OJSC International Bank of Azerbaijan

Consolidated Financial Statements

For the year ended 31 December 2020
together with an independent auditor's report

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Ernst & Young Holdings (CIS) B.V.
Port Baku Towers Business Centre
South Tower, 9th floor,
153, Neftchilar Ave.
Baku, AZ1010, Azerbaijan
Tel: +994 (12) 490 70 20
Fax: +994 (12) 490 70 17
www.ey.com/az

Ernst & Yanq Holdinqs (SiAyEs) Bi.Vi.
Port Baku Tauers Biznes Mərkəzi
Cənub Qülləsi, 9-cu mərtəbə
Neftçilər prospekti, 153
Bakı, AZ1010, Azərbaycan
Tel: +994 (12) 490 70 20
Faks: +994 (12) 490 70 17

Independent auditor's report

To the Shareholders and Supervisory Board of
OJSC International Bank of Azerbaijan

Report on the audit of the consolidated financial statements

Opinion

We have audited the consolidated financial statements of OJSC International Bank of Azerbaijan and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2020, and the consolidated statement of profit or loss and other comprehensive income, statement of changes in equity and of cash flows for the year ended 31 December 2020, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2020 and its consolidated financial performance and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs").

Basis for opinion

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

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

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We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Key audit matter	How our audit addressed the key audit matter
Allowance for loans to customers and provision for credit related commitments	
Given the significance of the allowance for loans to customers and provision for credit related commitments to the Group's financial position, the complexity and judgments related to the estimation of expected credit losses ("ECL") under IFRS 9 *Financial Instruments* ("IFRS 9"), we considered this area as a key audit matter. The Group exercises significant judgement and applies estimation techniques to determine probability of default, projected exposure at default and loss arising at default, considering observed historical data, current economic situation and available forward-looking information. The calculation of ECL for financial assets on an individual basis requires scenario analysis of the estimated future cash flows considering current and projected financial performance of the borrowers and value of collateral. Information on the allowance for expected credit losses on loans to customers and provision for credit related commitments is included in Note 5 - *Significant accounting judgements and estimates*, Note 10 - *Loans to customers*, Note 19 - *Commitments and contingencies*, and Note 23 - *Risk management* to the consolidated financial statements.	Our audit procedures, among others, comprised the following: ▸ We evaluated expected credit loss methodology developed by the Group in accordance with the requirements of IFRS 9 to calculate allowance for impairment of loans to customers and provision for credit related commitments; ▸ We considered the appropriateness of the Group's definition of default and criteria for significant increase in credit risk with the consideration of COVID-19 pandemic and consistency of their application in accordance with methodology; ▸ We evaluated underlying statistical models, key inputs and assumptions used and assessed incorporation of forward-looking information, including the impact of COVID-19 pandemic in the calculation of ECL on a collective basis; ▸ We analysed the expected cash flow projections on individually significant loans, including those arising from potential sale of collateral. We considered reports of the Group's internal and external appraisers and available market information on the fair value of collateral; ▸ We evaluated information disclosed in the notes to the consolidated financial statements in regard to allowance for impairment of loans to customers and provision for credit related commitments.

Other information included in the Group's 2020 Annual Report

Other information consists of the information included in The Group's 2020 Annual Report other than the consolidated financial statements and our auditor's report thereon. Management is responsible for the other information. The Group's 2020 Annual Report is expected to be made available to us after the date of this auditor's report.

Our opinion on the consolidated financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

Responsibilities of management and the Audit committee for the consolidated financial statements

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

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

The Audit committee is responsible for overseeing the Group's financial reporting process.

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

Our objectives are to obtain reasonable assurance about whether the consolidated 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 consolidated financial statements.

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

- Identify and assess the risks of material misstatement of the consolidated 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 Group'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 Group'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 consolidated 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 Group to cease to continue as a going concern;
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation;
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

We also provide the Audit committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Audit committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The partner in charge of the audit resulting in this independent auditor's report is Turgay Teymurov.

Ernst & Young Holdings (CIS) B.V.

Baku, Azerbaijan

16 April 2021

Consolidated statement of financial position

As at 31 December 2020

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2020	2019
Assets			
Cash and cash equivalents	7	2,504,501	2,789,673
Mandatory cash balances with the central banks		55,058	60,059
Due from banks and other financial institutions	8	2,505,784	3,179,615
Investment securities	9	881,620	207,661
Loans to customers	10	2,397,018	2,165,804
Receivables from CJSC Agrarkredit	2	576,729	693,281
Current income tax assets		–	4,387
Deferred income tax assets	17	709	1,029
Property, equipment and intangible assets	11	200,766	192,993
Other assets	12	82,597	47,243
Total assets		**9,204,782**	**9,341,745**
Liabilities			
Due to banks and other financial institutions	13	56,917	31,979
Customer accounts	14	5,460,956	5,606,673
Payables to CJSC Agrarkredit	2	88,217	89,055
Other borrowed funds	15	220,207	104,504
Debt securities issued	16	1,490,500	1,526,354
Current income tax liabilities		–	74,748
Deferred income tax liabilities	17	89,464	83,498
Other liabilities	12	101,628	141,206
Total liabilities		**7,507,889**	**7,658,017**
Equity			
Share capital	18	1,241,287	1,241,287
Additional paid-in capital		1,847,437	1,847,437
Foreign currency translation reserve		(38,545)	6,368
Revaluation reserve for premises		39,926	38,760
Unrealized gain on investment securities		86,524	58,568
Accumulated deficit		(1,479,736)	(1,508,692)
Total equity		**1,696,893**	**1,683,728**
Total liabilities and equity		**9,204,782**	**9,341,745**

Signed and authorised for release on behalf of the Management Board:

Mr. Abbas Ibrahimov
Chairman of the Management Board

Mr. Nabi Aliyev
Deputy Chairman of the Management Board, CFO

Baku, Azerbaijan

16 April 2021

The accompanying notes on pages 6 to 57 are an integral part of these consolidated financial statements.

Consolidated statement of profit or loss and other comprehensive income

For the year ended 31 December 2020

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2020*	*2019*
Interest income calculated using the effective interest rate			
Loans to customers		291,025	234,885
Due from banks and other financial institutions		93,092	152,673
Receivables from CJSC Agrarkredit		27,601	47,478
Cash and cash equivalents		13,092	35,941
Investment securities		18,056	3,431
		442,866	**474,408**
Interest expense			
Debt securities issued		(96,446)	(95,891)
Customer accounts		(37,576)	(35,945)
Other borrowed funds		(4,765)	(2,990)
Due to banks and other financial institutions		(1,959)	(685)
Lease liabilities		(582)	(377)
		(141,328)	**(135,888)**
Net interest income		**301,538**	**338,520**
Credit loss expense	20	(20,186)	(37,765)
Net interest income after impairment losses for interest bearing assets		**281,352**	**300,755**
Fee and commission income	21	82,148	90,163
Fee and commission expense	21	(21,274)	(24,572)
Net loss arising on initial recognition of financial instruments and loan modification		(16,349)	(23,016)
Net gains from operations in foreign currencies:			
- Dealing		47,346	68,248
- translation differences		19,849	(17,957)
Impairment of property, equipment and intangible assets	11	(1,620)	(4,482)
Reversal of provision for credit losses on credit-related commitments and other financial assets	20	23,394	14,059
Other impairment (charge)/reversal	20	(2,651)	17,707
Loss on repurchase of debt		(2,564)	–
Operating expenses	22	(177,259)	(143,619)
Other operating income		10,528	7,031
Non-interest loss		**(38,452)**	**(16,438)**
Profit before income tax expense		**242,900**	**284,317**
Income tax expense	17	(63,944)	(68,609)
Net profit for the year		**178,956**	**215,708**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Unrealized gains on debt securities at FVOCI		22,704	2,707
Reclassification of currency translation reserve to income statement on liquidation of subsidiary		(6,193)	–
Exchange differences on translating foreign operations		(38,720)	19,214
Income tax relating to components of other comprehensive income to be reclassified to profit or loss in subsequent periods		(4,541)	(542)
Net other comprehensive (loss)/gain to be reclassified to profit or loss in subsequent periods		**(26,750)**	**21,379**
Other comprehensive income not to be reclassified to profit or loss in subsequent periods			
Unrealised gains on equity securities		12,241	22,479
Change in revaluation reserve for premises	11	1,458	2,353
Income tax relating to components of other comprehensive income not to be reclassified to profit or loss in subsequent periods		(2,740)	(4,966)
Net other comprehensive gain not to be reclassified to profit or loss in subsequent periods		**10,959**	**19,866**
Total comprehensive income for the year		**163,165**	**256,953**
Earnings per share, basic and diluted (AZN per share)	18	0.04	0.05

The accompanying notes on pages 6 to 57 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2020

(Figures in tables are in thousands of Azerbaijani manats)

	Share capital	*Additional paid-in capital*	*Foreign currency translation reserve*	*Revaluation reserve for premises and investment*	*Unrealised gain on investment securities*	*Accumulated deficit*	*Total equity*
As at 1 January 2019	**1,241,287**	**1,909,116**	**(12,846)**	**36,878**	**38,419**	**(1,569,665)**	**1,643,189**
Net profit for the year	–	–	–	–	–	215,708	**215,708**
Other comprehensive income for the year	–	–	19,214	1,882	20,149	–	**41,245**
Total comprehensive income for the year	**–**	**–**	**19,214**	**1,882**	**20,149**	**215,708**	**256,953**
Additional paid-in capital	–	6,609	–	–	–	–	**6,609**
Distribution from additional paid-in capital (Note 18)	–	(68,288)	–	–	–	–	**(68,288)**
Dividends declared to shareholders	–	–	–	–	–	(150,000)	**(150,000)**
Other distributions to shareholders	–	–	–	–	–	(4,735)	**(4,735)**
As at 31 December 2019	**1,241,287**	**1,847,437**	**6,368**	**38,760**	**58,568**	**(1,508,692)**	**1,683,728**
Net profit for the year	–	–	–	–	–	178,956	**178,956**
Other comprehensive income/(loss) for the year	–	–	(44,913)	1,166	27,956	–	**(15,791)**
Total comprehensive income for the year	**–**	**–**	**(44,913)**	**1,166**	**27,956**	**178,956**	**163,165**
Dividends declared to shareholders (Note 18)	–	–	–	–	–	(150,000)	**(150,000)**
As at 31 December 2020	**1,241,287**	**1,847,437**	**(38,545)**	**39,926**	**86,524**	**(1,479,736)**	**1,696,893**

The accompanying notes on pages 6 to 57 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2020

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2020*	*2019*
Cash flows from operating activities			
Interest received		372,052	461,306
Interest paid		(104,211)	(101,267)
Fees and commissions received		80,345	92,444
Fees and commissions paid		(21,981)	(24,625)
Gains from operations in foreign currencies		47,346	68,248
Staff costs paid		(80,263)	(67,140)
Other operating expenses paid		(59,841)	(52,016)
Other operating income received		4,334	2,942
Cash flows from operating activities before changes in operating assets and liabilities		**237,781**	**379,892**
Net (increase)/decrease in operating assets			
Mandatory cash balances with central banks		5,002	(5,358)
Due from banks and other financial institutions		676,437	39,777
Loans to customers		(231,917)	(536,023)
Other assets		(35,126)	(7,230)
Net (decrease)/increase in operating liabilities			
Due to banks and other financial institutions		24,630	(13,168)
Customer accounts		(144,524)	1,244,546
Other liabilities		757	(1,888)
Net cash flows from operating activities before income tax		**533,040**	**1,100,548**
Income tax paid		(135,982)	(4,580)
Net cash from operating activities		**397,058**	**1,095,968**
Cash flows (used in) / from investing activities			
Purchase of investment securities		(537,571)	(101,008)
Proceeds from redemption of investment securities		147,905	11,560
Purchase of and prepayments for property, equipment and intangible assets		(37,202)	(17,924)
Proceeds from sale of property, equipment and intangible assets		–	52
Net cash used in investing activities		**(426,868)**	**(107,320)**
Cash flows (used in) / from financing activities			
Repayments of other borrowed funds		(46,271)	(31,481)
Proceeds from other borrowed funds		161,217	28,848
Repayments on debt securities issued		(346,519)	(992)
Acquisition of non-controlling interests		–	–
Dividend payment (Note 18)		(5,047)	(7,086)
Net cash used in financing activities		**(236,620)**	**(10,711)**
Effect of exchange rate changes on cash and cash equivalents		(18,742)	1,563
Effect of change in credit loss allowance		–	–
Net increase/(decrease) in cash and cash equivalents		**(285,172)**	**979,500**
Cash and cash equivalents, beginning of year	7	2,789,673	1,810,173
Cash and cash equivalents, end of year	7	**2,504,501**	**2,789,673**

The accompanying notes on pages 6 to 57 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows (continued)

(Figures in tables are in thousands of Azerbaijani manats)

Changes in liabilities arising from financing activities comprise:

	Debt securities issued	*Other borrowed funds*	*Total*
Carrying amount at 31 December 2018	**1,490,698**	**106,630**	**1,597,328**
Cash proceeds	–	28,848	**28,848**
Redemption	(992)	(31,481)	**(32,473)**
Other changes	36,648	507	**37,155**
Carrying amount at 31 December 2019	**1,526,354**	**104,504**	**1,630,858**
Non-cash transactions on finalisation of Restructuring Plan (Note 2)	271,360	–	**271,360**
Cash proceeds	–	161,217	**161,217**
Redemption	(346,519)	(46,271)	**(392,790)**
Other changes	39,305	757	**40,062**
Carrying amount at 31 December 2020	**1,490,500**	**220,207**	**1,710,707**

The “Other changes” line includes the effect of accrued but not yet paid interest on debt securities issued and other borrowed funds. The Group classifies interest paid (including those accrued in prior periods) as cash flows from operating activities.

