Bank VTB (Azerbaijan) OJSC

Financial statements

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

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Independent auditor's report

To the Shareholders and Supervisory Board of
Bank VTB (Azerbaijan) OJSC

Opinion

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

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2021, and its financial performance and its 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 financial statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' (IESBA) International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of management and Audit Committee for the consolidated financial statements

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

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

The Audit Committee is responsible for overseeing the Bank'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 Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the 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 Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Bank to express an opinion on the 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.

Ernst & Young Holdings (CIS) B.V.

13 April 2022

Baku, Azerbaijan

Statement of financial position

As at 31 December

(Amounts presented are in thousands of Azerbaijani manats)

	Notes	2021	2020
Assets			
Cash and cash equivalents	5	44,409	56,532
Mandatory reserves with the Central Bank of the Republic of Azerbaijan		477	471
Amounts due from credit institutions	7	509	308
Investment securities	6	4,534	14,432
Derivative financial assets	8	182	180
Loans to customers	9	181,764	121,058
Property and equipment	10	1,704	1,796
Right-of-use assets	12	658	1,315
Intangible assets	11	5,544	3,292
Deferred tax assets	13	621	800
Other assets	14	10,407	9,806
Total assets		**250,809**	**209,990**
Liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan and other credit institutions	15	51,366	29,744
Amounts due to customers	16	103,142	85,267
Current income tax liability		–	1,569
Lease liabilities	12	734	1,402
Other liabilities	14	5,911	4,637
Total liabilities		**161,153**	**122,619**
Equity			
Share capital	17	315,815	315,815
Accumulated deficit		(226,159)	(228,444)
Total equity		**89,656**	**87,371**
Total liabilities and equity		**250,809**	**209,990**

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

Iqor Okayev — Chairman of the Management Board

Maksim Vlasov — Chief Financial Officer

Yusif Mamedov — Chief Accountant

13 April 2022

The accompanying notes on pages 5 to 48 are an integral part of these financial statements.

Statement of profit or loss and other comprehensive income

For the year ended 31 December

(Amounts presented are in thousands of Azerbaijani manats)

	Notes	*2021*	*2020*
Interest income calculated using effective interest rate		19,802	12,595
Interest expense		(5,464)	(4,215)
Net interest income	20	**14,338**	**8,380**
Credit loss (expense)/reversal on financial assets	19	(3,233)	9,683
Net interest income after credit loss reversal		**11,105**	**18,063**
Fee and commission income	21	4,055	3,319
Fee and commission expense	21	(2,275)	(1,568)
Net losses on derecognition of financial assets measured at amortized cost		(180)	–
Net gains/(losses) arising on initial recognition of financial instruments and loan modification		5,493	(3,690)
Net gains/(losses) from foreign currencies:			
- dealing		2,196	2,684
- translation differences		416	(855)
Government grants		126	380
Other income		484	633
Non-interest income		**10,315**	**903**
Operating expenses	22	(20,525)	(17,718)
Profit before income tax benefit		**895**	**1,248**
Income tax benefit	13	1,390	800
Net profit for the year		**2,285**	**2,048**
Other comprehensive income for the year		–	–
Total comprehensive income for the year		**2,285**	**2,048**

The accompanying notes on pages 5 to 48 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December

(Amounts presented are in thousands of Azerbaijani manats)

	Share capital	*Accumulated deficit*	*Total equity*
1 January 2020	**315,815**	**(230,492)**	**85,323**
Total comprehensive income for the year	–	2,048	**2,048**
31 December 2020	**315,815**	**(228,444)**	**87,371**
Total comprehensive income for the year	–	2,285	**2,285**
31 December 2021	**315,815**	**(226,159)**	**89,656**

The accompanying notes on pages 5 to 48 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December

(Amounts presented are in thousands of Azerbaijani manats)

	Notes	*2021*	*2020*
Cash flows from operating activities			
Interest received		18,573	14,817
Interest paid		(3,823)	(3,418)
Fees and commissions received		4,034	3,215
Fees and commissions paid		(2,808)	(1,655)
Realised gains less losses from dealing in foreign currencies		2,194	2,387
Other operating income received		225	357
Personnel expenses paid		(9,766)	(10,636)
Other operating expenses paid		(4,980)	(4,258)
Government grant received in relation to operating activities		126	–
Cash flows from operating activities before changes in operating assets and liabilities		**3,775**	**809**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		(201)	(6)
Mandatory reserves with the Central Bank of the Republic of Azerbaijan		(6)	(31)
Loans to customers		(58,738)	(30,077)
Other assets		406	327
Net increase/(decrease) in operating liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan and other credit institutions		23,210	7,995
Amounts due to customers		17,963	14,832
Other liabilities		(2,847)	(142)
Net cash used in operating activities before income tax		**(15,040)**	**(6,293)**
Income tax paid		–	–
Net cash used in operating activities		**(15,040)**	**(6,293)**
Cash flows from investing activities			
Purchase of investment securities		(45,851)	(99,706)
Proceeds from sale and redemption of investment securities		55,836	104,330
Purchase of property and equipment		(365)	(661)
Purchase of intangible assets		(2,506)	(2,224)
Net cash from investing activities		**7,114**	**1,739**
Cash flows from financing activities			
Proceeds from borrowings	27	–	1,793
Repayment of borrowings	27	(2,121)	–
Lease liabilities paid	12	(774)	(773)
Net cash (used in) / from financing activities		**(2,895)**	**1,020**
Effect of exchange rates changes on cash and cash equivalents		96	(263)
Net decrease in cash and cash equivalents		**(12,123)**	**(3,797)**
Cash and cash equivalents, beginning		56,532	60,329
Cash and cash equivalents, ending	5	**44,409**	**56,532**

The accompanying notes on pages 5 to 48 are an integral part of these financial statements.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

1. Principal activities

Bank VTB (Azerbaijan) Open Joint Stock Company (the "Bank") was formed as "AF-Bank" OJSC on 14 December 1993 under the laws of the Republic of Azerbaijan. The Bank operates under a general banking license under registration number 162 issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") on 22 October 1993.

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

The Bank participates in the state deposit insurance scheme, which was introduced by the Azeri Law, "Insurance of individual deposits in the Republic of Azerbaijan" dated 29 December 2006. Insurance covers Bank's liabilities to individual depositors in case of business failure and revocation of the CBAR banking license.

On 27 October 2007, two companies registered in Cyprus − Balmwell Limited LLC and Nies Ventures Limited LLC acquired 99.8% of the Bank from its former shareholders. On 31 July 2008 and on 9 November 2009, "Bank VTB" PJSC (Russian Federation) (Parent) and "Ata Holding" OJSC acquired 51% and 48.99% of the Bank, respectively, from Nies Ventures Limited LLC and Balmwell Limited LLC. On 13 October 2017, VTB 24 (subsidiary of Bank VTB PJSC) acquired 48.99% of the Bank from "Ata Holding" OJSC. During 2018 Bank VTB PJSC acquired 48.99% of the Bank from VTB 24 and currently owns 99.99% of the Bank.

The Bank had 4 branches (2020: 4 branches) within the Republic of Azerbaijan. The Bank had 376 employees as of 31 December 2021 (2020: 361). The Bank's registered legal address is 38, Khatai Avenue, Baku, the Republic of Azerbaijan.

As of 31 December 2021 and 2020 the following shareholders owned the share capital of the Bank:

Shareholders	***2021, %***	***2020, %***
Bank VTB PJSC (Russian Federation)	99.99	99.99
Agayev Adigozel	0.01	0.01
Total	**100.00**	**100.00**

As at the date of these financial statements, the ultimate controlling party of the Bank is the government of the Russian Federation through Bank VTB PJSC (Russian Federation).

2. Basis of preparation

General

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

The Bank maintains its accounting records in accordance with regulations of the Republic of Azerbaijan. These financial statements are based on those accounting records, as adjusted and reclassified to comply with IFRS.

These financial statements have been prepared under the historical cost convention except for derivative financial instruments which have been measured at fair value.

The Azerbaijani manat ("AZN"), which is the national currency of the Republic of Azerbaijan, is the reporting and functional currency of the Bank. Transactions in other currencies are treated as transactions in foreign currencies. These financial statements are presented in thousands of AZN except for share amounts and unless otherwise indicated.

The summary of principal accounting policies applied in the preparation of these financial statements is set out below in Note 3. These policies have been consistently applied to all the periods presented, unless otherwise stated.

Effect of COVID-19 pandemic

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

2. Basis of preparation (continued)

Effect of COVID-19 pandemic (continued)

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

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

3. Summary of accounting policies

Changes in accounting policies

The Bank 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. No other standard, interpretation or amendment that has been issued but is not yet effective was early adopted by the Bank.

Several other amendments effective since 1 January 2021 were applied but do not have an impact on the financial statements of the Bank.

Fair value measurement

The Bank measures financial instruments, such as derivatives, at fair value at each balance sheet date. Fair values of financial instruments measured at amortized cost are disclosed in Note 24.

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

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

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

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

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

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Financial assets and liabilities

Initial recognition

Date of recognition

All regular way purchases and sales of financial assets and liabilities are recognized on the trade date i.e. the date that the Bank 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.

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

Measurement categories of financial assets and liabilities

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

- Amortized cost;
- FVOCI;
- FVPL.

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

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

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

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

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

The details of these conditions are outlined below.

Business model assessment

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

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

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

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

The SPPI test

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

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortization 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 Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

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

Financial guarantees, letters of credit and undrawn loan commitments

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

Financial guarantees are initially recognized in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognized less cumulative amortization recognized in the 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 Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, these contracts are in the scope of the ECL requirements.

