“PREMIUM BANK” OPEN JOINT STOCK COMPANY

International Financial Reporting Standards
Financial Statements and
Independent Auditors’ Report
For the Year Ended December 31, 2021

“PREMIUM BANK” OPEN JOINT STOCK COMPANY

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2021

The following statement is made with a view to distinguishing respective responsibilities of the management and those of the independent auditors in relation to the financial statements of "Premium Bank" OJSC (the "Bank").

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Bank as at December 31, 2021, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgements and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Preparing the financial statements on a going concern basis, unless it is inappropriate to presume that the Bank will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Bank;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Bank, and which enable them to ensure that the financial statements of the Bank comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Bank; and
- Detecting and preventing fraud, errors and other irregularities.

The financial statements for the year ended December 31, 2021 were authorized for issue on May 16, 2022 by the Management Board of the Bank.

On behalf of the Management Board:

Mahir Najafov
Chairman of the Management Board

May 16, 2022
Baku, the Republic of Azerbaijan

Elshan Safarov
Chief Financial Officer

May 16, 2022
Baku, the Republic of Azerbaijan

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INDEPENDENT AUDITORS' REPORT

To the Shareholders, Supervisory Board and Management of "Premium Bank" Open Joint Stock Company:

Opinion

We have audited the financial statements of "Premium Bank" Open Joint Stock Company (the "Bank"), which comprise the statement of financial position as at December 31, 2021, statement of profit or loss and other comprehensive income, statement of changes in equity and 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 statement of financial position as at December 31, 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 Auditors' 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' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other matter

The financial statements of the Bank for the year ended December 31, 2020 were audited by another auditor who expressed an unmodified opinion on those financial statements on April 30, 2021.

Responsibilities of Management and Audit Committee for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, 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 have no realistic alternative but to do so.

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

Auditors' Responsibilities for the Audit of the Financial Statements

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

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

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

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

Baker Tilly Azerbaijan

May 16, 2022
Baku, the Republic of Azerbaijan

"PREMIUM BANK" OPEN JOINT STOCK COMPANY

STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2021
(In thousands of AZN, unless otherwise indicated)

	Notes	December 31, 2021	December 31, 2020 (Restated)
ASSETS:			
Cash and balances with Central Bank	5	134,091	37,352
Balances with other banks	7	109,118	43,596
Loans and advances to customers	8, 22	486,879	546,393
Property, equipment and right-of-use assets	9	6,565	8,462
Intangible assets	9	1,660	1,589
Deferred income tax asset	21	899	-
Other assets	10	5,301	6,946
Total assets		**744,513**	**644,338**
LIABILITIES AND EQUITY			
LIABILITIES:			
Loans and deposits from banks and financial institutions	11	37,520	39,627
Deposits from customers	12, 22	533,528	431,252
Other liabilities	13	10,796	13,968
Total liabilities		**581,844**	**484,847**
EQUITY:			
Share capital	14	154,601	154,601
Retained earnings		8,068	4,890
Total equity		**162,669**	**159,491**
TOTAL LIABILITIES AND EQUITY		**744,513**	**644,338**

On behalf of the Management Board:

Mahir Najafov
Chairman of the Management Board

May 16, 2022
Baku, the Republic of Azerbaijan

Elshan Safarov
Chief Financial Officer

May 16, 2022
Baku, the Republic of Azerbaijan

The notes on pages 9-54 form an integral part of these financial statements.

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2021

(In thousands of AZN, unless otherwise indicated)

	Notes	Year ended December 31, 2021	Year ended December 31, 2020 (Reclassified)
Interest income	15, 22	32,298	34,770
Interest expense	15, 22	(15,262)	(20,721)
Net interest income	15, 22	**17,036**	**14,049**
Recovery of expected credit losses on debt financial assets	7, 8, 13	6,466	2,628
Net interest income after recovery of expected credit losses		**23,502**	**16,677**
Fee and commission income	17, 22	11,962	11,226
Fee and commission expense	18	(9,630)	(3,865)
Net gain on foreign exchange operations	16	2,725	2,803
Operating profit		**28,559**	**26,841**
Administrative and general expenses	20, 22	(21,487)	(19,598)
Depreciation and amortization expense	19	(2,305)	(2,414)
Other income, net		8	34
Profit before income tax		**4,775**	**4,863**
Income tax expense	21	(1,597)	(1,450)
Net profit for the year		**3,178**	**3,413**
Other comprehensive income for the year		-	-
Total comprehensive income for the year		**3,178**	**3,413**
Earnings per share attributable to the owners of the Bank, basic and diluted (expressed in AZN per share)	27	**3.17**	**3.40**

On behalf of the Management Board:

PREMIUM BANK

Mahir Najafov
Chairman of the Management Board

May 16, 2022
Baku, the Republic of Azerbaijan

Elshan Safarov
Chief Financial Officer

May 16, 2022
Baku, the Republic of Azerbaijan

The notes on pages 9-54 form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2021
(In thousands of AZN, unless otherwise indicated)

	Share capital	Retained earnings	Total equity
January 1, 2020	**104,601**	**1,477**	**106,078**
Total comprehensive income for the year	-	3,413	3,413
Increase of share capital	50,000	-	50,000
December 31, 2020	**154,601**	**4,890**	**159,491**
Total comprehensive income for the year	-	3,178	3,178
December 31, 2021	**154,601**	**8,068**	**162,669**