Non-cash transactions arising from the finalisation of restructuring of assets is disclosed in Note 2.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

The International Bank of Azerbaijan ("the Bank") was incorporated in 1991 as a fully state-owned bank and is domiciled in the Republic of Azerbaijan.

The activities of the Bank are regulated by the Central Bank of the Republic of Azerbaijan ("CBAR"). The Bank conducts its business under a general full banking license issued on 30 December 1992. The Bank's primary business consists of commercial activities, trading with securities, foreign currencies and derivative instruments, originating loans and guarantees.

The registered office of the Bank is located at 67, Nizami Street, AZ1005, Baku, the Republic of Azerbaijan.

As at 31 December 2020 and 2019 the Bank had 36 branches operating in the Republic of Azerbaijan.

The accompanying consolidated financial statements comprise the accounts of the Bank and its subsidiaries (hereinafter, the "Group"). The consolidated financial statements include the following subsidiaries:

Name	*Country of operation*	*Proportion of ownership interest (%) 2020*	*2019*	*Type of operation*
The International Bank of Azerbaijan OJSC	The Republic of Azerbaijan	Parent		Banking
Subsidiaries				
IBA-Moscow LLC	Russian Federation	100.0	100.0	Banking
IBA GEO JSC	The Republic of Georgia	100.0	100.0	None
Azericard LLC	The Republic of Azerbaijan	100.0	100.0	Plastic cards processing center
International Leasing Company LLC	The Republic of Azerbaijan	100.0	100.0	Leasing
IBA-Invest Investment Company CJSC	The Republic of Azerbaijan	100.0	100.0	Investment

As at 31 December 2020 and 2019 shareholders of the Group were as follows:

Shareholders	*2020 (%)*	*2019 (%)*
Ministry of Finance of the Republic of Azerbaijan	91.40	91.40
State Committee on Property Issues of the Republic of Azerbaijan	3.76	3.76
CJSC Agrarkredit	0.13	0.13
Other*****	4.71	4.71
Total	**100.00**	**100.00**

(*) Other shareholders included minority shareholders holding an interest less than 2% each.

2. Restructuring of the Group's operations

Restructuring of problematic assets

In the turbulent economic conditions due to a continued decline in the quality of the Group's assets, an increase in problematic loans and a decline in the liquidity position of the Group, the Government of Azerbaijan took a number of steps during 2015-2016 to strengthen the Group's capital position and the quality of its assets. Following an in-depth review of the asset quality and liquidity position of the Group by the CBAR and the Ministry of Finance of the Republic of Azerbaijan (MoF), President of the Azerbaijan Republic signed a decree on 15 July 2015 providing measures to improve the health of the Group's assets. On 28 July 2015, the MoF, the Central Bank of Azerbaijan and the Group confirmed the list of problematic assets, which were included in the Group's Restructuring Plan. The problematic assets include bad or overdue loans to customers and banks, as well as certain guarantees and other off-balance sheet commitments. According to the President's decree and other documents signed between the parties involved, certain problematic assets of the Group were transferred to government owned company − Agrarkredit in several tranches during 2015-2017.

The first part of the problematic assets transfer program was successfully completed in 2016. The assets transferred as part of the program amounted to AZN 9,930,957 thousand representing the gross carrying value of the assets at the date of transfer (before provisions).

(Figures in tables are in thousands of Azerbaijani manats)

2. Restructuring of the Group's operations (continued)

Restructuring of problematic assets (continued)

During 2016, the MoF, CBAR, FMSA and the Group further worked together to identify the remaining problematic assets to be transferred to CJSC Agrarkredit as the final part of the program. On 10 February 2017, the list of such problematic assets was approved by the parties involved and the Cabinet of Ministers of the Republic of Azerbaijan. These assets amounted to AZN 4,013,909 thousand. The transfer was agreed to be made at full gross value of the respective transactions as at 1 January 2017, including all on and off-balance sheet exposures. In April 2017 the Group and CJSC Agrarkredit signed an agreement and initiated the transfer of the problematic assets. During the year 2017, the Group received promissory notes in the total amount of USD 2,900,000 thousand with a 4% coupon rate payable at maturity in exchange for the problematic assets transferred. The promissory notes in the amount of USD 2,248,000 thousand were then transferred to the State along with debt obligations of the Group under the restructuring program. The promissory notes are guaranteed by the MoF.

The value of promissory notes received from CJSC Agrarkredit in 2017 exceeded the value of corresponding problematic assets transferred by AZN 515,767 thousand, for which the payables to CJSC Agrarkredit were recognised in the consolidated statement of financial position as at 31 December 2017. Due to further transfers of problematic assets and off-balance sheet commitments the payable amount decreased in 2018 and as at 31 December 2018 amounted to AZN 364,596 thousand.

During 2019, the remaining part of problematic loans in a net amount of AZN 37,443 thousand, which were planned to be transferred to CJSC Agrarkredit, was written-off by the Group. As a result of cancellation of the transfer by shareholders, AZN 68,288 thousand were recognised as a distribution to shareholders.

On 22 November 2019, the Group signed a trilateral agreement with MoF and CJSC Agrarkredit, to offset dividends payable to MoF in the amount of AZN 157,652 thousand and CJSC Agrarkredit in the amount of AZN 179 thousand and payables to CJSC Agrarkredit in the amount of AZN 334,682 with the promissory notes received from CJSC Agrarkredit in the amount of AZN 492,334 thousand.

During 2020, in accordance with the trilateral agreement signed on 22 November 2019, the Group offset dividends payable to MoF in the amount of AZN 142,729 thousand and CJSC Agrarkredit in the amount of AZN 179 thousand resulting from the dividend declaration on 15 September 2020 with promissory notes received from CJSC Agrarkredit in the amount of AZN 142,908 thousand. On 14 February 2020, the Group recognised a modification loss in the amount of AZN 4,127 thousand arising from the prolongation of maturity of the promissory notes untill 14 February 2025.

As a result, as at 31 December 2020 Receivable from CJSC Agrarkredit and payables to CJSC Agrarkredit amounted to AZN 576,729 thousand and AZN 88,217 thousand, respectively. As at 31 December 2020, the ECL relating to receivables from CJSC Agrarkredit of the Group is AZN 3,195 thousand (31 December 2019: AZN 9,111 thousand).

Restructuring of liabilities

Due to financial difficulties, on 11 May 2017 the Group defaulted on certain of its liabilities and announced their restructuring.

In September 2017 the Group completed the restructuring of its liabilities under the terms set out in the approved Restructuring Plan. The Group was not able to obtain "permanent moratorium" under the Cross-Border Insolvency Regulations in support of a voluntary restructuring of the Group in the Republic of Azerbaijan due to objection made by several creditors.

Finalisation of the Group's Liability Restructuring Plan

In 2020, the Group agreed on a settlement with the creditors who had objected to the Group's Restructuring Plan. According to the settlement agreement, the Group distributed USD 159,623 thousand (AZN 271,360 thousand) to the creditors and was entitled to bonds with the fair value of USD 144,633 thousand (AZN 245,876 thousand) issued by MoF with a coupon rate of 5.125% and maturity of 1 September 2029 as per the voluntary Restructuring Plan. Following the third anniversary of the Restructuring Plan and with the settlement made, the restructuring process was completed.

A significant portion of the problematic assets transferred as part of the first stage of the program were denominated in foreign currencies. As the payments made by CJSC Agrarkredit to the Group in exchange for the problematic assets included in the first stage of the program were denominated in AZN, this created significant exposure for the Group to foreign currency risk. As at 31 December 2020, the Group's foreign currency short position was approximately AZN 611,580 thousand (as at 31 December 2019: AZN 897,099 thousand).

(Figures in tables are in thousands of Azerbaijani manats)

2. Restructuring of the Group's operations (continued)

Restructuring of liabilities (continued)

During 2020, Moody's confirmed the Bank's ratings as follows: Baseline Credit Assessment at b3, Adjusted baseline credit assessment at b3, Long term bank deposit at B1, Long-Term Counterparty Risk Rating Ba3. Fitch confirmed the Bank's ratings in the following way: Long Term Issuer Default Rating at B-, Short Term Issuer Default Rating at B, Viability rating at b-. Both Moody's and Fitch's outlooks for the Bank's rating were stable.

The Group's stable external ratings reflects improved profitability and reduced pressure from a large short foreign currency position. It is also supported by the Group's currently low-risk asset structure and liquidity position.

To ensure future operational profitability and maintain financial stability, the Group's management and shareholders intend to develop the Group's business both in the corporate and retail segments and have developed a plan that includes, but is not limited to, the following steps:

- Improve cost effectiveness of the existing operations;
- Abandon investments with low returns;
- Hedge or close the final short open currency position;
- Attract funding in the functional currency;
- Continue the implementation of the development strategy for 2020-2022; and
- Prepare for privatization of the Group in future.

Management believes that the above-mentioned measures and continued financial support of the controlling shareholder will ensure that the Group will continue as a going concern and, accordingly, these consolidated financial statements have been prepared on the assumption that the Group will continue in operation for the foreseeable future.

3. Basis of preparation

General

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

The Azerbaijani manat is the presentation currency of the Group and the functional currency of OJSC International Bank of Azerbaijan as the majority of the transactions are denominated, measured, or funded in Azerbaijani manat. Transactions in other currencies are treated as transactions in foreign currencies. The Group is required to maintain its records and prepare its financial statements in Azerbaijani manat and in accordance with IFRS. These consolidated financial statements are presented in thousands of Azerbaijani manat ("AZN"), except when otherwise indicated. The consolidated financial statements have been prepared under the historical cost convention except for premises and debt and equity instruments at fair value through other comprehensive income (FVOCI).

Effect of the COVID-19 pandemic

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

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

The Group continues to assess the effect of the pandemic and changing economic conditions on its activities, financial position and financial results.

Estimation uncertainty

To the extent that information is available as at 31 December 2020, the Group has reflected revised estimates of expected future cash flows in its ECL assessment (Note 10) and the estimation of fair values of financial instruments (Note 24).

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies

Changes in accounting policies

The Group has early adopted Amendment to IFRS 16: Covid-19-Related Rent Concessions, which provides lessees with an exemption from assessing whether a COVID-19-related rent concession is a lease modification. The amendment did not have impact on the consolidated financial statements of the Group. No other standard, interpretation or amendment that has been issued but is not yet effective was early adopted by the Group.

Several other amendments effective since 1 January 2020 were applied but do not have an impact on the consolidated financial statements of the Group.

Basis of consolidation

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

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

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

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

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

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

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

Fair value measurement

The Group measures financial instruments carried at FVOCI and non-financial assets such as premises, at fair value at each reporting date.

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Fair value measurement (continued)

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

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

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

Financial assets and liabilities

Initial recognition

Date of recognition

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

Initial measurement

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

Measurement categories of financial assets and liabilities

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

- Amortised cost;
- FVOCI; or
- FVPL.

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

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

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

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

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

The details of these conditions are outlined below.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Financial assets and liabilities (continued)

Business model assessment

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

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

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

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

The SPPI test

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

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

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

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

Debt instruments at FVOCI

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Financial assets and liabilities (continued)

Equity instruments at FVOCI

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

Dividends are recognised in profit or loss as other income when the right of the payment has been established, except when the Group benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment. Upon disposal of these instruments, the accumulated revaluation reserve is transferred directly to retained earnings.

Financial guarantees, letters of credit and undrawn loan commitments

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

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

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

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

Performance guarantees

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Performance guarantees do not transfer credit risk. The risk under performance guarantee contracts is the possibility that the failure to perform the contractual obligation by another party occurs. Therefore, performance guarantees are not considered financial instruments and thus do not fall within the scope of IFRS 9.

Reclassification of financial assets and liabilities

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

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, current accounts with the CBAR and Central Bank of Russia ("CBR"), excluding obligatory reserves, and amounts due from banks and other financial institutions due on demand or within 90 days from the date of origination and that are free from contractual encumbrances.

Borrowings

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

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Leases

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

Right-of-use assets

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

Lease liabilities

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

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

Short-term leases and leases of low-value assets

The Group applies the short-term lease recognition exemption to its short-term leases (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value (i.e., below USD 10,000). Lease payments on short-term leases and leases of low-value assets are recognised as expenses on a straight-line basis over the lease term.

Offsetting of financial instruments

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

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

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

Renegotiated loans

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Renegotiated loans (continued)

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

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

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

For modifications not resulting in derecognition, the Group also reassesses whether there has been a significant increase in credit risk or whether the assets should be classified as credit-impaired. Once an asset has been classified as credit-impaired as a result of modification, it will remain in Stage 3 for a minimum 6-month probation period. In order for the restructured loan to be reclassified out of Stage 3, regular payments of more than an insignificant amount of principal or interest must have been made during at least half of the probation period in accordance with the modified payment schedule.

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Write-off

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

Financial liabilities

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

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Taxation

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

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

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

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.

Deferred taxes are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case the deferred taxes are recognised in other comprehensive income or directly in equity, respectively.

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

Office premises of the Group are recorded at a revalued amount subject to revaluation to market value on a regular basis. The frequency of revaluation depends upon the movements in the fair values of the premises being revalued. Increases in the carrying amount arising on revaluation are credited to other comprehensive income unless the increase reverses a revaluation decrease of the same asset previously recognised in profit or loss, in which case the revaluation gain is recognised in profit or loss to the extent of the amount of the reversal. Decreases that offset previous increases of the same asset are recognised in other comprehensive income and decrease the previously recognised revaluation reserve in equity; all other decreases are charged to profit or loss for the year. The revaluation reserve for office premises included in equity is reclassified directly to retained earnings on the retirement or disposal of the asset.

