JSC Credo Bank

Financial statements

Year ended 31 December 2017
together with independent auditor's report

Contents

Independent auditor’s report

Statement of financial position 1
Statement of profit and loss and other comprehensive income 2
Statement of changes in equity 3
Statement of cash flows 4

Notes to the financial statements

1. Principal activities 5
2. Basis of preparation 5
3. Summary of accounting policies 6
4. Significant accounting judgments and estimates 14
5. Cash and cash equivalents 15
6. Amounts due from credit institutions 15
7. Derivative financial instruments 15
8. Loans to customers 16
9. Property and equipment 18
10. Intangible assets 19
11. Taxation 19
12. Other financial assets 21
13. Other non-financial assets 21
14. Loans from banks and other financial institutions and subordinated loans 22
15. Changes in liabilities arising from financing activities 22
16. Other liabilities 22
17. Equity 23
18. Commitments and contingencies 23
19. Fee and commission income 24
20. Fee and commission expense 24
21. Net gains/(losses) from foreign currencies 24
22. Other operating income 25
23. Personnel expenses 25
24. Other general administrative expenses 25
25. Risk management 26
26. Fair value measurements 30
27. Related party disclosures 32
28. Capital adequacy 33

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Independent auditor's report

To the Shareholders and the Supervisory Board of JSC Credo Bank

Opinion

We have audited the financial statements of JSC Credo Bank (the Company) which comprise the statement of financial position as at 31 December 2017, and the statement of profit and loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2017 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

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

Responsibilities of management and Audit Committee for the financial statements

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

In preparing the financial statements, management is responsible for assessing the Company'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 Company or to cease operations, or has no realistic alternative but to do so.

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

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an 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 financial statements.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company'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 Company'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 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 Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

Ruslan Khoroshvili

On behalf of EY Georgia LLC

Tbilisi, Georgia

18 April 2018

Statement of financial position

As at 31 December 2017

(Thousands of Georgian Lari)

	Note	*2017*	*2016*
Assets			
Cash and cash equivalents	5	52,785	67,815
Amounts due from credit institutions	6	19,752	–
Derivative financial assets	7	3,717	12,415
Loans to customers	8	514,476	443,429
Property and equipment	9	7,429	7,155
Intangible assets	10	3,741	3,152
Current income tax asset		2,967	–
Deferred income tax assets	11	578	2,547
Other financial assets	12	4,878	5,115
Other non-financial assets	13	4,369	2,362
Total assets		**614,692**	**543,990**
Liabilities			
Derivative financial liabilities	7	610	–
Promissory notes issued		–	578
Loans from banks and other financial institutions	14	476,100	410,546
Current income tax liabilities		–	568
Other financial liabilities	16	9,092	8,541
Subordinated debt	14	8,420	8,418
Total liabilities		**494,222**	**428,651**
Equity			
Share capital	17	4,400	4,400
Retained earnings		116,070	110,939
Total equity		**120,470**	**115,339**
Total liabilities and equity		**614,692**	**543,990**

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

Zaal Pirtskhelava Chief Executive Officer

Irakli Zatiashvili Chief Financial Officer

18 April 2018

The accompanying selected explanatory notes on pages 5 to 34 are an integral part of these financial statements.

Statement of profit and loss and other comprehensive income

For the year ended 31 December 2017

(Thousands of Georgian Lari)

	Note	*2017*	*2016*
Interest income			
Loans to customers		128,467	125,224
Cash and balances with banks		1,820	2,344
		130,287	**127,568**
Interest expense			
Loans from banks and other financial institutions		(38,804)	(30,464)
Subordinated loans		(893)	(893)
Promissory notes issued		(40)	(32)
		(39,737)	**(31,389)**
Net interest income		**90,550**	**96,179**
Impairment charge for loan losses	8	(9,680)	(9,689)
Net interest income after allowance for impairment		**80,870**	**86,490**
Fee and commission income	19	20,115	18,285
Fee and commission expense	20	(4,521)	(5,074)
Net fee and commission income		**15,594**	**13,211**
Net losses from foreign currencies	21	(2,168)	(2,472)
Other operating income	22	561	1,198
Other operating expense		(991)	(149)
Net non-interest income		**12,996**	**11,788**
Personnel expenses	23	(48,440)	(46,522)
Depreciation and amortization	9,10	(3,346)	(3,276)
Other general administrative expenses	24	(19,982)	(18,501)
Non-interest expenses		**(71,768)**	**(68,299)**
Profit before income tax expense		**22,098**	**29,979**
Income tax expense	11	(1,967)	(3,760)
Profit for the period		**20,131**	**26,219**
Other comprehensive income		–	–
Total comprehensive income for the year		**20,131**	**26,219**

The accompanying selected explanatory notes on pages 5 to 34 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December 2017

(Thousands of Georgian Lari)

	Share capital	***Retained earnings***	***Total equity***
31 December 2015	**4,400**	**84,720**	**89,120**
Total comprehensive income for the period	**–**	26,219	**26,219**
31 December 2016	**4,400**	**110,939**	**115,339**
Total comprehensive income for the period	**–**	20,131	**20,131**
Dividends (Note 17)	**–**	(15,000)	**(15,000)**
31 December 2017	**4,400**	**116,070**	**120,470**

The accompanying selected explanatory notes on pages 5 to 34 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2017

(Thousands of Georgian Lari)

	Note	*2017*	*2016*
Cash flows from operating activities			
Interest received		129,335	129,149
Interest paid		(38,063)	(30,252)
Fees and commissions received		20,264	17,908
Fees and commissions paid		(4,521)	(5,074)
Realized gains from dealing in foreign currencies		337	2,122
Other income received		269	792
Other expense paid		(375)	(77)
Personnel expenses paid		(48,859)	(45,733)
Other operating expenses paid		(21,365)	(17,858)
Cash flows from operating activities before changes in operating assets and liabilities		**37,022**	**50,977**
Net (increase)/decrease in operating assets			
Derivative financial assets		3,705	439
Amounts due from credit institutions		(17,970)	–
Loans to customers		(85,447)	(33,090)
Other financial assets		(1,289)	(1,025)
Net increase/(decrease) in operating liabilities			
Other financial liabilities		1,449	1,022
Promissory notes issued		(550)	550
Net cash flows (used in)/ from operating activities before income tax		**(63,080)**	**18,873**
Income tax paid		(3,535)	(5,114)
Net cash from (used in) operating activities		**(66,615)**	**13,759**
Cash flows used in investing activities			
Purchase of property, equipment and intangible assets		(4,208)	(4,532)
Proceeds from sale of property and equipment		67	–
Net cash used in investing activities		**(4,141)**	**(4,532)**
Cash flows from financing activities			
Proceeds from borrowings and subordinated loans	14	243,341	145,384
Repayment of borrowings and subordinated loans	14	(170,100)	(137,784)
Dividends paid	17	(15,000)	–
Net cash from financing activities		**58,241**	**7,600**
Net (decrease)/ increase in cash and cash equivalents		**(12,515)**	**16,827**
Effect of exchange rates changes on cash and cash equivalents	5	(2,515)	6,886
Cash and cash equivalents, beginning	5	67,815	44,102
Cash and cash equivalents, ending		**52,785**	**67,815**

The accompanying selected explanatory notes on pages 5 to 34 are an integral part of these financial statements.

(thousands of Georgian Lari)

1. Principal activities

Organization and operations

JSC Credo Bank (former Microfinance Organization Credo JSC) (the "Bank") was established in 2007 to provide sustainable lending services to those individual entrepreneurs who are not able to access credit facilities through the conventional banking system. The Bank supports the development of the private economy of Georgia by providing credit and related services to micro, small and medium-sized entrepreneurs and companies. On 20 March 2017 the Bank received banking license from the National Bank of Georgia (the "NBG").