On behalf of the Management Board:

Mahir Najafov
Chairman of the Management Board

May 16, 2022
Baku, the Republic of Azerbaijan

Elshan Safarov
Chief Financial Officer

May 16, 2022
Baku, the Republic of Azerbaijan

The notes on pages 9-54 form an integral part of these financial statements.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2021
(In thousands of AZN, unless otherwise indicated)

	Notes	Year ended December 31, 2021	Year ended December 31, 2020
OPERATING ACTIVITIES			
Profit before income tax		4,775	4,863
Adjustments for non-cash and non-operating items:			
Depreciation and amortization expense	20	2,305	2,414
Charge of expected credit losses on balances with other banks	7	674	51
Recovery of expected credit loss on guarantees issued	13	(4,594)	(7,749)
(Recovery)/charge of expected credit losses on loans and advances to customers	8	(2,546)	5,070
Net change in accrued interest		(184)	386
Foreign currency translation loss/(gain)		32	(95)
Gain on sale of property and equipment		-	(5)
Changes in operating assets and liabilities:			
Mandatory minimum reserve deposit with the CBAR		35	(191)
Balances with other banks		(1,158)	227
Loans and advances to customers		61,521	(16,847)
Other assets		63	625
Deposits from customers		104,561	(42,890)
Other liabilities		2,505	11,484
Cash generated from/(used in) operating activities		**167,989**	**(42,657)**
Income tax paid		(646)	(2,120)
Net cash generated from/(used in) operating activities		**167,343**	**(44,777)**
INVESTING ACTIVITIES			
Purchase of property and equipment		(174)	(277)
Purchase of intangible assets		(391)	(529)
Proceed from sale of property and equipment		-	12
Net cash used in investing activities		**(565)**	**(794)**
FINANCING ACTIVITIES			
Proceeds from loans and deposits from banks and other financial institutions	11	85,437	98,001
Repayment of loans and deposits from banks and other financial institutions	11	(87,611)	(96,134)
Repayment of principal portion of lease liability	13	(1,048)	(860)
Amounts paid to shareholders		(200)	-
Increase in share capital		-	50,000
Net cash (used in)/generated from financing activities		**(3,422)**	**51,007**

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2021 (Continued)
(In thousands of AZN, unless otherwise indicated)

	Notes	Year ended December 31, 2021	Year ended December 31, 2020
Effect of exchange rate changes on cash and cash equivalents		(1,544)	1,825
Net increase in cash and cash equivalents		**161,812**	**7,261**
CASH AND CASH EQUIVALENTS, *beginning of the year*	6	75,202	67,941
CASH AND CASH EQUIVALENTS, *end of the year*	6	237,014	75,202

Interest paid and received by the Bank during the year ended December 31, 2021 amounted to AZN 14,960 thousand and AZN 32,282 thousand, respectively (2020: AZN 20,767 thousand and AZN 34,760 thousand, respectively).

On behalf of the Management Board:

Mahir Najafov
Chairman of the Management Board

May 16, 2022
Baku, the Republic of Azerbaijan

Elshan Safarov
Chief Financial Officer

May 16, 2022
Baku, the Republic of Azerbaijan

The notes on pages 9-54 form an integral part of these financial statements.

1 INTRODUCTION

Legal status and nature of operations

"Premium Bank" Open Joint Stock Company (the "Bank") was established on January 6, 1994 and held license no. 175 for commercial banking issued by the Central Bank of Azerbaijan Republic (CBAR or Central Bank). The activities of the Bank are regulated by the Central Bank of Azerbaijan Republic. As at December 31, 2021 the registered address of the Bank is Hasan Aliyev Street 131A, AZ 1110, Baku, the Republic of Azerbaijan.

The principal activity of the Bank is providing commercial banking services to legal entities and physical persons. The Bank has five branches and one service point. The Bank operates a network of 54 (2020: 54) automatic teller machines. The Bank has 166 employees as at December 31, 2021 (2020: 172 employees).

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

	December 31, 2021, %	December 31, 2020, %
"VIP Aviation Services Company" LLC	15.217	15.217
Ms. Zarifa Hamzayeva	84.466	84.466
Ms. Elvira Ahmadova	0.3170	0.3170
	100.00	**100.00**

2 STATEMENT OF COMPLIANCE

These financial statements for the year ended December 31, 2021 have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

Going concern

These financial statements have been prepared on the assumption that the Bank is a going concern and will continue in operation for the foreseeable future.

Management views the Bank as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations of the Republic of Azerbaijan. Accordingly, assets and liabilities are recorded on the basis that the Bank will be able to realize its assets and discharge its liabilities in the normal course of business. Some financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the Bank's ability to continue as a going concern, and standards regarding matters to be considered and disclosures to be made in connection with going concern.

Management's assessment of the going concern assumption involves making a judgment, at a particular point in time, about the future outcome of events or conditions which are inherently uncertain.

Other basis of presentation criteria

These financial statements are presented in thousands of Azerbaijani Manat ("AZN"), unless otherwise indicated. These financial statements have been prepared under the historical cost convention, except measurement at fair value of certain financial instruments.

The Bank maintains its accounting records in accordance with the laws of the Republic of Azerbaijan.

Offsetting

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank currently has a legally enforceable right to set-off the recognized amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Bank currently has a legally enforceable right to set off if that right is not contingent on a future event and enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the Bank and all counterparties.

