

“Azerbaijan Airlines” Closed Joint Stock Company

Consolidated Financial Statements
for the Year Ended 31 December 2019

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

TABLE OF CONTENTS

	Page
STATEMENT OF MANAGEMENT’S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019	1
INDEPENDENT AUDITOR’S REPORT	2
CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019:	
Consolidated statement of profit or loss and other comprehensive income	5
Consolidated statement of financial position	6
Consolidated statement of changes in equity	7
Consolidated statement of cash flows	8-9
Notes to the consolidated financial statements	10-55

“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 2019

Management is responsible for the preparation of the consolidated financial statements, which present the financial position of Closed Joint Stock Company “AZERBAIJAN AIRLINES” and its subsidiaries (the “Group”) as at 31 December 2019, 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;
- 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 of the Group for the year ended 31 December 2019 were approved by management on 13 April 2021.

On behalf of Management:


Sabir Ilyasov
First Vice-President

Baku, the Republic of Azerbaijan
13 April 2021




Esmira Tahirova
Chief Accountant

Baku, the Republic of Azerbaijan
13 April 2021

INDEPENDENT AUDITOR'S REPORT

To the Shareholder and Management 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 2019, 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 2019, 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 discussed 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.

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



13 April 2021

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2019

(in thousands of Azerbaijan Manat)

	Notes	2019	2018
Traffic and other revenue	5	1,008,459	955,231
Operating costs	6	(949,588)	(977,849)
Operating profit / (loss)		58,871	(22,618)
Finance costs	7	(111,185)	(117,352)
Foreign exchange loss	8	(6,579)	(8,867)
Loss before tax		(58,893)	(148,837)
Income tax expense	9	(19,877)	(2,483)
LOSS FOR THE YEAR AND TOTAL COMPREHENSIVE LOSS		(78,770)	(151,320)

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 2019

(in thousands of Azerbaijan Manat)

	Notes	31 December 2019	31 December 2018
ASSETS			
Non-current assets			
Property and equipment	10	1,483,726	1,875,361
Right-of-use assets	11	377,979	-
Intangible assets		4,658	4,929
Long-term advances given	12	39,186	11,726
Other non-current assets	13	32,558	35,633
Total non-current assets		1,938,107	1,927,649
Current assets			
Consumable spare parts and inventories	14	23,823	17,610
Trade and other receivables	15	86,759	65,547
Cash and cash equivalents	16	34,959	32,303
Total current assets		145,541	115,460
Total assets		2,083,648	2,043,109
EQUITY AND LIABILITIES			
Equity			
Share capital	17	823,975	823,975
Additional paid-in capital		148,413	160,813
Accumulated deficit		(1,687,501)	(1,608,731)
Total equity		(715,113)	(623,943)
Non-current liabilities			
Long-term loans and borrowings	18	1,605,934	1,722,532
Lease liabilities, non-current portion	19	340,546	379,354
Deferred revenue related to Frequent Flyer Programme (FFP), non-current portion	20	22,932	32,203
Deferred tax liability	21	36,360	16,483
Total non-current liabilities		2,005,772	2,150,572
Current liabilities			
Trade and other payables	22	167,266	112,271
Short-term borrowings and current portion of long-term loans and borrowings	18	472,267	315,087
Lease liabilities, current portion	19	50,153	45,025
Unearned revenue	20	46,884	31,308
Deferred revenue related to FFP, current portion	20	5,193	6,546
Other current liabilities	23	51,226	6,243
Total current liabilities		792,989	516,480
Total liabilities		2,798,761	2,667,052
Total equity and liabilities		2,083,648	2,043,109

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 2019
(in thousands of Azerbaijan Manat)**

	Notes	Share capital	Additional paid-in capital	Accumulated deficit	Total equity (deficit)
Balance at 1 January 2018		823,975	104,604	(1,433,579)	(505,000)
Effect of transition to IFRS 9		-	-	(3,832)	(3,832)
Loss for the year and total comprehensive loss		-	-	(151,320)	(151,320)
Shareholder's contribution	17	-	56,209	-	56,209
Distribution to shareholder	17	-	-	(20,000)	(20,000)
Balance at 31 December 2018		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)

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 2019
(in thousands of Azerbaijan Manat)**

	Notes	2019	2018
OPERATING ACTIVITIES:			
Loss before tax		(58,893)	(148,837)
Adjustments for:			
Depreciation and amortisation		138,647	134,699
Change in provision for trade and other receivables and advances given		3,708	4,278
Gain on disposal of property and equipment		(4,607)	(2,983)
Change in provision for obsolescence of consumable spare parts and inventories		(1,249)	(332)
Change in provision for VAT recoverable		8,498	74,787
Impairment of property and equipment		-	22,767
Foreign exchange loss	8	6,579	8,867
Finance costs	7	111,185	117,352
Change in other provisions		4,325	-
<i>Operating cash flow before movements in working capital</i>		<i>208,193</i>	<i>210,598</i>
Change in trade and other receivables		19,258	(13,957)
Change in consumable spare parts and inventories		(4,964)	(5,135)
Change in trade and other payables		(36,792)	(82,232)
Change in deferred revenue related to FFP	20	(10,624)	3,460
Change in unearned revenue		15,574	7,539
Change in other current liabilities		40,652	(9,603)
Cash generated from operations		231,297	110,670
Income tax paid		-	(600)
Interest paid		(24,136)	(19,443)
Net cash from operating activities		207,161	90,627
INVESTING ACTIVITIES:			
Purchase of property and equipment		(103,415)	(63,746)
Cash paid for additions to right-of-use assets during the period		(14,338)	-
Proceeds from disposal of property and equipment		717	10,839
Purchase of intangible assets		(2,831)	(1,202)
Net cash used in investing activities		(119,867)	(54,109)
FINANCING ACTIVITIES:			
Shareholder's contribution	17	-	70,000
Distribution to shareholder	17	-	(20,000)
Proceeds from loans and borrowings		20,155	22,804
Principal payments on loans and borrowings		(50,952)	(54,676)
Principal payments on lease obligations		(51,119)	(44,655)
Net cash used in financing activities		(81,916)	(26,527)
NET INCREASE IN CASH AND CASH EQUIVALENTS		5,378	9,991
Effect of exchange rate changes on cash and bank balances held in foreign currencies		(2,722)	(3,587)
CASH AND CASH EQUIVALENTS, at the beginning of the year		32,303	25,899
CASH AND CASH EQUIVALENTS, at the end of the year		34,959	32,303

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 2019
(in thousands of Azerbaijan 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 2019 and 31 December 2018 do not include the following non-cash transactions:

- (a) Reclassification of aircraft from property and equipment to right-of-use assets of AZN 372,335 in 2019;
- (b) Recognition of right-of-use assets of AZN 12,648 through lease liabilities in 2019;
- (c) Contribution of property and equipment and other assets by shareholder of AZN 654 and AZN 209 recognised as additional paid-in capital in 2019 and 2018, respectively;
- (d) Partial payment of principal amount of a loan from a local bank of AZN 10,010 in both 2019 and 2018 directly by the Government on behalf of the Group as a form of subsidy for Baku-Nakhchivan-Baku flights;
- (e) 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;
- (f) Transfer of asset at government’s instruction with carrying value of AZN 7,510 in 2019;
- (g) Acquisition of two new Embraer ERJ190-100 BHH aircraft through finance lease of AZN 111,010 (Note 19) in 2018;
- (h) Transfer of asset held for sale as a prepayment for purchased aircraft of AZN 9,031 in 2018;
- (i) Transfer of old aircraft for AZN 17,000 to the lessor for the lease of two new aircraft as an initial payment in 2018; and
- (j) Set off of interest payment according to the Government decree in the amount off AZN 14,500 with Ministry of Finance with VAT asset in 2018.