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

Depreciation of an asset begins when it is available for use. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Office premises	3-50
Furniture, fixtures, vehicles and other fixed assets	4
Computer and communication equipment	4
Leasehold improvements	10

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

A property, equipment or intangible asset that is no longer used by the Group is written-off from the accounting records.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Repossessed collateral

İn certain circumstances, collateral is repossessed following the foreclosure on loans that are in default. Repossessed collateral is measured at the lower of the carrying amount and net realisable value and reported within "Other assets".

Intangible assets

Intangible assets include banking licenses, software and other licenses, as well as computer software.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is the fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation 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 amortised over the useful economic lives of 1-10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

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

Provisions

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

Retirement and other employee benefit obligations

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

Share capital

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 recognised as additional paid-in capital.

Dividends

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

Segment reporting

The Group's segmental reporting is based on the following operating segments: Retail banking, Corporate banking and Treasury.

Contingencies

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Recognition of income and expenses

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

Interest and similar revenue and expense

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

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

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

Fee and commission income

The Group earns fee and commission income from a diverse range of services it provides to its customers. Fee and commission income include fee and commission received on plastic cards operations, settlement transactions, servicing of contingent liabilities and cash transactions which are recognised as revenue as the services are provided. Fee and commission expense consist of fee and commission paid on plastic card operations, settlement transactions and cash transactions.

Fee and commission income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate and recorded in ‘interest income’.

Foreign currency translation

The consolidated financial statements are presented in AZN, which is the Bank’s functional currency and the presentation currency of the Group. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in current year profit as gains less losses from foreign currencies − translation differences.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

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

As at the reporting date, the assets and liabilities of the Bank’s subsidiaries whose functional currency is different from the presentation currency of the Bank are translated into AZN at the rate of exchange ruling at the reporting date and, their statements of profit or loss and other comprehensive income are translated at the average exchange rates for the year. The exchange rate differences arising on the translation are recognised in other comprehensive income.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Foreign currency translation (continued)

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

	2020	***2019***
1 US dollar	AZN 1.7000	AZN 1.7000
1 Euro	AZN 2.0890	AZN 1.9035
1 Georgian lari	AZN 0.5193	AZN 0.5936
1 Russian rouble	AZN 0.0231	AZN 0.0274

Standards and interpretations issued but not yet effective

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

IFRS 17 Insurance Contracts

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

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

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

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

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

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

The Group continues to assess the impact of these amendments on the consolidated financial statements.

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

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

The amendment is effective for annual reporting periods beginning on or after 1 January 2022 with earlier adoption permitted. The Group will apply the amendments to consolidated financial liabilities that are modified or exchanged on or after the beginning of the annual period in which it will first apply the amendment and does not expect this to result in a material impact on its consolidated financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

Interest Rate Benchmark Reform − Phase 2 Amendments to IFRS 9, IAS 39 IFRS 7, IFRS 4 and IFRS 16

In August 2020 the IASB issued *Interest Rate Benchmark Reform − Phase 2* Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 (IBOR reform Phase 2), to address the accounting issues which arise upon the replacement of an IBOR with a risk-free-rate (RFR).

IBOR reform Phase 2 includes a number of reliefs and additional disclosures. The reliefs apply upon the transition of a financial instrument from an IBOR to a RFR.

Changes to the basis for determining contractual cash flows as a result of interest rate benchmark reform are required as a practical expedient to be treated as changes to a floating interest rate, provided that, for the financial instrument, the transition from the IBOR benchmark rate to RFR takes place on an economically equivalent basis.

The Group will apply IBOR reform Phase 2 from 1 January 2021, however does not expect that amendment will have a material impact on its consolidated financial statements.

5. Significant accounting judgments and estimates

In the process of applying the Group's accounting policies, management has made the following judgements and made estimates which have affected the amounts recognised in the consolidated financial statements:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values (Note 23).

Impairment losses on financial assets

The measurement of impairment losses both under IFRS 9 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. In addition, large-scale business disruptions may give rise to liquidity issues for some entities and consumers. Deterioration in credit quality of loan portfolios (amongst other items) as a result of the COVID-19 pandemic may have a significant impact on the Group's ECL measurement. The Group's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

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

More details are provided in Notes 10 and 23.

(Figures in tables are in thousands of Azerbaijani manats)

6. Segment reporting

The Group discloses information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. This matter is regulated by IFRS 8 *Operating Segments* and other standards that require special disclosures in the form of segmental reporting.

Information reported to the chief operating decision maker for the purposes of resource allocation and assessment of segment performance focuses on types of services delivered or provided. The Group's reportable segments under IFRS 8 are therefore as follows:

- Corporate banking − direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, foreign currency and derivative products;
- Retail banking − private banking services, private customer current accounts, savings, deposits, investment savings products, custody, credit and debit cards, consumer loans and mortgages;
- Treasury − interbank lending and borrowings, securities trading swaps, foreign exchange services, issuance of bonds and promissory notes and other treasury functions.

(Figures in tables are in thousands of Azerbaijani manats)

6. Segment reporting (continued)

	Corporate		*Retail*		*Treasury*		*Unallocated*		*Total*	
	2020	***2019***	***2020***	***2019***	***2020***	***2019***	***2020***	***2019***	***2020***	***2019***
Interest income	113,895	81,276	177,130	153,609	151,841	239,523	–	–	**442,866**	**474,408**
Interest expense	(11,400)	(8,707)	(30,646)	(29,750)	(99,282)	(97,054)	–	(377)	**(141,328)**	**(135,888)**
Net interest income	**102,495**	**72,569**	**146,484**	**123,859**	**52,559**	**142,469**	**–**	**(377)**	**301,538**	**338,520**
Reversal of impairment losses / (impairment losses) for interest bearing assets	10,889	(16,615)	(41,746)	(10,696)	10,671	(10,454)	–	–	**(20,186)**	**(37,765)**
Net interest income after provision for impairment losses	**113,384**	**55,954**	**104,738**	**113,163**	**63,230**	**132,015**	**–**	**(377)**	**281,352**	**300,755**
Fee and commission income	49,319	75,576	20,441	14,049	12,388	538	–	–	**82,148**	**90,163**
Fee and commission expense	(2,254)	(5,791)	(17,616)	(16,329)	(1,404)	(2,452)	–	–	**(21,274)**	**(24,572)**
Impairment of property, equipment and intangible assets	–	–	–	–	–	–	(1,620)	(4,482)	**(1,620)**	**(4,482)**
Other impairment reversal	(2,651)	17,707	–	–	–	–	–	–	**(2,651)**	**17,707**
Reversal of provision for credit losses on credit-related commitments	23,394	14,059	–	–	–	–	–	–	**23,394**	**14,059**
Net gains from operations in foreign currencies:										
- dealing	49,083	65,430	4,753	2,700	(6,490)	118	–	–	**47,346**	**68,248**
- translation differences	–	–	–	–	19,849	(17,957)	–	–	**19,849**	**(17,957)**
Other operating income	–	1,032	1,889	1,910	–	–	8,639	4,089	**10,528**	**7,031**
Non-interest income	**116,891**	**168,013**	**9,467**	**2,330**	**24,343**	**(19,753)**	**7,019**	**(393)**	**157,720**	**150,197**
Operating expenses	(20,649)	(26,426)	(52,626)	(48,412)	(6,081)	(2,476)	(97,903)	(66,305)	**(177,259)**	**(143,619)**
Loss (gain) on repurchase of debt	–	–	–	–	(2,564)	–	–	–	**(2,564)**	**–**
Losses on initial recognition of financial instruments and loan modification	(14,573)	(23,016)	–	–	(1,776)	–	–	–	**(16,349)**	**(23,016)**
Non-interest expenses	**(35,222)**	**(49,442)**	**(52,626)**	**(48,412)**	**(10,421)**	**(2,476)**	**(97,903)**	**(66,305)**	**(196,172)**	**(166,635)**
Profit/(loss) before income tax expense	**195,053**	**174,525**	**61,579**	**67,081**	**77,152**	**109,786**	**(90,884)**	**(67,075)**	**242,900**	**284,317**
Income tax expense	(37,451)	(34,076)	(11,797)	(13,098)	(14,696)	(21,435)	–	–	**(63,944)**	**(68,609)**
Net profit/(loss) for the year	**157,602**	**140,449**	**49,782**	**53,983**	**62,456**	**88,351**	**(90,884)**	**(67,075)**	**178,956**	**215,708**
Segment assets	**1,291,794**	**1,186,730**	**1,295,263**	**1,121,214**	**6,528,615**	**6,931,136**	**89,110**	**102,665**	**9,204,782**	**9,341,745**
Segment liabilities	**4,503,494**	**4,467,932**	**1,362,455**	**1,362,213**	**1,536,023**	**1,659,787**	**105,917**	**168,085**	**7,507,889**	**7,658,017**

The amount of revenues from entities that are under common control with the Group is disclosed in Note 26 “Related party disclosures”.

The geographic information comprises:

	Azerbaijan Republic		*OECD countries*		*Non-OECD countries*		*Total*	
	2020	***2019***	***2020***	***2019***	***2020***	***2019***	***2020***	***2019***
Revenue	521,717	579,718	15,832	42,014	7,314	11,087	**544,863**	**632,819**
Non-current assets	171,015	160,990	–	–	29,751	32,003	**200,766**	**192,993**

Revenue includes operating income excluding interest expense, fee and commission expense and provision for impairment losses.

(Figures in tables are in thousands of Azerbaijani manats)

7. Cash and cash equivalents

Cash and cash equivalents comprise:

	2020	*2019*
Cash on hand	264,072	228,796
Current accounts with central banks	108,820	179,090
Correspondent accounts and time deposits with original maturity up to 90 days with credit institutions	2,131,609	2,381,787
Cash and cash equivalents	**2,504,501**	**2,789,673**

As at 31 December 2020, the Group had a concentration of correspondent accounts and time deposits with original maturity up to 90 days with credit institutions represented by AZN 2,048,112 thousand (31 December 2019: AZN 2,359,322 thousand) in the eight (31 December 2019: six) largest banks.

All balances of cash equivalents are allocated to Stage 1. The ECL relating to cash equivalents of the Group rounds to zero.

8. Due from banks and other financial institutions

Due from banks and other financial institutions comprise:

	2020	*2019*
Time deposits with the CBAR	2,465,478	2,825,550
Time deposits with non-resident banks	20,951	339,784
Blocked accounts with non-resident banks	10,739	12,694
Loans to credit institutions	9,601	8,761
Time deposits with resident banks	1,724	1,652
Less: allowance for impairment	(2,709)	(8,826)
Due from banks and other financial institutions	**2,505,784**	**3,179,615**

As at 31 December 2020, the Group had one time deposit (31 December 2019: one) with the CBAR maturing in December 2021 (31 December 2019: in December 2020) with interest rate 3.5% p.a (31 December 2019: 3.5% p.a. each).

Movements in allowance on balances due from banks and other financial institutions are presented below:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2020	**3,184,871**	**1,652**	**1,918**	**3,188,441**
New assets originated or purchased	2,493,731	–	–	**2,493,731**
Assets repaid	(3,168,548)	–	(1,904)	**(3,170,452)**
Change in accrued interest balance	(3,512)	–	(13)	**(3,525)**
Transfer to lifetime ECL credit-impaired	–	(1,652)	1,652	**–**
Foreign exchange	298	–	–	**298**
At 31 December 2020	**2,506,840**	**–**	**1,653**	**2,508,493**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL allowance as at 1 January 2020	**(5,256)**	**(1,652)**	**(1,918)**	**(8,826)**
New assets originated or purchased	(4,115)	–	–	**(4,115)**
Assets repaid	5,229	–	1,918	**7,147**
Unwind of discount	–	–	–	**–**
Transfer to lifetime ECL credit-impaired	–	1,652	(1,652)	**–**
Net remeasurement of loss allowance	3,085	–	–	**3,085**
At 31 December 2020	**(1,057)**	**–**	**(1,652)**	**(2,709)**

(Figures in tables are in thousands of Azerbaijani manats)

8. Due from banks and other financial institutions (continued)

	Stage 1	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**3,250,971**	**4,513**	**–**	**3,255,484**
New assets originated or purchased	3,164,328	–	–	**3,164,328**
Assets repaid	(3,204,505)	(2,859)	–	**(3,207,364)**
Change in accrued interest balance	(23,862)	(2)	14	**(23,850)**
Transfer to lifetime ECL credit-impaired	(1,904)	–	1,904	
Foreign exchange	(157)	–	–	**(157)**
At 31 December 2019	**3,184,871**	**1,652**	**1,918**	**3,188,441**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL allowance as at 1 January 2019	**(5,553)**	**(158)**	**–**	**(5,711)**
New assets originated or purchased	(4,985)	–	–	**(4,985)**
Assets repaid	5,154	106	–	**5,260**
Unwind of discount	40	(1)	(14)	**25**
Transfer to lifetime ECL credit-impaired	–	–	–	**–**
Net remeasurement of loss allowance	88	(1,599)	(1,904)	**(3,415)**
At 31 December 2019	**(5,256)**	**(1,652)**	**(1,918)**	**(8,826)**

9. Investment securities

Investment securities comprise:

	2020	*2019*
Debt securities at amortised cost		
Corporate debt securities	**110,516**	**–**
Less: allowance for impairment	(613)	–
	109,903	**–**
Debt securities at FVOCI		
Government bonds	442,132	63,772
Corporate bonds	191,635	72,632
Notes issued by Central Bank of Azerbaijan Republic	54,452	–
	688,219	**136,404**
Equity securities at FVOCI		
Corporate shares	83,498	71,257
	83,498	**71,257**
Total investment securities	**881,620**	**207,661**

All balances of debt investment securities are allocated to Stage 1.

