JSC Isbank Georgia

Financial statements

for the year ended 31 December 2017

Contents

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Independent auditor's report

To the Shareholder and the Supervisory Council of JSC Isbank Georgia

Opinion

We have audited the financial statements of JSC Isbank Georgia (the Bank), which comprise the statement of financial position as at 31 December 2017, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and 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 Bank 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 Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with 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 the 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 Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

The Audit Committee are responsible for overseeing the Bank'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 Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our 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 Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with 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.

Other matter

The financial statements of the Bank for the years ended 31 December 2016 and 31 December 2015 were audited by another auditor who expressed unmodified opinions on those statements on 8 May 2017 and 8 April 2016, respectively.

Ruslan Khoroshvili

On behalf of EY Georgia LLC

Tbilisi, Georgia

15 May 2018

Statement of profit or loss and other comprehensive income
for the year ended 31 December 2017

	Notes	2017 000'GEL	2016 000'GEL	2015 000'GEL
Interest income		18,850	16,373	12,767
Interest expense		(10,595)	(7,892)	(6,060)
Net interest income	4	**8,255**	**8,481**	**6,707**
Fee and commission income		970	1,334	803
Fee and commission expense		(878)	(1,041)	(677)
Net fee and commission income	5	**92**	**293**	**126**
Net foreign exchange gain		808	1,189	1,308
Operating income		**9,155**	**9,963**	**8,141**
Reversal of impairment losses / (impairment losses)	9	380	861	(1,324)
Personnel expenses		(4,568)	(3,615)	(2,739)
Other general administrative expenses	6	(3,229)	(2,757)	(2,202)
Profit before income tax		**1,738**	**4,452**	**1,876**
Income tax expense	7	(214)	(665)	(205)
Profit for the year		**1,524**	**3,787**	**1,671**
Other comprehensive income to be reclassified subsequently to profit or loss when specific conditions are met:				
Unrealized gains on investment securities available-for-sale		65	–	–
Income tax effect		(10)	–	–
Net other comprehensive income to be reclassified subsequently to profit or loss when specific conditions are met		**55**	**–**	**–**
Other comprehensive income for the year, net of tax		**55**	**–**	**–**
Total comprehensive income for the year		**1,579**	**3,787**	**1,671**

The financial statements as set out on pages 6 to 47 were approved by management on 14 May 2018 and were signed on its behalf by:

Ozan Gür
Chief Executive Officer

Ucha Saralidze
Chief Financial Officer

Statement of financial position

as at 31 December 2017

	Notes	2017 000'GEL	2016 000'GEL	2015 000'GEL
Assets				
Cash and cash equivalents	8	21,579	44,098	38,889
Amounts due from banks		434	–	–
Mandatory reserves at the National Bank of Georgia		28,897	46,607	25,819
Loans to customers	9	157,004	179,786	145,285
Investment securities	10	24,633	1,018	–
Property, equipment and intangible assets	11	1,529	2,283	2,831
Deferred tax assets	7	–	–	–
Other assets		3,498	2,258	233
Total assets		**237,574**	**276,050**	**213,057**
Liabilities				
Deposits and balances from banks	12	54,456	173,884	126,224
Current accounts and deposits from customers	13	74,023	65,100	55,016
Other borrowed funds and subordinated debt	14	68,638	–	–
Deferred tax liabilities	7	209	579	40
Other liabilities		3,385	1,203	280
Total liabilities		**200,711**	**240,766**	**181,560**
Equity				
Share capital		30,000	30,000	30,000
Statutory reserve		–	–	–
Unrealised gains on investment securities available-for-sale		55	–	–
Retained earnings		6,808	5,284	1,497
Total equity	15	**36,863**	**35,284**	**31,497**
Total liabilities and equity		**237,574**	**276,050**	**213,057**

The statement of financial position is to be read in conjunction with the notes to, and forming part of, the financial statements.

Statement of cash flows

for the year ended 31 December 2017

	Notes	2017 000'GEL	2016 000'GEL	2015 000'GEL
Cash flows from operating activities				
Profit before income tax		1,738	4,452	1,876
Adjustments for:				
Depreciation and amortization	11	770	836	563
Interest income	4	(18,850)	(16,373)	(12,767)
Interest expense	4	10,595	7,892	6,060
(Reversal of impairment losses) / impairment losses	9	(380)	(861)	1,324
Net foreign exchange gain		(808)	(1,189)	(1,308)
Other non-cash movements		80	–	–
		(6,855)	**(5,243)**	**(4,252)**
Change in operating assets and liabilities:				
Decrease/(increase) in mandatory reserves at the National Bank of Georgia		16,383	(16,203)	(18,334)
Increase in amounts due from banks		(434)	–	–
Decrease/(increase) in loans to customers		16,624	(17,863)	(55,611)
(Increase)/decrease in other assets		(1,326)	(1,891)	525
Increase in deposits and balances from banks		(114,054)	30,061	63,527
(Decrease)/increase in current accounts and deposits from customers		8,135	5,368	14,093
Increase/(decrease) in other liabilities		2,192	923	(443)
Cash flows used in operations before interest and foreign exchange		**(79,335)**	**(4,848)**	**(495)**
Interest receipts		17,438	14,541	11,837
Interest payments		(6,796)	(7,925)	(4,762)
Net receipts from foreign exchange		719	957	998
Income tax paid		(594)	(126)	–
Cash flows (used in) / from operations		**(68,568)**	**2,599**	**7,578**
Cash flows from investing activities				
Purchases of investment securities		(22,915)	(1,018)	–
Purchases of property, equipment and intangible assets	11	(46)	(288)	(1,443)
Cash flows used in investing activities		**(22,961)**	**(1,306)**	**(1,443)**
Cash flows from financing activities				
Receipts from other borrowed funds and subordinated debt		68,155	–	–
Receipts from increase of share capital		–	–	17,620
Cash flows from financing activities		**68,155**	**–**	**17,620**
Net (decrease)/increase in cash and cash equivalents		**(23,374)**	**1,293**	**23,755**
Effect of changes in exchange rates on cash and cash equivalents		855	3,916	1,100
Cash and cash equivalents as at the beginning of the year	8	44,098	38,889	14,034
Cash and cash equivalents as at the end of the year	8	**21,579**	**44,098**	**38,889**

The statement of cash flows is to be read in conjunction with the notes to, and forming part of, the financial statements.

Statement of changes in equity
for the year ended 31 December 2017

000'GEL	*Statutory reserve*	*Share capital*	*Retained earnings / (accumulated losses)*	*Total equity*
Balance as at 1 January 2015	**13,013**	**–**	**(807)**	**12,206**
Profit and total comprehensive income for the year	–	–	1,671	1,671
Transactions with shareholder, recorded directly in equity				
Transfer of statutory reserve to the share capital	(13,013)	13,013	–	–
Transfer of accumulated losses to the share capital	–	(807)	807	–
Transfer of accumulated gain to the share capital	–	174	(174)	–
Cash contribution into the share capital	–	17,620	–	17,620
Total transactions with shareholder	**(13,013)**	**30,000**	**633**	**17,620**
Balance as at 31 December 2015	**–**	**30,000**	**1,497**	**31,497**
Balance as at 1 January 2016	**–**	**30,000**	**1,497**	**31,497**
Profit and total comprehensive income for the year	–	–	3,787	3,787
Balance as at 31 December 2016	**–**	**30,000**	**5,284**	**35,284**
Balance as at 1 January 2017	**–**	**30,000**	**5,284**	**35,284**
Profit for the year	–	–	1,524	1,524
Other comprehensive income for the year	–	–	55	55
Total comprehensive income for the year	**–**	**–**	**1,579**	**1,579**
Balance as at 31 December 2017	**–**	**30,000**	**6,863**	**36,863**

The statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the financial statements.

1. Background

(a) Organisation and operations

Batumi Branch of JSC Isbank Turkey (the "Branch") was registered on 13 July 2012 as a branch of a foreign bank Türkiye İş Bankası Anonim Şirketi (the "Parent" or the "Shareholder") which was incorporated in Turkey in 1924. On 1 August 2015 the Branch was reorganized into JSC Isbank Georgia (the "Bank").

The principal activities of the Bank are deposit taking and customer account maintenance, lending, cash and settlement operations and foreign exchange transactions. The Bank has a general banking license and its activities are regulated by the National Bank of Georgia (the "NBG").

The registered office of the Bank is D. Aghmashenebeli Ave. 140/B, Tbilisi, Georgia. The Bank has two branches in Tbilisi and Batumi and two service centers in Batumi.

Significant share of the funding (40% as at 31 December 2017, 45% as at 31 December 2016 and 51% as at 31 December 2015) of the Bank is from the Parent. As a result the Bank is economically dependent upon the Parent. In addition, the activities of the Bank are closely linked with the requirements of the Parent.

The Bank is ultimately controlled by Isbank Members' Supplementary Pension Fund. Related party transactions are disclosed in Note 20.

(b) Business environment

Georgian 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 emerging-market characteristics. Legal, tax and regulatory frameworks continue to develop, but are subject to varying interpretations and frequent changes that, 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 the Georgian business environment on the operations and financial position of the Bank. The future business environment may differ from management's assessment.

2. Basis of preparation

(a) Statement of compliance

The accompanying financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). The Bank presents comparative information for all amounts reported in the current period's financials statement for the two preceding periods – years ended 31 December 2016 and 2015. The Bank's management considers such disclosure more useful and informative for the stakeholders of the Bank.

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.

(b) Basis of measurement

The financial statements are prepared on the historical cost basis, except for investment securities available-for-sale that have been measured at fair value.

(c) Functional and presentation currency

The national currency of Georgia is the Georgian Lari (GEL), which is the Bank's functional and presentation currency. All financial information presented in GEL has been rounded to the nearest thousands, except otherwise stated.

(d) Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results could differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies is described in the Note 9 (b) – key assumptions and judgments for estimating loan impairment.

3. Significant accounting policies

The accounting policies set out below are applied consistently to all periods presented in these financial statements.

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 the amendments 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 the current period in Note 14.

The Bank has also adopted amendments to IAS 12 *Income Taxes* and IFRS 12 *Disclosure of Interests in Other Entities*, which did not have any effect on the financial statements.

