JSC Isbank Georgia

Financial statements

for the year ended 31 December 2018
together with Independent auditor's report

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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 (hereinafter, the "Bank"), which comprise the statement of financial position as at 31 December 2018, 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 2018 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.

Other information included in the Bank's 2018 Management Report

Other information consists of the information included in the Bank's 2018 Management Report, other than the financial statements and our auditor's report thereon. Management is responsible for the other information. The Bank's 2018 Management Report is expected to be made available to us after the date of this auditor's report.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon in our report on the audit of the financial statements.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

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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 is 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 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.

Marchello Gelashvili

On behalf of EY LLC

Tbilisi, Georgia

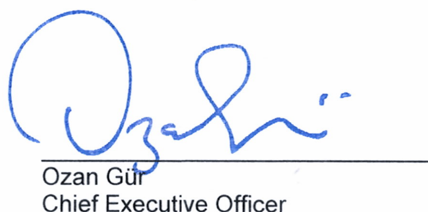
24 May 2019

Statement of profit or loss and other comprehensive income

for the year ended 31 December 2018

	Notes	2018 000'GEL	2017 000'GEL	2016 000'GEL
Interest revenue calculated using effective interest rate		14,672	18,850	16,373
Interest expense		(6,284)	(10,595)	(7,892)
Net interest income	4	**8,388**	**8,255**	**8,481**
Fee and commission income		1,457	970	1,334
Fee and commission expense		(1,366)	(878)	(1,041)
Net fee and commission income	5	**91**	**92**	**293**
Net foreign exchange gain		1,748	808	1,189
Operating income		**10,227**	**9,155**	**9,963**
Credit loss reversal	6	443	380	861
Personnel expenses		(4,635)	(4,568)	(3,615)
Other general administrative expenses	7	(2,808)	(3,229)	(2,757)
Profit before income tax		**3,227**	**1,738**	**4,452**
Income tax expense	8	(677)	(214)	(665)
Profit for the year		**2,550**	**1,524**	**3,787**
Other comprehensive income to be reclassified subsequently to profit or loss when specific conditions are met				
Unrealized net gains/(losses) from investment securities available-for-sale		–	65	–
Net change in fair value and expected credit losses for debt securities at fair value through other comprehensive income		(621)	–	–
Income tax effect	8	94	(10)	–
Net other comprehensive income to be reclassified subsequently to profit or loss when specific conditions are met		**(527)**	**55**	**–**
Other comprehensive income for the year, net of tax		**(527)**	**55**	**–**
Total comprehensive income for the year		**2,023**	**1,579**	**3,787**

The financial statements as set out on pages 5 to 55 were approved by management on 24 May 2019 and were signed on its behalf by:



Ozan Gür
Chief Executive Officer

Ucha Saralidze
Chief Financial Officer

The statement of profit or loss and other comprehensive income for the year ended is to be read in conjunction with the notes to, and forming part of, the financial statements.

Statement of financial position
as at 31 December 2018

	Notes	2018 000'GEL	2017 000'GEL	2016 000'GEL
Assets				
Cash and cash equivalents	9	38,031	21,579	44,098
Amounts due from banks	10	5,155	434	–
Mandatory reserves at the National Bank of Georgia		26,567	28,897	46,607
Loans to customers	11	156,471	157,004	179,786
Investment securities	12	25,461	24,633	1,018
Property, equipment and intangible assets	13	984	1,529	2,283
Other assets	14	12,089	3,498	2,258
Total assets		**264,758**	**237,574**	**276,050**
Liabilities				
Deposits and balances from banks	15	106,509	54,456	173,884
Current accounts and deposits from customers	16	38,352	74,023	65,100
Other borrowed funds and subordinated debt	17	31,916	68,638	–
Deferred tax liabilities	8	649	209	579
Other liabilities	14	9,132	3,385	1,203
Total liabilities		**186,558**	**200,711**	**240,766**
Equity				
Share capital		69,162	30,000	30,000
Fair value reserve on investment securities		(404)	55	–
Retained earnings		9,442	6,808	5,284
Total equity	17	**78,200**	**36,863**	**35,284**
Total liabilities and equity		**264,758**	**237,574**	**276,050**

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 2018

	Notes	2018 000'GEL	2017 000'GEL	2016 000'GEL
Cash flows from operating activities				
Profit before income tax		3,227	1,738	4,452
Adjustments for:				
Depreciation and amortization	13	805	770	836
Interest revenue calculated using effective interest rate	4	(14,672)	(18,850)	(16,373)
Interest expense	4	6,284	10,595	7,892
Credit loss reversal	6	(443)	(380)	(861)
Net foreign exchange gain		(1,748)	(808)	(1,189)
Other non-cash movements		–	80	–
		(6,547)	**(6,855)**	**(5,243)**
Change in operating assets and liabilities				
Decrease/(increase) in mandatory reserves at the National Bank of Georgia		2,895	16,383	(16,203)
Increase in amounts due from banks		(4,721)	(434)	–
(Increase)/decrease in loans to customers		(2,917)	16,624	(17,863)
Increase in other assets		(8,535)	(1,326)	(1,891)
Increase/(decrease) in deposits and balances from banks		46,545	(114,054)	30,061
(Decrease)/increase in current accounts and deposits from customers		(31,452)	8,135	5,368
Increase in other liabilities		5,733	2,192	923
Cash flows received/(used) in operations before interest and foreign exchange		**1,001**	**(79,335)**	**(4,848)**
Interest receipts		19,050	17,438	14,541
Interest payments		(10,539)	(6,796)	(7,925)
Net receipts from foreign exchange		706	719	957
Income tax paid		(949)	(594)	(126)
Cash flows from / (used in) operations		**9,269**	**(68,568)**	**2,599**
Cash flows from investing activities				
Purchases of investment securities		(4,603)	(22,915)	(1,018)
Receipts from investment securities		3,800	–	–
Purchases of property, equipment and intangible assets	13	(260)	(46)	(288)
Cash flows used in investing activities		**(1,063)**	**(22,961)**	**(1,306)**
Cash flows from financing activities				
Receipts from other borrowed funds and subordinated debt	17	26,468	68,155	–
Repayments from other borrowed funds and subordinated debt	17	(59,294)	–	–
Receipts from increase of share capital	17	39,162	–	–
Cash flows from financing activities		**6,336**	**68,155**	**–**
Net increase/(decrease) in cash and cash equivalents		**14,542**	**(23,374)**	**1,293**
Effect of changes in exchange rates and expected credit losses on cash and cash equivalents		658	855	3,916
Cash and cash equivalents as at the beginning of the year	8	21,579	44,098	38,889
Cash and cash equivalents as at the end of the year	8	**38,031**	**21,579**	**44,098**

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 2018

000'GEL	*Notes*	*Share capital*	*Fair value reserve on investment securities*	*Retained earnings*	*Total equity*
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**
Profit for the year		–	–	1,524	**1,524**
Other comprehensive income for the year		–	55	–	**55**
Balance as at 31 December 2017		**30,000**	**55**	**6,808**	**36,863**
Impact of adopting IFRS 9	3	–	68	84	**152**
Balance as at 1 January 2018		**30,000**	**123**	**6,892**	**37,015**
Profit for the year		–	–	2,550	**2,550**
Other comprehensive income for the year		–	(527)	–	**(527)**
Total comprehensive income for the year		**–**	**(527)**	**2,550**	**2,023**
Increase in share capital	17	39,162	–	–	**39,162**
Balance as at 31 December 2018		**69,162**	**(404)**	**9,442**	**78,200**

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 by the National Bank of Georgia (License N: 908) 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"), (License N: 368). The Bank is registered by the LEPL National Agency of Public Registry, and its identification number is 404496611.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its commercial and retail customers. Its main office is in Tbilisi and it has two branches in Tbilisi and Batumi. The Bank's registered legal address is D. Aghmashenebeli Ave. 140/B, Tbilisi, Georgia.

The Bank has a general banking license and its activities are regulated by the National Bank of Georgia (the "NBG").

Significant share of the funding (40% as at 31 December 2017 and 45% as at 31 December 2016) of the Bank was from the Parent. The Bank has diversified its funding base and the Parent's share in funding decreased to 26% as at 31 December 2018. The Bank decrease its dependency on upon the Parent but the activities of the Bank are closely link with the requirements of the Parent.

The Bank is ultimately controlled by Isbank Members' Supplementary Pension Fund. Related party transactions are disclosed in Note 23.

(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.