These financial statements have not yet been approved by the Parent on the general meeting of shareholders of the Bank. The shareholders have the power and authority to amend the financial statements after the issuance.

Shareholders

Shareholding structure of the Bank as at 31 December 2017 and 2016 was as follows:

Shareholder	***Ownership %***
Joint Stock Company Access Microfinance Holding AG	60.20%
Triodos SICAV II (Triodos Microfinance Fund)	9.90%
Triodos Custody B.V., Triodos Fair Share Fund	9.90%
ResponsAbility Participations AG	9.34%
ResponsAbility SICAV (Lux) − responsAbility SICAV (Lux) Microfinance Leaders Fund	1.87%
ResponsAbility Management Company S.A., responsAbility Global Microfinance Fund	8.79%

Ownership, voting and dividend rights among shareholders are allocated in proportion to their ordinary shares held in the Bank.

As at 31 December 2017 and 2016 the Bank's parent and ultimate controlling party with 60.2% of the voting rights is Joint Stock Company Access Microfinance Holding AG, Germany.

The supreme governing body of the Bank is the General Meeting of Shareholders. The supervision of the Bank's operations is conducted by the Supervisory Board, members of which are appointed by the General Meeting of Shareholders. Daily management of the Bank is carried out by the Management Board appointed by the Supervisory Board. The legal address of the Bank is 27, Revaz Tabukashvili Street, Tbilisi, Georgia.

Business environment

The Bank's operations are located in Georgia. Consequently, the Bank is exposed to the economic and financial markets of Georgia which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in Georgia. The financial statements reflect management's assessment of the impact of Georgian business environment on the operations and the financial position of the Bank. The future business environment may differ from management's assessment.

2. Basis of preparation

General

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

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. Derivative financial instruments have been measured at fair value.

Bank's functional and presentation currency is the Georgian Lari (GEL). Financial information is presented in GEL rounded to the nearest thousands, unless otherwise indicated.

(thousands of Georgian Lari)

3. Summary of accounting policies

Changes in accounting policies

The Bank applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2017. The Bank has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective. The nature and the impact of each amendment is described below:

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

The amendments require entities to provide disclosure of changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). The Bank has provided the information for both the current and the comparative period in Note 14.

No other new or revised IFRS that became effective during the reporting period had any impact on the Bank's financial position or performance.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, call deposits, amounts due from the National Bank of Georgia, excluding mandatory reserves, unrestricted current accounts and short-term deposits held with banks, with maturities of three months or less from the origination date that are subject to insignificant risk of changes in their fair value.

Mandatory reserve deposit with the NBG

Mandatory reserve deposits with the NBG are carried at amortised cost and represent interest bearing assets. The Bank's ability to withdraw these deposits is restricted by the regulation and hence they are not considered as part of cash and cash equivalents for the purposes of the statement of cash flows. Mandatory reserve is presented within amounts due from credit institutions in the statement of financial position.

Fair value measurement

The Bank measures financial instruments, such as derivatives, at fair value at each balance sheet date.

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

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

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

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

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

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

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Financial assets

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

All regular way purchases and sales of financial assets are recognized on the settlement date. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss

Derivatives are included in the category “financial assets at fair value through profit or loss” and are classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognized in profit or loss.

All trading derivatives in a net receivable position (positive fair value), as well as options purchased, are reported as assets. All trading derivatives in a net payable position (negative fair value), as well as options written, are reported as liabilities.

Management determines the appropriate classification of financial instruments at the time of the initial recognition. The Bank classifies non-derivative financial assets into loans and receivables category, which consists of loans to customers and cash and cash equivalents. The Bank classifies non-derivative financial liabilities into the other financial liabilities category. Other financial liabilities comprise loans and borrowings and other payables.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the Bank:

- Intends to sell immediately or in the near term;
- Upon initial recognition designates as at fair value through profit or loss;
- Upon initial recognition designates as available-for-sale; or
- May not recover substantially all of its initial investment, other than because of credit deterioration.

Measurement of financial instruments at initial recognition

When financial instruments are recognized initially, they are measured at fair value, adjusted, in the case of instruments not at fair value through profit or loss, for directly attributable fees and costs.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Bank determines that the fair value at initial recognition differs from the transaction price, then:

- The fair value is evidenced by a quoted price in an active market for an identical asset or liability or based on a valuation technique that uses only data from observable markets, the Bank recognizes the difference;
- In all other cases, the initial measurement of the financial instrument is adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the Bank recognizes that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

Amortized cost

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortized based on the effective interest rate of the instrument.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Gains and losses on subsequent measurement

A gain or loss on a financial instrument classified as at fair value through profit or loss is recognized in profit or loss.

For financial assets and liabilities carried at amortized cost, a gain or loss is recognized in profit or loss when the financial asset or liability is derecognized or impaired, and through the amortization process.

Derecognition

The Bank derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualify for de recognition that is created or retained by the Bank is recognized as a separate asset or liability in the statement of financial position. The Bank derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

The Bank writes off assets deemed to be uncollectible, usually after 180 days past due.

Derivative financial instruments

In the normal course of business, the Bank enters into various derivative financial instruments including foreign currency forwards and cross currency swaps (back to back loans) in the foreign exchange and capital markets. The counterparties are mostly local banks.

The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of profit or loss within net gains/ (losses) from foreign currencies.

Although the Bank has derivative instruments for risk hedging purposes, these instruments do not qualify for hedge accounting.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. The right of set-off must not be contingent on a future event and must be legally enforceable in all of the following circumstances:

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

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

Impairment of financial assets

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Loans to customers

For amounts due from credit institutions and loans to customers, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred).

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in profit or loss. Interest income continues to be accrued on the outstanding principal based on the original effective interest rate of the asset.

Loans together with the associated allowance are usually written off when the respective loan becomes overdue for more than 180 days.

If a future write-off is later recovered, the recovery is credited to the statement of profit or loss.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers past-due status.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as payment status, or other factors that are indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Derecognition of financial assets and liabilities

Financial assets

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

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

Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

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

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Borrowings are included in Loans from banks and other financial institutions and Subordinated loans and represent amounts due to the local banks, foreign financial institutions and international financial institutions. After initial recognition, borrowings are subsequently measured at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the borrowings are derecognized as well as through the amortization process.

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

Leases

Operating – Bank as lessee

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognized as expenses on a straight-line basis over the lease term and included into other general administrative expenses.

Taxation

The current income tax expense is calculated in accordance with the regulations of the Georgian tax code.

Income tax comprises current and deferred tax. Income tax is recognized in profit or loss except to the extent that it relates to items of other comprehensive income or transactions with shareholder recognized directly in equity, in which case it is recognized within other comprehensive income or directly within equity.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the asset and liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes.

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

Property and equipment

Property and equipment is carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

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

	Years
Buildings	20
Leasehold improvements	2
Furniture, fixtures and equipment	2-5
IT and computer equipment	5
Motor vehicles	10

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

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

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Intangible assets

Intangible assets include licenses, core banking software and other software. Licenses represent rights of usage of various software. Core banking software represents cost of accounting and loan portfolio management software. Other software includes internally developed software and other purchased software.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic lives of 2 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end.

In 2017, the Bank revised useful lives for certain intangible assets from 5 to 10 years, resulting in decrease of mortization expense for 2017 by GEL 225.