(a) Foreign currency

Transactions in foreign currencies are translated to the respective functional currency of the Bank at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in foreign currency translated at the exchange rate at the end of the reporting period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value is determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on revaluation are recognized in profit or loss.

(b) Cash and cash equivalents and mandatory reserve with the NBG

Cash and cash equivalents include notes and coins on hand, unrestricted balances (Nostro accounts) held with the NBG and other banks and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of short-term commitments.

Resident financial institutions are required to maintain an interest-earning obligatory reserve with the NBG, the amount of which depends on the level of funds attracted by the financial institutions. The mandatory reserve deposit with the NBG is not available to finance the Bank's day to day operations and hence is not considered as part of cash and cash equivalents.

Cash and cash equivalents are carried at amortized cost in the statement of financial position.

(c) Financial instruments

(i) Classification

Loans and receivables are non-derivative financial assets with fixed or fluctuating 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.

(ii) Recognition

Financial assets and liabilities are recognized in the statement of financial position when the Bank becomes a party to the contractual provisions of the instrument. All regular way purchases of financial assets are accounted for at the settlement date.

3. Significant accounting policies (continued)

(c) Financial instruments (continued)

(iii) Measurement

A financial asset or liability is initially measured at its fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method. Available-for sale financial assets are measured at fair value.

All financial liabilities are measured at amortized cost.

(iv) 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.

(v) Fair value measurement principles

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 in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

When there is no quoted price in an active market, the Bank uses valuation techniques that maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The chosen valuation technique incorporates all the factors that market participants would take into account in these circumstances.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price, i.e., the fair value of the consideration given or received. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognized in profit or loss on an appropriate basis over the life of the instrument, but no later than when the valuation is supported wholly by observable market data or the transaction is closed out.

(vi) Gains and losses on subsequent measurement

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. Available-for sale financial assets are measured at fair value with gains or losses being recognised in other comprehensive income until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to profit or loss. However, interest calculated using the effective interest method is recognised in profit or loss.

(vii) 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. 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.

3. Significant accounting policies (continued)

(c) Financial instruments (continued)

(viii) Offsetting

Financial assets and liabilities are offset and the net amount 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 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.

(d) Property and equipment

(i) Owned assets

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

(ii) Depreciation

Depreciation is charged to profit or loss on a straight-line basis over the estimated useful lives of the individual assets. Depreciation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. The estimated useful lives are as follows:

leasehold improvements	5 years
computers and office equipment	5 years
furniture and fixtures	5 years
motor vehicles	5 years

Leasehold improvements are depreciated over the shorter of the lease term and their useful lives.

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

(e) Intangible assets

Acquired intangible assets are stated at cost less accumulated amortization and impairment losses.

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use the specific software.

Amortization is charged to profit or loss on a straight-line basis over the estimated useful lives of intangible assets. The estimated useful lives range from 6 to 7 years.

(f) Impairment

The Bank assesses at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the Bank determines the amount of any impairment loss.

A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a loss event) and that event (or events) has had an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, breach of loan covenants or conditions, restructuring of financial asset or group of financial assets that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, deterioration in the value of collateral, or other observable data related to a group of assets such as adverse changes in the payment status of borrowers in the group, or economic conditions that correlate with defaults in the group.

3. Significant accounting policies (continued)

(f) Impairment (continued)

(i) Financial assets carried at amortized cost

Financial assets carried at amortized cost consist principally of loans and other receivables (loans and receivables). The Bank reviews its loans and receivables to assess impairment on a regular basis.

The Bank first assesses whether objective evidence of impairment exists individually for loans and receivables that are individually significant, and individually or collectively for loans and receivables that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed loan or receivable, whether significant or not, it includes the loan or receivable in a group of loans and receivables with similar credit risk characteristics and collectively assesses them for impairment. Loans and receivables 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 objective evidence that an impairment loss on a loan or receivable has been incurred, the amount of the loss is measured as the difference between the carrying amount of the loan or receivable and the present value of estimated future cash flows including amounts recoverable from guarantees and collateral discounted at the loan or receivable's original effective interest rate. Contractual cash flows and historical loss experience adjusted on the basis of relevant observable data that reflects current economic conditions provide the basis for estimating expected cash flows.

In some cases the observable data required to estimate the amount of an impairment loss on a loan or receivable may be limited or no longer fully relevant to current circumstances. This may be the case when a borrower is in financial difficulties and there is little available historical data related to similar borrowers. In such cases, the Bank uses its experience and judgment to estimate the amount of any impairment loss.

All impairment losses in respect of loans and receivables are recognized in profit or loss and are only reversed if a subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognized.

When a loan is uncollectable, it is written off against the related allowance for loan impairment. The Bank writes off a loan's outstanding amount (and any related allowances for loan losses) when management determines that the loans are uncollectible and when all necessary steps to collect the loan are completed.

(ii) Available-for-sale financial investments

For available-for-sale financial investments, the Bank assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition coast and the current fair value, less any impairment loss on that investment previously recognised in profit or loss – is reclassified from other comprehensive income to profit or loss.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in profit or loss. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

(iii) Non-financial assets

Non-financial assets, other than deferred taxes, are assessed at each reporting date for any indications of impairment. The recoverable amount of non-financial assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. An impairment loss is recognized when the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

All impairment losses in respect of non-financial assets are recognized in profit or loss and reversed only if there has been a change in the estimates used to determine the recoverable amount. Any impairment loss reversed is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

3. Significant accounting policies (continued)

(g) Credit related commitments

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

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

A financial guarantee liability is recognized initially at fair value net of associated transaction costs, and is measured subsequently at the higher of the amount initially recognized, less cumulative amortization or the amount of provision for losses under the guarantee. Provisions for losses under financial guarantees and other credit related commitments are recognized when losses are considered probable and can be measured reliably.

Financial guarantee liabilities and provisions for other credit related commitment are included in other liabilities.

(h) Share capital

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

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

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

(i) Income tax

Income tax expense comprises current and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or in other comprehensive income.

Current tax

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Current tax payable also includes any tax liability arising from dividends.

On 13 May 2016 the Parliament of Georgia passed the bill on corporate income tax reform (also known as the Estonian model of corporate taxation), which mainly moves the moment of taxation from when taxable profits are earned to when they are distributed. The law has entered into force in 2016 and is effective for tax periods starting after 1 January 2017 for all entities except for financial institutions (such as banks, insurance companies, microfinance organizations, pawnshops), for which the law should become effective from 1 January 2019.

The new system of corporate income taxation does not imply exemption from Corporate Income Tax (CIT), rather CIT taxation is shifted from the moment of earning the profits to the moment of their distribution; i.e. the main tax object is distributed earnings. Corporate income tax is paid on dividends is levied on profit distributed as dividends to the shareholders that are individuals or non-residents of Georgia at the rate of 15/85 of net distribution. The Tax Code of Georgia defines Distributed Earnings (DE) to mean profit distributed to shareholders as a dividend.

Tax reimbursement is available for the current tax paid on the undistributed earnings in the years 2008-2016, if those earnings are distributed in 2019 or further years.

The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared, regardless of the actual payment date or the period for which the dividends are paid.

Some other transactions are also considered as DE, for example non-arm's length cross-border transactions with related parties and/or with persons exempted from tax are also considered as DE for CIT purposes. In addition, the tax object includes expenses or other payments not related to the entity's economic activities, free of charge supply and over-limit representative expenses. Taxation of such transactions is accounted similar to operating taxes and is reported as Taxes other than on income within Other general administrative expenses in statement of profit or loss and other comprehensive income.

3. Significant accounting policies (continued)

(i) Income tax (continued)

Deferred tax

Deferred tax is provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities until 1 January 2019, using tax rates enacted or substantially enacted at the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available until 1 January 2019 against which the temporary differences, unused tax losses and credits can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Due to the nature of the new taxation system described above, the financial institutions registered in Georgia will not have any differences between the tax bases of assets and their carrying amounts from 1 January 2019 and hence, no deferred income tax assets and liabilities will arise thereon.

(j) Income and expense recognition

Interest income and expense are recognized in profit or loss using the effective interest method.

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

Other fees, commissions and other income and expense items are recognized in profit or loss when the corresponding service is provided.

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

4. Net interest income

	2017 *000'GEL*	*2016* *000'GEL*	*2015* *000'GEL*
Interest income			
Loans to customers	17,205	15,106	12,096
Cash and cash equivalents and due from banks	1,028	1,251	671
Investment securities	617	16	–
	18,850	**16,373**	**12,767**
Interest expense			
Deposits and balances from banks	(4,475)	(5,996)	(3,437)
Other borrowed funds and subordinated debt	(3,515)	–	(186)
Current accounts and deposits from customers	(2,605)	(1,896)	(2,437)
	(10,595)	**(7,892)**	**(6,060)**
Net interest income	**8,255**	**8,481**	**6,707**

5. Net fee and commission income

	2017 *000'GEL*	*2016* *000'GEL*	*2015* *000'GEL*
Fee and commission income			
Settlement operations	355	389	341
Other operations	365	687	397
Commissions from guarantees	250	258	65
Total fee and commission income	**970**	**1,334**	**803**

5. Net fee and commission income (continued)

	2017 000'GEL	*2016 000'GEL*	*2015 000'GEL*
Fee and commission expense			
Settlement operations	231	259	248
Other operatıons	647	782	429
Total fee and commission expense	**878**	**1,041**	**677**
Total net fee and commission income	**92**	**293**	**126**

6. Other general administrative expenses

	2017 000'GEL	*2016 000'GEL*	*2015 000'GEL*
Operating lease	1,058	1,003	814
Depreciation and amortization (Note 11)	793	836	563
Write-off of other assets	349	–	–
Professional services	197	384	350
Deposit insurance expense	100	–	–
Entertainment expenses	94	34	48
Communications and information services	65	58	115
Travel expenses	53	17	58
Utilities	47	38	32
Repairs and maintenance	34	5	21
Advertising and marketing	23	11	10
Taxes other than on income	21	15	40
Office supplies	15	19	15
Insurance	–	11	18
Other	380	326	118
	3,229	**2,757**	**2,202**

Remuneration of the Bank's auditor for the audit of the Bank's annual financial statements the year ended 31 December 2017 comprised GEL 87 thousand (2016: GEL 94 thousand, 2015: GEL 84 thousand) (net of VAT).