From the beginning of year 2018 the new regulations on responsible lending practice set by the National Bank of Georgia for commercial banks came into force. The regulations aim to protect consumer rights and bolster healthy credit portfolios at commercial banks. The new regulations enacted on 7 May 2018 obliges commercial banks to fully analyse clients' solvency before issuing a loan. However they do not imply any further limitations for emigrants since remittances as well as other sources of income will be further perceived as approved income. From 1 November 2018, the decree of the President of the National Bank of Georgia entered into force, which activated additional restrictions on issuing loans in the country. According to the changes, loan services Payment To Income (PTI) and provision Loan To Value (LTV) coefficients should not exceed the maximum norms established by the National Bank of Georgia. The regulations apply to any entrepreneurial entity where more than 20 individuals have a loan or credit obligations.

To reduce the level of indebtedness in the country, from 1 September 2018 the maximum annual effective rate on loans has been reduced from 100% to 50% and also, fees, penalties and other financial sanctions for violations shall not exceed 0.27% of the remaining principal amount of the loan for each day and the sum of interest payments, any fees, penalties and other financial sanctions shall not exceed 1.5. times the remaining principal amount of loan.

Those requirements did not have material direct impact on the Bank's performance, however, wider effects of the new regulations might affect the Bank in the manner not currently determinable.

Starting from 1 January 2018 the Bank is a member of the deposit insurance system. The Deposit Insurance Agency is an independent legal entity of the public law (LEPL) that was established on 24 July 2017 in accordance with the Law of Georgia *On Deposit Insurance System.* The main function of the Agency is to insure the deposits of resident and non-resident individuals in all commercial banks operating in Georgia. In the event of the commencement of liquidation, insolvency or bankruptcy proceedings in any of the banks (according to the Law of Georgia *On Activities of Commercial Bank*), the Deposit Insurance Agency will ensure the reimbursement of deposits, up to the set limit, to depositors within 20 calendar days. The Deposit Insurance Agency administers the deposit insurance system in the country and ensures its proper and effective operation. Insurance covers Bank's liabilities to individual depositors for the amount up to 5 thousand GEL for each individual in case of business failure and revocation of the banking license.

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 two preceding periods – years ended 31 December 2017 and 2016. 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, 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 19 (f) – key assumptions and judgments for estimating loan impairment.

3. Significant accounting policies

Changes in accounting policies

The Bank applied IFRS 15 and IFRS 9 for the first time. The nature and effect of the changes as a result of adoption of these new accounting standards are described below. Other than mentioned above, standards and interpretations that became effective on 1 January 2018 did not have material impact on the financial statements of the Bank.

The Bank has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective.

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* for annual periods on or after 1 January 2018. The Bank has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings as of 1 January 2018 and are disclosed below.

(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 amortised 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.

3. Significant accounting policies (continued)

Changes in accounting policies (continued)

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 realised and unrealised gains and losses, except for dividend income, are recognised in other comprehensive income with no subsequent reclassification to profit and loss.

The classification and measurement of financial liabilities remains largely unchanged from the current IAS 39 requirements. Derivatives will continue to be measured at FVPL. Embedded derivatives are no longer separated from a host financial asset.

(b) Impairment

The adoption of IFRS 9 has fundamentally changed the Bank's accounting for loan impairment by replacing IAS 39 incurred loss approach with a forward-looking expected credit loss (ECL) approach. From 1 January 2018, the Bank has been recording the allowance for expected credit losses for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. Equity instruments are not subject to impairment under IFRS 9.

The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset. Details of the Bank's impairment method are disclosed in Note 19. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in section (c) below.

(c) Effect of transition to IFRS 9

The following tables set out the impact of adopting IFRS 9 on the statement of financial position and retained earnings as at 1 January 2018 including the effect of replacing IAS 39 incurred credit loss calculations with IFRS 9 ECL.

A reconciliation between the carrying amounts under IAS 39 to the balances reported under IFRS 9 as at 1 January 2018 is as follows:

	IAS 39 measurement			*IFRS 9*	
Financial assets 000'GEL	***Category***	***Amount***	***ECL (accrual)/ recovery***	***Amount***	***Category***
Cash and cash equivalents	L&R[1]	21,579	–	21,579	Amortised cost
Amounts due from banks institutions	L&R	434	(1)	433	Amortised cost
Mandatory reserves at the National Bank of Georgia	L&R	28,897	–	28,897	Amortised cost
Loans to customers – amortised cost	L&R	157,004	307	157,311	Amortised cost
Total assets		**237,574**	**306**	**237,880**	
Non-financial liabilities					
Deferred tax liabilities		(209)	(14)	(223)	
Provisions for financial guarantees and off-balance sheet commitments		–	(140)	(140)	
Total liabilities		**(200,711)**	**(154)**	**(200,865)**	

[1] *L&R: Loans and receivables.*

3. Significant accounting policies (continued)

Changes in accounting policies (continued)

As of 1 January 2018, the Bank's analysis highlighted that all loans to customers met the SPPI criterion and are classified by Bank at amortised cost category.

The impact of transition to IFRS 9 on reserves and retained earnings is as follows:

000'GEL	***Reserves and retained earnings***
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	**6,808**
Recognition of IFRS 9 ECLs including those measured at FVOCI	98
Deferred tax in relation to the above	(14)
Restated opening balance under IFRS 9 (1 January 2018)	**6,892**
Fair value reserve on investment securities	
Closing balance under IAS 39 (31 December 2017)	**55**
Recognition of expected credit losses under IFRS 9 for debt financial assets at FVOCI	68
Restated opening balance under IFRS 9 (1 January 2018)	**123**
Total change in equity due to adopting IFRS 9	**152**

The following table reconciles the aggregate opening loan loss allowances under IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37 *Provisions Contingent Liabilities and Contingent Assets* to the ECL allowances under IFRS 9.

000'GEL	***Loan loss allowance/ provision under IAS 39 / IAS 37 at 31 December 2017***	***Re-measurement***	***ECL under IFRS 9 at 1 January 2018***
Impairment allowance for			
Loans to customers at amortised cost	(1,511)	306	(1,205)
Available-for-sale debt investment securities per IAS 39 / debt financial assets at FVOCI under IFRS 9	–	(68)	(68)
	(1,511)	**238**	**(1,273)**
Financial guarantees and off-balance sheet commitments	–	(140)	(140)
	(1,511)	**98**	**(1,413)**

IFRS 15 Revenue from Contracts with Customers

IFRS 15, issued in May 2014, and amended in April 2016, establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognized 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, the standard does not apply to revenue associated with financial instruments and leases, and therefore, does not impact the majority of the Bank's revenue including interest revenue, gains/(losses) on operations with securities which are covered by IFRS 9 *Financial Instruments*. As a result, the adoption of IFRS 15 has no significant impact on the Bank's financial statements.

3. Significant accounting policies (continued)

Financial instruments

Initial recognition

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Financial instruments are initially measured at their fair value and, except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from this amount. The Bank determines the classification of its financial assets upon initial recognition and subsequently can reclassify financial assets in certain cases as described below.

Classification and measurement

Measurement categories of financial assets and liabilities.

From 1 January 2018, the Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortised cost;
- FVOCI;
- FVPL.

The Bank classifies and measures its derivative and trading portfolio at FVPL. The Bank may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies

Before 1 January 2018, the Bank classified its financial assets as loans and receivables (amortised cost), FVPL, available-for-sale or held-to-maturity (amortised cost).

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVPL when they are held for trading, are derivative instruments or the fair value designation is applied.

Amounts due from credit institutions loans to customers, investments securities at amortised cost

Before 1 January 2018, amounts due from credit institutions and loans to customers included non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. Such assets were carried at amortised cost using the effective interest method.

From 1 January 2018, the Bank only measures amounts due from credit institutions, loans to customers and other financial investments at amortized cost if both of the following conditions are met:

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

The corporate bonds represent debt securities issued by the legal entities, which the Bank intends to hold until maturity. They are measured at amortised cost and recognized within loans to customers section in the statement of financial position.

Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected);
- The expected frequency, value and timing of sales are also important aspects of the Bank's assessment.

3. Significant accounting policies (continued)

Financial instruments (continued)

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realized in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

The SPPI test

As a second step of its classification process the Bank assesses the contractual terms of financial asset to identify whether they meet the SPPI test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortization of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

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.

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 *Debt instruments at FVOCI*.

From 1 January 2018, the Bank applies the new category under IFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets;
- The contractual terms of the financial asset meet the SPPI test.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest revenue and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

The ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit and loss upon derecognition of the asset.

Financial guarantees and undrawn loan commitments

The Bank issues financial guarantees, and loan commitments.

Financial guarantees are initially recognised in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the statement of profit or loss, and – under IAS 37 (before 1 January 2018) – the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee, or – under IFRS 9 (from 1 January 2018) – an ECL provision.

