Bank did not recognise any expected credit loss allowance because of significant excess of collateral value over the gross carrying value of these loans.

In thousands of Azerbaijani Manats	31 December 2020	31 December 2019
Corporate lending	4,425	-
Small business lending	-	-
Consumer lending	-	-
Residential mortgages	-	-
Total significantly over-collateralised loans and advances to customers carried at AC	**4,425**	**-**

Individually impaired loans

As at 31 December 2020, loans in the amount of AZN 43,091 were assessed individually. An individual impairment allowance of AZN 26,626 were recognized for such loans.

In accordance with the CBAR requirements, loans may only be written off with the approval of the Supervisory Board and, in certain cases, with the respective decision of the Court.

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

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

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.

Concentration of loans to customers

As of 31 December 2020, the Bank had a concentration of loans represented by AZN 41,436 or 25% of gross loan portfolio (2019: AZN 65,064 or 32%) due from the ten (2019: ten) largest third party borrowers.

Loans have been extended to the following types of customers (amounts are presented prior to allowance):

	2020	2019
Private companies	96,627	129,808
Individuals	70,750	74,363
Gross loans to customers	**167,377**	**204,171**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

Loans are provided within Azerbaijan in the following industry sectors (amounts are presented prior to allowance):

	2020	2019
Individuals	70,750	74,363
Trading enterprises	58,826	86,985
Real estate construction	23,347	24,483
Manufacturing	14,454	18,340
Gross loans to customers	**167,377**	**204,171**

Refer to Note 24 for the estimated fair value of each class of loans to customers. Maturity analysis of loans to customers is disclosed in Note 1 . Information on related party balances is disclosed in Note 25.

10 Investments in debt securities

	2020	2019
Notes issued by the Central Bank of the Republic of Azerbaijan (CBAR)	20,311	33,868
Bonds issued by the Ministry of Finance of Azerbaijan Republic	2,815	2,798
Other	60	60
Less credit loss allowance	(90)	(190)
Total	**23,096**	**36,536**

As of 31 December 2020, all Notes issued by the Central Bank of the Republic of Azerbaijan (CBAR) and Other Bonds were classified as Stage 1.

Nominal interest rates and maturities of debt securities are as follows:

	2020		2019	
	Annual Interest rate	Maturity	Annual Interest rate	Maturity
Notes issued by the CBAR	5.76%-6.01%	Jan'21	5.76%-6.01%	Jan'20
Bonds issued by the Ministry of Finance of Azerbaijan Republic	8.46% - 8.79%	Mar"21	8.46% - 8.79%	Mar"21

Notes from CBAR has original maturity of 28 days and as per Bank policy represents cash and cash equivalents. Notes from CBAR are neither past due nor impaired.

Bonds from the Ministry of Finance of Azerbaijan Republic has original maturity of 1,092 days. Bonds from Ministry of Finance are neither past due nor impaired.

All debt securities are measured at amortised cost. The credit quality of the debt securities is good. Refer to Note 23 for the description of the Bank's credit risk grading system.

Refer to Note 24 for the estimated fair value of notes issued by Central Bank of the Republic of Azerbaijan and other bonds.

(Amounts expressed in thousands of Azerbaijani Manats)

11 Property and Equipment

The movements in tangible assets were as follows:

	Leasehold improvements	Computers and office equipment	Furniture and fixtures	Motor vehicles	Total
Cost					
31 December 2019	**8,858**	**13,792**	**2,023**	**111**	**24,784**
Additions	32	2,112	7	3	2,154
Disposals	-	-	-	-	-
Transfers	-	-	-	-	-
31 December 2020	**8,890**	**15,904**	**2,030**	**114**	**26,938**
Accumulated depreciation					
31 December 2019	**(7,326)**	**(11,628)**	**(1,849)**	**(107)**	**(20,910)**
Depreciation charge	(622)	(1,253)	(48)	(3)	(1,926)
Disposals	–	–	–	–	–
Transfers	–	–	–	–	–
31 December 2020	**(7,948)**	**(12,881)**	**(1,897)**	**(110)**	**(22,836)**
Net book value					
31 December 2019	**1,532**	**2,164**	**174**	**4**	**3,874**
31 December 2020	**942**	**3,023**	**133**	**4**	**4,102**

	Leasehold improvements	Computers and office equipment	Furniture and fixtures	Motor vehicles	Total
Cost					
31 December 2018	**8,770**	**13,067**	**1,985**	**110**	**23,932**
Additions	88	940	7	1	1,036
Disposals	-	(162)	(11)	–	(173)
Transfers	-	(53)	42	-	(11)
31 December 2019	**8,858**	**13,792**	**2,023**	**111**	**24,784**
Accumulated depreciation					
31 December 2018	**(6,657)**	**(10,820)**	**(1,781)**	**(101)**	**(19,359)**
Depreciation charge	(669)	(833)	(77)	(6)	(1,585)
Disposals	–	25	9	–	34
Transfers	–	-	-	–	–
31 December 2019	**(7,326)**	**(11,628)**	**(1,849)**	**(107)**	**(20,910)**
Net book value					
31 December 2018	**2,113**	**2,247**	**204**	**9**	**4,573**
31 December 2019	**1,532**	**2,164**	**174**	**4**	**3,874**

As at 31 December 2020 gross carrying amount of fully depreciated property and equipment was AZN 12,213 (2019: AZN 11,564).