7. Income tax expense

	2017 000'GEL	*2016 000'GEL*	*2015 000'GEL*
Current year tax expense	**(594)**	**(126)**	**(23)**
Deferred tax benefit/(expense)			
Movement in deferred tax assets and liabilities due to origination and reversal of temporary differences	380	(376)	(182)
Write off of tax loss carried forward	–	(163)	–
	380	**(539)**	**(182)**
Total income tax expense	**(214)**	**(665)**	**(205)**

In 2017, the applicable tax rate for current and deferred tax is 15% (2016: 15%; 2015: 15%).

Reconciliation of effective tax rate for the year ended 31 December:

	2017 000'GEL	*%*	*2016 000'GEL*	*%*	*2015 000'GEL*	*%*
Profit before tax	**1,738**	**100%**	**4,452**	**100%**	**1,876**	**100%**
Income tax at the applicable tax rate	**(261)**	**(15%)**	**(668)**	**(15%)**	**(281)**	**(15%)**
Non-taxable income and other differences	47	3%	3	0%	76	4%
	(214)	**(12%)**	**(665)**	**(15%)**	**(205)**	**(11%)**

7. Income tax expense (continued)

(a) Deferred tax assets and liabilities

Movements in temporary differences during the years ended 31 December 2017, 2016 and 2015 are presented as follows.

000'GEL	*Balance 1 January 2017*	*Recognized in profit or loss*	*Recognized in other comprehensive income*	*Balance 31 December 2017*
Property, equipment and intangible assets	24	(24)	–	–
Loans to customers	(603)	468	–	(135)
Investment securities available-for-sale	–	(36)	(10)	(46)
Other liabilities	–	(28)	–	(28)
Net tax (liabilities)/assets	**(579)**	**380**	**(10)**	**(209)**

000'GEL	*Balance 1 January 2016*	*Recognized in profit or loss*	*Recognized in other comprehensive income*	*Balance 31 December 2016*
Property, equipment and intangible assets	7	17	–	24
Loans to customers	(210)	(393)	–	(603)
Tax loss carry-forwards	163	(163)	–	–
Net tax liabilities	**(40)**	**(539)**	**–**	**(579)**

000'GEL	*Balance 1 January 2015*	*Recognized in profit or loss*	*Recognized in other comprehensive income*	*Balance 31 December 2015*
Property, equipment and intangible assets	(21)	28	–	7
Loans to customers	–	(210)	–	(210)
Tax loss carry-forwards	163	–	–	163
Net tax assets/(liabilities)	**142**	**(182)**	**–**	**(40)**

8. Cash and cash equivalents

	2017 000'GEL	*2016 000'GEL*	*2015 000'GEL*
Cash on hand	**4,249**	**3,865**	**2,646**
Cash equivalents			
Nostro accounts with the NBG	530	423	528
Nostro accounts with other banks rated BB-	12,707	3,198	17,710
Term deposits with other banks:			
- rated BB-	2,593	33,964	13,503
- not rated	1,500	2,648	4,502
Total cash equivalents	**17,330**	**40,233**	**36,243**
Total cash on hand and cash equivalents	**21,579**	**44,098**	**38,889**

No cash and cash equivalents are impaired or past due.

As at 31 December 2017 the Bank has a placement with one bank (2016: two banks; 2015: three banks) with carrying value that individually exceeds 10% of equity. The gross value of that balance as at 31 December 2017 is GEL 14,862 thousand (2016: GEL 34,799 thousand; 2015: GEL 34,557 thousand).

The above ratings are based on Fitch Ratings agency.

9. Loans to customers

	2017 000'GEL	*2016 000'GEL*	*2015 000'GEL*
Loans to legal entities			
Loans to corporate customers	142,636	162,872	140,507
Loans to small and medium size companies	8,223	10,828	2,867
Total loans to legal entities	**150,859**	**173,700**	**143,374**
Loans to individuals			
Consumer loans	4,747	5,774	3,344
Mortgage loans	2,710	2,073	1,297
Overdrafts	199	130	22
Total loans to individuals	**7,656**	**7,977**	**4,663**
Gross loans to customers	**158,515**	**181,677**	**148,037**
Impairment allowance	(1,511)	(1,891)	(2,752)
Net loans to customers	**157,004**	**179,786**	**145,285**

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2017 are as follows:

	Loans to legal entities 000'GEL	*Loans to individuals 000'GEL*	*Total 000'GEL*
Balance at the beginning of the year	**1,403**	**488**	**1,891**
Net reversal	(362)	(18)	(380)
Balance at the end of the year	**1,041**	**470**	**1,511**

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2016 are as follows:

	Loans to legal entities 000'GEL	*Loans to individuals 000'GEL*	*Total 000'GEL*
Balance at the beginning of the year	**2,568**	**184**	**2,752**
Net (reversal)/charge	(1,165)	304	(861)
Balance at the end of the year	**1,403**	**488**	**1,891**

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2015 are as follows:

	Loans to legal entities 000'GEL	*Loans to individuals 000'GEL*	*Total 000'GEL*
Balance at the beginning of the year	**1,395**	**33**	**1,428**
Net charge	1,173	151	1,324
Balance at the end of the year	**2,568**	**184**	**2,752**

9. Loans to customers (continued)

(a) Credit quality of loans to customers

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

	Gross loans 000'GEL	*Impairment allowance 000'GEL*	*Net loans 000'GEL*	*Impairment allowance to gross loans, %*
Loans to legal entities				
Loans to corporate customers				
Individually assessed impaired loans	2,286	(37)	2,249	1.63%
Individually assessed not impaired loans	140,350	(848)	139,502	0.60%
Total loans to corporate customers	**142,636**	**(885)**	**141,751**	**0.62%**
Loans to small and medium size companies				
Individually assessed impaired loans	1,988	(36)	1,952	1.79%
Individually assessed not impaired loans	1,686	(74)	1,612	4.42%
Collectively assessed not impaired loans	4,549	(46)	4,503	1.01%
Total loans to small and medium size companies	**8,223**	**(156)**	**8,067**	**1.90%**
Total loans to legal entities	**150,859**	**(1,041)**	**149,818**	**0.69%**
Loans to individuals				
Consumer loans				
- not overdue	4,456	(182)	4,274	4.09%
- overdue less than 90 days	51	(14)	37	29.22%
- overdue more than 90 days	356	(233)	123	65.34%
Mortgage loans				
- not overdue	2,590	(22)	2,568	0.84%
- overdue less than 90 days	4	–	4	0.00%
- overdue more than 90 days	–	–	–	0.00%
Overdrafts				
- not overdue	199	(19)	180	9.34%
Total loans to individuals	**7,656**	**(470)**	**7,186**	**6.14%**
Total loans to customers	**158,515**	**(1,511)**	**157,004**	**0.97%**

Individually assessed impaired loans to corporate customers decreased by GEL 64,818 thousand in 2017 due to full repayment of the two loans with the gross amount of GEL 49,137 thousand and decrease of risk exposure on the other two borrowers with the gross amount of GEL 8,656 thousand, out of which one borrower with the gross amount of GEL 7,025 thousand was transferred to individually assessed not impaired loans.

From individually assessed impaired loans to corporate customers and small and medium size companies of GEL 4,274 thousand, GEL 2,286 thousand is not overdue and GEL 1,988 thousand is overdue for more than 90 days.

From total loans to customers of GEL 158,515 thousand GEL 155,755 thousand is not in overdue, GEL 69 is overdue for less than 90 days and GEL 2,691 thousand is overdue for more than 90 days (1.7% of total loans to customers).

9. Loans to customers (continued)

(a) Credit quality of loans to customers (continued)

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

	Gross loans 000'GEL	*Impairment allowance 000'GEL*	*Net loans 000'GEL*	*Impairment allowance to gross loans, %*
Loans to legal entities				
Loans to corporate customers				
Individually assessed impaired loans	67,104	(92)	67,012	0.14%
Individually assessed not impaired loans	95,768	(1,046)	94,722	1.09%
Total loans to corporate customers	**162,872**	**(1,138)**	**161,734**	**0.70%**
Loans to small and medium size companies				
Individually assessed impaired loans	1,988	(40)	1,948	2.01%
Individually assessed not impaired loans	4,270	(73)	4,197	1.71%
Collectively assessed not impaired loans	4,570	(152)	4,418	3.33%
Total loans to small and medium size companies	**10,828**	**(265)**	**10,563**	**2.45%**
Total loans to legal entities	**173,700**	**(1,403)**	**172,297**	**0.81%**
Loans to individuals				
Consumer loans				
- not overdue	4,814	(162)	4,652	3.37%
- overdue less than 90 days	347	(12)	335	3.46%
- overdue more than 90 days	613	(286)	327	46.66%
Mortgage loans				
- not overdue	2,032	(19)	2,013	0.94%
- overdue less than 90 days	41	(1)	40	2.44%
- overdue more than 90 days	–	–	–	0.00%
Overdrafts				
- not overdue	130	(8)	122	6.15%
Total loans to individuals	**7,977**	**(488)**	**7,489**	**6.12%**
Total loans to customers	**181,677**	**(1,891)**	**179,786**	**1.04%**

No provision was provided on individually assessed loans with signs of impairment of GEL 62,224 thousand as they are fully collateralized by cash and deposits, see Note 9 (c) (i) and therefore the credit risk is fully mitigated. In case of a default of those loans the cash collaterals can be repossessed. Cash and deposits are provided as a cash cover against loans to customers to be in compliance with single borrower lending limits in accordance with the NBG regulation. From individually assessed impaired loans of GEL 67,104 thousand, GEL 17,967 thousand is not overdue and GEL 49,137 thousand is overdue for less than 90 days. From total loans to customers of GEL 181,677 thousand GEL 2,744 thousand is overdue for more than 90 days, which amounts 1.51% of total loans to customers.