3 STANDARDS, INTERPRETATIONS AND AMENDMENTS TO EXISTING STANDARDS

Standards, interpretations and amendments to existing standards that are effective in 2021

In the current year, the Bank has adopted all of the applicable new and revised Standards and Interpretations issued by the IASB and the IFRIC of the IASB that are relevant to its operations and effective for annual reporting periods ending on December 31, 2021.

IASB has published **"Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)"** as a first reaction to the potential effects the IBOR reform could have on financial reporting. A hedging relationship is affected if the reform gives rise to uncertainty about the timing and/or amount of benchmark-based cash flows of the hedged item or the hedging instrument. These amendments have no impact on the financial statements of the Bank as it does not have any interest rate hedge relationships.

IFRS 3 Business Combinations. Amendment of the definition of "Business" – The amendments will help companies determine whether an acquisition made is of a business or a group of assets.

The amended definition emphasizes that the output of a business is to provide goods and services to customers, whereas the previous definition focused on returns in the form of dividends, lower costs or other economic benefits to investors and others. Distinguishing between a business and a group of assets is important because an acquirer recognizes goodwill only when acquiring a business.

According to the amendment new definition a "business" is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

New definition of "Material" – The IASB has issued amendments to its definition of material to make it easier for companies to make materiality judgements. The updated definition amends IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS Standards. According to the new definition, information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

On May 15, 2020 IASB has published **"COVID-19-Related Rent Concessions (Amendment to IFRS 16)"** amending the standard to provide lessees with an exemption from assessing whether a COVID-19-related rent concession is a lease modification.

The changes in COVID-19-Related Rent Concessions (Amendment to IFRS 16) amend IFRS 16 to:

- provide lessees with an exemption from assessing whether a COVID-19-related rent concession is a lease modification;
- require lessees that apply the exemption to account for COVID-19-related rent concessions as if they were not lease modifications;
- require lessees that apply the exemption to disclose that fact; and
- require lessees to apply the exemption retrospectively in accordance with IAS 8, but not require them to restate prior period figures.

The amendment is effective for annual reporting periods beginning on or after June 1, 2020. Earlier application is permitted. The impact of adoption of this standard had no effect on the financial statements.

Standards, interpretations and amendments to existing standards that are not yet effective and have not been adopted early by the Bank

At the date of authorization of these financial statements, other than the Standards and Interpretations adopted by the Bank in advance of their effective dates, the following Interpretations were in issue but not yet effective.

IFRS 17 "Insurance contracts" was issued in May 2017 and replaced IFRS 4 "Insurance contracts". The new standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. An entity shall apply IFRS 17 "Insurance Contracts" to insurance contracts, including reinsurance contracts, it issues; reinsurance contracts it holds; and investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

IFRS 17 is effective for annual reporting periods beginning on or after January 1, 2023. Earlier application is permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments have also been applied.

Amendments to IAS 1 to clarify the classification of liabilities – In January 2020 the IASB has issued **"Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)"** providing a more general approach to the classification of liabilities under IAS 1 based on the contractual arrangements in place at the reporting date. The amendments in Classification of Liabilities as Current or Non-Current (Amendments to IAS 1) affect only the presentation of liabilities in the statement of financial position — not the amount or timing of recognition of any asset, liability income or expenses, or the information that entities disclose about those items.

The amendments are effective for annual reporting periods beginning on or after January 1, 2023 and are to be applied retrospectively. Earlier application is permitted.

Reference to the Conceptual Framework – Amendments to IFRS 3 – In May 2020, the IASB issued Amendments to IFRS 3 "Business Combinations" – Reference to the Conceptual Framework. The amendments are intended to replace a reference to the Framework for the Preparation and Presentation of Financial Statements, issued in 1989, with a reference to the Conceptual Framework for Financial Reporting issued in March 2018 without significantly changing its requirements. The Board also added an exception to the recognition principle of IFRS 3 to avoid the issue of potential 'day 2' gains or losses arising for liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 Levies, if incurred separately. At the same time, the Board decided to clarify existing guidance in IFRS 3 for contingent assets that would not be affected by replacing the reference to the Framework for the Preparation and Presentation of Financial Statements. The amendments are effective for annual reporting periods beginning on or after January 1, 2022 and apply prospectively.

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 recognizes 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 January 1, 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.

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 January 1, 2022.

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 January 1, 2022 with earlier adoption permitted.

IFRS 9 Financial Instruments – Fees in the "10 percent" 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 January 1, 2022 with earlier adoption permitted. The Bank will apply the amendments to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment.

"IAS 41 Agriculture" – Taxation in fair value measurements – As part of its 2018-2020 annual improvements to IFRS standards process the IASB issued an amendment to IAS 41 Agriculture. The amendment removes the requirement in paragraph 22 of IAS 41 that entities exclude cash flows for taxation when measuring the fair value of assets within the scope of IAS 41. An entity applies the amendment prospectively to fair value measurements on or after the beginning of the first annual reporting period beginning on or after January 1, 2022 with earlier adoption permitted.

IFRS 10 "Consolidated Financial Statements" and IAS 28 (amendments) Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognized in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. Similarly, gains and losses resulting from the re-measurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognized in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

(In thousands of AZN, unless otherwise indicated)

Unless otherwise disclosed, the new standards are not expected to have a material effect on the financial statements of the Bank.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

The accounting policies applied in the preparation of these financial statements are consistent with those applied in the annual financial statements for the year ended December 31, 2020, except for the effect of new adopted standards, if any.