Reclassification of financial assets and liabilities

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

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the CBAR, excluding obligatory reserves and short-term notes issued by the CBAR, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Mandatory reserves with the Central Bank of the Republic of Azerbaijan

Mandatory cash balances in AZN and foreign currency held with the CBAR represent non-interest bearing mandatory reserve deposits, which are not available to finance the Bank's day-to-day operations, and hence are not considered as part of cash and cash equivalents for the purpose of the statement of cash flows.

Amounts due from credit institutions

Amounts due from other institutions are recorded when the Bank advances money to counterparty banks with no intention of trading the resulting receivable, which is due on fixed or determinable dates. Amounts due from credit institutions are carried at amortized cost less allowance for expected credit losses.

Investment securities

After initial measurement investment securities (including short-term notes issued by the CBAR) are subsequently measured at amortized cost. Amortized cost is calculated by taking into account any discount or premium on funds, and costs that are an integral part of the effective interest rate (EIR).

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Derivative financial instruments

In the normal course of business, the Bank enters into various derivative financial instruments including futures, forwards, swaps and options in the foreign exchange. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of profit or loss and other comprehensive income as net gains/(losses) from trading securities or net gains/(losses) from foreign currencies dealing, depending on the nature of the instrument.

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

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

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

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to the Central Bank of the Republic of Azerbaijan and other credit institutions, due to customers' and subordinated debts. After initial recognition, borrowings are subsequently measured at Amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the borrowings are derecognized as well as through the amortization process.

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

Leases

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

Right-of-use assets

The Bank recognizes 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 recognized, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Unless the Bank is reasonably certain to obtain ownership of the leased asset at the end of the lease term, the recognized right-of-use assets are depreciated on a straight-line basis over the shorter of its estimated useful life (3-4 years) and the lease term. Right-of-use assets are subject to impairment.

Lease liabilities

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Leases (continued)

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

Short-term leases and leases of low-value assets

The Bank applies the short-term lease recognition exemption to its short-term leases (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value (i.e., below USD 5 thousand). Lease payments on short-term leases and leases of low-value assets are recognized as expense 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 statement of financial position when there is a legally enforceable right to set off the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. The right of set-off must not be contingent on a future event and must be legally enforceable in all of the following circumstances:

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

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

Renegotiated loans

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

The Bank derecognizes 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 recognized as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognized loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI. Restructuring of impaired loans does not result in derecognition of financial instrument, unless there is a change in contractual currency of the loan on renegotiation along with a substantial change in interest rate. When assessing whether or not to derecognize a loan to a customer, amongst others, the Bank considers the following factors:

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

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

Financial assets

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

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Renegotiated loans (continued)

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

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

Write-off

Financial assets are written off either partially or in their entirety only when the Bank has no realistic expectation of recovering the financial assets and as a result – stopped pursuing their 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 derecognized 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 recognized in the statement of profit or loss and other comprehensive income.

Taxation

The current income tax expense is calculated in accordance with regulations of the Republic of Azerbaijan.

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

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

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

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.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Property and equipment (continued)

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

	Years
Leasehold improvements	3-5
Computer equipment	4
Furniture and fixtures	4
Motor vehicles	4
Other property and equipment	5

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

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

Intangible assets

Intangible assets include computer software and licenses. Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are Amortized over the useful economic lives of 3 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortization periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

Provisions

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

Retirement and other employee benefit obligations

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

Repossessed collateral

In certain circumstances, collateral is repossessed following the foreclosure on loans that are in default. Repossessed collateral is measured in accordance with IAS 2 *Inventories* at the lower of cost and net realizable value and reported within "Other assets".

Share capital

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

Dividends

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

Contingencies

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Recognition of income and expenses

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

Interest and similar income and expense

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

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

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates interest income by calculating the credit-adjusted EIR and applying that rate to the Amortized 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 Amortized cost of the POCI assets.

Fee and commission income

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

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

Fees earned for the provision of services over a period of time are accrued over that period as respective performance obligations are satisfied. These fees include commission income and asset management, custody and other management and advisory fees. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognized as an adjustment to the effective interest rate on the loan.

Fee income from providing transaction services

Fees include commission income for provision of the following services: cash withdrawals, consulting, settlement operations, documentary operations and fees charged for transactions with plastic cards and etc. These fees or components of fees are linked to a certain performance are recognized after fulfilling the corresponding criteria.

Foreign currency translation

The financial statements are presented in Azerbaijani manats, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognized in the statement of profit or loss and other comprehensive income as net gain/(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 net gain/(losses) from foreign currencies-dealing. The official CBAR exchange rates at 31 December 2021 and 31 December 2020 were as follows:

	31 December 2021	*31 December 2020*
USD/AZN	1.7000	1.7000
GBP/AZN	2.2925	2.3021
EUR/AZN	1.9265	2.0890
RUB/AZN	0.0229	0.0231

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Foreign exchange revaluation of expected credit loss allowance of loans denominated in foreign currency

Allowance for impairment of loans denominated in foreign currency is accounted for in the same currency as the loans, which they are made for. Gains and losses from the revaluation of previously recognized allowance for loan impairment denominated in foreign currencies is included in 'net losses/gains from foreign currencies − translation differences' in the statement of profit or loss and other comprehensive income.

Government grants and government assistance

Government grants are recognized where there is reasonable assurance that the grant will be received and all the related conditions will be complied with. Where the grant relates to an expense item, it is recognized as income in the same periods as the respective expenses it is intended to compensate on a systematic basis. Where the grant relates to an asset, it is recognized as deferred income and released to income in equal amounts over the expected useful life of the related asset.

Government loans provided at below market interest rates are recognized in accordance with IFRS 9. The benefit of the government loan is measured at the inception of the loan as the difference between the cash received and the amount at which the loan is initially recognized in the statement of financial position. This benefit is accounted for in accordance with IAS 20.

A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs is recognized in a separate line of the statement of profit or loss and other comprehensive income for the period in which it becomes receivable.

Adoption of new and revised standards

The following amended standards and interpretations became effective from 1 January 2021, but did not have any material impact on the Bank:

- *Interest Rate Benchmark Reform – Phase 2 Amendments to IFRS 9, IAS 39 IFRS 7, IFRS 4 and IFRS 16* (issued in August 2020 and effective for annual periods beginning on or after 1 January 2021).

4. Significant accounting judgments and estimates

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 Bank's financial statements are disclosed below. The Bank intends to adopt these new and amended standards and interpretations, if applicable, when they become effective.

IFRS 17 Insurance Contracts

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

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

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

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

4. Significant accounting judgments and estimates (continued)

Standards and interpretations issued but not yet effective (continued)

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

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

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

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 Bank will apply the amendments to 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 will result in a material impact on its financial statements.

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

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

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

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

Property, Plant and Equipment: Proceeds before Intended Use – Amendments to IAS 16

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

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

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

Onerous Contracts – Costs of Fulfilling a Contract – Amendments to IAS 37

In May 2020, the IASB issued amendments to IAS 37 to specify which costs an entity needs to include when assessing whether a contract is onerous or loss-making.

The amendments apply a "directly related cost approach". The costs that relate directly to a contract to provide goods or services include both incremental costs and an allocation of costs directly related to contract activities. General and administrative costs do not relate directly to a contract and are excluded unless they are explicitly chargeable to the counterparty under the contract.

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

4. Significant accounting judgments and estimates (continued)

Standards and interpretations issued but not yet effective (continued)

IFRS 1 First-time Adoption of International Financial Reporting Standards – Subsidiary as a first-time adopter

As part of its 2018-2020 Annual Improvements to IFRS standards process, the IASB issued an amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The amendment permits a subsidiary that elects to apply paragraph D16(a) of IFRS 1 to measure cumulative translation differences using the amounts reported by the parent, based on the parent's date of transition to IFRS. This amendment is also applied to an associate or joint venture that elects to apply paragraph D16(a) of IFRS 1.

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

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

Definition of Accounting Estimates – Amendments to IAS 8

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

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

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

Estimation uncertainty

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

Fair value of financial instruments

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

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. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

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

The amount of allowance for loan impairment recognized in the statement of financial position at 31 December 2021 was AZN 22,926 (2020: AZN 27,090). More details are provided in Notes 9 and 23.

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

4. Significant accounting judgments and estimates (continued)

Estimation uncertainty (continued)

Initial recognition of related party transactions

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

More details are provided in Note 26.

Leases − estimating the incremental borrowing rate

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

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

Taxation

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

Deferred tax assets

Deferred income tax assets are recorded to the extent that realization of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are probable in the future are based on medium term business plan prepared by management and extrapolated results thereafter. The business plans are based on management expectations that are believed to be reasonable under the circumstances.

Deferred tax asset in amount of AZN 621 was recognized in the statement of financial position as at 31 December 2021 (2020: AZN 800).

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2021	***2020***
Cash on hand	7,841	9,435
Current accounts with the CBAR	24,902	23,313
Current accounts with other banks	11,666	17,116
Time deposits with the CBAR up to 90 days	–	6,668
Cash and cash equivalents	**44,409**	**56,532**

Current accounts with other banks consist of non-interest-bearing correspondent account balances with resident and non-resident banks in the amount of AZN 494 (2020: AZN 1,452) and AZN 11,172 (2020: AZN 15,664), respectively.

Current accounts with non-resident banks are mainly concentrated in Russia and denominated in USD and EUR.

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

6. Investment securities

Investment securities comprise:

	2021	**2020**
Notes issued by the Ministry of Finance of the Republic of Azerbaijan	4,534	–
Notes issued by the CBAR	–	14,432
Investment Securities	**4,534**	**14,432**

All investment securities are measured at amortized cost and are allocated to Stage 1. The ECL relating to investment securities of the Bank rounds to zero.