As at 31 December 2020, the Government bonds comprise bonds of the Ministry of Finance of the Republic of Azerbaijan, (as at 31 December 2019: Bonds of the Ministry of Finance of the Republic of Azerbaijan) in the amount of AZN 442,132 thousand (as at 31 December 2019: AZN 63,772 thousand).

As at 31 December 2020, the corporate bonds comprise bonds issued in OECD countries and non-OECD countries in the amounts of AZN 135,669 thousand and AZN 165,868 thousand, respectively (as at 31 December 2019: AZN 61,443 thousand in OECD countries and AZN 11,189 thousand in non-OECD countries, respectively).

As at 31 December 2020, the corporate shares comprise class 'B' common equity shares of Mastercard Incorporated and class 'C' common equity shares of Visa Incorporated at fair market values of AZN 22,931 thousand and AZN 60,257 thousand, respectively, as well as ordinary shares of Azerbaijan Credit Bureau and Baku Stock Exchange at fair market values of AZN 250 thousand and AZN 60 thousand, respectively (as at 31 December 2019: class 'B' common equity shares of Mastercard Incorporated and class 'C' common equity shares of Visa Incorporated at fair market values of AZN 19,182 thousand and AZN 51,765 thousand, respectively, as well as ordinary shares of Azerbaijan Credit Bureau and Baku Stock Exchange at fair market values of AZN 250 thousand and AZN 60 thousand, respectively).

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers

Loans to customers comprise:

	2020	*2019*
Loans to legal entities	1,297,797	1,193,240
Loans to individuals	1,249,486	1,095,309
Loans to be transferred to CJSC Agrarkredit	–	–
Total loans to customers, gross	**2,547,283**	**2,288,549**
Less: allowance for impairment losses	(150,265)	(122,745)
Total loans to customers	**2,397,018**	**2,165,804**

As at 31 December 2020, the Group had a concentration of loans consisting of AZN 850,372 thousand, or 34% of the gross loan portfolio (31 December 2019: AZN 969,542 thousand or 42%) due from its ten (31 December 2019: ten) largest borrowers. An allowance of AZN 19,559 thousand (31 December 2019: AZN 39,551 thousand) was recognised against these loans.

Loans to individuals comprise the following products:

	2020	*2019*
Mortgage loans	653,827	576,843
Consumer loans and others	595,659	518,466
Total loans to customers, gross	**1,249,486**	**1,095,309**
Less: allowance for impairment losses	(104,586)	(63,398)
Total loans to customers	**1,144,900**	**1,031,911**

Economic sector risk concentrations within the loan portfolio are as follows:

	2020	*2019*
Analysis by sector		
Individuals	1,249,486	1,095,309
Trade and service	697,319	559,361
Oil and gas sector, power production and distribution	245,689	244,604
Railroad, air and other transportation	33,713	195,091
Manufacturing	101,560	76,625
Construction and real estate development	136,255	50,393
Communication	35,246	40,224
Others	48,015	26,942
Loans to be transferred to CJSC Agrarkredit	–	–
Total loans to customers, gross	**2,547,283**	**2,288,549**
Less: allowance for impairment losses	(150,265)	(122,745)
Total loans to customers	**2,397,018**	**2,165,804**

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost

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

Loans to legal entities	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2020	**999,469**	**86,193**	**107,578**	**1,193,240**
New assets originated or purchased	493,314	–	–	**493,314**
Change in accrued interest balance	8,567	782	27,685	**37,034**
Assets repaid	(315,402)	(2,381)	(92,173)	**(409,956)**
Transfer to 12-month ECL	43,621	(13,368)	(30,253)	**–**
Transfer to lifetime ECL not credit-impaired	(31,107)	31,107	–	**–**
Transfer to lifetime ECL credit-impaired	(9,352)	(68,434)	77,786	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	–	(5,173)	(5,273)	**(10,446)**
Write-offs	–	–	(5,389)	**(5,389)**
At 31 December 2020	**1,189,110**	**28,726**	**79,961**	**1,297,797**

Loans to legal entities	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2020	**(12,227)**	**(15,499)**	**(31,621)**	**(59,347)**
New assets originated or purchased	(20,685)	–	–	**(20,685)**
Change in accrued interest balance	(197)	(539)	–	**(736)**
Unwind of discount	–	–	(2,610)	**(2,610)**
Assets repaid	4,881	184	24,514	**29,579**
Transfer to 12-month ECL	(7,132)	988	6,144	**–**
Transfer to lifetime ECL not credit-impaired	2,174	(2,174)	–	**–**
Transfer to lifetime ECL credit-impaired	2,977	14,105	(17,082)	**–**
Net remeasurement of ECL	7,144	(2,329)	(4,206)	**609**
Changes due to modifications not resulting in derecognition	–	1,067	1,055	**2,122**
Write-offs	–	–	5,389	**5,389**
At 31 December 2020	**(23,065)**	**(4,197)**	**(18,417)**	**(45,679)**

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

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

Loans to individuals	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2020	**1,019,371**	**28,103**	**47,835**	**1,095,309**
New assets originated or purchased	482,775	–	–	**482,775**
Change in accrued interest balance	(99)	647	114	**662**
Assets repaid	(319,131)	(4,184)	(4,760)	**(328,075)**
Transfer to 12-month ECL	9,748	(8,208)	(1,540)	**–**
Transfer to lifetime ECL not credit-impaired	(32,749)	33,266	(517)	**–**
Transfer to lifetime ECL credit-impaired	(62,897)	(13,906)	76,803	**–**
Write-offs	–	–	(1,185)	**(1,185)**
At 31 December 2020	**1,097,018**	**35,718**	**116,750**	**1,249,486**

Loans to individuals	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2020	**(20,192)**	**(6,088)**	**(37,118)**	**(63,398)**
New assets originated or purchased	(13,350)	–	–	**(13,350)**
Change in accrued interest balance	(1,000)	(165)	–	**(1,165)**
Unwind of discount	–	–	(627)	**(627)**
Assets repaid	5,202	1,334	4,097	**10,633**
Transfer to 12-month ECL	(2,801)	1,664	1,137	**–**
Transfer to lifetime ECL not credit-impaired	826	(1,220)	394	**–**
Transfer to lifetime ECL credit-impaired	1,748	3,171	(4,919)	**–**
Net remeasurement of ECL	11,177	(4,491)	(44,550)	**(37,864)**
Write-offs	–	–	1,185	**1,185**
At 31 December 2020	**(18,390)**	**(5,795)**	**(80,401)**	**(104,586)**

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Loans to legal entities during the year ended 31 December 2019 was as follows:

Loans to legal entities	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**663,036**	**127,350**	**134,991**	**925,377**
New assets originated or purchased	472,586	–	–	**472,586**
Change in accrued interest balance	10,174	1,313	8,156	**19,643**
Assets repaid	(137,057)	(46,715)	(24,011)	**(207,783)**
Transfer to 12-month ECL	65,679	(64,520)	(1,159)	**–**
Transfer to lifetime ECL not credit-impaired	(68,376)	68,765	(389)	**–**
Transfer to lifetime ECL credit-impaired	(6,573)	–	6,573	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	–	–	(23,016)	**(23,016)**
Write-offs	–	–	(5,809)	**(5,809)**
Transfer from other financial assets	–	–	12,242	**12,242**
At 31 December 2019	**999,469**	**86,193**	**107,578**	**1,193,240**

Loans to legal entities	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(15,839)**	**(9,924)**	**(53,747)**	**(79,510)**
New assets originated or purchased	(12,832)	–	–	**(12,832)**
Change in accrued interest balance	(37)	(165)	–	**(202)**
Unwind of discount	–	–	(1,696)	**(1,696)**
Assets repaid	2,417	3,248	12,538	**18,203**
Transfer to 12-month ECL	(3,894)	3,691	203	**–**
Transfer to lifetime ECL not credit-impaired	7,831	(7,882)	51	**–**
Transfer to lifetime ECL credit-impaired	6,242	–	(6,242)	**–**
Net remeasurement of ECL	3,885	(4,467)	5,936	**5,354**
Changes due to modifications not resulting in derecognition	–	–	7,486	**7,486**
Write-offs	–	–	5,809	**5,809**
Transfer from other asset	–	–	(1,959)	**(1,959)**
At 31 December 2019	**(12,227)**	**(15,499)**	**(31,621)**	**(59,347)**

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Loans to individuals during the year ended 31 December 2019 is as follows:

Loans to individuals	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2019	**780,362**	**27,095**	**44,169**	**851,626**
New assets originated or purchased	520,495	–	–	**520,495**
Change in accrued interest balance	3,287	(43)	(1,239)	**2,005**
Assets repaid	(261,576)	(5,441)	(9,571)	**(276,588)**
Transfer to 12-month ECL	17,836	(13,345)	(4,491)	**–**
Transfer to lifetime ECL not credit-impaired	(20,035)	22,211	(2,176)	**–**
Transfer to lifetime ECL credit-impaired	(20,998)	(2,374)	23,372	**–**
Write-offs	–	–	(2,229)	**(2,229)**
At 31 December 2019	**1,019,371**	**28,103**	**47,835**	**1,095,309**

Loans to individuals	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(21,307)**	**(7,832)**	**(33,459)**	**(62,598)**
New assets originated or purchased	(10,511)	–	–	**(10,511)**
Change in accrued interest balance	(631)	8	–	**(623)**
Unwind of discount	–	–	33	**33**
Assets repaid	3,631	1,578	7,710	**12,919**
Transfer to 12-month ECL	(7,013)	4,010	3,003	**–**
Transfer to lifetime ECL not credit-impaired	667	(2,144)	1,477	**–**
Transfer to lifetime ECL credit-impaired	481	639	(1,120)	**–**
Net remeasurement of ECL	14,491	(2,347)	(16,991)	**(4,847)**
Write-offs	–	–	2,229	**2,229**
At 31 December 2019	**(20,192)**	**(6,088)**	**(37,118)**	**(63,398)**

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Loans to CJSC Agrarkredit during the year ended 31 December 2019 is as follows:

Loans to CJSC Agrarkredit	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**–**	**–**	**113,025**	**113,025**
Assets transferred to the CJSC Agrarkredit	–	–	(4,403)	**(4,403)**
Change in accrued interest balance	–	–	7,901	**7,901**
Write-offs	–	–	(116,523)	**(116,523)**
At 31 December 2019	**–**	**–**	**–**	**–**

Loans to CJSC Agrarkredit	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**–**	**–**	**(73,767)**	**(73,767)**
Assets transferred to the CJSC Agrarkredit	–	–	2,588	**2,588**
Unwind of discount	–	–	(5,045)	**(5,045)**
Net remeasurement of ECL	–	–	(40,299)	**(40,299)**
Write-offs	–	–	116,523	**116,523**
At 31 December 2019	**–**	**–**	**–**	**–**

During the year ended 31 December 2020, the Group did not introduce widescale payment holidays or any additional measures for customers affected by the ongoing COVID-19 pandemic. The Group consistently applied its staging criteria for the purpose of estimating expected credit losses as at 31 December 2020, including the backstop indicators for default and a significant increase in credit risk based on the number of overdue days. The Group also updated forward looking information, including forecasts of macroeconomic indicators to consider all up-to-date relevant information on the local and international macroeconomic environment.

Modified and restructured loans

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

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

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

Modified and restructured loans (continued)

The table below includes Stage 2 and Stage 3 assets that were modified during the period, with the related modification loss suffered by the Group.

	2020	*2019*
Loans modified during the period		
Amortised cost before modification	96,154	104,376
Net modification loss	(10,446)	(23,016)
Loans modified since initial recognition		
Gross carrying amount at 1 January of loans for which the loss allowance has changed to 12-month measurement during the period	95,219	–

11. Property, equipment and intangible assets

The movements in property and equipment were as follows:

Historical cost / revalued amount	*Office premises*	*Leasehold improvements*	*Furniture, fixtures, vehicles, and other fixed assets*	*Computers and communication equipment*	*Total property and equipment*	*Intangible assets*	*Total property, equipment and intangible assets*
As at 31 December 2018	**151,976**	**3,699**	**65,824**	**72,549**	**294,048**	**27,269**	**321,317**
Additions	2,919	332	4,176	6,960	**14,387**	3,591	**17,978**
Disposals	–	(132)	(2,581)	(469)	**(3,182)**	(2,313)	**(5,495)**
Impairment	(4,482)	–	–	–	**(4,482)**	–	**(4,482)**
Revaluation	(1,653)	–	–	–	**(1,653)**	–	**(1,653)**
Foreign exchange difference	280	–	1,045	–	**1,325**	–	**1,325**
As at 31 December 2019	**149,040**	**3,899**	**68,464**	**79,040**	**300,443**	**28,547**	**328,990**
Additions	2,891	331	5,639	17,013	**25,874**	12,168	**38,042**
Disposals and write-offs	(760)	–	(1,003)	(619)	**(2,382)**	(768)	**(3,150)**
Impairment	(1,620)	–	–	–	**(1,620)**	–	**(1,620)**
Revaluation	(3,520)	–	–	–	**(3,520)**	–	**(3,520)**
Foreign exchange difference	(442)	–	–	–	**(442)**	–	**(442)**
As at 31 December 2020	**145,589**	**4,230**	**73,100**	**95,434**	**318,353**	**39,947**	**358,300**

(Figures in tables are in thousands of Azerbaijani manats)

11. Property, equipment and intangible assets (continued)

Accumulated depreciation	*Office premises*	*Leasehold improvements*	*Furniture, fixtures, vehicles, and other fixed assets*	*Computers and communication equipment*	*Total property and equipment*	*Intangible assets*	*Total property, equipment and intangible assets*
As at 31 December 2018	**–**	**(2,356)**	**(51,522)**	**(55,818)**	**(109,696)**	**(10,890)**	**(120,586)**
Depreciation charge	(3,487)	(1,238)	(6,794)	(8,530)	**(20,049)**	(3,835)	**(23,884)**
Disposals	–	–	2,238	469	**2,707**	2,313	**5,020**
Revaluation	3,535	–	–	–	**3,535**	–	**3,535**
Foreign exchange differences	(48)	–	(34)	–	**(82)**	–	**(82)**
As at 31 December 2019	**–**	**(3,594)**	**(56,112)**	**(63,879)**	**(123,585)**	**(12,412)**	**(135,997)**
Depreciation charge	(4,992)	(337)	(7,154)	(11,185)	**(23,668)**	(4,552)	**(28,220)**
Disposals	90	–	834	98	**1,022**	759	**1,781**
Revaluation	4,874	–	–	–	**4,874**	–	**4,874**
Foreign exchange differences	28	–	–	–	**28**	–	**28**
As at 31 December 2020	**–**	**(3,931)**	**(62,432)**	**(74,966)**	**(141,329)**	**(16,205)**	**(157,534)**
Net book value							
As at 31 December 2018	**151,976**	**1,343**	**14,302**	**16,731**	**184,352**	**16,379**	**200,731**
As at 31 December 2019	**149,040**	**305**	**12,352**	**15,161**	**176,858**	**16,135**	**192,993**
As at 31 December 2020	**145,589**	**299**	**10,668**	**20,468**	**177,024**	**23,742**	**200,766**

As at 31 December 2020 and 2019, fully depreciated assets in use were included in property, equipment and intangible assets in the amount of AZN 76,212 thousand and AZN 60,604 thousand, respectively.