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected. Information about significant areas of estimation uncertainty and critical management judgments in applying accounting policies and changes in estimation uncertainty and critical management judgments that have the most significant effect on the amounts recognized in the financial statements are described in Note 4.

Foreign currency translation

Functional and presentation currency

These financial statements are presented in Azerbaijan Manat (AZN), which is also Bank's functional currency.

Foreign currency transactions and balances

Foreign currency transactions are translated into the functional currency, using the exchange rates prevailing at the dates of the transactions (spot exchange rate). Foreign exchange gains and losses resulting from the settlement of such transactions and from the remeasurement of monetary items at year-end exchange rates are recognized in statement of comprehensive income.

Non-monetary items measured at historical cost are translated using the exchange rates at the date of the transaction (not retranslated). Non-monetary items measured at fair value are translated using the exchange rates at the date when fair value was determined. For the purpose of translation of financial assets and financial liabilities denominated in foreign currencies the following year-end exchange rates have been used:

	December 31, 2021	December 31, 2020
AZN/1 USD	1.7000	1.7000
AZN/1 EUR	1.9265	2.0890
AZN/1 GBP	2.2925	2.3021
AZN/1 RUB	0.0229	0.0231

Financial instruments

Recognition, initial measurement and derecognition

Financial assets and financial liabilities are recognized when the Bank becomes a party to the contractual provisions of the financial instrument and are measured initially at fair value plus transactions costs. Regular purchases and sales of financial assets are recognized on the trade-date – the date on which the Bank commits to purchase or sell the asset.

Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and all substantial risks and rewards are transferred.

A financial liability is derecognized when it is extinguished, discharged, cancelled or expired.

Financial assets and financial liabilities are measured subsequently as described below.

Classification and measurement

Financial assets

On initial recognition, a financial asset is classified as measured: at amortized cost, Fair Value through Other Comprehensive Income (FVOCI) or Fair Value through Profit and Loss (FVTPL).

A financial asset is measured at amortized cost if it meets both the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- 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.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- 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.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Business model assessment

The Bank makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is being managed and information is provided to management.

The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realizing cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Bank's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about the future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realized.

Assessment of whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. "Profit" is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic financing risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rate.

Reclassifications

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets.

Classification and subsequent measurement of financial liabilities

The Bank's financial liabilities include loans and deposits from banks and financial institutions, deposits from customers and certain other liabilities. Financial liabilities are measured subsequently at amortized cost using the effective interest method.

Measurement of ECL

ECL is a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;

- undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive.

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognized and ECL are measured as follows:

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset. The cash shortfalls are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortized cost and debt financial assets carried at FVOCI are credit-impaired. A financial asset is 'credit- impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganization; or
- the disappearance of an active market for a security because of financial difficulties.

Purchased or originated credit impaired assets (POCI)

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. Life time ECLs are only recognized or released to the extent that there is a subsequent change in the ECL.

Revolving facilities

The Bank's product offering includes a variety of corporate and retail overdraft and credit cards facilities, in which the Bank has the right to cancel and/or reduce the facilities at a short notice. The Bank does not limit its exposure to credit losses to the contractual notice period, but, instead calculates ECL over a period that reflects the Bank's expectations of the customer behavior, its likelihood of default and the Bank's future risk mitigation procedures, which could include reducing or cancelling the facilities. Based on past experience and the Bank's expectations, the period over which the Bank calculates ECLs for these products, is estimated based on the period over which the Bank is exposed to credit risk and where the credit losses would not be mitigated by management actions.

Write-off

Assets carried at amortized cost and debt securities at FVOCI are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Bank has exhausted all legal and remedial efforts to recover from the customers. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

Reversals of impairment loss

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognized, the excess is written back by reducing the loan impairment allowance account accordingly. The write back is recognized in the consolidated statement of comprehensive income.

Financial guarantees and loan commitments

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holders for a loss they incur because a specified debtor fails to make payment when due, in accordance with the terms of a debt instrument. The financial guarantee liability is carried at amortized cost when payment under the contract has become probable.

'Loans commitments' are firm irrevocable commitments to provide credit under pre-specified terms and conditions. Financial guarantees issued or irrevocable commitments to provide credit are initially measured at fair value and their initial fair value is amortized over the life of the guarantee or the commitment.

Subsequently, they are measured at the higher of this amortized amount and the amount of loss allowance.

Loans and advances to customers

Loans to customers are recorded when the Bank advances money to purchase or originate a loan due from a customer. Based on the business model and the cash flow characteristics, the Bank measures loans to customers at amortized cost. They are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortized cost using the effective interest method.

Impairment allowances are determined based on the forward-looking ECL models.

Cash and cash equivalents

Cash and cash equivalents are items, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents include cash on hand and balances with Central Bank and balances with other banks with original maturities of three months or less from the date of acquisition. Cash and cash equivalents are carried at amortized cost in the statement of financial position.

Property, equipment, and right-of-use assets

Property and equipment are initially recognized at acquisition cost, including any costs directly attributable to bringing the assets to the location and condition necessary for it to be capable of operating in the manner intended by the Bank's management. These assets are subsequently measured using the cost model and are stated at cost less subsequent depreciation and impairment losses, except for building.