(Amounts expressed in thousands of Azerbaijani Manats)

12 Intangible Assets

The movements in intangible assets were as follows:

	Licenses	Computer software	Total
Cost			
31 December 2019	10,692	11,273	21,965
Additions	985	1,314	2,299
Disposals	-	(5)	(5)
Transfers	-	(3)	(3)
31 December 2020	11,677	12,579	24,256
Accumulated amortization			
31 December 2019	(9,534)	(4,541)	(14,075)
Amortization charge	(1,326)	(1,178)	(2,504)
31 December 2020	(10,860)	(5,719)	(16,579)
Net book value			
31 December 2019	1,158	6,732	7,890
31 December 2020	817	6,860	7,677

	Licenses	Computer software	Total
Cost			
31 December 2018	9,568	10,212	19,780
Additions	1,144	1,061	2,205
Disposals	(31)		(31)
Transfers	11		11
31 December 2019	10,692	11,273	21,965
Accumulated amortization			
31 December 2018	(8,336)	(3,504)	(11,840)
Amortization charge	(1,198)	(1,037)	(2,235)
31 December 2019	(9,534)	(4,541)	(14,075)
Net book value			
31 December 2018	1,232	6,708	7,940
31 December 2019	1,158	6,732	7,890

As at 31 December 2020 gross carrying amount of fully amortized intangible assets was AZN 10,262 (2019: AZN 8,661).

(Amounts expressed in thousands of Azerbaijani Manats)

13 Right of Use Assets and Lease Liabilities

The Bank leases buildings, vehicles and others. Rental contracts are typically made for fixed periods but may have extension options.

Contracts may contain both lease and non-lease components. The Bank elected not to separate lease and non-lease components and instead accounts for these as a single lease component.

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as security for borrowing purposes.

Extension and termination options are included in a number of leases across the Bank. These are used to maximise operational flexibility in terms of managing the assets used in the Bank's operations. The majority of extension and termination options held are exercisable by both the Bank and the respective lessors.

From 1 January 2019, leases are recognised as a right-of-use asset and a corresponding liability from the date when the leased asset becomes available for use by the Bank.

The Bank has received 3 AZN COVID-19 related monthly rent concession on one contract and it results with the decrease in net right of use asset and lease liability 47 AZN and 68 AZN, respectively. The decrease in interest and depreciation expenses were 1 AZN and 2 AZN, respectively.

The right of use assets by class of underlying items is analysed as follows:

	Buildings	Vehicles	Other	Total
Carrying amount at 31 December 2019	**5,392**	**359**	**-**	**5,751**
Additions	5,905	680	158	**6,743**
Disposals	(3,847)	(518)	-	**(4,365)**
Depreciation charge	(1,916)	(192)	(109)	**(2,217)**
Carrying amount at 31 December 2020	**5,534**	**329**	**49**	**5,912**

Interest expense on lease liabilities in 2020 was AZN 330 (2019: AZN 360). Total cash outflow for leases in 2020 was AZN 2,448 (2019: AZN 2,680).

At the end of each reporting period, the expected residual values are reviewed to reflect actual residual values achieved on comparable assets and expectations about future prices. As at 31 December 2020, AZN 6,968 (2019: AZN 9,123) is expected to be payable and is included in calculating the lease liabilities.

	Buildings	Vehicles	Other	Total
Carrying amount at 1 January 2019	**5,624**	**651**	**99**	**6,374**
Additions	2,009	540	74	**2,623**
Disposals	(190)	(651)	(77)	**-918**
Depreciation charge	(2,051)	(181)	(96)	**(2,328)**
Carrying amount at 31 December 2019	**5,392**	**359**	**-**	**5,751**

(Amounts expressed in thousands of Azerbaijani Manats)

14 Income Taxes

The corporate income tax expense comprises:

	2020	2019
Current tax charge	(544)	(1,439)
Deferred income tax credit for the year	399	29
Income tax expense	**(145)**	**(1,410)**

Standard corporate income tax rate for companies (including banks) comprised 20% for 2020 and 2019. 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:

	2020	2019
Profit before income tax expense	3,473	7,605
Statutory tax rate	20%	20%
Income tax expense at the statutory rate	(695)	(1,521)
Tax effect of items which are not deductible or assessable for taxation purposes:		
Impact of non-deductible and other permanent expenses	476	147
Impact of prior year tax expense	74	(36)
Income tax expense	**(145)**	**(1,410)**

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

	2018	Recognized in the statement of profit or loss and other comprehensive income	2019	Recognized in the statement of profit or loss and other comprehensive income	2020
Tax effect of temporary differences					
Cash and cash equivalents	227	(183)	44	45	89
Investment securities available-for-sale	-	38	38	(20)	18
Amounts due from credit institutions	(291)	241	(50)	-	(50)
Loans to customers	(2,988)	1	(2,987)	306	(2,681)
Property and equipment	322	75	397	32	429
Intangible assets	(59)	(36)	(95)	23	(72)
Other liabilities	519	74	593	(44)	549
Other assets	125	(181)	(56)	57	1
Deferred tax liability	**(2,145)**	**29**	**(2,116)**	**399**	**(1,717)**

(Amounts expressed in thousands of Azerbaijani Manats)

15 Other Assets and Liabilities

Other assets comprise:

	2020	2019
Amounts in the course of settlement	2,971	2,865
Other financial assets	**2,971**	**2,865**
Repossessed collateral	2,869	2,703
Prepayments	1,607	2,892
Tax Receivables	382	473
Other	6	3
Other non-financial assets	**4,864**	**6,071**
Other assets	**7,835**	**8,936**

As at 31 December 2020, prepayments of AZN 1,697 (2019: AZN 2,892) primarily comprise of advance payments for purchase of property, equipment and insurance.

Other liabilities comprise:

	2020	2019
Settlements on plastic cards	1,899	3,469
Lease Liabilities	5,297	5,698
Other	585	174
Other financial liabilities	**7,781**	**9,341**
Accrued employee costs	1,718	1,644
Payables to social funds	422	430
Deferred income	332	463
Provisions	136	383
Other	987	661
Other non-financial liabilities	**3,595**	**3,581**
Other liabilities	**11,376**	**12,922**

Accrued employee costs include bonuses for employees based on the financial performance of the Bank of AZN 1,043 (2019: AZN 926) and an accrual for unused vacations of AZN 675 (2019: AZN 718).

As at 31 December 2020 and 2019, deferred income represents deferred revenue which was primarily comprised of fee received for issuance of plastic cards, guarantees and letter of credits.

As at 31 December 2020, AZN 827 (2019: 230) of other non-financial liabilities is other tax liabilities.