As at 31 December 2020 and 2019 premises owned by the Group were recognised at fair value. The valuation was carried out by an independent firm of appraisers, who hold relevant professional qualifications and who have experience in the valuation of assets in similar locations and in a similar category. The fair value is determined by reference to market-based evidence. The sales comparison method (comparative approach) was used by the independent appraisers engaged by the Group for the valuation of the premises. As at 31 December 2020 and 2019, the fair value of the Group's premises was categorised within Level 3 within the fair value hierarchy.

The following table summarises the sensitivity of the fair value measurement of the Group's premises categorised within Level 3 of the fair value hierarchy to changes in unobservable inputs as at 31 December 2020.

Input	*Description of input*	*Description of sensitivity*
Trade discount (difference between bid and ask price)	Local realtors were interviewed, and the resulting discount interval on bargain was found to be between 10% and 15%	The corrective adjustment on bargain may vary from 10% to 15%. An increase in the trade discount input might lead to a decrease in the fair value of the Group's premises

(Figures in tables are in thousands of Azerbaijani manats)

12. Other assets and liabilities

Other assets comprise:

	2020	*2019*
Other financial assets		
Receivables from the Azerbaijan Deposit Insurance Fund	32,524	–
Funds in settlement	24,595	23,290
Pledged funds with non-resident organisations	10,005	10,005
Accrued commission and receivables from settlement of off-balance sheet commitments	8,894	8,572
Allowance for impairment of other assets	(9,445)	(8,887)
	66,573	**32,980**
Other non-financial assets		
Prepayments	9,607	5,068
Right-of-use assets	3,963	3,255
Deferred expense	656	3,267
Repossessed collateral	1,798	2,673
	16,024	**14,263**
Other assets	**82,597**	**47,243**

Other liabilities comprise:

	2020	*2019*
Other financial liabilities		
Credit loss allowance for credit-related commitments	33,459	82,894
Funds in settlement	27,676	24,156
Lease liability	3,589	3,415
Dividends payable to shareholders	3,539	1,494
	68,263	**111,959**
Other non-financial liabilities		
Provision for other contingencies and commitments	6,579	3,928
Payables to employees	16,508	14,345
Deferred revenue on plastic cards	4,515	5,837
Payables to local budget	5,763	5,137
	33,365	**29,247**
Other liabilities	**101,628**	**141,206**

The movements in allowances for impairment under IFRS 9 of other financial assets at amortised cost during the year ended 31 December 2020 are as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2020	**(624)**	**–**	**(8,263)**	**(8,887)**
New assets originated or purchased	(3)	(1)	(263)	**(267)**
Assets repaid	1	–	654	**655**
Transfer to loans to customers	–	–	–	**–**
Net remeasurement of ECL	(773)	–	(173)	**(946)**
Write-offs	–	–	–	**–**
ECL as at 31 December 2020	**(1,399)**	**(1)**	**(8,045)**	**(9,445)**

The movements in allowances for impairment under IFRS 9 of other financial assets at amortised cost during the year ended 31 December 2019 are as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(4)**	**(23)**	**(12,901)**	**(12,928)**
New assets originated or purchased	(3)	–	–	**(3)**
Assets repaid	3	23	2,679	**2,705**
Transfer to loans to customers	–	–	1,959	**1,959**
Net remeasurement of ECL	(620)	–	–	**(620)**
Write-offs	–	–	–	**–**
ECL as at 31 December 2019	**(624)**	**–**	**(8,263)**	**(8,887)**

(Figures in tables are in thousands of Azerbaijani manats)

12. Other assets and liabilities (continued)

The loss allowance for credit related commitments and provision for other contingencies and commitments comprise the following:

	2020	*2019*
Credit-related commitments	33,459	82,894
Performance guarantees	6,579	3,928
Legal claims	–	–
Credit loss allowance for credit-related commitments and provision for other contingencies and commitments	**40,038**	**86,822**

13. Due to banks and other financial institutions

Due to banks and other financial institutions comprise:

	2020	*2019*
Correspondent accounts of resident banks	44,017	13,884
Time deposits of resident banks and other financial institutions	10,200	10,205
Correspondent accounts of non-resident banks	2,700	7,890
Due to banks and other financial institutions	**56,917**	**31,979**

14. Customer accounts

The amounts due to customers include the following:

	2020	*2019*
Legal entities		
- Current/settlement accounts	3,897,997	3,978,599
- Term deposits	139,423	300,803
- Restricted customer deposits	140,463	120,681
Total legal entities	**4,177,883**	**4,400,083**
Individuals		
- Current/settlement accounts	650,707	524,763
- Term deposits	632,366	681,722
- Restricted customer deposits	–	105
Total individuals	**1,283,073**	**1,206,590**
Total customer accounts	**5,460,956**	**5,606,673**

As at 31 December 2020, customer accounts included balances with the ten (31 December 2019: ten) largest customers in the amount of AZN 2,406,598 thousand or 44% of the total customer accounts portfolio (31 December 2019: AZN 2,635,656 thousand or 47% of the total customer accounts portfolio).

As at 31 December 2020, customer accounts included balances blocked with the Group against letters of credit and letter of guarantees in the amount of AZN 140,672 thousand (as at 31 December 2019: AZN 120,776 thousand) (Note 19).

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

	2020	*2019*
Analysis by economic sector / customer type		
Government related entities	3,499,395	3,912,810
Individuals	1,283,073	1,206,590
Trade and service	372,137	274,826
Transportation and communication	78,134	49,727
Public organizations	33,161	31,637
Energy	71,253	30,033
Manufacturing	60,835	21,709
Construction	23,965	13,973
Other	39,003	65,368
Total customer accounts	**5,460,956**	**5,606,673**

(Figures in tables are in thousands of Azerbaijani manats)

15. Other borrowed funds

Other borrowed funds comprise:

	2020	*2019*
Term borrowings from non-resident financial institutions	13,700	16,859
Term borrowings from the CBAR	115,439	–
National Fund for Support of Entrepreneurship and the Mortgage Fund (the Republic of Azerbaijan)	91,068	87,645
Total other borrowed funds	**220,207**	**104,504**

In order to mitigate the negative effect of the COVID-19 pandemic on the country's food supply sector, a loan in the amount of AZN 115,000 thousand with an annual interest rate of 0.5% and a two-year maturity period was issued by the CBAR to the Group under a government program. Loans were then granted by the Group to respective companies with a 1% annual interest rate and two-year maturity.

16. Debt securities issued

Debt securities issued comprise:

	2020	*2019*
Eurobonds	1,485,463	1,521,784
Certificates of deposit	5,037	4,570
Total debt securities issued	**1,490,500**	**1,526,354**

As at 31 December 2020, the Group had one class of Eurobonds issued in September 2017 with a coupon rate of 3.5% p.a. maturing in September 2024. The Group is obliged to comply with non-financial covenants in relation to these Eurobonds. As of the date of issuance of these consolidated financial statements, the Group was in compliance with these covenants.

17. Taxation

Deferred tax assets and liabilities comprise:

	2020	*2019*
Deferred tax (liabilities)/assets in relation to:		
Due from banks and loans to customers	(16,476)	(27,248)
Investment securities	(26,201)	(14,730)
Property, equipment and intangible assets	5,462	6,771
Debt securities issued	(30,346)	(39,389)
Other assets	4,342	4,531
Other liabilities	(23,124)	(13,600)
Others	(114)	(111)
Tax loss carry forward	–	3,605
Unrecognised deferred tax assets	(2,298)	(2,298)
Net deferred tax liability	**(88,755)**	**(82,469)**

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 tax	**242,900**	**284,317**
Tax expense at the statutory tax rate (20%)	**(48,580)**	**(56,863)**
Change in deferred tax assets recognised	–	–
Tax effect of permanent differences	(3,426)	(2,915)
Adjustments in respect of current income tax of previous years	(11,938)	–
Other	–	(8,831)
Income tax expense	**(63,944)**	**(68,609)**
Current income tax expense	(65,621)	(76,189)
Changes in deferred tax	1,677	7,580
Income tax expense	**(63,944)**	**(68,609)**

(Figures in tables are in thousands of Azerbaijani manats)

17. Taxation (continued)

Deferred income tax assets/(liabilities)	***2020***	***2019***
Deferred tax assets at 1 January	**1,029**	**900**
Deferred tax liabilities at 1 January	**(83,498)**	**(85,255)**
Change in deferred income tax balances recognised in profit or loss	1,678	7,580
Change in deferred income tax recognised in other comprehensive income	(7,964)	(5,694)
Deferred income tax assets at 31 December	**709**	**1,029**
Deferred income tax liabilities at 31 December	**(89,464)**	**(83,498)**
Net deferred income tax liability	**(88,755)**	**(82,469)**

At 31 December 2020, the aggregate amount of temporary differences associated with investments in subsidiaries for which deferred tax liability has not been recognised was AZN 103,355 thousand (31 December 2019: AZN 129,823 thousand).

18. Equity

The Group's share capital comprises the following shares:

Ordinary shares (par value of 0.27 AZN)	***Number of paid-in shares (in thousands)***	***Share capital***
As at 1 January 2019	**4,597,359**	**1,241,287**
As at 31 December 2019	**4,597,359**	**1,241,287**
As at 31 December 2020	**4,597,359**	**1,241,287**

All ordinary shares have a nominal value of AZN 0.27 per share as at 31 December 2020 and 2019 and rank equally. Each share carries one vote.

On 15 September 2020, in accordance with a resolution of the Annual General Meeting of Shareholders, the Group declared a dividend of AZN 150,000 thousand. The dividend per share is AZN 0.03. As a result of the dividend declaration, the Bank's statutory net assets decreased to a level below the share capital. In February 2021, statutory net assets exceeded the share capital as a result of booking statutory profit.

Dividend movement comprises:

	2020	***2019***
Dividend payable to Shareholders at 1 January	**1,494**	**16,411**
Dividend declared	150,000	150,000
Dividend off-set (Note 2)	(142,908)	(157,831)
Dividend paid	(5,047)	(7,086)
Dividend payable to Shareholders at 31 December	**3,539**	**1,494**

Revaluation reserve for premises

The revaluation reserve for property and equipment is used to record increases in the fair value of premises and decreases to the extent that such a decrease relates to an increase on the same asset previously recognised in equity through other comprehensive income.

Additional paid-in capital

Additional paid-in capital reflects results from transactions with shareholders acting in their capacity as shareholders. In turbulent economic conditions due to a continued decline in the quality of the Group's assets, an increase in problematic loans and a decline in the liquidity position of the Group, the Government of Azerbaijan took a number of steps to strengthen the Group's capital position and the quality of its assets. As part of these measures, certain of the problematic assets of the Group were transferred in several tranches during 2015-2019 to CJSC Agrarkredit (Note 2). The transfer of the problematic assets occured at an agreed amount at the time of transfer. Since CJSC Agrarkredit is also ultimately controlled by the Ministry of Finance any amounts received from CJSC Agrarkredit in excess of the net carrying amounts of transferred assets have been recognised as additional paid-in capital of the Group.

(Figures in tables are in thousands of Azerbaijani manats)

18. Equity (continued)

Additional paid-in capital (continued)

The gain and weighted average number of shares used in the calculation of the basic and diluted loss per share are as follows:

	2020	*2019*
Net profit for the period attributable to shareholders of the Group	178,956	215,708
Weighted average number of ordinary shares in issue	4,597,359	4,597,359
Earnings per share − basic and diluted (AZN)	**0.04**	**0.05**

The Group has no dilutive potential ordinary shares; therefore, the diluted earnings per share are equal to basic earnings per share.

19. Commitments and contingencies

Operating environment

The economy of Azerbaijan is sensitive to oil and gas prices. During recent years, the Azerbaijani Government has conducted major economic and social reforms to transmit to a more balanced economy with less dependence on the oil and gas sector.

During 2019, the CBAR initiated an expansionary monetary policy and decreased the refinancing rate from 9.75% to 7.5%. Moreover, on 28 February 2019 the President of Azerbaijan signed a decree whereby the government provided funds for problem retail loans whose debt burden had increased due to the devaluation of the Azerbaijani manat in 2015. This measure significantly decreased non-performing loans, and supported bank capital and the liquidity of local banks.

