

“Azerbaijan Airlines” Closed Joint Stock Company

Consolidated Financial Statements and
Independent Auditor’s Report
for the Year Ended 31 December 2020

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

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INDEPENDENT AUDITOR'S REPORT

To the Supervisory Board and the Shareholder of Closed Joint Stock Company "Azerbaijan Airlines":

Opinion

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

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

Basis for Opinion

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

Material Uncertainty Related to Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Group will continue as a going concern. As disclosed in Note 2 to the consolidated financial statements, the Group has been significantly impacted by the COVID-19 pandemic, has negative working capital, recurring losses from operations and accumulated deficit. These events or conditions, along with other matters as set forth in Note 2, indicate that a material uncertainty related to events or conditions exists that may cast significant doubt on the Group's ability to continue as a going concern. Management's plans concerning these matters are also discussed in Note 2 to the consolidated financial statements. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified in respect of this matter.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

STATEMENT OF MANAGEMENT’S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

Management is responsible for the preparation of the consolidated financial statements, which present fairly the financial position of Closed Joint Stock Company “Azerbaijan Airlines” and its subsidiaries (the “Group”) as at 31 December 2020, and the consolidated results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards (“IFRSs”).

In preparing the consolidated financial statements, management is responsible for:

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group’s consolidated financial position and financial performance; and
- Making an assessment of the Group’s ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls throughout the Group;
- Maintaining adequate accounting records that are sufficient to show and explain the Group’s transactions and disclose with reasonable accuracy at any time the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRSs;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Preventing and detecting fraud and other irregularities.

The consolidated financial statements for the year ended 31 December 2020 were approved by the Supervisory Board and management of the Group on 11 January 2022.

On behalf of the Supervisory Board and management:



Sabir Ilyasov
First Vice-President

Baku, the Republic of Azerbaijan
11 January 2022





Esmira Tahirova
Chief Accountant

Baku, the Republic of Azerbaijan
11 January 2022

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

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

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

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

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

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

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

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

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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.

DELOITTE + TOUCHE LLC

11 January 2022



“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2020
(in thousands of Azerbaijani Manat)**

	Notes	2020	2019
Traffic and other revenue	5	335,236	1,008,459
Subsidies received from government due to COVID-19	4	232,082	-
Operating costs	6	(540,149)	(949,588)
Operating profit		27,169	58,871
Finance costs	7	(83,966)	(111,185)
Foreign exchange loss	8	(9,399)	(6,579)
Loss before tax		(66,196)	(58,893)
Income tax expense	9	(10,219)	(19,877)
LOSS FOR THE YEAR AND TOTAL COMPREHENSIVE LOSS		(76,415)	(78,770)

The accompanying notes are an integral part of these consolidated financial statements.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2020
(in thousands of Azerbaijani Manat)**

	Notes	31 December 2020	31 December 2019
ASSETS			
Non-current assets			
Property and equipment	10	1,382,518	1,483,726
Right-of-use assets	11	372,468	377,979
Intangible assets		4,086	4,658
Long-term advances given	12	48,454	39,186
Other non-current assets	13	34,137	32,558
Total non-current assets		1,841,663	1,938,107
Current assets			
Consumable spare parts and inventories	14	19,919	23,823
Trade and other receivables	15	71,892	86,759
Cash and cash equivalents	16	44,726	34,959
Total current assets		136,537	145,541
Total assets		1,978,200	2,083,648
EQUITY AND LIABILITIES			
Equity			
Share capital	17	823,975	823,975
Additional paid-in capital	17	160,181	148,413
Accumulated deficit		(1,763,916)	(1,687,501)
Total equity		(779,760)	(715,113)
Non-current liabilities			
Long-term loans and borrowings	18	1,277,930	1,605,934
Lease liabilities, non-current portion	19	285,154	340,546
Deferred revenue related to Frequent Flyer Programme (FFP), non-current portion	20	27,158	22,932
Deferred tax liability	21	46,197	36,360
Total non-current liabilities		1,636,439	2,005,772
Current liabilities			
Trade and other payables	22	108,517	167,266
Short-term borrowings and current portion of long-term loans and borrowings	18	905,861	472,267
Lease liabilities, current portion	19	49,004	50,153
Unearned revenue	20	25,103	46,884
Deferred revenue related to FFP, current portion	20	1,529	5,193
Other current liabilities	23	31,507	51,226
Total current liabilities		1,121,521	792,989
Total liabilities		2,757,960	2,798,761
Total equity and liabilities		1,978,200	2,083,648

The accompanying notes are an integral part of these consolidated financial statements.

"AZERBAIJAN AIRLINES" CLOSED JOINT STOCK COMPANY

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2020
(in thousands of Azerbaijani Manat)**

	Notes	Share capital	Additional paid-in capital	Accumulated deficit	Total equity (deficit)
Balance at 1 January 2019		823,975	160,813	(1,608,731)	(623,943)
Loss for the year and total comprehensive loss		-	-	(78,770)	(78,770)
Shareholder's contribution	17	-	654	-	654
Distribution to shareholder	17	-	(13,054)	-	(13,054)
Balance at 31 December 2019		823,975	148,413	(1,687,501)	(715,113)
Loss for the year and total comprehensive loss		-	-	(76,415)	(76,415)
Shareholder's contribution	17	-	11,768	-	11,768
Balance at 31 December 2020		823,975	160,181	(1,763,916)	(779,760)

The accompanying notes are an integral part of these consolidated financial statements.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2020
(in thousands of Azerbaijani Manat)**

	Notes	2020	2019
OPERATING ACTIVITIES:			
Loss before tax		(66,196)	(58,893)
Adjustments for:			
Depreciation and amortisation		139,678	138,647
Change in provision for trade and other receivables and advances given		2,592	3,708
Loss on disposal of property and equipment		-	(4,607)
Loss on disposal of right-of-use assets		722	-
Change in provision for obsolescence of consumable spare parts and inventories		(151)	(1,249)
Change in provision for VAT recoverable		(476)	8,498
Impairment of property and equipment and right-of-use assets	10, 11	15,794	-
Impairment of capital projects		4,797	-
Foreign exchange loss	8	9,399	6,579
Finance costs	7	83,966	111,185
Change in other provisions		(925)	4,325
<i>Operating cash flow before movements in working capital</i>		<i>189,200</i>	<i>208,193</i>
Change in trade and other receivables		(4,730)	19,258
Change in consumable spare parts and inventories		1,707	(4,964)
Change in trade and other payables		(68,233)	(36,792)
Change in deferred revenue related to FFP	20	562	(10,624)
Change in unearned revenue		(21,781)	15,574
Change in other current liabilities		(16,237)	40,652
Cash generated from operations		80,488	231,297
Income tax paid		-	-
Interest paid		(16,563)	(24,136)
Net cash from operating activities		63,925	207,161
INVESTING ACTIVITIES:			
Purchase of property and equipment		(58,571)	(103,415)
Cash paid for additions to right-of-use assets during the period		(71)	(14,338)
Proceeds from disposal of property and equipment		310	717
Purchase of intangible assets		(1,818)	(2,831)
Net cash used in investing activities		(60,150)	(119,867)
FINANCING ACTIVITIES:			
Shareholder's contribution	17	10,248	-
Proceeds from loans and borrowings	18	24,406	20,155
Principal payments on loans and borrowings		(3,584)	(50,952)
Principal payments on lease obligations		(24,085)	(51,119)
Net cash from / (used in) financing activities		6,985	(81,916)
NET INCREASE IN CASH AND CASH EQUIVALENTS		10,760	5,378
Effect of exchange rate changes on cash and bank balances held in foreign currencies		(993)	(2,722)
CASH AND CASH EQUIVALENTS, at the beginning of the year		34,959	32,303
CASH AND CASH EQUIVALENTS, at the end of the year		44,726	34,959

The accompanying notes are an integral part of these consolidated financial statements.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2020 (in thousands of Azerbaijani Manat)

Non-cash transactions excluded from the consolidated statement of cash flows

Amounts presented in the consolidated statement of cash flows for the year ended 31 December 2020 and 31 December 2019 do not include the following non-cash transactions:

- (a) Reclassification of aircraft and engine from property and equipment to right-of-use assets with net book value of AZN 26,784 and AZN 372,335 in 2020 and 2019, respectively (see Note 10);
- (b) Recognition of right-of-use assets of AZN 12,648 through lease liabilities in 2019;
- (c) Reassessment of lease term of right-of-use assets with net book value of AZN 7,174 and related lease liability of AZN 6,452 in 2020 (see Notes 11 and 19);
- (d) Payment of the government guaranteed loan and lease liabilities by Ministry of Finance on behalf of the Group of AZN 3,250 and AZN 32,695, respectively, recognised as loan to Ministry of Finance in 2020;
- (e) Partial payment of principal amount of a loan from a local bank of AZN 10,010 in both 2020 and 2019 directly by the government on behalf of the Group as a form of subsidy for Baku-Nakhchivan-Baku flights;
- (f) Transfer of advances given of AZN 34,000 to foreign supplier in regards to aircraft and spare parts pursuant to three-party agreement, whereby the Group increased long-term advances given and trade and other payables balances on the consolidated statement of financial position in 2019;
- (g) Transfer of asset at the government’s instruction with carrying value of AZN 7,510 in 2019;
- (h) Contribution of property and equipment and other assets by the shareholder of AZN 654 recognised as additional paid-in capital in 2019.

The accompanying notes are an integral part of these consolidated financial statements.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (in thousands of Azerbaijani Manat)

1. NATURE OF ACTIVITIES

“Azerbaijan Airlines” CJSC (the “Company”) was officially established as a state concern on 17 August 1992. In April 2008, under the decree of the President of the Republic of Azerbaijan the Company was reorganised into closed joint stock company, and is wholly owned by the government. The Company is designated as a National air carrier of the Republic of Azerbaijan.

In February 2021, the governance of the Company was transferred from the Ministry of Finance to the Azerbaijan Investment Holding (wholly owned by the government) pursuant to the order signed by the President of the Republic of Azerbaijan.

“Azerbaijan Airlines” CJSC has two subsidiaries – Nakhchivan International Airport and National Aviation Academy, collectively the “Group”.

