# ENTREPRENEURSHIP DEVELOPMENT FUND OF THE REPUBLIC OF AZERBAIJAN

International Financial Reporting Standards
Financial Statements and
**Independent Auditor's Report**

**For the year ended 31 December 2020**

**ENTREPRENEURSHIP DEVELOPMENT FUND OF THE REPUBLIC OF AZERBAIJAN**

**TABLE OF CONTENTS**

**Pages**

**INDEPENDENT AUDITOR'S REPORT**

To the Management of the Entrepreneurship Development Fund of the Republic of Azerbaijan:

***Opinion***

We have audited the financial statements of the Entrepreneurship Development Fund of the Republic of Azerbaijan ("the Fund") which comprise the statement of financial position as at 31 December 2020, and the 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 a summary of significant accounting policies and other explanatory notes.

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

***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 Fund 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 Fund for the year ended 31 December 2019 were audited by other auditors who expressed unqualified opinion on those statements on 23 April 2020.

***Responsibilities of Management and Those Charged with Governance for the Financial Statements***

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

Those charged with governance are responsible for overseeing the Fund'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 Fund'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 Fund'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 Fund 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 those charged with governance 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.

23 April 2021

Baku, Republic of Azerbaijan

Nexia EA

Azərbaycan Respublikası "NEXİA EA" QSC
NEXİA EA
Azerbaijan Republic "NEXIA EA" CJSC

**ENTREPRENEURSHIP DEVELOPMENT FUND OF THE REPUBLIC OF AZERBAIJAN**

**STATEMENT OF FINANCIAL POSITION**
**AS AT 31 DECEMBER 2020**
*(Amounts are expressed in thousand AZN unless otherwise indicated)*

| | Notes | 31 December 2020 | 31 December 2019 (Restated)* | 1 January 2019 (Restated)* |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and cash equivalents | 8 | 95,453 | 56,353 | 61,321 |
| Deposits at banks | 9 | 30,083 | - | - |
| Loans to credit institutions | 10 | 735,813 | 789,001 | 782,465 |
| Premises, equipment and intangible assets | 11 | 6,666 | 6,811 | 111 |
| Other assets | 12 | 122 | 17 | 33 |
| **TOTAL ASSETS** | | **868,137** | **852,182** | **843,930** |
| **LIABILITIES AND EQUITY** | | | | |
| Liabilities for the subsidies by the Government | 13 | 49,467 | - | - |
| Other liabilities | 14 | 63 | 18 | 191 |
| **TOTAL LIABILITIES** | | **49,530** | **18** | **191** |
| **EQUITY** | | | | |
| Charter capital | 15 | 1,007,307 | 1,007,307 | 1,007,307 |
| Contributions by the Government | 16 | 4,769 | 6,097 | - |
| Accumulated loss | | (193,469) | (161,240) | (163,568) |
| **TOTAL EQUITY** | | **818,607** | **852,164** | **843,739** |
| **TOTAL LIABILITIES AND EQUITY** | | **868,137** | **852,182** | **843,930** |

**See Note 6*

**On behalf of the Management:**

**Kanan Najafov**
**Chairman of the Executive Board**

23 April 2021
Baku, Republic of Azerbaijan

**Aynur Jabrailova**
**Head of Financial and Loan Accounting Department – Chief Accountant**

23 April 2021
Baku, Republic of Azerbaijan

The notes on pages 7-35 form an integral part of these financial statements

**ENTREPRENEURSHIP DEVELOPMENT FUND OF THE REPUBLIC OF AZERBAIJAN**

## STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME AS AT 31 DECEMBER 2020

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

| | Notes | Year ended 31 December 2020 | Year ended 31 December 2019 (Restated)* |
|---|---|---|---|
| Interest income | 17 | 9,416 | 8,729 |
| Penalty income | | 2 | 15 |
| Other operating income | 18 | 688 | 1 |
| **OPERATING INCOME** | | **10,106** | **8,745** |
| Impairment losses | 10 | (37,102) | (1,206) |
| Bad debt expense | 6 | - | (1,097) |
| Operating expenses | 19 | (5,012) | (4,030) |
| **(LOSS)/PROFIT BEFORE TAX** | | **(32,008)** | **2,412** |
| Income tax expense | 20 | (221) | (84) |
| **(LOSS)/PROFIT FOR THE YEAR** | | **(32,229)** | **2,328** |
| **TOTAL COMPREHENSIVE (LOSS)/PROFIT FOR THE YEAR** | | **(32,229)** | **2,328** |

**See Note 6*

**On behalf of the Management:**

**Kanan Najafov**
**Chairman of the Executive Board**

23 April 2021
Baku, Republic of Azerbaijan

AZƏRBAYCAN RESPUBLİKASI İQTİSADİYYAT NAZİRLİYİ SAHİBKARLIĞIN İNKİŞAFI FONDU

**Aynur Jabrailova**
**Head of Financial and Loan Accounting Department – Chief Accountant**

23 April 2021
Baku, Republic of Azerbaijan

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## ENTREPRENEURSHIP DEVELOPMENT FUND OF THE REPUBLIC OF AZERBAIJAN

### STATEMENT OF CHANGES IN EQUITY
### FOR THE YEAR ENDED 31 DECEMBER 2020

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

| | Charter capital | Contributions by Government | Accumulated loss | Total capital |
|---|---|---|---|---|
| **As at 1 January 2019, previously reported*** | **1,007,307** | **-** | **(51,792)** | **955,515** |
| Restatement* | - | - | (111,776) | (111,776) |
| **As at 1 January 2019, restated*** | **1,007,307** | **-** | **(163,568)** | **843,739** |
| Contributions by government | - | 6,097 | - | 6,097 |
| Total comprehensive income for the year | - | - | 2,328 | 2,328 |
| **As at 31 December 2019, restated*** | **1,007,307** | **6,097** | **(161,240)** | **852,164** |
| As at 31 December 2019, previously reported* | 1,007,307 | 6,097 | (86,289) | 927,115 |
| Restatement* | - | - | (74,951) | (74,951) |
| **As at 31 December 2019, restated*** | **1,007,307** | **6,097** | **(161,240)** | **852,164** |
| Payments to government | - | (1,328) | - | (1,328) |
| Total comprehensive loss for the year | - | - | (32,229) | (32,229) |
| **As at 31 December 2020** | **1,007,307** | **4,769** | **(193,469)** | **818,607** |

**See Note 6*

**On behalf of the Management:**

K. Najafov

**Kanan Najafov**
**Chairman of the Executive Board**

23 April 2021
Baku, Republic of Azerbaijan

AZƏRBAYCAN RESPUBLİKASI İQTİSADİYYAT NAZİRLİYİ SAHİBKARLIĞIN İNKİŞAFI FONDU

**Aynur Jabrailova**
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23 April 2021
Baku, Republic of Azerbaijan

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## ENTREPRENEURSHIP DEVELOPMENT FUND OF THE REPUBLIC OF AZERBAIJAN

### STATEMENT OF CASH FLOWS
### FOR THE YEAR ENDED 31 DECEMBER 2020
*(Amounts are expressed in thousand AZN unless otherwise indicated)*

| | Notes | Year ended 31 December 2020 | Year ended 31 December 2019 |
|---|---|---|---|
| **Cash flow from operating activities** | | | |
| Interest received | | 8,734 | 8,770 |
| Penalty received | | 2 | 14 |
| Net other income received | | 683 | 1 |
| Staff costs paid | | (3,984) | (3,321) |
| Other operating expenses paid | | (570) | (488) |
| Settlements on contributions from the Government | | (1,328) | (552) |
| Transfers from the Government for subsidies | | 70,000 | - |
| Payments of the subsidies from the Government | | (20,533) | - |
| **Cash flows from operating activities before changes in operating assets** | | **53,004** | **4,424** |
| Net decrease/(increase) in loans to credit institutions | | 16,577 | (8,921) |
| **Cash generated from/(used in) operations** | | **69,581** | **(4,497)** |
| Income tax paid | | (74) | (190) |
| **Net cash from/(used in) operating activities** | | **69,507** | **(4,687)** |
| **Cash flows from investing activities** | | | |
| Deposits at banks | | (30,000) | - |
| Acquisition of premises, equipment and intangible assets | | (407) | (281) |
| **Net cash used in investing activities** | | **(30,407)** | **(281)** |
| **Net increase/(decrease) in cash and cash equivalents** | | **39,100** | **(4,968)** |
| **Cash and cash equivalents at the beginning of the year** | 8 | **56,353** | **61,321** |
| **Cash and cash equivalents at the end of the year** | 8 | **95,453** | **56,353** |