9. Loans to customers (continued)

(a) Credit quality of loans to customers (continued)

The following table provides information on the credit quality of the loans to customers as at 31 December 2015:

	Gross loans 000'GEL	*Impairment allowance 000'GEL*	*Net loans 000'GEL*	*Impairment allowance to gross loans, %*
Loans to legal entities				
Loans to corporate customers				
Individually assessed impaired loans	57,447	–	57,447	0.00%
Individually assessed not impaired loans	82,913	(2,498)	80,415	3.01%
Collectively assessed not impaired loans	147	(14)	133	9.52%
Total loans to corporate customers	**140,507**	**(2,512)**	**137,995**	**1.79%**
Loans to small and medium size companies				
Individually assessed not impaired loans	709	(14)	695	1.97%
Collectively assessed not impaired loans	2,158	(42)	2,116	1.95%
Total loans to small and medium size companies	**2,867**	**(56)**	**2,811**	**1.95%**
Total loans to legal entities	**143,374**	**(2,568)**	**140,806**	**1.79%**
Loans to individuals				
Consumer loans				
- not overdue	3,070	(131)	2,939	4.27%
- overdue less than 90 days	247	(12)	235	4.86%
- overdue more than 90 days	27	(27)	–	100.00%
Mortgage loans				
- not overdue	1,184	(12)	1,172	1.01%
- overdue less than 90 days	113	(1)	112	0.88%
Overdrafts				
- not overdue	22	(1)	21	4.55%
Total loans to individuals	**4,663**	**(184)**	**4,479**	**3.95%**
Total loans to customers	**148,037**	**(2,752)**	**145,285**	**1.86%**

No provision was provided on loans of GEL 57,447 thousand with individual signs of impairment as they are fully collateralized by cash and deposits, see Note 9 (c) (i) and therefore the credit risk is fully mitigated; in case of a default of those loans the cash collaterals can be repossessed. Cash and deposits are provided as a cash cover against loans to customers to be in compliance with single borrower lending limits in accordance with the NBG regulation.

As at 31 December 2017 in the loan portfolio renegotiated loans to legal entities and individuals that would otherwise be past due or impaired were GEL 2,331 thousand (2016: GEL 60,380 thousand, 2015: GEL 48,173 thousand).

(b) Key assumptions and judgments for estimating loan impairment

(i) Individually significant loans

The Bank uses a threshold of 1.5% of total equity to consider a borrower as individually significant. Impairment for loans to significant borrowers is determined based on an analysis of following triggers:

- The loan meets the definition of a non-performing loan;
- The loan has been restructured;
- There was a material decrease in the collateral value;
- There was a material decrease in the estimated future cash flows of the borrower;
- There is an evident deterioration in the borrower's debt servicing capacity.

The amount of impairment is measured as the difference between the carrying amount of the credit facility and the present value of estimated future cash flows, discounted at the credit facility's original effective interest rate. The estimated future cash flows will include any expected cash flows from the borrowers operations, any other sources of funds and the expected proceeds from the liquidation of collateral, where applicable.

9. Loans to customers (continued)

(b) Key assumptions and judgments for estimating loan impairment (continued)

(ii) Collectively assessed loans

For the assessment of collectively assessed loans, the Bank estimates loan impairment based on the following criteria:

- Credit facility type;
- Collateral type;
- Days in arrears;
- Economic sectors.

Based on the above criteria, the Bank creates the following groups for collective assessment and determines impairment provision rates, based on the banking sector financial information as provided by the NBG to the financial institutions, as well as on the loss given default assumptions based on the expected proceeds from collateral.

(c) Analysis of collateral and other credit enhancements

(i) Loans to legal entities

Loans to legal entities are subject to individual credit appraisal and impairment testing. The general creditworthiness of a legal entity tends to be the most relevant indicator of credit quality of the loan extended to it. However, collateral provides additional security and the Bank generally requests corporate borrowers to provide it.

The following tables provides information on collateral and other credit enhancements securing loans to legal entities, net of impairment, by types of collateral:

31 December 2017 000'GEL	***Loans to customers, carrying amount***	***Value of collateral assessed as of loan inception date***
Loans to legal entities		
Loans to corporate customers		
Cash and deposits	52,680	52,680
Real estate	78,449	78,449
Other	10,622	10,622
Total loans to corporate customers	**141,751**	**141,751**
Loans to small and medium size companies		
Cash and deposits	2,306	2,306
Real estate	3,539	3,539
Other	1,875	1,875
Unsecured	347	–
Total loans to small and medium size companies	**8,067**	**7,720**
Total loans to legal entities	**149,818**	**149,471**

31 December 2016 000'GEL	***Loans to customers, carrying amount***	***Value of collateral assessed as of loan inception date***
Loans to legal entities		
Loans to corporate customers		
Cash and deposits	134,336	134,336
Real estate	27,398	27,398
Unsecured	–	–
Total loans to corporate customers	**161,734**	**161,734**
Loans to small and medium size companies		
Cash and deposits	17	17
Real estate	10,150	10,150
Unsecured	396	–
Total loans to small and medium size companies	**10,563**	**10,167**
Total loans to legal entities	**172,297**	**171,901**

9. Loans to customers (continued)

(c) Analysis of collateral and other credit enhancements (continued)

31 December 2015 *000'GEL*	*Loans to customers, carrying amount*	*Value of collateral assessed as of loan inception date*
Loans to legal entities		
Loans to corporate customers		
Cash and deposits	111,396	111,396
Real estate	22,199	22,199
Unsecured	4,400	–
Total loans to corporate customers	**137,995**	**133,595**
Loans to small and medium size companies		
Cash and deposits	695	695
Real estate	2,116	2,116
Total loans to small and medium size companies	**2,811**	**2,811**
Total loans to legal entities	**140,806**	**136,406**

The tables above excludes overcollateralization. Information on the valuation of collateral is based on when this estimate was made, if any.

For loans secured by multiple types of collateral, collateral that is most relevant for impairment assessment is disclosed. Sureties received from individuals, such as shareholders of small and medium size borrowers, are not considered for impairment assessment purposes. Accordingly, such loans and unsecured portions of partially secured exposures are presented as loans without collateral or other credit enhancement.

The recoverability of loans which are neither past due nor impaired primarily depends on the creditworthiness of borrowers rather than the value of collateral, and the Bank does not necessarily update the valuation of collateral as at each reporting date.

(ii) Loans to individuals

Mortgage loans and partly consumer loans are secured by the underlying real estate. The Bank has a policy that defines maximal loan-to-value ratios at the date of loan issuance to individuals.

The following tables provide information on real estate collateral securing loans to individuals, net of impairment:

31 December 2017 *000'GEL*	*Loans to customers, carrying amount*	*Value of collateral assessed as of loan inception date*
Loans to individuals		
Consumer loans		
Real estate	1,822	1,822
Other	867	867
Unsecured	1,687	–
Mortgage loans		
Real estate	2,629	2,629
Overdrafts		
Unsecured	181	–
Total loans individuals	**7,186**	**5,318**

9. Loans to customers (continued)

(c) Analysis of collateral and other credit enhancements (continued)

31 December 2016 *000'GEL*	*Loans to customers, carrying amount*	*Value of collateral assessed as of loan inception date*
Loans to individuals		
Consumer loans		
Real estate	1,950	1,950
Other	75	75
Unsecured	3,289	–
Mortgage loans		
Real estate	2,053	2,053
Overdrafts		
Unsecured	122	–
Total loans individuals	**7,489**	**4,078**

31 December 2015 *000'GEL*	*Loans to customers, carrying amount*	*Value of collateral assessed as of loan inception date*
Loans to individuals		
Consumer loans		
Real estate	1,169	1,169
Unsecured	2,005	–
Mortgage loans		
Real estate	1,284	1,284
Overdrafts		
Unsecured	21	–
Total loans individuals	**4,479**	**2,453**

The tables above exclude overcollateralization.

For certain loans above the Bank updates the appraised values of collateral obtained at inception of the loan to the current values, taking into account the approximate changes in property values. The Bank may also obtain a specific individual valuation of collateral at each reporting date where there are indications of impairment. For the remaining loans the fair value of collateral was estimated at inception of the loans and was not adjusted for subsequent changes to the reporting date.

For overdrafts, there is no collateral or it is impracticable to determine the fair value of the collateral. Per management estimates recoverability of these loans is primarily dependent on the creditworthiness of the borrowers rather than the collateral.

9. Loans to customers (continued)

(d) 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 *000'GEL*	*2016* *000'GEL*	*2015* *000'GEL*
Healthcare	51,237	82,323	82,917
Consumer goods	31,507	17,692	13,258
Energy	21,026	–	–
Construction and land development	17,554	34,492	30,929
Production and trade of clothes, shoes and textiles	10,101	11,616	–
Hotels and tourism	7,025	25,589	10,448
Real estate management	5,526	–	3,830
Agriculture	1,988	1,988	1,992
Financial institutions	1,701	–	–
Other sectors	3,194	–	–
Loans to individuals	7,656	7,977	4,663
	158,515	**181,677**	**148,037**
Impairment allowance	(1,511)	(1,891)	(2,752)
	157,004	**179,786**	**145,285**

(e) Significant credit exposures

As at 31 December 2017 the Bank has loans issued to eleven borrowers or groups of connected borrowers (2016: eight; 2015: eight) with carrying values that individually exceed 10% of equity. The gross value of these loans as at 31 December 2017 is GEL 136,138 thousand (2016: GEL 157,824 thousand; 2015: GEL 128,372 thousand). Cash collateral of GEL 45,071 thousand was obtained against these exposures to comply with the NBG requirements (2016: GEL 134,336 thousand 2015: GEL 104,454 thousand), of which GEL 3,596 thousand was provided by the Parent (2016: GEL 92,822 thousand, 2015: GEL 75,236 thousand). Customer deposits and borrowed funds from the Parent had the same maturity as the underlying loans and were not payable unless the loans from the customers were repaid or the collateral is realized.

(f) Loan maturities

The maturity of the loan portfolio is presented in Note 16 (f) which shows the remaining period from the reporting date to the contractual maturity of the loans. Due to the short-term nature of the loans issued by the Bank, it is likely that many of the loans will be renewed at maturity. Accordingly, the effective maturity of the loan portfolio may be significantly longer than the contractually agreed term.

10. Investment securities

Investment securities as at 31 December are as follows:

	2017 *000'GEL*	*2016* *000'GEL*	*2015* *000'GEL*
Available-for-sale			
Treasury bonds of Ministry of Finance of Georgia	13,843	1,018	–
Treasury bonds of Republic of Turkey	10,790	–	–
Total investment securities	**24,633**	**1,018**	**–**

Investment securities pledged under short-term loan from the NBG as at 31 December are as follows:

	2017 *000'GEL*	*2016* *000'GEL*	*2015* *000'GEL*
Available-for-sale			
Treasury bonds of Ministry of Finance of Georgia	4,101	–	–
Total investment securities	**4,101**	**–**	**–**

Treasury bonds of Republic of Turkey are rated BB+ by Fitch.