Company name	Registered address	Principal activity	2020	2019
Nakhchivan International Airport	E002, Nakhchivan AZ6725, Azerbaijan	Airport	100%	100%
National Aviation Academy	AZ1045, Baku, Khazar, Mardakan, 30, Azerbaijan	Educational Centre	100%	100%

Subsequent to the year ended 31 December 2020, Cabinet of Ministers of the Republic of Azerbaijan issued a resolution on 23 June 2021 ordering spin-off of Nakhchivan International Airport as part of structure of the Group and transferring the control to the Cabinet of Ministers of the Autonomous Republic of Nakhchivan, effective from 1 July 2021. The carrying value of total assets of the subsidiary as at 31 December 2020 was AZN 94,195. The transfer is accounted for at cost as the transaction is between parties under common control.

The registered office of the Company is 11 Azadlyg Avenue, Baku, AZ1000, Azerbaijan.

The Group’s principal activities comprise:

- Commercial air transportation, which includes passenger and cargo services;
- Air navigation services – provision of air navigation services for overflights and on routes, meteorological services provided in the territory of the Republic of Azerbaijan;
- Aircraft refueling services – refueling services provided to local and foreign passenger and cargo airline companies flying to the Republic of Azerbaijan;
- Operation of airport terminals and infrastructure, and provisioning of aviation security services in the airports of the Republic of Azerbaijan;
- Other related activities.

The laws of the Republic of Azerbaijan determine the Group to be a natural monopoly and a sole provider for airport operations, runways and structures, as well as passenger aviation. The main objective of the Group is development and improvement of civil aviation in Azerbaijan.

The consolidated financial statements were authorised for issue on 11 January 2022 by the Supervisory Board and management of the Group.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (in thousands of Azerbaijani Manat)

2. GOING CONCERN

These consolidated financial statements have been prepared on the assumption that the Group will continue as a going concern in the foreseeable future, which implies the realisation of assets and settlement of liabilities in the normal course of business. In making this judgment, management considered the Group’s financial position, current intentions, profitability of operations and access to financial resources.

The Group incurred total comprehensive loss of AZN 76,415 in 2020 (2019: AZN 78,770). As of 31 December 2020, the Group’s current liabilities exceeded its current assets by AZN 984,984 (31 December 2019: AZN 647,448) and the Group had negative equity of AZN 779,760 (31 December 2019: AZN 715,113). These results were negatively impacted by the devaluation of Azerbaijani Manat in 2015 and 2016, reinstatement of a loan of AZN 273,226 in 2017 that had been previously transferred to the Ministry of Finance pursuant to the government decree and recurring losses. The devaluation of Azerbaijani Manat significantly increased the AZN equivalent of the obligations of the Group to financial institutions on lease payables, as well as loans and borrowings denominated in foreign currencies. The vast majority of such loans are state-guaranteed loans from international banks, loans from local banks and the government.

In addition, starting from early 2020 a new coronavirus disease (COVID-19) began rapidly spreading all over the world resulting in announcement of the pandemic status by the World Health Organization in March 2020. Measures put in place by many countries to contain the spread of COVID-19 resulted in significant operational disruption for many companies and have a significant impact on the airline sector.

Management considers that these events and conditions indicate that a material uncertainty exists that may cast significant doubt on the Group’s ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

In assessing going concern basis, management have considered the following circumstances:

- During 2020, the operations of the Group were severely impacted by the COVID-19 pandemic. During the first two months of 2020, the Group had 21% growth in passenger flight revenue compared to the same period of 2019. However, starting from March 2020 it began experiencing a significant decline of international and domestic traffic related to COVID-19. Due to the restrictions imposed, the Group had to significantly reduce its operations and as a result, all revenue streams were affected and experienced around 67% decrease compared to 2019. Starting from February 2021, quarantine restrictions were eased and the Group announced partial reopening of flights. The Group generated a revenue (unaudited) of AZN 383,215 for ten months of 2021.

As a response to the pandemic situation, management of the Group took a number of actions, including increasing focus on special flights, reducing costs, negotiating with lenders about payments deferrals, identifying additional opportunities to increase liquidity, deferring aircraft purchases (until 2024-2025) and postponing a number of planned internal projects in order to provide liquidity and cover current liabilities critical for continuous operation of the Group. Procurement controls over the purchases of the Group have been made stricter, only essential maintenance expenses have been kept while other capital expenditures have been deferred. None of the old trade receivables was forgiven and the Group renewed its efforts to collect its receivables, particularly those from foreign counterparties owed for navigation and overflight services.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2020

(in thousands of Azerbaijani Manat)

- Starting from 27 September 2020, the Group’s operations were also impacted by escalations in the Nagorno-Karabakh conflict. Almost all flights were suspended and a no-flight zone was established in the west of the country for safety reasons. As a result, revenue figures of the Group decreased substantially in October compared to September 2020. The conflict ended on 10 November 2020 after a ceasefire agreement was signed between the conflicting countries and the curfew was lifted.
- During 2017, a loan amounting to AZN 273,226 that had been previously transferred to the Ministry of Finance was reinstated as the Group’s liability pursuant to the government decree, resulting in increase in liabilities and decrease in equity. The loan is due in 2026, however, management is in negotiations with the government regarding the terms of settlement of this reinstated liability.
- Major part of current liabilities amounting to AZN 832,317 are due to entities owned by the government, the sole shareholder of the Group. Management believes that in case of immediate cash shortage, the Group has enough leverage (due to fact that the Group is the national carrier and therefore is strategic for the government) to renegotiate terms of its existing liabilities to defer principal and interest payments or obtain additional loans to bridge any liquidity gap as it arises.
- During 2020, the Group received around AZN 279,000 of funds as a support from the government to continue its operations, pay salaries and make payments for loan agreements obtained with the government guarantee (recognised as subsidy income of AZN 232,082, additional paid-in capital of AZN 6,500, loan of AZN 35,945 and payable on-demand of AZN 4,078). In addition, AZN 5,320 was recognised as capital contribution during 2020, which comprised government financing for flight landing zone of AZN 1,800 and for construction of simulator building in National Aviation Academy of AZN 2,000; and forgiven loan originally due to Central Bank of Azerbaijan Republic of AZN 1,520.
- During ten months of 2021, AZN 41,000 and AZN 17,390 have been provided by the government to relieve the impact of COVID-19 pandemic and to support necessary capital expenditures of the Group, respectively. In addition, Ministry of Finance paid AZN 25,407 for the government guaranteed loans and leases on behalf of the Group.
- The Group is in the process of requesting additional support from the government for 2022 mainly represented by planned capital costs and other investment projects. Management of the Group believes that these funds, together with own cash inflows generated from operations, will cover any liquidity gap that might arise during 2022 as a direct impact of COVID-19 pandemic.
- Management believes that the Group can monetise some of its aircraft and spare engines to extinguish the working capital shortage, if needed.

The full extent of the ongoing impact of COVID-19 pandemic on the Group’s longer-term operational and financial performance will depend on future developments, many of which are outside of the Group’s control and cannot be predicted. The Group expects demand for aviation services to remain suppressed in the foreseeable future, however, the ongoing rollout of vaccination programs across the world and in Azerbaijan from 2021 is viewed as a positive development.

Management has assessed future operations of the Group considering the restrictions due to COVID-19, revenue streams denominated in foreign currencies, cost reductions and non-essential capital expenditure deferrals, and expectations of the Group that the government support will be available if needed. Based on these assessments, management believes that the Group will be able to cover all of its liabilities, including those denominated in foreign currencies, as they become due in the foreseeable future. Accordingly, management considers that using the going concern basis of accounting is appropriate.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (in thousands of Azerbaijani Manat)

3. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRSs”) and comply with all issued and effective IFRSs for the reporting period.

Basis of preparation

These consolidated financial statements have been prepared on the historical cost basis except for property and equipment, which is stated at deemed cost as of 1 January 2016, the date of transition to the International Financial Reporting Standards (“IFRSs”). The deemed cost as of that date was equal to fair value as determined by an independent appraiser. Historical cost is generally based on the fair value of the consideration given in exchange for assets. In estimating the fair value of an asset or a liability, the Group takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 or value in use in IAS 36.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year. Control is achieved when the Company:

- Has the power over the investee;
- Is exposed, or has rights, to variable returns from its involvement with the investee; and
- Has the ability to use its power to affect its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, the results of subsidiaries acquired or disposed of during the year are included in profit or loss from the date the Company gains control until the date when the Company ceases to control the subsidiary.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with the Group’s accounting policies.

All intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between the members of the Group are eliminated on consolidation.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020 (in thousands of Azerbaijani Manat)

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of sales related taxes.

Passenger revenue

Ticket sales are reported as traffic revenue when the transportation service has been provided. The value of tickets sold and still valid but not used by the reporting date is reported in the Group’s consolidated statement of financial position in a separate line item (unearned revenue) within current liabilities. This item is reduced either when the Group completes the transportation service or when the passenger requests a refund, or loses the right for refund.

Passenger revenue includes revenue from code-share agreements with certain other airlines as per which the Group and other airlines sell seats for each other’s flights (“code-share agreements”). Revenue from the sale of code-share seats by the Group on flights of other airlines is accounted for in the amount of the commission retained by the Group and is recognised subject to the probability of refund if the ticket sold is not used. Revenue from the sale of code-share seats on Group’s flights by other airlines are recorded at the moment of the transportation service provision and is fully accounted for in the Group’s traffic revenue in the consolidated statement of profit or loss and other comprehensive income.

Ticket reissue revenue – Each fare type that the Group issues will have its own conditions attached, which may include it being refundable or non-refundable. This means that if passengers need to make a change to their booking, cancel flights or buy replacement tickets then a change fee may apply. The change service is not considered distinctly, because the customer cannot benefit from it without taking the flight – because the service for changes in bookings is not distinguishable and is part of the performance obligation to provide a seat for the passenger on the selected flight. Although the change service is provided in advance of the flight, the benefit from it is not provided until the customer takes the flight. As a result, the change fee is recognised as revenue together with the original ticket sale on the date of travel.

Ticket breakage – Certain ticket fare types allow customers to claim a refund of a price paid if the customer hasn’t actually taken a flight. Under IFRS 15, *Revenue from contracts with customers*, the timing of revenue recognition for such amounts depends on whether the entity expects to be entitled to this breakage amount. This amount then should be recognised as revenue in proportion to the pattern of rights exercised by the customer when the entity expects to be entitled to breakage revenue. Otherwise, an entity should recognise breakage revenue when the likelihood of the customer exercising its remaining rights becomes remote.