**On behalf of the Management:**

K. Najafov

**Kanan Najafov**
**Chairman of the Executive Board**

23 April 2021
Baku, Republic of Azerbaijan

AZƏRBAYCAN RESPUBLİKASI İQTİSADİYYAT NAZİRLİYİ SAHİBKARLIĞIN İNKİŞAFI FONDU

**Aynur Jabrailova**
**Head of Financial and Loan Accounting Department – Chief Accountant**

23 April 2021
Baku, Republic of Azerbaijan

The notes on pages 7-35 form an integral part of these financial statements

## 1 FUND AND ITS OPERATIONS

The Entrepreneurship Development Fund of the Republic of Azerbaijan (the “Fund”) is one of the financial facilities implementing state support for the development of the entrepreneurship in the Republic of Azerbaijan. The purpose of the Fund is to provide soft loans to entrepreneurs, supporting the increase of employment activity of population in the Republic of Azerbaijan and provision of financial support to them. The Fund was re-established as separate public legal entity under the Ministry of Economy with the Decree of the President of the Republic of Azerbaijan on “Improvement of the state support mechanism for entrepreneurship development in the Republic of Azerbaijan” dated 31 July 2018 in order to improve the support mechanism for entrepreneurship development, create new production and processing enterprises based on innovative technologies in the non-oil sector, ensure the financing of export operations, accelerate investments in the real sector and expand access to financial resources of business units operating in the private sector. The application of the new procedures will form opportunities for expansion of entrepreneurs’ access to concessional financial resources and non-oil production and exports, reduction of production expenses and product cost, creation of new production areas and wider use of the state support mechanisms by the private sector.

“The Charter of the Entrepreneurship Development Fund of the Republic of Azerbaijan” and “The Guidance on use of funds of the Entrepreneurship Development Fund of the Republic of Azerbaijan” were approved by the Decree of the President of the Republic of Azerbaijan dated 31 July 2018 to regulate the Funds’ activities with the economic development priorities and long-term targets of the Republic of Azerbaijan. According to the Guidance all banks and non-bank credit organisations licensed by the Central Bank of Azerbaijan Republic and meeting the criteria established by the Supervisory Board of the Fund may participate in the provision of soft loans.

Main responsibilities of the Fund include:

- financing entrepreneurs’ investment projects in compliance with national legislation in line with priorities of the social and economic development priorities of the Republic of Azerbaijan;
- undertake activities to mobilize financial resources, including negotiating and making proposals on borrowing from financial markets;
- ensure efficient and purposeful use of resources allocated to the Fund for entrepreneurship support;
- assess investment project proposals submitted to the Fund for financing;
- give preference to financing investment projects that are in line with state programs on entrepreneurship development;
- participate in development and implementation of sector and regional programs aimed at entrepreneurship development and new employment;
- setting minimal assessment indicators and minimal requirements to apply against development of investment projects submitted to the Fund for financing;
- set monitoring rules to verify the use of loan proceed for the declared purposes;
- collection and dissemination of legal, economic and other information required for entrepreneurs, researching market conjuncture, supporting the development of programs and investment projects for entrepreneurship development;
- support human resource development and retraining for entrepreneurship entities;
- assist entrepreneurship entities in development of foreign economic relations;

- support the establishment and development of entrepreneurship market infrastructure;
- support dissemination of scientific-technical knowledge and novelties important for entrepreneurship entities;
- fulfil other objectives envisaged in the legislation.

According to the approved Charter of the Fund, the following sources may form the capital of the Fund for implementation of its prime activities:

- Contributions from the state budget of the Republic of Azerbaijan;
- Earnings made by the Fund, such as payments received for principal amount, interest and penalty income from extended soft loans;
- Voluntary donations made by local and foreign legal entities and physical persons;
- Financial aids and grants contributed by foreign countries and international organisations, as well as loans acquired by the state in local and foreign financial markets meeting requirements of the state; and
- Other sources as stipulated in the legislation.

***Registered address and place of operations.*** The Fund’s main office is located on the following address: 172, Sharifzada Street, Baku, AZ1122, Azerbaijan. At 31 December 2020, the Fund had 83 employees (2019: 78 employees).

## 2 OPERATING ENVIRONMENT OF THE FUND

The Fund’s operations are conducted mainly in the Republic of Azerbaijan. Thus, the Fund is exposed to risks associated with its activities in the economic and financial markets of Azerbaijan, which are characterized by emerging market economies. Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks, however, these regulations are both differently interpreted and frequently changed. As a result of all these and other legal and tax barriers, enterprises operating in Azerbaijan face various difficulties. At the same time, the recent sharp depreciation of the Azerbaijani manat and the persistently low oil prices on the world market have increased the level of uncertainty in the business environment.

In the financial statements the impact of the business environment in Azerbaijan on the Fund's operations and financial position is assessed by the Fund's management. In the future, the business environment may differ from management's current assessment.

In December 2019, a novel strain of coronavirus disease (“COVID-19”) was first reported in Wuhan, China. Four months later, the World Health Organization declared the COVID-19 a pandemic on March 11, 2020. In this regard, starting from April 2020, a special quarantine regime has been initiated in the Republic of Azerbaijan, as well as in most countries of the world, which resulted in ceasing of business activities of commercial entities, except public entities which are active in sectors of prime importance.

Initiation of the special regime has not resulted in significant limitations in the Fund’s business activity due to the fact that the Fund is in the list of the public entities which are active in sectors of prime importance. The extent of the COVID-19’s effect on the Fund’s operational and financial performance will depend on future developments, including the duration, spread and intensity of the pandemic, all of which are uncertain and difficult to predict. However, if the pandemic continues to evolve into a severe worldwide health crisis, the disease could have a material adverse effect on the Fund's business operations, financial condition and cash flows.

International credit rating agencies regularly evaluate credit rating of the Republic of Azerbaijan. Fitch and S&P evaluated rating of the Republic of Azerbaijan as "BB+". Moody's Investors Service set "Ba2" credit rating for the country.

The future economic growth of the Republic of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory and political developments. The Management is unable to predict, all developments in the economic environment which would have an impact on the Fund's operations and consequently what effect, if any, they could have on the financial position of the Fund.

Manat has remained stable during 2020. However, uncertainty over the exchange rate in the future and the ongoing fragility of the banking system hinders policy transmission into the real economy.

In January 2021, Standard & Poor's, international credit agency, affirmed long and short-term sovereign credit rating of Azerbaijan in foreign and local currency at 'BB+/B'.

## 3 SIGNIFICANT ACCOUNTING POLICIES

***Basis of preparation.*** These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The reporting date of the Fund's financial statements is 31 December.

The principal accounting policies applied in the preparation of these financial statements are set out below.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Fund's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4.

***Presentation currency.*** All amounts in these financial statements are presented in Azerbaijani manats ("AZN") unless otherwise indicated.

***Financial instruments - key measurement terms.*** *Financial instrument* is any contract that gives rise to a financial asset of the Fund and a financial liability or equity instrument of another entity (Fund).

*Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is the price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the number of instruments held by the entity.

This is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Valuation techniques such as discounted cash flow models or models based on recent arm's length transactions or consideration of financial data of the investees are used to measure fair value of certain financial instruments for which external market pricing information is not available.

Fair value measurements are analysed by level in the fair value hierarchy as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based on solely observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period.

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

*Amortised cost* is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any allowance for expected credit losses *("ECL").*

Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to the maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of the related items in the statement of financial position.

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

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

***Financial instruments – initial recognition***. When financial assets are initially recognized, they are classified accordingly in one of the following categories: (1) financial assets recognized at fair value through profit or loss (FVTPL), and (2) financial assets recognized at fair value in other comprehensive income (FVTOCI). or (3) financial assets recorded at amortized cost ("AC").

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

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

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

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

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

***Financial assets – classification and subsequent measurement – cash flow characteristics.*** Where the business model is to hold assets to collect contractual cash flows or to hold contractual cash flows and sell, the Fund assesses whether the cash flows represent solely payments of principal and interest ("SPPI"). In making this assessment, the Fund considers whether the contractual cash flows are consistent with a basic lending arrangement, i.e. interest includes only consideration for credit risk, time value of money, other basic lending risks and profit margin.

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

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

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

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

The Fund applies a three-stage model for impairment, based on changes in credit quality since initial recognition. A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial assets in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that results from default events possible within the next 12 months or until contractual maturity, if shorter (“12 Months ECL”). If the Fund identifies a significant increase in credit risk (“SICR”) since initial recognition, the asset is transferred to Stage 2 and its ECL is measured based on ECL on a lifetime basis, that is, up until contractual maturity but considering expected prepayments, if any (“Lifetime ECL”). Refer to Note 4 for a description of how the Fund determines when a SICR has occurred. If the Fund determines that a financial asset is credit-impaired, the asset is transferred to Stage 3 and its ECL is measured as a Lifetime ECL. Note 21 provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Fund incorporates forward-looking information in the ECL models.

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

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

***Financial liabilities – measurement categories.*** Financial liabilities are classified as subsequently measured at AC, except for (i) financial liabilities at FVTPL and (ii) financial guarantee contracts and loan commitments

***Derecognition of financial liabilities.*** A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

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

***Cash and cash equivalents.*** Cash and cash equivalents are short-term items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash and cash equivalents consist of cash on hand in local currency and unrestricted balances on correspondent accounts. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents, both in the statement of financial position and for the purposes of the statement of cash flows. Cash and cash equivalents are carried at AC because: (i) they are held for collection of contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL.

***Income taxes.*** Income taxes have been provided for in the financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax expense is recognised in profit or loss for the year.

***Intangible assets.*** The Fund's intangible assets have definite useful lives and primarily include capitalised computer software and licenses. Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring them to use. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred. Capitalised intangible assets are amortised on a straight-line basis over expected useful lives of 10 years.

***Premises and equipment.*** Premises and equipment are stated at cost less accumulated depreciation and impairment, where required.

Costs of minor repairs and maintenance are expensed when incurred. Costs of replacing major parts or components of premises and equipment items are capitalised and the replaced part is written-off.

At the end of each reporting period management assesses whether there is any indication of impairment of premises and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss for the year. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss for the year (within other operating income or expenses).

***Depreciation.*** Depreciation of an asset begins when it is available for use. Land and construction in progress are not depreciated. Depreciation on other items of premises and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives using the following rates:

| | Useful lives in years |
|---|---|
| Buildings | 20 |
| Furniture and fixtures | 4 |
| Office and computer equipment | 4 |
| Motor vehicles | 4 |
| Other | 5 |

The residual value of an asset is the estimated amount that the Fund would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

***Charter Capital.*** The Fund’s capital is comprised of the charter capital and accumulated deficits. As stated in Note **Error! Reference source not found.**, the Fund is a state establishment. The Ministry of F inance of the Republic of Azerbaijan is an executive financial agent for transfer of funds to the Fund. Transfers to and from the Fund are recognized in the Funds’ statement of changes in equity at the fair value on the date of payment.

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

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

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

***Offsetting.*** Financial assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

***Staff costs and related contributions.*** Wages, salaries, contributions to the Republic of Azerbaijan state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Fund. The Fund has no legal or constructive obligation to make pension or similar benefit payments beyond the payments to the State Social Security Fund under statutory defined contribution scheme.

***Presentation of statement of financial position in order of liquidity.*** The Fund does not have a clearly identifiable operating cycle and therefore does not present current and non-current assets and liabilities separately in the statement of financial position. Instead, analysis of assets and liabilities by their expected maturities is presented in Note 21.

## 4 CRITICAL ACCOUNTING ESTIMATES, AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

***ECL measurement.*** Measurement of ECLs is a significant estimate that involves determination methodology, models and data inputs. Details of ECL measurement methodology are disclosed in

Note 21. The following components have a major impact on credit loss allowance: definition of default, SICR, probability of default ("PD"), exposure at default ("EAD"), and loss given default ("LGD"). The Fund regularly reviews and validates the models and inputs to the models to reduce any differences between expected credit loss estimates and actual credit loss experience.

The Fund used supportable forward-looking information for measurement of ECL, primarily an outcome of its own macro-economic forecasting model.

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

***Business model assessment.*** The business model drives classification of financial assets. Management applied judgement in determining the level of aggregation and portfolios of financial instruments when performing the business model assessment. When assessing sales transactions, the Fund considers their historical frequency, timing and value, reasons for the sales and expectations about future sales activity. Sales transactions aimed at minimising potential losses due to credit deterioration are considered consistent with the "hold to collect" business model. Other sales before maturity, not related to credit risk management activities, are also consistent with the "hold to collect" business model, provided that they are infrequent or insignificant in value, both individually and in aggregate.

The Fund assesses significance of sales transactions by comparing the value of the sales to the value of the portfolio subject to the business model assessment over the average life of the portfolio. In addition, sales of financial asset expected only in stress case scenario, or in response to an isolated event that is beyond the Fund's control, is not recurring and could not have been anticipated by the Fund, are regarded as incidental to the business model objective and do not impact the classification of the respective financial assets.

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

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

***Assessment whether cash flows are solely payments of principal and interest ("SPPI").*** Determining whether a financial asset's cash flows are solely payments of principal and interest required judgement. The time value of money element may be modified, for example, if a contractual interest rate is periodically reset but the frequency of that reset does not match the tenor of the debt instrument's underlying base interest rate, for example a loan pays three months interbank rate but the rate is reset every month. The effect of the modified time value of money was assessed by comparing relevant instrument's cash flows against a benchmark debt instrument with SPPI cash flows, in each period and cumulatively over the life of the instrument. The assessment was done for all reasonably possible scenarios, including reasonably possible financial stress situation that can occur in financial markets. The Fund applied a threshold of 5% to determine whether differences against a benchmark instruments are significantly different. In case of a scenario with cash flows that significantly differ from the benchmark, the assessed instrument's cash flows are not SPPI and the instrument is then carried at FVTPL.

The Fund identified and considered contractual terms that change the timing or amount of contractual cash flows. The SPPI criterion is met if a loan allows early settlement and the prepayment amount substantially represents principal and accrued interest, plus a reasonable additional compensation for the early termination of the contract.

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

## 5 ADOPTION OF NEW AND REVISED STANDARDS AND INTERPRETATIONS

Some of the new Standards and Interpretations that are mandatory for the annual reporting periods beginning on or after January 1, 2021 and have not previously been adopted by the Fund are as follows:

***IFRS 17 "Insurance Contracts"(issued on 18 May 2017 and effective for annual periods beginning on or after 1 January 2023).*** IFRS 17 replaces IFRS 4, which has given companies dispensation to carry on accounting for insurance contracts using existing practices. As a consequence, it was difficult for investors to compare and contrast the financial performance of otherwise similar insurance companies.