Analysis by credit quality of other financial assets outstanding at 31 December 2020 is as follows:

Settlements on money transfers	2020	2019
Neither past due nor impaired		
Other financial assets		
Good	2,971	2,865
Total other financial assets	**2,971**	**2,865**

(Amounts expressed in thousands of Azerbaijani Manats)

16 Amounts Due to Credit Institutions

Amounts due to credit institutions comprise:

	2020	2019
Amounts due to Azerbaijan Mortgage Fund	8,360	5,624
Amounts due to the National Fund for Entrepreneurship Support	3,605	4,289
Demand deposits	7	138
Amounts due to credit institutions	**11,972**	**10,051**

As at 31 December 2020, the Bank had loans financed by the Azerbaijan Mortgage Fund and National Fund for Entrepreneurship Support amounting to AZN 8,360 (2019: AZN 5,624) and AZN 3,605 (2019: AZN 4,289) maturing in 2050 (2019: 2043) and 2024 (2019: 2024), with the annual interest rates of 1-4% p.a. (2019: 1-4% p.a.) and 1% p.a. (2019: 1% p.a.), respectively.

17 Amounts Due to Customers

The amounts due to customers include the following:

	2020	2019
Current accounts	216,856	276,430
Time deposits	32,707	54,179
Amounts due to customers	**249,563**	**330,609**

As at 31 December 2020, amounts due to customers of AZN 103,987 or 42% (2019: AZN 144,537 or 44%) of total amounts due to customers were due to ten (2019: ten) largest customers.

The average annual interest rate on term deposits of individual customers outstanding at 31 December 2020 comprised 2.56% (2019: 2.39%), while the average annual interest rate on term deposits of legal entities outstanding at 31 December 2020 was 4.32% (2019: 3.59%).

Amounts due to customers include accounts with the following types of customers:

	2020	2019
Private enterprises	166,049	231,322
Individuals	83,467	99,244
Public organizations	47	43
Amounts due to customers	**249,563**	**330,609**

An analysis of customer accounts by economic sector follows:

	2020	2019
Trade	126,915	142,026
Individuals	83,467	99,244
Real estate constructions	23,841	60,783
Insurance and other financial institutions	3,689	8,914
Transport and communication	7,332	13,524
State and public organizations	4,319	6,118
Amounts due to customers	**249,563**	**330,609**

Refer to Note 24 for the disclosure of the fair value of each class of customer accounts. Information on related party balances is disclosed in Note 25.

(Amounts expressed in thousands of Azerbaijani Manats)

18 Share Capital

As at 31 December 2020 number of ordinary shares are 2,769,035,194 (2019: 2,769,035,194). All ordinary shares have a nominal value of 0.02 per share denominated in Azerbaijani Manats and rank equally. Each share carries one vote.

The share capital of the Bank was contributed by the shareholders in Azerbaijani Manats and they are entitled to dividends and any capital distribution in Azerbaijani Manats.

At 31 December 2020 and 2019, the share capital of the Bank was, as follows:

	Number of outstanding ordinary shares	**Total nominal value of paid-in and registered ordinary Shares**
31 December 2019	**2,769,035,194**	**55,381**
New shares issued	-	-
31 December 2020	**2,769,035,194**	**55,381**

19 Commitments and Contingencies

Legal proceedings. 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.

Tax contingencies. 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 Azerbaijan suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review.

Management believes that as at 31 December 2020 its interpretation of the relevant legislation is appropriate and that the Bank's tax and social contribution position will be sustained.

Compliance with regulatory ratios. The regulator requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2020 and 31 December 2019, the Bank was in compliance with all prudential ratios.

Credit related commitments. 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.

19 Commitments and Contingencies (Continued)

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

	2020	2019
Undrawn loan commitments	103,725	78,792
Guarantees issued	10,913	17,628
Letters of credit	2,124	1,904
Total loan commitments	116,762	98,324
Less – cash held as security against guarantees	(3,783)	(4,284)
Total credit related commitments, net of provision and cash covered exposures	**112,979**	**94,040**

Most of the outstanding guarantee letters as at 31 December 2020 and 2019 represent guarantees issued to clients for the letters' performance on delivering goods and services, and tender guarantees issued to clients as a pledge of their intent to participate in a bidding tender, announced by various institutions.

20 Interest Income and Expense

Interest income and expense comprises:

In thousands of Azerbaijani Manats	2020	2019
Interest income calculated using the effective interest method		
Loans and advances to customers	18,038	19,776
Amounts due from credit institutions	2,256	3,979
Investment securities at AC	1,374	2,633
Total interest income	**21,668**	**26,388**
Interest expense		
Amounts due to customers	(1,502)	(2,887)
Amounts due to credit institutions	(218)	(169)
Total interest expense	**(1,720)**	**(3,056)**
Other similar expense		
Lease liabilities	(330)	(360)
Total other similar expense	**(330)**	**(360)**
Total interest and other similar expense	**(2,050)**	**(3,416)**
Net margin on interest	**19,618**	**22,972**

(Amounts expressed in thousands of Azerbaijani Manats)

21 Net Fee and Commission Income

Net fee and commission income comprises:

	2020	2019
Plastic card operations	3,242	4,030
Settlements operations	3,102	3,872
Cash operations	1,516	1,587
Guarantees and letters of credit	546	737
Agent activities	206	248
Other	94	55
Fee and commission income	**8,706**	**10,529**
Plastic card operations	(3,281)	(3,711)
Settlements operations	(1,045)	(1,287)
Agent activities	(81)	(219)
Guarantees and letters of credit	(7)	(13)
Other	(301)	(342)
Fee and commission expense	**(4,715)**	**(5,572)**
Net fee and commission income	**3,991**	**4,957**

22 Personnel, General and Administrative Expenses

	2020	2019
Salaries and bonuses	(7,505)	(8,013)
Social security costs	(1,082)	(1,013)
Other employee benefits	(735)	(893)
Personnel expenses	**(9,322)**	**(9,919)**