11. Property, equipment and intangible assets

000'GEL	*Leasehold improve-ments*	*Computers and office equipment*	*Furniture and fixtures*	*Motor vehicles*	*Intangible assets*	*Total*
Cost						
Balance at 1 January 2017	**2,125**	**772**	**344**	**167**	**729**	**4,137**
Additions	–	46	–	–	–	46
Transfer	(26)	–	26	–	–	–
Write-off	(45)	–	–	–	–	(45)
Balance at 31 December 2017	**2,054**	**818**	**370**	**167**	**729**	**4,138**
Depreciation and amortization						
Balance at 1 January 2017	**(1,012)**	**(297)**	**(170)**	**(98)**	**(277)**	**(1,854)**
Write-off	15	–	–	–	–	15
Depreciation and amortization for the year	(399)	(157)	(72)	(33)	(109)	(770)
Balance at 31 December 2017	**(1,396)**	**(454)**	**(242)**	**(131)**	**(386)**	**(2,609)**
Carrying amount						
At 31 December 2017	**658**	**364**	**128**	**36**	**343**	**1,529**

000'GEL	*Leasehold improve-ments*	*Computers and office equipment*	*Furniture and fixtures*	*Motor vehicles*	*Intangible assets*	*Total*
Cost						
Balance at 1 January 2016	**2,095**	**513**	**344**	**168**	**729**	**3,849**
Additions	30	259	–	(1)	–	288
Balance at 31 December 2016	**2,125**	**772**	**344**	**167**	**729**	**4,137**
Depreciation and amortization						
Balance at 1 January 2016	**(531)**	**(159)**	**(101)**	**(59)**	**(168)**	**(1,018)**
Depreciation and amortization for the year	(481)	(138)	(69)	(39)	(109)	(836)
Balance at 31 December 2016	**(1,012)**	**(297)**	**(170)**	**(98)**	**(277)**	**(1,854)**
Carrying amount						
At 31 December 2016	**1,113**	**475**	**174**	**69**	**452**	**2,283**

000'GEL	*Leasehold improve-ments*	*Computers and office equipment*	*Furniture and fixtures*	*Total*
Cost				
Balance at 1 January 2015	**1,254**	**285**	**221**	**2,406**
Additions	841	228	123	1,443
Balance at 31 December 2015	**2,095**	**513**	**344**	**3,849**
Depreciation and amortization				
Balance at 1 January 2015	**(206)**	**(89)**	**(54)**	**(455)**
Depreciation and amortization for the year	(325)	(70)	(47)	(563)
Balance at 31 December 2015	**(531)**	**(159)**	**(101)**	**(1,018)**
Carrying amount				
At 31 December 2015	**1,564**	**354**	**243**	**2,831**

12. Deposits and balances from banks

	2017 000'GEL	*2016 000'GEL*	*2015 GEL*
Vostro accounts	5,265	1,047	2,800
Term deposits	46,189	172,837	123,424
Short-term loan from the NBG	3,002	–	–
	54,456	**173,884**	**126,224**

As at 31 December 2017 the Bank has placements with two banks (2016: two banks; 2015: two banks) with carrying values that individually exceed 10% of equity. The gross value of these balances as at 31 December 2017 is GEL 48,342 thousand (2016: GEL 173,884 thousand; 2015: GEL 126,224 thousand).

The major part of term deposits in 2016 and 2015 was obtained from the Parent to be in compliance with NBG requirement, see Note 9 (e).

As at 31 December 2017, short-term loan from the NBG with carrying value of GEL 3,002 thousand was secured by investment securities available-for-sale with fair value of GEL 4,101 (Note 10).

13. Current accounts and deposits from customers

	2017 000'GEL	*2016 000'GEL*	*2015 000'GEL*
Current accounts and demand deposits			
- Retail	3,471	4,065	6,054
- SME	3,837	3,532	1,872
- Corporate	7,400	2,588	1,404
Term deposits			
- Retail	50,510	50,897	40,551
- SME	7,112	4,018	103
- Corporate	1,693	–	5,032
	74,023	**65,100**	**55,016**

As at 31 December 2017 the Bank maintained customer deposit balances of GEL 49,786 thousand (2016: GEL 43,761 thousand; 2015: GEL 35,085 thousand) that serve as collateral for loans granted by the Bank. As at 31 December 2017 the Bank has placements from five customers (2016: four customers; 2015: six customers) with carrying values that individually exceed 10% of equity. These balances as at 31 December 2017 are GEL 49,003 thousand (2016: GEL 43,717 thousand; 2015: GEL 46,031 thousand).

14. Other borrowed funds and subordinated debt

	2017 000'GEL	*2016 000'GEL*	*2015 000'GEL*
Borrowings from the Parent	12,918	–	–
Other financial institutions	12,568	–	–
Total other borrowed funds	**25,486**	**–**	**–**
Subordinated loan from the Parent	43,152	–	–
Total other borrowed funds and subordinated debt	**68,638**	**–**	**–**

Borrowings from the Parent are obtained under the special program of Turkish Eximbank supporting trade with Turkey, and are usually utilized by the Bank for corporate and SME lending purposes. Borrowings from the Parent are denominated in EUR and mature in 2019.

14. Other borrowed funds and subordinated debt (continued)

Subordinated loan from the Parent is denominated in USD and matures in 2027.

	Other borrowed funds	*Subordinated loans*	*Total liabilities from financing activities*
Carrying amount at 31 December 2016	**–**	**–**	**–**
Proceeds from issue	24,360	43,795	68,155
Redemption	–	–	–
Foreign currency translation	950	(2,320)	(1,370)
Other	176	1,677	1,853
Carrying amount at 31 December 2017	**25,486**	**43,152**	**68,638**

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.

15. Capital management

The National Bank of Georgia sets and monitors capital requirements for the Bank.

The Bank defines as capital those items defined by statutory regulation as capital for credit institutions. Under the current capital requirements set by the NBG, banks have to maintain a ratio of capital to risk weighted exposures (statutory capital ratio) above the prescribed minimum level.

The compliance with the capital adequacy ratios set by the NBG is monitored monthly with the reports outlining their calculation and are reviewed and signed by the Bank’s CEO and CFO.

Basel I

Under the NBG Basel I capital requirements banks have to maintain a ratio of regulatory capital to risk weighted exposures (“statutory capital ratio”) above the minimum level of 9.6% and a ratio of Tier 1 capital to risk weighted exposures above the minimum level of 6.4%. The bank was in compliance with the minimum requirement of NBG. 2017 is the last year for Basel I capital requirement and it will be removed fully from January 2018.

As at 31 December 2016 and throughout the period until 31 December 2017 minimal requirement of capital to risk weighted exposures was as follow:

Common Equity Tier 1: 7%; Tier 1: 8.5% and Regulatory Capital: 10.5%

Basel III

In December 2017, the NBG has introduced amendments to the “Regulation on Capital Adequacy Requirements for Commercial Banks”. Under the updated capital framework, capital requirements are divided into Pillar 1 Requirements for Common Equity Tier 1, Tier 1 and Regulatory Capital and additional buffers under Pillar 1 and Pillar 2.

Pillar 1

- The capital conservation buffer (which was incorporated in minimum capital requirements) is separated and set at 2.5%;
- A countercyclical capital buffer is currently set at 0%;
- A systemic risk buffer will be introduced for systematically important banks over the 4 years period.

Pillar 2

- A currency induced credit risk (CICR) buffer replaced conservative weighting for un-hedged FX loans denominated in foreign currencies;
- Concentration buffer for sectoral and single borrower exposure will be introduced;
- A net stress buffer will be introduced based on stress testing results provided by the Group;
- A General Risk-assessment Programme (GRAPE) buffer defined by the regulator, based on the Bank’s specific risks.

15. Capital management (continued)

	Minimum Requirement	*Ratios*
1	**Pillar 1 requirement**	
1.1	Core Tier 1 minimum requirement	4.50%
1.2	Tier 1 minimum requirement	6.00%
1.3	Regulatory capital minimum requirement	8.00%
2	**Pillar 1 buffer**	**2.50%**
2.1	The Capital conservation buffer	2.50%
2.2	A countercyclical capital buffer	0.00%
2.3	A systemic risk buffer	0.00%
3	**Pillar 2 buffer**	
3.1	**Core Tier 1 capital requirement**	**1.60%**
3.1.1	Un-hedged FX credit risk buffer	1.60%
3.1.2	Credit portfolio concentration risk buffer	0.00%
3.1.3	Net stress test buffer	0.00%
3.1.4	A General Risk-assessment Programme (GRAPE) buffer	0.00%
3.2	**Tier 1 capital requirement**	**2.13%**
3.2.1	Un-hedged FX credit risk buffer	2.13%
3.2.2	Credit portfolio concentration risk buffer	0.00%
3.2.3	Net stress test buffer	0.00%
3.2.4	A General Risk-assessment Programme (GRAPE) buffer	0.00%
3.3.	**Regulatory capital minimum requirement**	**2.84%**
3.3.1	Un-hedged FX credit risk buffer	2.84%
3.3.2	Credit portfolio concentration risk buffer	0.00%
3.3.3	Net stress test buffer	0.00%
3.3.4	A General Risk-assessment Programme (GRAPE) buffer	0.00%
4	**Total Core Tier 1 minimum requirement**	**8.60%**
5	**Total Tier 1 minimum requirement**	**10.63%**
6	**Total Regulatory capital minimum requirement**	**13.34%**

In addition, specific PTI (payment to income) and LTV (loan to value) thresholds were introduced based on the new methodology. Exposures that do not meet pre-defined PTI and LTV limits are subject to weighting at higher rates.