IFRS 17 is a single principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds. The standard requires recognition and measurement of groups of insurance contracts at: (i) a risk-adjusted present value of the future cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information; plus (if this value is a liability) or minus (if this value is an asset) (ii) an amount representing the unearned profit in the group of contracts (the contractual service margin). Insurers will be recognising the profit from a group of insurance contracts over the period they provide insurance coverage, and as they are released from risk. If a group of contracts is or becomes loss-making, an entity will be recognising the loss immediately.

Management takes into account the implementation of the new standards, the impact on the financial statements and the timing of their adoption by the Fund.

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

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

## 6 RESTATEMENT AND RECLASSIFICATION

During the year ended December 31, 2020, management identified certain errors in the financial statements of previous years. These errors have been corrected retrospectively, as shown below.

| | Notes | As previously reported<br>31 December 2019 | Correction of errors<br>31 December 2019 | After restatement<br>31 December 2019 |
|---|---|---|---|---|
| Retained earnings | | (86,289) | (74,951) | (161,240) |
| Loans to credit institutions | (a) | 863,952 | (74,951) | 789,001 |

| | Notes | As previously reported<br>Year ended 31 December 2019 | Correction of errors/ Reclassification<br>Year ended 31 December 2019 | After restatement<br>Year ended 31 December 2019 |
|---|---|---|---|---|
| Impairment losses | (a)(b) | (39,128) | 37,922 | (1,206) |
| Bad debt expense | (b) | - | (1,097) | (1,097) |

| | Notes | As previously reported<br>1 January 2019 | Correction of errors<br>1 January 2019 | After restatement<br>1 January 2019 |
|---|---|---|---|---|
| Retained earnings | | (51,792) | (111,776) | (163,568) |
| Loans to credit institutions | (a) | 894,241 | (111,776) | 782,465 |

(a) Restatements by recalculating provisions for loans to credit institutions for the previous periods.
(b) Reclassification of written-off debts of the International Bank of Azerbaijan OJSC due to court decision as bad debt expense by deducting from the impairment of loans.

## 7 RELATED PARTY TRANSACTIONS

For the purposes of these financial statements, parties are generally considered to be related if the parties are directly or indirectly under common control or one party has the ability to control the other party or can 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. Transactions with related parties may not be considered compatible to the conditions of the transactions between commercially independent parties.

At 31 December 2020, 31 December 2019 and 1 January 2019, the outstanding balances with related parties were as follows:

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

| | Government of Azerbaijan and Government controlled entities | Government of Azerbaijan and Government controlled entities | Government of Azerbaijan and Government controlled entities |
|---|---|---|---|
| | **Amount** | **Amount (Restated)** | **Amount (Restated)** |
| | **31 December 2020** | **31 December 2019** | **1 January 2019** |
| **Statement of financial position** | | | |
| **ASSETS** | | | |
| Loans to credit institutions | 53,288 | 55,129 | 63,318 |

The income and expense items with related parties for 2020 and 2019 were as follows:

| | Government of Azerbaijan and Government controlled entities | Government of Azerbaijan and Government controlled entities |
|---|---|---|
| | **Amount** | **Amount** |
| **Statement of comprehensive income** | | |
| Interest income | 567 | 606 |

The Fund is controlled by the Government of the Republic of Azerbaijan. Therefore, in accordance with IAS 24 transactions with the Government, government bodies and entities controlled by the government of the Republic of Azerbaijan are included in the above related party balances and transactions.

Key management compensation is presented below:

| | Year ended 31 December 2020 | Year ended 31 December 2019 |
|---|---|---|
| Short-term benefits | | |
| - Salaries and other short-term benefits | 351 | 226 |
| - Social security costs | 79 | 50 |
| **Total** | **430** | **276** |

## 8 CASH AND CASH EQUIVALENTS

| | 31 December 2020 | 31 December 2019 |
|---|---|---|
| Correspondent accounts and overnight placements with other banks: | | |
| - The Republic of Azerbaijan | 95,453 | 56,353 |
| **Total cash and cash equivalents** | **95,453** | **56,353** |

At 31 December 2020, the Fund's cash and cash equivalents in the amount of AZN 279,000 were held in the Central Bank of the Republic of Azerbaijan, and the remaining amount was held in Pasha Bank OJSC. At 31 December 2019, all of the Fund’s cash and cash equivalents were held at “Pasha Bank” OJSC.

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

The credit quality of cash and cash equivalents balances may be summarised based on rating assigned by Standard&Poors as follows at 31 December 2020 and 31 December 2019:

| | **31 December 2020** | **31 December 2019** |
|---|---|---|
| Neither past due nor impaired | | |
| - BB+ | 279 | - |
| - B+ | 95,174 | 56,353 |
| **Total cash and cash equivalents** | **95,453** | **56,353** |

For the purpose of ECL measurement cash and cash equivalents balances are included in Stage 1. The ECL for these balances represents an insignificant amount, therefore the Fund did not recognise any credit loss allowance for cash and cash equivalents. The ECL measurement approach is presented in Note 21.

## 9 DEPOSITS AT BANKS

Deposits at banks comprise:

| | **31 December 2020** | **31 December 2019** |
|---|---|---|
| Term deposit in bank | 30,083 | - |
| **Total due from banks** | **30,083** | **-** |

The Fund's deposits are as follows as at 31 December 2020:

| **Bank name** | **Contract date** | **Maturity date** | **Currency** | **Annual interest rate** | **Amount per contract** | **As at 31 December 2020** |
|---|---|---|---|---|---|---|
| “Pashabank” OJSC | 05.03.2020 | 06.03.2021 | AZN | 4% | 10,000 | 10,000 |
| “Pashabank” OJSC | 05.03.2020 | 06.03.2021 | AZN | 4% | 10,000 | 10,000 |
| “Pashabank” OJSC | 05.03.2020 | 06.03.2021 | AZN | 4% | 10,000 | 10,000 |
| *Accrued interest* | | | | | | *83* |
| **Total** | | | | | | **30,083** |

For the purpose of ECL measurement deposits at banks are included in Stage 1. The ECL for these balances represents an insignificant amount, therefore the Fund did not recognise any credit loss allowance for deposits at banks. The ECL measurement approach is presented in Note 21.

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

## 10 LOANS TO CREDIT INSTITUTIONS

Loans to the credit institutions comprise:

| | 31 December 2020 | 31 December 2019 (Restated) | 1 January 2019 (Restated) |
|---|---|---|---|
| Gross carrying amount of loans to Credit Institutions at AC | 1,002,149 | 1,018,235 | 1,010,493 |
| Less credit loss allowance | (266,336) | (229,234) | (228,028) |
| **Total loans to credit institutions** | **735,813** | **789,001** | **782,465** |

The Fund uses the following credit limit ranges to classify loans:

- Small loans, up to AZN 50,000
- Medium loans, from AZN 50,001 up to AZN 1,000,000
- Large loans, from 1,000,001 up to AZN 10,000,000

Gross carrying amount and credit loss allowance amount for loans to credit institutions at AC by classes at 31 December 2020, 31 December 2019 and 1 January 2019 are disclosed in the table below:

| | 31 December 2020 | | |
|---|---|---|---|
| | Gross carrying amount | Credit loss allowance | Carrying amount |
| Large loans | 876,987 | (211,837) | 665,150 |
| Medium loans | 55,136 | (7,554) | 47,582 |
| Small loans | 70,026 | (46,945) | 23,081 |
| **Total loans to credit institutions at AC** | **1,002,149** | **(266,336)** | **735,813** |

| | 31 December 2019 (Restated) | | |
|---|---|---|---|
| | Gross carrying amount | Credit loss allowance | Carrying amount |
| Large loans | 903,800 | (181,293) | 722,507 |
| Medium loans | 43,004 | (7,142) | 35,862 |
| Small loans | 71,431 | (40,799) | 30,632 |
| **Total loans to credit institutions at AC** | **1,018,235** | **(229,234)** | **789,001** |

| | 1 January 2019 (Restated) | | |
|---|---|---|---|
| | Gross carrying amount | Credit loss allowance | Carrying amount |
| Large loans | 909,414 | (39,386) | 870,028 |
| Medium loans | 28,631 | (1,515) | 27,116 |
| Small loans | 72,448 | (187,127) | (114,679) |
| **Total loans to credit institutions at AC** | **1,010,493** | **(228,028)** | **782,465** |