Frequent flyer programme – The Group operates a customer loyalty programme referred to as “AZAL Miles”. Subject to the programme’s terms and conditions, the miles earned entitle members to a number of benefits such as free flights, flight class upgrades and redeem miles for special awards from programme partners. In accordance with IFRS 15, accumulated but as yet unused bonus miles are deferred as a material right. IFRS 15 requires the allocation of transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract in the moment of its signing. The stand-alone selling price of a ticket for a regular flight of the Group is the tariff established by the Group on the specified route at the time of the sale, regardless of whether the customer is a programme participant or not. The stand-alone selling price of one separate bonus mile is an approximation of the fair value of services that will be provided in the future to the programme participant. The portion of revenue associated

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with miles and accumulated on the Group’s own flights is recognised under current and non-current deferred revenue related to customer loyalty programme within current and non-current liabilities, respectively, in the Group’s consolidated statement of financial position.

Revenue is recognised upon the provision of services to AZAL Miles members or expiry of the rights to receive such services.

Accounting for commission fees payable to agents selling tickets – the Group uses a practical expedient in accordance with IFRS 15 that allows not to capitalise the incremental costs of obtaining a contract with a customer, and recognises commission fees payable to agents on sale of tickets within operating costs in the consolidated statement of profit or loss and other comprehensive income in the period of the sale of the tickets, as according to the current tariffs of the Group the period of performance obligations on transportation of passengers does not exceed one year.

Cargo flight sales

Cargo flight sales are recognised as revenue when the transportation is provided.

Other services

Revenues from air navigation, refueling, airport and security and other services are recognised net of discounts and VAT taxes when services are provided.

Leases

The Group as lessee

The Group assesses whether a contract is or contains a lease, at inception of the contract. The Group recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets (such as tablets and personal computers, small items of office furniture and telephones). For these leases, the Group recognises the lease payments as an operating expense on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by using the rate implicit in the lease. If this rate cannot be readily determined, the Group uses its incremental borrowing rate.

The lease liability is presented as a separate line in the consolidated statement of financial position.

The lease liability is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made.

The right-of-use assets comprise the initial measurement of the corresponding lease liability, lease payments made at or before the commencement day, less any lease incentives received and any initial direct costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

The right-of-use assets are presented as a separate line in the consolidated statement of financial position.

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The Group applies IAS 36 to determine whether a right-of-use asset is impaired and accounts for any identified impairment loss as described in the “Property and equipment” policy.

Variable rents that do not depend on an index or rate are not included in the measurement the lease liability and the right-of-use asset. The related payments are recognised as an expense in the period in which the event or condition that triggers those payments occurs and are included in the line “Operating costs” in the consolidated statement of profit or loss and other comprehensive income.

As a practical expedient, IFRS 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. The Group has used this practical expedient.

Functional and presentation currency

The national currency of Azerbaijan is the Azerbaijani Manat (“AZN”), which is the functional currency of all entities within the Group, because it reflects the economic substance of the underlying events and circumstances of the Group. Azerbaijani Manat is also the presentation currency for these consolidated financial statements. All values are rounded to the nearest thousand AZN, except when otherwise indicated.

Foreign currencies

In preparing the financial statements of the Group entities, transactions in currencies other than the entity’s functional currency (foreign currencies) are recognised at the rates of exchange prevailing on the dates of the transactions. At each reporting date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Below are exchange rates as at the year-end, which were used by the Group for the purposes of these consolidated financial statements:

	<u>31 December 2020</u>	<u>31 December 2019</u>
AZN / USD	1.7000	1.7000
AZN / EUR	2.0890	1.9035

Government grants

Government grants are not recognised until there is reasonable assurance that the Group will comply with the conditions attaching to them and that the grants will be received.

Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the Group with no future related costs are recognised in profit or loss in the period in which they become receivable.

The benefit of a government loan at a below-market rate of interest is treated as a government grant, measured as the difference between proceeds received and the fair value of the loan based on prevailing market interest rates.

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Taxation

Income tax expense represents the sum of taxes currently payable and deferred tax.

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of profit or loss and other comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group’s liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date at the end of the reporting period.

A provision is recognised for those matters for which the tax determination is uncertain but it is considered probable that there will be a future outflow of funds to a tax authority. The provisions are measured at the best estimate of the amount expected to become payable. The assessment is based on the judgement of tax professionals within the Group supported by previous experience in respect of such activities and in certain cases based on specialist independent tax advice.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been enacted or substantively enacted at the reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

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Current tax and deferred tax for the year

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

Property and equipment

Property and equipment is stated at cost (deemed cost) less accumulated depreciation and impairment losses. For assets acquired after 1 January 2016, cost consists of purchase cost, together with any incidental expenses of acquisition. Depreciation is calculated in order to allocate the cost (less estimated residual value where applicable) over the remaining useful lives of the assets.

Subsequent costs are included in the assets' carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost can be measured reliably. Repairs and maintenance are charged to the consolidated statement of profit or loss and other comprehensive income during the period in which they are incurred.

Freehold land is not depreciated.

The useful lives are estimated as follows:

Category	Useful life
Buildings and infrastructure	25-50 years
Aircraft and engines	25 years
Machinery and equipment	10-15 years
Other assets	5-10 years

The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

Aircraft and engines

The purchase price of aircraft and engines is denominated in foreign currencies. They are recognised at the exchange rate prevailing at the date of the transaction. Manufacturer's discounts, if any, are deducted from the value of the related asset.

Aircraft and engines are depreciated using a straight-line method over their average estimated useful life of 25 years, assuming no residual value. During the operating cycle, the Group reviews whether the depreciable base or useful life should be adjusted and, if necessary, determines whether a residual value should be recognised.

Major overhaul expenditures, including replacement spares and labor costs, are capitalised and depreciated over the shorter of the period to the next major overhaul (based on flight hours or flight cycles), the remaining lease term or the useful life of the asset concerned.

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Capital projects are stated at cost. When the asset is ready for its intended use it is transferred from capital projects to the appropriate category under property and equipment and depreciated in accordance with the Group’s policies.

Impairment of property and equipment

At each reporting date, the Group reviews the carrying amounts of its property and equipment to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss to the extent that it eliminates the impairment loss which has been recognised for the asset in prior years.

Consumable spare parts and inventories

Consumable spare parts and inventories are stated at the lower of cost and estimated net realisable value. Costs of such inventories are determined on a first-in-first-out basis, except for fuel, which is determined on weighted average cost basis. Fuel is written off upon actual consumption. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Financial instruments

Financial assets and financial liabilities are recognised in the Group’s consolidated statement of financial position when the Group becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

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Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, current accounts and cash deposits with banks with original maturities of three months or less.

Financial assets

All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

All recognised financial assets are measured subsequently in their entirety at either amortised cost or fair value, depending on the classification of the financial assets.

Classification of financial assets

Debt instruments that meet the following conditions are measured subsequently at amortised cost:

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

Debt instruments that meet the following conditions are measured subsequently at fair value through other comprehensive income (FVTOCI):

- The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling the financial assets; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

By default, all other financial assets are measured subsequently at fair value through profit or loss (FVTPL).

Amortised cost and effective interest method

The effective interest method is a method of calculating the amortised cost of a debt instrument and of allocating interest income over the relevant period.

For financial assets other than purchased or originated credit-impaired financial assets (i.e. assets that are credit-impaired on initial recognition), the effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) excluding expected credit losses, through the expected life of the debt instrument, or, where appropriate, a shorter period, to the gross carrying amount of the debt instrument on initial recognition.

The amortised cost of a financial asset is the amount at which the financial asset is measured at initial recognition minus the principal repayments, plus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, adjusted for any loss allowance. The gross carrying amount of a financial asset is the amortised cost of a financial asset before adjusting for any loss allowance.

Interest income is recognised in profit or loss.

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Impairment of financial assets

The Group recognises a loss allowance for expected credit losses on investments in debt instruments that are measured at amortised cost. The amount of expected credit losses is updated at each reporting date to reflect changes in credit risk since initial recognition of the respective financial instrument.

The expected credit losses on trade receivables are estimated using a provision matrix based on the Group’s historical credit loss experience, adjusted for factors that are specific to the debtors, general economic conditions, credit ratings and an assessment of both the current as well as the forecast direction of conditions at the reporting date, including time value of money where appropriate. The Group always measures the loss allowance for trade receivables at an amount equal to lifetime ECL.

For other financial instruments, the Group recognises lifetime ECL when there has been a significant increase in credit risk since initial recognition. However, if the credit risk on the financial instrument has not increased significantly since initial recognition, the Group measures the loss allowance for that financial instrument at an amount equal to 12-month ECL.

Lifetime ECL represents the expected credit losses that will result from all possible default events over the expected life of a financial instrument. In contrast, 12-month ECL represents the portion of lifetime ECL that is expected to result from default events on a financial instrument that are possible within 12 months after the reporting date.

(i) Significant increase in credit risk

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, the Group compares the risk of a default occurring on the financial instrument at the reporting date with the risk of a default occurring on the financial instrument at the date of initial recognition. In making this assessment, the Group considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort. Forward-looking information considered includes the future prospects of the industries in which the Group’s debtors operate, obtained from economic expert reports, financial analysts, governmental bodies, relevant think-tanks and other similar organizations, as well as consideration of various external sources of actual and forecast economic information that relate to the Group’s core operations.

Irrespective of the outcome of the above assessment, the Group presumes that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due, unless the Group has reasonable and supportable information that demonstrates otherwise.

(ii) Definition of default

If historical experience indicates that financial assets, for which information developed internally or obtained from external sources indicates that the debtor is unlikely to pay its creditors, including the Group, in full, the Group considers this as an event of default for internal risk management purposes.

Irrespective of the above analysis, the Group considers that default has occurred when a financial asset is more than 90 days past due unless the Group has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate.

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(iii) Measurement and recognition of expected credit losses

The measurement of expected credit losses is a function of the probability of default, loss given default (i.e. the magnitude of the loss if there is a default) and the exposure at default.

The Group recognises an impairment gain or loss in profit or loss for all financial instruments with a corresponding adjustment to their carrying amount through a loss allowance account.

Derecognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

Financial liabilities and equity

Classification as debt or equity

Debt and equity instruments issued by the Group are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

Loans and Borrowings

Borrowings are recognised initially at fair value, net of transaction cost incurred. Borrowings are measured at amortised cost with any difference between the proceeds (net of transaction costs) and the redemption value recognised in the consolidated statement of profit or loss and other comprehensive income over the period of the borrowings using the effective interest method.

Derecognition of financial liabilities

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in the consolidated statement of profit or loss and other comprehensive income.