Depreciation is recognized on reducing balance method, except for depreciation of right-of-use assets which is recognized using straight-line method over the period of respective lease liabilities, to write down the cost less estimated residual value of property and equipment. The following estimated useful lives are applied:

Furniture	4 years
Equipment	5 years
Computers	4 years
Motor vehicles	4 years
Other assets	5 years
Leasehold improvements	over the term of the contract
Right-of-use assets	over the term of the underlying lease

Material residual value estimates and estimates of useful life are updated as required, but at least annually, whether or not the asset is revalued.

Gains or losses arising on the disposal of property and equipment are determined as the difference between the disposal proceeds and the carrying amount of the assets and are recognized in profit or loss within "other income".

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 re-measurement 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. Right-of-use assets are depreciated on a straight-line basis over the shorter of the lease term.

If the ownership of the leased asset transfers to the Bank at the end of the lease term or the cost reflects the exercise of a purchase option, depreciation is calculated using the estimated useful life of the asset. The right-of-use assets are also subject to impairment.

Leasehold improvements

Leasehold improvements are amortized over the life of the related leased asset. Expenses related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization

Repossessed collaterals

Repossessed collateral represents non-financial assets acquired by the Bank in settlement of overdue loans. These assets are initially recognized at lower of their previous carrying amount or fair value less costs to sell and are included in other assets. These assets are subsequently measured and accounted for in accordance with the accounting policies for these categories of assets.

Intangible assets

Intangible assets include acquired software used in operations. They are accounted for using the cost model whereby capitalized costs are amortized on a reducing balance method over their estimated useful lives, as these assets are considered finite. Residual values and useful lives are reviewed at each reporting date. In addition, they are subject to impairment testing. The useful life of software is 10 years.

Costs associated with maintaining computer software, i.e. expenditure relating to patches and other minor updates as well as their installation, is expensed as incurred.

The gain or loss arising on the disposal of an intangible asset is determined as the difference between the proceeds and the carrying amount of the asset, and is recognized in profit or loss within 'other income'.

Impairment of non-financial assets

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows (cash-generating units). As a result, some assets are tested individually for impairment and some are tested at cash-generating unit level.

All individual assets or cash-generating units are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount, which is the higher of fair value less costs to sell and value-in-use. To determine the value-in-use, management estimates expected future cash flows from each cash-generating unit and determines a suitable interest rate in order to calculate the present value of those cash flows.

All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist. An impairment charge is reversed if the cash-generating unit's recoverable amount exceeds its carrying amount.

Other assets

Other assets are measured at initial recognition at fair value and are subsequently measured at amortized cost using the effective interest rate method.

Loans and deposits from banks and financial institutions

Loans and deposits from banks and financial institutions are recorded when money or other assets are advanced to the Bank by counterparty banks. The non-derivative liability is carried at amortized cost. If the Bank purchases its own debt, the liability is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from retirement of debt.

Deposits from customers

Deposits from customers are non-derivative liabilities to individuals, state or corporate customers and are carried at amortized cost.

Leases

The Bank assesses at contract inception whether a contract is, or contains, a lease. That is, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Bank as a lessee

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

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 the lease, if the lease term reflects the Bank exercising the option to terminate.

Variable lease payments that do not depend on an index or a rate are recognized as expenses (unless they are incurred to produce inventories) in the period in which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Bank uses its incremental borrowing rate at the lease commencement date because 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 re-measured if there is a modification, a change in the lease term, a change in the lease payments (e.g., changes to future payments resulting from a change in an index or rate used to determine such lease payments) or a change in the assessment of an option to purchase the underlying asset.

Other liabilities

Other liabilities are initially measured at fair value, and are subsequently measured at amortized cost, using the effective interest rate method.

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects.

The ability of the Bank to declare and pay dividends is subject to the rules and regulations of Azerbaijan legislation.

Dividends in relation to ordinary shares are reflected as an appropriation of retained earnings in the period when they are declared.

Provisions and contingent liabilities

Provisions are recognized when present obligations as a result of a past event will probably lead to an outflow of economic resources from the Bank and amounts can be estimated reliably. Timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events.

Provision for guarantee claims and other off-balance sheet obligations is recognized when intimated and reasonable certainty exists to settle the obligations. Expected recoveries are recognized by debiting customer accounts. Charge to profit and loss account is stated net of expected recoveries. Provisions are not recognized for future operating losses.

Provisions are discounted to their present values, where the time value of money is material.

All provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

In those cases where the possible outflow of economic resources as a result of present obligations is considered improbable or remote, no liability is recognized, unless it was assumed in the course of a business combination.

Retirement and other benefit obligations

In accordance with the requirements of the legislation of the Republic of Azerbaijan state pension system provides for the calculation of current payments by the employer as a percentage of current total payments to staff. This expense is charged in the period the related salaries are earned. Upon retirement all retirement benefit payments are made by pension funds selected by employees. The Bank does not have any pension arrangements separate from the state pension system of the Republic of Azerbaijan. In addition, the Bank has no post-retirement benefits or other significant compensated benefits requiring accrual.

Recognition of interest income and expense

Interest income and expense are recognized in profit or loss using the effective interest method. The "effective interest rate" is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortized cost of the financial liability.

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not expected credit losses. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including expected credit losses.

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Fee and commission

Fee and commission income and expense that are integral to the effective interest rate on a financial asset or financial liability are included in the effective interest rate.