Provisions

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

Share capital

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

Dividends

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

Contingencies

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

Recognition of income and expenses

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

Interest and similar income and expense

For all financial instruments measured at amortized cost, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability.

The calculation takes into account all contractual terms of the financial instrument (for example prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original effective interest rate applied to the new carrying amount.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Fee and commission income

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

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

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

Fee income from providing transaction services

Fees arising from separate transactions done by customer – are recognized on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognized after fulfilling the corresponding criteria.

Foreign currency translation

The financial statements are presented in Georgian Lari, which is the Bank's functional currency.

Transactions in foreign currencies are recorded in the foreign currency and same time in functional currency converted at the rate of transaction date exchange rate of National Bank of Georgia.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency exchange rate existing at the reporting date.

Gains and losses resulting from the translation of foreign currency transactions are recognized in the statement of profit or loss within net gains/(losses) from foreign currencies.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the National Bank of Georgia exchange rate on the date of the transaction are included in Net gains/losses from foreign currencies.

The official National Bank of Georgia exchange rates at 31 December 2017 and 31 December 2016 were 2.5922 GEL and 2.6468 GEL to 1 USD, respectively.

Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective.

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018. Except for hedge accounting, retrospective application is required but restating comparative information is not compulsory.

The Bank plans to adopt the new standard by recognizing the cumulative transition effect in opening retained earnings on 1 January 2018 and will not restate comparative information.

The Bank is in the process of quantifying the effect of adoption of IFRS 9, however no reasonable and reliable estimate of this effect is yet available.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

(a) Classification and measurement

Under IFRS 9, all debt financial assets that do not meet a “solely payment of principal and interest” (SPPI) criterion, are classified at initial recognition as fair value through profit or loss (FVPL). Under this criterion, debt instruments that do not correspond to a “basic lending arrangement”, such as instruments containing embedded conversion options or “non-recourse” loans, are measured at FVPL. For debt financial assets that meet the SPPI criterion, classification at initial recognition is determined based on the business model, under which these instruments are managed:

- Instruments that are managed on a “hold to collect” basis are measured at amortized cost;
- Instruments that are managed on a “hold to collect and for sale” basis are measured at fair value through other comprehensive income (FVOCI);
- Instruments that are managed on other basis, including trading financial assets, will be measured at FVPL.

Equity financial assets are required to be classified at initial recognition as FVPL unless an irrevocable designation is made to classify the instrument as FVOCI. For equity investments classified as FVOCI, all realized and unrealized gains and losses, except for dividend income, are recognized in other comprehensive income with no subsequent reclassification to profit and loss.

The classification and measurement of financial liabilities remain largely unchanged from the current IAS 39 requirements. Derivatives will continue to be measured at FVPL.

The Bank expects to continue measuring most of the financial assets currently classified as loans and receivables at amortised cost.

The Bank initiated IFRS 9 implementation project and contracted an external consultant to develop provisioning methodology under IFRS 9.

(b) Impairment

IFRS 9 requires the Bank to record an allowance for expected credit losses (ECL) on all of its debt financial assets at amortised cost or FVOCI, as well as loan commitments and financial guarantees. The allowance is based on the ECL associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case the allowance is based on the ECL over the life of the asset. If the financial asset meets the definition of purchased or originated credit impaired, the allowance is based on the change in the lifetime ECL.

According to the new model for the recognition of impairment losses, introduced by IFRS 9, there is “three stage” approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired. Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL.

IFRS 15 Revenue from Contracts with Customers

IFRS 15, issued in May 2014, and amended in April 2016, will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. The Bank plans to adopt the new standard using the modified retrospective method by recognizing the cumulative transition effect in opening retained earnings on 1 January 2018, without restating comparative information.

IFRS 15 establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. However, interest and fee income integral to financial instruments and leases will fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (IFRS 9 and IFRS 16 *Leases*). As a result, the majority of the Bank’s income will not be impacted by the adoption of this standard.

The Bank is currently assessing the impact of IFRS 15.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement Contains a Lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of ’low-value’ assets and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today’s accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard’s transition provisions permit certain reliefs. In 2018, the Bank will continue to assess the potential effect of IFRS 16 on its financial statements.

4. Significant accounting judgments and estimates

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses.

Estimation uncertainty

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

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Please refer to Note 26.

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its experienced judgment to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data on similar borrowers.

Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

(thousands of Georgian Lari)

4. Significant accounting judgments and estimates (continued)

Estimation uncertainty (continued)

Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its experienced judgment to adjust observable data for a group of loans or receivables to reflect current circumstances. Please refer to Note 8 for the amounts of the allowance for loan impairment recognized as at 31 December 2017.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2017	*2016*
Cash on hand	19,395	7,316
Current accounts with the NBG	4,154	–
Current accounts with other credit institutions	15,036	23,497
Time deposits with credit institutions up to 90 days	14,200	37,002
Cash and cash equivalents	**52,785**	**67,815**

None of cash and cash equivalents are impaired or past due. Most of current accounts are placed with BB- rated banks as at 31 December 2017 and 2016. As at 31 December 2017, current accounts and time deposits with credit institutions denominated in GEL and USD represent 55.30% and 40.88% of total current and time deposits, respectively (31 December 2016: GEL 23.87%, USD 10.83%).

6. Amounts due from credit institutions

Amounts due from credit institutions comprise mandatory reserve with the NBG in amount of GEL 19,752. Starting from 20 March 2017 the Bank is required to maintain a mandatory interest earning cash deposit with the NBG at the level of 7% and 20% of the average of funds attracted from customers and non-resident financial institutions for the appropriate two-week period in GEL and foreign currencies, respectively. The Bank earns up to 1.25% per annum on that deposit.

7. Derivative financial instruments

The Bank enters into derivative financial instruments to mitigate currency risk (Note 24). The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of the credit risk.

	2017			*2016*		
	Notional amount	*Fair values*		*Notional amount*	*Fair value*	
		Asset	*Liability*		*Asset*	*Liability*
Foreign currency contracts						
Cross-currency swaps – domestic	43,490	3,717	24	96,943	12,415	–
Cross-currency swaps – foreign	13,528	–	586	–	–	–
Total derivative assets/liabilities		**3,717**	**610**		**12,415**	**–**

Domestic contracts are concluded with Georgian and foreign with non-Georgian entities.

(thousands of Georgian Lari)

7. Derivative financial instruments (continued)

As of 31 December 2017 and 2016, the Bank has positions in the following types of derivatives:

Swaps

Swaps are contractual agreements between two parties to exchange movements in interest and foreign currency rates on specified notional amounts.

The Bank also aggregates non-derivative transactions of back to back loans from banks guaranteed by foreign currency deposits placed at the same banks as derivative instruments (foreign currency contracts), due to the fact that the transactions (placement of deposit and taking of loan) result, in substance, in a derivative. The conclusion is based on the following indicators:

- They are entered into at the same time and in contemplation of one another;
- They have the same counterparty;
- They relate to the same risk;
- There is no apparent economic need or substantive business purpose for structuring the transactions separately that could not also have been accomplished in a single transaction;
- There is an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and future settlement.

8. Loans to customers

Loans to customers' breakdown per components was as follows:

	2017	*2016*
Agro Loans	297,773	272,854
Urban Loans	184,036	164,991
Tourism Loans	17,439	10,657
Other	23,421	5,001
Gross loans to customers	**522,669**	**453,505**
Less: allowance for impairment	(8,193)	(10,076)
Loans to customers	**514,476**	**443,429**

Allowance for impairment of loans to customers

Movements in impairment allowance for loans to customers for the year ended 31 December were as follows:

	2017	*2016*
1 January	**10,076**	**6,889**
Charge for the year − collective impairment	9,680	9,689
Recoveries of written-off loans	4,503	1,656
Amounts written off	(16,066)	(8,158)
31 December	**8,193**	**10,076**

Management estimates loan impairment for loans to customers based on its past historical loss experience. The objective evidence of impairment used by management in determining the impairment losses for loans to customers include overdue payments under the loan agreement, significant difficulties in the financial position of the borrower, deterioration in the business environment and negative changes in borrower's market.