Offsetting of financial assets and liabilities

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy. Income and expense is not offset in the consolidated statement of profit or loss and other comprehensive income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

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The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

New and amended IFRS Standards that are effective for the current year

Impact of the initial application of COVID-19 – Related Rent Concessions Amendment to IFRS 16

The amendment was early adopted by the Group during 2020, while no rent concessions have occurred as a direct consequence of COVID-19 during the year.

Impact of the initial application of other new and amended IFRS Standards that are effective for the current year

In the current year, the Group has applied the below amendments to IFRS Standards and Interpretations issued by the International Accounting Standards Board (IASB) that are effective for an annual period that begins on or after 1 January 2020. Their adoption has not had any material impact on the disclosures or on the amounts reported in these consolidated financial statements:

Conceptual Framework	<i>Amendments to References to the Conceptual Framework in IFRS Standards</i>
Amendments to IFRS 3	<i>Definition of a business</i>
Amendments to IAS 1 and IAS 8	<i>Definition of material</i>

New and revised IFRS Standards in issue but not yet effective

At the date of authorisation of these consolidated financial statements, the Group has not applied the following new and revised IFRS Standards that have been issued but are not yet effective:

IFRS 17 ¹	<i>Insurance Contracts</i>
IFRS 10 and IAS 28 (amendments) ²	<i>Sale or Contribution of Assets between an Investor and its Associate or Joint Venture</i>
Amendments to IAS 1 ¹	<i>Classification of Liabilities as Current or Non-current</i>
Amendments to IFRS 3 ³	<i>Reference to the Conceptual Framework</i>
Amendments to IAS 16 ⁴	<i>Property, Plant and Equipment—Proceeds before Intended Use</i>
Amendments to IAS 37 ⁴	<i>Onerous Contracts – Cost of Fulfilling a Contract</i>
Annual Improvements to IFRS Standards 2018-2020 Cycle ⁴	<i>Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards, IFRS 9 Financial Instruments, IFRS 16 Leases and IAS 41 Agriculture</i>
Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 ⁵	<i>Interest Rate Benchmark Reform — Phase 2</i>
Amendments to IAS 1 ¹	<i>Disclosure of Accounting Policies</i>
Amendments to IAS 12 ¹	<i>Deferred tax related to assets and liabilities arising from a single transaction</i>
Amendments to IAS 8 ¹	<i>Definition of Accounting Estimates</i>

¹ Effective for annual reporting periods beginning on or after 1 January 2023;

² Effective date of the amendments has yet to be set by the Board;

³ Effective for business combinations for which the date of acquisition is on or after the beginning of the first annual period beginning on or after 1 January 2022;

⁴ Effective for annual periods beginning on or after 1 January 2022;

⁵ Effective for annual periods beginning on or after 1 January 2021.

Management does not expect that the adoption of the standards listed above will have a material impact on the consolidated financial statements of the Group in future periods.

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4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In applying the Group’s accounting policies, which are described in Note 3, Management is required to make judgments (other than those involving estimations) that have a significant impact on the amounts recognised and to make estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Critical judgments in applying accounting policies

The following are the critical judgments that management have made in the process of applying the Group’s accounting policies and that have the most significant effect on the amounts recognised in the consolidated financial statements.

Subsidies received from government due to COVID-19

The government has implemented financial assistance program to support entities suffering negative impact of COVID-19 pandemic. According to the decree of the Cabinet of Ministers of the Republic of Azerbaijan dated 19 March 2020, the Group received AZN 232,082 (AZN 215,467 for AZAL, AZN 15,433 for National Aviation Academy and AZN 1,182 for Nakchivan International Airport) financial aid from the government during 2020.

Management exercised significant judgment in assessing the accounting treatment of the government assistance received in deciding whether the assistance should be treated as a shareholder contribution by government in its capacity as a shareholder, or government grant relating to income. Considering that no equity instruments were issued in return, that the government decree did not specify equity designation of the assistance, and that similar financial support was provided to other companies regardless of whether they were government-owned or not, management concluded that the transaction represented a government grant under IAS 20 rather than a contribution by shareholder. Accordingly, the full amount was recognised as income in the consolidated statement of profit or loss and other comprehensive income because there were no conditions or future related costs associated with the grant.

Key sources of estimation uncertainty

The below are listed key estimations that management have used in the process of applying the Group’s accounting policies and that have the most significant effect on the amounts recognised in the consolidated financial statements.

Impairment testing

The Group tests whether there is any indication of impairment at the end of each reporting date. If any indications of impairment are identified, the Group performs impairment testing.

The recoverable amount of property and equipment and right-of-use assets is determined based on value in use calculations for Airports, Aeronavigation, AZALOil CGUs and fair value less cost to sell for Airlines CGU. These calculations require the use of the estimates described in more detail in Note 10.

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Useful lives of property and equipment

Management assigns useful lives to property and equipment based on the intended use of assets and the economic lives of those assets. The Group’s property and equipment are depreciated using the straight-line method over their estimated useful lives or flight cycles / hours, which are based on management’s business plans and operational estimates. Subsequent changes in circumstances such as technological advances or prospective utilisation of the assets concerned could result in the actual useful lives or residual values differing from initial estimates. Management periodically reviews the appropriateness of the remaining useful lives of property and equipment. Revisions to estimates of the useful lives of items of property and equipment are recognised prospectively in the period of the revision and where applicable, future periods. Accordingly, this may materially impact the amount of depreciation charge and carrying amount of property and equipment to be recognised in the future.

Recoverability of VAT assets

VAT asset balances, which have already become receivable from tax authority (input VAT balances that have been recovered through payment of invoices or provision of services or goods) are equivalent to having a prepayment with tax authority, which would be used to offset the Group’s future tax obligations. Management believes that the VAT asset balances due from the government are recoverable and will be used to offset future tax obligations. The Group does not need to get permission from tax authorities to be able to offset tax assets with liabilities and thus it is considered that tax liabilities would offset tax assets as they accrue. This would mean that these tax assets substantially turn over within twelve months and are recoverable. However, VAT asset balances, which have not yet become receivables from tax authority (“input VAT recoverable”) were analysed by management of the Group as at 31 December 2020 and AZN 82,809 of such balances were concluded as being doubtful (31 December 2019: AZN 83,285). Consistent with the prior year, management of the Group believes that these balances will not be recovered in the nearest future due to fact that corresponding payables balances of these VAT balances would not be paid in cash (instead of settling gross balances, management expects settlement on a net basis against receivables with those counter-parties).

Taxation

Significant judgment is required in determining the provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Group recognises liabilities for anticipated additional tax assessments as a result of tax audits based on estimates of whether it is probable that additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax provisions in the period in which such determinations are made. Fiscal periods remain open to review by the tax authorities in respect of taxes for the three calendar years preceding the year of tax review. Under certain circumstances reviews may cover longer periods. While the Group believes it has provided adequately for all tax liabilities based on its understanding of the tax legislation, the above facts may create additional financial risks for the Group.

There were no provisions recognised for taxes as at 31 December 2020 and 2019.

A deferred tax asset has not been recognised in respect of carried forward tax losses for all the periods presented in the consolidated financial statements (AZN 115,179 and AZN 707,650 as of 31 December 2020 and 2019, respectively, which expire in five years from origination), as there is no reasonable certainty that the Group will be able to utilise those carried forward tax losses in the foreseeable future.

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5. TRAFFIC AND OTHER REVENUE

	<u>2020</u>	<u>2019</u>
Scheduled passenger flights	128,662	517,644
Airport and aviation security services	58,145	196,434
Refueling services	53,449	121,940
Charter passenger flights	39,584	51,142
Air navigation services	35,271	68,526
Cargo transportation	2,528	14,659
Other revenue	17,597	38,114
Total traffic and other revenue	<u>335,236</u>	<u>1,008,459</u>

The events associated with the COVID-19 pandemic and the related restrictions imposed by the governments significantly affected the operations of the Group. Once the restrictions were eased, the Group opened special flights to a number of destinations. By essence, the special flights are similar to scheduled regular flights except for specific measures to prevent the spread of COVID-19 pandemic. Revenue from these flights have been included within scheduled passenger flights.

6. OPERATING COSTS

	<u>2020</u>	<u>2019</u>
Depreciation and amortisation	139,678	138,647
Staff costs	107,068	124,493
Aircraft and other maintenance	54,336	95,061
Fuel expenses	52,712	157,050
Taxes other than income tax	25,174	50,094
Ground handling services	23,420	74,300
Commercial services and commission fees	16,614	63,929
Impairment of property and equipment and right-of-use assets	15,794	-
Air navigation services outside of Azerbaijan	14,089	49,995
Food and beverages for catering services	10,602	41,555
Insurance expense	10,088	9,066
Foreign airports passenger fees	7,991	34,824
Communication expenses	6,441	17,806
Materials expenses	6,397	8,625
Electricity expenses	5,303	6,391
Passenger services	5,136	11,524
Impairment of capital projects	4,797	-
Impairment loss on trade receivables and amounts due from related parties	2,678	529
Business trip expenses	2,632	8,481
Consulting expenses	1,359	1,975
Change in impairment provision of advances given	(86)	4,523
Change in impairment provision of VAT recoverable balance	(476)	8,498
Other expenses	31,067	50,041
Other income	(2,665)	(7,819)
Total operating costs	<u>540,149</u>	<u>949,588</u>

Impairment of property and equipment and right-of-use assets in the amount of AZN 15,794 was recognised during the year as detailed in Note 10.

In 2020, major operating expenses of the Group decreased compared to 2019 as operations of the Group were significantly impacted by the COVID-19 pandemic due to decrease in flights carried out.

Other expenses are mainly made up of short-term and low-value lease expenses and other individually immaterial expenses of the Group.

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7. FINANCE COSTS

	<u>2020</u>	<u>2019</u>
Interest expense on loans and borrowings	69,647	91,392
Interest expense on lease liabilities	14,319	19,793
Total finance costs	<u>83,966</u>	<u>111,185</u>

8. FOREIGN EXCHANGE LOSS

The Group’s sales are generated and purchases are made, and major part of the loans and borrowings and leases are denominated in USD and EUR. Major part of the foreign exchange loss in 2020 and 2019 arose from loans and borrowings, cash and cash equivalents and trade receivables.