	2021	**2020**
Notes issued by the Ministry of Finance of the Republic of Azerbaijan	4,534	–
Trading securities pledged under sale and repurchase agreements	**4,534**	**–**

7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2021	**2020**
Loans to banks	201	–
Blocked accounts with resident banks	313	313
	514	**313**
Less: allowance for impairment	(5)	(5)
Amounts due from credit institutions	**509**	**308**

The ECL relating to Loans to Banks rounds to zero.

8. Derivative financial instruments

The table below shows the fair value of derivative financial instruments, recorded as asset (2020: asset), together with their notional amounts.

	31 December 2021			***31 December 2020***		
	Notional	***Fair values***		***Notional***	***Fair value***	
Foreign exchange contracts	***amount***	***Asset***	***Liability***	***amount***	***Asset***	***Liability***
Swap – foreign	6,460	175	–	6,460	176	–
Forward – foreign	5,440	7	–	3,400	4	–
Total derivative assets/(liabilities)		**182**	**–**		**180**	**–**

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

Forwards

Forwards contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customized contracts transacted in the over-the-counter market.

Swaps

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

9. Loans to customers

Loans to customers comprise:

	2021	*2020*
Small business lending	36,076	44,519
Corporate lending	83,776	68,770
Consumer lending	84,317	34,445
Auto lending	521	414
Gross loans to customers	**204,690**	**148,148**
Less: allowance for impairment	(22,926)	(27,090)
Loans to customers	**181,764**	**121,058**

As of 31 December 2021, the Bank had a concentration of loans represented by AZN 71,681 due from ten (2020: ten) largest third-party borrowers (35% of gross loan portfolio) (2020: AZN 68,962 or 47% of gross loan portfolio). An allowance of AZN 7,046 (2020: AZN 13,241) was recognized against these loans.

Loans have been extended to the following types of customers:

	2021	*2020*
Private companies	96,926	83,338
Individual entrepreneurs	22,926	29,951
Individuals	84,838	34,859
Gross loans to customers	**204,690**	**148,148**

Loans are made principally within the Republic of Azerbaijan in the following industry sectors:

	2021	*2020*
Individuals	84,838	34,859
Services	62,960	27,806
Trading enterprises	22,904	36,309
Credit Institutions	16,158	15,769
Construction	7,288	15,092
Manufacturing	4,123	5,665
Transport	3,606	9,944
Agriculture and food processing	1,710	1,476
Energy	1,103	1,228
Gross loans to customers	**204,690**	**148,148**

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

Small business lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2021	**6,415**	**97**	**38,007**	**44,519**
New assets originated or purchased	12,454	–	–	**12,454**
Contractual interest receivable	–	–	10	**10**
Assets repaid	(3,707)	(38)	(10,257)	**(14,002)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	(2,965)	(59)	3,024	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	(3)	–	(2,040)	**(2,043)**
Unwinding of discount	1	–	1,777	**1,778**
Amounts written off	–	–	(6,821)	**(6,821)**
Foreign exchange	–	–	181	**181**
Gross carrying value as at 31 December 2021	**12,195**	**–**	**23,881**	**36,076**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

9. Loans to customers (continued)

Small business lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2021	**362**	**35**	**14,773**	**15,170**
Movements with impact on credit loss allowance charge/(reversal) in profit or loss				
New assets originated or purchased	432	–	–	**432**
Contractual interest receivable	–	–	8	**8**
Assets repaid	(238)	(16)	(3,099)	**(3,353)**
Changes due to modifications not resulting in derecognition	–	–	(67)	**(67)**
Changes to inputs used for ECL calculations	(76)	3	1,200	**1,127**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	(131)	(15)	146	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	2,415	**2,415**
Movements without impact on credit loss allowance charge/(reversal) in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	2	**2**
Amounts written off	–	–	(6,821)	**(6,821)**
Foreign exchange	–	–	181	**181**
ECL as at 31 December 2021	**349**	**7**	**8,738**	**9,094**

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

Corporate lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2021	**54,383**	**–**	**14,387**	**68,770**
New assets originated or purchased	61,657	–	–	**61,657**
Contractual interest receivable	–	–	15	**15**
Assets repaid	(41,731)	–	(4,558)	**(46,289)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	(870)	–	870	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	–	–	(163)	**(163)**
Unwinding of discount	–	–	15	**15**
Amounts written off	–	–	(229)	**(229)**
Gross carrying value as at 31 December 2021	**73,439**	**–**	**10,337**	**83,776**

Corporate lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2021	**1,286**	**–**	**6,276**	**7,562**
Movements with impact on credit loss allowance charge/(reversal) in profit or loss				
New assets originated or purchased	1,079	–	–	**1,079**
Contractual interest receivable	–	–	12	**12**
Assets repaid	(1,483)	–	(2,590)	**(4,073)**
Changes due to modifications not resulting in derecognition	–	–	(74)	**(74)**
Changes to inputs used for ECL calculations	(3)	–	190	**187**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	(196)	–	196	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	500	500
Movements without impact on credit loss allowance charge/(reversal) in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	3	**3**
Amounts written off	–	–	(229)	**(229)**
ECL as at 31 December 2021	**683**	**–**	**4,284**	**4,967**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

9. Loans to customers (continued)

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

Consumer lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2021	**30,279**	**1,334**	**2,832**	**34,445**
New assets originated or purchased	56,341	–	–	**56,341**
Contractual interest receivable	–	–	2,965	**2,965**
Assets repaid	(7,909)	(140)	(1,105)	**(9,154)**
Transfers to Stage 1	1,171	(575)	(596)	**–**
Transfers to Stage 2	(661)	670	(9)	**–**
Transfers to Stage 3	(1,004)	(551)	1,555	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	(5)	–	–	**(5)**
Unwinding of discount	–	–	401	**401**
Amounts written off	–	(18)	(658)	**(676)**
Gross carrying value as at 31 December 2021	**78,212**	**720**	**5,385**	**84,317**

Consumer lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2021	**907**	**755**	**2,387**	**4,049**
Movements with impact on credit loss allowance charge/(reversal) in profit or loss				
New assets originated or purchased	3,246	–	–	**3,246**
Contractual interest receivable	–	–	2,755	**2,755**
Assets repaid	(361)	(36)	(1,033)	**(1,430)**
Changes to inputs used for ECL calculations	(82)	(43)	17	**(108)**
Transfers to Stage 1	736	(329)	(407)	**–**
Transfers to Stage 2	(107)	115	(8)	**–**
Transfers to Stage 3	(198)	(307)	505	**–**
Impact on period end ECL of exposures transferred between stages during the period	(720)	241	801	**322**
Movements without impact on credit loss allowance charge/(reversal) in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	210	**210**
Amounts written off	–	(18)	(658)	**(676)**
ECL as at 31 December 2021	**3,421**	**378**	**4,569**	**8,368**

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

Auto lending	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2021	**76**	**34**	**304**	**414**
New assets originated or purchased	7	–	–	**7**
Contractual interest receivable	–	–	245	**245**
Assets repaid	(48)	(30)	–	**(78)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	(7)	–	7	**–**
Amounts written off	–	–	(67)	**(67)**
Gross carrying value as at 31 December 2021	**28**	**4**	**489**	**521**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

9. Loans to customers (continued)

Auto lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2021	**16**	**23**	**270**	**309**
Movements with impact on credit loss allowance charge/(reversal) in profit or loss				
New assets originated or purchased	3	–	–	**3**
Contractual interest receivable	–	–	245	**245**
Assets repaid	(5)	(15)	–	**(20)**
Changes to inputs used for ECL calculations	(6)	(6)	33	**21**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	(1)	–	1	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	6	**6**
Movements without impact on credit loss allowance charge/(reversal) in profit or loss	–	–	–	**–**
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	–	**–**
Amounts written off	–	–	(67)	**(67)**
ECL as at 31 December 2021	**7**	**2**	**488**	**497**

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

Small business lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2020	**4,250**	**–**	**128,520**	**132,770**
New assets originated or purchased	5,614	–	–	**5,614**
Contractual interest receivable	–	–	14,955	**14,955**
Assets repaid	(1,190)	–	(8,697)	**(9,887)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(97)	97	–	**–**
Transfers to Stage 3	(2,154)	–	2,154	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	(11)	–	(4,557)	**(4,568)**
Unwinding of discount	3	–	599	**602**
Amounts written off	–	–	(93,132)	**(93,132)**
Foreign exchange	–	–	(1,835)	**(1,835)**
Gross carrying value as at 31 December 2020	**6,415**	**97**	**38,007**	**44,519**

Small business lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2020	**124**	**–**	**105,211**	**105,335**
Movements with impact on credit loss allowance charge/(reversal) in profit or loss				
New assets originated or purchased	264	–	–	**264**
Contractual interest receivable	–	–	2,699	**2,699**
Assets repaid	(55)	–	(8,256)	**(8,311)**
Changes due to modifications not resulting in derecognition	(1)	–	(4,420)	**(4,421)**
Changes to inputs used for ECL calculations	67	3	121	**191**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(7)	7	–	**–**
Transfers to Stage 3	(30)	–	30	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	25	1,491	**1,516**
Movements without impact on credit loss allowance charge/(reversal) in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	12,256	**12,256**
Amounts written off	–	–	(93,132)	**(93,132)**
Foreign exchange	–	–	(1,227)	**(1,227)**
ECL as at 31 December 2020	**362**	**35**	**14,773**	**15,170**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