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 2019 (in thousands of Azerbaijan Manat)

1. NATURE OF ACTIVITIES

“Azerbaijan Airlines” (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. CJSC “Azerbaijan Airlines” 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 Azerbaijan Investment Holding (wholly owned by the government) pursuant to the order signed by the President of the Republic of Azerbaijan.

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

Company name	Registered address	Principal activity	2019	2018
Nakhchivan International Airport	E002, Nakhchivan AZ6725, Azerbaijan	Airport	100%	100%
National Aviation Academy	AZ1045, Baku, Khazar, Mardakan, 30	Educational Centre	100%	100%

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 13 April 2021 by management of the Group.

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

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

considered the Group’s financial position, current intentions, profitability of operations and access to financial resources.

The Group incurred total comprehensive loss from continuing operations of AZN 78,770 in 2019 (2018: AZN 151,320). As of 31 December 2019, the Group’s current liabilities exceeded its current assets by AZN 647,448 (31 December 2018: AZN 401,020) and the Group had negative equity of AZN 715,113 (31 December 2018: AZN 623,943). These results were negatively impacted by devaluation of Azerbaijani Manat in 2015 and 2016. 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 government.

In addition, starting from early 2020 a new coronavirus disease (COVID-19) has begun 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 are resulting 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 2019, the operations of the Group were stable with slight increase in revenue of 4% compared to 2018. During the first two months of 2020, the Group had 21% growth in passenger flight revenue (total revenue: 6% average increase) 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. Starting from February 2021, quarantine restrictions were eased and the Group announced partial reopening of flights.

As a response to the pandemic situation, management of the Group took a number of actions, including increasing focus on cargo flights, reducing costs, negotiating with lenders about payments deferrals, identifying additional opportunities to increase liquidity, deferring aircraft purchases (until 2026) 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 has 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.

- 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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

- 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 government decree, resulting in increase in liabilities and decrease in equity. Management is in negotiations with the government regarding the terms of settlement of this reinstated liability.
- Major part of current liabilities 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 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 subsidies as a support from government (recognised as a liability until formal documentation is completed, however, management does not expect that the Group will have to repay these amounts in the future) to continue its operations, pay salaries and make payments for loan agreements obtained with government guarantee. Further AZN 75,000 has been approved for 2021 so far.
- Management believes that the Group can monetise some of its aircraft 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.

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

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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 affects 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.

When the Company has less than a majority of the voting rights of an investee, it considers that it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Company considers all relevant facts and circumstances in assessing whether or not the Company's voting rights in an investee are sufficient to give it power, including:

- The size of the Company's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- Potential voting rights held by the Company, other vote holders or other parties;
- Rights arising from other contractual arrangements; and
- Any additional facts and circumstances that indicate that the Company has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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

Non-controlling interests in subsidiaries are identified separately from the Group's equity therein. Those interests of non-controlling shareholders that are present ownership interests entitling their holders to a proportionate share of net assets upon liquidation may initially be measured at fair value or at the non-controlling interests' proportionate share of the fair value of the acquiree's identifiable net assets. The choice of measurement is made on an acquisition-by-acquisition basis. Other non-controlling interests are initially measured at fair value. Subsequent to acquisition, the carrying amount of non-controlling interests is the amount of those interests at initial recognition plus the non-controlling interests' share of subsequent changes in equity.

Profit or loss and each component of other comprehensive income are attributed to the owners of the Company and to the non-controlling interests. Total comprehensive income of the subsidiaries is attributed to the owners of the Company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

Changes in the Group's interests in subsidiaries that do not result in a loss of control are accounted for as equity transactions. The carrying amount of the Group's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Company.

When the Group loses control of a subsidiary, the gain or loss on disposal recognised in profit or loss is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), less liabilities of the subsidiary and any non-controlling interests. All amounts previously recognised in other comprehensive income in relation to that subsidiary are accounted for as if the Group had directly disposed of the related assets or liabilities of the subsidiary (i.e. reclassified to profit or loss or transferred to another category of equity as required/permitted by applicable IFRS Standards). The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IFRS 9 when applicable, or the cost on initial recognition of an investment in an associate or a joint venture.

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 traffic 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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2019

(in thousands of Azerbaijan Manat)

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.

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 should be 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, 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, *Revenue from contracts with customers*, 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 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 expenses in the consolidated statement of profit or loss in the period of

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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 sales

Cargo 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

In the current year, the Group has applied IFRS 16 retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application and without restatement of the comparative information. Effect of application of the standard and other details are disclosed further below in the section *Impact of initial application of IFRS 16 Leases* of this note.

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.

Lease payments included in the measurement of the lease liability comprise:

- Fixed lease payments (including in-substance fixed payments), less any lease incentives receivable;
- Variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date;
- The amount expected to be payable by the lessee under residual value guarantees;
- The exercise price of purchase options, if the lessee is reasonably certain to exercise the options; and
- Payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.

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

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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 Group remeasures the lease liability (and makes a corresponding adjustment to the related right-of-use asset) whenever:

- The lease term has changed or there is a significant event or change in circumstances resulting in a change in the assessment of exercise of a purchase option, in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate.
- A lease contract is modified and the lease modification is not accounted for as a separate lease, in which case the lease liability is remeasured based on the lease term of the modified lease by discounting the revised lease payments using a revised discount rate at the effective date of the modification.

The Group did not make any such adjustments during the periods presented.

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.

Whenever the Group incurs an obligation for costs to dismantle and remove a leased asset, restore the site on which it is located or restore the underlying asset to the condition required by the terms and conditions of the lease, a provision is recognised and measured under IAS 37. To the extent that the costs relate to a right-of-use asset, the costs are included in the related right-of-use asset, unless those costs are incurred to produce inventories.

Right-of-use assets are depreciated over the shorter period of lease term and useful life of the underlying asset. If a lease transfers ownership of the underlying asset or the cost of the right-of-use asset reflects that the Group expects to exercise a purchase option, the related right-of-use asset is depreciated over the useful life of the underlying asset. The depreciation starts at the commencement date of the lease.

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

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 expenses” in the consolidated statement of profit or loss.

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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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.

Exchange differences are recognised in profit or loss in the period in which they arise except for:

- Exchange differences on foreign currency borrowings relating to assets under construction for future productive use, which are included in the cost of those assets when they are regarded as an adjustment to interest costs on those foreign currency borrowings;
- Exchange differences on transactions entered into to hedge certain foreign currency risks (see below under financial instruments/hedge accounting); and
- Exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur in the foreseeable future (therefore forming part of the net investment in the foreign operation), which are recognised initially in other comprehensive income and reclassified from equity to profit or loss on disposal or partial disposal of the net investment.