General and administrative expenses comprise:

	2020	2019
Depreciation and amortization	(4,430)	(3,820)
Depreciation charge on right of use assets	(2,217)	(2,328)
Support expenses	(1,670)	(1,722)
Legal and consultancy	(1,002)	(840)
Repairs and Maintenance	(916)	(892)
Security	(892)	(838)
Communications	(863)	(846)
Marketing and advertising	(442)	(467)
Utilities	(277)	(279)
Operating taxes other than income tax	(214)	(208)
Donations	(147)	-
Membership	(106)	(324)
Insurance	(98)	(123)
Office supplies	(61)	(115)
Entertainment	(26)	(143)
Losses on disposal of fixed assets and intangible assets	(13)	(35)
Fines, penalties, and forfeits	(6)	141
Business travel	(4)	(27)
Other expenses	(657)	(618)
General and administrative expenses	**(14,041)**	**(13,484)**

23 Financial Risk Management

Risk is inherent in the Bank's activities and 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 sustainability and 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, market risk and operating risks.

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

Risk management structure. The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

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

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

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

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

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

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

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

Risk measurement and reporting systems. The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worst case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

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

Information compiled from all the businesses is examined and processed in order to analyze, control and identify early risks. On a regular basis detailed reporting of industry and customer risks takes place.

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

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

23 Financial Risk Management (Continued)

Credit risk. The Bank exposes itself to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to meet an obligation.

Exposure to credit risk arises as a result of the Bank's lending and other transactions with counterparties, giving rise to financial assets and off-balance sheet credit-related commitments.

The Bank's maximum exposure to credit risk is reflected in the carrying amounts of financial assets in the statement of financial position. For financial guarantees issued, commitments to extend credit, undrawn credit lines and export/import letters of credit, the maximum exposure to credit risk is the amount of the commitment.

Credit-related commitments risks. The Bank offers guarantees to its customers which may require that the Bank makes payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to risks similar to loans and these are mitigated by the same control processes and policies. The maximum exposure to credit risk for the components of the statement of financial position, before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

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

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, which assigns each counterparty a risk rating at initiation. The Bank actively uses collateral to reduce its credit risks.

Expected credit loss (ECL) is a probability-weighted estimate of the present value of future cash shortfalls (i.e., the weighted average of credit losses, with the respective risks of default occurring in a given time period used as weights). An ECL measurement is unbiased and is determined by adjusting risk of default to the expectations on development of macroeconomic situation in future. ECL measurement is based on four components used by the Bank: Probability of Default ("PD"), Exposure at Default ("EAD"), Loss Given Default ("LGD") and Discount Rate.

Default definition. The Bank defines default as a situation when the exposure meets the following criteria:

- The loan was 90+ days overdue at any point within the considered time horizon

Expected credit losses are modelled over instrument's *lifetime period.* The *lifetime period* is equal to the remaining contractual period to maturity of debt instruments, adjusted for expected prepayments, if any. For loan commitments and financial guarantee contracts, it is the contractual period over which an entity has a present contractual obligation to extend credit. As a matter of exception from determining the lifetime exposure based on contractual maturity, for credit cards issued to individuals, the lifetime exposure is measured over a period that is based on expected life of the credit card contracts, based on internal statistics, and it is equal on average to 1 to 5 years.

Management models *Lifetime ECL,* that is, losses that result from all possible default events over the remaining lifetime period of the financial instrument. The *12-month ECL,* represents a portion of lifetime ECLs that result from default events on a financial instrument that are possible within 12 months after the reporting period, or remaining *lifetime period* of the financial instrument if it is less than a year.

The Bank has three approaches for ECL measurement: (i) assessment on an individual basis; (ii) assessment on a portfolio basis: internal ratings are estimated on an individual basis but the same credit risk parameters (e.g. PD, LGD) will be applied during the process of ECL calculations for the same credit risk ratings and homogeneous segments of the loan portfolio; and (iii) assessment based on external ratings.

23 Financial Risk Management (Continued)

The level of ECL that is recognised in these financial statements depends on whether the credit risk of the borrower has increased significantly since initial recognition. This is a three-stage model for ECL measurement. A financial instrument that is not credit-impaired on initial recognition and its credit risk has not increased significantly since initial recognition has a credit loss allowance based on 12-month ECLs (Stage 1). If a SICR since initial recognition is identified, the financial instrument is moved to Stage 2 but is not yet deemed to be credit-impaired and the loss allowance is based on lifetime ECLs. If a financial instrument is credit-impaired, the financial instrument is moved to Stage 3 and loss allowance is based on lifetime ECLs. The consequence of an asset being in Stage 3 is that the entity ceases to recognise interest income based on gross carrying value and applies the asset's effective interest rate to the carrying amount, net of ECL, when calculating interest income.

If there is evidence that the SICR criteria are no longer met, the instrument is transferred back to Stage 1. If an exposure has been transferred to Stage 2 based on a qualitative indicator, the Bank monitors whether that indicator continues to exist or has changed.

Leaving default status depends on which defaulted triggers exposure experienced during its default. Number of scenarios can be limited to two:

- if exposure experienced only more than 90 days past due then it's no longer considered as default when it reaches 30 days delinquency;
- if exposure experienced also other default triggers then it leaves default status when it no longer meets any of the default criteria for a consecutive period of twelve months;

This logic has been determined based on an analysis that considers the likelihood of a financial instrument returning to default status after curing by using different possible definitions of cures

ECL measurement for financial guarantees and loan commitments. The ECL measurement for these instruments includes the same steps as described above for on-balance sheet exposures and differs with respect to EAD calculation. The EAD is a product of credit conversion factor ("CCF") and amount of the commitment ("$ExOff$"). CCF for undrawn credit lines of corporate customers, credit cards issued to individuals and for financial guarantees is defined based on statistical analysis of past exposures at default. CCF for overdrafts is defined as 100% since the limits can be used by the customers at any time.

Internal ratings. For purpose of PD modelling simplified behavioural scoring models were created and developed to differentiate the risk profile of an individual exposure.