Individually impaired loans

The Bank considers loan with outstanding balance of over EUR 30 as individually significant. None of individually significant loans were impaired as at 31 December 2017.

(thousands of Georgian Lari)

8. Loans to customers (continued)

Credit quality of the loan portfolio

The following table provides information on the credit quality of loans to customers as at 31 December 2017:

	Gross loans	*Impairment allowance*	*Net loans*	*Impairment to gross loans %*
Neither past due nor impaired loans	515,055	(4,120)	510,935	0.8%
Impaired loans:				
- overdue less than 90 days	4,471	(2,187)	2,284	48.9%
- overdue more than 90 days and less than 1 year	3,143	(1,886)	1,257	60.0%
Total	**522,669**	**(8,193)**	**514,476**	1.6%

The following table provides information on the credit quality of loans to customers as at 31 December 2016:

	Gross loans	*Impairment allowance*	*Net loans*	*Impairment to gross loans %*
Neither past due nor impaired loans	443,239	(4,130)	439,109	0.9%
Impaired loans:				
- overdue less than 90 days	4,718	(2,075)	2,643	44.0%
- overdue more than 90 days and less than 1 year	5,548	(3,871)	1,677	69.8%
Total	**453,505**	**(10,076)**	**443,429**	2.2%

The Bank does not have an internal credit rating system to evaluate credit quality of past due but not impaired loans.

Gross carrying value of renegotiated loans to customers that would have been otherwise considered past due or impaired comprised GEL 7,455 as of 31 December 2017 (2016: GEL 6,249).

Collateral and other credit enhancements

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

The loans with value of over USD 10 thousand are collateralised. The main types of collateral are land and other real estate, vehicles and gold.

As at 31 December 2017, gross carrying value of collateralized loans amounted GEL 77,069 (2016: 81,417) that represents 15% (2016: 18%) of total loans to customers. This amount represent the carrying value of the loans, and do not necessarily represent the fair value of the collateral.

All loans are covered by customer life insurance.

Industry and geographical analysis of the loan portfolio

Loans to customers were issued to customers located within Georgia who operate in the following economic sectors:

	2017	*2016*
Agriculture	273,555	256,768
Trade	103,074	96,914
Service	66,259	49,306
Consumer	55,077	29,407
Manufacturing	14,885	17,938
Transportation	9,723	2,933
Household	96	239
	522,669	**453,505**
Loan loss allowance	(8,193)	(10,076)
Net loans to customers	**514,476**	**443,429**

(thousands of Georgian Lari)

9. Property and equipment

The movements in property and equipment were as follows in 2017:

	Land and buildings (including leasehold improvement)	*Furniture, fixtures and equipment*	*Motor vehicles*	*IT and computer equipment*	*Total*
Cost					
31 December 2016	**929**	**6,364**	**2,516**	**4,656**	**14,465**
Additions	248	1,470	575	875	**3,168**
Disposals	−	(607)	(100)	(148)	**(855)**
31 December 2017	**1,177**	**7,227**	**2,991**	**5,383**	**16,778**
Accumulated depreciation					
31 December 2016	**(355)**	**(3,072)**	**(1,503)**	**(2,380)**	**(7,310)**
Depreciation charge	(98)	(1,440)	(372)	(852)	**(2,762)**
Disposals	−	505	89	129	**723**
31 December 2017	**(453)**	**(4,007)**	**(1,786)**	**(3,103)**	**(9,349)**
Net book value as at 31 December 2016	**574**	**3,292**	**1,013**	**2,276**	**7,155**
Net book value as at 31 December 2017	**724**	**3,220**	**1,205**	**2,280**	**7,429**

The movements in property and equipment were as follows in 2016:

	Land and buildings (including Leasehold improvement)	*Furniture, fixtures and equipment*	*Motor vehicles*	*IT and computer equipment*	*Total*
Cost					
31 December 2015	**929**	**5,212**	**2,269**	**3,661**	**12,071**
Additions	−	1,355	316	1,000	**2,671**
Disposals	−	(203)	(69)	(5)	**(277)**
31 December 2016	**929**	**6,364**	**2,516**	**4,656**	**14,465**
Accumulated depreciation					
31 December 2015	**(308)**	**(1,976)**	**(1,132)**	**(1,605)**	**(5,021)**
Depreciation charge	(47)	(1,270)	(396)	(778)	**(2,491)**
Disposals	−	174	25	3	**202**
31 December 2016	**(355)**	**(3,072)**	**(1,503)**	**(2,380)**	**(7,310)**
Net book value as at 31 December 2015	**621**	**3,236**	**1,137**	**2,056**	**7,050**
Net book value as at 31 December 2016	**574**	**3,292**	**1,013**	**2,276**	**7,155**

The gross amount of fully depreciated property plant and equipment that is still in use was GEL 835 (2016: GEL1,444).

(thousands of Georgian Lari)

10. Intangible assets

The movements in intangible assets were as follows in 2017:

	Licenses, rights, patents	*Core banking software*	*Other software*	*Total*
Cost				
31 December 2016	**3,401**	**781**	**456**	**4,638**
Additions	415	361	397	**1,173**
31 December 2017	**3,816**	**1,142**	**853**	**5,811**
Accumulated amortization				
31 December 2016	**(934)**	**(163)**	**(389)**	**(1,486)**
Amortization charge	(336)	(97)	(151)	**(584)**
31 December 2017	**(1,270)**	**(260)**	**(540)**	**(2,070)**
Net book value as at 31 December 2016	**2,467**	**618**	**67**	**3,152**
Net book value as at 31 December 2017	**2,546**	**882**	**313**	**3,741**

The movements in intangible assets 2016 were as follows:

	Licenses, rights, patents	*Core banking software*	*Other software*	*Total*
Cost				
31 December 2015	**2,082**	**160**	**473**	**2,715**
Additions	1,319	621	–	**1,940**
Disposals and write-offs	–	–	(17)	**(17)**
31 December 2016	**3,401**	**781**	**456**	**4,638**
Accumulated amortization				
31 December 2015	**(366)**	**(53)**	**(294)**	**(713)**
Amortization charge	(568)	(110)	(107)	**(785)**
Disposals and write-offs	–	–	12	**12**
31 December 2016	**(934)**	**(163)**	**(389)**	**(1,486)**
Net book value as at 31 December 2015	**1,716**	**107**	**179**	**2,002**
Net book value as at 31 December 2016	**2,467**	**618**	**67**	**3,152**

11. Taxation

The corporate income tax expense comprises:

	2017	*2016*
Current year tax charge	–	5,823
Deferred taxation charge/(benefit) due to origination and reversal of temporary differences	1,967	(2,063)
Total income tax expense	**1,967**	**3,760**

(thousands of Georgian Lari)

11. Income tax (continued)

The income tax rate applicable to the Bank's income is 15%. The effective income tax rate differs from the statutory income tax rate. A reconciliation of the income tax benefit expense on statutory rates with actual is as follows:

	2017	***2016***
Profit before tax	**22,098**	**29,979**
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	**3,315**	**4,497**
Non-deductible expenses	200	2,083
Tax exempt income	(271)	(1,151)
Change in tax base of loan loss allowance and accrued interest (b)	(665)	(1,511)
Change in tax regulation (a)	(612)	(158)
Income tax expense	**1,967**	**3,760**

(a) In June 2016, amendments to the Georgian tax law in respect of corporate income tax became enacted. The amendments become effective from 1 January 2017 for all Georgian companies except the banks, insurance companies and microfinance organization, for which the effective date is 1 January 2019. Under the new regulation, corporate income tax will be levied on profit distributed as dividends to the shareholders that are individuals or non-residents of Georgia, rather than on profit earned as under the current regulation. The amount of tax payable on a dividend distribution will be calculated as 15/85 of the amount of net distribution. The companies will be able to offset corporate income tax liability arising from dividend distributions out of profits earned in 2008-2016 by the amount of corporate income tax paid for the respective period under the current regulation. Dividends distributions between Georgian resident companies will not be subject to corporate income tax.