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

The following table discloses the changes in gross carrying amount for loans to credit institutions carried at amortised cost between the beginning and the end of the reporting period:

| | **Gross carrying amount** | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| | **(12-months ECL)** | **(lifetime ECL for SICR)** | **(lifetime ECL for credit im-paired)** | |
| **At 1 January 2020** | **727,069** | **56,679** | **234,487** | **1,018,235** |
| *Movements with impact on credit loss allowance charge for the period:* | | | | |
| New originated or purchased | 86,645 | 8,189 | - | 94,834 |
| Derecognised or repaid | (85,977) | (28,051) | 2,616 | (111,412) |
| Changes in accrued interest | 22 | - | 470 | 492 |
| **Total movement in the gross carrying amount for the year** | **690** | **(19,862)** | **3,086** | **(16,086)** |
| Credit loss allowance | (30,976) | (10,392) | (224,968) | (266,336) |
| **At 31 December 2020** | **696,783** | **26,425** | **12,605** | **735,813** |

| | **Gross carrying amount** | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| | **(12-months ECL)** | **(lifetime ECL for SICR)** | **(lifetime ECL for credit im-paired)** | |
| **At 1 January 2019 (Restated)** | **746,209** | **38,750** | **225,534** | **1,010,493** |
| *Movements with impact on credit loss allowance charge for the period:* | | | | |
| New originated or purchased | 140,683 | 15,932 | - | 156,615 |
| Derecognised or repaid | (157,220) | 1,995 | 7,530 | (147,695) |
| Changes in accrued interest | (2,603) | 2 | 1,423 | (1,178) |
| **Total movement in the gross carrying amount for the year** | **(19,140)** | **17,929** | **8,953** | **7,742** |
| Credit loss allowance | (31,462) | (10,213) | (187,559) | (229,234) |
| **At 31 December 2019 (Restated)** | **695,607** | **46,466** | **46,928** | **789,001** |

Movements in the provision for impairment of loans to credit institutions during the year ended 31 December 2020 of are as follows:

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

| | Small loans | Medium loans | Large loans | Total |
|---|---|---|---|---|
| **Balance at the beginning of the year** | **(40,799)** | **(7,142)** | **(181,293)** | **(229,234)** |
| Net charge for the year | (6,146) | (412) | (30,544) | (37,102) |
| **Balance at the end of the year** | **(46,945)** | **(7,554)** | **(211,837)** | **(266,336)** |

Movements in the provision for impairment of loans to credit institutions during the year ended 31 December 2019 of are as follows:

| | Small loans | Medium loans | Large loans | Total |
|---|---|---|---|---|
| **Balance at the beginning of the year** | **(187,127)** | **(1,515)** | **(39,386)** | **(228,028)** |
| Net charge for the year | 146,328 | (5,627) | (141,907) | (1,206) |
| **Balance at the end of the year** | **(40,799)** | **(7,142)** | **(181,293)** | **(229,234)** |

The credit loss allowance for loans to credit institutions recognised in the period is impacted by a variety of factors, details of ECL measurement are provided in Note 21.

The credit quality of loans to credit institutions carried at amortised cost is as follows at 31 December 2020:

| | Stage 1 (12-months ECL) | Stage 2 (lifetime ECL for SICR) | Stage 3 (lifetime ECL for credit impaired) | Total |
|---|---|---|---|---|
| Less than 30 days | 727,758 | 36,736 | 4,395 | 768,889 |
| 30 to 90 days overdue | - | - | - | - |
| 91 to 180 days overdue | - | - | - | - |
| 181 to 360 days overdue | - | - | 6,396 | 6,396 |
| Over 360 days overdue | - | 82 | 226,782 | 226,864 |
| **Gross carrying amount** | **727,758** | **36,818** | **237,573** | **1,002,149** |
| Credit loss allowance | (30,976) | (10,392) | (224,968) | (266,336) |
| **Carrying amount** | **696,782** | **26,426** | **12,605** | **735,813** |

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

The credit quality of loans to credit institutions carried at amortized cost is as follows at 31 December 2019:

| | **Stage 1 (12-months ECL)** | **Stage 2 (lifetime ECL for SICR)** | **Stage 3 (lifetime ECL for credit impaired)** | **Total** |
|---|---|---|---|---|
| Less than 30 days | 700,719 | 56,622 | 102,095 | 859,436 |
| 30 to 90 days overdue | - | - | - | - |
| 91 to 180 days overdue | - | - | - | - |
| 181 to 360 days overdue | - | 1 | 3,031 | 3,032 |
| Over 360 days overdue | 26,350 | 56 | 129,361 | 155,767 |
| **Gross carrying amount** | **727,069** | **56,679** | **234,487** | **1,018,235** |
| Credit loss allowance | (31,462) | (10,213) | (187,559) | (229,234) |
| **Carrying amount** | **695,607** | **46,466** | **46,928** | **789,001** |

The credit quality of loans to credit institutions carried at amortized cost is as follows at 1 January 2019:

| | **Stage 1 (12-months ECL)** | **Stage 2 (lifetime ECL for SICR)** | **Stage 3 (lifetime ECL for credit impaired)** | **Total** |
|---|---|---|---|---|
| Less than 30 days | 622,798 | 38,649 | 5,286 | 666,733 |
| 30 to 90 days overdue | - | 6 | 1 | 7 |
| 91 to 180 days overdue | 529 | - | 286 | 815 |
| 181 to 360 days overdue | 568 | 95 | 43,358 | 44,021 |
| Over 360 days overdue | 122,315 | - | 176,602 | 298,917 |
| **Gross carrying amount** | **746,210** | **38,750** | **225,533** | **1,010,493** |
| Credit loss allowance | (36,998) | (11,574) | (179,456) | (228,028) |
| **Carrying amount** | **709,212** | **27,176** | **46,077** | **782,465** |

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

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

| | 31 December 2020 | | 31 December 2019 | | 31 December 2018 | |
|---|---|---|---|---|---|---|
| | **Amount** | **%** | **Amount** | **%** | **Amount** | **%** |
| Agricultural | 659,383 | 65.80 | 678,964 | 66.68 | 900,397 | 89.10 |
| Industry | 219,766 | 21.93 | 204,015 | 20.04 | 75,038 | 7.43 |
| Service | 123,000 | 12.27 | 135,256 | 13.28 | 35,058 | 3.47 |
| **Gross carrying amount of loans to credit institutions carried at amortised cost** | **1,002,149** | **100** | **1,018,235** | **100** | **1,010,493** | **100** |