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 2019</u>	<u>31 December 2018</u>
AZN / USD	1.7000	1.7000
AZN / EUR	1.9035	1.9468

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 statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2019

(in thousands of Azerbaijan Manat)

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 financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the liability method. Deferred tax liabilities are generally 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. In addition, a deferred tax liability is not recognised if the temporary difference arises from the initial recognition of goodwill.

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.

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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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 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, the remaining lease term or the useful life of the asset concerned.

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

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease and to the extent that the impairment loss is greater than the related revaluation surplus, the excess impairment loss is recognised 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. Any increase in excess of this amount is treated as a revaluation increase.

Inventories

Inventories are stated at the lower of cost and estimated net realisable value. Costs of 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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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. Bank overdrafts are shown within current borrowings in the consolidated statement of financial position.

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. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated by discounting the estimated future cash flows, including expected credit losses, to the amortised cost 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

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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 using the effective interest method for debt instruments measured subsequently at amortised cost and at FVTOCI. For financial assets other than purchased or originated credit-impaired financial assets, interest income is calculated by applying the effective interest rate to the gross carrying amount of a financial asset, except for financial assets that have subsequently become credit-impaired (see below). For financial assets that have subsequently become credit-impaired, interest income is recognised by applying the effective interest rate to the amortised cost of the financial asset. If, in subsequent reporting periods, the credit risk on the credit-impaired financial instrument improves so that the financial asset is no longer credit-impaired, interest income is recognised by applying the effective interest rate to the gross carrying amount of the financial asset.

For purchased or originated credit-impaired financial assets, the Group recognises interest income by applying the credit-adjusted effective interest rate to the amortised cost of the financial asset from initial recognition. The calculation does not revert to the gross basis even if the credit risk of the financial asset subsequently improves so that the financial asset is no longer credit-impaired.

Interest income is recognised in profit or loss.

Foreign exchange gains and losses

The carrying amount of financial assets that are denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the end of each reporting period.

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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

(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.

In particular, the following information is taken into account when assessing whether credit risk has increased significantly since initial recognition:

- An actual or expected significant deterioration in the financial instrument’s external (if available) or internal credit rating;
- Significant deterioration in external market indicators of credit risk for a particular financial instrument, e.g. a significant increase in the credit spread, the credit default swap prices for the debtor, or the length of time or the extent to which the fair value of a financial asset has been less than its amortised cost;
- Existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant decrease in the debtor’s ability to meet its debt obligations;
- An actual or expected significant deterioration in the operating results of the debtor;
- Significant increases in credit risk on other financial instruments of the same debtor; and
- An actual or expected significant adverse change in the regulatory, economic, or technological environment of the debtor that results in a significant decrease in the debtor’s ability to meet its debt obligations.

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.

Despite the foregoing, the Group assumes that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date. A financial instrument is determined to have low credit risk if:

1. The financial instrument has a low risk of default;
2. The debtor has a strong capacity to meet its contractual cash flow obligations in the near term; and
3. Adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations.

The Group considers a financial asset to have low credit risk when the asset has external credit rating of ‘investment grade’ in accordance with the globally understood definition or if an external

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

rating is not available, the asset has an internal rating of ‘performing’. Performing means that the counterparty has a strong financial position and there is no past due amounts.

The Group regularly monitors the effectiveness of the criteria used to identify whether there has been a significant increase in credit risk and revises them as appropriate to ensure that the criteria are capable of identifying significant increase in credit risk before the amount becomes past due.

(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.

(iii) Credit-impaired financial assets

A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired includes observable data about the following events:

- (a) Significant financial difficulty of the issuer or the borrower;
- (b) A breach of contract, such as a default or past due event (see (ii) above);
- (c) The lender(s) of the borrower, for economic or contractual reasons relating to the borrower’s financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;
- (d) It is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
- (e) The disappearance of an active market for that financial asset because of financial difficulties.

(iv) Write-off policy

The Group writes off a financial asset when there is information indicating that the debtor is in severe financial difficulty and there is no realistic prospect of recovery, e.g. when the debtor has been placed under liquidation or has entered into bankruptcy proceedings, or in the case of trade receivables, when the amounts are over two years past due, whichever occurs sooner. Financial assets written off may still be subject to enforcement activities under the Group’s recovery procedures, taking into account legal advice where appropriate. Any recoveries made are recognised in profit or loss.

(v) 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 assessment of the probability of default and loss given default is based on historical data adjusted by forward-looking information as described above. As for the exposure at default, for financial assets, this is represented by the assets’ gross carrying amount at the reporting date, together with any additional amounts expected to be drawn down in the future by default date determined based

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

on historical trend, the Group’s understanding of the specific future financing needs of the debtors, and other relevant forward-looking information.

For financial assets, the expected credit loss is estimated as the difference between all contractual cash flows that are due to the Group in accordance with the contract and all the cash flows that the Group expects to receive, discounted at the original effective interest rate.

If the Group has measured the loss allowance for a financial instrument at an amount equal to lifetime ECL in the previous reporting period, but determines at the current reporting date that the conditions for lifetime ECL are no longer met, the Group measures the loss allowance at an amount equal to 12-month ECL at the current reporting date, except for assets for which simplified approach was used.

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. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset’s carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in profit or loss.

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.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Group are recorded at the proceeds received, net of direct issue costs.

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 income statement over the period of the borrowings using the effective interest method.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

Financial liabilities

All financial liabilities are measured subsequently at amortised cost using the effective interest method or at FVTPL.

However, financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies, and financial guarantee contracts issued by the Group, are measured in accordance with the specific accounting policies set out below.

Financial liabilities measured subsequently at amortised cost

Financial liabilities that are not (i) contingent consideration of an acquirer in a business combination, (ii) held for trading, or (iii) designated as at FVTPL, are measured subsequently at amortised cost using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (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) through the expected life of the financial liability, or (where appropriate) a shorter period, to the amortised cost of a financial liability.

Foreign exchange gains and losses

For financial liabilities that are denominated in a foreign currency and are measured at amortised cost at the end of each reporting period, the foreign exchange gains and losses are determined based on the amortised cost of the instruments. These foreign exchange gains and losses are recognised in the ‘Foreign exchange loss’ line item in the consolidated statement of profit or loss.

The fair value of financial liabilities denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the end of the reporting period.

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 profit or loss.

Offsetting of financial assets and liabilities

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to 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 statement of comprehensive income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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.

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 initial application of IFRS 16 Leases

In the current year, the Group has applied IFRS 16 (as issued by the IASB in January 2016) that is effective for annual periods that begin on or after 1 January 2019.

IFRS 16 introduces new or amended requirements with respect to lease accounting. It introduces significant changes to lessee accounting by removing the distinction between operating and finance lease and requiring the recognition of a right-of-use asset and a lease liability at commencement for all leases, except for short-term leases and leases of low value assets. In contrast to lessee accounting, the requirements for lessor accounting have remained largely unchanged. The impact of the adoption of IFRS 16 on the Group's consolidated financial statements is described below.

The date of initial application of IFRS 16 for the Group is 1 January 2019.