3. Significant accounting policies (continued)

Financial instruments (continued)

Undrawn loan commitments are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, under IAS 39, a provision was made if they were an onerous contract but, from 1 January 2018, these contracts are in the scope of the ECL requirements.

Available-for-sale financial assets

Before 1 January 2018, available-for-sale financial assets were those non-derivative financial assets that were designated as available-for-sale or were not classified in other categories in accordance with IAS 39.

Gains and losses on subsequent measurement

Before 1 January 2018, for financial assets and liabilities carried at amortized cost, a gain or loss was recognized in profit or loss when the financial asset or liability was derecognized or impaired, and through the amortization process. Available-for sale financial assets were measured at fair value with gains or losses being recognised in other comprehensive income until the investment was derecognised or until the investment was determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income was reclassified to profit or loss. However, interest calculated using the effective interest method was recognised in profit or loss.

Reclassification of financial assets and liabilities

From 1 January 2018, the Bank does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank changes the business model for managing financial assets. Financial liabilities are never reclassified. The Bank did not reclassify any of its financial assets and liabilities in 2017 and 2016.

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.

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 measured at amortized cost in the statement of financial position.

3. Significant accounting policies (continued)

Derivative financial instruments

In the normal course of business, the Bank enters into various derivative financial instruments including, forwards, swaps and options in the foreign exchange and capital markets. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of profit or loss or net foreign exchange gain, depending on the nature of the instrument.

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.

Impairment of financial assets under IAS 39

Before 1 January 2018 the Bank assessed at the end of each reporting period whether there was any objective evidence that a financial asset or group of financial assets were impaired. If any such evidence existed, the Bank was determining the amount of any impairment loss.

A financial asset or a group of financial assets were impaired and impairment losses were incurred if, and only if, there was 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 were impaired included 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 would 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.

Financial assets carried at amortized cost

Before 1 January 2018, financial assets carried at amortized cost consisted principally of loans and other receivables (loans and receivables). The Bank was reviewing its loans and receivables to assess impairment on a regular basis.

The Bank first was assessing whether objective evidence of impairment was existing individually for loans and receivables that were individually significant, and individually or collectively for loans and receivables that were not individually significant. If the Bank determined that no objective evidence of impairment existed for an individually assessed loan or receivable, whether significant or not, it included the loan or receivable in a group of loans and receivables with similar credit risk characteristics and collectively assessed them for impairment. Loans and receivables that were individually assessed for impairment and for which an impairment loss to be recognized were not included in a collective assessment of impairment.

If there was objective evidence that an impairment loss on a loan or receivable has been incurred, the amount of the loss was 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 was in financial difficulties and there was little available historical data related to similar borrowers. In such cases, the Bank used its experience and judgment to estimate the amount of any impairment loss.

3. Significant accounting policies (continued)

Impairment of financial assets under IAS 39 (continued)

All impairment losses in respect of loans and receivables were recognized in profit or loss and were 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 was uncollectable, it was written off against the related allowance for loan impairment. The Bank was writing off a loan's outstanding amount (and any related allowances for loan losses) when management determined that the loans were uncollectible and when all necessary steps to collect the loan were completed.

Available-for-sale financial investments

Before 1 January 2018 for available-for-sale financial investments, the Bank assessed at each reporting date whether there was objective evidence that an investment or a group of investments was 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 was 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 – was reclassified from other comprehensive income to profit or loss.

In the case of debt instruments classified as available-for-sale, impairment was assessed based on the same criteria as financial assets carried at amortised cost. Future interest income was based on the reduced carrying amount and was accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income was 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.

Information on impairment assessment under IFRS 9 is presented in Note 19.

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.

Write-off

From 1 January 2018, financial assets are written off either partially or in their entirety only when the Bank has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense. A write-off constitutes a derecognition event.

Once the loan is in overdue, the problematic debt collection process is started. The loan is transferred to problem asset manager, who is trying to contact the borrower and find a solution for covering the loan. If there is no any result within the 90 days, court actions are undertaken, which may last for 3 or 4 years, including all steps of the process. The management believes that around 4 years are needed to conclude that there is no reasonable expectation of recovery and the asset should be written off.

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.

3. Significant accounting policies (continued)

Property and equipment (continued)

(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.

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.

Impairment of 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.

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.

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.

3. Significant accounting policies (continued)

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.

Deferred tax

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method.

Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

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

Georgia also has various operating taxes that are assessed on the Bank’s activities. These taxes are included as a component of other operating expenses.

Income and expense recognition

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

Interest revenue and expense

From 1 January 2018, the Bank calculates interest revenue on debt financial assets measured at amortized cost by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets (before 1 January 2018: by applying EIR to the amortized cost of financial assets). EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest revenue or expense.

When a financial asset becomes credit-impaired, the Bank calculates interest revenue by applying the effective interest rate to the net amortised cost of the financial asset. If the financial assets cures and is no longer creditimpaired, the Bank reverts to calculating interest revenue on a gross basis.

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates interest revenue by calculating the credit-adjusted EIR and applying that rate to the amortised cost of the asset. The credit-adjusted EIR is the interest rate that, at original recognition, discounts the estimated future cash flows (including credit losses) to the amortised cost of the POCI assets.

Fee and commission income

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 revenue 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 o 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

	2018 000'GEL	2017 000'GEL	2016 000'GEL
Financial assets measured at amortized cost			
Loans to customers	12,213	17,205	15,106
Cash and cash equivalents and due from banks	811	1,028	1,251
Financial assets measured at fair value through other comprehensive income (2017: investment securities available-for-sale)			
Investment securities	1,648	617	16
Interest revenue calculated using effective interest rate	**14,672**	**18,850**	**16,373**
Other borrowed funds and subordinated debt	(3,356)	(3,515)	–
Deposits and balances from banks	(1,838)	(4,475)	(5,996)
Current accounts and deposits from customers	(1,090)	(2,605)	(1,896)
Interest expense	**(6,284)**	**(10,595)**	**(7,892)**
Net interest income	**8,388**	**8,255**	**8,481**

5. Net fee and commission income

	2018 000'GEL	2017 000'GEL	2016 000'GEL
Fee and commission income			
Commissions from guarantees	596	250	258
Settlement operations	435	355	389
Other operations	426	365	687
Total fee and commission income	**1,457**	**970**	**1,334**
Fee and commission expense			
Settlement operations	298	231	259
Other operations	1,068	647	782
Total fee and commission expense	**1,366**	**878**	**1,041**
Total net fee and commission income	**91**	**92**	**293**

The "Other operations" mainly include processing fees to payment systems and early repayment fees.

6. Credit loss reversal

The table below shows the ECL charges on financial instruments recorded in the statement of profit or loss for the year ended 31 December 2018:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
Cash and cash equivalents	(1)	–	–	**(1)**
Amounts due from banks and international financial institutions	(2)	–	–	**(2)**
Loans and advances to customers	237	(6)	200	**431**
Investment securities	(3)	–	–	**(3)**
Financial guarantees	18	–	–	**18**
Credit loss reversal	**249**	**(6)**	**200**	**443**

6. Credit loss reversal (continued)

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**

7. Other general administrative expenses

	2018 000'GEL	*2017 000'GEL*	*2016 000'GEL*
Operating lease	1,063	1,058	1,003
Depreciation and amortization (Note 13)	805	770	836
Write-off of other assets	–	349	–
Professional services	146	197	384
Deposit insurance expense	10	100	–
Entertainment expenses	95	94	34
Communications and information services	53	65	58
Travel expenses	54	53	17
Utilities	49	47	38
Repairs and maintenance	45	34	5
Advertising and marketing	6	23	11
Taxes other than on income	15	21	15
Office supplies	14	15	19
Insurance	–	–	11
Other	453	403	326
	2,808	**3,229**	**2,757**

Remuneration of the Bank's auditor for the audit of the Bank's annual financial statements for the year ended 31 December 2018 comprised GEL 90 thousand (2017: GEL 87 thousand, 2016: GEL 94 thousand) (net of VAT).

8. Income tax expense

In June 2016, amendments to the Georgian tax law in respect of corporate income tax became enacted. The amendments became effective from 1 January 2017 for all Georgian companies except the banks, insurance companies and microfinance organization, for which the effective date was initially set at January 2019. On 5 May the effective date of the amendment for banks was revised to January 2023. Under the new regulation, corporate income tax will be levied on profit distributed as dividends, rather than on profit earned as under the current regulation. The amount of tax payable on a dividend distribution will be calculated as 15/85 of the amount of net distribution. The companies will be able to offset corporate income tax liability arising from dividend distributions out of profits earned in 2008-2016 by the amount of corporate income tax paid for the respective period under the current regulation.