## 11 PREMISES, EQUIPMENT AND INTANGIBLE ASSETS

| | Premises | Furniture and fixtures | Office and computer equipment | Vehicles | Intangible assets | Total |
|---|---|---|---|---|---|---|
| **Net book value at 1 January 2019** | **-** | **6** | **56** | **19** | **30** | **111** |
| Additions | 6,639 | 23 | 53 | 213 | 6 | 6,934 |
| Depreciation expense | (172) | (7) | (29) | (19) | (7) | (234) |
| **Net book value at 31 December 2019** | **6,467** | **22** | **80** | **213** | **29** | **6,811** |
| Additions | - | 3 | - | 124 | 165 | 292 |
| Depreciation expense | (332) | (9) | (28) | (58) | (10) | (437) |
| **Net book value at 31 December 2020** | **6,135** | **16** | **52** | **279** | **184** | **6,666** |
| Cost at 31 December 2019 | 6,639 | 194 | 231 | 259 | 81 | 7,404 |
| Accumulated depreciation at 31 December 2019 | (172) | (172) | (151) | (46) | (52) | (593) |
| **Net book value at 31 December 2019** | **6,467** | **22** | **80** | **213** | **29** | **6,811** |
| Cost at 31 December 2020 | 6,639 | 197 | 231 | 383 | 246 | 7,696 |
| Accumulated depreciation at 31 December 2020 | (504) | (181) | (179) | (104) | (62) | (1,030) |
| **Net book value at 31 December 2020** | **6,135** | **16** | **52** | **279** | **184** | **6,666** |

The material part of the Fund's fixed assets as at 31 December 2020 consist of the administrative building which has the cost in the amount of AZN 6,639 thousand and book value in the amount of AZN 6,135 thousand. Detailed information on the purchase of the administrative building is presented in Note 16.

## 12 OTHER ASSETS

Other assets as at 31 December 2020 and 31 December 2019 consist of various accounts receivables and prepayments arose from operational activity of the Fund. Other assets also include excess payment on corporate income tax in the amount of AZN 888 as at 31 December 2019.

## 13 LIABILITIES FOR THE SUBSIDIES BY GOVERNMENT

Approved by the Decree #1052 of the President of the Republic of Azerbaijan dated June 4, 2020 and the Resolution #249 of the Cabinet of Ministers of the Republic of Azerbaijan dated July 9, 2020, funds in the amount of AZN 20,000 thousand in accordance with “Rules for issuing state guarantees and subsidizing interest rates on bank loans to be issued to businesses operating in areas affected by the coronavirus (COVID-19) pandemic” and in the amount of AZN 50,000 thousand in accordance with “Rules for subsidizing interest rates on the existing loan portfolio of businesses operating in areas affected by the coronavirus (COVID-19) pandemic” were transferred to the Fund. The Fund provides subsidies for 50 percent of interest to be paid on state-guaranteed loans and 10 percent of interest to be paid on the existing portfolio loans by using funds from the Government.

As at December 31, 2020, the Fund has paid interest subsidies in the amount of AZN 476 thousand and AZN 20,057 thousand for state-guaranteed and existing portfolio loans, respectively.

As at December 31, 2020, the balance of the liabilities for the subsidies by government amounted to AZN 49,467 thousand.

## 14 OTHER LIABILITIES

Other liabilities as at 31 December 2020 consist of various accounts payables arose from operational activity of the Fund and tax liability on corporate income tax in the amount of AZN 36,000. Other liabilities as at 31 December 2019 consist of various accounts payables arose from operational activity of the Fund.

## 15 CHARTER CAPITAL

Pursuant to Decree #224 of the President of the Republic of Azerbaijan dated 31 July 2018, the National Fund for Entrepreneurship Support of the Republic of Azerbaijan was liquidated and new public legal entity, the Entrepreneurship Development Fund was established under the Ministry of Economy. Based on the Decree, the authorized charter capital of the Fund constitutes AZN 1,094,254,581.

## 16 CONTRIBUTION BY THE GOVERNMENT

Under the decree of the Minister of Economy of the Republic of Azerbaijan dated 14 May 2019 and the act of acceptance between the Fund and the Ministry of Economy of the Republic of Azerbaijan dated 25 June 2019, the administrative building with total square of 2,650 s.m. and evaluated value of AZN 6,639,000 which is located at 172 Sharifzada street, Baku has been transferred to the Fund from the balance of the Ministry of Economy.
Settlements with the Government as at 31 December 2019 also include two automobiles of Hyudai Sonata and Toyota Camry models with the total net book value of AZN 10,669 which are transferred to the Fund from the balance of “Azerlotoreya” OJSC under the decree of the Minister of Economy of the

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

Republic of Azerbaijan dated 3 January, 2019 and during 2020 and 2019, funds in the amount of AZN 1,328 thousand and AZN 552 thousand respectively paid by the Fund to the Ministry of Economy of the Republic of Azerbaijan.

## 17 INTEREST INCOME

| | Year ended 31 December 2020 | Year ended 31 December 2019 |
|---|---|---|
| **Interest income:** | | |
| Loans to banks | 7,895 | 8,019 |
| Loans to non-bank credit institutions | 331 | 293 |
| Deposits placed at local banks | 1,190 | 417 |
| **Total interest income** | **9,416** | **8,729** |

## 18 OTHER OPERATING INCOME

| | Year ended 31 December 2020 | Year ended 31 December 2019 |
|---|---|---|
| **Other operating income:** | | |
| Comission fee | 28 | - |
| Guarantee fee | 651 | - |
| Other | 9 | 1 |
| **Total other operating income** | **688** | **1** |

A significant part of the Fund's other operating income for the year ended 31 December 2020 consisted of commission fee and one-time guarantee fee received from credit institutions due to the issuance of state guarantees for loans to businesses operating in areas affected by the COVID-19 pandemic. The commission fee is calculated in the amount of 0.5% of the total amount of the guarantee issued to the credit organization from the date that the guarantee is effective. The one-time guarantee fee is calculated at 1% of the loan amount issued by the credit organization, 50% of the guarantee fee is transferred to the Ministry of Finance in accordance with the Rules and the rest is recognized as income.
Detailed information on state-guaranteed loans is provided in Note 13.

## 19 OPERATING EXPENSES

| | Year ended 31 December 2020 | Year ended 31 December 2019 |
|---|---|---|
| Staff costs | 3,984 | 3,321 |
| Depreciation of premises, equipment and intangible assets | 436 | 234 |
| Business travel and related expenses | 22 | 66 |
| Insurance expense | 115 | 65 |
| Advertising and marketing services | 4 | 63 |
| Office supplies | 26 | 57 |
| Professional services | 21 | 43 |
| Bank commissions | 38 | 35 |
| Communication | 29 | 34 |
| Other expenses | 337 | 112 |
| **Total operating expenses** | **5,012** | **4,030** |

## 20 INCOME TAX EXPENSE

Income tax rate applicable to the Funds profit for the year 2020 presented in these financial statements amounts to 20% (2019: 20%). Income tax expense for the year 2020 amounts to AZN 221 thousand (2019: AZN 84 thousand).

## 21 FINANCIAL RISK MANAGEMENT

The risk management function within the Fund is carried out in respect of financial risks, operational risks and legal risks. Financial risk comprises market risk (including currency risk, interest rate risk and other price risk), credit risk and liquidity risk. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits.

The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures, in order to minimise operational and legal risks.

Each individual within the Fund is accountable for the risk exposures relating to his or her responsibilities. The Fund is exposed to credit, market 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 Fund’s strategic planning process.

The Supervisory Board is ultimately responsible for identifying and controlling risks; however, there are separate business units responsible for managing and monitoring the various risks:

***Management Board.*** The Chairman of the Board is responsible for the overall risk management approach, risk tolerance levels and for approving the main principles of risk management.

**Internal control policies and procedures**

Although the Supervisory Board is ultimately responsible for identifying and controlling risks, the Management Board has responsibility for the development, implementation and maintaining of internal controls in the Fund that are commensurate with the scale and nature of operations.

The purpose of internal controls is to ensure:

- proper and comprehensive risk assessment and management;
- proper management and accounting and financial reporting functions, including proper authorization, processing and recording of transactions;
- completeness, accuracy and timeliness of accounting records, managerial information, regulatory reports, etc.;
- determination of risk of fraudulent or illegal activities, including misappropriation of assets;
- compliance with laws and regulations.