9. Loans to customers (continued)

Small business lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2020	**124**	**–**	**105,211**	**105,335**
Movements with impact on credit loss allowance charge/(reversal) in profit or loss				
New assets originated or purchased	264	–	–	**264**
Contractual interest receivable	–	–	2,699	**2,699**
Assets repaid	(55)	–	(8,256)	**(8,311)**
Changes due to modifications not resulting in derecognition	(1)	–	(4,420)	**(4,421)**
Changes to inputs used for ECL calculations	67	3	121	**191**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(7)	7	–	**–**
Transfers to Stage 3	(30)	–	30	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	25	1,491	**1,516**
Movements without impact on credit loss allowance charge/(reversal) in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	12,256	**12,256**
Amounts written off	–	–	(93,132)	**(93,132)**
Foreign exchange	–	–	(1,227)	**(1,227)**
ECL as at 31 December 2020	**362**	**35**	**14,773**	**15,170**

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

Corporate lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2020	**37,622**	**–**	**19,660**	**57,282**
New assets originated or purchased	53,771	–	–	**53,771**
Contractual interest receivable	–	–	1,976	**1,976**
Assets repaid	(35,142)	–	(2,237)	**(37,379)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	(1,868)	–	1,868	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	–	–	471	**471**
Unwinding of discount	–	–	(110)	**(110)**
Amounts written off	–	–	(7,241)	**(7,241)**
Gross carrying value as at 31 December 2020	**54,383**	**–**	**14,387**	**68,770**

Corporate lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2020	**879**	**–**	**12,485**	**13,364**
Movements with impact on credit loss allowance charge/(reversal) in profit or loss				
New assets originated or purchased	1,239	–	–	**1,239**
Contractual interest receivable	–	–	1,007	**1,007**
Assets repaid	(681)	–	(2,223)	**(2,904)**
Changes due to modifications not resulting in derecognition	–	–	199	**199**
Changes to inputs used for ECL calculations	35	–	259	**294**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	(186)	–	186	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	635	**635**
Movements without impact on credit loss allowance charge/(reversal) in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	969	**969**
Amounts written off	–	–	(7,241)	**(7,241)**
ECL as at 31 December 2020	**1,286**	**–**	**6,276**	**7,562**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

9. Loans to customers (continued)

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

Consumer lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2020	**18,705**	**566**	**23,996**	**43,267**
New assets originated or purchased	17,568	–	–	**17,568**
Contractual interest receivable	–	–	4,326	**4,326**
Assets repaid	(3,874)	(121)	(2,912)	**(6,907)**
Transfers to Stage 1	277	(264)	(13)	**–**
Transfers to Stage 2	(1,174)	1,179	(5)	**–**
Transfers to Stage 3	(1,201)	(26)	1,227	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	(28)	–	(2)	**(30)**
Unwinding of discount	6	–	1	**7**
Amounts written off	–	–	(23,786)	**(23,786)**
Gross carrying value as at 31 December 2020	**30,279**	**1,334**	**2,832**	**34,445**

Consumer lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2020	**414**	**245**	**23,704**	**24,363**
Movements with impact on credit loss allowance charge/(reversal) in profit or loss				
New assets originated or purchased	680	–	–	**680**
Contractual interest receivable	–	–	21	**21**
Assets repaid	(183)	(47)	(2,819)	**(3,049)**
Changes due to modifications not resulting in derecognition	(1)	–	(2)	**(3)**
Changes to inputs used for ECL calculations	108	28	216	**352**
Transfers to Stage 1	125	(116)	(9)	**–**
Transfers to Stage 2	(43)	47	(4)	**–**
Transfers to Stage 3	(74)	(13)	87	**–**
Impact on period end ECL of exposures transferred between stages during the period	(119)	611	674	**1,166**
Movements without impact on credit loss allowance charge/(reversal) in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	4,305	**4,305**
Amounts written off	–	–	(23,786)	**(23,786)**
ECL as at 31 December 2020	**907**	**755**	**2,387**	**4,049**

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

Auto lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2020	**315**	**21**	**27,538**	**27,874**
New assets originated or purchased	–	–	–	**–**
Contractual interest receivable	–	–	3,831	**3,831**
Assets repaid	(56)	(8)	(1,923)	**(1,987)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(21)	21	–	**–**
Transfers to Stage 3	(162)	–	162	**–**
Amounts written off	–	–	(29,304)	**(29,304)**
Gross carrying value as at 31 December 2020	**76**	**34**	**304**	**414**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

9. Loans to customers (continued)

Auto lending	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2020	**42**	**9**	**27,476**	**27,527**
Movements with impact on credit loss allowance charge/(reversal) in profit or loss				
New assets originated or purchased	–	–	–	**–**
Contractual interest receivable	–	–	487	**487**
Assets repaid	(5)	(3)	(1,904)	**(1,912)**
Changes to inputs used for ECL calculations	(4)	7	31	**34**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(3)	3	–	**–**
Transfers to Stage 3	(14)	–	14	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	7	126	**133**
Movements without impact on credit loss allowance charge/(reversal) in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	3,344	**3,344**
Amounts written off	–	–	(29,304)	**(29,304)**
ECL as at 31 December 2020	**16**	**23**	**270**	**309**

Modified and restructured loans

The Bank derecognizes 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 recognized as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognized loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI.

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

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

Loans modified during the period	***2021***	***2020***
Amortized cost before modification	10,663	27,553
Net modification loss	(2,207)	(4,088)

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

- ► For corporate and small business lending: charges over real estate and trade receivables, third party guarantees;
- ► For consumer lending: cash, charges over credited consumer appliances, third party guarantees and mortgages over residential properties;
- ► For auto lending: cash, liens over vehicles and third-party guarantees.

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

The Bank calculates LGD rate of several corporate and small business lending loans in Stage 3 using discounted value of collaterals. As at 31 December 2021, maximum exposure of such loans amounted to AZN 33,934 (2020: AZN 46,778) for which ECL of AZN 12,852 (2020: AZN 16,656) was created. If these loans were not collateralized, ECL amount for these loans would be AZN 32,972 (2020: AZN 45,272).

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

10. Property and equipment

The movements in property and equipment were as follows:

	Leasehold improvements	*Computer equipment*	*Furniture and fixtures*	*Motor vehicles*	*Other property and equipment*	*Total*
Cost						
31 December 2019	**1,637**	**3,703**	**1,851**	**755**	**234**	**8,180**
Additions	–	597	280	–	16	**893**
Disposals	–	–	–	–	–	**–**
Write-offs	–	–	(3)	–	(67)	**(70)**
31 December 2020	**1,637**	**4,300**	**2,128**	**755**	**183**	**9,003**
Additions	37	229	15	6	39	**326**
Disposals	–	–	–	(135)	–	**(135)**
Write-offs	–	(53)	–	–	(2)	**(55)**
31 December 2021	**1,674**	**4,476**	**2,143**	**626**	**220**	**9,139**
Accumulated depreciation						
31 December 2019	**(1,637)**	**(3,136)**	**(1,457)**	**(335)**	**(164)**	**(6,729)**
Disposals	–	–	–	–	–	**–**
Write-off	–	–	3	–	67	**70**
Depreciation charge	–	(255)	(150)	(122)	(21)	**(548)**
31 December 2020	**(1,637)**	**(3,391)**	**(1,604)**	**(457)**	**(118)**	**(7,207)**
Disposals	–	–	–	135	–	**135**
Write-off	–	53	–	–	2	**55**
Depreciation charge	(5)	(199)	(119)	(74)	(21)	**(418)**
31 December 2021	**(1,642)**	**(3,537)**	**(1,723)**	**(396)**	**(137)**	**(7,435)**
Net book value						
31 December 2019	**–**	**567**	**394**	**420**	**70**	**1,451**
31 December 2020	**–**	**909**	**524**	**298**	**65**	**1,796**
31 December 2021	**32**	**939**	**420**	**230**	**83**	**1,704**

As at 31 December 2021, property and equipment amounting to AZN 6,218 (2020: AZN 6,332) were fully depreciated.

11. Intangible assets

	Licenses	*Computer software*	*Total*
Cost			
31 December 2019	**2,720**	**1,744**	**4,464**
Additions	226	1,396	**1,622**
Write-off	(456)	–	**(456)**
31 December 2020	**2,490**	**3,140**	**5,630**
Additions	696	2,544	**3,240**
Write-off	–	–	**–**
31 December 2021	**3,186**	**5,684**	**8,870**
Accumulated amortization			
31 December 2019	**(1,564)**	**(749)**	**(2,313)**
Write-off	456	–	**456**
Amortization charge	(240)	(241)	**(481)**
31 December 2020	**(1,348)**	**(990)**	**(2,338)**
Write-off	–	–	**–**
Amortization charge	(627)	(361)	**(988)**
31 December 2021	**(1,975)**	**(1,351)**	**(3,326)**
Net book value			
31 December 2019	**1,156**	**995**	**2,151**
31 December 2020	**1,142**	**2,150**	**3,292**
31 December 2021	**1,211**	**4,333**	**5,544**

As at 31 December 2021, intangible assets amounting to AZN 1,431 (2020: AZN 1,018) were fully amortized.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

12. Right of use assets and lease liability

The movements in right-of-use assets were as follows:

	2021	*2020*
As at 1 January	**1,315**	**720**
Additions	–	1,253
Depreciation expense	(657)	(658)
As at 31 December	**658**	**1,315**

The movements in lease liability were as follows:

	2021	*2020*
As at 1 January	**1,402**	**756**
Additions	–	1,253
Interest expense	106	166
Payments	(774)	(773)
As at 31 December	**734**	**1,402**

13. Taxation

The corporate income tax benefit comprises:

	2021	*2020*
Adjustments in respect of current income tax of previous years	1,569	–
Deferred tax (expense)/benefit	(179)	800
Income tax benefit	**1,390**	**800**

Azerbaijani legal entities have to file individual corporate income tax declarations. Standard corporate income tax rate for companies (including banks) is 20% for 2021 and 2020.