Following the enactment of the amendments, the Bank remeasured its deferred tax assets and liabilities at the tax rates that were expected to apply to the period when the asset is realised or the liability is settled. As IAS 12 *Income Taxes* requires, the Bank used 0% tax rate applicable for undistributed profits in respect of assets and liabilities expected to be realized or settled in the periods when the new regulation becomes effective starting from 1 January 2019.

As a result of new regulation coming the Bank recognized income tax benefit resulting from reversal of deferred tax assets and liabilities in net amount of GEL 612 in profit or loss for the year ended 31 December 2017 (2016: GEL 158).

The amendments to the Georgian tax law described above also provide for charging corporate income tax on certain transactions that are considered deemed profit distributions, e.g. some transactions at non-market prices, non-business related expenses or supply of goods and services free of charge. Taxation of such transaction is outside scope of IAS 12 *Income Taxes* and will be accounted similar to operating taxes starting from 1 January 2019. Tax law amendments related to such deemed profit distribution did not have any effect on the Bank's financial statements for the year ended 31 December 2017.

(b) According to the Georgian Tax Code, certain transactions are treated differently in tax accounting for banks as compared to microfinance organization. The key difference is loan loss allowance which is a deductible expense for banks. The Bank obtained banking licence on 20 March 2017, and thereafter, in accordance to the advance tax ruling obtained from Revenue Service of Georgia, the Bank deducted accumulated loan loss allowance, determined in accordance with respective tax regulations, in estimation of the taxable result for 2017. Mostly as the result of that deduction, the Bank has available GEL 8,927 of tax losses carried forward as at 31 December 2017. As at 31 December 2016, the Bank recognized deferred tax asset related to loan loss allowance based on the best estimate of the amount to be deductible after obtaining banking licence available at that date.

Deferred tax asset and liability

Temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes give rise to net deferred tax assets as of 31 December 2017 and 2016.

The Bank has available GEL 8,927 of tax losses carried forwards which expire in 2019 if not utilised. The management expects to fully utilise tax loss carries forward in upcoming year and deferred tax asset on tax loss carried forward was recognized fully as at 31 December 2017.

(thousands of Georgian Lari)

11. Income tax (continued)

Deferred tax asset and liability (continued)

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

	Balance 31 December 2015	*Recognized in profit or loss*	*Balance 31 December 2016*	*Recognized in profit or loss*	*Balance 31 December 2017*
Tax effect of deductible temporary differences					
Tax loss carry forward	–	–	–	1,339	1,339
Loan portfolio, except for loan loss allowance	370	95	465	(210)	253
Deferred tax assets	**370**	**95**	**465**	**1,129**	**1,592**
Tax effect of taxable temporary differences					
Loan loss allowance	–	1,512	1,512	(1,936)	(424)
Property and equipment and intangible assets	(898)	168	(730)	371	(359)
Loans and borrowings	483	260	743	(878)	(135)
Salaries payable and other liabilities	598	24	622	(718)	(96)
Other assets	(10)	(16)	(26)	26	–
Derivatives	(59)	20	(39)	39	–
Deferred tax liabilities	**114**	**1,968**	**2,082**	**(3,096)**	**(1,014)**
Net deferred tax assets/(liabilities)	**484**	**2,063**	**2,547**	**(1,967)**	**578**

12. Other financial assets

Other financial assets comprise:

	2017	*2016*
Other financial assets		
Funds in settlement	3,082	3,678
Accrued life insurance fees	1,016	963
Receivables from employees	517	387
Other	878	228
Less: allowance for impairment of other financial assets	(615)	(141)
Total financial assets	**4,878**	**5,115**

The Bank recognized GEL 615 charge on allowance for impairment of other financial assets (2016: GEL 141), that were recognised in other operating expenses.

13. Other non-financial assets

Other non-financial assets comprise:

	2017	*2016*
Other non-financial assets		
Prepayments and advances	2,672	1,199
Repossessed property	776	531
Inventory	570	441
Prepaid taxes other than income tax	351	191
Total non-financial assets	**4,369**	**2,362**

The Bank holds repossessed property which represent land and other real estate taken into Bank's ownership as a settlement of non-performing loans. The Bank intends to sell those assets in normal course of business.

(thousands of Georgian Lari)

14. Loans from banks and other financial institutions and subordinated loans

	2017	*2016*
Senior debt		
Non-current liabilities		
Unsecured loans from financial institutions	297,197	228,036
Current liabilities		
Unsecured loans from financial institutions	178,903	182,510
Total senior debt	**476,100**	**410,546**
Subordinated debt		
Non-current liabilities		
Unsecured loans from financial institutions	8,120	8,120
Current liabilities		
Unsecured loans from financial institutions	300	298
Total subordinated debt	**8,420**	**8,418**
Total debt	**484,520**	**418,964**

As at 31 December 2017 loans from banks and other financial institutions and subordinated loans mature from January 2018 to April 2023, and are denominated in GEL and USD. As at 31 December 2016 loans from banks and other financial institutions and subordinated loans mature from January 2017 to December 2020 and are denominated in GEL and USD. As at 31 December 2017, the Bank was in compliance with all externally imposed financial covenants.

15. Changes in liabilities arising from financing activities

	Other borrowed funds	*Subordinated loans*	*Total liabilities from financing activities*
Carrying amount at 31 December 2015	**371,496**	**10,863**	**382,359**
Proceeds from issue	145,384	–	**145,384**
Redemption	(135,210)	(2,574)	**(137,784)**
Foreign currency translation	27,556	180	**27,736**
Other	1,320	(51)	**1,269**
Carrying amount at 31 December 2016	**410,546**	**8,418**	**418,964**
Proceeds from issue	243,341	–	**243,341**
Redemption	(170,100)	–	**(170,100)**
Foreign currency translation	(9,123)	–	**(9,123)**
Other	1,436	2	**1,438**
Carrying amount at 31 December 2017	**476,100**	**8,420**	**484,520**

The “Other” line includes the effect of accrued but not yet paid interest on other borrowed funds and subordinated loans. The Bank classifies interest paid as cash flows from operating activities.

16. Other liabilities

	2017	*2016*
Salaries accrued	3,904	4,323
Funds in settlement	3,838	2,447
Payables for goods and services	1,045	827
Accrued expenses	130	529
Taxes other than income tax payable	121	60
Grant liabilities	54	355
	9,092	**8,541**

(thousands of Georgian Lari)

17. Equity

The share capital of the Bank was contributed by the shareholders in GEL and they entitle to dividends and any capital distribution in GEL.

As at 31 December 2017 and 2016, the Bank's authorized, issued and fully paid capital amounted to GEL 4,400 thousand comprising of 440,000 common shares with nominal value of GEL 10.00. Each share entitles one vote to the shareholder.