Dividends distributions between Georgian resident companies will not be subject to corporate income tax.

8. Income tax expense (continued)

Following the enactment of the initial 2016 amendment, as at 31 December 2017 the Bank remeasured its deferred tax assets and liabilities for the periods after 1 January 2019. As IAS 12 *Income Taxes* requires, the Bank used 0% tax rate applicable for undistributed profits in respect of assets and liabilities expected to be realized or settled in the periods when the new regulation becomes effective.

Following the enactment of the latest amendment, the Bank recalculated its deferred tax assets at 31 December 2018 and made the relevant recognition of deferred tax expense in the profit and loss statement for 2018.

The corporate income tax expense comprises:

	2018 000'GEL	*2017 000'GEL*	*2016 000'GEL*
Current year tax expense	**(157)**	**(594)**	**(126)**
Deferred tax benefit/(expense)			
Movement in deferred tax assets and liabilities due to origination and reversal of temporary differences	(520)	380	(376)
Write off of tax loss carried forward	–	–	(163)
	(520)	**380**	**(539)**
Total income tax expense	**(677)**	**(214)**	**(665)**

In 2018, the applicable tax rate for current and deferred tax is 15% (2017: 15%; 2016: 15%).

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

	2018 000'GEL	*%*	*2017 000'GEL*	*%*	*2016 000'GEL*	*%*
Profit before tax	**3,227**	**100%**	**1,738**	**100%**	**4,452**	**100%**
Income tax at the applicable tax rate	**(484)**	**(15%)**	**(261)**	**(15%)**	**(668)**	**(15%)**
Non-taxable income and other differences	(36)	(1%)	47	3%	3	0%
	(520)	**(16%)**	**(214)**	**(12%)**	**(665)**	**(15%)**

Deferred tax assets and liabilities

Movements in temporary differences during the years ended 31 December 2018, 2017 and 2016 are presented as follows.

000'GEL	*Balance 1 January 2018*	*Recognized in profit or loss*	*IFRS 9 adoption*	*Recognized in other comprehensive income*	*Balance 31 December 2018*
Property, equipment and intangible assets	–	(102)	–	–	(102)
Loans to customers	(135)	(432)	(14)	–	(581)
Investment securities	(46)	40	–	94	88
Other liabilities	(28)	(26)	–	–	(54)
Net tax (liabilities)/assets	**(209)**	**(520)**	**(14)**	**94**	**(649)**

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	–	(36)	(10)	(46)
Other liabilities	–	(28)	–	(28)
Net tax (liabilities)/assets	**(579)**	**380**	**(10)**	**(209)**

8. Income tax expense (continued)

Deferred tax assets and liabilities (continued)

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)**

9. Cash and cash equivalents

	2018 000'GEL	*2017 000'GEL*	*2016 000'GEL*
Cash on hand	**5,109**	**4,249**	**3,865**
Cash equivalents			
Nostro accounts with the NBG	370	530	423
Nostro accounts with other banks	17,445	12,707	3,198
Term deposits with the NBG	10,502	–	–
Term deposits with other banks	4,606	4,093	36,612
Less – allowance for impairment	(1)	–	–
Total cash equivalents	**32,922**	**17,330**	**40,233**
Total cash on hand and cash equivalents	**38,031**	**21,579**	**44,098**

All balances of cash equivalents are allocated to Stage 1; there were no significant movements in ECL during the year.

As at 31 December 2018 the Bank has a placement with one bank (2017: one bank; 2016: two banks) with carrying value that individually exceeds 10% of equity. The gross value of that balance as at 31 December 2018 is GEL 14,148 thousand (2017: GEL 14,862 thousand; 2016: GEL 34,799 thousand).

10. Amounts due from banks

	2018 000'GEL	*2017 000'GEL*	*2016 000'GEL*
With less than 1 year contractual maturity	4,569	434	–
With more than 1 year contractual maturity	586	–	–
Total amount due from banks	**5,155**	**434**	**–**

All amounts due from banks are allocated to Stage 1. ECL recognized for due from banks as at 31 December 2018 was GEL 3 thousands and there were no significant movements in ECL during the year (Note 6).

11. Loans to customers

	2018 000'GEL	2017 000'GEL	2016 000'GEL
Loans to legal entities			
Corporate lending	132,010	142,636	162,872
Small and medium business lending	12,480	8,223	10,828
Total loans to legal entities	**144,490**	**150,859**	**173,700**
Loans to individuals			
Residential mortgages	8,867	2,710	2,073
Consumer lending	3,892	4,946	5,904
Total loans to individuals	**12,759**	**7,656**	**7,977**
Gross loans to customers	**157,249**	**158,515**	**181,677**
Less – allowance for impairment	(778)	(1,511)	(1,891)
Loans to customers	**156,471**	**157,004**	**179,786**

(a) Allowance for impairment of loans to customers at amortised cost

An analysis of changes in the gross carrying value and corresponding ECL in relation to corporate lending during the year ended 31 December 2018 is as follows:

Corporate lending 000'GEL	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**133,550**	**9,086**	**–**	**142,636**
New assets originated or purchased	97,559	–	–	**97,559**
Assets repaid	(103,157)	(5,306)	–	**(108,463)**
Transfers to Stage 1	2,302	(2,302)	–	**–**
Foreign exchange adjustments	230	48	–	**278**
At 31 December 2018	**130,484**	**1,526**	**–**	**132,010**

Corporate lending 000'GEL	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**(344)**	**(1)**	**–**	**(345)**
New assets originated or purchased	(167)	–	–	**(167)**
Assets repaid	289	1	–	**290**
Net remeasurement of ECL	47	–	–	**47**
At 31 December 2018	**(175)**	**–**	**–**	**(175)**

An analysis of changes in the gross carrying value and corresponding ECL in relation to small and medium business lending during the year ended 31 December 2018 is as follows:

Small and medium business 000'GEL	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**4,923**	**878**	**2,422**	**8,223**
New assets originated or purchased	9,795	–	–	**9,795**
Assets repaid	(4,486)	(878)	(181)	**(5,545)**
Transfers to Stage 2	(463)	463	–	**–**
Transfers to Stage 3	(307)	–	307	**–**
Foreign exchange adjustments	5	–	2	**7**
At 31 December 2018	**9,467**	**463**	**2,550**	**12,480**

Small and medium business 000'GEL	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**(65)**	**(39)**	**(323)**	**(427)**
New assets originated or purchased	(85)	–	–	**(85)**
Assets repaid	56	39	4	**99**
Transfers to Stage 2	46	(46)	–	**–**
Transfers to Stage 3	17	–	(17)	**–**
Net remeasurement of ECL	4	–	96	**100**
At 31 December 2018	**(27)**	**(46)**	**(240)**	**(313)**

11. Loans to customers (continued)

(a) Allowance for impairment of loans to customers at amortised cost (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Residential mortgages during the year ended 31 December 2018 is as follows:

Residential mortgages 000'GEL	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2018	**2,440**	**150**	**120**	**2,710**
New assets originated or purchased	7,320	–	–	**7,320**
Assets repaid	(1,125)	(72)	–	**(1,197)**
Transfers to Stage 3	(30)	(60)	90	**–**
Foreign exchange adjustments	29	–	5	**34**
At 31 December 2018	**8,634**	**18**	**215**	**8,867**

Residential mortgages 000'GEL	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**(4)**	**–**	**–**	**(4)**
New assets originated or purchased	(9)	–	–	**(9)**
Assets repaid	3	–	–	**3**
Net remeasurement of ECL	(4)	–	–	**(4)**
At 31 December 2018	**(14)**	**–**	**–**	**(14)**

An analysis of changes in the gross carrying value and corresponding ECL in relation to consumer lending during the year ended 31 December 2018 is as follows:

Consumer lending 000'GEL	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2018	**4,254**	**157**	**535**	**4,946**
New assets originated or purchased	1,937	–	–	**1,937**
Assets repaid	(2,743)	(93)	(166)	**(3,002)**
Transfers to Stage 2	(129)	129	–	**–**
Transfers to Stage 3	(250)	–	250	**–**
Foreign exchange adjustments	9	2	–	**11**
At 31 December 2018	**3,078**	**195**	**619**	**3,892**

Consumer lending 000'GEL	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**(71)**	**(33)**	**(329)**	**(433)**
New assets originated or purchased	(85)	–	–	**(85)**
Assets repaid	10	14	125	**149**
Transfers to Stage 2	1	(1)	–	**–**
Transfers to Stage 3	71	–	(71)	**–**
Net remeasurement of ECL	43	(13)	63	**93**
At 31 December 2018	**(31)**	**(33)**	**(212)**	**(276)**

(b) Credit quality of loans to customers

The bank is working on implementation its own internal grading system, which will define credit risk category based on the several factors, which has impact on the quality of the loans to customers by business segment. Before implementation the mentioned internal grading system, the Bank is controlling its loan portfolio by four overdue buckets on daily basis and relevant actions are planned according to the information, retrieved after such analysis.