9. INCOME TAX EXPENSE

	<u>2020</u>	<u>2019</u>
Current tax expense	762	-
Deferred tax expense	9,457	19,877
Total income tax expense	<u>10,219</u>	<u>19,877</u>

The income tax expense for the year calculated at statutory income tax rate of 20% can be reconciled to the accounting profit as follows:

	<u>2020</u>	<u>2019</u>
Loss before income tax	(66,196)	(58,893)
Income tax benefit at statutory tax rate (20%)	(13,239)	(11,779)
Effect of non-deductible expenses	16,015	31,245
Effect of income tax provision	762	-
Effect of unrecognised tax losses and utilisation of tax losses not previously recognised	6,681	411
Total income tax expense	<u>10,219</u>	<u>19,877</u>

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10. PROPERTY AND EQUIPMENT

	Buildings and infrastructure	Aircraft and engines	Machinery and equipment	Other property and equipment	Capital projects	Total
Cost						
Balance at 1 January 2019	804,641	1,086,479	264,290	87,626	24,561	2,267,597
Additions	6,699	40,621	7,700	3,127	46,582	104,729
Disposal of assets	(8,588)	(1,145)	(2,042)	(729)	-	(12,504)
Transfer of right-of-use assets	-	(430,664)	-	-	-	(430,664)
Transfer of assets	6,911	-	1,178	-	(8,089)	-
Balance at 31 December 2019	809,663	695,291	271,126	90,024	63,054	1,929,158
Additions	8,574	20,906	15,373	2,837	10,881	58,571
Disposal of assets	(61)	(8,344)	(119)	(1,295)	-	(9,819)
Transfer of right-of-use assets	-	(39,149)	-	-	-	(39,149)
Transfer of assets*	61,131	913	24,218	(26,254)	(60,008)	-
Balance at 31 December 2020	879,307	669,617	310,598	65,312	13,927	1,938,761
Accumulated depreciation and impairment						
Balance at 1 January 2019	87,451	191,900	74,369	33,443	5,073	392,236
Charge for the year	33,772	44,923	28,807	7,096	-	114,598
Disposal of assets	(1,019)	-	(1,469)	(585)	-	(3,073)
Transfer of right-of-use assets	-	(58,329)	-	-	-	(58,329)
Balance at 31 December 2019	120,204	178,494	101,707	39,954	5,073	445,432
Charge for the year	29,291	51,323	25,677	6,466	-	112,757
Disposal of assets	(22)	(8,344)	(80)	(1,063)	-	(9,509)
Impairment loss	837	13,598	117	579	4,797	19,928
Transfer of right-of-use assets	-	(12,365)	-	-	-	(12,365)
Transfer of assets*	8,955	(265)	622	(9,312)	-	-
Balance at 31 December 2020	159,265	222,441	128,043	36,624	9,870	556,243
Net book value						
Balance at 1 January 2019	717,190	894,579	189,921	54,183	19,488	1,875,361
Balance at 31 December 2019	689,459	516,797	169,419	50,070	57,981	1,483,726
Balance at 31 December 2020	720,042	447,176	182,555	28,688	4,057	1,382,518

*During 2020, management reclassified some of the property and equipment between the asset classes in order to more appropriately disclose the amounts of property and equipment. This had no impact on the carrying value of the property and equipment and the profit or loss for the year.

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Spare engine related to a leased aircraft was previously shown as part of property and equipment for the year ended 31 December 2019. The spare engine with net book value of AZN 26,784 as at 1 January 2020 was transferred from property and equipment to right-of-use assets in order to consistently present all assets under right-of-use assets.

The infrastructure is mainly comprised of runways, airport ramps, hangars and terminals for aircraft of the Group. During 2020, construction works performed in respect of Nakhchivan Airport runway and of a simulator building and related equipment was completed and balances of AZN 27,147 and AZN 9,779, respectively, were transferred to respective property and equipment accounts. Moreover, capital projects comprised of costs incurred for purchase and installation of equipment for Air Space Efficiency Center, Aeronautical Information Management and Automated Helicopter ATC system of AZN 9,451, AZN 4,050 and AZN 4,117, respectively, were transferred to respective property and equipment accounts during 2020.

Both in 2020 and 2019, major vendors engaged with construction work of the Group included Thales Las France S.A.S, Retro Holding LLC, Gemiqaya Holding, which provided construction of airspace efficiency center, simulator building and flight-landing zone in Nakhchivan International Airport, respectively.

No items of property and equipment of the Group were pledged as collateral as at 31 December 2020.

Impairment testing

In accordance with IAS 36 “Impairment of Assets”, an entity is required to assess whether there is any indication that assets may be impaired at the end of each reporting period. The Group considered the COVID-19 pandemic and its impact on the industry as impairment trigger and carried out impairment tests across all of the four CGUs. For Airports, Aeronavigation and AZALOil CGUs, the recoverable amounts are determined by reference to the value in use by discounting future cash flows to be generated as a result of respective activities, whereas for Airlines CGU the recoverable amount has been determined by reference to the fair value less cost to sell.

The cash flows were projected based on the Group’s forecasts considering the impact of COVID-19 pandemic in 2021 and the expected recovery to pre-crisis performance. Management considers 2019 as the baseline pre-crisis level and expects to gradually reach similar level of operations by 2024.

Value in use calculation for all CGUs except for Airlines CGU have generated healthy headrooms and no impairment or sensitive inputs have been identified for these CGUs as at 31 December 2020. Key assumptions used in value in use calculations were the pre-tax discount rate of 13.7% (determined as the Group’s WACC) and global airlines industry demand recovery curve covering the period of 2021-2024.

As coming to Airlines CGU, management has determined that carrying value of property and equipment and right-of-use assets pertaining to the CGU exceeded their fair value less cost to sell determined with reference to market data and adjusted to the actual maintenance status of main components, therefore an impairment charge of AZN 15,794 (AZN 15,131 for property and equipment and AZN 663 for right-of-use assets) was recognised as at 31 December 2020 (31 December 2019: nil). Management considers the estimate of cost to sell (10% of market value) as the most sensitive assumption in determining the recoverable amount for the Airlines CGU. A change of 8.5% in the estimated cost to sell would result in a material change in the amount of impairment recognised for the CGU.

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11. LEASES (GROUP AS A LESSEE)

Right-of-use assets (aircraft and engines)

	Total
Cost	
Balance at 1 January 2019	-
Transferred from property and equipment	430,664
Additions to right-of-use assets during the period	14,338
Effect of transition to IFRS 16	12,648
Balance at 31 December 2019	457,650
Additions to right-of-use assets during the period	71
Transferred from property and equipment	39,149
Reassessment of lease term	(12,648)
Balance at 31 December 2020	484,222
Accumulated depreciation and impairment	
Balance at 1 January 2019	-
Transferred from property and equipment	58,329
Charge for the year	21,342
Balance at 31 December 2019	79,671
Charge for the year	24,529
Impairment loss	663
Transferred from property and equipment	12,365
Reassessment of lease term	(5,474)
Balance at 31 December 2020	111,754
Net book value	
Balance at 1 January 2019	-
Balance at 31 December 2019	377,979
Balance at 31 December 2020	372,468

The Group leases several assets, which mainly comprise aircraft and engines. The average lease term is 10 years (2019: 10 years).

The Group’s obligations are secured by the lessors’ title to the leased assets for such leases. The maturity analysis of lease liabilities is presented in Note 19. At the maturity of the lease term, and provided that no event of default has occurred, the title to the aircraft and engines will be transferred to the Group.

Management decided not to exercise extension options for some lease contracts due to reduction in its operations due to COVID-19 pandemic and reassessed the lease term of right-of-use assets (net book value of AZN 7,174) and related lease liabilities.

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12. LONG-TERM ADVANCES GIVEN

	<u>31 December 2020</u>	<u>31 December 2019</u>
Long-term advances given	61,097	55,850
Less: impairment of long-term advances given	<u>(12,643)</u>	<u>(16,664)</u>
Total long-term advances given	<u>48,454</u>	<u>39,186</u>

Long-term advances given balances mainly comprised advances given to foreign suppliers in regards to aircraft and training equipment. Management estimates unrecoverable portion at the end of every period based on the likelihood of refund or receipt of goods and services in the future.

In 2020, major counterparties that the Group has made advance payments during the year included Boeing Company, Flight Safety International Inc., GE Engine Services LLC for purchase of aircraft, simulator equipment and overhaul of engines, respectively.

In 2019, major counterparties that the Group has made advance payments during the year included Boeing Company, GE Engine Services LLC for purchase of aircraft and overhaul of engines, respectively.

13. OTHER NON-CURRENT ASSETS

Other non-current assets mainly comprised spare part balances of AZN 29,820 and AZN 27,472 as at 31 December 2020 and 2019, respectively. These spare parts are expected to be utilised, are not impaired and are in good condition. Hence, no slow-moving provision was recognised in regards of these balances.

14. CONSUMABLE SPARE PARTS AND INVENTORIES

	<u>31 December 2020</u>	<u>31 December 2019</u>
Spare parts	18,907	22,959
Fuel	<u>4,449</u>	<u>4,452</u>
Less: allowance to NRV of obsolete consumable spare parts and inventories	<u>(3,437)</u>	<u>(3,588)</u>
Total consumable spare parts and inventories	<u>19,919</u>	<u>23,823</u>

15. TRADE AND OTHER RECEIVABLES

	<u>31 December 2020</u>	<u>31 December 2019</u>
Trade receivables	33,620	49,424
Amounts due from related parties	<u>1,731</u>	<u>6,625</u>
Financial assets	35,351	56,049
Advances given and prepaid expenses	19,832	14,516
VAT receivable	8,791	6,963
VAT recoverable	7,918	9,231
Non-financial assets	36,541	30,710
Total trade and other receivables	<u>71,892</u>	<u>86,759</u>

Under the local tax legislation, the Group has rights to recover VAT balances only after the associated payables have been settled and contracted work has been delivered, when input VAT recoverable becomes VAT receivable. VAT recoverable balance arises from purchase of equipment, fuel and services that will be set off with tax liabilities as they become eligible for set off.

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The Group exercised its rights under the local tax legislation to settle tax payable balances with VAT receivable balance of AZN 15,394 for the year ended 31 December 2020 (2019: AZN 32,275).

Trade receivables mainly include amounts due for overflights and tickets sold by international agents. Advances given and prepaid expenses mainly include prepayments for aircraft spare parts and service fee for air navigation database renewal, which are expected to be delivered and used within twelve-month period.

In 2020, major customers of the Group include IATA members (air-navigation services), BSP entities (scheduled passenger flights) and Silk Way West Airlines LLC (air-navigation and airport services).

In 2019, major customers of the Group include IATA members (air-navigation services), BSP entities (scheduled passenger flights), SOCAR Overseas Ltd (charter flights) and Lufthansa Group (aircraft refueling and airport security).