Management is responsible for identifying and assessing risks, designing controls and monitoring their effectiveness. Management periodically implements additional controls or modifies existing controls as considered necessary.

The Fund developed a system of standards, policies and procedures to ensure effective operations and compliance with relevant legal and regulatory requirements, including the following areas:

- requirements for appropriate segregation of duties, including the independent authorization of transactions
- requirements for the recording, reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- training and professional development

There is a hierarchy of requirements for authorization of transactions depending on their size and complexity.

Compliance with the laws and regulations of the Fund is supported by periodic reviews undertaken by the Chamber of Accounts of the Republic of Azerbaijan.

Requirements for Fund's risk management and internal control systems are approved by the Supervisory Board of Fund and risk management and internal control systems are corresponding to the volume, nature and complexity of operations.

***Risk management policies and procedures***

Management of risk is fundamental to the Fund’s work and is an essential element of the Fund’s operations. The risk management policies aim to identify, analyse and manage the risks faced by the Fund, to set appropriate risk limits and controls, and to continuously monitor risk levels and adherence to limits. Risk management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and emerging best practice.

The Supervision Board approves risk management strategy, relevant policies and procedures.

Assets-liabilities and risk management strategy adopted by the Fund incorporate policies on risk management, credit, liquidity, currency, operational and other risks through Supervision Board of the Fund.

Both external and internal risk factors are identified and managed throughout the Fund. Particular attention is given to identifying the full range of risk factors and determination of the level of assurance over the current risk mitigation procedures. Apart from the standard credit and market risk analysis, the investment project expertise and monitoring division monitors financial and non-financial risks by holding regular meetings with operational units in order to obtain expert judgments in their areas of expertise.

Monitoring of the projects is an integral part of risk management process of the Fund. According to the guidance determined by the Fund, the correspondent credit institutions are conducting monitoring of each entrepreneur's projects financed through the Fund's resources not less than twice a year and reports are presented to the Fund. The structure and template of the report are determined by the Fund. Then correspondent credit institutions should demand entrepreneurs to repay the principal and interest amounts prior to the maturity if inappropriate use of Fund's resources were identified during the monitoring. The correspondent credit institutions should repay the total principal and interest amounts on the specific defaulted project to the Fund without regard of their obligations of fulfilment within ten banking days.

Monitoring of the entrepreneurs could be conducted independently by the Fund in order to control appropriate use of the Fund's resources by the entrepreneurs. If inappropriate use of Fund's resources were identified during the monitoring, the correspondent credit institutions should repay the principal and interest amounts on the specific defaulted project to the Fund upon the Fund's written request without regard of the entrepreneurs' obligations of fulfilment within ten banking days. The correspondent credit institutions are charged penalties if they delay to repay the amount upon the Fund's request. The Fund takes appropriate legislative measures to redeem its resources if the duration of delay is more than thirty calendar days. If the payment of required resources is delayed for more than thirty calendar days, the Fund takes appropriate legal measures to redeem its resources.

***Redeeming of the Fund's resources.*** If the correspondent credit institutions breach identified terms of monitoring more than three times, then Fund will repeal the main and additional limits established for these correspondent credit institutions or exclude these institutions from the list of correspondent credit institutions.

***Market risk.*** Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk arises from open positions in interest rate, equity financial instruments, which are exposed to general and specific market movements and changes in the level of volatility of market prices. The Fund has no significant concentration of market risk.

***Credit risk*** is the risk of financial loss to the Fund if an authorised lending agency fails to meet its contractual obligations. The Fund has policies and procedures for the management of credit exposures through setting up limits for financing loans of borrowing credit institutions. Limits on the level of credit risk by product and industry sector are approved regularly by management. Such risks are monitored on a revolving basis and are subject to an annual, or more frequent, review.

An individual ceiling is set by the Supervision Board of the Fund for each authorised lending agency at the beginning of each year based on its aggregate capital and appropriate financial data. After exceeding this limit, the Supervision Board of the Fund, based on repaid loans, as well as other inflows, can set additional limit for financing investment projects of entrepreneurship entities against requests of the authorized lending agencies.

The total value of the balance of assets mobilized from the Fund can be up to 100% of aggregate capital of authorized banks and 100% of charter capital of non-banking credit organizations.

Corresponding loan applications reflecting financial information on credit institutions are prepared by the business sector dealing with entrepreneurs and authorised credit institutions of the Entrepreneurship development division, and are passed on to the Supervisory Board of the Fund for approval of the credit limits for authorised credit institutions. In order to monitor credit risk exposures, regular reports are produced by the investment project expertise and monitoring division’s officers based on a structured analysis focusing on the customer’s business and financial performance. Any significant exposure to customers with deteriorating creditworthiness are reported to, and reviewed by, the Supervision Board. The Fund does not use formalised internal credit ratings to monitor exposure to credit risk. Management monitors and follows up on past due balances. The Central Bank of the Republic of Azerbaijan regularly provides the Fund with information on financial-statistic indicators of authorized lending agencies as of certain date. This information is represented by letter, which includes list of financial institutions and their main financial performance indicators such as total assets, liabilities, total capital, loan portfolio, capital adequacy ratio, profit or loss.

The Fund’s investment project expertise and monitoring division reviews the ageing analysis of outstanding loans and follows up on past due balances. Management, therefore, considers it appropriate to provide ageing and other information about credit risk as disclosed below.

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

Apart from individual customer analysis, the credit portfolio is assessed by the Finance and Supply Division with regard to credit concentration and market risks.

The maximum exposure to credit risk is generally reflected in the carrying amounts of financial assets in the statement of financial position and unrecognised contractual commitment amounts. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

The maximum exposure to credit risk from financial assets at the reporting date is as follows:

| | 31 December 2020 | 31 December 2019 (Restated) | 1 January 2019 (Restated) |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and cash equivalents | 95,453 | 56,353 | 61,321 |
| Deposits at banks | 30,083 | - | - |
| Loans to credit institutions | 735,813 | 789,001 | 782,465 |
| **Total on-balance sheet exposure** | **861,349** | **845,354** | **843,786** |

***Credit risks concentration.*** The Fund is exposed to concentrations of credit risk. At 31 December 2020 the Fund had 2 counterparties (2019: 2 counterparties) with aggregated loan balance above AZN 100,000 thousand. The total aggregate amount of these balances was AZN 392,359 (2019: AZN 358,522) or 53% of the total loans to credit institutions (2019: 45%).

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

EAD is an estimate of exposure at a future default date, taking into account expected changes in the exposure after the reporting period, including repayments of principal and interest, and expected drawdowns on committed facilities. The EAD on credit related commitments is estimated using Credit Conversion Factor (“CCF”). CCF is a coefficient that shows the probability of conversion of the committed amounts to an on-balance sheet exposure within a defined period.

PD *is* an estimate of the likelihood of default to occur over a given time period. LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from any collateral. It is usually expressed as a percentage of the EAD. The expected losses are discounted to present value at the end of the reporting period. The discount rate represents the effective interest rate (“EIR”) for the financial instrument or an approximation thereof.

Expected credit losses are modelled over instrument’s *lifetime period.* The *lifetime period* is equal to the remaining contractual period to maturity of debt instruments, adjusted for expected prepayments, if any.

Management models *Lifetime ECL,* that is, losses that result from all possible default events over the remaining lifetime period of the financial instrument. The *12-month ECL,* represents a portion of lifetime

ECLs that result from default events on a financial instrument that are possible within 12 months after the reporting period, or remaining *lifetime period* of the financial instrument if it is less than a year.