The Group has applied IFRS 16 retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application and without restatement of the comparative information.

(a) Impact of the new definition of a lease

The Group has made use of the practical expedient available on transition to IFRS 16 not to reassess whether a contract is or contains a lease. Accordingly, the definition of a lease in accordance with IAS 17 and IFRIC 4 will continue to be applied to those contracts entered or modified before 1 January 2019.

The change in definition of a lease mainly relates to the concept of control. IFRS 16 determines whether a contract contains a lease on the basis of whether the customer has the right to control the use of an identified asset for a period of time in exchange for consideration. This is in contrast to the focus on 'risks and rewards' in IAS 17 and IFRIC 4.

The Group applies the definition of a lease and related guidance set out in IFRS 16 to all contracts entered into or changed on or after 1 January 2019. In preparation for the first-time application of IFRS 16, the Group has carried out an implementation project. The project has shown that the new definition in IFRS 16 will not significantly change the scope of contracts that meet the definition of a lease for the Group.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

(b) Impact on Lessee Accounting

(i) Former operating leases

IFRS 16 changes how the Group accounts for leases previously classified as operating leases under IAS 17, which were off balance sheet.

Applying IFRS 16, for all leases (except as noted below), the Group:

- (a) Recognises right-of-use assets and lease liabilities in the consolidated statement of financial position, initially measured at the present value of the future lease payments;
- (b) Recognises depreciation of right-of-use assets and interest on lease liabilities in the consolidated statement of profit or loss;
- (c) Separates the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the consolidated statement of cash flows.

Lease incentives (e.g. rent-free period) are recognised as part of the measurement of the right-of-use assets and lease liabilities whereas under IAS 17 they resulted in the recognition of a lease incentive, amortised as a reduction of rental expenses generally on a straight-line basis. Under IFRS 16, right-of-use assets are tested for impairment in accordance with IAS 36.

For short-term leases (lease term of 12 months or less) and leases of low-value assets (such as transportation assets, apartments, equipment and etc.), the Group has opted to recognise a lease expense on a straight-line basis as permitted by IFRS 16. This expense is presented within ‘Operating costs’ in the consolidated statement of profit or loss.

(ii) Former finance leases

The main differences between IFRS 16 and IAS 17 with respect to contracts formerly classified as finance leases is the measurement of the residual value guarantees provided by the lessee to the lessor. IFRS 16 requires that the Group recognises as part of its lease liability only the amount expected to be payable under a residual value guarantee, rather than the maximum amount guaranteed as required by IAS 17. This change did not have a material effect on the Group’s consolidated financial statements.

(c) Impact on Lessor Accounting

IFRS 16 does not change substantially how a lessor accounts for leases. Under IFRS 16, a lessor continues to classify leases as either finance leases or operating leases and account for those two types of leases differently.

However, IFRS 16 has changed and expanded the disclosures required, in particular with regard to how a lessor manages the risks arising from its residual interest in leased assets.

(d) Financial impact of the initial application of IFRS 16

The weighted-average incremental borrowing rate applied to lease liabilities recognised in the consolidated statement of financial position on 1 January 2019 under IFRS 16, which were previously recognized as operating lease is 8 per cent.

The following table shows the operating lease commitments disclosed applying IAS 17 at 31 December 2018, discounted using the incremental borrowing rate at the date of initial

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

application and the lease liabilities recognised in the consolidated statement of financial position at the date of initial application.

Operating lease commitments at 31 December 2018	16,763
Revisions made to estimates of lease term	2,602
Short-term leases and leases of low-value assets	(2,109)
Effect of discounting	(2,967)
Variable lease payments	(1,641)
Total additional lease liabilities recognized on adoption of IFRS 16	<u>12,648</u>
Finance lease obligations at 31 December 2018	<u>424,379</u>
Lease liabilities recognised at 1 January 2019	<u>437,027</u>

For tax purposes the Group does not receive tax deductions in respect of the right-of-use assets and the lease liabilities in a manner consistent with the accounting treatment.

Group as a lessee:

The application of IFRS 16 to leases previously classified as operating leases under IAS 17 resulted in the recognition of right-of-use assets of AZN 12,648 and lease liabilities of AZN 12,648 on 1 January 2019. It also resulted in a decrease in other expenses of AZN 4,080 and an increase in depreciation of AZN 3,902 and finance costs of AZN 861 during 2019.

The application of IFRS 16 has an impact on the consolidated statement of cash flows of the Group.

Under IFRS 16, lessees must present:

- Short-term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability as part of operating activities;
- Cash paid for the interest portion of a lease liability as either operating activities or financing activities, as permitted by IAS 7 (the Group has opted to include interest paid as part of operating activities); and
- Cash payments for the principal portion for a lease liability, as part of financing activities.

Under IAS 17, all lease payments on operating leases were presented as part of cash flows from operating activities. Consequently, the net cash generated by operating activities has increased by AZN 3,219 (excluding the effect of interest expense of AZN 861) being the lease payments, and net cash used in financing activities has increased by the same amount.

The adoption of IFRS 16 did not have an impact on net cash flows.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

Amendments to IFRS Standards and Interpretations issued by the IASB effective for annual periods beginning on or after January 1, 2019

In the current year, the Group has applied a number of amendments to IFRS Standards and Interpretations issued by the IASB that are effective for an annual period that begins on or after 1 January 2019. Their adoption has not had any material impact on the disclosures or on the amounts reported in these consolidated financial statements:

IAS 12 <i>Income Taxes</i> and IAS 23 <i>Borrowing Costs</i> IFRIC 23	<i>Annual Improvements to IFRS Standards 2015–2017 Cycle</i> <i>Uncertainty over Income Tax Treatments</i>
--	---

New and revised IFRS Standards in issue but not yet effective

At the date of authorisation of these 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	<i>Insurance Contracts</i>
IFRS 10 and IAS 28 (amendments)	<i>Sale or Contribution of Assets between an Investor and its Associate or Joint Venture</i>
Amendments to IFRS 3	<i>Definition of a business</i>
Amendments to IAS 1 and IAS 8	<i>Definition of material</i>
Amendments to IAS 19	<i>Employee Benefits Plan Amendment, Curtailment or Settlement</i>
Amendments to IFRS 9, IAS 39 and IFRS 7	<i>Interest Rate Benchmark Reform and its Effects on Financial Reporting</i>
Conceptual Framework	<i>Amendments to References to the Conceptual Framework in IFRS Standards</i>
Amendments to IAS 1	<i>Classification of Liabilities as Current or Non-current</i>
Amendments to IFRS 3	<i>Reference to the Conceptual Framework</i>
Amendments to IAS 16	<i>Property, Plant and Equipment—Proceeds before Intended Use</i>
Amendments to IAS 37	<i>Onerous Contracts – Cost of Fulfilling a Contract</i>
Annual Improvements to IFRS Standards 2018-2020 Cycle	<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>
Amendment to IFRS 16	<i>Covid-19-Related Rent Concessions</i>
Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16	<i>Interest Rate Benchmark Reform — Phase 2</i>
Amendments to IAS 1 and IFRS Practice Statement 2	<i>Disclosure of Accounting Policies</i>
Amendments to IAS 8	<i>Definition of Accounting Estimates</i>

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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Group’s accounting policies, which are described in Note 3, Management is required to make judgments, 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 and estimates

The following are the critical judgments and estimates 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.