The calculation of the capital adequacy ratios in accordance with the NBG accounting rules and capital adequacy Basel I framework, effective as at 31 December 2016 is as follows:

000'GEL	*2017*	*2016*
Share capital	30,000	30,000
Retained earnings	4,129	1,049
Deductions	(330)	(602)
Total common equity and Tier 1	**33,799**	**30,447**
Subordinated debt (included in regulatory capital)	41,475	-
General loan loss provisions (up to 1.25 % of risk–weighted exposures)	2,072	1,899
Total regulatory capital	**77,346**	**32,346**

15. Capital management (continued)

000'GEL	*2017*	*2016*
Risk-weighted exposures		
Credit risk-weighted exposures (balance and off-balance items)	166,595	141,806
Market risk-weighted exposures	2,495	1,010
Operational risk-weighted exposures	13,094	8,563
Currency-induced credit risk	62,793	10,141
Total Risk-weighted exposures	**244,977**	**161,520**
Minimum limit for Common Equity Tier 1 Ratio	***7%***	***7%***
Tier 1 Capital adequacy ratio	**13.8%**	**18.9%**
Minimum limit for Total Capital adequacy ratio	***10.5%***	***10.5%***
Total Capital adequacy ratio	**31.6%**	**20.0%**

The calculation of the capital adequacy ratios in accordance with the NBG accounting rules and capital adequacy Basel III framework, effective from 31 December 2017 is as follows:

000'GEL	*2017*
Share capital	30,000
Retained earnings	4,129
Deductions	(330)
Total common equity and Tier 1 capital	**33,799**
Subordinated debt (included in regulatory capital)	41,475
General loan loss provisions (up to 1.25 % of risk–weighted exposures)	2,072
Total regulatory capital	**77,346**
Risk-weighted exposures	
Credit risk-weighted exposures (balance and off-balance items)	166,595
Market risk-weighted exposures	2,495
Operational risk-weighted exposures	13,094
Total Risk-weighted exposures	**182,184**
Common Equity Tier 1 ratio	**18.6%**
Tier 1 capital ratio	**18.6%**
Total regulatory capital ratio	**42.5%**
Common Equity Tier 1 ratio minimum requirement	**8.60%**
Tier 1 capital ratio minimum requirement	**10.63%**
Total regulatory capital minimum requirement	**13.34%**

No comparative information is available in respect of capital adequacy measured in accordance with the NBG Basel III framework which only became effective from 31 December 2017.

The risk-weighted exposures are measured by means of a hierarchy of risk weights classified according to the nature and reflecting an estimate of credit, market and other risks associated with each asset and counterparty, taking into account any eligible collateral or guarantees.

16. Risk management, corporate governance and internal control

(a) Corporate governance framework

The Bank is established as a bank in accordance with Georgian law. The supreme governing body of the Bank is the Supervisory Council. The Supervisory Council makes strategic decisions on the Bank's operations.

The Supervisory Council elects the Board of Directors. The Board of Directors is responsible for overall governance of the Bank's activities.

(b) Internal control policies and procedures

Management has responsibility for the development, implementation and maintaining of internal controls in the Bank that are commensurate with the scale and nature of operations.

The purpose of internal controls is to ensure:

- Proper and comprehensive risk assessment and management;
- Proper business and accounting and financial reporting functions, including proper authorization, processing and recording of transactions;
- Completeness, accuracy and timeliness of accounting records, managerial information, regulatory reports, etc.;
- Reliability of IT-systems, data and systems integrity and protection;
- Prevention of fraudulent or illegal activities, including misappropriation of assets;
- Compliance with laws and regulations.

Management is responsible for identifying and assessing risks, designing controls and monitoring their effectiveness. Management monitors the effectiveness of the Bank's internal controls and periodically implements additional controls or modifies existing controls as considered necessary.

Management believes that the Bank complies with the NBG requirements related to risk management and internal control systems, including requirements related to the internal audit function, and that risk management and internal control systems are appropriate for the scale, nature and complexity of operations.

(c) Risk management policies and procedures

Management of risk is fundamental to the business of banking and forms an essential element of the Bank's operations. The major risks faced by the Bank are those related to market risk, credit risk, liquidity risk and operational risks.

The risk management policies aim to identify, analyze and manage the risks faced by the Bank, to set appropriate risk limits and controls, and to continuously monitor risk levels and adherence to limits. Risk management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and emerging best practice.

Management has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing its risk management policies and procedures as well as approving significantly large exposures.

Management is responsible for monitoring and implementing risk mitigation measures, and ensuring that the Bank operates within established risk parameters. The Head of the Risk Department is responsible for the overall risk management and compliance functions, ensuring the implementation of common principles and methods for identifying, measuring, managing and reporting both financial and non-financial risks. He reports directly to management.

Credit, market and liquidity risks, both at the portfolio and transactional levels, are managed and controlled through a system of Credit Committees and Risk Management Division and ALCO.

Both external and internal risk factors are identified and managed throughout the organization. Particular attention is given to identifying the full range of risk factors and determining the level of assurance over current risk mitigation procedures.

16. Risk management, corporate governance and internal control (continued)

(d) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises currency risk, interest rate risk and other price risks. Market risk arises from open positions in interest rate instruments, which are exposed to general and specific market movements and changes in the level of volatility of market prices and foreign currency rates.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

The Bank manages its market risk by setting open position limits in relation to financial instruments, interest rate maturity and currency positions. These are monitored on a regular basis and reviewed and approved by management.

(i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes, but may also reduce or create losses in the event that unexpected movements occur.

Interest rate gap analysis

Interest rate risk is managed principally through monitoring interest rate gaps. A summary of the interest gap position for major financial instruments is as follows:

000'GEL	*Less than 3 months*	*3-6 months*	*6-12 months*	*1-5 years*	*More than 5 years*	*Carrying amount*
31 December 2017						
Assets						
Cash and cash equivalents	21,579	–	–	–	–	21,579
Amounts due from banks	–	–	434	–	–	434
Mandatory reserves at the NBG	28,897	–	–	–	–	28,897
Investment securities	–	–	4,175	11,203	9,255	24,633
Loans to customers	5,397	12,748	18,845	52,340	67,674	157,004
	55,873	**12,748**	**23,454**	**63,543**	**76,929**	**232,547**
Liabilities						
Accounts and deposits from banks	24,857	–	26,001	3,598	–	54,456
Current accounts and deposits from customers	21,197	2,123	6,079	51	44,573	74,023
Other borrowed funds and subordinated debt	–	–	–	25,486	43,152	68,638
	46,054	**2,123**	**32,080**	**29,135**	**87,725**	**197,117**
	9,819	**10,625**	**(8,626)**	**34,408**	**(10,796)**	**35,430**

000'GEL	*Less than 3 months*	*3-6 months*	*6-12 months*	*1-5 years*	*More than 5 years*	*Carrying amount*
31 December 2016						
Assets						
Cash and cash equivalents	44,098	–	–	–	–	44,098
Mandatory reserves at the NBG	46,607	–	–	–	–	46,607
Investment securities	–	–	–	1,018	–	1,018
Loans to customers	20,119	8,792	16,915	109,430	24,530	179,786
	110,824	**8,792**	**16,915**	**110,448**	**24,530**	**271,509**

16. Risk management, corporate governance and internal control (continued)

(d) Market risk (continued)

000'GEL	*Less than 3 months*	*3-6 months*	*6-12 months*	*1-5 years*	*More than 5 years*	*Carrying amount*
Liabilities						
Accounts and deposits from banks	12,092	2,648	82,530	44,972	31,642	173,884
Current accounts and deposits from customers	14,064	120	7,156	43,760	–	65,100
	26,156	**2,768**	**89,686**	**88,732**	**31,642**	**238,984**
	84,668	**6,024**	**(72,771)**	**21,716**	**(7,112)**	**32,525**
31 December 2015						
Assets						
Cash and cash equivalents	38,889	–	–	–	–	38,889
Mandatory reserves at the NBG	25,819	–	–	–	–	25,819
Loans to customers	10,663	11,939	20,305	76,668	25,710	145,285
	75,371	**11,939**	**20,305**	**76,668**	**25,710**	**209,993**
Liabilities						
Deposits and balances from banks	3,041	8,167	53,668	11,557	49,791	126,224
Current accounts and deposits from customers	18,787	12,049	5,994	18,186	–	55,016
	21,828	**20,216**	**59,662**	**29,743**	**49,791**	**181,240**
	53,543	**(8,277)**	**(39,357)**	**46,925**	**(24,081)**	**28,753**

Average nominal interest rates

The table below displays average nominal interest rates for interest-bearing assets and liabilities as at 31 December 2017, 2016 and 2015. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

	2017 Average nominal interest rates, %			*2016 Average nominal interest rates, %*			*2015 Average nominal interest rates, %*		
	GEL	*USD*	*EUR*	*GEL*	*USD*	*EUR*	*GEL*	*USD*	*EUR*
Interest bearing assets									
Cash and cash equivalents	7.4%	1.0%	–	6.9%	0.7%	–	8.8%	–	–
Amounts due from banks	–	4.2%	–	–	–	–	–	–	–
Investment securities	7.4%	5.8%	–	6.7%	–	–	–	–	–
Loans to customers	13.1%	6.9%	5.5%	12.8%	8.2%	10.0%	11.9%	10.8%	10.5%
Interest bearing liabilities									
Deposits and balances from banks	7.3%	3.4%	1.2%	–	4.1%	–	–	3.9%	–
Deposits from customers	7.2%	3.9%	–	5.0%	4.3%	–	4.0%	6.4%	2.5%
Other borrowed funds and subordinated debt	–	8.5%	2.6%	–	–	–	–	–	–

Interest rate sensitivity analysis

The management of interest rate risk, based on an interest rate gap analysis, is supplemented by monitoring the sensitivity of financial assets and liabilities. An analysis of the sensitivity of net profit or loss and equity (net of taxes) to changes in interest rates (repricing risk), based on a simplified scenario of a 100 basis point (bps) symmetrical fall or rise in all yield curves and positions of interest-bearing assets and liabilities existing as at 31 December 2017, 2016 and 2015, is as follows:

	2017 000'GEL	*2016 000'GEL*	*2015 000'GEL*
100 bps parallel fall	67	2	211
100 bps parallel rise	(67)	(2)	(211)

16. Risk management, corporate governance and internal control (continued)

(d) Market risk (continued)

Sensitivity of equity (net of taxes) to a 100 bps shift of yield curve as at 31 December 2017 was as follows:

	2017 *000'GEL*
100 bps parallel fall	(98)
100 bps parallel rise	98

(i) Currency risk

The Bank has assets and liabilities denominated in several foreign currencies.

Currency risk is the risk that the fair value or the future cash flows of a financial instrument will fluctuate because of changes in foreign currency exchange rates. The Bank constantly monitors that the NBG limits of currency positions against regulatory capital are maintained.