The Second Nagorno-Karabakh War

The Second Nagorno-Karabakh war started on 27 September 2020 and ended on 10 November 2020 with the signing of a ceasefire statement by the President of the Republic of Azerbaijan, the Prime Minister of the Republic of Armenia and the President of the Russian Federation. Azerbaijan regained control over territories that had previously been occupied by Armenia.

Azerbaijan aims to rebuild the liberated zones and develop regionally important infrastructure that will change the overall outlook of the region. In line with this, management of the Group projects an increase in the nominal GDP of Azerbaijan in the foreseeable future.

The COVID-19 pandemic

Azerbaijan Republic

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

During this year, restrictive measures to combat COVID-19 significantly reduced economic activity and the aggregate spending level of consumers. Many business lines such as retail, tourism and entertainment were severely impacted by restrictive measures. Oil prices tumbled to a historical low but a moderate recovery was observed by year end. A support package was introduced by the Government and CBAR to counter the economic downturn caused by the pandemic. These measures include, but are not limited to, subsidized lending to affected industries, payments to unemployed individuals and easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources and help customers avoid liquidity shortages as a result of the COVID-19 containment measures.

On 23 April 2020, the CBAR decided to reduce the minimum required capital adequacy from 12% to 11% for banks that are systematically important, which includes the Bank. The capital adequacy ratio requirement was reduced from 10% to 9% for other banks. Moreover, the CBAR later decreased the refinancing rate from 7.25% to 6.25% during 2020. Significant foreign currency sales were made to maintain the stability of the Azerbaijani manat, which was kept flat at 1.7000 per 1 USD throughout the year.

By June-July 2020, many countries had started to demonstrate signs of reduced spread of the virus. Governments started to gradually lift or ease restrictions. This trend supported a recovery in global financial and commodity markets. However, the peak of the pandemic in Azerbaijan was observed in October-December 2020 and gradually decreased after the introduction of a strict lockdown between 14 December 2020 and 18 January 2021.

(Figures in tables are in thousands of Azerbaijani manats)

19. Commitments and contingencies (continued)

Operating environment (continued)

Russian Federation

Russia's commodity-dependent economy has been hit this year by a plunge in prices for oil, its main export, and by the impact of the new coronavirus, with lockdowns slowing business activity. There were immediate impacts of the pandemic-driven recession, such as a steep rise in unemployment, a drop in real wages, reduced fiscal revenues, and a weakened banking sector. In light of these events, the rouble continued to depreciate against the US dollar and lost 19% during the year. As a response to these impacts, several economic stimulus packages were announced during 2020. The National Plan for Economic Recovery, adopted in June 2020, is the government's program to help the economy recover after the COVID-19 shock subsides and oil prices increase. On 27 July 2020, the Bank of Russia cut the key rate to 4.25% per annum. The program of increased spending will last until the end of 2021 with the aim of bringing Russia's unemployment rate back below 5% and getting the economy growing at 2.5% a year.

The future economic and regulatory environment and its impact on the Group's operations may differ from management's current expectations. The Group's management is monitoring economic developments in the current environment and taking precautionary measures it considers necessary in order to support the sustainability and development of the Group's business in the foreseeable future.

Legal

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

Taxation

Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant authorities. Recent events within Azerbaijan suggest that the tax authorities are taking a more assertive position in their interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. 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. The last tax inspection covered the year ended 31 December 2018. The result of the tax inspection is reflected in the consolidated financial statements (Note 17).

Management believes that its interpretation of the relevant legislation as at 31 December 2020 and 2019 is appropriate and that the Group's tax, currency and customs positions will be sustained.

Insurance

The Group has not currently obtained insurance coverage related to liabilities arising from errors or omissions. Liability insurance is generally not available in Azerbaijan at present.

Compliance with CBAR ratios

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

- The ratio of maximum credit exposure of the bank per single borrower or group of borrowers;
- The currency position.

Consequences of the breach of the prudential ratios include withdrawal of the banking license by the regulating body. Throughout the year the Group submitted information regarding these breaches to the CBAR on a monthly basis and no sanctions were imposed on the Group. Moreover, Management of the Group has provided the CBAR with an action plan to improve the remaining ratios in future.

Considering all the above-mentioned facts, Management believes that the Group will not face any sanctions in the future.

Financial commitments and contingencies

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

(Figures in tables are in thousands of Azerbaijani manats)

19. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

Financial commitments and contingencies comprise:

Commitments and contingencies	***2020***	***2019***
Guarantees	904,511	799,042
Letters of credit	124,000	108,753
Undrawn loan commitments	1,788,157	659,953
Less: allowance	(40,038)	(86,822)
Commitments and contingencies	**2,776,630**	**1,480,926**
Less: cash held as security against guarantees and letters of credit	(140,672)	(120,776)
Less: cash received from CJSC Agrarkredit held as security against guarantees and letters of credit*	(88,149)	(89,186)
Total	**2,547,809**	**1,270,964**

* *Promissory notes in the amount of AZN 88,149 thousand were pledged on behalf of CJSC Agrarkredit to the Group in case issued letters of credit or guarantees are defaulted on.*

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

Financial guarantees	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2020	**(6,264)**	**(1,016)**	**(69,988)**	**(77,268)**
New exposures originated or purchased	(6,367)	–	–	**(6,367)**
Amount paid	–	–	25,483	**25,483**
Exposures derecognised or matured (excluding write-offs)	1,863	–	12,714	**14,577**
Transfer to 12-month ECL	(31,791)	–	31,791	**–**
Net remeasurement of ECL	23,783	–	–	**23,783**
At 31 December 2020	**(18,776)**	**(1,016)**	**–**	**(19,792)**

Letters of credit	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2020	**(50)**	**–**	**–**	**(50)**
New exposures originated or purchased	(2)	–	–	**(2)**
Exposures derecognised or matured (excluding write-offs)	23	–	–	**23**
Net remeasurement of ECL	15	–	–	**15**
At 31 December 2020	**(14)**	**–**	**–**	**(14)**

Undrawn commitments	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2020	**(5,576)**	**–**	–	**(5,576)**
New exposures originated or purchased	(9,649)	–	–	(9,649)
Exposures derecognised or matured (excluding write-offs)	25	–	–	25
Transfer to lifetime ECL not credit-impaired	195	(195)	–	–
Transfer to lifetime ECL credit-impaired	3,379	–	(3,379)	–
Net remeasurement of ECL	1,547	–	–	1,547
At 31 December 2020	**(10,079)**	**(195)**	**(3,379)**	**(13,653)**

(Figures in tables are in thousands of Azerbaijani manats)

19. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

An analysis of changes in the ECLs during the year ended 31 December 2019 is as follows:

Financial guarantees	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(3,316)**	**(5,028)**	**(80,064)**	**(88,408)**
New exposures originated or purchased	(2,709)	–	–	**(2,709)**
Exposures derecognised or matured (excluding write-offs)	1,982	1,523	26,675	**30,180**
Transfer to 12-month ECL	(1,275)	1,275	–	**–**
Net remeasurement of ECL	(946)	1,214	(16,599)	**(16,331)**
At 31 December 2019	**(6,264)**	**(1,016)**	**(69,988)**	**(77,268)**

Letter of credit	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(300)**	**(568)**	**–**	**(868)**
New exposures originated or purchased	(50)	–	–	**(50)**
Exposures derecognised or matured (excluding write-offs)	300	568	–	**868**
At 31 December 2019	**(50)**	**–**	**–**	**(50)**

Undrawn commitments	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(3,362)**	**–**	**(274)**	**(3,636)**
New exposures originated or purchased	(3,754)	–	–	**(3,754)**
Exposures derecognised or matured (excluding write-offs)	2,471	–	274	**2,745**
Net remeasurement of ECL	(931)	–	–	**(931)**
At 31 December 2019	**(5,576)**	**–**	**–**	**(5,576)**

The movements in gross amounts of credit-related commitments that most significantly contributed to changes in respective ECLs predominantly consist of exposures derecognised or matured and also financial guarantees transferred from Stage 3 to Stage 1.

An analysis of changes in the provision for performance guarantees and legal claims during the year ended 31 December 2020 is provided in Note 20.

20. Credit loss expense and other impairment

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

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Loans and receivables at amortised cost	10	(6,828)	(4,939)	(19,090)	**(30,857)**
Due from banks and other financial institutions	8	4,199	–	1,918	**6,117**
Debt securities at amortised cost		(613)	–	–	**(613)**
Debt securities at FVOCI		(750)	–	–	**(750)**
Receivables from CJSC Agrarkredit		5,917	–	–	**5,917**
Credit loss expense on interest bearing financial assets		**1,923**	**(4,939)**	**(17,170)**	**(20,186)**
Financial guarantees	19	19,279	–	12,714	**31,993**
Letters of credit	19	36	–	–	**36**
Undrawn loan commitments	19	(8,077)	–	–	**(8,077)**
Credit-related commitments		**11,238**	**–**	**12,714**	**23,952**
Other financial assets	12	(775)	(1)	218	**(558)**
Reversal of provision for credit losses on credit-related commitments and other financial assets		**10,463**	**(1)**	**12,932**	**23,394**
Total credit loss reversal		**12,386**	**(4,940)**	**(4,238)**	**3,208**

(Figures in tables are in thousands of Azerbaijani manats)

20. Credit loss expense and other impairment (continued)

The table below shows the ECL charges on financial instruments recorded in the consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2019:

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Loans and receivables at amortised cost	10	413	(2,145)	(25,579)	**(27,311)**
Due from banks and other financial institutions	8	297	(1,494)	(1,918)	**(3,115)**
Receivables from CJSC Agrarkredit		(7,339)	–	–	**(7,339)**
Credit loss reversal on interest bearing financial assets		**(6,629)**	**(3,639)**	**(27,497)**	**(37,765)**
Financial guarantees	19	(1,673)	2,737	10,076	**11,140**
Letters of credit	19	250	568	–	**818**
Undrawn loan commitments	19	(2,214)	–	274	**(1,940)**
Credit-related commitments		**(3,637)**	**3,305**	**10,350**	**10,018**
Other financial assets	12	(620)	23	4,638	**4,041**
Reversal of provision for credit losses on credit-related commitments and other financial assets		**(4,257)**	**3,328**	**14,988**	**14,059**
Total credit loss expense		**(10,886)**	**(311)**	**(12,509)**	**(23,706)**

Other impairment reversal affected the balances as follows:

	Legal claims	*Performance guarantees*	*Total*
1 January 2019	**(4,980)**	**(19,835)**	**(24,815)**
Reversal	1,800	15,907	**17,707**
Redemption	3,180	–	**3,180**
31 December 2019	**–**	**(3,928)**	**(3,928)**
Charge	–	(2,651)	**(2,651)**
31 December 2020	**–**	**(6,579)**	**(6,579)**

Provisions for ECL for credit-related commitments and provision on legal claims and performance guarantees are recorded within other non-financial liabilities (Note 12).

21. Fee and commission income and expense

Fee and commission income and expense comprises:

	2020	*2019*
Plastic cards operations	56,547	61,263
Servicing guarantees and letters of credit	10,613	11,608
Settlement transactions	10,234	11,305
Cash transactions	3,228	4,353
Others	1,526	1,634
Fee and commission income	**82,148**	**90,163**
Plastic cards operations	(16,569)	(17,179)
Cash transactions	(1,000)	(3,834)
Settlement transactions	(2,318)	(2,659)
Others	(1,387)	(900)
Fee and commission expense	**(21,274)**	**(24,572)**
Net fee and commission income	**60,874**	**65,591**

(Figures in tables are in thousands of Azerbaijani manats)

22. Operating expenses

Operating expenses comprise:

	2020	*2019*
Staff costs	(88,770)	(73,094)
Depreciation of premises and equipment	(23,668)	(20,049)
Consultancy and other professional services	(14,434)	(11,068)
Fees paid to deposit insurance funds	(5,855)	(5,423)
Amortisation of software and other intangible assets	(4,552)	(3,835)
Advertising and marketing services	(2,393)	(3,787)
Customs duties and taxes other than on income	(3,404)	(3,553)
Software maintenance	(4,597)	(3,312)
Premises, property and maintenance	(2,140)	(3,136)
Outsourced staffing and security	(3,054)	(3,054)
Communication	(2,407)	(2,038)
Rent	(606)	(1,739)
Utilities	(978)	(1,560)
Stationary, books, printing, and other supplies	(1,616)	(1,540)
Insurance expense	(1,349)	(1,010)
Charity and financial aid	(4,001)	(150)
Fines and penalties	(4,108)	(112)
Others	(9,327)	(5,159)
Total operating expenses	**(177,259)**	**(143,619)**

23. Risk management

Introduction

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

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

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

Supervisory Board

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

Audit Committee

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

Management Board

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

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.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Risk management structure

Risk Management

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

Bank Treasury

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

Internal Audit

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

Risk measurement and reporting systems

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

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

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

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

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

Risk mitigation

The Group actively uses collateral to reduce its credit risks.

Excessive risk concentration

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

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

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk

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

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

Credit-related commitment risks

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

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

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

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes.

Impairment assessment

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

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

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

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

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

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

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

Definition of default and cure

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

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

- Default and credit-impaired assets:
  - Loans with the principal amount and/or accrued interest and/or any of other payment overdue by more than 90 days from the date specified in the contract;
  - Loans that have been restructured with significant NPV losses;
  - Any loan considered by management as non-performing;
- Existing of information that borrower will/has enter bankruptcy, insolvency or a similar condition;
- Default on other financial instruments of the same borrower;
- Default according to external rating.