Credit scoring is an instrument widely used by companies for the internal processes of portfolio risk measurement and management. Scoring can be defined in general as a statistical technique to predict, at a specific point in time with the available information, the probability of a future event. More specifically it allows banks to estimate the probability of default of a person requesting credit (then application scoring model is usually used) or a customer already in the portfolio (behavioural scoring model).

The main assumption for scoring model development is that the past behaviour is a good predictor for the future, thus models are developed based on historical data. In particular, behavioural models are leveraging the information regarding past delinquency, historical credit utilization, history of payments or collection actions. In practice, credit scoring results in the definition of a table listing the characteristics that provide the most predictive information together with the associated attributes and weightings. A total score is obtained as the sum of the points for each characteristic.

Credit granting authorization levels are also determined in accordance with the rating of Corporate, Commercial and SME customers. By using this methodology; it is aimed to establish risk based optimization of credit processes through assigning the lower rated customer to higher authority levels whereas assigning higher rated customer to lower authority levels.

(Amounts expressed in thousands of Azerbaijani Manats)

23 Financial Risk Management (Continued)

The Bank takes following criterias into consideration for the identification of default:

- The loan is overdue more than 90 days.
- The borrower is not able to pay at least one of the loans he received from the Bank (cross default)
- Having a negative intelligence and bad-record for the borrower in the market.
- Deterioration of the creditworthiness of the borrower

Ratings, which were created base on score values, gather exposures with similar risk profile. Therefore PDs are estimated on homogenies risk groups (i.e. per segment and rating).

External ratings. External ratings are assigned to counterparties by independent international rating agencies, such as S&P, Moody's and Fitch. These ratings are publicly available. Such ratings and the corresponding range of PD are applied for the following financial instruments: amounts due from the CBAR, balances on correspondent accounts including overnight deposits and deposits.

Master scale credit risk grade	Corresponding ratings of external international rating agencies (S&P)	Corresponding PD interval
Excellent	AAA to BB+	0,01% - 0,5%
Good	BB to B+	0,51% - 3%
Satisfactory	B, B-	3% - 10%
Special monitoring	CCC+ to CC-	10% - 99,9%
Default	C, D-I, D-II	100%

Each master scale credit risk grade is assigned a specific degree of creditworthiness:

- *Excellent* – strong credit quality with low expected credit risk;
- *Good* – adequate credit quality with a moderate credit risk;
- *Satisfactory* – moderate credit quality with a satisfactory credit risk;
- *Special monitoring* – facilities that require closer monitoring and remedial management; and
- *Default* – facilities in which a default has occurred.

External ratings are assigned to counterparties by independent international rating agencies, such as S&P, Moody's and Fitch. These ratings are publicly available.

Probability of default (PD). PD is an estimate of the likelihood of default to occur over a given time period. For every exposure is estimated lifetime PD curve which is dependant from time, credit risk rating and segment. 12-month PD is calculated as part of lifetime PD curve. The Bank uses different statistical approaches depending on the segment and product type to calculated lifetime PDs, such as Bayesian Scalar approach, Weibull and Adjusted Weibull distribution.

Two types of PDs are used for calculating ECLs: 12-month and lifetime PD. An assessment of a 12-month PD is based on the latest available historic default data and adjusted for supportable forward-looking information when appropriate. Lifetime PDs represent the estimated probability of a default occurring over the remaining life of the financial instrument and it is a sum of the 12 months PDs over the life of the instrument. The Bank uses different statistical approaches depending on the segment and product type to calculated lifetime PDs, such as the extrapolation of 12-month PDs based on migration matrixes, developing lifetime PD curves based on the historical default data, hazard rate approach or other.

Macro-economic factors. Internal bank forecasts provide the best estimate of the expected macro-economic development over the next 3 years. After 3 years, no macro-economic impact is used. The impact of the relevant economic variables on the PD has been determined by performing statistical regression analysis to understand the impact that the changes in these variables historically had on the default rates.

As with any economic forecast, the projections are subject to a high degree of inherent uncertainty, and therefore the actual outcomes may be significantly different to those projected. The Bank considers these forecasts to represent its best estimate of the possible outcomes.

23 Financial Risk Management (Continued)

Loss given default (LGD). LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive. It is usually expressed as a percentage of the gross book value. The expected losses are discounted to present value at the end of the reporting period.

LGD varies by the type of counterparty and product type. The LGDs are determined based on the factors that impact the expected recoveries after a default event. The calculation of LGD is based on recovery statistics.

LGD represents the Bank's expectation of the extent of loss on a defaulted exposure. LGD varies by the type of counterparty, type and seniority of the claim, and the availability of collateral or other credit support.

The 12-month and lifetime LGDs are determined based on the factors that impact the expected recoveries after a default event. The approach to LGD measurement can be divided into three possible approaches:

- measurement of LGD based on the specific characteristics of the collateral;
- calculation of LGD on a portfolio basis based on recovery statistics; or
- individually defined LGD depending on different factors and scenarios.

The Bank calculates LGD based on specific characteristics of the collateral, such as projected collateral values, historical discounts on sales and other factors for loans secured by real estate, cash and liquid securities. LGD is calculated on a collective basis based on the latest available recovery statistics for the remainder of the corporate loan portfolio and for retail secured and unsecured products.

Exposure at default (EAD). EAD is an estimate of exposure at a future default date, taking into account expected changes in the exposure after the reporting period, including repayments of principal and interest, and expected drawdowns on committed facilities.

For revolving products EAD is estimated using Credit Conversion Factor ("CCF"). CCF is a coefficient that shows the probability of conversion of the off-balance amounts to an on-balance sheet exposure within a defined period. CCF for financial guarantees is defined based on globally accepted Basel 3 standard.

The EADs are determined based on the expected payment profile that varies by product type. EAD is based on the contractual repayments owed by the borrower over a 12-month or lifetime basis for amortising products and bullet repayment loans. This will also be adjusted for any expected overpayments made by a borrower. Early repayment or refinancing assumptions are also incorporated into the calculation. For revolving products, the EAD is predicted by taking the current drawn balance and adding a "credit conversion factor" that accounts for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type, current limit utilisation and other borrower-specific behavioural characteristics.