Impairment indicators

At each reporting date, the Group’s management reviews its property and equipment to determine whether there is any indication of impairment of those assets. If any impairment indicators are determined, the recoverable amount of the asset is estimated by management as the higher of an asset’s fair value less costs to sell and its value in use. In making its assessments as to the possibility of impairment losses having arisen, the Group at a minimum considers the indications listed below as forms of an internal and external sources of information:

(i) Internal sources of information:

- Evidence is available of obsolescence or physical damage of the asset;
- Significant changes with an adverse effect on the Group have taken place during the period, or are expected to take place in the near future, in the extent to which, or the manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite; or
- Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

(ii) External sources of information:

- There are observable indications that the asset’s value has declined during the period significantly more than would be expected as a result of the passage of time or normal use. For example, in case with aircraft, external market quotations and recent transactions are reviewed to determine if there has been a decline in market value of specific aircraft models in excess of depreciation recognised over the past year;

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

- Significant changes with an adverse effect on the Group have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the Group operates or in the market to which the asset is dedicated;
- Market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating the asset's value in use and decrease the asset's recoverable amount materially.

If there is an indication that the asset may be impaired, the underlying facts are considered by Management when performing the annual reviews of the useful life of the asset, the depreciation or amortisation method used and the estimated residual value.

There were no impairment indications identified as at 31 December 2019.

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.

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 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 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 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 2019 and AZN 83,285 of such balances were concluded as being doubtful (31 December 2018: AZN 74,787). The main triggering event for such analysis was the change in management's assumptions and estimate on expected settling approach of these balances in the future. 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

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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 2019 and 2018.

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 707,650 and AZN 715,178 as of 31 December 2019 and 2018, 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.

Recoverability of inventory balances

Management assess the recoverability of inventory balances that majorly comprise of spare parts on annual basis. While making such analysis, Management classifies spare parts into several types depending on the nature of spare parts, their intended destination and the expected period of utilisation. Crucial spare parts that have to be kept in stock for maintenance of ongoing flight operations and are expected to be utilised later than 12 months after the reporting period, are reclassified by Management as long-term inventory. These spare parts are not impaired and are kept in good working condition. Hence, no provision is recognised in the consolidated financial statements of the Group in respect of these assets.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

5. TRAFFIC AND OTHER REVENUE

	<u>2019</u>	<u>2018</u>
Scheduled passenger flights	517,644	429,407
Airport and aviation security services	196,434	206,492
Refueling services	121,940	141,790
Air navigation services	68,526	83,386
Charter passenger flights	51,142	41,001
Cargo transportation	14,659	15,418
Other revenue	38,114	37,737
Total traffic and other revenue	<u>1,008,459</u>	<u>955,231</u>

6. OPERATING COSTS

	<u>2019</u>	<u>2018</u>
Fuel expenses	157,050	171,026
Depreciation and amortisation	138,647	134,699
Staff costs	124,493	121,358
Aircraft and other maintenance	95,061	77,262
Ground handling services	74,300	68,009
Commercial services and commission fees	63,929	58,579
Taxes other than income tax	50,094	47,933
Air navigation services outside of Azerbaijan	49,995	47,264
Food and beverages for catering services	41,555	36,874
Foreign airports passenger fees	34,824	29,082
Communication expenses	17,806	14,675
Passenger services	11,524	9,161
Insurance expense	9,066	7,890
Materials expenses	8,625	8,426
Write-off of VAT recoverable balance	8,498	74,787
Business trip expenses	8,481	7,678
Electricity expenses	6,391	6,337
Impairment of advances given	4,523	(506)
Consulting expenses	1,975	1,870
Impairment loss on trade receivables and amounts due from related parties	529	954
Impairment of property and equipment	-	22,767
Other expenses	50,041	40,264
Other income	(7,819)	(8,540)
Total operating costs	<u>949,588</u>	<u>977,849</u>

VAT recoverable balances (not yet receivables because related liabilities remain unpaid) were analysed by management of the Group and AZN 83,285 was concluded as being doubtful as at 31 December 2019 (31 December 2018: AZN 74,787). Accordingly, AZN 8,498 was charged to operating expenses during 2019 as change in provision. The main reason for this was the change in management’s expectation regarding the settlement of related liabilities in the future from gross to net basis, which may preclude the entities within the Group to claim the VAT on such net-settled balances as receivable according to the local legislation.

Management of the Group performed impairment indicators analysis for the aircraft fleet during 2018 and impairment charge of AZN 22,767 was recognised for five aircraft where the carrying amount exceeded the recoverable amount based on fair value less costs to sell. Such indicators were not identified for the year ended 31 December 2019.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

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

7. FINANCE COSTS

	<u>2019</u>	<u>2018</u>
Interest expense on loans and borrowings	91,392	101,951
Interest expense on lease liabilities	<u>19,793</u>	<u>15,401</u>
Total finance costs	<u>111,185</u>	<u>117,352</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 2019 and 2018 arose from cash and cash equivalents and trade receivables.

9. INCOME TAX EXPENSE

	<u>2019</u>	<u>2018</u>
Current tax expense	-	-
Deferred tax expense	<u>19,877</u>	<u>2,483</u>
Total income tax expense	<u>19,877</u>	<u>2,483</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>2019</u>	<u>2018</u>
Loss before income tax	(58,893)	(148,837)
Income tax benefit at statutory tax rate (20%)	(11,779)	(29,767)
Effect of non-deductible expenses	31,245	48,812
Effect of previously unrecognised deferred tax assets	-	(27,678)
Effect of deferred tax expense relating to changes in tax legislation	-	10,694
Effect of unrecognised tax losses and utilisation of tax losses not previously recognised	<u>411</u>	<u>422</u>
Total income tax expense	<u>19,877</u>	<u>2,483</u>

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

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 2018	803,079	957,935	236,782	82,730	20,300	2,100,826
Additions	9,570	128,544	29,166	5,247	5,510	178,037
Disposal of assets	(9,216)	-	(1,699)	(351)	-	(11,266)
Transfer of assets	1,208	-	41	-	(1,249)	-
Balance at 31 December 2018	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
Accumulated depreciation and impairment						
Balance at 1 January 2018	56,337	104,398	50,134	21,452	5,073	237,394
Charge for the year	31,180	64,735	24,509	12,078	-	132,502
Disposal of assets	(66)	-	(274)	(87)	-	(427)
Impairment losses recognised in profit or loss	-	22,767	-	-	-	22,767
Balance at 31 December 2018	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
Net book value						
Balance at 31 December 2018	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

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

The infrastructure is mainly comprised of runways, airport ramps, hangars and terminals for aircraft of the Group.

As at 31 December 2018, the net book value of the property and equipment (aircraft) obtained through finance lease was AZN 372,335.

Capital projects balance as at 31 December 2019 mainly comprised expenditure incurred on construction works performed in respect of Nakhchivan Airport runway of AZN 34,105 and uninstalled equipment for air navigation services of AZN 9,972. Construction of Airspace Efficiency Center was completed during 2019 and AZN 6,238 was transferred to respective property and equipment accounts.