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

PD estimation process

The Group has developed a scoring model for collective assessment. Each borrower in a credit portfolio is assigned a score based on the internal scoring model that creates scores for one-year PD assessments. Lifetime PD is calculated based on the migration matrices approach. The scoring model captures different risk levels depending on exposure/client characteristics and a total score is assigned to a contract based on the weighted sum of points for each characteristic of financial quality of a portfolio unit. To consider the impact of macroeconomic factors on probability of default, the sensitivity of probabilities to macroeconomic factors is calculated by a statistical regression method. Where practicable, PDs incorporate forward-looking macroeconomic information, and the IFRS 9 stage classifications of the exposure are assigned for each grade. This is repeated for each economic scenario as appropriate.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

Treasury and interbank relationships

The Group's treasury and interbank relationships and counterparties comprise financial services institutions, banks, broker-dealers, exchanges and clearing-houses. For these relationships, the Group's credit risk department analyses publicly available information such as financial information and other external data (e.g., \external ratings).

Consumer lending and residential mortgages

Consumer lending comprises unsecured personal loans, credit cards and overdrafts. These products along with residential mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by days past due. Other key inputs to the models are the oil price, exchange rate, annual real GDP growth, the unemployment rate and others.

Corporate and small business lending

The same approach and inputs for consumer lending apply to corporate and small business lending. For corporate loans that are significant to the Group's financial statements, the borrowers are assessed by specialised credit risk employees of the Group.

Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default as well as potential early repayments.

Loss given default

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

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

Where appropriate, further recent data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios.

LGD rates are estimated for the Stage 1, Stage 2, Stage 3 and POCI segment of each asset class. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries. These are repeated for each economic scenario as appropriate.

Significant increase in credit risk

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

Grouping financial assets measured on a collective basis

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

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

- ► All significant Stage 3 assets, regardless of the class of financial assets;
- ► Treasury and interbank relationships (such as amount due from banks, cash equivalents and debt investment securities at amortised cost and FVOCI).

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

- ► The smaller and more generic balances of the Group's small business lending;
- ► Stage 1 and 2 retail mortgages, consumer lending and the corporate lending portfolio.

The Group allocates these exposures to smaller homogeneous portfolios based on a combination of internal and external characteristics of the loans, for example an overdue bucket or a product type.

Forward-looking information and multiple economic scenarios

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

- ► Oil prices;
- ► Real GDP growth year to year;
- ► Unemployment rates;
- ► Foreign exchange rates;
- ► CPI growth year to year.

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

Credit quality per class of financial assets

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

Scoring based on probability of default for loans to customers	***S&P ratings' based on internal/external ratings for Financial Institutions***	***Internal rating description***
0-2.5%	AAA to A-	High
2.5-25%	BBB+ to B-	Standard
25-75%	CCC+ to C	Sub-standard
75-100%	D	Impaired

The probability of default is used as a basis for internal ratings of corporate customers, while the S&P rating is used for financial institutions. Financial assets from or guaranteed by the Government of Azerbaijan are assigned a "High" internal rating.

Credit quality per class of financial assets

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

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

The table below shows gross balances as at 31 December 2020 based on the Group's internal credit rating system:

	Note		*High grade*	*Standard grade*	*Sub-standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	7	Stage 1	2,225,183	15,246	–	–	**2,240,429**
Due from banks and other financial institutions	8	Stage 1	2,469,551	35,283	2,006	–	**2,506,840**
		Stage 2	–	–	–	–	**–**
		Stage 3	–	–	–	1,653	**1,653**
Loans to customers	10						
- Legal entities							
		Stage 1	621,684	563,247	4,179	–	**1,189,110**
		Stage 2	–	67	28,659	–	**28,726**
- Individuals		Stage 3	–	–	–	79,961	**79,961**
		Stage 1	487,911	596,060	13,047	–	**1,097,018**
		Stage 2	–	2,195	33,523	–	**35,718**
		Stage 3	–	–	–	116,750	**116,750**
Investment securities at FVOCI	9	Stage 1	468,710	205,865	13,644	–	**688,219**
Investment securities at amortised cost	9	Stage 1	–	110,516	–	–	**110,516**
Receivables from CJSC Agrarkredit	2	Stage 1	579,924	–	–	–	**579,924**
Other financial assets	12						
		Stage 1	10,005	57,119	126	–	**67,250**
		Stage 3	–	–	–	8,768	**8,768**
Undrawn loan commitments	19						
		Stage 1	1,348,701	434,121	–	–	**1,782,822**
		Stage 2	–	2	1,015	–	**1,017**
		Stage 3	–	–	–	4,318	**4,318**
Letters of credit	19	Stage 1	122,093	1,907	–	–	**124,000**
		Stage 2	–	–	–	–	**–**
		Stage 3	–	–	–	–	**–**
Financial guarantees	19	Stage 1	320,234	577,546	–	–	**897,780**
		Stage 2	–	–	–	–	**–**
		Stage 3	–	–	–	6,731	**6,731**
Total			**8,653,996**	**2,599,174**	**96,199**	**218,181**	**11,567,550**

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

The table below shows gross balances as at 31 December 2019 based on the Group's internal credit rating system:

	Note		*High grade*	*Standard grade*	*Sub-standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	7	Stage 1	1,655,582	905,295	–	–	**2,560,877**
Due from banks and other financial institutions	8	Stage 1	2,905,912	278,959	–	–	**3,184,871**
		Stage 2	–	–	1,652	–	**1,652**
		Stage 3	–	–	–	1,918	**1,918**
Loans to customers	10						
- Legal entities							
		Stage 1	746,595	252,874	–	–	**999,469**
		Stage 2	68	25,700	60,425	–	**86,193**
- Individuals		Stage 3	–	–	–	107,578	**107,578**
		Stage 1	435,243	584,128	–	–	**1,019,371**
		Stage 2	49	2,388	25,666	–	**28,103**
		Stage 3	–	–	–	47,835	**47,835**
Debt securities at FVOCI	9	Stage 1	84,772	51,632	–	–	**136,404**
Receivables from CJSC Agrarkredit	2	Stage 1	702,392	–	–	–	**702,392**
Other financial assets	12						
		Stage 1	10,005	23,290	96	–	**33,391**
		Stage 3	–	–	–	8,476	**8,476**
Undrawn loan commitments	19						
		Stage 1	496,452	163,501	–	–	**659,953**
		Stage 3	–	–	–	–	**–**
Letters of credit	19	Stage 1	106,822	1,676	–	–	**108,498**
		Stage 2	–	–	–	–	**–**
		Stage 3	–	–	–	255	**255**
Financial guarantees	19	Stage 1	136,865	110,498	–	–	**247,363**
		Stage 2	199,000	–	–	–	**199,000**
		Stage 3	–	–	–	352,679	**352,679**
Total			**7,479,757**	**2,399,941**	**87,839**	**518,741**	**10,486,278**

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

Geographical concentration information is based on the place of registration of the Group's counterparties. As at 31 December 2020, the geographical concentration of the Group's financial assets and liabilities is set out as below:

	2020				*2019*			
	The Republic of Azerbaijan	*OECD countries*	*CIS and other non-OECD countries*	*Total*	*The Republic of Azerbaijan*	*OECD countries*	*CIS and other non-OECD countries*	*Total*
Financial assets								
Cash and cash equivalents	373,737	2,072,639	58,125	**2,504,501**	349,811	2,381,213	58,649	**2,789,673**
Mandatory cash balances with central banks	54,695	–	363	**55,058**	59,199	–	860	**60,059**
Due from banks and other financial institutions	2,472,270	16,584	16,930	**2,505,784**	2,829,351	327,629	22,635	**3,179,615**
Investment securities	632,796	135,669	113,155	**881,620**	64,724	132,390	10,547	**207,661**
Loans to customers	2,383,070	–	13,948	**2,397,018**	2,160,704	–	5,100	**2,165,804**
Receivables from CJSC Agrarkredit	576,729	–	–	**576,729**	693,281	–	–	**693,281**
Other financial assets	55,899	10,005	669	**66,573**	18,697	10,018	4,265	**32,980**
Total	**6,549,196**	**2,234,897**	**203,190**	**8,987,283**	**6,175,767**	**2,851,250**	**102,056**	**9,129,073**
Financial liabilities								
Due to banks and other financial institutions	54,310	190	2,417	**56,917**	25,550	1,111	5,318	**31,979**
Customer accounts	5,381,186	45,267	34,503	**5,460,956**	5,454,107	39,997	112,569	**5,606,673**
Payables to CJSC Agrarkredit	88,217	–	–	**88,217**	89,055	–	–	**89,055**
Other borrowed funds	206,507	13,700	–	**220,207**	87,645	16,859	–	**104,504**
Debt securities issued	4,835	1,485,615	50	**1,490,500**	4,234	1,522,075	45	**1,526,354**
Other financial liabilities	62,562	–	5,701	**68,263**	111,649	–	310	**111,959**
Total	**5,797,617**	**1,544,772**	**42,671**	**7,385,060**	**5,772,240**	**1,580,042**	**118,242**	**7,470,524**
Net assets/(liabilities)	**751,579**	**690,125**	**160,519**	**1,602,223**	**403,527**	**1,271,208**	**(16,186)**	**1,658,549**

Liquidity risk and funding management

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

The liquidity position is assessed and managed by the Group based on certain liquidity ratios established by the CBAR. As at 31 December 2020 and 2019, these ratios were as follows:

	2020, %	*2019, %*
Instant Liquidity Ratio (30% is the minimum required by the CBAR) (assets receivable or realisable within one day* / liabilities repayable on demand)	48	51

* *The deposits held in the CBAR are not taken into account.*

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2020 and 2019 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group does not expect many customers to request repayment on the earliest date the Group could be required to pay and believes that the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

Financial liabilities	***Less than 1 month***	***1 to 6 months***	***6 to 12 months***	***Over 12 months***	***Total 2020***
As at 31 December 2020					
Due to banks and other financial institutions	46,726	43	51	10,332	**57,152**
Customer accounts	4,740,976	258,989	380,089	117,982	**5,498,036**
Payables to CJSC Agrarkredit	88,217	–	–	–	**88,217**
Other borrowed funds	8,230	10,030	10,882	222,532	**251,674**
Debt securities issued	–	31,634	31,595	1,815,682	**1,878,911**
Other financial liabilities	30,339	1,119	1,343	4,127	**36,928**
Total undiscounted financial liabilities	**4,914,488**	**301,815**	**423,960**	**2,170,655**	**7,810,918**

Financial liabilities	***Less than 1 month***	***1 to 6 months***	***6 to 12 months***	***Over 12 months***	***Total 2019***
As at 31 December 2019					
Due to banks and other financial institutions	20,928	10,215	1,191	–	**32,334**
Customer accounts	4,774,665	425,095	331,748	113,725	**5,645,233**
Payables to CJSC Agrarkredit	89,055	–	–	–	**89,055**
Other borrowed funds	4,402	11,672	10,642	109,523	**136,239**
Debt securities issued	–	33,081	33,107	1,970,098	**2,036,286**
Other financial liabilities	25,066	555	666	3,840	**30,127**
Total undiscounted financial liabilities	**4,914,116**	**480,618**	**377,354**	**2,197,186**	**7,969,274**

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

	Up to 1 month	***1 to 6 months***	***6 to 12 months***	***More than 12 months***	***Total***
As at 31 December 2020	1,884,089	372,266	137,263	423,050	**2,816,668**
As at 31 December 2019	672,130	368,484	122,259	404,696	**1,567,569**

The Group's financial commitments and contingencies are contractually on demand. However, the Group expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The Group's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant concentration of deposits from organisations of related parties in the period of one year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Group. Management believes that this level of funding will remain with the Group for the foreseeable future and that in the event of withdrawal of funds, the Group would be given sufficient notice so as to realise its liquid assets to enable repayment.

In addition, the Group has a significant amount held in the CBAR as disclosed in Note 8, which can be used to mitigate any negative impacts in case of withdrawals.

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

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Operational risk

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

Market risk

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

Interest rate risk

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

The sensitivity of current year profit is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2020. The Group does not have a substantial amount of floating rate non-trading financial instruments as at 31 December 2020 and 2019.