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

	2021	*2020*
Profit before tax	**895**	**1,248**
Statutory tax rate	20%	20%
Theoretical income expense at the statutory rate	**(179)**	**(250)**
Adjustments in respect of current income tax of previous years	1,569	–
Tax effect of permanent differences	(77)	(87)
Change in unrecognized deferred tax asset	98	1,230
Other	(21)	(93)
Income tax benefit	**1,390**	**800**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

13. Taxation (continued)

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

	2019	*Origination and reversal of temporary differences in statement of profit or loss and other comprehensive income*	*2020*	*Origination and reversal of temporary differences in statement of profit or loss and other comprehensive income*	*2021*
Tax effect of deductible temporary differences					
Tax losses carried forward	48,341	(807)	47,534	(1,022)	46,512
Loans to customers	–	1,209	1,209	1,401	2,610
Derivative financial liabilities	29	(29)	–	–	–
Property and equipment	145	337	482	(398)	84
Intangible assets	11	(11)	–	116	116
Other assets	–	98	98	56	154
Lease liabilities	151	130	281	(133)	148
Other liabilities	615	(482)	133	15	148
Deferred tax assets	**49,292**	**445**	**49,737**	**35**	**49,772**
Loans to customers	(4,907)	(345)	(5,252)	(653)	(5,905)
Amounts due from credit institutions	(46)	8	(38)	14	(24)
Amounts due to credit institutions	(415)	(145)	(560)	179	(381)
Derivative financial assets	(5)	(31)	(36)	-	(36)
Right-of-use assets	(144)	(119)	(263)	131	(132)
Other assets	(378)	(243)	(621)	17	(604)
Deferred tax liabilities	**(5,895)**	**(875)**	**(6,770)**	**(312)**	**(7,082)**
Unrecognized deferred tax asset	(43,397)	1,230	(42,167)	98	(42,069)
Net deferred income tax assets	**–**	**800**	**800**	**(179)**	**621**

14. Other assets and liabilities

Other assets comprise:

	2021	*2020*
Amounts in the course of settlement	2,333	1,995
Other financial receivables	22	80
Total other financial assets	**2,355**	**2,075**
Prepayment for purchase of property, equipment and intangible assets	139	834
Other prepayments	819	719
Repossessed collateral	6,786	5,940
Other non-financial assets	308	238
Total other non-financial assets	**8,052**	**7,731**
Other assets	**10,407**	**9,806**

Other liabilities comprise:

	2021	*2020*
Payable for professional services	329	246
Provision for credit related commitments	164	383
Other financial liabilities	1,944	983
Total other financial liabilities	**2,437**	**1,612**
Payable to employees	2,576	1,895
Taxes payable, other than income tax	892	640
Other non-financial liabilities	6	490
Total other non-financial liabilities	**3,474**	**3,025**
Other liabilities	**5,911**	**4,637**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

15. Amounts due to the Central Bank of the Republic of Azerbaijan and other credit institutions

Amounts due to the CBAR and other credit institutions comprise:

	2021	*2020*
Long term loans due to the Central Bank of the Republic of Azerbaijan	7,331	9,578
Amount due to Azerbaijan Mortgage and Credit Guarantee Fund	27,268	19,228
Short-term loans from resident banks	11,000	–
Current accounts of other banks	926	938
Long-term Loans from Entrepreneurship Development Fund	254	–
Payables under repurchase agreement for up to 30 days	4,587	–
Amounts due to the Central Bank of the Republic of Azerbaijan and other credit institutions	**51,366**	**29,744**

Long term loans due to the Central Bank of the Republic of Azerbaijan are funds provided in accordance with the Presidential Decree on additional measures for resolution of the issues relating to non-performing loans of individuals in the Republic of Azerbaijan, which was signed on 28 February 2019. The loans mature in 2024-2025 (2020: 2024) and bear contractual interest rate of 0.1% p.a (2020: 0.1% p.a.).

As at 31 December 2021, the the Bank attracted short-term deposits from four resident banks comprising AZN 11,000 (31 December 2020: AZN 0) maturing through December 2022 and with interest rates ranging between 7% and 8% p.a.

In 2016, the Bank signed a credit agreement with the Azerbaijan Mortgage Fund OJSC for granting long-term mortgage loans to individuals. Name of the fund was change to Azerbaijan Mortgage and Credit Guarantee Fund OJSC in 2018. Under this program, funds are made available to the Bank at interest rates between 1% and 4% p.a. (2020: 1% and 4% p.a.) and mature in 2023-2050 (2020: 2023-2049). The Bank is obliged to make these funds to issue loans to eligible borrowers at rates not higher than 8.0% p.a.

Current accounts include accounts in amount of AZN 74 (2020: AZN 127) from Parent and AZN 851 (2020: AZN 798) from entities under common control.

In 2021, the Bank signed a credit agreement with Entrepreneurship Development Fund of the Republic of Azerbaijan, a program under the Ministry of Economic Development of the Republic of Azerbaijan, for financing of small and medium sized enterprises. Under this program, funds are made available to the Bank at an interest rate of 1% p.a. and mature in 2025. The Bank uses these funds to issue loans to eligible borrowers at rates not higher than 7% p.a.

As at 31 December 2021, the Bank entered into repurchase agreement and borrowed funds amounting to AZN 4,587. The Bank pledged its investment securities as collateral in National Depository Center of Azerbaijan.

16. Amounts due to customers

The amounts due to customers comprise:

	2021	*2020*
Current accounts	48,550	47,385
Term deposits	54,592	37,882
Amounts due to customers	**103,142**	**85,267**
Held as security against guarantees and letters of credit (Note 18)	(459)	(541)

As of 31 December 2021, customer accounts of AZN 46,422 or 45% (2020: AZN 42,308 or 50%) were due to the ten (2020: ten) largest customers.

The average interest rate on term deposits of individual customers outstanding as of 31 December 2021 is 9% p.a. (2020: 9.4% p.a.), while the average interest rate on term deposits of legal entities outstanding as of 31 December 2021 was 7% p.a. (2020: 5% p.a.).

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

16. Amounts due to customers (continued)

An analysis of amounts due to customers by economic sector is as follows:

	2021	*2020*
Individuals	54,575	39,606
Trading	15,315	13,106
Insurance	14,980	10,988
Service	14,198	12,311
Manufacturing	1,877	5,412
Transportation	1,336	3,049
Public organizations	566	496
Other	295	299
Amounts due to customers	**103,142**	**85,267**

17. Equity

As at 31 December 2021 and 2020, the Bank's share capital is represented by ordinary shares which were registered at State Securities Committee of the Republic of Azerbaijan on 29 December 2017, thus, authorized, issued and fully paid up capital comprised of 1,579,075,000 ordinary shares with nominal amount of 0.2 Azerbaijani manat per ordinary share. Each ordinary share carries one vote.

In accordance with Azerbaijan legislation, the shareholders of the Bank should have the following rights: elect and be elected to its management and executive bodies, collect information related to the activity of the Bank, familiarize with annual reports and accounts once a year, request holding the General Meeting of Shareholders, request amendments to the agenda of the General Meeting of Shareholders of the Bank, request audit of the activity of the Bank and in case of termination of Bank's activity, receive a distribution of Bank's assets remained after settlements with creditors and payment of calculated but unpaid dividends.

18. Commitments and contingencies

Operating environment

The Bank conducts all operations in the Republic of Azerbaijan. The Republic of Azerbaijan displays certain characteristics of an emerging market. The legal, tax and regulatory frameworks continue to develop and are subject to frequent changes and varying interpretations. Its economy is particularly sensitive to oil and gas prices.

The future economic and regulatory situation and its impact on the Bank's operations may differ from management's current expectations. Certain economic factors, including contraction of real incomes of households, reduced corporate liquidity and profitability and increased corporate and personal insolvencies, may affect the Bank's borrowers' ability to repay the amounts due to the Bank. Adverse changes in economic conditions may result in deterioration in the value of collateral held against loans and other obligations.

The Bank considered available current macro-economic information in its impairment assessments.

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

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

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

18. Commitments and contingencies (continued)

Operating environment (continued)

COVID-19 pandemic

During 2020, the global economy was negatively impacted by the spread of the coronavirus pandemic (COVID-19). During March-August 2020, the increasingly restrictive lockdown measures to combat COVID-19 in many countries significantly reduced economic activity and aggregate spending levels. Social distancing and quarantine measures resulted in the closure of retail, transport, travel, catering, hotel, entertainment and many other businesses. International trade was also significantly reduced. Finally, oil prices tumbled to historic lows but fully recovered by the end of the period. A support package was introduced by the Government and the CBAR to counter the economic downturn caused by the pandemic. These measures include, but are not limited to, subsidized lending to affected industries, payments to unemployed individuals and easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources and help customers avoid liquidity shortages as a result of the COVID-19 containment measures.

On 23 April 2020, the CBAR decided to temporarily reduce the minimum required capital adequacy ratio from 12% to 11% for banks of systematic importance, and from 10% to 9% for all other banks, including the Bank, and keep it at these levels until July 2021. Since July 2021, the required minimum ratios were set back at pre-pandemic levels (12% and 10%, respectively).

With the start of vaccination of Azerbaijani population on 16 January 2021 the Azerbaijani Government decided to gradually eliminate the special strict quarantine regime measures introduced in the previous year to combat the COVID-19 outbreak, such as travel restrictions, closure of business and other venues, lockdowns of certain areas throughout the country.

Despite this relief of strict quarantine regime for preventing coronavirus, the CBAR decided to prolong the easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources.

The Bank'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 Bank's business in the foreseeable future. The Bank considers its current liquidity position to be sufficient for its sustainable functioning. The Bank monitors its liquidity position on a daily basis.