11. Loans to customers (continued)

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

The following table provides information on the credit quality of loans to customers as at 31 December 2018:

000'GEL	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Loans to legal entities				
Corporate lending	**130,484**	**1,526**	**–**	**132,010**
- not overdue	130,484	1,526	–	**132,010**
Small and medium business lending	**9,467**	**463**	**2,550**	**12,480**
- not overdue	9,467	463	108	**10,038**
- overdue more than 90 days	–	–	2,442	**2,442**
Total loans to legal entities	**139,951**	**1,989**	**2,550**	**144,490**
Loans to individuals				
Residential mortgages	**8,634**	**18**	**215**	**8,867**
- not overdue	8,434	18	41	**8,493**
- overdue less than 30 days	200	–	–	**200**
- overdue more than 90 days	–	–	174	**174**
Consumer lending	**3,078**	**195**	**619**	**3,892**
- not overdue	2,917	61	189	**3,167**
- overdue less than 30 days	161	3	–	**164**
- overdue more than 30 days and less than 90 days	–	131	16	**147**
overdue more than 90 days	–	–	414	**414**
Total loans to individuals	**11,712**	**213**	**834**	**12,759**
Total gross loans to customers	**151,663**	**2,202**	**3,384**	**157,249**

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%**

11. Loans to customers (continued)

(b) 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%**

(c) Analysis of collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

- For commercial lending, charges over real estate properties, inventory, trade receivables, movable properties, sureties;
- For retail lending, mortgages over residential properties, movable properties and sureties.

The below table provides an analysis of the current fair values of collateral held and credit enhancements for credit-impaired (stage 3) assets. Dependent on the level of collateral, some Stage 3 exposures may not have individual ECLs when the expected value of the collateral is greater than the LGD, even in if the future value of collateral is forecast using multiple economic scenarios. However, the Stage 3 ECL can be higher than net exposure show below when the future value of collateral, measured using multiple economic scenarios, is expected to decline.

000'GEL	*Maximum exposure to credit risk*	*Fair value of collateral held under the base scenario*				*Net exposure*	*Associated ECL*
		Real estate property	*Other**	*Surplus collateral*	*Total collateral*		
31 December 2018	**3,384**	**8,728**	**2,795**	**(8,383)**	**3,140**	**244**	**452**
Corporate lending	–	–	–	–	**–**	–	–
Small and medium business lending	2,550	7,619	2,516	(7,611)	**2,524**	26	240
Residential mortgages	215	447	41	(279)	**209**	6	–
Consumer lending	619	662	238	(493)	**407**	212	212

* *Vehicles, sureties, machinery, other fixed assets, inventory and trade receivables.*

11. Loans to customers (continued)

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

The following table shows carrying value of loans on which no ECL was recognized because of existence of collateral as at 31 December 2018:

	000'GEL
Loans to legal entities	
Corporate lending	39,363
Small and medium business lending	5,669
Total loans to legal entities	**45,032**
Loans to individuals	
Residential mortgages	6,133
Consumer lending	1,736
Total loans to individuals	**7,869**
Gross loans to customers	**52,901**

(i) Loans to legal entities

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**

11. Loans to customers (continued)

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

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**

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 to individuals	**7,489**	**4,078**

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.

11. 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:

	2018 000'GEL	*2017 000'GEL*	*2016 000'GEL*
Construction and land development	27,766	17,554	34,492
Consumer goods	27,715	31,507	17,692
Energy	21,241	21,026	–
Financial institutions	16,192	1,701	–
Service	15,274	–	–
Telecommunication	10,831	–	–
Hotels, restaurants and tourism	10,487	7,025	25,589
Real estate management	4,497	5,526	–
Production and trade of clothes, shoes and textiles	4,108	10,101	11,616
Healthcare	3,001	51,237	82,323
Agriculture	1,988	1,988	1,988
Other sectors	1,390	3,194	–
Loans to individuals	12,759	7,656	7,977
Total loans to customers	**157,249**	**158,515**	**181,677**
Less – allowance for impairment	(778)	(1,511)	(1,891)
Total net loans to customers	**156,471**	**157,004**	**179,786**

(e) Significant credit exposures

As at 31 December 2018 the Bank has loans issued to seven borrowers or groups of connected borrowers (2017: eleven; 2016: eight) with carrying values that individually exceed 10% of equity. The gross value of these loans as at 31 December 2018 is GEL 73,033 thousand (2017: GEL 136,138 thousand; 2016: GEL 157,824 thousand). Cash collateral of GEL 1,788 thousand was obtained against these exposures to comply with the NBG requirements (2017: GEL 45,071 thousand 2016: GEL 134,336 thousand), of which GEL 1,788 thousand was provided by the Parent (2017: GEL 3,596 thousand, 2016: GEL 92,822 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 19 (i) 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.

12. Investment securities

Investment securities as at 31 December are as follows:

	2018 000'GEL	*2017 000'GEL*	*2016 000'GEL*
Debt securities at FVOCI (2017: investment securities available-for-sale)			
Treasury bonds of Ministry of Finance of Georgia	15,022	13,843	1,018
Treasury bonds of Republic of Turkey	10,439	10,790	–
Total investment securities	**25,461**	**24,633**	**1,018**

All securities are allocated to Stage 1. ECL recognized for investment securities as at 31 December 2018 was GEL 71 thousand and there were no significant movements in ECL during the year (Note 6).

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

	2018 000'GEL	*2017 000'GEL*	*2016 000'GEL*
Available-for-sale			
Treasury bonds of Ministry of Finance of Georgia	–	4,101	–
Total investment securities	**–**	**4,101**	**–**

13. 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 2018	**2,054**	**818**	**370**	**167**	**729**	**4,138**
Additions	2	75	12	171	–	**260**
Balance at 31 December 2018	**2,056**	**893**	**382**	**338**	**729**	**4,398**
Depreciation and amortization						
Balance at 1 January 2018	**(1,396)**	**(454)**	**(242)**	**(131)**	**(386)**	**(2,609)**
Depreciation and amortization for the year	(393)	(169)	(75)	(59)	(109)	**(805)**
Balance at 31 December 2018	**(1,789)**	**(623)**	**(317)**	**(190)**	**(495)**	**(3,414)**
Carrying amount						
At 31 December 2018	**267**	**270**	**65**	**148**	**234**	**984**

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**

14. Other assets and liabilities

	2018 000'GEL	2017 000'GEL	2016 000'GEL
Other assets			
Settlement operations	11,084	3,289	2,224
Income tax asset	939	147	–
Receivables from problematic borrowers	63	48	21
Other	3	14	13
Total other assets	**12,089**	**3,498**	**2,258**
Other liabilities			
Settlement operations	8,272	2,613	978
Other	860	772	225
Total other liabilities	**9,132**	**3,385**	**1,203**

15. Deposits and balances from banks

	2018 000'GEL	2017 000'GEL	2016 000'GEL
Vostro accounts	13,672	5,265	1,047
Term deposits	92,837	46,189	172,837
Short-term loan from the NBG	–	3,002	–
	106,509	**54,456**	**173,884**

As at 31 December 2018 the Bank has placements from three banks (2017: two banks; 2016: two banks) with carrying values that individually exceed 10% of equity. The gross value of these balances as at 31 December 2018 is GEL 106,509 thousand (2017: GEL 48,342 thousand; 2016: GEL 173,884 thousand).

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.

16. Current accounts and deposits from customers

	2018 000'GEL	2017 000'GEL	2016 000'GEL
Current accounts and demand deposits			
- Retail	2,877	3,471	4,065
- SME	2,895	3,837	3,532
- Corporate	6,202	7,400	2,588
	11,974	**14,708**	**10,185**
Term deposits			
- Retail	16,236	50,510	50,897
- SME	3,993	7,112	4,018
- Corporate	6,149	1,693	–
	26,378	**59,315**	**54,915**
	38,352	**74,023**	**65,100**

As at 31 December 2018 the Bank maintained customer deposit balances of GEL 225 thousand (2017: GEL 49,786 thousand; 2016: GEL 43,761 thousand) that serve as collateral for loans granted by the Bank. As at 31 December 2018 the Bank does not have placements from any customers (2017: five customers; 2016: four customers) with carrying values that individually exceed 10% of equity. These balances as at 31 December 2017 are GEL 49,003 thousand and 2016: GEL 43,717.