Currency risk

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

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

Currency risk sensitivity

The following table details the Group's sensitivity to increases and decreases in the USD and EUR against the AZN. These are the sensitivity rates used when reporting foreign currency risk internally to key management personnel and represent management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency-denominated monetary items and adjusts their translation at the end of the period for specified changes in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Group where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

Impact on profit before tax based on asset values as at 31 December 2020 and 2019:

	31 December 2020		***31 December 2019***	
USD	+20%/-3%	(130,836)/19,625	+10%/-3%	(98,454)/29,536
EUR	+22%/-10%	4,504/(2,047)	+10%/-6%	2,353/(1,412)

(Figures in tables are in thousands of Azerbaijani manats)

24. Fair value measurements

Fair value hierarchy

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

		Fair value measurement using			
	Date of valuation	***Quoted prices in active markets (Level 1)***	***Significant observable inputs (Level 2)***	***Significant unobservable inputs (Level 3)***	***Total***
Assets measured at fair value					
Investment securities at FVOCI	31 December 2020	755,567	16,150	–	**771,717**
Office premises	31 December 2020	–	–	145,587	**145,587**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2020	2,504,501	–	–	**2,504,501**
Mandatory cash balances with central banks	31 December 2020	–	–	55,058	**55,058**
Investment securities at amortised cost	31 December 2020		–	109,903	109,903
Due from banks and other financial institutions	31 December 2020	–	–	2,505,784	**2,505,784**
Loans to customers	31 December 2020	–	109,588	2,299,905	**2,409,493**
Receivables from CJSC Agrarkredit	31 December 2020	–	–	576,729	**576,729**
Other financial assets	31 December 2020	–	–	66,573	**66,573**

		Fair value measurement using			
As at 31 December 2020	***Date of valuation***	***Quoted prices in active markets (Level 1)***	***Significant observable inputs (Level 2)***	***Significant unobservable inputs (Level 3)***	***Total***
Liabilities for which fair values are disclosed					
Due to banks and other financial institutions	31 December 2020	–	–	56,917	**56,917**
Customer accounts	31 December 2020	–	4,689,167	771,789	**5,460,956**
Payables to CJSC Agrarkredit	31 December 2020	–	–	88,217	**88,217**
Other borrowed funds	31 December 2020	–	206,507	13,700	**220,207**
Debt securities issued	31 December 2020	–	1,476,297	4,704	**1,481,001**
Other financial liabilities	31 December 2020	–	–	68,263	**68,263**

(Figures in tables are in thousands of Azerbaijani manats)

24. Fair value measurement (continued)

Fair value hierarchy (continued)

		Fair value measurement using			
	Date of valuation	***Quoted prices in active markets (Level 1)***	***Significant observable inputs (Level 2)***	***Significant unobservable inputs (Level 3)***	***Total***
Assets measured at fair value					
Investment securities	31 December 2019	204,388	3,273	–	**207,661**
Office premises	31 December 2019	–	–	149,822	**149,822**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2019	2,789,673	–	–	**2,789,673**
Mandatory cash balances with the central banks	31 December 2019	–	–	60,059	**60,059**
Due from banks and other financial institutions	31 December 2019	–	–	3,179,615	**3,179,615**
Loans to customers	31 December 2019	–	83,188	2,136,464	**2,219,652**
Receivables from CJSC Agrarkredit	31 December 2019	–	–	693,281	**693,281**
Other financial assets	31 December 2019	–	–	32,980	**32,980**

		Fair value measurement using			
As at 31 December 2019	***Date of valuation***	***Quoted prices in active markets (Level 1)***	***Significant observable inputs (Level 2)***	***Significant unobservable inputs (Level 3)***	***Total***
Liabilities for which fair values are disclosed					
Due to banks and other financial institutions	31 December 2019	–	–	31,979	**31,979**
Customer accounts	31 December 2019	–	4,503,362	1,103,311	**5,606,673**
Payables to CJSC Agrarkredit	31 December 2019	–	–	89,055	**89,055**
Other borrowed funds	31 December 2019	–	87,645	16,859	**104,504**
Debt securities issued	31 December 2019	–	1,476,297	4,704	**1,481,001**
Other financial liabilities	31 December 2019	–	–	111,959	**111,959**

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

	Carrying value 2020	***Fair value 2020***	***Carrying value 2019***	***Fair value 2019***
Financial assets				
Cash and cash equivalents	2,504,501	2,504,501	2,789,673	2,789,673
Mandatory cash balances with central banks	55,058	55,058	60,059	60,059
Due from banks and other financial institutions	2,505,784	2,505,784	3,179,615	3,179,615
Investment securities at amortized cost	109,903	109,903	–	–
Loans to customers	2,397,018	2,409,493	2,165,804	2,219,652
Receivables from CJSC Agrarkredit	576,729	576,729	693,281	693,281
Other financial assets	66,317	66,317	32,980	32,980
Financial liabilities				
Due to banks and other financial institutions	56,917	56,917	31,979	31,979
Customer accounts	5,460,956	5,464,802	5,606,673	5,606,673
Payables to CJSC Agrarkredit	88,217	88,217	89,055	89,055
Other borrowed funds	220,207	220,207	104,504	104,504
Debt securities issued	1,490,500	1,555,176	1,526,354	1,481,001
Other financial liabilities	68,263	68,263	111,959	111,959

(Figures in tables are in thousands of Azerbaijani manats)

24. Fair value measurement (continued)

Fair value hierarchy (continued)

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost is estimated by comparing market interest rates when they were first recognised with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. For quoted debt issued the fair values are calculated based on quoted market prices. For those notes issued where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term to maturity.

25. Maturity analysis of assets and liabilities

The table below shows assets and liabilities as at 31 December 2020 and 2019 by their remaining contractual maturity, (expected maturity matches the remaining contractual maturity, except for Receivables from CJSC Agrarkredit as at 31 December 2019, where a decision of the shareholders to prolong the contractual maturity is taken into account) by when the Group has a right to realise the assets and an obligation to settle the liabilities. The Group considers assets and liabilities with a remaining contractual maturity of Within one year as current, and assets and liabilities with remaining contractual maturity of More than one year as non-current. The Group's contractual undiscounted repayment obligations are disclosed in Note 23.

	2020			*2019*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	2,504,501	–	**2,504,501**	2,789,673	–	**2,789,673**
Mandatory cash balances with central banks	55,058	–	**55,058**	60,059	–	**60,059**
Due from banks and other financial institutions	2,502,740	3,044	**2,505,784**	3,171,789	7,826	**3,179,615**
Investment securities	153,649	727,971	**881,620**	71,257	136,404	**207,661**
Loans to customers	933,607	1,463,411	**2,397,018**	686,555	1,479,249	**2,165,804**
Receivables from CJSC Agrarkredit	–	576,729	**576,729**	–	693,281	**693,281**
Property, equipment and intangibles	–	200,766	**200,766**	–	192,993	**192,993**
Current income tax assets	–	–	**–**	4,387	–	**4,387**
Deferred income tax assets	–	709	**709**	–	1,029	**1,029**
Other assets	68,629	13,968	**82,597**	33,986	13,257	**47,243**
Total assets	**6,218,184**	**2,986,598**	**9,204,782**	**6,817,706**	**2,524,039**	**9,341,745**
Due to banks and other financial institutions	46,717	10,200	**56,917**	31,979	–	**31,979**
Customer accounts	5,360,214	100,742	**5,460,956**	5,511,644	95,029	**5,606,673**
Payables to CJSC Agrarkredit	88,217	–	**88,217**	89,055	–	**89,055**
Other borrowed funds	21,825	198,382	**220,207**	22,859	81,645	**104,504**
Debt securities issued	34,384	1,456,116	**1,490,500**	34,282	1,492,072	**1,526,354**
Current income tax liabilities	–	–	**–**	74,748	–	**74,748**
Deferred income tax liabilities	–	89,464	**89,464**	–	83,498	**83,498**
Other liabilities	98,962	2,666	**101,628**	138,715	2,491	**141,206**
Total liabilities	**5,650,319**	**1,857,570**	**7,507,889**	**5,903,282**	**1,754,735**	**7,658,017**
Net assets/(liabilities)	**567,865**	**1,129,028**	**1,696,893**	**914,424**	**769,304**	**1,683,728**

26. Related party disclosures

In accordance with IAS 24 *Related Party Disclosures*, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

(Figures in tables are in thousands of Azerbaijani manats)

26. Related party disclosures (continued)

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

	2020		*2019*	
	Related party balances	***Total category as per the financial statements item***	***Related party balances***	***Total category as per the financial statements item***
Cash and cash equivalents		**2,504,501**		**2,789,673**
- Government bodies and state-owned entities	*108,820*		*126,494*	
Due from banks and other financial institutions		**2,508,493**		**3,188,441**
- Government bodies and state-owned entities	*2,465,480*		*2,825,550*	
Allowance for impairment losses on due from banks and other financial institutions		**(2,709)**		**(8,826)**
- Government bodies and state-owned entities	–		*(4,176)*	
Investment securities		**881,620**		**207,661**
- Government bodies and state-owned entities	*633,546*		*63,722*	
- Associates	*250*		*250*	
Loans to customers, gross		**2,547,283**		**2,288,549**
- Government bodies and state-owned entities	*579,595*		*745,839*	
- Key management personnel of the Group	*448*		*391*	
- Other related parties	*1,316*		*1,175*	
Allowance for impairment losses on loans to customers		**(150,265)**		**(122,745)**
- Government bodies and state-owned entities	*(3,759)*		*(8,595)*	
- Key management personnel of the Group	*(21)*		*(10)*	
- Other related parties	*(857)*		*(14)*	
Other assets		**82,597**		**47,243**
- Government bodies and state-owned entities	*32,524*		*41*	
Receivables from CJSC Agrarkredit		**579,924**		**702,392**
- Government bodies and state-owned entities	*579,924*		*702,392*	
Allowance for impairment on receivables from CJSC Agrarkredit		**(3,195)**		**(9,111)**
- Government bodies and state-owned entities	*(3,195)*		*(9,111)*	
Customer accounts		**(5,460,956)**		**(5,606,673)**
- Government bodies and state-owned entities	*(3,499,395)*		*(3,912,810)*	
- Key management personnel of the Group	*(1,104)*		*(606)*	
- Other related parties	*(7,760)*			
Payables to CJSC Agrarkredit		**(88,217)**		**(89,055)**
- Government bodies and state-owned entities	*(88,217)*		*(89,055)*	
Due to banks and other financial institutions		**(56,917)**		**(31,979)**
- Government bodies and state-owned entities	*(328)*		*(3,732)*	
- Other related parties				
Other borrowed funds		**(220,207)**		**(104,504)**
- Government bodies and state-owned entities	*(206,317)*		*(87,645)*	
Undrawn loan commitments		**1,788,157**		**659,953**
- Government bodies and state-owned entities	*1,294,727*		*490,100*	
- Key management personnel of the Group	*128*			
- Other related parties	*148*			
Letters of credit and guarantees		**1,028,511**		**907,795**
- Government bodies and state owned entities	*335,051*		*318,303*	
Provision for off-balance sheet commitments		**(40,038)**		**(86,822)**
- Government bodies and state owned entities	*(3,667)*		*(4,681)*	
- Key management personnel of the Group	*(2)*			
- Other related parties	*(13)*			

(Figures in tables are in thousands of Azerbaijani manats)

26. Related party disclosures (continued)

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

	2020		*2019*	
	Related party transactions	***Total category as per the financial statements item***	***Related party transactions***	***Total category as per the financial statements item***
Key management personnel compensation:				
- short-term employee benefits	(11,065)	**(88,770)**	(9,372)	**(73,094)**
Total	**(11,065)**		**(9,372)**	

Key management personnel include Management Board Members, Executive Directors and head of departments and their aggregate remuneration for the year ended 31 December 2020 amounted to AZN 11,065 thousand.

Included in the consolidated statement of profit or loss and other comprehensive income for the years ended 31 December 2020 and 2019 are the following amounts which were recognised in transactions with related parties:

	2020		*2019*	
	Related party transactions	***Total category as per the financial statements item***	***Related party transactions***	***Total category as per the financial statements item***
Interest income		**442,866**		**474,408**
- Government bodies and state-owned entities	*159,725*		*224,646*	
- Key management personnel of the Group	*61*		*37*	
- Other related parties	*132*		*90*	
Interest expense		**(141,328)**		**(135,888)**
- Government bodies and state-owned entities	*(96,446)*		*(96,419)*	
- Key management personnel of the Group	*(10)*		*–*	
- Other related parties	*(83)*		*(128)*	
Impairment losses / reversal of impairment losses on interest bearing assets		**(20,186)**		**(37,765)**
- Government bodies and state-owned entities	*4,837*		*(1,288)*	
- Key management personnel of the Group	*(10)*		*10*	
- Other related parties	*(206)*		*14*	
Reversal of impairment losses / (impairment losses) on contingent liabilities and credit commitments		**23,394**		**14,059**
- Government bodies and state-owned entities	*1,014*		*(2,719)*	
Gains from operations in foreign currencies		**47,346**		**68,248**
- Government bodies and state-owned entities	*33,972*		*38,299*	
Fee and commission income		**82,148**		**90,163**
- Government bodies and state-owned entities	*20,409*		*14,565*	
- Key management personnel of the Group	*5*		*14*	
- Other related parties	*20*			
Fee and commission expense		**(21,274)**		**(24,572)**
- Government bodies and state-owned entities	*(1,000)*		*(3,686)*	
Operating expenses		**(177,259)**		**(143,619)**
- Government bodies and state-owned entities	*(13,784)*		*(4,048)*	
- Key management personnel of the Group	*(11,065)*		*(9,372)*	

(Figures in tables are in thousands of Azerbaijani manats)

27. Capital adequacy

The Group maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Group's capital is managed by the ratios established by the Basel Capital Accord 1988 and monitored using the ratios established by the regulator.

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

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

Compliance with capital adequacy ratios set by the regulator is monitored monthly with reports outlining their calculation reviewed and signed by the Group's Chief Financial Officer (CFO).

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum Tier 1 and total capital adequacy ratio of 6% and 11% respectively, of risk-weighted assets for regulatory capital. As at 31 December 2020, the Bank was in compliance with these requirements.

Capital adequacy ratio under the Basel Capital Accord 1988

The Group's international risk based capital adequacy ratio is computed in accordance with the Basel Capital Accord 1988, with subsequent amendments including the amendment to incorporate market risks.

As at 31 December 2020 and 2019 these ratios exceeded the minimum ratio of 8.0% recommended by the Basel Accord, as disclosed below:

	2020	***2019***
Tier 1 capital	1,608,988	1,580,032
Tier 2 capital	187,418	150,690
Less: deductions from capital	(83,498)	(71,257)
Total capital	**1,712,908**	**1,659,465**
Risk weighted assets	**4,877,449**	**4,130,704**
Tier 1 capital ratio	32.99%	38.25%
Total capital ratio	35.12%	40.17%

28. Events after the reporting period

The strict measures introduced by the Azerbaijani Government to combat the COVID-19 outbreak, such as travel restrictions, quarantine, closure of businesses and other venues, and lockdowns of certain areas throughout the country, ended on 18 January 2021.

In April 2021, Moody's Investors Service upgraded the Bank's Baseline Credit Assessment and adjusted its Baseline Credit Assessment from b3 to b2 and confirmed the long-term local and foreign currency deposit ratings at B1 and the Long-Term Counterparty Risk Rating at Ba3. The outlooks on the long-term local and foreign currency deposit ratings were changed to positive from stable.