Staging

The level of ECL that is recognised in these financial statements depends on which stage was assigned to exposure from a three stage model. A financial instrument that is not credit-impaired on initial recognition and its credit risk has not deteriorated significantly since initial recognition has a credit loss allowance based on 12-month ECLs (Stage 1). If a stage 2 since initial recognition is identified, the financial instrument is moved to Stage 2 but is not yet deemed to be credit-impaired and the loss allowance is based on lifetime ECLs. If a financial instrument is credit-impaired, the financial instrument is moved to Stage 3 and loss allowance is based on lifetime ECLs. The consequence of an asset being in Stage 3 is that the entity ceases to recognise interest income based on gross carrying value and applies the asset's nominal interest rate to the carrying amount, net of ECL, when calculating interest income.

- *Significant deterioration in credit risk (Stage 2)*

The assessment whether or not there has been a significant deterioration in credit risk (stage 2) since initial recognition is performed on whole portfolio. The criteria used to identify stage 2 are monitored and reviewed periodically for appropriateness by the Bank's Risk Management Department. The presumption, being that there have been significant deterioration in credit risk since initial recognition when financial assets are more than 30 days past due, has not been rebutted.

23 Financial Risk Management (Continued)

The Bank considers a financial instrument to have experienced a stage 2 when one or more of the following quantitative, qualitative or backstop criteria have been met:

- 31-90 days overdue
- Restructured overdue loans
- Clients with specific monitoring status
- Any other relevant management information on financial situation deterioration on the customer.

If there is evidence that the stage 2 criteria are no longer met, the instrument is transferred back to Stage 1 after quarantine, which is defined as 6 months.

If an exposure has been transferred to Stage 2 based on a qualitative indicator, the Bank monitors whether that indicator continues to apply or it is no longer valid.

Forward-looking information incorporated in the ECL models. The assessment of SICR and the calculation of ECLs both incorporate supportable forward-looking information. The Bank identified certain key economic variables that correlate with developments in credit risk and ECLs. Forecasts of economic variables (the "base economic scenario") are provided by the Bank's and provide the best estimate of the expected macro-economic development over the next three years. The impact of the relevant economic variables on the PD, EAD and LGD has been determined by performing statistical regression analysis to understand the impact that the changes in these variables historically had on the default rates and on the components of LGD and EAD.

In addition to the base economic scenario, the Bank's Risk Department also provides other possible scenarios along with scenario weightings. The number of other scenarios used is set based on the analysis of each major product type to ensure that non-linearities are captured. The number of scenarios and their attributes are reassessed at each reporting date. The scenario weightings are determined by a combination of statistical analysis and expert credit judgement, taking into account the range of possible outcomes of which each chosen scenario is representative. The assessment of SICR is performed using the Lifetime PD under each of the bases and the other scenarios, multiplied by the associated scenario weighting, along with qualitative and backstop indicators. This determines whether the whole financial instrument is in Stage 1, Stage 2, or Stage 3 and hence whether a 12-month or lifetime ECL should be recorded. Following this assessment, the Bank measures ECL as either a probability-weighted 12 month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running each scenario through the relevant ECL model and multiplying it by the appropriate scenario weighting (as opposed to weighting the inputs).

As with any economic forecast, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty, and therefore the actual outcomes may be significantly different to those projected. The Bank considers these forecasts to represent its best estimate of the possible outcomes and has analysed the non-linearities and asymmetries within the Bank's different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible scenarios.

The Bank regularly reviews its methodology and assumptions to reduce any difference between the estimates and the actual loss of credit. Such backtesting is performed at least once a year.

The results of backtesting the ECL measurement methodology are communicated to Bank Management and further steps for tuning models and assumptions are defined after discussions between authorised persons.

(Amounts expressed in thousands of Azerbaijani Manats)

23 Financial Risk Management (Continued)

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

	2020				2019			
	Azerbaijan	**OECD**	**CIS and other foreign countries**	**Total**	**Azerbaijan**	**OECD**	**CIS and other foreign countries**	**Total**
Assets								
Cash and cash equivalents	87,235	93,612	2,693	**183,540**	114,592	87,731	73	**202,396**
Amounts due from credit institutions	1,750	6,131	3,579	**11,460**	8,551	6,156	6,279	**20,986**
Loans to customers	125,683	–	–	**125,683**	160,678	–	–	**160,678**
Notes issued by CBAR and other bonds	23,096	–	–	**23,096**	36,536	–	–	**36,536**
Other financial assets	2,971	–	–	**2,971**	2,865	–	–	**2,865**
Total assets	**240,735**	**99,743**	**6,272**	**346,750**	**323,222**	**93,887**	**6,352**	**423,461**
Liabilities								
Amounts due to credit institutions	11,972	–	–	**11,972**	10,051	–	–	**10,051**
Amounts due to customers	249,563	–	–	**249,563**	330,609	–	–	**330,609**
Other financial liabilities	7,781	–	–	**7,781**	9,341	–	–	**9,341**
Total liabilities	**269,316**	**-**	**-**	**269,316**	**350,001**	**-**	**-**	**350,001**
Net assets/(liabilities)	**(28,581)**	**99,743**	**6,272**	**77,434**	**(26,779)**	**93,887**	**6,352**	**73,460**

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 developed a sophisticated system for comprehensive assessment of expected cash flows. The methodology of the liquidity management tools and reports is approved by the Supervisory Board of the Bank, prepared by the Assets and Liabilities Management department and reviewed on the monthly basis by Asset Liabilities Committee.