Risk profile of trade receivables based on the provision matrix, which is used by the Group for credit risk assessment and management is as follows:

31 December 2020	Trade receivables – days past due						
	Not past due	<30	31-90	91-180	180-360	>360	Total
	AZN	AZN	AZN	AZN	AZN	AZN	AZN
Expected credit loss rate	2%	2%	3%	45%	81%	100%	29%
Estimated total gross carrying amount at default	24,509	3,309	4,346	2,393	3,621	7,238	45,416
Lifetime ECL	(372)	(51)	(139)	(1,081)	(2,915)	(7,238)	(11,796)
Total trade receivables							33,620

31 December 2019	Trade receivables – days past due						
	Not past due	<30	31-90	91-180	180-360	>360	Total
	AZN	AZN	AZN	AZN	AZN	AZN	AZN
Expected credit loss rate	3%	3%	5%	15%	37%	100%	20%
Estimated total gross carrying amount at default	36,104	12,113	1,575	927	520	10,602	61,841
Lifetime ECL	(1,025)	(377)	(83)	(137)	(193)	(10,602)	(12,417)
Total trade receivables							49,424

The Group has adjusted expected credit loss rates considering delays in cash collection in trade receivables due to COVID-19 pandemic.

	2020	2019
Balance at the beginning of the year	12,417	10,975
Net remeasurement of loss allowance	(621)	1,442
Amount recovered	(1,074)	(615)
Change in loss allowance due to new trade receivables originated net of those derecognised due to settlement	453	2,057
Balance at the end of the year	11,796	12,417

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The Group’s exposure to credit and currency risks, and impairment losses related to trade and other receivables are disclosed in Note 24.

	<u>31 December 2020</u>	<u>31 December 2019</u>
Short-term advances given	19,146	12,799
Less: impairment of short-term advances given	<u>(216)</u>	<u>(302)</u>
Total advances given	<u>18,930</u>	<u>12,497</u>
Prepaid expenses	<u>902</u>	<u>2,019</u>
Total short-term advances given and prepaid expenses	<u>19,832</u>	<u>14,516</u>

16. CASH AND CASH EQUIVALENTS

	<u>31 December 2020</u>	<u>31 December 2019</u>
Cash on bank accounts in US dollars	35,920	25,108
Cash on bank accounts in Euro	5,147	6,961
Cash on bank accounts in AZN	2,140	799
Cash on bank accounts in other foreign currencies	1,135	1,636
Cash on hand	-	83
Other cash and cash equivalents	<u>384</u>	<u>372</u>
Total cash and cash equivalents	<u>44,726</u>	<u>34,959</u>

The Group’s exposure to foreign currency, credit risk as well as a sensitivity analysis for financial assets and liabilities are disclosed in Note 24.

17. SHARE CAPITAL

In accordance with the Group’s charter, the Group’s declared charter capital as at 31 December 2020 constituted AZN 823,975 composed of 411,987,235 shares with par value of AZN 2 each (31 December 2019: AZN 823,975 composed of 411,987,235 shares with par value of AZN 2 each).

Shareholder’s contribution

During 2020, the Group received from the government a total contribution of AZN 1,802 for the reconstruction of landing and take-off runway at Nakhchivan International Airport and a total of AZN 8,446 for construction of simulator building and transformer in National Aviation Academy. Moreover, loan previously owed to government of AZN 1,900 was forgiven and recognised as shareholder contribution during the year. Income tax consequence of this transaction amounting AZN 380 was also recognised through additional paid-in capital where the Group originally recognised the transaction itself.

Contribution of other assets by shareholder at fair value of AZN 654 was recognised as additional paid-in capital during 2019.

Distribution to shareholder

In April 2019, at the government’s instruction, the Group transferred property and equipment at fair value of AZN 13,054, which was treated as distribution to shareholder. No distributions to shareholder were made in 2020.

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18. LOANS AND BORROWINGS

	Interest rate	31 December 2020 Amount	31 December 2019 Amount
AZN – denominated			
Local banks	Fixed	44,275	34,425
Ministry of Finance of the Republic of Azerbaijan	Fixed	624,168	626,068
Cabinet of Ministers of Nakhchivan Autonomous Republic		4,078	-
Total AZN denominated		672,521	660,493
USD – denominated			
Local banks	Fixed	67,202	60,409
Local banks	Floating	6,311	16,321
Ministry of Finance of the Republic of Azerbaijan	Floating	1,077,899	1,077,899
Ministry of Finance of the Republic of Azerbaijan	Fixed	32,695	-
Total USD denominated		1,184,107	1,154,629
EUR – denominated			
Foreign banks	Fixed	35,982	35,598
Ministry of Finance of the Republic of Azerbaijan	Fixed	3,411	-
Total EUR denominated		39,393	35,598
Accrued interest		287,770	227,481
Total loans and borrowings		2,183,791	2,078,201
Long-term portion of loans and borrowings		1,277,930	1,605,934
Short-term portion of loans and borrowings		905,861	472,267

The effective average interest rate per annum on term loans for AZN, USD and EUR as at 31 December 2020, was 5.6%, 3.5% and 1.2%, respectively (31 December 2019: 5.3%, 4.5% and 1.2%, respectively). Variable rates for 2020 have been calculated on the basis of 1 month and 3 month USD LIBOR rates plus 2% and 2.2% per annum and also fixed annual interest rates range from 0.75% to 9% for the period. Loan and borrowing agreements do not contain any financial covenant terms.

The Group obtained four new loan tranches under existing credit lines from Premium Bank (related party of the Group) in total amount of AZN 20,118 during 2020. Ministry of Finance of the Republic of Azerbaijan paid AZN 35,945 for loans and leases on behalf of the Group during 2020 and Cabinet of Ministers of Nakhchivan Autonomous Republic financed construction of runway in the amount of AZN 4,078, which were recognised as on-demand payable within loans and borrowings. Subsequent to year end on 26 February 2021, an agreement with Ministry of Finance was reached to apply an interest rate of 2% per annum effective from 1 January 2021 with a specified repayment schedule during 2022-2025.

The maturity profile of loans and borrowings is as follows:

	31 December 2020	31 December 2019
Due in one month	627,834	236,567
Due from one month to one year	278,027	235,700
Total current portion of loans and borrowings	905,861	472,267
Due from one year to five years	1,008,364	1,086,376
Due over five years	269,566	519,558
Total long-term portion of loans and borrowings	1,277,930	1,605,934
Total loans and borrowings	2,183,791	2,078,201

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Reconciliation of liabilities arising from financing activities

The table below details changes in the Group’s liabilities arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the Group’s consolidated statement of cash flows as cash flows from financing activities.

	Cash changes		Non-cash changes		31 December 2020	
	Financing cash in-flows (i)	Repayments by the Group	Payments on behalf of the Group (ii)	Forex		Other non-cash changes (iii)
1 January 2020						
Bank loans	35,539	-	-	3,111	(1,900)	-
Loans from related parties	2,042,662	(3,585)	(13,260)	160	35,945	60,713
Lease liabilities	390,699	(24,084)	(32,695)	-	(6,452)	6,690
Total liabilities from financing activities	2,468,900	(27,669)	(45,955)	3,271	27,593	67,403

	Cash changes		Non-cash changes		31 December 2019	
	Financing cash in-flows (i)	Repayments by the Group	Payments on behalf of the Group (ii)	Forex		Other non-cash changes (iii)
1 January 2019						
Bank loans	39,284	(2,818)	-	(869)	-	-
Loans from related parties	1,998,335	(48,134)	(10,010)	-	-	82,258
Lease liabilities	424,379	(51,119)	-	-	12,648	4,791
Total liabilities from financing activities	2,461,998	(102,071)	(10,010)	(869)	12,648	87,049

- (i) The cash flows from loans from related parties make up the total amount of proceeds from borrowings in the consolidated statement of cash flows.
- (ii) Payment on behalf of the Group is disclosed in the consolidated statement of cash flows under heading “Non-cash transactions excluded from the consolidated statement of cash flows”, (d) and (e).
- (iii) Other non-cash changes in 2020 include loan recognised from Ministry of Finance of AZN 35,945 for payments of loans and leases made by Ministry of Finance on behalf of the Group which is recognized as loan to Ministry of Finance, reassessment of lease term of leases amounting AZN 6,452 and derecognition of loan from CBAR amounting AZN 1,900. Other non-cash changes in 2019 include recognition of new leases amounting AZN 12,648.
- (iv) Other changes include accruals and payments of interest (net movement) on loans and borrowings and lease liabilities.

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19. LEASE LIABILITIES

	<u>31 December 2020</u>	<u>31 December 2019</u>
Non-current portion of lease liabilities	285,154	340,546
Current portion of lease liabilities	49,004	50,153
Total lease liabilities	<u>334,158</u>	<u>390,699</u>

Reconciliation of future lease payments and their present values:

Maturity analysis:	<u>31 December 2020</u>	<u>31 December 2019</u>
Year 1	72,689	75,564
Year 2	60,336	64,623
Year 3	60,752	63,306
Year 4	61,170	63,314
Year 5	61,608	63,318
Onwards	70,259	135,480
Less: unearned interest	(52,656)	(74,906)
Total	<u>334,158</u>	<u>390,699</u>
Analysed as:		
Current	49,004	50,153
Non-current	285,154	340,546
Total	<u>334,158</u>	<u>390,699</u>

All lease arrangements are denominated in US dollar, and the interest rates are linked to market interest rates (normally the LIBOR).

On 1 January 2019, the Group adopted IFRS 16 for the first time and recognised lease liability of AZN 12,648 for contracts previously recognised as operating lease under IAS 17. During 2020, management decided not to exercise extension option for these contracts and reassessed the lease term of right-of-use assets and related lease liabilities (Note 11). The Group did not contract any new lease agreements during 2020.

20. UNEARNED REVENUE AND DEFERRED REVENUE RELATED TO FFP

Unearned revenue

The principal amount of obligations to passenger flight customers relates to the cost of tickets sold but unused at the reporting date, as well as obligations under the Frequent Flyer Programme.

	<u>2020</u>	<u>2019</u>
Unearned revenue balance brought forward	46,884	31,308
Additions during the year	135,627	626,164
Recognised as revenue during the year	(157,408)	(610,588)
Unearned revenue balance carried forward	<u>25,103</u>	<u>46,884</u>

The change in the amount of obligations for tickets sold but unused compared with 2019 was due to the significant decrease in the volume of services rendered as a result of spread of the new coronavirus infection COVID-19.