Legal

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

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within the Republic of Azerbaijan suggest that the tax authorities may be taking a more assertive position in their interpretation and application of this legislation and assessments. It is therefore possible that transactions and activities of the Bank that have not been challenged in the past may be challenged at any time in the future. As a result, significant additional taxes, penalties and interest may be assessed by the relevant authorities. Fiscal periods remain open and subject to review by the tax authorities for a period of three calendar years immediately preceding the year in which the decision to conduct a tax review is taken. The last tax audit of the Bank is ongoing as of the date of these financial statements and covers the period from 2018 to 2020.

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

Commitments and contingencies

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

Credit related commitments	***2021***	***2020***
Guarantees	20,030	14,794
Undrawn loan commitments	18,268	18,499
Less: provisions for ECL for credit related commitments	(164)	(383)
Commitments and contingencies (before deducting collateral)	**38,134**	**32,910**
Less: cash held as security against guarantees and letters of credit (Note 16)	(459)	(541)
Commitments and contingencies	**37,675**	**32,369**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

18. Commitments and contingencies (continued)

Commitments and contingencies (continued)

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

Financial guarantees	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECLs as at 1 January 2021	**193**	**–**	**–**	**193**
New exposures	118	–	–	**118**
Exposures derecognized or matured	(183)	–	–	**(183)**
Changes to models and inputs used for ECL	(5)	–	–	**(5)**
At 31 December 2021	**123**	**–**	**–**	**123**

Undrawn loan commitments	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECLs as at 1 January 2021	**178**	**12**	**–**	**190**
New exposures	28	–	–	**28**
Exposures derecognized or matured	(182)	–	–	**(182)**
Transfers to stage 1	11	(11)	–	**–**
New remeasurement of ECL	5		–	**5**
At 31 December 2021	**40**	**1**	**–**	**41**

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***
ECLs as at 1 January 2020	**350**	**–**	**–**	**350**
New exposures	159	–	–	159
Exposures derecognized or matured	(339)	–	–	(339)
Changes to models and inputs used for ECL	23	–	–	23
At 31 December 2020	**193**	**–**	**–**	**193**

Undrawn loan commitments	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECLs as at 1 January 2020	**279**	**66**	**–**	**345**
New exposures	154	–	–	**154**
Exposures derecognized or matured	(272)	(66)	–	**(338)**
Transfers to stage 2	(2)	2	–	**–**
Changes to models and inputs used for ECL	19	10	–	**29**
At 31 December 2020	**178**	**12**	**–**	**190**

Expected credit loss allowance on credit-related commitments is recorded within other non-financial liabilities balance.

Compliance with the CBAR ratios

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

19. Credit loss reversal and other impairment provisions

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

	Note	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Loans to customers	9	1,889	(408)	1,752	**3,233**
Credit loss (expense)/reversal on financial assets		**1,889**	**(408)**	**1,752**	**3,233**
Financial guarantees	18	70	–	–	**70**
Undrawn loan commitments	18	138	11	–	**149**
Credit related commitments		**208**	**11**	**–**	**219**
Total credit loss reversal		**2,097**	**(397)**	**1,752**	**3,452**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

19. Credit loss reversal and other impairment provisions (continued)

The table below shows the ECL charges on financial instruments recorded in the 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 to customers	9	(1,112)	(559)	11,354	**9,683**
Credit loss reversal on financial assets		**(1,112)**	**(559)**	**11,354**	**9,683**
Financial guarantees	18	157	–	–	**157**
Undrawn loan commitments	18	101	54	–	**155**
Credit related commitments		**258**	**54**	**–**	**312**
Total credit loss reversal		**(854)**	**(505)**	**11,354**	**9,995**

ECL provision for credit related commitments are recorded in other liabilities, charge for the year is included within "Other impairment reversals" line of operating expenses (Note 22), which comprises the following:

	2021	*2020*
ECL reversal for financial guarantees	70	157
ECL reversal for undrawn loan commitments	149	155
Other impairment reversals	**219**	**312**

20. Net interest income

Net interest income comprises:

	2021	*2020*
Interest income on loans to customers	19,054	11,569
Interest income on investment securities	224	581
Interest income on cash and cash equivalents	524	445
Interest income on financial assets recorded at amortized cost	**19,802**	**12,595**
Interest expense on due to credit institutions	(1,513)	(1,525)
Interest expense on due to customers	(3,845)	(2,524)
Interest expense on lease liabilities	(106)	(166)
Interest expense on financial liabilities recorded at amortized cost	**5,464**	**(4,215)**
Net interest income	**14,338**	**8,380**

21. Fee and commission income and expense

Fee and commission income and expense comprises:

	2021	*2020*
Plastic card operations	1,263	846
Settlements operations	1,810	1,469
Cash operations	372	258
Documentary operations	299	283
Consulting and expert operations	145	140
Other	166	323
Fee and commission income	**4,055**	**3,319**
Plastic card operations	(1,671)	(1,197)
Settlements operations	(435)	(328)
Cash operations	(14)	(7)
Other	(155)	(36)
Fee and commission expense	**(2,275)**	**(1,568)**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

22. Operating expenses

Operating expenses comprise:

	2021	*2020*
Salaries and bonuses	11,483	9,458
Social security costs	1,958	1,527
Other employment expenses	340	332
Personnel expenses	**13,781**	**11,317**
Depreciation and amortization	2,063	1,687
Legal and consultancy	1,920	1,326
Software cost	727	943
Marketing and advertising	470	236
Communications	343	296
Security	233	274
Office supplies	213	145
Occupancy and rent	209	192
Repair and maintenance of property and equipment	189	183
Representation	186	217
Other expenses	160	891
Operating taxes	135	195
Utilities	90	73
Business travel and related	25	55
Other impairment reversals	(219)	(312)
Other operating expenses	**6,744**	**6,401**
Total operating expenses	**20,525**	**17,718**

23. Risk management

Introduction

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

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

Risk management structure

The Bank's 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.

Management Board

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

Risk Committee

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

Risk Management

The Risk Management Unit is responsible for implementing and maintaining risk related procedures to ensure an independent control process. In addition, Risk Management Unit is responsible for monitoring compliance with risk principles, policies and limits, across the Bank.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

23. Risk management (continued)

Introduction (continued)

Risk Controlling

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

Bank Treasury

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

Internal audit

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

Risk measurement and reporting systems

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

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

Information compiled from all the businesses is examined and processed in order to analyze, 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. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis.

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

Risk mitigation

As part of its overall risk management, the Bank uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions.

The Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration

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

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

23. Risk management (continued)

Credit risk

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

Derivative financial instruments

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

Credit-related commitments risks

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

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

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

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 9.

Impairment assessment

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

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

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

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

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

The Bank has established a 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. Risk ratings are subject to regular revision. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

23. Risk management (continued)

Credit risk (continued)

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

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

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

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

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

Definition of default and cure

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

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

- Internal rating of the borrower indicating default or near-default;
- The borrower is deceased;
- If the borrower's status "PD" (Problematic Delinquency);
- A material decrease in the borrower's turnover or the loss of a major customer;
- A covenant breach not waived by the Bank;
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy;
- Debtor's listed debt or equity suspended at the primary exchange because of rumors or facts about financial difficulties.

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

Internal rating and PD estimation process

The Bank's independent Credit Risk Department operates its internal rating models. The Bank runs separate models for its key portfolios in which its corporate and small and medium business customers are rated from 1 to 100 using internal grades. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilize supplemental external information that could affect the borrower's behavior. Where practical, they also build on information from the national and international external rating agencies. PDs, incorporating forward looking information and the IFRS 9 stage classification of the exposure, are assigned for each grade. This is repeated for each economic scenario as appropriate.

Treasury and interbank relationships

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

23. Risk management (continued)

Credit risk (continued)

Corporate and small business lending

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

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realized and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention.
- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies, independent analyst reports, publicly traded bond prices or press releases and articles.
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

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

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 primarily rated by days past due. Other key input into the models is GDP growth.

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

Credit risk grades	***Description***
High grade	Acceptable risk level assets by internal probability of default calculation viewed as target segment by the Bank in context of loan portfolio growth. Specific lending transactions could be ranked in this category on the basis of expected loss assessment (as the basic parameter of quantitative evaluation of risk in this segment). High grade is generally attached to counterparties with excellent financial performance or sovereign risk, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.
Standard grade	Higher-level risk assets ranked untargeted by the Bank in context of new loans, by internal probability of default calculation. Standard grade is generally attached to counterparties with stable financial performance, having no changes in the terms and conditions of loan agreements and overdue in principal and interest up to 30 days.
Sub-standard grade	High-risk assets exposed to substantial credit risk factors or assets ranked unacceptable by the Bank in context of new loans, by internal probability of default calculation. This category may also include loans the Bank was forced to restructure. Such loans are currently serviced in accordance with the schedule but criteria for Default status rescinding for them were not yet met because not enough time has passed since restructuring or significant part of loan was not yet repaid under the terms of restructured loan. Standard grade is generally attached to counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and no overdue in principal and interest.
Impaired	The Bank defines non-performing loans (NPL) as lifetime ECL credit-impaired financial assets with contractual principal and (or) interest payments overdue more than 90 days and POCI loans with principal and (or) interest payments becoming overdue more than 90 days after the date of initial recognition. Loans with no contractual payments until maturity, grace period on principal and or interest payments, as well as restructured loans are not considered NPL unless amounts due contractually become more than 90 days overdue. Impaired grade is generally attached to counterparties with unsatisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

23. Risk management (continued)

Credit risk (continued)

Exposure at default

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

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

Loss given default

For corporate lending assets, LGD values are assessed at least quarterly by account managers and reviewed and approved by the Bank's credit risk department.

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

The Bank segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type, 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. Examples of key inputs involve changes in, collateral values including property prices for mortgages, commodity prices, payment status or other factors that are indicative of losses in the group.