Loan origination fees, loan servicing fees and other fees that are considered to be integral to the overall profitability of a loan, together with the related transaction costs, are deferred and amortized to interest income over the estimated life of the financial instrument using the effective interest method.

Other fee and commission income – including account servicing fees, investment management fees, sales commission, placement fees and syndication fees – is recognized as the related services are performed. If a loan commitment is not expected to result in the draw-down of a loan, then the related loan commitment fee is recognized on a straight-line basis over the commitment period.

A contract with a customer that results in a recognized financial instrument in the Bank's financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Bank first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual.

The following table provides information about the nature and timing of the satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies.

Type of service	Nature and timing of satisfaction of performance obligations, including significant payment terms	Revenue recognition under IFRS 15
Retail and corporate banking service	The Bank provides banking services to retail and corporate customers, foreign currency transactions, cash operations, settlements and credit card transactions. Transaction-based fees for interchange, foreign currency transactions are charged to the customer's account when transaction takes place.	Revenue related to transactions is recognized at the point in time when the transaction takes place.
	The Bank charges a commission fee to the customers for the guarantee letters issued.	Since, the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs, Bank recognized revenue over time.

Other fee and commission expenses relate mainly to transaction and service fees, which are expensed as the services are received.

Operating expenses

Operating expenses are recognized in profit or loss upon utilisation of the service or at the date of their origin.

Taxation

Income tax expense represents the sum of the current and deferred tax expense.

Current

The current tax expense is based on taxable profit for the year. Taxable profit differs from net profit as reported in the statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Bank's current tax expense is calculated using tax rates that have been enacted or substantively enacted during the reporting period.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from the initial recognition of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the statement of comprehensive income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity. Deferred income tax assets and deferred income tax liabilities are offset and reported net on the statement of financial position if:

- The Bank has a legally enforceable right to set off current income tax assets against current income tax liabilities; and
- Deferred tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

Azerbaijan Republic also has various other taxes, which are assessed on the Bank's activities. These taxes are included as a component of operating expenses in the statement of comprehensive income.

Earnings per share

Earnings per share are determined by dividing the profit or loss attributable to owners of the Bank by the weighted average number of participating shares outstanding during the reporting year.

Significant management judgements in applying accounting policies

The preparation of the financial statements requires management to make certain judgements, estimates and assumptions that affect the reported amount of financial assets and liabilities and the resultant allowances for impairment and fair values. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of allowances required for impaired loans to customers. Estimates and judgments are continually evaluated and are based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognized prospectively.

The following are significant management judgements in applying the accounting policies of the Bank that have the most significant effect on the financial statements. Critical estimation uncertainties are described in Note 4.

Judgements and estimates related to financial instruments

Judgements made in applying accounting policies that have most significant effects on the amount recognized in the financial statements of the period ended December 31, 2021 are as follows:

- Classification of financial assets: assessment of business model within which the assets are held and assessment of whether the contractual terms of the financial assets are solely payment of principal and interest of the principal amount outstanding.
- Calculation of expected credit loss (ECL): changes to the assumptions and estimation uncertainties that have a significant impact on ECL for the year ended December 31, 2021 and 2020 pertain to the changes introduced as a result of adoption of IFRS 9: Financial instruments. The impact is mainly driven by inputs, assumptions and techniques used for ECL calculation under IFRS 9 methodology.

Inputs, assumptions and techniques used for ECL calculation – IFRS 9 Methodology

Key concepts in IFRS 9 that have the most significant impact and require a high level of judgment, as considered by the Bank while determining the impact assessment, are:

Assessment of significant increase in credit risk

The assessment of a significant increase in credit risk is done on a relative basis. To assess whether the credit risk on a financial asset has increased significantly since origination, the Bank compares the risk of default occurring over the expected life of the financial asset at the reporting date to the corresponding risk of default at origination, using key risk indicators that are used in the Bank's existing risk management processes.

The assessment of significant increases in credit risk is being performed at least quarterly for each individual exposure based on below mentioned factors. If any of the following factors indicates that a significant increase in credit risk has occurred, the instrument will be moved from Stage 1 to Stage 2:

1. The Bank has stablished thresholds for significant increases in credit risk relative to initial recognition.
2. Additional qualitative reviews have been performed to assess the staging results and make adjustments, as necessary, to better reflect the positions which have significantly increased in risk.
3. IFRS 9 contains a rebuttable presumption that instruments which are 30 days past due have experienced a significant increase in credit risk.

Movements between Stage 2 and Stage 3 are based on whether financial assets are credit impaired as at the reporting date. The determination of credit-impairment under IFRS 9 is similar to the individual assessment of financial assets for objective evidence of impairment under IAS 39.

Macroeconomic Factors, Forward Looking Information (FLI) and Multiple Scenarios

The measurement of expected credit losses for each stage and the assessment of significant increases in credit risk must consider information about past events and current conditions as well as reasonable and supportable forecasts of future events and economic conditions. The estimation and application of forward-looking information requires significant judgment.

PD, Loss Given Default (LGD) and Exposure At Default (EAD) inputs used to estimate Stage 1 and Stage 2 credit loss allowances are modelled based on the macroeconomic variables (or changes in macroeconomic variables) that are most closely correlated with credit losses in the relevant portfolio. Management overlay is also used to align the macroeconomics factors with the current condition of portfolio based on best management estimate and information. The estimation of expected credit losses in Stage 1 and Stage 2 is a discounted probability weighted estimate that considers a minimum of three future macroeconomic scenarios.