17. Other borrowed funds and subordinated debt

	2018 000'GEL	*2017 000'GEL*	*2016 000'GEL*
Borrowings from the Parent	13,093	12,918	–
Other financial institutions	18,823	12,568	–
Total other borrowed funds	**31,916**	**25,486**	**–**
Subordinated loan from the Parent	–	43,152	–
Total other borrowed funds and subordinated debt	**31,916**	**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 mostly denominated in EUR with around 2 years maturity.

The bank repaid the subordinated loan from the Parent in the amount of USD 16,000 thousand (GEL 39,162 thousand), and the Parent increased share capital with the same amount on 25 July 2018.

Changes in liabilities arising from financing activities are as follows:

000'GEL	*Other borrowed funds*	*Subordinated loans*	*Total liabilities from financing activities*
Carrying amount at 31 December 2017	**25,486**	**43,152**	**68,638**
Proceeds from issue	26,468	–	**26,468**
Redemption	(20,132)	(39,162)	**(59,294)**
Foreign currency translation	(50)	(2,313)	**(2,363)**
Other	144	(1,677)	**(1,533)**
Carrying amount at 31 December 2018	**31,916**	**–**	**31,916**

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.

18. 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 was 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%.

18. Capital management (continued)

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.

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**
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%**

18. Capital management (continued)

Basel III (continued)

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	*2018*	*2017*
Share capital	69,162	30,000
Retained earnings	5,549	4,129
Deductions	(220)	(330)
Total common equity and Tier 1 capital	**74,491**	**33,799**
Subordinated debt (included in regulatory capital)	–	41,475
General loan loss provisions (up to 1.25% of risk-weighted exposures)	3,394	2,072
Total regulatory capital	**77,885**	**77,346**
Risk-weighted exposures		
Credit risk-weighted exposures (balance and off-balance items)	271,488	166,595
Market risk-weighted exposures	346	2,495
Operational risk-weighted exposures	18,304	13,094
Total risk-weighted exposures	**290,138**	**182,184**
Common equity Tier 1 ratio	**25.67%**	**18.6%**
Tier 1 capital ratio	**25.67%**	**18.6%**
Total regulatory capital ratio	**26.84%**	**42.5%**
Common equity Tier 1 ratio minimum requirement	**9.31%**	**8.60%**
Tier 1 capital ratio minimum requirement	**11.59%**	**10.63%**
Total regulatory capital minimum requirement	**20.38%**	**13.34%**

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.

19. 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.

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

(b) Internal control policies and procedures (continued)

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. CRO 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 CEO.

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.

(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.

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

(d) Market risk (continued)

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 2018						
Assets						
Cash and cash equivalents	38,031	–	–	–	–	38,031
Amounts due from banks	4,878	73	204	–	–	5,155
Mandatory reserves at the NBG	26,567	–	–	–	–	26,567
Investment securities	–	–	6,430	13,612	5,419	25,461
Loans to customers	4,654	14,197	44,471	48,700	44,449	156,471
	74,130	**14,270**	**51,105**	**62,312**	**49,868**	**251,685**
Liabilities						
Accounts and deposits from banks	46,987	–	44,339	15,183	–	106,509
Current accounts and deposits from customers	25,133	8,029	4,530	660	–	38,352
Other borrowed funds and subordinated debt	635	1,780	4,584	24,917	–	31,916
	72,755	**9,809**	**53,453**	**40,760**	**–**	**176,777**
	1,375	**4,461**	**(2,348)**	**21,552**	**49,797**	**74,837**

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**
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**

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

(d) Market risk (continued)

Average nominal interest rates

The table below displays average nominal interest rates for interest-bearing assets and liabilities as at 31 December 2018, 2017 and 2016. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

	2018 Average nominal interest rates, %			*2017 Average nominal interest rates, %*			*2016 Average nominal interest rates, %*		
	GEL	*USD*	*EUR*	*GEL*	*USD*	*EUR*	*GEL*	*USD*	*EUR*
Interest bearing assets									
Cash and cash equivalents	5.9%	–	1.5%	7.4%	1.0%	–	6.9%	0.7%	–
Amounts due from banks	–	6.5%	3.9%	–	4.2%	–	–	–	–
Investment securities	7.7%	5.7%	–	7.4%	5.8%	–	6.7%	–	–
Loans to customers	11.7%	8.3%	5.7%	13.1%	6.9%	5.5%	12.8%	8.2%	10.0%
Interest bearing liabilities									
Deposits and balances from banks	–	4.2%	1.0%	7.3%	3.4%	1.2%	–	4.1%	–
Deposits from customers	8.9%	3.4%	0.6%	7.2%	3.9%	–	5.0%	4.3%	–
Other borrowed funds and subordinated debt	–	6.4%	1.9%	–	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 2018, 2017 and 2016, is as follows:

	2018 000'GEL	*2017 000'GEL*	*2016 000'GEL*
100 bps parallel fall	255	67	2
100 bps parallel rise	(255)	(67)	(2)

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

	2018 000'GEL	*2017 000'GEL*
100 bps parallel fall	(75)	(98)
100 bps parallel rise	75	98

(ii) 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.

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

(d) Market risk (continued)

The following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2018:

	EUR 000'GEL	*USD 000'GEL*	*TRY 000'GEL*	*GBP 000'GEL*	*Total 000'GEL*
Assets					
Cash and cash equivalents	17,775	6,993	146	344	**25,258**
Amounts due from banks	509	4,646	–	–	**5,155**
Mandatory reserves at the NBG	10,678	15,889	–	–	**26,567**
Investment securities	–	10,440	–	–	**10,440**
Loans to customers	22,947	77,628	–	–	**100,575**
Other financial assets	148	5,421	–	–	**5,569**
Total assets	**52,057**	**121,017**	**146**	**344**	**173,564**
Liabilities					
Deposits and balances from banks	37,930	68,183	51	345	**106,509**
Current accounts and deposits from customers	1,112	31,658	30	–	**32,800**
Other borrowed funds and subordinated debt	12,986	18,930	–	–	**31,916**
Other liabilities	4	247	–	–	**251**
Total liabilities	**52,032**	**119,018**	**81**	**345**	**171,476**
Net position	**25**	**1,999**	**65**	**(1)**	**2,088**

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**

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

(d) Market risk (continued)

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**

A weakening of the GEL, as indicated below, against the following currencies at 31 December 2018, 2017 and 2016, 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.

	2018 000'GEL	*2017 000'GEL*	*2016 000'GEL*
20% appreciation of USD against GEL	340	284	(94)
20% appreciation of EUR against GEL	4	(61)	139
20% appreciation of TRY against GEL	11	22	32
20% appreciation of GBP against GEL	–	(1)	–

A strengthening of the GEL against the above currencies at 31 December 2018, 2017 and 2016 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.

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.

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

(e) Credit risk (continued)

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 19.

The maximum exposure to credit risk from unrecognized contractual commitments at the reporting date is presented in Note 19.

Credit-related commitments risks

The Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

The maximum exposure to credit risk for the components of the statement of financial position, including derivatives, before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

Where financial instruments are recorded at fair value, the carrying value represents the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

Impairment assessment

From 1 January 2018, the Bank calculates ECL based on several probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. The mechanics of the ECL calculations are outlined below and the key elements are as follows:

PD — The Probability of Default is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.

EAD — The Exposure at Default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.

LGD — The Loss Given Default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, excluding the realisation of any collateral. It is usually expressed as a percentage of the EAD.

LGL — The Loss Given Liquidation represents the percentage of the exposure that cannot be recovered from collateral liquidation if the exposure is defaulted.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12m ECL). The 12m ECL is the portion of LTECL that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Both LTECL and 12mECL are calculated on an individual basis.

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. Based on the above process, the Bank groups its loans into Stage 1, Stage 2 and Stage 3, as described below:

Stage 1: When loans are first recognised, the Bank recognises an allowance based on 12m ECL. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.

Stage 2: When a loan has shown a significant increase in credit risk since origination, the Bank classifies the loan as Stage 2 loan and records an allowance for the LTECL. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.

Stage 3: Loans considered credit-impaired. The Bank records an allowance for the LTECL.

POCI: Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and interest revenue is subsequently recognised based on a credit-adjusted EIR. ECL are only recognised or released to the extent that there is a subsequent change in the lifetime expected credit losses.