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

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

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

Grouping financial assets measured on a collective basis

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

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

- Stage 3 assets, regardless of the class of financial assets;
- Stage 3 corporate lending portfolio;
- The treasury and interbank relationships (such as amounts due from credit institutions, cash equivalents and debt investment securities at Amortized cost and FVOCI);
- Exposures that have been classified as POCI when the original loan was derecognized and a new loan was recognized as a result of a credit driven debt restructuring.
- If the borrower's status "PD" (Problematic Delinquency).

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

23. Risk management (continued)

Credit risk (continued)

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

- The smaller and more generic balances of the Bank's small business lending;
- Stage 1, 2 and 3 retail mortgages and consumer lending and Stage 1 and stage 2 corporate lending portfolio;
- Purchased POCI exposures managed on a collective basis.

The Bank groups these exposures into smaller homogeneous portfolios, based on a combination of internal and external characteristics of the loans, for example internal grade, overdue bucket, product type, loan-to-value ratios, or borrower's industry.

Forward-looking information and multiple economic scenarios

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

- GDP growth;
- Inflation;
- Central Bank base rates;
- Foreign exchange rates.
- Real estate price.

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

Credit quality per class of financial assets

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

31 December 2021	*Note*		*High grade*	*Standard grade*	*Sub-standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	5	Stage 1	24,902	11,666	–	–	**36,568**
Investment securities	6	Stage 1	4,534	–	–	–	**4,534**
Amounts due from credit institutions	7	Stage 1	–	514	–	–	**514**
Loans to customers:	9						
- Small business lending		Stage 1	–	12,195	–	–	**12,195**
		Stage 2	–	–	-	–	**–**
		Stage 3	–	–	–	23,881	**23,881**
- Corporate lending		Stage 1	–	73,439	–	–	**73,439**
		Stage 2	–	–	–	–	**–**
		Stage 3	–	–	–	10,337	**10,337**
- Consumer lending		Stage 1	–	78,212	–	–	**78,212**
		Stage 2	–	271	449	–	**720**
		Stage 3	–	–	–	5,385	**5,385**
- Auto lending		Stage 1	–	28	–	–	**28**
		Stage 2	–	–	4	–	**4**
		Stage 3	–	–	–	489	**489**
Undrawn loan commitments	18	Stage 1	–	17,653	–	–	**17,653**
		Stage 2	–	–	615	–	**615**
Financial guarantees	18	Stage 1	–	20,030	–	–	**20,030**
Other financial assets	14	Stage 1	–	2,355	–	–	**2,355**
Total			**29,436**	**216,363**	**1,068**	**40,092**	**286,959**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

23. Risk management (continued)

Credit risk (continued)

31 December 2020	*Note*		*High grade*	*Standard grade*	*Sub-standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	5	Stage 1	29,981	17,116	–	–	**47,097**
Investment securities	6	Stage 1	14,432	–	–	–	**14,432**
Amounts due from credit institutions	7	Stage 1	–	313	–	–	**313**
Loans to customers:	9						
- Small business lending		Stage 1	–	6,415	–	–	**6,415**
		Stage 2	–	–	97	–	**97**
		Stage 3	–	–	–	38,007	**38,007**
- Corporate lending		Stage 1	–	54,383	–	–	**54,383**
		Stage 2	–	–	–	–	**–**
		Stage 3	–	–	–	14,387	**14,387**
- Consumer lending		Stage 1	–	30,279	–	–	**30,279**
		Stage 2	–	271	1,063	–	**1,334**
		Stage 3	–	–	–	2,832	**2,832**
- Auto lending		Stage 1	–	76	–	–	**76**
		Stage 2	–	10	24	–	**34**
		Stage 3	–	–	–	304	**304**
Undrawn loan commitments	18	Stage 1	–	18,468	–	–	**18,468**
		Stage 2	–	–	31	–	**31**
Financial guarantees	18	Stage 1	–	14,794	–	–	**14,794**
Other financial assets	14	Stage 1	–	2,075	–	–	**2,075**
Total			**44,413**	**144,200**	**1,215**	**55,530**	**245,358**

See Note 9 for more detailed information with respect to the allowance for impairment of loans to customers.

ECLs for financial guarantees and letters of credit are assessed in a similar manner as for loans.

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

	2021				*2020*			
	Azerbaijan	*OECD*	*CIS and other foreign banks*	*Total*	*Azerbaijan*	*OECD*	*CIS and other foreign banks*	*Total*
Assets								
Cash and cash equivalents	33,237	2,171	9,001	**44,409**	40,868	5,234	10,430	**56,532**
Mandatory reserve with the CBAR	477	–	–	**477**	471	–	–	**471**
Amounts due from credit institutions	509	–	–	**509**	308	–	–	**308**
Investment securities	4,534	–	–	**4,534**	14,432	–	–	**14,432**
Loans to customers	181,764	–	–	**181,764**	121,058	–	–	**121,058**
Derivative financial assets	–	–	182	**182**	–	–	180	**180**
Other financial assets	2,355	–	–	**2,355**	2,075	–	–	**2,075**
	222,876	**2,171**	**9,183**	**234,230**	**179,212**	**5,234**	**10,610**	**195,056**
Liabilities								
Amounts due to the CBAR and other credit institutions	(50,440)	–	(926)	**(51,366)**	(28,819)	–	(925)	**(29,744)**
Amounts due to customers	(103,142)	–	–	**(103,142)**	(85,267)	–	–	**(85,267)**
Lease liabilities	(734)	–	–	**(734)**	(1,402)	–	–	**(1,402)**
Other financial liabilities	(2,219)	–	(218)	**(2,437)**	(1,436)	–	(176)	**(1,612)**
	(156,535)	**–**	**(1,144)**	**(157,679)**	**(116,924)**	**–**	**(1,101)**	**(118,025)**
Net assets	**66,341**	**2,171**	**8,039**	**76,551**	**62,288**	**5,234**	**9,509**	**77,031**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

23. Risk management (continued)

Liquidity risk and funding management

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

The Bank maintains a portfolio of highly marketable assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can assess to meet liquidity needs. In addition, the Bank maintains a cash deposit (mandatory reserve) with the CBAR, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank based on certain liquidity ratios established by the CBAR. The CBAR requires banks to maintain instant liquidity ratio of more than 30%. As at 31 December, these ratios were as follows:

	2021	***2020***
Instant Liquidity Ratio	58.45%	101.60%

Analysis of financial liabilities by remaining contractual maturities

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

As of 31 December 2021	***Less than 3 months***	***3 to 12 months***	***1 to 5 years***	***Over 5 years***	***Total***
Financial liabilities					
Amounts due to the CBAR and other credit institutions	6,973	12,794	17,863	27,495	**65,125**
Amounts due to customers	55,977	37,520	15,331	–	**108,828**
Lease liabilities	181	374	251	–	**806**
Other financial liabilities	2,437	–	–	–	**2,437**
Total undiscounted financial liabilities	**65,568**	**50,688**	**33,445**	**27,495**	**177,196**

As of 31 December 2020	***Less than 3 months***	***3 to 12 months***	***1 to 5 years***	***Over 5 years***	***Total***
Financial liabilities					
Amounts due to the CBAR and other credit institutions	2,552	1,043	18,012	18,816	**40,423**
Amounts due to customers	57,173	15,955	15,939	–	**89,067**
Lease liabilities	193	580	1,546	–	**2,319**
Other financial liabilities	1,612	–	–	–	**1,612**
Total undiscounted financial liabilities	**61,530**	**17,578**	**35,497**	**18,816**	**133,421**

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

	Less than 3 months	***3 to 12 months***	***1 to 5 years***	***Over 5 years***	***Total***
2021	38,298	–	–	–	**38,298**
2020	33,293	–	–	–	**33,293**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

23. Risk management (continued)

Liquidity risk and funding management (continued)

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

The Bank's capability to repay its liabilities relies on its ability to realize an equivalent amount of assets within the same period of time. There is a significant concentration as of 31 December 2021 of deposits from individuals and entities that represents about 86% of total portfolio (2020: 82%) in the period less than one year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realize its liquid assets to enable repayment.

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

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

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 and foreign exchanges. The Bank classifies exposures to market risk into non-trading portfolios. Non-trading positions are managed and monitored using sensitivity analysis. Except for the concentrations within foreign currency, the Bank has no significant concentration of market risk.

Currency risk

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

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2021 and 2020 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Azerbaijani manat, with all other variables held constant on the statement of comprehensive income (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on the statement of comprehensive income. A negative amount in the table reflects a potential net reduction in statement of comprehensive income or equity, while a positive amount reflects a net potential increase.

	2021		*2020*	
Currency	***Increase in currency rate in %***	***Effect on profit before tax***	***Increase in currency rate in %***	***Effect on profit before tax***
USD	20%	1,433	20.00%	1,808
RUB	15%	26	16.00%	467
EUR	21%	50	–	–
GBP	22%	17	23.00%	(9)

	2021		*2020*	
Currency	***Decrease in currency rate in %***	***Effect on profit before tax***	***Decrease in currency rate in %***	***Effect on profit before tax***
USD	(3%)	(215)	(3.00%)	(271)
RUB	(15%)	(26)	(16.00%)	(467)
EUR	(9%)	(21)	–	–
GBP	(9%)	(7)	(10.00%)	4

Operational risk

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

24. Fair value measurements

Fair value hierarchy

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

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

For the purpose of fair value disclosures, the Bank 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 as explained above.