Dividends

In accordance with Georgian legislation the Bank's distributable reserves are limited to the balance of retained earnings as recorded in the Bank's statutory financial statements prepared in accordance with IFRSs.

On 13 July 2017, at the general meeting of shareholders, the Bank declared dividends for 2016 in amount of GEL 15,000. Dividend declared was fully paid to shareholders in 2017.

18. Commitments and contingencies

Credit related commitments

In the normal course of business, the Bank enters into credit related commitments, comprising undrawn loan commitments.

The Bank has outstanding credit related commitments to extend loans. These credit related commitments take the form of approved credit card limits of "Wish" and "Crop" credit cards. These credit cards have fixed limits and generally extend for a period of up to eight months.

The Bank applies the same credit risk management policies and procedures when granting credit commitments as it does for granting loans to customers. Customers with loans in arrears more than four days cannot draw any portion of their limits.

The respective undrawn balances are as follow:

	2017	*2016*
Undrawn limit on credit cards	34,912	44,300

The total outstanding contractual credit related commitments above do not necessarily represent future cash requirements, as these credit related commitments may expire or terminate without being funded. The Bank has unconditional right to cancel unused card balance any time without notice.

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

	2017	*2016*
Operating lease commitments		
Not later than 1 year	1,221	–
More than 1 year but less than 5 years	2,551	–
	3,772	**–**
Capital commitments	2,197	–
Commitments and contingencies	**5,969**	**–**

Legal

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

(thousands of Georgian Lari)

18. Commitments and contingencies (continued)

Taxation

Tax legislation in Georgia is subject to varying interpretations and changes can occur frequently. These circumstances may create tax risks in Georgia that are more significant than in other developed economics. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Georgian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

In the event of a breach of tax legislation, no liabilities for additional taxes, fines or penalties may be imposed by the tax authorities after three years have passed since the end of the year in which the breach occurred.

As at 31 December 2017 management believes that its interpretation of the relevant legislation is appropriate and that the Bank's tax positions will be sustained.

Insurance

The Bank has full insurance coverage of its premises and equipment. The Bank has insurance for third party liability, directors' and officers' liability and Banker's Blanket Bond insurance.

19. Fee and commission income

Fee and commission income comprises:

	2017	*2016*
Fees from credit related activities	18,122	16,004
Fees from settlement and cash operations	1,508	2,043
Other	485	238
	20,115	**18,285**

20. Fee and commission expense

Fee and commission expense comprises:

	2017	*2016*
Fees from credit related activities	3,448	3,729
Fees from settlement and cash operations	967	1,207
Other	106	138
	4,521	**5,074**

21. Net losses from foreign currencies

Net losses from foreign currencies comprises:

	2017	*2016*
Dealing	337	1,596
Translation differences	3,933	(9,599)
Net result from foreign currency derivatives	(6,438)	5,531
	(2,168)	**(2,472)**

(thousands of Georgian Lari)

22. Other operating income

Other operating income comprises:	*2017*	*2016*
Income from grants	396	437
Gains from disposal of property, plant and equipment	67	22
Income from sale of repossessed property	52	–
Reversal of provision	–	656
Reimbursement of losses	–	58
Other	46	25
	561	**1,198**

23. Personnel expenses

Personnel expenses comprise:

	2017	*2016*
Salary expenses	42,555	39,043
Other personnel expenses	5,885	7,479
	48,440	**46,522**

Other personnel expenses are represented by salaries of village councils, health and pension insurance and other employee benefits.

24. Other general administrative expenses

	2017	*2016*
Rent and utilities	5,765	5,107
Transport and travel expenses	4,343	3,712
Marketing, advertising and entertainment	1,926	1,847
Legal and advisory expenses	1,714	2,248
Supplies and other consumables	1,502	1,516
Communication expenses	1,439	1,283
Software expenses	719	383
Repair and maintenance	574	762
Training	493	501
Insurance expenses	413	235
Security service expenses	188	181
Operating taxes	121	151
Other	785	575
	19,982	**18,501**

Auditor’s remuneration

Legal and advisory expenses include auditor’s remuneration. Remuneration of the Bank’s auditor for the years ended 31 December 2017 and 2016 comprises:

	2017	*2016*
Fees for the audit of the Bank’s annual financial statements for the year ended 31 December	119	100
Expenditures for other assurance services	33	–
	152	**100**

Fees and expenditures payable to other auditors and audit firms in respect of the other professional services comprised GEL 41 (2016: GEL 42).

(thousands of Georgian Lari)

25. Risk management

Risk is inherent in the Bank's activities, but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. The Bank is exposed to credit risk, financial risk and operating risks.

Supervisory Board and Management Board

The Supervisory Board together with its committees has overall responsibility for the execution of the risk management framework, overseeing the management of key risks and reviewing its risk management policies and procedures.

Management Board is responsible for monitoring and implementation of risk mitigation measures and making sure that the Bank operates within the established risk parameters. The Management Board reports directly to the Supervisory Board.

Asset Liability Committee (ALCO)

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

Internal audit

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

Credit risk

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

Credit risk is monitored by credit department. There are several levels of approval based on loan amount.

The maximum exposure to credit risk for the components of the statement of financial position, including derivatives, is best represented by their carrying amounts. Where financial instruments are recorded at fair value, the carrying value represents the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values. For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 8.

Decision on loan issuance are approved by a Bank's credit committee of appropriate level, depending on the amount and product of the loan. The Bank has several levels of credit committees, starting from the credit committee of a service center and up to the Head Office credit committee.

Financial risk

Bank is exposed to different types of financial risks: liquidity risk and market risk, including foreign currency risk and interest rate risk.

These risks are controlled and managed on ongoing basis.

Financial risks are measured and controlled by Financial Risk Management Unit, which reports to the main decision making body – ALCO which includes members of the senior management. ALCO is responsible for making primary risk decisions, as well for establishment of risk policies and limits. The policies developed by ALCO are approved by the Supervisory Board.

ALCO meetings are held on regular basis. At ALCO meetings, exposures to financial risks are discussed and risk mitigation decisions are made. In addition, any potential exposure to financial risks related to any new product are analyzed and appropriate decisions are made on measurement, limitation and managing of such the risks.

(thousands of Georgian Lari)

25. Risk management (continued)

Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances To limit the risk, management has arranged diversified funding sources, these are long-term fund from international financial institutions (IFIs) and loans with local banks, to provide funds timely upon request. Overdrafts from local banks are also available in case of emergency liquidity needs.

Liquidity management is the key part of asset and liability management. Future cash inflows and outflows are monitored continuously. Short-term liquidity plan is developed in the beginning of every month. The plan includes weekly liquidity planning for the following one month and detailed planning for the next two months, along with projections for the following twelve months that are prepared on a monthly basis.

Funding decisions are made on regular ALCO meetings that are held at least monthly or more frequently if required. Liquidity position is assessed on monthly basis by liquidity ratios that are defined by Financial Risk Management Policy. In addition, Bank's Treasury department monitors liquidity position on daily basis and ensures that appropriate liquidity positions are maintained in accordance with the internal limits that are set based on historical data and consider relevant internal and external factors, such as funding cost and disbursement seasonality. By doing so, Treasury may reallocate funds to branches and for various operational needs efficiently as needed.

To avoid holding excessive liquidity, the management establishes maximum cash levels. The amounts above the limit are placed with top rated local banks. Exposure limits are defined for the local banks and approved by the Management Board.