In view of the very fluid and developing considerations, ascertaining the reliability and reasonableness of any forward-looking information is challenging. Notwithstanding this, the Bank continues to recognize the likely impact of this crisis on market credit environment and will continue to monitor the changes, including macroeconomic forecast and consider adjustments to ECL appropriately.

Definition of default

The definition of default used in the measurement of expected credit losses and the assessment to determine movement between stages is consistent with the definition of default used for internal credit risk management purposes. IFRS 9 does not define default but contains a rebuttable presumption that default has occurred when an exposure is greater than 90 days past due.

Expected life

When measuring ECL, the Bank must consider the maximum contractual period over which the Bank is exposed to credit risk. All applicable contractual terms are considered when determining the expected life, including prepayment options and extension and rollover options. For certain revolving credit facilities that do not have a fixed maturity, the expected life is estimated based on the period over which the Bank is exposed to credit risk

Governance

In addition to the existing risk management framework, the Bank has established an internal Committee to provide oversight to the IFRS 9 impairment process. The Committee is comprized of senior representatives from Finance, Risk Management and Economics and is responsible for reviewing and approving key inputs and assumptions used in our expected credit loss estimates. It also assesses the appropriateness of the overall allowance results to be included in the financial statements. The following other principal criteria are also used to determine that there is objective evidence that an impairment loss has occurred:

- the viability of the customer's business model and its capability to trade successfully out of financial difficulties and generate sufficient cash flow to service its debt obligations;
- the realisable value of security (or other credit mitigations) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding;
- the borrower experiences a significant financial difficulty as evidenced by borrower's financial information that the Bank obtains;
- the borrower considers bankruptcy or a financial reorganisation; or
- the adverse change in the payment status of the borrower as a result of changes in the international or local economic conditions that impact the borrower.

Recognition of deferred tax assets

The extent to which deferred tax assets can be recognized is based on an assessment of the probability of the Bank's future taxable income against which the deductible temporary differences can be utilized. In addition, significant judgement is required in assessing the impact of any legal or economic limits or uncertainties in various tax jurisdictions.

Estimation uncertainty

Information about estimates and assumptions that have the most significant effect on recognition and measurement of assets, liabilities, income and expenses is provided below. Actual results may substantially differ.

Useful lives of depreciable and amortizable assets

Management reviews the useful lives of depreciable and amortisable assets which include property and equipment, and intangible assets at each reporting date, based on the expected utility of the assets to the Bank. Actual results, however, may vary due to technical obsolescence, particularly relating to software and IT equipment.

Impairment of property and equipment and intangible assets

An impairment loss is recognized for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount. To determine the recoverable amount, management estimates expected future cash flows from each cash-generating unit and determines a suitable interest rate in order to calculate the present value of those cash flows. In the process of measuring expected future cash flows management makes assumptions about future operating results. These assumptions relate to future events and circumstances. The actual results may vary, and may cause significant adjustments to the Bank's assets within the next financial year.

In most cases, determining the applicable discount rate involves estimating the appropriate adjustment to market risk and the appropriate adjustment to asset-specific risk factors.

(In thousands of AZN, unless otherwise indicated)

Allowance for ECL on loans and advances to customers

Loans and advances to customers are measured at amortized cost less allowance for ECL. The estimation of allowances for ECL involves the exercise of significant judgment and estimates. The Bank estimates allowances for ECL with the objective of maintaining provisions at a level believed by management to be sufficient to absorb losses incurred in the Bank's loan portfolio. The calculation of provisions is mainly made using ECL model and also time base criteria determined by the applicable prudential regulations.

Provisions

Provisions are raised based on management's estimates from information available surrounding particular transactions. Prudence is exercised when estimating provisions so as not to materially overstate the Bank's reported net income and understates its liabilities.

Contingent liability arising from litigations

Due to the nature of its operations, the Bank may be involved in litigations arising in the ordinary course of business. Provision for contingent liabilities arising from litigations is based on the probability of outflow of economic resources and reliability of estimating such outflow. Such matters are subject to many uncertainties and the outcome of individual matters is not predictable with assurance. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are applied prospectively.

Prior period restatements and reclassifications

During the year ended December 31, 2021, the Management detected certain errors and made certain reclassifications in the financial statements for the year ended December 31, 2020.

The effect of restatements and reclassifications on the statement of financial position and the statement of profit or loss and other comprehensive income for the year ended December 31, 2020 is presented in the tables below:

	Notes	As previously reported December 31, 2020	Effect of restatements	As restated December 31, 2020
Statement of financial position:				
Loans and advances to customers	a	539,186	7,207	546,393
Other liabilities	a	(6,761)	(7,207)	(13,968)

	Notes	As previously reported December 31, 2020	Effect of reclassifications	As reclassified December 31, 2020
Statement of profit or loss and other comprehensive income:				
Interest expense	b	(19,686)	(1,035)	(20,721)
Administrative and general expenses	b	(20,633)	1,035	(19,598)
Fee and commission income	c	9,753	1,473	11,226
Net gain on foreign exchange operations	c	4,276	(1,473)	2,803

a) Accrued interest on guarantees issued and allowance for ECL on guarantees issued in the amount of AZN 7,207 thousand were separated from loans and advances to customers to other liabilities;
b) Finance charge on lease liabilities in the amount of AZN 1,035 thousand was reclassified from administrative and general expenses to interest expense;
c) Fee income received from transactions with foreign currencies in the amount of AZN 1,473 thousand was reclassified from net gain on foreign exchange operations to fee and commission income.