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Deferred revenue related to FFP

Revenue related to FFP is recognised when the Group fulfils its obligations by supplying free or discounted services on the redemption of the award credits or when such award credits expire. Deferred revenue is classified within current and non-current liabilities based on expected redemption patterns. The Group accounts for award credits as a separately identifiable component of the sales transaction in which they are granted. The consideration in respect of the initial sale is allocated to award credits based on their stand-alone selling price and is accounted for as a liability (deferred revenue) in the consolidated statement of financial position. The stand-alone selling price of one separate bonus mile is an approximation of the fair value of services that are expected to be provided to the FFP participant in the future.

	<u>2020</u>	<u>2019</u>
Deferred revenue balance brought forward	28,125	38,749
Accrual during the year	2,983	12,008
Redemption during the year	(1,611)	(11,361)
Actual expiry during the year	(810)	(11,271)
Deferred revenue balance carried forward	<u>28,687</u>	<u>28,125</u>
	<u>31 December 2020</u>	<u>31 December 2019</u>
Deferred revenue, current portion	1,529	5,193
Deferred revenue, non-current portion	<u>27,158</u>	<u>22,932</u>
Total deferred revenue related to FFP	<u>28,687</u>	<u>28,125</u>

The change in obligations under the passenger bonuses program was due to decrease in volume of miles accumulated by members of the programme and use of these miles during the COVID-19 pandemic. During 2020, the Group extended expiration period of miles points until 31 December 2021. Subsequently during 2021, expiration period was extended until 30 June 2022. Non-current portion of deferred revenue recognised as at 31 December 2020 is expected to be released to revenue within next three years (maximum period of expiration) after this date.

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21. DEFERRED INCOME TAX

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting period.

Deferred tax assets and (liabilities) presented by types of temporary differences:

	1 January 2020	Effect of IFRS 16 reclassification and reassessment of lease term	Recognised in equity	Recognised in profit or loss	31 December 2020
Property and equipment	(32,330)	2,204	-	(3,549)	(33,675)
Right-of-use assets	(21,195)	(914)	-	150	(21,959)
Intangible assets	(170)	-	-	-	(170)
Trade and other receivables	4,691	-	-	2,532	7,223
Consumable spare parts and inventories	828	-	-	2,334	3,162
Cash and cash equivalents	43	-	-	-	43
Loans and borrowings	-	-	(380)	32	(348)
Lease liabilities	3,708	(1,290)	-	(1,125)	1,293
Trade and other payables	3,487	-	-	(2,874)	613
Unearned revenue	-	-	-	(4,624)	(4,624)
Deferred revenue	5,625	-	-	113	5,738
Other current liabilities	(1,047)	-	-	(2,446)	(3,493)
Total	(36,360)	-	(380)	(9,457)	(46,197)

	1 January 2019	Effect of IFRS 16 reclassification and transition	Recognised in equity	Recognised in profit or loss	31 December 2019
Property and equipment	(32,307)	13,106	-	(13,129)	(32,330)
Right-of-use assets	-	(15,636)	-	(5,559)	(21,195)
Intangible assets	(160)	-	-	(10)	(170)
Trade and other receivables	4,131	-	-	560	4,691
Consumable spare parts and inventories	616	-	-	212	828
Cash and cash equivalents	119	-	-	(76)	43
Lease liabilities	864	2,530	-	314	3,708
Trade and other payables	3,224	-	-	263	3,487
Deferred revenue	7,751	-	-	(2,126)	5,625
Other current liabilities	(721)	-	-	(326)	(1,047)
Total	(16,483)	-	-	(19,877)	(36,360)

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22. TRADE AND OTHER PAYABLES

	<u>31 December 2020</u>	<u>31 December 2019</u>
Trade and other payables	66,301	122,643
Staff related payables	11,546	14,361
Amounts due to related parties	<u>15,374</u>	<u>8,060</u>
Financial liabilities	<u>93,221</u>	<u>145,064</u>
Advances received	9,991	11,339
Other taxes payable	4,493	10,863
Property tax	50	-
Income tax payable	<u>762</u>	<u>-</u>
Non-financial liabilities	<u>15,296</u>	<u>22,202</u>
Total trade and other payables	<u>108,517</u>	<u>167,266</u>

Trade and other payables mainly include payables for repair and maintenance, ground handling, catering and other services provided by suppliers of the Group.

As at 31 December 2020, staff related liabilities primarily include salaries payables of AZN 4,986 (31 December 2019: AZN 6,675) and the unused vacation accrual of AZN 6,560 (31 December 2019: AZN 7,686).

In 2020, major suppliers of the Group included Azneft PU of SOCAR (fuel), AJ Walter Aviation Ltd. (spare parts), GA Telesis LLC (spare parts), Silk Way Group (aircraft maintenance), ASG Business Aviation Group (ground handling, catering, and maintenance), Silk Row Travel LLC (sales and marketing), Ipek Yolu Sigorta OJSC (insurance), Azerishiq OJSC (electricity) and SITA (communication).

In 2019, major suppliers of the Group included Azneft PU of SOCAR (fuel), AJ Walter Aviation Ltd. (spare parts), Aircraft Maintenance & Engineering Corporation (overhaul and the maintenance of the aircraft engines), Silk Way Group (aircraft maintenance), Silk Row Travel LLC (sales and marketing), SITA (communication), Chelebi Aviation Holding (ground handling and commercial) and ASG Business Aviation Group (ground handling).

Advances received balance mainly represents advances paid by foreign airlines for services provided by the Group.

Other taxes payable mainly represents liabilities arising from land, personal income, social and withholding taxes. As at 31 December 2020, it mainly comprised social tax of AZN 1,497, output VAT payable of AZN 2,535 and other taxes of AZN 461 after settling tax payables with VAT receivable (Note 14). As at 31 December 2019, other taxes payable mainly comprised social tax of AZN 2,183, tax on fuel export of AZN 1,244 and other taxes of AZN 7,259 after settling tax payables with VAT receivable.

The Group’s exposure to currency risks related to trade and other payables are disclosed in Note 24.

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23. OTHER CURRENT LIABILITIES

Other current liabilities are comprised of payables to the government, deposits received and insurance payables of the Group. Insurance payables were AZN 6,769 and AZN 8,671 as at 31 December 2020 and 31 December 2019, respectively. The payable to the government represents liability arising from funds received from the government for special projects. As at 31 December 2020, the amount was AZN 20,206 due to the government (31 December 2019: AZN 36,614). Deposits received balances from international sales representatives were AZN 751 and AZN 1,429 as at 31 December 2020 and 31 December 2019, respectively. The Group has also recognised other provision of AZN 3,400 in 2020 for payments it is liable to make under one of its contracts within next 12 months after the reporting period (31 December 2019: AZN 4,325).

24. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Exposure to credit, liquidity and market risks arise in the normal course of the Group's business. The Group does not hedge its exposure to such risks.

Capital management

The Group manages its capital to ensure the Group will be able to continue as a going concern.

The capital structure of the Group consists of net debt and shareholder deficit of the Group (comprising share capital and accumulated deficit).

Under the requirements of the Azerbaijani law, the Group is required to remediate negative equity position in the year subsequent to the year in which such negative equity position arises (see Note 2 for disclosure of management's going concern considerations). Except for this, the Group is not subject to any other externally imposed capital requirements.

Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group has adopted a policy of only dealing with creditworthy counterparties and obtaining sufficient collateral, where appropriate, as a means of mitigating the risk of financial loss from defaults.

Trade receivables consist of a large number of customers, spread across diverse industries and geographical areas. Ongoing credit evaluation is performed on the financial condition of trade receivables. A significant portion of the Group's air tickets are sold by agents participating in the BSP, a clearing system between airlines and sales agents organised by the International Air Transportation Association. The balance (gross of ECL) due from the BSP agents amounted to approximately AZN 9,067 or 20% of trade receivables as at 31 December 2020 (31 December 2019: AZN 26,241 or 42%).

The sale of passenger and cargo transportation and overflight services arrangements are largely achieved through International Air Transport Association (IATA) approved sales agents and online sales. All IATA agents have to meet minimum financial criteria applicable to their country of operation to remain accredited. Adherence to the financial criteria is monitored on an ongoing basis by IATA through their Agency Programme. The balance (gross of ECL) due from IATA agents amounted to approximately AZN 11,056 or 24% of trade receivables as at 31 December 2020 (31 December 2019: AZN 15,160 or 25%). The credit risk associated with such sales agents is relatively small owing to a broad diversification. The credit risk exposure to BSP and IATA is monitored by the Group on an ongoing basis. In the opinion of management, the Group has no significant credit risk with BSP and/or IATA as the Group maintains long-term and stable business relationships with BSP and IATA with healthy repayment history.

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Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure, except for cash and cash equivalents where exposure is reduced by the amount of petty cash. The maximum exposure to credit risk at the reporting date was:

Carrying amount	31 December 2020	31 December 2019
Amounts due from related parties	5,372	8,858
Trade receivables	45,416	61,841
Cash and cash equivalents	44,726	34,876
Total	95,514	105,575

Cash and bank balances are mainly held in one local bank in the amount of AZN 22,987 and AZN 28,334 as at 31 December 2020 and 31 December 2019, respectively.

Market risk

The Group’s activities expose it primarily to the financial risks of changes in foreign currency exchange rates and interest rates (see below).

Interest rate risk

The Group is exposed to the effects of fluctuations at the prevailing levels of market interest rates on its financial results and cash flows. Changes in interest rate impact primarily lease liabilities, loans and borrowings by changing their cash flows. At the time of raising new borrowings including lease liabilities, management uses judgment to decide which (fixed or variable) interest rate would be more favorable to the Group over the expected period until maturity.

Cash flow sensitivity analysis for variable rate instruments

An increase of the variable interest rates, as indicated below, as at 31 December 2020 and 31 December 2019 would have decreased profit or loss and equity, respectively, by the amounts shown below. This analysis is based on variable interest rates variances that the Group considered to be reasonably possible at the end of the reporting.

This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

	Profit or (loss) / Equity	
	31 December 2020	31 December 2019
Three-month USD LIBOR 20 basis points increase (2019: 20 basis points increase)	(1,774)	(2,597)
One-month USD LIBOR 10 basis points increase (2019: 10 basis points increase)	(6)	(16)
Cash flow sensitivity	(1,780)	(2,613)

A decrease of the variable interest rates would have increased equity and profit or loss by the same amounts shown in above table.

Foreign currency risk

The Group is exposed to currency risk in relation to revenue as well as purchases, borrowings and leases that are denominated in a currency other than AZN. The currencies in which these transactions are primarily denominated are Euro and US Dollar. The Groups analyses the exchange rate trends on a regular basis.