		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					
Derivative financial assets	31 December 2021	–	182	–	**182**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2021	44,409	–	–	**44,409**
Investment securities	31 December 2021	–	4,534	–	**4,534**
Amounts due from credit institutions	31 December 2021	–	–	509	**509**
Loans to customers	31 December 2021	–	27,525	154,399	**181,924**
Other financial assets	31 December 2021	–	–	2,355	**2,355**
Liabilities for which fair values are disclosed					
Amounts due to the CBAR and other credit institutions	31 December 2021	–	27,268	24,098	**51,366**
Amounts due to customers	31 December 2021	–	–	103,240	**103,240**
Other financial liabilities	31 December 2021	–	–	2,437	**2,437**

		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					
Derivative financial assets	31 December 2020	–	180	–	**180**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2020	56,532	–	–	**56,532**
Investment securities	31 December 2020	–	14,432	–	**14,432**
Amounts due from credit institutions	31 December 2020	–	–	308	**308**
Loans to customers	31 December 2020	–	18,834	102,594	**121,428**
Other financial assets	31 December 2020	–	–	2,075	**2,075**
Liabilities for which fair values are disclosed					
Amounts due to the CBAR and other credit institutions	31 December 2020	–	19,228	10,516	**29,744**
Amounts due to customers	31 December 2020	–	–	85,503	**85,503**
Other financial liabilities	31 December 2020	–	–	1,612	**1,612**

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

24. Fair value measurements (continued)

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

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

	2021			2020		
	Carrying value	*Fair value*	*Unrecog-nized gain/(loss)*	*Carrying value*	*Fair value*	*Unrecog-nized gain/(loss)*
Assets						
Cash and cash equivalents	44,409	44,409	–	56,532	56,532	–
Investment securities	4,534	4,534	–	14,432	14,432	–
Amounts due from credit institutions	509	509	–	308	308	–
Loans to customers	181,764	181,924	160	121,058	121,428	370
Other financial assets	2,355	2,355	–	2,075	2,075	–
Liabilities						
Amounts due to the CBAR and other credit institutions	51,366	51,366	–	29,744	29,744	–
Amounts due to customers	103,142	103,240	(98)	85,267	85,503	(236)
Other financial liabilities	2,437	2,437	–	1,612	1,612	–
			62			**134**

Valuation techniques and assumptions

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets for which fair value approximates carrying value

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

Financial assets and financial liabilities carried at amortized cost

Fair value of the quoted notes and bonds is based on price quotations at the reporting date. The fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to the CBAR and credit institutions and other financial assets and liabilities, obligations under finance leases is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

25. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 23 "Risk management" for the Bank's contractual undiscounted repayment obligations and how management addresses the negative maturity mismatch below for within one year.

	2021			*2020*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	44,409	–	**44,409**	56,532	–	**56,532**
Investment securities	4,534	–	**4,534**	14,432	–	**14,432**
Mandatory reserves with the CBAR	477	–	**477**	471	–	**471**
Amounts due from credit institutions	509	–	**509**	308	–	**308**
Loans to customers	102,483	79,281	**181,764**	75,935	45,123	**121,058**
Property and equipment	–	1,704	**1,704**	–	1,796	**1,796**
Intangible assets	–	5,544	**5,544**	–	3,292	**3,292**
Right-of-use assets	–	658	**658**	–	1,315	**1,315**
Deferred tax asset	–	621	**621**	–	800	**800**
Derivative financial assets	182	–	**182**	180	–	**180**
Other assets	3,621	6,786	**10,407**	3,866	5,940	**9,806**
Total assets	**156,215**	**94,594**	**250,809**	**151,724**	**58,266**	**209,990**
Amounts due to the CBAR and other credit institutions	18,096	33,270	**51,366**	2,766	26,978	**29,744**
Amounts due to customers	90,969	12,173	**103,142**	72,565	12,702	**85,267**
Current income tax liability	–	–	**–**	1,569	–	**1,569**
Lease liabilities	496	238	**734**	607	795	**1,402**
Other liabilities	5,911	–	**5,911**	4,637	–	**4,637**
Total liabilities	**115,472**	**45,681**	**161,153**	**82,144**	**40,475**	**122,619**
Net assets	**40,743**	**48,913**	**89,656**	**69,580**	**17,791**	**87,371**

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 affected on the same terms, conditions and amounts as transactions between unrelated parties.

The outstanding balances of related party transactions are as follows:

	2021			*2020*		
	Parent	*Entities under common control*	*Other related parties*	*Parent*	*Entities under common control*	*Other related parties*
Deposits at 1 January	**–**	**–**	**54**	**–**	**–**	**103**
Deposits received during the year	–	–	474	–	–	–
Deposits repaid during the year	–	–	(11)	–	–	(49)
Other movements	–	–	–	–	–	
Deposits at 31 December	**–**	**–**	**517**	**–**	**–**	**54**
Current accounts at 31 December	**–**	**–**	**–**	**–**	**–**	**121**
Cash and cash equivalents	2,428	8,745	–	3,729	11,935	–
Amounts due to the CBAR and other credit institutions	74	851	–	127	798	–
Derivative financial assets	7	175	–	180	–	–

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

26. Related party disclosures (continued)

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

	For the year ended 31 December					
	2021			***2020***		
	Parent	***Entities under common control***	***Other related parties***	***Parent***	***Entities under common control***	***Other related parties***
Interest income	6	16	–	7	16	–
Interest expense	–	–	(19)	–	–	(26)
Net (loss)/gain on dealing in foreign currencies	1,957	175	–	2,572	–	–

Compensation of key management personnel was comprised of the following:

	2021	***2020***
Salaries and other short-term benefits	1,039	1,742
Social security costs	171	286
Total key management personnel compensation	**1,210**	**2,028**

As of 31 December 2021 key management personnel of the Bank consisted of 4 members (2020: 3 members).

27. Changes in liabilities arising from financing activities

	Notes	***Long term loans due to the CBAR***	***Total liabilities from financing activities***
Carrying amount at 31 December 2019		**7,316**	**7,316**
Proceeds		1,793	**1,793**
Gain on initial recognition of the loan at fair value (recognized as government grant)		(380)	**(380)**
Other		849	**849**
Carrying amount at 31 December 2020	15	**9,578**	**9,578**
Redemption		(2,121)	**(2,121)**
Reversal of credit loss allowance for loan exposures repaid by Azerbaijani Government on behalf of customers		(126)	**(126)**
Other		–	**–**
Carrying amount at 31 December 2021	15	**7,331**	**7,331**

The "Other" line includes the effect of accrued but not yet paid interest. The Bank classifies interest paid within cash flows from operating activities.

28. Capital adequacy

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

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

(Amounts presented are in thousands of Azerbaijani manats, unless otherwise stated)

28. Capital adequacy (continued)

The CBAR requires each bank or banking group to: (a) hold the minimum level of share capital AZN 50,000; (b) maintain a ratio of total regulatory capital to the risk-weighted assets (the "total capital ratio") at or above the prescribed minimum of 10% (2020: 9%) and (c) maintain a ratio of tier 1 capital to the risk-weighted assets (the "Tier 1 capital ratio") at or above the prescribed minimum of 6% (2020: 5.5%).

As at 31 December 2021 and 2020, the Bank's capital adequacy ratios, as per reports submitted to the CBAR, were as follows:

	2021	*2020*
Tier 1 capital	57,320	56,677
Tier 2 capital	5,860	4,919
Total regulatory capital	**63,180**	**61,596**
Risk weighted assets	**184,450**	**115,223**
Capital adequacy ratio (Tier 1)	31.08%	49.19%
Capital adequacy ratio (Total Capital)	34.25%	53.46%

29. Events after reporting period

Subsequent to year end, in February 2022, due to the conflict between the Russian Federation and Ukraine, numerous sanctions have been announced by majority of western countries against the Russian Federation. A number of countries have and continue to impose sanctions against Russian government entities, state-owned enterprises and entities and individuals linked to Russia anywhere in the world including Bank VTB PJSC (Russian Federation) and Bank VTB (Azerbaijan) OJSC.

The main impact of the imposed sanctions affected the Bank's functionality on transactions with US dollar and euro, as well as restrictions on the Bank's payment cards outside the Republic of Azerbaijan and blockage of SWIFT system.

In order to minimize the negative impact of the sanctions on the Bank's operations, the Bank implemented FMTS system (Financial Message Transfer System) which is considered as alternative for SWIFT system. FMTS system makes money transfer possible between Russian Federation and countries which are connected to this system. Furthermore, the Bank has a "Transit" system in place, which also allows transfer of funds between members of the VTB Group. The system of urgent money transfers ("Contact") is in active mode and has not been blocked. Individual customers can transfer funds from Azerbaijan to the CIS countries and vice versa by using "Contact" system.

Due to the termination of payment card servicing by Visa and Mastercard, plastic card operations abroad are no longer possible. However, the cards are functioning within the borders of Azerbaijan Republic.

The Bank currently assesses the reasonableness of joining "Mir" and "Union Pay" systems.

In terms of liquidity, the Bank has faced a considerable outflow of customer funds during the period from 24 February 2022 to 2 March 2022 and has fulfilled all the obligations. Liquidity prudential norm set by the CBAR (minimum of 30%) is met since the Bank's liquidity ratio is 52.58% as of 31 March 2022.

As at 31 March 2022, the Bank's total capital adequacy ratio, as per report submitted to the CBAR, was 38.34%.

Since the beginning of the recent geopolitical crisis, the Bank has attracted funds in the amount of AZN 7,500 from Russian-resident individuals (for a term of 1 year). The Bank expects that the inflows of funds from the Parent's customers will continue. As part of the normal course of business, considerable financial inflows are expected from local entrepreneurs with businesses in Russian Federation.

The Bank conducts its operations predominantly in Azerbaijan. The Bank's exposure to European and US financial markets is insignificant.

The Bank has insignificant RUB open currency position.

The Bank has not faced any considerable decrease in the quality of its loan portfolio after 24 February 2022, and customers continue to fulfil their loan obligations to the Bank in a timely manner.