Capital projects balance as at 31 December 2018 mainly comprised expenditure incurred on construction works performed in respect of Airspace Efficiency Center of AZN 6,114 and uninstalled equipment for air navigation services of AZN 4,118.

During 2019 and subsequently in 2020, re-construction works in Nakhchivan International Airport continued (Note 17) and by the end of October 2020 around AZN 30,701 of works were completed and transferred to respective property and equipment accounts.

No items of property and equipment of the Group were pledged as collateral as at 31 December 2019.

11. LEASES (GROUP AS A LESSEE)

Right-of-use assets (aircraft and engines)

	<u>Total</u>
<i>Cost</i>	
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 (Note 3)	12,648
Balance at 31 December 2019	<u><u>457,650</u></u>
<i>Accumulated depreciation and impairment</i>	
Balance at 1 January 2019	-
Transferred from property and equipment	(58,329)
Charge for the year	(21,342)
Balance at 31 December 2019	<u><u>(79,671)</u></u>
<i>Net book value</i>	
Balance at 1 January 2019	-
Balance at 31 December 2019	<u><u>377,979</u></u>

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

The Group leases several assets, which mainly comprise aircraft, engines and other aircraft spare parts. The average lease term is 10 years for aircraft, while for engines and other aircraft spare parts it is 5 years.

The maturity analysis of lease liabilities is presented in Note 19.

12. LONG-TERM ADVANCES GIVEN

	<u>31 December 2019</u>	<u>31 December 2018</u>
Long-term advances given	55,850	25,240
Less: impairment of long-term advances given	<u>(16,664)</u>	<u>(13,514)</u>
Total long-term advances given	<u>39,186</u>	<u>11,726</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.

13. OTHER NON-CURRENT ASSETS

Other non-current assets mainly comprised spare part balances of AZN 27,472 and AZN 31,886 as at 31 December 2019 and 2018, 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 2019</u>	<u>31 December 2018</u>
Spare parts	22,959	19,516
Fuel	<u>4,452</u>	<u>2,931</u>
Less: impairment provision for obsolete consumable spare parts and inventories	<u>(3,588)</u>	<u>(4,837)</u>
Total consumable spare parts and inventories	<u>23,823</u>	<u>17,610</u>

15. TRADE AND OTHER RECEIVABLES

	<u>31 December 2019</u>	<u>31 December 2018</u>
Trade receivables	49,424	35,847
Amounts due from related parties	<u>6,625</u>	<u>5,713</u>
Financial assets	56,049	41,560
Advances given and prepaid expenses	14,516	13,225
VAT recoverable	9,231	6,496
VAT receivable	<u>6,963</u>	<u>4,266</u>
Non-financial assets	30,710	23,987
Total trade and other receivables	<u>86,759</u>	<u>65,547</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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

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

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.

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 2019	Trade receivables – days past due						Total AZN
	Not past due	<30	31-90	91-180	180-360	>360	
	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

31 December 2018	Trade receivables – days past due						Total AZN
	Not past due	<30	31-90	91-180	180-360	>360	
	AZN	AZN	AZN	AZN	AZN	AZN	
Expected credit loss rate	1%	2%	5%	21%	56%	100%	22%
Estimated total gross carrying amount at default	25,401	7,558	2,461	734	1,013	9,655	46,822
Lifetime ECL	(284)	(185)	(125)	(155)	(571)	(9,655)	(10,975)
Total trade receivables							35,847

	<u>31 December 2019</u>	<u>31 December 2018</u>
Balance at the beginning of the year	10,975	10,812
Net remeasurement of loss allowance	1,442	163
Amount recovered	(615)	(876)
Change in loss allowance due to new trade receivables originated net of those derecognised due to settlement	2,057	1,039
Balance at the end of the year	12,417	10,975

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

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

	<u>31 December 2019</u>	<u>31 December 2018</u>
Short-term advances given	12,799	12,684
Less: impairment of short-term advances given	(302)	(264)
Total advances given	<u>12,497</u>	<u>12,420</u>
Prepaid expenses	2,019	805
Total short-term advances given and prepaid expenses	<u>14,516</u>	<u>13,225</u>

16. CASH AND CASH EQUIVALENTS

	<u>31 December 2019</u>	<u>31 December 2018</u>
Cash on bank accounts in US dollars	25,108	23,743
Cash on bank accounts in Euro	6,961	5,955
Cash on bank accounts in other foreign currencies	1,636	104
Cash on bank accounts in AZN	799	1,803
Cash on hand	83	549
Other cash and cash equivalents	372	149
Total cash and cash equivalents	<u>34,959</u>	<u>32,303</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 2019 constituted AZN 823,975 composed of 411,987,235 shares with par value of AZN 2 each (31 December 2018: AZN 823,975 composed of 411,987,235 shares with par value of AZN 2 each).

Shareholder’s contribution

In March and December 2018, the Group received from the government a total contribution of AZN 70,000 for the re-construction of landing and take-off runway (asphalt-concrete, with 30 years life) at Nakhchivan International Airport. Income tax consequence of this transaction amounting AZN 14,000 was also recognised through additional paid-in capital where the Group originally recognised the transaction itself. In addition to above mentioned event, contribution of other assets by shareholder at fair value of AZN 654 was recognised as additional paid-in capital during 2019 (31 December 2018: AZN 209). Subsequent to the reporting period in 2020, the Group received around AZN 279,000 of subsidies as a support from government during pandemic period to continue its operations, pay salaries and make payments for loan agreements obtained under government guarantee (Note 2).

Distribution to shareholder

In April 2019, at government’s instruction, the Group transferred property and equipment at fair value of AZN 13,054, which was treated as distribution to shareholder. In November 2018, at government’s instruction, the Group disbursed AZN 20,000, which was also treated as distribution to shareholder.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

18. LOANS AND BORROWINGS

	<u>Interest rate</u>	<u>31 December 2019 Amount</u>	<u>31 December 2018 Amount</u>
<i>AZN – denominated</i>			
Local banks	Fixed	34,425	31,460
Ministry of Finance of the Republic of Azerbaijan	Fixed	626,068	624,168
Total AZN denominated		660,493	655,628
<i>USD – denominated</i>			
Local banks	Fixed	60,409	93,253
Local banks	Floating	16,321	26,331
Ministry of Finance of the Republic of Azerbaijan	Floating	1,077,899	1,077,899
Total USD denominated		1,154,629	1,197,483
<i>EUR – denominated</i>			
Foreign banks	Fixed	35,598	39,284
Total EUR denominated		35,598	39,284
Accrued interest		227,481	145,224
Total loans and borrowings		2,078,201	2,037,619
Long-term portion of loans and borrowings		1,605,934	1,722,532
Short-term portion of loans and borrowings		472,267	315,087

The effective average interest rate per annum on term loans for AZN, USD and EUR as at 31 December 2019, was 5.3%, 4.5% and 1.2%, respectively (31 December 2018: 5.3%, 4.4% and 1.2%, respectively).

Variable rates for 2019 have been calculated on the basis of USD LIBOR ranging from 2% to 2.2% per annum and also fixed annual interest rates range from 0.75% to 9% for the period.