The table below summarizes the maturity profile of the Bank's financial assets and liabilities as of 31 December 2017 based on contractual undiscounted obligations:

	Demand and less than 1 month	*More than 1 month and less than 1 year*	*More than 1 year*	*Total gross outflow*
Cash and cash equivalents	52,794	–	–	**52,794**
Amounts due from credit institutions	–		19,999	**19,999**
Gross-settled derivative financial assets/liabilities (notional amounts receivable/payable)	70	43,479	–	**43,549**
Loans to customers	24,938	334,215	263,262	**622,415**
Other financial assets	3,718	814	346	**4,878**
Total financial assets	**81,520**	**378,508**	**283,607**	**743,635**
Loans from banks and other financial institutions	7,155	206,944	351,318	**565,417**
Gross-settled derivative financial assets/liabilities (notional amounts receivable/payable)	149	40,783	4,465	**45,397**
Other payables	7,821	1,041	50	**8,912**
Subordinated debt	–	893	8,671	**9,564**
Total financial liabilities	**15,125**	**249,661**	**364,504**	**629,290**
Maturity gap	**66,395**	**128,847**	**(80,897)**	**114,345**

The table below summarizes the maturity profile of the Bank's financial assets and liabilities as of 31 December 2016 based on contractual undiscounted obligations:

(thousands of Georgian Lari)

25. Risk management (continued)

Liquidity risk (continued)

	Demand and less than 1 month	*More than 1 month and less than 1 year*	*More than 1 year*	*Total gross outflow*
Cash and cash equivalents	43,994	23,949	–	**67,943**
Gross-settled derivative financial assets/liabilities (notional amounts receivable/payable)	16,115	38,841	42,759	**97,715**
Loans to customers	20,447	313,590	208,432	**542,469**
Other financial assets	4,163	727	225	**5,115**
Total financial assets	**84,719**	**377,107**	**251,416**	**713,242**
Loans from banks and other financial institutions	8,310	196,532	253,980	**458,822**
Gross-settled derivative financial assets/liabilities (notional amounts receivable/payable)	16,177	32,714	38,452	**87,343**
Promissory notes payable	–	630	–	**630**
Other payables	5,341	2,785	–	**8,126**
Subordinated debt	–	893	9,564	**10,457**
Total financial liabilities	**29,828**	**233,554**	**301,996**	**565,378**
Maturity gap	**54,891**	**143,553**	**(50,580)**	**147,864**

Currency risk

Foreign currency asset and liability matching is the key tool in monitoring the net open foreign currency (FX) position of the Bank. The table below quantifies the net open FX position for the Bank as the difference between foreign currency assets and liabilities, less the effect of foreign currency derivatives held for risk management purposes. A gap in any currency other than the local currency represents potential risk. Negative FX gap represents risk to appreciation of the foreign currency, while positive gap represents risk towards depreciation of the foreign currency. The Management Board sets limits on the FX positions within the limits established by the Supervisory Board.

The following table shows the foreign currency exposure structure of monetary assets and liabilities:

		2017			*2016*	
	USD	*EUR*	*Other FC*	*USD*	*EUR*	*Other FC*
Cash and cash equivalents	19,265	1,956	1,769	47,336	1,848	814
Amounts due from credit institutions	19,752	–	–	–	–	–
Loans to customers	85,298	–	–	156,658	–	–
Other monetary assets	546	34	–	1,874	10	–
Total assets	**124,861**	**1,990**	**1,769**	**205,868**	**1,858**	**814**
Loans and borrowings	(173,250)	–	–	(275,024)	–	–
Other monetary liabilities	(388)	–	–	(1,583)	(268)	–
Total liabilities	**(173,638)**	**–**	**–**	**(276,607)**	**(268)**	**–**
The effect of derivatives held for risk management	56,440	(1,554)		65,008	–	–
Net position after derivatives held for risk management purposes	7,663	436	1,769	(5,731)	1,590	814

(thousands of Georgian Lari)

25. Risk management (continued)

Currency risk (continued)

Exchange rate sensitivity analysis

A weakening of the GEL, as indicated below, against the USD at 31 December 2017 and 2016 would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis is on net of tax basis and is based on foreign currency exchange rate variances that the Bank 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.

	2017	*2016*
20% appreciation of USD against GEL	1,533	(1,146)
20% depreciation of USD against GEL	(1,533)	1,146

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows. Bank's loans to clients are issued at fixed rates. Rates can be changed upon renewal of the loans. Therefore Bank aims to obtain preferably fixed rate debt funding to reduce the risk of re-pricing from the funding side. The management controls the maturity gap between interest bearing assets and liabilities, as well as monitors the margin between actual interest rate on the loan portfolio and weighted cost of funding. Bank continuously works to set interest rates in a competitive environment and negotiates funding terms with the investors.

The table reflects asset and liabilities that are exposed to fluctuation in interest rate risk as of 31 December 2017:

	Demand and less than 1 month	***More than 1 month and less than 1 year***	***More than 1 year***	***Carrying amount***
Cash and cash equivalents	52,785	–	–	52,785
Amounts due from credit institutions	–	–	19,752	19,752
Loans and advances to customers	21,007	57,146	436,323	514,476
Total interest-bearing assets	**73,792**	**57,146**	**456,075**	**587,013**
Loans from banks and other financial institutions, including subordinated debt	19,053	40,089	425,378	484,520
Total interest-bearing liabilities	**19,053**	**40,089**	**425,378**	**484,520**
Interest rate maturity gap	**54,739**	**17,057**	**30,697**	**102,493**

The table reflects asset and liabilities that are exposed to fluctuation in interest rate risk as of 31 December 2016:

	Demand and less than 1 month	***More than 1 month and less than 1 year***	***More than 1 year***	***Carrying amount***
Cash and cash equivalents	43,994	23,821	–	67,815
Loans and advances to customers	20,484	52,404	370,541	443,429
Total interest-bearing assets	**64,478**	**76,225**	**370,541**	**511,244**
Loans from banks and other financial institutions, including subordinated debt	62,618	72,631	283,715	418,964
Total interest-bearing liabilities	**62,618**	**72,631**	**283,715**	**418,964**
Interest rate maturity gap	**1,860**	**3,594**	**86,826**	**92,280**

(thousands of Georgian Lari)

25. Risk management (continued)

Interest rate risk (continued)

Interest rate sensitivity analysis

The management of interest rate risk based on interest rate gap analysis is supplemented by monitoring the sensitivity of financial assets and liabilities. An analysis of sensitivity of profit or loss net of taxes to changes in interest rates (repricing risk) based on a simplified scenario of a 100 basis point (bp) symmetrical fall or rise in all yield curves and positions of interest-bearing assets and liabilities existing as at 31 December 2017 and 2016 is as follows:

	2017	***2016***
	Profit or loss	***Profit or loss***
100 bp parallel fall	(718)	(55)
100 bp parallel rise	718	55

Operating risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. Controls are in place to ensure segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit. Anti-money laundering (AML) compliance is controlled by a dedicated AML unit.

Tax compliance is monitored by the tax compliance unit.

The Bank has Operating Risk Committee, which is held quarterly and reports to Supervisory Board. The Operational Risk Unit reports to the Operational Risk Committee and covers operational risk appetite and KRIs (Key Performance Indicators), the classification of operational risk types, business process identification and mapping, operational risk assessment tools and methods, and bank-wide operational risk monitoring, reporting and mitigation.

26. Fair value measurements

Fair value measurement procedures

The estimates of fair value are intended to approximate the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realizable in an immediate sale of the assets or transfer of liabilities.

The Bank's financial department determines the policies and procedures for fair value measurement for Bank's assets including derivatives. The estimated fair values of all financial assets and liabilities are calculated using discounted cash flow techniques based on estimated future cash flows and discount rates for similar instruments at the reporting date.