For purposes of measuring PD, the Fund defines default as a situation when the exposure meets one or more of the following criteria:

- the borrower is more than 90 days past due on its contractual payments;
- the credit rating of a financial asset is downgraded to "D" (C) by leading international rating agencies
- licence of the borrower to operate in banking industry is revoked;

The Fund considers a financial instrument to have experienced *a significant increase in credit risk* when one or more of the following criteria have been met:

- Actual or expected significant adverse change in operating results of the authorised lending agency;
- when financial assets are downgraded by the leading international credit rating agencies of the long-term credit rating by 5 grades since initial recognition.

For purposes of disclosure, the Fund fully aligned the definition of default with the definition of credit-impaired assets. The default definition stated above is applied to all types of financial assets of the Fund.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of six months. This period of six months has been determined based on an analysis that considers the likelihood of a financial instrument returning to default status after curing by using different possible definitions of cures.

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

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

***The key principles of calculating the credit risk parameters.*** The EADs are determined based on the expected payment profile including contractual principal plus interest. EAD is based on the contractual repayments owed by the borrower over a 12-month or lifetime basis for amortising products and bullet repayment loans. This will also be adjusted for any expected overpayments made by a borrower. Early repayment or refinancing assumptions are also incorporated into the calculation.

Two types of PDs are used for calculating ECLs: 12-month and lifetime PD. An assessment of a 12-month PD is based on the latest available historic default data and adjusted for supportable forward-looking information when appropriate. Lifetime PDs represent the estimated probability of a default occurring over the remaining life of the financial instrument and it is a sum of the 12 months PDs over the life of the instrument.

The Fund has direct exposure towards credit institutions which finance loans to the Entreprenuers. Therefore, risk of default is combination of risk of default of given credit institutions and underlying portfolio financed by the Fund. Credit institutions divided into two categories for ECL purposes:

- Banks
- Non-Bank Credit Organizations (NBCO) and credit unions

LGD represents the Fund's expectation of the extent of loss on a defaulted exposure. LGD varies by the type of counterparty, type and seniority of the claim and the availability of collateral or other credit support. The 12-month and lifetime LGDs are determined based on the factors that impact the expected recoveries after a default event. The value of LGD has been benchmarked using estimates provided by World Bank, directly for country of Azerbaijan.

***Forward-looking information incorporated in the ECL models.*** PD and LGD estimations for loans are based on history from last 36 months so the most recent economic environment is already reflected in the estimation process. In case of measuring PD and LGD figures, information from external rating agencies is used where macroeconomic factors are already incorporated within.

***Backtesting.*** The Fund regularly reviews its methodology and assumptions to reduce any difference between the estimates and the actual loss of credit. Such backtesting is performed at least once a year. The results of backtesting are communicated to the Management and further steps for tuning models and assumptions are defined after discussions between authorised persons.

***Currency risk.*** Currency risk results from the currency rates fluctuation. Due to the reason that all operations of the Fund are carried out in national currency, the Fund is not directly subject to the currency risk.

***Interest rate risk.*** The Fund takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. The Fund is not significantly exposed to interest rate risk as the Fund does not have floating rate non-trading financial assets and financial liabilities held as of 31 December 2020 and 2019.

***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 Fund cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Fund is able to manage the risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes.

***Liquidity risk.*** Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Fund is not exposed to liquidity risk, as it does not have significant financial liabilities as at 31 December 2020, 31 December 2019 and 1 January 2019. The following tables provide an analysis, by expected maturities, of amounts recognised in the statement of financial position:

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

| | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | From 12 months to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| **At 31 December 2020** | | | | | | |
| Cash and cash equivalents | 95,453 | - | - | - | - | 95,453 |
| Deposits at banks | 83 | 30,000 | - | - | - | 30,083 |
| Loans to credit institutions | 2,553 | 2,775 | 10,891 | 373,282 | 346,312 | 735,813 |
| Liabilities for the subsidies by Government | (5,870) | (18,273) | (25,324) | - | - | (49,467) |
| Financial liabilities | (27) | - | - | - | - | (27) |
| **Net position based on expected maturities** | **92,192** | **14,502** | **(14,433)** | **373,282** | **346,312** | **811,855** |

| | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | From 12 months to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| **At 31 December 2019** | | | | | | |
| Cash and cash equivalents | 56,353 | - | - | - | - | 56,353 |
| Loans to credit institutions | 15,665 | 7,523 | 8,146 | 363,281 | 394,386 | 789,001 |
| Financial liabilities | (18) | - | - | - | - | (18) |
| **Net position based on expected maturities** | **72,000** | **7,523** | **8,146** | **363,281** | **394,386** | **845,336** |

| | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | From 12 months to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| **At 1 January 2019** | | | | | | |
| Cash and cash equivalents | 61,321 | - | - | - | - | 61,321 |
| Loans to credit institutions | 13,206 | 9,923 | 17,009 | 318,446 | 423,881 | 782,465 |
| Financial liabilities | (44) | - | - | - | - | (44) |
| **Net position based on expected maturities** | **74,483** | **9,923** | **17,009** | **318,446** | **423,881** | **843,742** |

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

## 22 CONTINGENCIES AND COMMITMENTS

***Legal proceedings*.** From time to time and in the normal course of operations, claims against the Fund may be received. On the basis of its own estimates and both internal professional advice management is of the opinion that no material losses will be incurred in respect of claims and accordingly no provision has been made in these financial statements.

## 23 FAIR VALUE DISCLOSURES

Fair value measurements are analysed by level in the fair value hierarchy as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based on observable market data (that is, unobservable inputs). Management applies judgement in categorising financial instruments using the fair value hierarchy.

If a fair value measurement uses observable inputs that require significant adjustment, that measurement is a Level 3 measurement. The significance of a valuation input is assessed against the fair value measurement in its entirety.

As at 31 December 2020 and 2019, there are no financial instruments measured at fair value recognized in the statement of financial position.

***Assets and liabilities not measured at fair value but for which fair value is disclosed***

For assets and liabilities maturing within three months, the carrying amount approximates fair value due to the relatively short-term maturity of these financial instruments. For all others the fair value is estimated as the present value of estimated future cash flows discounted at the appropriate year-end market rates for new instruments with similar credit risk and remaining maturity.

Management consider that the carrying amounts of financial assets and financial liabilities recognised in the financial statements approximate their fair values and categorised in the Level 2 fair value hierarchy.

## 24 PRESENTATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT CATEGORY

For the purposes of measurement, IFRS 9 “Financial Instruments” classifies financial assets into the following categories: (a) financial assets at FVTPL; (b) debt instruments at FVOCI, (c) equity instruments at FVOCI and (c) financial assets at AC. Financial assets at FVTPL have two sub-categories: (i) assets mandatorily measured at FVTPL, and (ii) assets designated as such upon initial recognition or subsequently. The following table provides a reconciliation of financial assets with these measurement categories as of 31 December 2020, 31 December and 1 January 2019:

| | **Financial assets at AC** | **Total** |
|---|---:|---:|
| **Assets** | | |
| Cash and cash equivalents | 95,453 | 95,453 |
| Deposits at banks | 30,083 | 30,083 |
| Loans to credit institutions | 735,813 | 735,813 |
| **Total financial assets** | **861,349** | **861,349** |

*(Amounts are expressed in thousand AZN unless otherwise indicated)*

| | Financial assets at AC | Total |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | 56,353 | 56,353 |
| Loans to credit institutions | 789,001 | 789,001 |
| **Total financial assets** | **845,354** | **845,354** |

| | Financial assets at AC | Total |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | 61,321 | 61,321 |
| Loans to credit institutions | 782,465 | 782,465 |
| **Total financial assets** | **843,786** | **843,786** |

As of 31 December 2020, and 2019 and 1 January 2019, all of the Fund's financial liabilities were carried at amortised cost.

## 25 EVENTS AFTER REPORTING PERIOD

The Fund carried out significant bond transactions after the reporting period. On 16 March 2021, the Fund carried out purchase of bonds of Ministry of Finance worth AZN 9,999,983.