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. Additionally, the Bank maintains obligatory reserve with the CBAR and utilizes a highly effective cash management system across all its branches, ATMs and balances of the correspondent accounts.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on minimum liquidity ratio of 30% established by the CBAR. As at 31 December, these ratios were as follows:

	2020	**2019**
Instant Liquidity Ratio	63.33%	48.25%

The Bank closely monitors potential effects of the pandemic and lower oil price on the liquidity situation in an alert phase. The deposit rates are adjusted timely with respect to the changes in interest rates and overall Banking sector liquidity situation. Client transactions are carried out by considering possible liquidity effects, including the crediting process.

The Bank has not experienced a critical liquidity situation in 2020 due to actions taken by alert liquidity phase and expects that liquidity condition will improve further in 2021, thanks to the expected normalization of the economic and financial conditions in the country.

(Amounts expressed in thousands of Azerbaijani Manats)

23 Financial Risk Management (Continued)

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

As at 31 December 2020	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	455	1,295	6,479	13,673	21,902
Amounts due to customers	224,294	7,560	19,207	37	251,098
Other financial liabilities	2,634	1,435	2,414	1,298	7,781
Total undiscounted financial liabilities	**227,383**	**10,290**	**28,100**	**15,008**	**280,781**

As at 31 December 2019	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	1,565	925	4,115	6,332	12,937
Amounts due to customers	295,234	17,756	9,060	10,948	332,998
Other financial liabilities	3,777	1,255	2,934	1,375	9,341
Total undiscounted financial liabilities	**300,576**	**19,936**	**16,109**	**18,655**	**355,276**

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

	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
2020	4,851	8,090	68,501	35,320	116,762
2019	11,485	12,633	38,817	35,389	98,324

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

The Bank's capability to repay its liabilities relies on its ability to realize an equivalent amount of assets within the same period of time.

The Bank does not receive any significant funds from any one organization or private individual.
Included in due to customers are term deposits of individuals. In accordance with the Azerbaijan legislation, the Bank is obliged to repay such deposits upon demand of a depositor. Refer to Note 17.

(Amounts expressed in thousands of Azerbaijani Manats)

23 Financial Risk Management (Continued)

As at 31 December 2019	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	1,565	925	4,115	6,332	12,937
Amounts due to customers	295,234	17,756	9,060	10,948	332,998
Other financial liabilities	3,777	1,255	2,934	1,375	9,341
Total undiscounted financial liabilities	**300,576**	**19,936**	**16,109**	**18,655**	**355,276**

The Bank does not use the above maturity analysis based on undiscounted contractual maturities of liabilities to manage liquidity. Instead, the Bank monitors expected maturities and the resulting expected liquidity gap as follows:

	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
At 31 December 2020					
Financial assets	268,480	42,758	22,740	12,772	346,750
Financial liabilities	227,469	9,487	22,928	9,432	269,316
Net liquidity gap based on expected maturities	**41,011**	**33,271**	**(188)**	**3,340**	**77,434**
At 31 December 2019					
Financial assets	310,825	69,037	37,084	6,515	423,461
Financial liabilities	300,578	19,307	13,897	16,219	350,001
Net liquidity gap based on expected maturities	**10,247**	**49,730**	**23,187**	**(9,704)**	**73,460**

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates and foreign exchanges. The Bank does not have any significant equity, corporate fixed income or derivatives holdings.

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. As at 31 December 2020 and 2019, the Bank did not have any instruments with floating interest rates.

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 financial position and cash flows.

(Amounts expressed in thousands of Azerbaijani Manats)

23 Financial Risk Management (Continued)

The table below summarises the Bank's exposure to foreign currency exchange rate risk at the end of the reporting period:

	At 31 December 2020			At 31 December 2019		
	Monetary financial assets	Monetary financial liabilities	Net position	Monetary financial assets	Monetary financial liabilities	Net position
Azerbaijani Manats	191,261	(126,248)	65,013	223,355	(172,634)	50,721
US Dollars	110,662	(112,507)	(1,845)	162,700	(161,527)	1,173
Euros	22,805	(28,230)	(5,425)	10,334	(14,181)	(3,847)
Other	22,022	(2,331)	19,691	27,072	(1,659)	25,413
Total	**346,750**	**(269,316)**	**77,434**	**423,461**	**(350,001)**	**73,460**

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

Currency	Increase in currency rate in % 2020	Effect on profit before tax 2020	Increase in currency rate in % 2019	Effect on profit before tax 2019
USD	10.00	170	10.00	869
EUR	10.00	(38)	10.00	(44)

Currency	Decrease in currency rate in % 2020	Effect on profit before tax 2020	Decrease in currency rate in % 2019	Effect on profit before tax 2019
USD	(10.00)	(170)	(10.00)	(869)
EUR	(10.00)	38	(10.00)	44

Operational risk. Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but a control framework and monitoring and responding to potential risks could be effective tools to manage the risks. Controls should include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

(Amounts expressed in thousands of Azerbaijani Manats)

24 Fair Values of Financial Instruments

	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 for which fair values are disclosed					
Cash and cash equivalents	31 December 2020	183,540	-	-	183,540
Amounts due from credit institutions	31 December 2020	-	11,460	-	11,460
Loans to customers	31 December 2020	-	-	125,683	125,683
Notes issued by CBAR and other bonds	31 December 2020	23,036	-	60	23,096
Other financial assets	31 December 2020	-	-	2,971	2,971
Liabilities for which fair values are disclosed					
Amounts due to credit institutions	31 December 2020	-	-	11,972	11,972
Amounts due to customers	31 December 2020	-	-	249,563	249,563
Other financial liabilities	31 December 2020	-	-	7,781	7,781

	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 for which fair values are disclosed					
Cash and cash equivalents	31 December 2019	-	-	202,396	202,396
Amounts due from credit institutions	31 December 2019	-	-	20,986	20,986
Loans to customers	31 December 2019	-	-	160,678	160,678
Notes issued by CBAR and other bonds	31 December 2019	36,476	-	60	36,536
Other financial assets	31 December 2019	-	-	2,865	2,865
Liabilities for which fair values are disclosed					
Amounts due to credit institutions	31 December 2019	-	-	10,051	10,051
Amounts due to customers	31 December 2019	-	-	330,609	330,609
Other financial liabilities	31 December 2019	-	-	9,341	9,341