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

(e) Credit risk (continued)

Definition of default and cure

The Bank's definition of default is based on quantitative and qualitative criteria. An instrument is classified as credit impaired if:

- Payments of interest, principal or fees by obligor are overdue for more than 90 days; or
- If a problematic restructuring of a loan took place, which otherwise would become defaulted; or
- There is a detrimental impact on the estimated future cash flows, when bankruptcy or insolvency proceedings of enforced liquidation have commenced or there is other evidence that payment obligations will not be fully met.

Once financial instrument is classified to Stage 2 it remains so until following two conditions are met:

1. The financial instrument should fulfil requirements for standard loan category as defined by NBG;
2. Overdue days and probation period conditions should be met.

If these two conditions are met, then the instrument is classified as Stage 1.

A loan is classified as standard if:

- The payments are done on time or overdue days do not exceed 30 days;
- The borrower's liquidity, capital and loan repayment capacity is stable;
- The borrower is financially sufficiently strong to absorb medium level stress outcomes, and has enough liquidity to service all liabilities.

As for overdue days and probation period, for non-restructured Stage 2 instruments, probation period is 6 months, during which the instrument must not fall in more than 30 days overdue.

For restructured performing Stage 2 financial instrument the probation period is 1 year (during which it should not fall in more than 30 days overdue and fulfil standard loan category requirements) after which the instrument is reclassified to Stage 1.

Cure period for non-restructured Stage 3 financial instruments is 6 months, after which the instrument is classified at Stage 1 if during the probation period the financial instrument was not more than 30 days overdue and fulfils standard loan category requirements, and is classified at Stage 2 if the instrument was 30-90 days overdue during the cure period.

For restructured Stage 3 financial instrument the cure period is six months, after which the instrument is classified as Stage 2 (Performing Restructured) if the instrument was not more than 90 days overdue during the cure period. As soon as the financial instrument is classified as Performing Restructured, starts one year probation period, after which the instrument is classified as Stage 1 if the instrument was not more than 30 days overdue during the probation period and fulfils standard loan category requirements. If the instrument falls in 30-90 days overdue it remains in Stage 2. One year probation period starts from the last month when the instrument last recovered from 30-90 days overdue.

PD estimation process

For retail and corporate portfolios PD is estimated through macro model, which describes relationship between historical PDs for retail and corporate portfolios and macroeconomic variables such as real GDP growth, USD/GEL exchange rate and unemployment level. Based on estimation results and predicted macro variables provided by the NBG conditional retail and corporate PDs are forecasted. The model will be re-estimated annually and other macroeconomic variables will be incorporated if they improve explanatory power of the model. With the forecasted conditional PD's migration matrices are constructed, from which unconditional marginal PD's are calculated that are further adjusted by age of the instrument in the portfolio.

PD for stage 3 financial instruments is considered as 100%.

For the loans, on which the Bank has surety from parent companies of the borrower, the Bank uses PDs of their parents.

Exposure at default

The exposure at default (EAD) is calculated differently for Stage 1, Stage 2 and Stage 3 financial instruments. EAD are reduced by cash cover amounts. Off-balance commitments are considered through Cash Conversion Factor (CCF), specifically by 100% for corporate commitments and 50% for retail commitments.

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

(e) Credit risk (continued)

For Stage 1, the EAD are calculated as a monthly average of outstanding amount of loans and off balance commitments taking into account CCF and cash cover amounts by the end of 12 month from the reporting date.

For Stage 2 financial instruments, the EAD is calculated for each contractual remaining year. EAD for each year is estimated as an outstanding amount by the reporting period minus the cumulative yearly principal repayments. The outstanding amount by the reporting period is calculated taking into account CCF and cash cover amounts.

For Stage 3, the EAD is calculated as the outstanding amount of the instrument by the reporting date taking into account CCF and cash cover amounts.

Loss given default

For corporate and retail lending assets, LGD values are assessed annually. LGD is defined as the likely loss arising in case of a counterparty defaults for unsecured exposures. It provides an estimation of the exposure that cannot be recovered in a default event and therefore captures the severity of a loss. LGD rate are calculated for corporate and retail portfolios. LGD is statistically calculated based on historical loan recovery data and takes into account historical losses incurred on unsecured exposures. While calculation LGD outlier recoveries are excluded from the calculation. LGD is expressed as a percentage of the EAD.

Loss Given Liquidation of collateralized exposures (LGL):

LGL represents the percentage of the exposure that cannot be recovered from collateral liquidation if the exposure is defaulted. Loss Given Liquidation calculation takes into account LTV, adjusted by time to sale of movable and immovable collateral, real estate price index, EIR, and expected sales ratio of collaterals. For uncollateralized exposures LGL is taken at 100%.

Average LGL ratios are calculated for five LTV bands separately for retail and non-retail borrowers, which then are assigned to each exposure depending on the LTV band the exposure falls.

Significant increase in credit risk (SICR)

The Bank continuously monitors all assets subject to ECLs. When assessing significance of increase in credit risk and whether the instrument is subject to 12m ECL or LTECL, the Bank compares the risk of default at the reporting date and risk of default occurring at the date of initial recognition. To identify significant increase in credit risk since initial recognition of the financial asset at individual financial instrument level, the Bank is undertaking the holistic analysis of various factors, including those which are specific to a particular financial instrument or to a borrower. The analysis includes considering of quantitative and qualitative information based on the Bank's historical experience, credit risk assessment and forward looking information.

For individually significant exposures the Bank evaluates individually whether an objective evidence of significant increase in credit risk or impairment exists to recognise lifetime expected credit losses. Individually significant exposures are considered exposures to the group exceeding 1% of the regulatory capital. The Bank collectively assesses loans that are not individually significant and loans that are individually significant but for which there is no objective evidence of significant increase in credit risk.

Individually significant loans

SICR identification process for individually significant exposures includes performing a qualitative test. To assess SICR for individually significant loans the Bank has established general trigger events for all types of exposures, specific trigger events for non-retail borrowers and specific trigger events for retail borrowers. General trigger events include but are not limited to:

- ► Deterioration of macroeconomic, regulatory, political or technological outlook relevant to particular or group of borrowers;
- ► Adverse changes in the sector or industry conditions in which borrower operates.

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

(e) Credit risk (continued)

Specific trigger events for non-retail borrowers include:

- Deterioration of borrowers' financial performance that is quantified by adverse changes in financial coefficients;
- Being overdue more than 30 days but less than 90 days;
- Those restructurings which if had not been done would not lead to the instrument falling in more than 90 days overdue;
- Breaching the contract;
- Sale of crucial part of the business or property which is necessary for the borrower's profit making operations;
- Fraud in borrower's business, etc.

If significant increase in credit risk is identified, for lifetime ECL calculation it is assessed whether future cash inflows of the borrower are enough to cover the cash outflows for different scenarios. Analysis of cash flow of the borrower includes analysis of existing and forecasted trends of industry within which the borrower operates. 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.

Collectively assessed loans

Non-retail exposures that are not individually significant are assessed for SICR based on overdue days (between 30 and 90 days), whether they are restructured and if not restructured whether they would fall in more than 90 days overdue, and deterioration of various financial coefficients (Payment To Income(PTI), Debt/EBITDA, Equity/Assets, Interest Coverage Ratio(ICR) and Debt Service Coverage Ratio(DSCR)).

Specific trigger events for retail borrowers include but are not limited to loan being overdue more than 30 days but less than 90 days, restructuring of an exposure which if would not be done would lead to the instrument falling in more than 90 days overdue, deterioration of PTI ratio, etc.

For the purpose of a collective evaluation of impairment, financial instruments are grouped within homogeneous pools on the basis of asset types – whether the instrument is retail or non-retail, and based on Loan to Value (LTV) ratio. On the basis of LTV ratios financial instruments are grouped into five LTV bands.

Treasury and interbank relationships

The Bank's treasury and interbank relationships and counterparties comprise financial services institutions, banks, corporates and Georgian and Turkish governments.

PDs are assigned to issuers or banks according to external rating default rates. The minimum PD is set to 0.03% according to Basel. LGD is taken at 45% for exposures that are not secured by recognized collateral, according to the foundation approach of the Basel document. For corporate securities LGD is taken at 38.75%. This figure represents the average historical recoveries of the Bank starting from 2014. EAD represents monthly average of outstanding exposures in the case of securities and sovereign bonds and monthly average outstanding amount of principal plus accrued interest for interbank exposures.

Forward-looking information and multiple economic scenarios

In its ECL models, the Bank relies on the following forward looking information as economic inputs, such as:

- GDP growth;
- Unemployment rates;
- Foreign exchange rates.

The Bank calculates ECL on an individual basis for all financial assets. ECL is calculated for three (Baseline 50%, Upside 25%, and Adverse 25%) scenarios and weighted ECL is computed as a weighted sum of all three scenario ECLs.