The following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2017:

	EUR *000'GEL*	*USD* *000'GEL*	*TRY* *000'GEL*	*GBP* *000'GEL*	*Total* *000'GEL*
Assets					
Cash and cash equivalents	11,988	5,568	137	349	18,042
Amounts due from banks	–	434	–	–	434
Mandatory reserves at the NBG	4,863	24,034	–	–	28,897
Investment securities	–	11,262	–	–	11,262
Loans to customers	23,931	107,209	–	–	131,140
Other financial assets	146	247	–	–	393
Total assets	**40,928**	**148,754**	**137**	**349**	**190,168**
Liabilities					
Deposits and balances from banks	13,436	37,663	–	355	51,454
Current accounts and deposits from customers	2,364	66,169	6	–	68,539
Other borrowed funds and subordinated debt	25,486	43,152	–	–	68,638
Other liabilities	–	102	–	–	102
Total liabilities	**41,286**	**147,086**	**6**	**355**	**188,733**
Net position	**(358)**	**1,668**	**131**	**(6)**	**1,435**

The following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2016:

	EUR *000'GEL*	*USD* *000'GEL*	*TRY* *000'GEL*	*GBP* *000'GEL*	*Total* *000'GEL*
Assets					
Cash and cash equivalents	605	39,477	219	284	40,585
Mandatory reserves at the NBG	394	46,213	–	–	46,607
Loans to customers	233	147,853	–	–	148,086
Other financial assets	1	1,120	–	–	1,121
Total assets	**1,233**	**234,663**	**219**	**284**	**236,399**
Liabilities					
Deposits and balances from banks	193	173,408	–	283	173,884
Current accounts and deposits from customers	222	61,701	30	–	61,953
Other liabilities	–	105	–	–	105
Total liabilities	**415**	**235,214**	**30**	**283**	**235,942**
Net position	**818**	**(551)**	**189**	**1**	**457**

16. Risk management, corporate governance and internal control (continued)

(d) Market risk (continued)

The following table shows the currency structure of financial assets and liabilities as at 31 December 2015:

	EUR 000'GEL	*USD 000'GEL*	*TRY 000'GEL*	*GBP 000'GEL*	*Total 000'GEL*
Assets					
Cash and cash equivalents	868	17,208	302	917	19,295
Mandatory reserves at the NBG	296	25,523	–	–	25,819
Loans to customers	159	135,464	–	–	135,623
Other financial assets	–	10	–	–	10
Total assets	**1,323**	**178,205**	**302**	**917**	**180,747**
Liabilities					
Deposits and balances from banks	1,185	124,438	–	601	126,224
Current accounts and deposits from customers	27	53,419	11	–	53,457
Other liabilities	–	24	–	–	24
Total liabilities	**1,212**	**177,881**	**11**	**601**	**179,705**
Net position	**111**	**324**	**291**	**316**	**1,042**

A weakening of the GEL, as indicated below, against the following currencies at 31 December 2017, 2016 and 2015, would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis is on a 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 000'GEL	*2016 000'GEL*	*2015 000'GEL*
20% appreciation of USD against GEL	284	(94)	55
20% appreciation of EUR against GEL	(61)	139	19
20% appreciation of TRY against GEL	22	32	49
20% appreciation of GBP against GEL	(1)	–	54

A strengthening of the GEL against the above currencies at 31 December 2017, 2016 and 2015 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remained constant.

(e) Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Bank has policies and procedures in place to manage credit exposures (both for recognized financial assets and unrecognized contractual commitments), including guidelines to limit portfolio concentration and the establishment of a Credit Committee to actively monitor credit risk. The credit policy is reviewed and approved by management.

The credit policy establishes:

- Procedures for reviewing and approving loan credit applications;
- Methodology for the credit assessment of borrowers (legal entities and individuals);
- Methodology for the evaluation of collateral;
- Credit documentation requirements;
- Procedures for the ongoing monitoring of loans and other credit exposures.

The loans presented for approval are based on limits established by the credit policy. All loans are authorized by the Bank's Credit Committee first. The final decision authority for loans below USD 750,000 is the Bank's Board of Directors, the loans above USD 750,000 and below USD 1,500,000 are authorized by the Supervisory Council Credit Committee and loans over USD 1,500,000 are authorized by the Supervisory Council of the Bank.

16. Risk management, corporate governance and internal control (continued)

For all loans to legal entities the Bank performs due diligence that focuses on the customer's business and financial performance.

Exposure to credit risk is also managed, in part, by obtaining collateral and personal guarantees. Valuation of collateral is performed by independent experts for loans mentioned above.

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

For the analysis of collateral held against loans to customers and concentration of credit risk in respect of loans to customers, see Note 9.

The maximum exposure to credit risk from unrecognized contractual commitments at the reporting date is presented in Note 17.

(f) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to liquidity management. It is unusual for financial institutions ever to be completely matched, since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

The Bank maintains liquidity management with the objective of ensuring that funds will be available at all times to honor all cash flow obligations as they become due. The liquidity policy is reviewed and approved by management.

The Bank seeks to actively support a diversified and stable funding base in order to be able to respond quickly and efficiently to unforeseen liquidity requirements.

The liquidity management policy requires:

- Maintaining a diverse range of funding sources;
- Managing the concentration and profile of debts;
- Maintaining debt financing plans;
- Monitoring liquidity ratios against regulatory requirements.

The liquidity position is monitored by the Finance Department and the Risk Management Division. Under the normal market conditions, information on the liquidity position is presented to the management on a weekly basis. Decisions on liquidity management are made by the Risk management Division and the Management and implemented by the Finance Department.

In addition, the Bank monitors on a regular basis the liquidity ratio calculated in accordance with the NBG requirements.

16. Risk management, corporate governance and internal control (continued)

(f) Liquidity risk (continued)

The following tables show the undiscounted cash flows on financial assets, liabilities and credit-related commitments on the basis of their earliest possible contractual maturity. The total gross inflow and outflow disclosed in the tables is the contractual, undiscounted cash flow on the financial assets, liability or credit related commitment. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee can be called.

The maturity analysis for financial liabilities as at 31 December 2017 is as follows:

000'GEL	*Demand and less than 1 month*	*From 1 to 3 months*	*From 3 to 6 months*	*From 6 to 12 months*	*From 1 to 5 years*	*More than 5 years*	*Total gross amount inflow (outflow)*	*Carrying amount*
Non-derivative liabilities								
Deposits and balances from banks	(25,038)	(169)	(254)	(26,358)	(4,116)	–	(55,936)	(54,456)
Current accounts and deposits from customers	(16,274)	(4,976)	(2,146)	(6,217)	(54)	(53,820)	(83,487)	(74,023)
Other borrowed funds and subordinated debt	(1,786)	(126)	(4,051)	(4,937)	(32,922)	(57,271)	(101,093)	(68,638)
Other liabilities	(3,594)	–	–	–	–	–	(3,594)	(3,594)
Total financial liabilities	**(46,692)**	**(5,271)**	**(6,450)**	**(37,513)**	**(37,093)**	**(111,091)**	**(244,110)**	**(200,711)**
Credit related commitments	**(9,652)**	**–**	**–**	**–**	**–**	**–**	**(9,652)**	**(9,652)**

The maturity analysis for financial liabilities as at 31 December 2016 is as follows:

000'GEL	*Demand and less than 1 month*	*From 1 to 3 months*	*From 3 to 6 months*	*From 6 to 12 months*	*From 1 to 5 years*	*More than 5 years*	*Total gross amount inflow (outflow)*	*Carrying amount*
Non-derivative liabilities								
Deposits and balances from banks	(2,644)	(9,500)	(2,712)	(84,691)	(54,368)	(42,264)	(196,179)	(173,884)
Current accounts and deposits from customers	(21,542)	(291)	(449)	(907)	(44,150)	–	(67,339)	(65,100)
Other liabilities	(1,213)	–	–	–	–	–	(1,213)	(1,203)
Total financial liabilities	**(25,399)**	**(9,791)**	**(3,161)**	**(85,598)**	**(98,518)**	**(42,264)**	**(264,731)**	**(240,187)**
Credit related commitments	**(10,207)**	**–**	**–**	**–**	**–**	**–**	**(10,207)**	**(10,207)**

16. Risk management, corporate governance and internal control (continued)

(f) Liquidity risk (continued)

The maturity analysis for financial liabilities as at 31 December 2015 is as follows:

000'GEL	*Demand and less than 1 month*	*From 1 to 3 months*	*From 3 to 6 months*	*From 6 to 12 months*	*From 1 to 5 years*	*More than 5 years*	*Total gross amount inflow (outflow)*	*Carrying amount*
Non-derivative liabilities								
Deposits and balances from banks	(3,042)	–	(8,257)	(55,054)	(13,309)	(66,460)	(146,122)	(126,224)
Current accounts and deposits from customers	(13,645)	(9,031)	(11,242)	(11,603)	(11,559)	–	(57,080)	(55,016)
Other liabilities	(256)	–	–	–	–	–	(256)	(256)
Total financial liabilities	**(16,943)**	**(9,031)**	**(19,499)**	**(66,657)**	**(24,868)**	**(66,460)**	**(203,458)**	**(181,496)**
Credit related commitments	**(5,310)**	**–**	**–**	**–**	**–**	**–**	**(5,310)**	**(5,310)**

Under Georgian law, individuals can withdraw their term deposits at any time, forfeiting in most of the cases the accrued interest. Accordingly, these deposits are shown in the table below in accordance with their stated maturity. The classification of these deposits in accordance with their stated maturity dates is presented below:

	2017 000'GEL	*2016 000'GEL*	*2015 000'GEL*
Demand and less than 1 month	1,512	–	–
From 1 to 3 months	616	919	426
From 3 to 12 months	3,811	3,677	2,184
From 1 to 5 years	–	6,489	36,432
More than 5 years	44,572	42,349	–
	50,510	**53,434**	**39,042**

16. Risk management, corporate governance and internal control (continued)

(f) Liquidity risk (continued)

The table below shows an analysis, by expected maturities, of amounts recognized in the statement of financial position as at 31 December 2017:

000'GEL	*Demand and less than 1 month*	*From 1 to 3 months*	*From 3 to 12 months*	*From 1 to 5 years*	*More than 5 years*	*No maturity*	*Total*
Assets							
Cash and cash equivalents	21,579	–	–	–	–	–	21,579
Amounts due from banks	–	–	434	–	–	–	434
Mandatory reserves at the NBG	28,897	–	–	–	–	–	28,897
Investment securities	–	–	4,175	11,203	9,255	–	24,633
Loans to customers	2,988	2,409	31,593	52,340	67,674	–	157,004
Property, equipment and intangible assets	–	–	–	–	–	1,529	1,529
Other assets	3,498	–	–	–	–	–	3,498
Total assets	**56,962**	**2,409**	**36,202**	**63,543**	**76,929**	**1,529**	**237,574**
Liabilities							
Deposits and balances from banks	24,857	–	26,001	3,598	–	–	54,456
Current accounts and deposits from customers	17,806	3,391	8,202	51	44,573	–	74,023
Other borrowed funds and subordinated debt	–	–	–	25,486	43,152	–	68,638
Other liabilities	3,594	–	–	–	–	–	3,594
Total liabilities	**46,257**	**3,391**	**34,203**	**29,135**	**87,725**	**–**	**200,711**
Net position	**10,705**	**(982)**	**1,999**	**34,408**	**(10,796)**	**1,529**	**36,863**

16. Risk management, corporate governance and internal control (continued)

(f) Liquidity risk (continued)

The table below shows an analysis, by expected maturities, of amounts recognized in the statement of financial position as at 31 December 2016:

000'GEL	*Demand and less than 1 month*	*From 1 to 3 months*	*From 3 to 12 months*	*From 1 to 5 years*	*More than 5 years*	*No maturity*	*Total*
Assets							
Cash and cash equivalents	44,098	–	–	–	–	–	44,098
Mandatory reserves at the NBG	46,607	–	–	–	–	–	46,607
Investment securities	–	–	–	1,018	–	–	1,018
Loans to customers	8,036	12,083	25,707	109,430	24,530	–	179,786
Property, equipment and intangible assets	–	–	–	–	–	2,283	2,283
Other assets	2,258	–	–	–	–	–	2,258
Total assets	**100,999**	**12,083**	**25,707**	**110,448**	**24,530**	**2,283**	**276,050**
Liabilities							
Deposits and balances from banks	2,640	9,452	85,178	44,972	31,642	–	173,884
Current accounts and deposits from customers	13,191	873	7,276	43,760	–	–	65,100
Other liabilities	1,203	–	–	–	–	–	1,203
Total liabilities	**17,034**	**10,325**	**92,454**	**88,732**	**31,642**	**–**	**240,187**
Net position	**83,965**	**1,758**	**(66,747)**	**21,716**	**(7,112)**	**2,283**	**35,863**

The table below shows an analysis, by expected maturities, of amounts recognized in the statement of financial position as at 31 December 2015:

000'GEL	*Demand and less than 1 month*	*From 1 to 3 months*	*From 3 to 12 months*	*From 1 to 5 years*	*More than 5 years*	*No maturity*	*Total*
Assets							
Cash and cash equivalents	38,889	–	–	–	–	–	38,889
Mandatory reserves at the NBG	25,819	–	–	–	–	–	25,819
Loans to customers	7,118	3,545	32,244	76,668	25,710	–	145,285
Property, equipment and intangible assets	–	–	–	–	–	2,831	2,831
Other assets	233	–	–	–	–	–	233
Total assets	**72,059**	**3,545**	**32,244**	**76,668**	**25,710**	**2,831**	**213,057**
Liabilities							
Deposits and balances from banks	3,041	–	61,835	11,557	49,791	–	126,224
Current accounts and deposits from customers	9,519	9,267	18,043	18,187	–	–	55,016
Other liabilities	280	–	–	–	–	–	280
Total liabilities	**12,840**	**9,267**	**79,878**	**29,744**	**49,791**	**–**	**181,520**
Net position	**59,219**	**(5,722)**	**(47,634)**	**46,924**	**(24,081)**	**2,831**	**31,537**

16. Risk management, corporate governance and internal control (continued)

(g) Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks, such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior. Operational risks arise from all of the Bank's operations.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and innovation. In all cases, the Bank policy requires compliance with all applicable legal and regulatory requirements.

The Bank manages operational risk by establishing internal controls that management determines to be necessary in each area of its operations.

17. Credit related commitments

The Bank has outstanding credit related commitments to extend loans. These credit related commitments take the form of overdraft facilities.

The Bank provides financial guarantees to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to five years.

The Bank applies the same credit risk management policies and procedures when granting credit commitments, financial guarantees and letters of credit as it does for granting loans to customers.

The contractual amounts of credit related commitments are set out in the following table by category. The amounts reflected in the table for credit related commitments assume that amounts are fully advanced. The amounts reflected in the table for guarantees and letters of credit represent the maximum accounting loss that would be recognized at the reporting date if the counterparties failed completely to perform as contracted.

	2017 000'GEL	***2016 000'GEL***	***2015 000'GEL***
Contracted amount			
Undrawn overdraft facilities	108	483	25
Guarantees	9,544	9,724	5,285
	9,652	**10,207**	**5,310**

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.

Of these credit related commitments GEL 6,437 thousand are to five counterparties (2016: GEL 5,717 thousand to four counterparties; 2015: GEL 3,685 thousand to two counterparties). This exposure represents a significant credit risk exposure to the Bank.

18. Operating leases

(a) Leases as lessee

Non-cancellable operating lease rentals as at 31 December are payable as follows:

	2017 000'GEL	***2016 000'GEL***	***2015 000'GEL***
Less than 1 year	1,065	1,023	998
	1,065	**1,023**	**998**

The Bank leases a number of premises and equipment under operating leases. The leases typically run for an initial period of five years, with an option to then renew the lease. Lease payments are usually increased annually to reflect market rentals. None of the leases includes contingent rentals.

19. Contingencies

(a) Insurance

The insurance industry in Georgia is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available.

(b) Litigations

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.

(c) Taxation contingencies

The taxation system in Georgia continues to evolve and is characterized by frequent changes in legislation, official pronouncements and court decisions, which are sometimes contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities which have the authority to impose severe fines, penalties and interest charges. 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.

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

20. Related party transactions

(a) Control relationships

The Bank is ultimately controlled by Isbank Members' Supplementary Pension Fund.

No publicly available financial statements are produced by the Bank's ultimate controlling party. However, such financial statements are produced by Türkiye İş Bankası Anonim Şirketi, which is an intermediate controlling party of the Bank.

(b) Transactions with the key management personnel

Total remuneration included in personnel expenses for the years ended 31 December 2017, 2016 and 2015 is as follows:

	2017 000'GEL	***2016 000'GEL***	***2015 000'GEL***
Short-term employee benefits	1,135	1,217	725

Loans to and deposits from the key management personnel and respective interest income and expenses were immaterial as at 31 December 2017, 2016 and 2015 and for the years then ended.

20. Related party transactions (continued)

(c) Transactions with the Parent

The outstanding balances and related profit or loss amounts of transactions are as below:

000'GEL	*2017*	*2016*	*2015*
Statement of financial position			
Assets			
Cash and cash equivalents			
- In TRY	74	142	158
- In EUR	26	9	–
- In USD	4	11	–
Liabilities			
Deposits and balances from banks			
- In EUR	13,436	192	1,187
- In USD	8,550	93,087	76,460
- In GBP	355	282	601
Other borrowed funds			
- In USD	43,152	–	–
- In EUR	12,918	–	–
Income/(expense)			
Interest income	12	–	–
Interest expense	(5,802)	(4,486)	(1,895)

The deposits and balances and other borrowed funds from the Parent mature according to contractual maturity as follows: GEL 18,744 thousand matures in less than 12 months, GEL 16,515 thousand during 1 to 5 years and GEL 43,152 thousand in more than 5 years. (2016: GEL 14,168 thousand in less than 12 months, GEL 24,715 thousand during 1 to 5 years and GEL 54,678 thousand in more than 5 years; 2015: GEL 5,328 thousand in less than 12 months, GEL 17,248 thousand during 1 to 5 years and GEL 55,672 thousand in more than 5 years).

21. Fair value of financial assets and liabilities

(a) Fair values estimates and assumptions

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 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.

The objective of valuation techniques is to arrive at a fair value determination that reflects the price that would be received to sell the asset, or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

The following assumptions are used by management to estimate the fair values of financial instruments:

- Discount rates of 9.4% to 16.9% are used for discounting future cash flows from loans to customers;
- A discount rate of 4.7% is used for discounting future cash flows from liabilities.

21. Fair value of financial assets and liabilities

(b) Fair value hierarchy

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements:

- Level 1: quoted market price (unadjusted) in an active market for an identical instrument.
- Level 2: inputs other than quotes prices included within Level 1 that are observable either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: inputs that are unobservable. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Level 1	*Level 2*	*Level 3*	*Total fair value*	*Carrying amount*
Assets measured at fair value					
Investment securities available-for-sale	13,843	10,790	–	24,633	24,633
Assets for which fair values are disclosed					
Loans to customers	–	–	153,884	153,884	157,004
Liabilities for which fair values are disclosed					
Amounts due to customers	–	131,668	–	131,668	128,479

Management believes that the fair value of other financial assets and liabilities approximates their carrying amounts. The principles for determining fair values is disclosed in Note 3c(v).

22. New standards and interpretations not yet adopted

A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2017, and have not been applied in preparing these financial statements. Of these pronouncements, potentially the following will have an impact on the Bank's operations. The Bank plans to adopt these pronouncements when they become effective.

IFRS 9 Financial Instruments

In July 2014, the IASB issued IFRS 9 *Financial Instruments* that replaces IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 addresses 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 estimate of this effect is yet available.

22. New standards and interpretations not yet adopted (continued)

IFRS 9 Financial Instruments (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 is in the process of assessment of the new classification and measurement criteria and their impact on the financial statements. The Bank expects that most of the loans are expected to satisfy the SPPI criterion and will continue to be measured at amortised cost. Investment securities are expected to continue to be measured at fair value.

(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. The Bank is in the process of assessment of the new impairment requirements of IFRS 9.

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 currently does not expect a material effect from initial application of IFRS 15.

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.

22. New standards and interpretations not yet adopted (continued)

IFRS 16 Leases (continued)

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.