The Group obtained five new loans from Premium Bank (related party of the Group) in total amount of AZN 20,155 during 2019.

The maturity profile of loans and borrowings is as follows:

	<u>31 December 2019</u>	<u>31 December 2018</u>
Due in one month	236,567	156,053
Due from one month to one year	235,700	159,034
Total current portion of loans and borrowings	472,267	315,087
Due from one year to five years	1,086,376	914,026
Due over five years	519,558	808,506
Total long-term portion of loans and borrowings	1,605,934	1,722,532
Total loans and borrowings	2,078,201	2,037,619

Loan and borrowing agreements do not contain any financial covenant terms.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

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 statement of cash flows as cash flows from financing activities.

31 December 2019

	Cash changes		Non-cash changes		31 December 2019
	Financing cash in-flows (i)	Repayments by the Group	Payments on behalf of the Group (ii)	Effect of transition to IFRS 16	
1 January 2019	39,284	(2,818)	-	-	35,597
Bank loans	1,998,335	(48,134)	(10,010)	-	2,042,604
Loans from related parties	424,379	(51,119)	-	12,648	390,699
Lease liabilities	-	-	-	-	-
Total liabilities from financing activities	2,461,998	(102,071)	(10,010)	12,648	2,468,900

31 December 2018

	Cash changes		Non-cash changes		31 December 2018
	Financing cash in-flows (i)	Repayments by the Group	Payments on behalf of the Group (ii)	Effect of transition to IFRS 16	
1 January 2018	43,975	(2,920)	-	-	39,285
Bank loans	1,958,301	(51,755)	(24,510)	-	1,998,334
Loans from related parties	371,248	(44,656)	(17,000)	111,010	424,379
Lease liabilities	-	-	-	-	-
Total liabilities from financing activities	2,373,524	(99,331)	(41,510)	111,010	2,461,998

- (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 statement of cash flows”.
(iii) Other changes include accruals and payments of interest (net movement) on loans and borrowings and lease liabilities.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

19. LEASE LIABILITIES

	<u>31 December 2019</u>	<u>31 December 2018</u>
Non-current portion of lease liabilities	340,546	379,354
Current portion of lease liabilities	<u>50,153</u>	<u>45,025</u>
Total lease liabilities	<u>390,699</u>	<u>424,379</u>

Reconciliation of future lease payments and their present values:

Maturity analysis:	<u>31 December 2019</u>	<u>31 December 2018</u>
Year 1	75,564	64,005
Year 2	64,623	64,395
Year 3	63,306	64,002
Year 4	63,314	81,112
Year 5	63,318	63,236
Onwards	<u>135,480</u>	<u>176,946</u>
Less: unearned interest	<u>(74,906)</u>	<u>(89,317)</u>
Total	<u>390,699</u>	<u>424,379</u>
Analysed as:		
Current	50,153	45,025
Non-current	<u>340,546</u>	<u>379,354</u>
Total	<u>390,699</u>	<u>424,379</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 (Note 3). The Group did not contract any new lease agreements during 2019.

In 2018, the Group obtained two new Embraer 190 BHH through finance lease in total amount of AZN 111,010.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

20. DEFERRED REVENUE RELATED TO FFP AND 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>31 December 2019</u>	<u>31 December 2018</u>
Unearned revenue balance brought forward	31,308	23,768
Additions during the year	626,164	553,639
Recognised as revenue during the year	<u>(610,588)</u>	<u>(546,099)</u>
Unearned revenue balance carried forward	<u>46,884</u>	<u>31,308</u>

The change in the amount of obligations for tickets sold but unused compared with 2018 was due to the growth in the volume of services rendered. Unearned revenue recognised as at 31 December 2019 is expected to be released to revenue within next 12 months during 2020.

	<u>31 December 2019</u>	<u>31 December 2018</u>
Deferred revenue, current portion	5,193	6,546
Deferred revenue, non-current portion	<u>22,932</u>	<u>32,203</u>
Total deferred revenue related to FFP	<u>28,125</u>	<u>38,749</u>

Revenue 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 will be provided in the future to the FFP participant.

	<u>31 December 2019</u>	<u>31 December 2018</u>
Deferred revenue balance brought forward	38,749	35,289
Accrual during the year	12,008	12,540
Redemption during the year	(11,361)	(9,080)
Actual expiry during the year	<u>(11,271)</u>	<u>-</u>
Deferred revenue balance carried forward	<u>28,125</u>	<u>38,749</u>

The reasons for the change in obligations under the passenger bonuses program are the increase in the rate of accumulation of bonus miles due to the increase in participants and the increase in the volume of services rendered for the carriage of passengers due to the continued development of services. The accumulation of bonus miles is partially offset by their use for similar reasons, or expiration. Non-current portion of deferred revenue recognised as at 31 December 2019 is expected to be released to revenue within next three years (maximum period of expiration).

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

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 2019	Effect of IFRS 16 reclassification and transition	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)
Unrecognised deferred tax asset	-	-	-	-
Total	(16,483)	-	(19,877)	(36,360)

	1 January 2018	Recognised in profit or loss	Recognised in equity	31 December 2018
Property and equipment	6,507	(38,814)	-	(32,307)
Intangible assets	(160)	-	-	(160)
Trade and other receivables	10,461	(6,330)	-	4,131
Consumable spare parts and inventories	4,971	(4,355)	-	616
Cash and cash equivalents	-	119	-	119
Lease liabilities	148	716	-	864
Trade and other payables	2,830	394	-	3,224
Deferred revenue	7,058	693	-	7,751
Other current liabilities	(1,059)	338	-	(721)
Unrecognised deferred tax asset	(30,756)	44,756	(14,000)	-
Total	-	(2,483)	(14,000)	(16,483)

22. TRADE AND OTHER PAYABLES

	31 December 2019	31 December 2018
Trade and other payables	122,643	73,324
Staff related payables	14,361	14,705
Amounts due to related parties	8,060	5,054
Financial liabilities	145,064	93,083
Advances received	11,339	10,911
Other taxes payable	10,863	8,277
Non-financial liabilities	22,202	19,188
Total trade and other payables	167,266	112,271

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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 2019, staff related liabilities primarily include salaries payables of AZN 6,675 (31 December 2018: AZN 6,258) and the unused vacation accrual of AZN 7,686 (31 December 2018: AZN 8,447).

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

Other taxes payable mainly represents liabilities arising from land, personal income, social and withholding taxes. As at 31 December 2019, it mainly comprised social tax of AZN 2,183, tax on fuel export of AZN 1,244 and other taxes 7,259 after settling tax payables with VAT receivable (Note 14). As at 31 December 2018, other taxes payable mainly comprised social tax of AZN 2,049, tax on fuel export of AZN 1,617 and other taxes 4,577 after settling tax payables with VAT receivable.

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

23. OTHER CURRENT LIABILITIES

Other liabilities are comprised of payables to government, deposits received and insurance payables of the Group. Insurance payables were AZN 8,671 and AZN 3,782 as at 31 December 2019 and 31 December 2018, respectively. The payable to government represents liability arising from funds received from government for special projects. As at 31 December 2019, the amount was AZN 36,614 due to government, while as at 31 December 2018 amount of AZN 1,147 was due from government. Deposits received balances from international sales representatives were AZN 1,429 and AZN 1,242 as at 31 December 2019 and 31 December 2018, respectively. The Group has also recognised other provision of AZN 4,325 in 2019 for payments it is liable to make under one of its contracts within next 12 months after the reporting period.