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

(Amounts expressed in thousands of Azerbaijani Manats)

24 Fair Values of Financial Instruments (Continued)

2020	Carrying value	Fair value	Unrecognized gain/(loss)
Financial assets			
Cash and cash equivalents	183,540	183,540	-
Amounts due from credit institutions	11,460	11,460	-
Loans to customers	125,683	120,553	-
Other financial assets	2,971	2,971	-
Financial liabilities			
Amounts due to credit institutions	11,972	11,972	-
Amounts due to customers	249,563	247,255	-
Other financial liabilities	7,781	7,781	-

2019	Carrying value	Fair value	Unrecognized gain/(loss)
Financial assets			
Cash and cash equivalents	202,396	202,396	-
Amounts due from credit institutions	20,986	20,986	-
Loans to customers	204,171	204,171	-
Other financial assets	2,865	2,865	-
Financial liabilities			
Amounts due to credit institutions	10,051	10,051	-
Amounts due to customers	330,609	330,609	-
Other financial liabilities	9,341	9,341	-

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

Financial assets and financial liabilities carried at amortized cost. Fair value of the quoted notes is based on price quotations at the reporting date. The fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to credit institutions 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.

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.

YKB and KFS directly and indirectly control and have significant influence over a significant number of entities. The Bank enters into banking transactions with these entities including but not limited to lending, deposit taking, cash.

(Amounts expressed in thousands of Azerbaijani Manats)

25 Related Party Disclosures

The outstanding balances of related party transactions are as follows:

	2020		2019	
	Parent	Entities under common control	Parent	Entities under common control
Loans outstanding at 1 January, gross	–	–	-	1,466
Loans issued during the year	–	–	–	–
Loan repayments during the year	–	–	–	(1,464)
Other movements	–	–	–	(2)
Loans outstanding at 31 December, gross	-	-	-	-
Less: allowance for impairment at 31 December	–	-	–	-
Loans outstanding at 31 December, net	-	-	-	-
Deposits outstanding at 1 January, gross	1,360	–	1,677	5,943
Deposits placed during the year	1,138	–	1,620	–
Deposit repayments during the year	(2,498)	–	(3,297)	(5,780)
Other movements	2,289	3	1,294	(163)
Translation gain/loss	(1)	–	66	–
Deposits outstanding at 31 December, gross	2,288	3	1,360	-
Less: allowance for impairment at 31 December	(37)	–	(18)	–
Deposits outstanding at 31 December, net	2,251	3	1,342	-
Current accounts at 31 December	2,288	3	1,360	186

Total current accounts with the parent as at 31 December2020 is AZN 2,288 (2019: AZN 1,360). During the year AZN 1,138 (2019: AZN 1,620) of deposit placed with parent carrying 0.25% interest rate (2019: 0.37%) and no deposit was placed (2019: nil) with entities under common control (2019: nil%).

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

	2020		2019	
	Parent	Entities under common control	Parent	Entities under common control
Interest income	-	-	10	152
Interest expense	-	(39)	-	(31)
Fee and commission income	-	22	-	23
Fee and commission expense	(99)	(1)	(109)	(14)
General and administrative expenses	(213)	(477)	(225)	(373)

Compensation of key management personnel of 4 members (2019: 5 members) comprised the following:

	2020	2019
Salaries and short term benefits	1,195	1,413
Other accrued employee costs	76	110
Total key management personnel compensation	1,271	1,523

(Amounts expressed in thousands of Azerbaijani Manats)

26 Capital Adequacy

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

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

The Regulatory requires each bank or banking group to: (a) hold the minimum level of total capital of AZN 50,000 (2019: AZN 50,000); (b) maintain a ratio of total regulatory capital to the risk-weighted assets (the "total capital ratio") at or above the prescribed minimum of 10% (2019: 10%) and (c) maintain a ratio of tier 1 capital to the risk-weighted assets (the "Tier 1 capital ratio") at or above the prescribed minimum of 5% (2019: 5%).

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2020.

As at 31 December 2020, the Bank's capital adequacy ratio based on the Regulatory requirements was as follows:

	2020	2019
Tier 1 capital	78,969	74,992
Tier 2 capital	2,955	6,269
Less: deductions from capital	(8,152)	(8,475)
Total regulatory capital	**73,772**	**72,786**
Risk-weighted assets	167,521	220,850
Tier 1 capital adequacy ratio	42.31%	30.15%
Total capital adequacy ratio	44.04%	32.96%

27 Events after the End of the Reporting Period

COVID-19 developments. The strict special quarantine regime measures introduced by the Azerbaijani Government to combat the COVID-19 outbreak, such as travel restrictions, quarantines, closure of business and other venues, lockdowns of certain areas throughout the country ceased in January 2021. Based on the order of Cabinet of Ministers on "Vaccination Strategy covering 2021-2022 years" dated 16 January 2021, gradual vaccination of Azerbaijan population has started.

Capital adequacy ratios were maintained at a level higher than regulatory minimums as of the date of issuance of these financial statements. Sensitivity analysis show that existing capital buffers give a confidence to absorb the risks that could appear from further evolution of COVID results.

Legislative changes. According to the newly introduced article 2.1.2.7 to law on deposit insurance starting from 2021 the funds of sole entrepreneurs in the amount of up to AZN 20 000 held at banks are also to be insured by banks, increasing thereby the basis for quarterly fee payable by banks to Azerbaijan Deposit Insurance Fund (ADIF) for deposit insurance. Also, starting from 2021, according to the enclosed letter from ADIF the quarterly fee is raised by 0.05% of the volume of insured deposits per quarter (or 0.2% annually).

Because of COVID-19 pandemic CBAR introduced waiver package and allowed the banks to keep provision categories of the loans for regulatory purpose, which were restructured because of pandemic effects, equal to 1 March 2020 levels. This waiver was lifted on 1 April 2021 and banks will update their provision categories according to current rules considering their repayment behaviours.