(In thousands of AZN, unless otherwise indicated)

5 CASH AND BALANCES WITH THE CBAR

	December 31, 2021	December 31, 2020
Cash in hand	31,564	21,011
Balances with the CBAR other than mandatory minimum reserve deposits	98,507	12,286
Included in cash and cash equivalents (Note 6)	**130,071**	**33,297**
Mandatory minimum reserve deposit with the CBAR	4,020	4,055
Total cash and balances with the CBAR	**134,091**	**37,352**

The mandatory minimum reserve deposit is a non-interest bearing deposit calculated in accordance with regulations issued by the CBAR and whose withdrawal ability is restricted. Reserves are measured in accordance with regulations issued by the CBAR and equal to 0.5% and 1% (2020: 0.5% and 1%) of the average qualifying customer accounts balances denominated in AZN and foreign currency, respectively.

All cash and balances with the CBAR are in Stage 1 and their ECL is not material as at December 31, 2021 and 2020.

6 CASH AND CASH EQUIVALENTS

Cash and cash equivalents for the purpose of the statement of cash flows include the following components:

	December 31, 2021	December 31, 2020
Cash and balances with the CBAR (Note 5)	130,071	33,297
Balances with other banks (Note 7)	106,943	41,905
Total cash and cash equivalents	**237,014**	**75,202**

7 BALANCES WITH OTHER BANKS

	December 31, 2021	December 31, 2020
Correspondent accounts	106,943	41,905
Amounts due from financial institutions	3,277	2,131
Less: Allowance for expected credit losses	(1,102)	(440)
Total balances with other banks	**109,118**	**43,596**

As at December 31, 2021 and 2020, accrued interest income included in balances with other banks amounted to nil.

(In thousands of AZN, unless otherwise indicated)

Allowance for expected credit losses

	December 31, 2021	December 31, 2020
As at January 1	**(440)**	**(389)**
Charge for the year	(674)	(51)
Write-off	12	-
As at December 31	**(1,102)**	**(440)**

8 LOANS AND ADVANCES TO CUSTOMERS

	December 31, 2021	December 31, 2020
Loans and advances	508,076	570,103
Accrued interest income	1,755	1,682
Gross carrying amount	**509,831**	**571,785**
Less: allowance for expected credit losses	(22,952)	(25,392)
Net carrying amount	**486,879**	**546,393**

Loans and advances to customers carry interest rates ranging from 4% to 25% per annum (2020: 3.88% to 26%).

For lending limits breach please refer to Note 23.

Analysis by industry for loans and advances to customers – gross excluding accrued interest

	December 31, 2021	December 31, 2020
Transportation	462,977	526,038
Individuals	33,424	32,979
Trading and service	8,382	10,368
Construction	2,619	718
Agriculture	674	-
	508,076	**570,103**

Analysis by currency for loans and advances to customers – gross excluding accrued interest

	December 31, 2021	December 31, 2020
AZN	142,642	132,159
USD	358,973	430,951
EUR	6,461	6,993
	508,076	**570,103**

(In thousands of AZN, unless otherwise indicated)

Allowance for expected credit losses

The movement in the expected credit loss (ECL) for loan to customers as at December 31, 2021 is as follows:

	Stage 1	Stage 2	Stage 3	Total
As at January 1, 2021	**(22,820)**	**(383)**	**(2,189)**	**(25,392)**
Transfer to Stage 1	(2)	1	1	-
Transfer to Stage 2	381	(381)	-	-
Transfer to Stage 3	158	-	(158)	-
New financial assets originated or purchased	(2,852)	-	-	(2,852)
Net remeasurement of allowance for expected credit losses	6,014	382	(998)	5,398
Write-offs	-	-	13	13
Unwinding of discount on present value of ECLs	-	-	(119)	(119)
As at December 31, 2021	**(19,121)**	**(381)**	**(3,450)**	**(22,952)**

The movement in the expected credit loss (ECL) for loan to customers as at December 31, 2020 is as follows:

	Stage 1	Stage 2	Stage 3	Total
As at January 1, 2020	**(18,149)**	**(99)**	**(2,077)**	**(20,325)**
Net remeasurement of allowance for expected credit losses	(4,671)	(284)	(115)	(5,070)
Write-offs	-	-	3	3
As at December 31, 2020	**(22,820)**	**(383)**	**(2,189)**	**(25,392)**

Transfers between stages were not significant during the year ended December 31, 2020.

	Loans and advances to customers			
	12-month ECL	**Life-time ECL**	**Life-time ECL (credit impaired)**	**Total**
December 31, 2021				
Gross carrying amount	490,333	16,027	3,471	509,831
Allowance for expected credit losses	(19,121)	(381)	(3,450)	(22,952)
	471,212	**15,646**	**21**	**486,879**

	Loans and advances to customers			
	12-month ECL	**Life-time ECL**	**Life-time ECL (credit impaired)**	**Total**
December 31, 2020				
Gross carrying amount	565,438	3,972	2,375	571,785
Allowance for expected credit losses	(22,820)	(383)	(2,189)	(25,392)
	542,618	**3,589**	**186**	**546,393**