As at 31 December 2017 and 2016, the Bank does not have any financial instruments measured at fair value, for which fair value is based on valuation techniques involving the use of significant non-market observable inputs.

(thousands of Georgian Lari)

26. Fair value measurements (continued)

Fair value hierarchy

The tables below analyses financial instruments value at 31 December 2017 and 31 December 2016, by the level in the fair value hierarchy into which the fair value measurement is categorized. The amounts are based on the values recognized in the statement of financial position:

	Fair value measurement using				
At 31 December 2017	***Quoted prices in active markets (Level 1)***	***Significant observable inputs (Level 2)***	***Significant unobservable inputs (Level 3)***	***Total***	***Carrying amount***
Assets measured at fair value					
Derivative financial assets					
Foreign exchange swaps	–	3,717	–	**3,717**	**3,717**
Assets for which fair values are disclosed					
Cash and cash equivalents	–	52,785	–	**52,785**	**52,785**
Amounts due from credit institutions	–	19,752	–	**19,752**	**19,752**
Loans to customers	–	–	525,623	**525,623**	**514,476**
Liabilities measured at fair value					
Derivative financial liabilities					
Foreign exchange swaps	–	610	–	**610**	**610**
Liabilities for which fair values are disclosed					
Loans from banks and other financial institutions, including subordinated debt	–	480,139	–	**480,139**	**484,520**

	Fair value measurement using				
At 31 December 2016	***Quoted prices in active markets (Level 1)***	***Significant observable inputs (Level 2)***	***Significant unobservable inputs (Level 3)***	***Total***	***Carrying amount***
Assets measured at fair value					
Derivative financial assets					
Foreign exchange forwards and swaps	–	12,415	–	**12,415**	**12,415**
Assets for which fair values are disclosed					
Cash and cash equivalents	–	67,815	–	**67,815**	**67,815**
Loans to customers	–	–	469,916	**469,916**	**443,429**
Liabilities for which fair values are disclosed					
Loans from banks and other financial institutions , including subordinated debt	–	443,486	–	443,486	**418,964**

Valuation techniques and assumptions

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

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or have a short term maturity (less than three months), as well as for floating rate instruments, the carrying amounts are assumed to approximate their fair value.

(thousands of Georgian Lari)

26. Fair value measurements (continued)

Derivatives

Derivatives valued using a valuation technique with market observable inputs are mainly currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves.

Fixed rate financial instruments

The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

27. Related party disclosures

In accordance with IAS 24 *Related Party Disclosures*, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

	2017		***2016***	
	Transaction value	***Balance***	***Transaction value***	***Balance***
Statement of financial position				
Assets				
Other financial assets	–	32	–	–
Liabilities				
Loans from banks and other financial institutions	–	39,825	–	52,822
Other liabilities	–	–	–	241
Profit or loss				
Loans from banks and other financial institutions interest expense	3,029	–	4,449	–
Other general and administrative expense	1,030	–	1,300	–

Loans received and related interest expense represent transactions with shareholders with significant influence over the Bank. As at 31 December 2017 loans received from related parties mature from March 2018 to June 2021, are denominated in USD and GEL and carry interest rates from 6.50% to 14.00%. As at 31 December 2016 loans received from related parties mature from February 2017 to April 2019, are denominated in USD and GEL and carry interest rates from 6.50% to 11.00%.

Transactions with key management personnel

Total remuneration included in employee compensation for the year ended 31 December and represented by short-term benefits:

	2017	***2016***
Members of the Management and Supervisory Board	1,155	964

(thousands of Georgian Lari)

28. Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in its business. The adequacy of the Bank's capital is monitored using, among other measures, the ratios established by the NBG in supervising the Bank.

As at 31 December 2017, the Bank complied with all its externally imposed capital requirements.

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities.

NBG Capital adequacy ratio

Regulatory capital consists of Tier 1 capital, which comprises common shares, reserve fund and retained earnings excluding current year profit or loss less amount of property revaluation reserve transferred to authorised capital, and intangible assets. Certain adjustments are made to IFRS amounts to comply with the NBG regulatory requirements. The other component of regulatory capital is Tier 2 capital, which includes profit or loss of current year, general reserves (not more than 1.25% of risk weighted assets) and subordinated long-term debt.

Until 31 December 2017 the NBG required banks to maintain a minimum regulatory capital adequacy ratio of 9.6% of risk-weighted assets, computed based on the NBG guidelines. As of 31 December 2017 the Bank's statutory regulatory capital adequacy ratio as calculated in accordance with the NBG requirements was 17.13%. The NBG also required banks to maintain a minimum tier 1 capital adequacy ratio of 6.4% of risk-weighted assets, computed based on the NBG guidelines. As of 31 December 2017 the Bank's statutory tier one capital adequacy ratio as calculated in accordance with the NBG requirements was 13.74%.

The above NBG capital adequacy calculation methodology was effective until 31 December 2017. Thereafter, it was replaced by the new methodology under Basel II/III framework (see below).

NBG Basel II/III Capital adequacy ratio

On 18 December 2017, the NBG published and approved amendments in capital adequacy regulation (Decree N100/04), according to which the minimum capital requirement ratios have been revised whereas incorporated Pillar I model and set Capital Conservation, Systemic Risk and Countercyclical buffers (Pillar I Buffers).

As at 31 December 2017 Common Equity Tier 1 Capital (CET I), Tier I Capital (Tier I) and Total Capital ratios were set at 4.50%, 6.00% and 8.00% respectively, in addition to which the Bank had to maintain Pillar I Buffers and Pillar II requirements.

Capital Conservation and Countercyclical buffers are set at 2.50% and 0.00%, respectively. Any adjustment of Pillar I Buffers is at NBG's discretion.

On 18 December 2017, the NBG also published and approved Pillar II Requirements in additional to Pillar I Buffers. Pillar II Requirements include the following capital buffers: Unhedged Currency Induced Credit Risk (CICR), Net GRAPE, Credit Portfolio Concentration Risk and Net Stress-Test buffers.

As of 31 December 2017, the Bank had to maintain CICR buffer of 0.74%, primary due to percentage share of foreign currency denominated loans to customers. All the rest Pillar II buffers were to preserve at zero.

As of 31 December 2017, under total Basel II/III requirements the Bank was required to maintain a minimum regulatory capital ratio, Common Equity Tier 1 capital adequacy ratio and Tier 1 capital adequacy ratio of 11.24%, 7.416% and 9.057%, respectively.

The Bank was in compliance with these capital adequacy ratios as of 31 December 2017. The Bank's capital adequacy ratios on this basis were as follows:

(thousands of Georgian Lari)

28. Capital adequacy (continued)

	2017
Common Equity Tier 1 capital	112,094
Additional Tier 1 capital	–
Tier 1 capital	112,094
Tier 2 capital	7,552
Total regulatory capital	**119,646**
Risk weighted assets	**765,493**
Common Equity Tier 1 capital ratio	**14.64%**
Total Tier 1 capital adequacy ratio	**14.64%**
Regulatory capital ratio	**15.63%**

As at 31 December 2016 the Company did not have any prudential requirements for capital adequacy from the National Bank of Georgia or other regulators. However, some loan agreements require the Company to comply with certain minimum capital adequacy requirements.

In 2016 the Company managed its capital using Debt to Equity ratio, with internally set target of below 5.5:

	2016
Total liabilities	428,651
Less cash and cash equivalents	(67,815)
Net debt	**360,836**
Total equity	115,339
Debt to capital ratio at 31 December	**3.13**