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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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 26,241 or 42% of trade receivables as at 31 December 2019 (31 December 2018: AZN 16,712 or 36%).

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 15,160 or 25% of trade receivables as at 31 December 2019 (31 December 2018: AZN 16,312 or 35%). 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.

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 2019	31 December 2018
Amounts due from related parties	8,858	8,868
Trade receivables	61,841	46,822
Cash and cash equivalents	34,959	32,303
Total	105,658	87,993

Cash and bank balances are mainly held in one local bank in the amount of AZN 28,334 and AZN 21,553 as at 31 December 2019 and 31 December 2018, 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).

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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 2019 and 31 December 2018 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 period that is based on changes in LIBOR rates during the past 12 months.

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

	Profit or (loss) / Equity	
	31 December 2019	31 December 2018
Three-month USD LIBOR 30 basis points increase (2018: 20 basis points increase)	(2,597)	(1,656)
One-month USD LIBOR 10 basis points increase (2018: 20 basis points increase)	(16)	(53)
Cash flow sensitivity	(2,613)	(1,709)

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.

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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

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
Loans and borrowings	761,988	1,280,615	35,598	-	2,078,201
Lease liabilities	-	390,699	-	-	390,699
Total financial liabilities	884,606	1,674,936	38,361	1,700	2,599,603
Open position	(864,998)	(1,630,430)	(27,135)	13,968	(2,508,595)

31 December 2018	AZN	USD	EUR	Other	Total
Trade receivables	19,199	11,675	4,267	706	35,847
Amounts due from related parties	5,713	-	-	-	5,713
Cash and cash equivalents	1,803	23,743	5,955	802	32,303
Total financial assets	26,715	35,418	10,222	1,508	73,863
Trade and other payables	36,756	22,651	10,151	3,766	73,324
Amounts due to related parties	5,054	-	-	-	5,054
Loans and borrowings	724,493	1,273,842	39,284	-	2,037,619
Lease liabilities	-	424,379	-	-	424,379
Total financial liabilities	766,303	1,720,872	49,435	3,766	2,540,376
Open position	(739,588)	(1,685,454)	(39,213)	(2,258)	(2,466,513)

Sensitivity analysis

A weakening of the AZN, as indicated below, against the above-indicated currencies as at 31 December 2019 and 31 December 2018 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 2019	USD	EUR	Other	Total
10% weakening of AZN	(163,043)	(2,714)	1,397	(164,360)
31 December 2018	USD	EUR	Other	Total
10% weakening of AZN	(168,545)	(3,921)	(226)	(172,692)

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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019
(in thousands of Azerbaijan Manat)**

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 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

	31 December 2018			
	Within one year	1 to 5 years	Over 5 years	Total
Lease liabilities	67,733	255,451	194,844	518,028
Loans and borrowings	498,509	1,219,284	880,478	2,598,271
Trade and other payables	73,324	-	-	73,324
Amounts due to related parties	5,054	-	-	5,054
Staff related payables	14,705	-	-	14,705
Total financial liabilities	659,325	1,474,735	1,075,322	3,209,382

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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, which are classified within Level 2 category of the above hierarchy, approximates their carrying amounts. 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 4,224. 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 2019</u>	<u>31 December 2018</u>
Fixed payments	5,818	4,868
Variable payments	2,826	1,641
Total payments	<u>8,644</u>	<u>6,509</u>

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

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 Azerbaijan Republic 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.

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (in thousands of Azerbaijan Manat)

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.

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 financial statements since dropping more than 40% in March 2020, the risk that the AZN may weaken against major currencies remains.

In addition to that, starting from early 2020 a new coronavirus disease (COVID-19) has begun rapidly spreading all over the world resulting in announcement of the pandemic status by the World Health Organization in March 2020. First identified in late 2019 and known now as COVID-19, the outbreak has impacted thousands of individuals worldwide. Responses put in place by many countries to contain the spread of COVID-19 are resulting in significant operational disruption for many companies and have significant impact on global financial markets. As the situation is rapidly evolving it may have a significant effect on business of many companies across a wide range of sectors, including, but not limited to such impacts as disruption of business operations as a result of interruption of production or closure of facilities, supply chain disruptions, quarantines of personnel, reduced demand and difficulties in raising financing. In response, many countries including Azerbaijan have implemented measures to combat the outbreak, which have impacted business operations. The significance of the effect of COVID-19 on the Group's business largely depends on the duration and the incidence of the pandemic effects on the world and Azerbaijani economy.

As of the date of issuance of these consolidated financial statements, the Group's operations have been significantly impacted by these events after the reporting period because starting from the March 2020 the Group 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. 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 are challenging to be predicted. The Group expects demand to remain suppressed until a widely accepted treatment and/or vaccine for COVID-19 becomes widely available. In addition, the Group does not expect the recovery from COVID-19 to follow a linear path. Accordingly, the results of operations for full-year 2020 were also materially impacted. Group revenue (unaudited) for 2020 comprised AZN 318,621 (2019: AZN 1,008,459).

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

(in thousands of Azerbaijan Manat)

The Nagorno-Karabakh conflict is a territorial conflict between Armenia and Azerbaijan. There was a recent escalation of this long-standing conflict in September 2020. As of the date of issuance of these consolidated financial statements, the Group’s operations have been significantly impacted by these events after the reporting period (Note 2).

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.

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 420 for the year ended 31 December 2019 (31 December 2018: AZN 537) in the form of short-term employee benefits.

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

		Year ended 31 December 2019	
	Notes	Related party transactions	Total per category
Traffic and other revenue <i>- entities under common control</i>	5	5,878	1,008,459
Operating costs <i>- entities under common control</i>	6	126,554	949,588
Finance cost <i>- entities under common control and other related parties</i>	7	91,277	111,185

“AZERBAIJAN AIRLINES” CLOSED JOINT STOCK COMPANY

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019**

(in thousands of Azerbaijan Manat)

	Notes	Year ended 31 December 2018	
		Related party transactions	Total per category
Traffic and other revenue	5		955,231
- <i>entities under common control</i>		4,785	
Operating costs	6		977,849
- <i>entities under common control</i>		156,659	
Finance cost	7		117,352
- <i>entities under common control and other related parties</i>		101,436	

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

	Notes	31 December 2019		31 December 2018	
		Related party balances	Total per category	Related party balances	Total per category
Cash and cash equivalents	16		34,959		32,303
- <i>entities under common control</i>		34,876		24,827	
Trade and other receivables	14		86,759		65,547
- <i>entities under common control</i>		6,625		5,713	
Trade and other payables	22		167,266		112,271
- <i>entities under common control</i>		8,060		5,054	
Loans and borrowings	18		2,078,201		2,037,619
- <i>shareholder and other related parties</i>		2,042,662		1,998,335	
Other current liabilities	23		51,226		6,243
- <i>entities under common control and other related parties</i>		45,285		4,929	