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Foreign currency sensitivity analysis

The Group is mainly exposed to the risk of change of exchange rates of AZN against USD and EUR.

The book values of the Group’s monetary assets and liabilities in foreign currency as at the reporting date have been provided below. This disclosure excludes assets and liabilities denominated in other currencies, as they do not have significant effect on the consolidated financial statements of the Group. Amounts due to and from related parties figures do not include balances prepaid or advances received from related parties, due to fact that such items are not considered as monetary.

31 December 2020	AZN	USD	EUR	Other	Total
Trade receivables	21,220	7,962	866	3,572	33,620
Amounts due from related parties	1,731	-	-	-	1,731
Cash and cash equivalents	2,524	35,920	5,147	1,135	44,726
Total financial assets	25,475	43,882	6,013	4,707	80,077
Trade and other payables	61,059	2,835	2,018	389	66,301
Amounts due to related parties	15,374	-	-	-	15,374
Staff related payables	11,546	-	-	-	11,546
Loans and borrowings	811,840	1,332,558	39,393	-	2,183,791
Lease liabilities	-	334,158	-	-	334,158
Total financial liabilities	899,819	1,669,551	41,411	389	2,611,170
Open position	(874,344)	(1,625,669)	(35,398)	4,318	(2,531,093)
31 December 2019	AZN	USD	EUR	Other	Total
Trade receivables	11,729	19,398	4,265	14,032	49,424
Amounts due from related parties	6,625	-	-	-	6,625
Cash and cash equivalents	1,254	25,108	6,961	1,636	34,959
Total financial assets	19,608	44,506	11,226	15,668	91,008
Trade and other payables	114,558	3,622	2,763	1,700	122,643
Amounts due to related parties	8,060	-	-	-	8,060
Staff related payables	14,361	-	-	-	14,361
Loans and borrowings	761,988	1,280,615	35,598	-	2,078,201
Lease liabilities	-	390,699	-	-	390,699
Total financial liabilities	898,967	1,674,936	38,361	1,700	2,613,964
Open position	(879,359)	(1,630,430)	(27,135)	13,968	(2,522,956)

Sensitivity analysis

A weakening of the AZN, as indicated below, against the above-indicated currencies as at 31 December 2020 and 31 December 2019 would have decreased profit or loss and equity, respectively, by the amounts shown below. This analysis is based on foreign currency exchange rate variances that the Group considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

31 December 2020	USD	EUR	Other	Total
10% weakening of AZN	(162,567)	(3,540)	432	(165,675)
31 December 2019	USD	EUR	Other	Total
10% weakening of AZN	(163,043)	(2,714)	1,397	(164,360)

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A strengthening of the AZN against the above currencies would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to settle all liabilities as they are due and to finance future needs.

The Group’s liquidity management process as monitored by senior management, includes the following:

- Day to day funding, managed by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature.
- Maintaining rolling forecasts of the Group’s liquidity position on the basis of expected cash flows.
- Maintaining debt financing plans.
- Maintaining diversified credit lines including stand-by credit facility.

Sources of liquidity are regularly reviewed by senior management to maintain a diversification by geography, provider, product and term.

Management of the Group believes, that the strategic importance of the Group to the economy of the Republic of Azerbaijan means that the government of the Republic of Azerbaijan will provide assistance to ensure continuity of local and international flights to, from and within the country. Management believes that the Group will receive necessary financial support from the government of the Republic of Azerbaijan due to the Group’s role as the flagship state airline and major provider of air transportation in the country that will allow the Group to continue operations.

The following tables detail the Group’s remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay.

	31 December 2020			
	Within one year	1 to 5 years	Over 5 years	Total
Lease liabilities	72,689	243,866	70,259	386,814
Loans and borrowings	963,088	1,109,070	274,455	2,346,613
Trade and other payables	66,301	-	-	66,301
Amounts due to related parties	15,374	-	-	15,374
Staff related payables	11,546	-	-	11,546
Total financial liabilities	1,128,998	1,352,936	344,714	2,826,648

	31 December 2019			
	Within one year	1 to 5 years	Over 5 years	Total
Lease liabilities	75,564	254,561	135,480	465,605
Loans and borrowings	727,546	1,304,801	590,469	2,622,816
Trade and other payables	122,643	-	-	122,643
Amounts due to related parties	8,060	-	-	8,060
Staff related payables	14,361	-	-	14,361
Total financial liabilities	948,174	1,559,362	725,949	3,233,485

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Fair values versus carrying amounts

The Group uses the hierarchy mentioned in Note 3 to determine and disclose fair value of financial instruments.

Management believes that the fair value of the Group’s financial assets and liabilities (such as cash and cash equivalents, trade receivables, trade payables and etc.), which are classified within Level 2 category of the above hierarchy, approximates their carrying amounts due to relatively short maturity and interest rates representative of market rates except for long-term loans and borrowings for which the fair value is less than carrying amount by AZN 163,514 as at 31 December 2020 (31 December 2019: AZN 113,921). The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. Management has used all available market information in estimating the fair value of financial instruments.

25. COMMITMENT AND CONTINGENCIES

Commitments related to rentals

Rental commitments in respect of short-term and low-value leases mainly comprise of engine, aircraft spare parts and property rental contracts of AZN 3,433. All contracts contain market review clauses in the event that the Group exercises its option to renew. The Group does not have an option to purchase the leased asset at the expiry of the lease period.

Rental contracts include fixed and variable lease payments, which vary according to flying hours and cycles.

	<u>31 December 2020</u>	<u>31 December 2019</u>
Fixed payments	2,938	5,818
Variable payments	<u>1,388</u>	<u>2,826</u>
Total payments	<u>4,326</u>	<u>8,644</u>

The fixed and variable rent payments are denominated and settled mainly in US Dollars.

Capital commitments

The Group agreed with Boeing to purchase four Boeing 787-8 and eight Boeing 737-8 aircraft. The Group is committed to pre-delivery payments in accordance with the agreed payment schedules. Delivery and expected pre-delivery payments of all aircraft were deferred to 2024 and 2025 in accordance with the latest agreements reached.

The terms of the Group’s contract with the above supplier precludes it from disclosing information on the purchase cost of the aircraft.

Other capital commitments include contracts for the purchase and construction of simulator equipment, Air Space Efficiency Center, specialised hardware and software, automated communication and archiving systems with a total committed amount of AZN 18,130.

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Taxation contingencies

The taxation system in the Republic of Azerbaijan continues to evolve and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities who have the authority to impose severe fines, penalties and interest charges. A tax year remains open for review by the tax authorities during the three subsequent calendar years; however, under certain circumstances a tax year may remain open longer. Recent events within the Republic of Azerbaijan suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation.

The Tax Code of the Republic of Azerbaijan establishes general principles of taxation in Azerbaijan, sets the rule for determining, payment and collection of taxes, identifies the rights and responsibilities of taxpayers and tax authorities. The Tax Code does not contain provisions specifically regulating air transportation services. For withholding and value added taxes purposes such services fall under the category of international transportation, whereas for profit tax purposes general services provided. All clauses in respect of these service categories are general and subject to interpretations. Therefore, the interpretation for air cargo transportation services involves uncertainty and judgement.

These circumstances may create tax risks in Azerbaijan that are substantially more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Azerbaijan tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on the financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

As of the date of issuance of these consolidated financial statements, the Group is under tax audit. Management believes no provision is required to include in the consolidated financial statements of the Group for the year ended 31 December 2020 with respect to the ongoing tax audit.

Operating environment

Emerging markets such as Azerbaijan are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. Laws and regulations affecting businesses in Azerbaijan continue to change rapidly, tax and regulatory frameworks are subject to varying interpretations. The future stability of the Azerbaijan economy is heavily influenced by reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

Because Azerbaijan produces and exports large volumes of oil and gas, its economy is particularly sensitive to the price of oil and gas on the world market. Although the crude oil prices have substantially recovered by the date of issuing these consolidated financial statements since dropping more than 40% in March 2020, the risk that the AZN may weaken against major currencies remains.

The Group's management is monitoring developments in the current environment and taking necessary measures to support the sustainability and development of the Group's business in the foreseeable future. The impact of further economic and political developments on future operations and financial position of the Group might be significant.

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26. RELATED PARTY TRANSACTIONS

Transactions with related parties

Parties are generally considered to be related if they are under common control or if one party has the ability to control the other party or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship attention is directed to the economic substance of the relationship, not merely the legal form.

Related parties comprise the shareholders of the Group and all other companies in which those shareholders, either individually or together, have a controlling interest. The Azerbaijan government directly owns 100% of the Group’s outstanding shares. The Group’s significant transactions with the government of the Republic of Azerbaijan and other entities controlled, jointly controlled or significantly influenced by the government of the Republic of Azerbaijan mainly include loans obtained and customs clearance expenses.

The remuneration of the key management personnel of the Group constituted AZN 284 for the year ended 31 December 2020 (31 December 2019: AZN 420) in the form of short-term employee benefits.

During the year, the Group entered into the following trading transactions with related parties:

	Notes	Year ended 31 December 2020	
		Related party transactions	Total per category
Traffic and other revenue	5		335,236
- <i>Entities under common control</i>		2,724	
Operating costs (fuel expense, insurance expense and other)	6		540,149
- <i>Entities under common control</i>		59,593	
Finance cost	7		83,966
- <i>Entities under common control and other related parties</i>		69,017	
	Notes	Year ended 31 December 2019	
		Related party transactions	Total per category
Traffic and other revenue	5		1,008,459
- <i>Entities under common control</i>		5,878	
Operating costs (fuel expense, insurance expense and other)	6		949,588
- <i>Entities under common control</i>		126,554	
Finance cost	7		111,185
- <i>Entities under common control and other related parties</i>		91,277	

The following balances were outstanding at the end of the reporting period:

	Notes	31 December 2020		31 December 2019	
		Related party balances	Total per category	Related party balances	Total per category
Cash and cash equivalents	16		44,726		34,959
- <i>Entities under common control</i>		25,439		28,331	
Trade and other receivables	15		71,892		86,759
- <i>Entities under common control</i>		1,731		6,625	
Trade and other payables	22		108,517		167,266
- <i>Entities under common control</i>		15,374		8,060	
Loans and borrowings	18		2,183,791		2,078,201
- <i>Shareholder and other related parties</i>		2,147,809		2,042,662	
Other current liabilities	23		31,507		51,226
- <i>Entities under common control and other related parties</i>		26,975		45,285	