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

(e) Credit risk (continued)

The Bank obtains the forward-looking information from the NBG. The tables below show the values of the forward looking economic variables/assumptions used in each of the economic scenarios for the ECL calculations. The figures for "Subsequent years" represent a long-term average and so are the same for each scenario as at 31 December 2018.

Key drivers	*ECL scenario*	*Assigned probabilities, %*	*2019*	*2020*	*2021*	*Subsequent years*
GDP growth, %						
	Upside	25%	6.5%	5.5%	5%	5%
	Base case	50%	5%	5%	5%	5%
	Downside	25%	2%	3%	4%	4%
USD/GEL exchange rate, % change						
	Upside	25%	-3%	-2%	-2%	0%
	Base case	50%	0%	0%	0%	0%
	Downside	25%	15%	10%	-5%	0%
Unemployment rate, %						
	Upside	25%	10.1%	9.6%	9.4%	9.4%
	Base case	50%	11%	10.8%	10.6%	10.6%
	Downside	25%	12.6%	13.1%	13.3%	13.3%

(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 Management Division 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 ALCO and implemented by the Treasury Division.

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

19. 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 2018 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	(36,336)	(10,764)	–	(45,006)	(16,018)	–	**(108,124)**	(106,509)
Current accounts and deposits from customers	(16,103)	(9,093)	(8,114)	(4,675)	(695)	–	**(38,680)**	(38,352)
Other borrowed funds and subordinated debt	–	(637)	(1,790)	(4,653)	(30,448)	–	**(37,528)**	(31,916)
Other liabilities	(9,781)	–	–	–	–	–	**(9,781)**	(9,781)
Total financial liabilities	**(62,220)**	**(20,494)**	**(9,904)**	**(54,334)**	**(47,161)**	–	**(194,113)**	**(186,558)**
Credit related commitments	**(42,820)**	**–**	**–**	**–**	**–**	**–**	**(42,820)**	**(42,820)**

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)**

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

(f) Liquidity risk (continued)

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)**

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:

	2018 000'GEL	*2017 000'GEL*	*2016 000'GEL*
Demand and less than 1 month	6,135	1,512	–
From 1 to 3 months	8,235	616	919
From 3 to 12 months	4,444	3,811	3,677
From 1 to 5 years	300	–	6,489
More than 5 years	–	44,572	42,349
	19,114	**50,510**	**53,434**

19. 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 2018:

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	38,031	–	–	–	–	–	**38,031**
Amounts due from banks	1,400	3,478	277	–	–	–	**5,155**
Mandatory reserves at the NBG	26,567	–	–	–	–	–	**26,567**
Investment securities	–	–	6,430	13,612	5,419	–	**25,461**
Loans to customers	6,260	8,148	69,482	58,045	14,536	–	**156,471**
Property, equipment and intangible assets	–	–	–	–	–	984	**984**
Other assets	12,089	–	–	–	–	–	**12,089**
Total assets	**84,347**	**11,626**	**76,189**	**71,657**	**19,955**	**984**	**264,758**
Liabilities							
Deposits and balances from banks	36,280	10,707	44,339	15,183	–	–	**106,509**
Current accounts and deposits from customers	16,099	9,033	12,559	661	–	–	**38,352**
Other borrowed funds and subordinated debt	153	2,321	12,630	16,812	–	–	**31,916**
Other liabilities	9,781	–	–	–	–	–	**9,781**
Total liabilities	**62,313**	**22,061**	**69,528**	**32,656**	**–**	**–**	**186,558**
Net position	**22,034**	**(10,435)**	**6,661**	**39,001**	**19,955**	**984**	**78,200**

19. 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**

19. 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**

19. 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.

20. 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 and financial guarantees 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 represent the maximum accounting loss that would be recognized at the reporting date if the counterparties failed completely to perform as contracted.

	2018 *000'GEL*	*2017* *000'GEL*	*2016* *000'GEL*
Contracted amount			
Undrawn overdraft facilities	89	108	483
Guarantees	42,731	9,544	9,724
	42,820	**9,652**	**10,207**

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 23,668 thousand are to four banks (2017: nil; 2016: nil) and GEL 14,861 thousand to five counterparties (2017: GEL 6,437 thousand to five counterparties; 2016: GEL 5,717 thousand to four counterparties). This exposure represents a significant concentration of credit risk exposure to the Bank.

All credit related commitments are allocated to Stage 1. ECL recognized for credit related commitments as at 31 December 2018 was GEL 122 thousands and there were no significant movements in ECL during the year (Note 6).

21. Operating leases

(a) Leases as lessee

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

	2018 *000'GEL*	*2017* *000'GEL*	*2016* *000'GEL*
Less than 1 year	970	1,065	1,023
	970	**1,065**	**1,023**

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.

22. 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.

23. 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 2018, 2017 and 2016 is as follows:

	2018 ***000'GEL***	***2017*** ***000'GEL***	***2016*** ***000'GEL***
Short-term employee benefits	1,153	1,135	1,217

Loans to and deposits from the key management personnel and respective interest income and expenses were immaterial as at 31 December 2018, 2017 and 2016 and for the years then ended.

23. 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	***2018***	***2017***	***2016***
Statement of financial position			
Assets			
Cash and cash equivalents			
- In TRY	44	74	142
- In EUR	13	26	9
- In USD	–	4	11
Liabilities			
Deposits and balances from banks			
- In EUR	7,074	13,436	192
- In USD	24,889	8,550	93,087
- In GBP	345	355	282
- In TRY	51	–	–
Other borrowed funds and subordinated debt			
- In USD	108	43,152	–
- In EUR	12,985	12,918	–
Income/(expense)			
Interest income	10	12	–
Interest expense	(4,161)	(5,802)	(4,486)

The deposits and balances and other borrowed funds from the Parent mature according to contractual maturity as follows: GEL 37,569 thousand matures in less than 12 months and GEL 7,883 thousand during 1 to 5 years.

(2017: GEL 18,744 thousand 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).

24. 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 following describes the methodologies and assumptions used to determine fair values for assets and liabilities recorded at fair value in the financial statements and those items that are not measured at fair value in the statement of financial position, but whose fair value is disclosed.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and savings accounts without a specific maturity.

Derivatives

Derivatives valued using a valuation technique with market observable inputs are mainly interest rate swaps, currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves. Derivatives valued using a valuation technique with significant non-market observable inputs are primarily long dated option contracts. These derivatives are valued using the binomial models. The models incorporate various non-observable assumptions, which include market rate volatilities.

Trading securities and investment securities

Trading securities and investment securities valued using a valuation technique or pricing models primarily consist of unquoted equity and debt securities. These securities are valued using models which sometimes only incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

24. Fair value of financial assets and liabilities (continued)

(a) Fair values estimates and assumptions (continued)

Financial assets and financial liabilities carried at amortised cost

Fair value of the quoted notes and bonds is based on price quotations at the reporting date. The fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to the NBG and credit institutions and other financial assets and liabilities, obligations under finance leases is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

(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. The table does not include the fair values of non-financial assets and non-financial liabilities.

31 December 2018	*Level 1*	*Level 2*	*Level 3*	*Total fair value*	*Carrying amount*
Assets measured at fair value					
Debt securities measured at FVOCI	15,022	10,439	–	**25,461**	**25,461**
Assets for which fair values are disclosed					
Loans to customers	–	–	156,676	**156,676**	**156,471**
Liabilities for which fair values are disclosed					
Amounts due to customers	–	144,900	–	**144,900**	**144,861**

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 3.

31 December 2017	*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 3.

25. New standards and interpretations not yet adopted

Up to the date of approval of the financial statements, certain new standards, interpretations and amendments to existing standards have been published that are not yet effective for the current reporting period and which the Bank has not early adopted. Such standards that are expected to have an impact on the Bank, or the impacts of which are currently being assessed, are as follows:

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 (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

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

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

IFRS 16, which is effective for annual periods beginning on or after 1 January 2019, requires lessees and lessors to make more extensive disclosures than under IAS 17.

The Bank plans to adopt IFRS 16 retrospectively with the cumulative effect of initially applying IFRS 16 recognised at the date of initial application. The Bank will elect to apply the standard to contracts that were previously identified as leases applying IAS 17 and IFRIC 4. The Bank will therefore not apply the standard to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

The Bank will elect to use the exemptions proposed by the standard on lease contracts for which the lease terms ends within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value. The Bank has leases of certain office equipment (i.e., personal computers, printing and photocopying machines) that are considered of low value.

The Bank is currently assessing the impact of adoption of IFRS 16 but does not expect any significant impact on equity at the date of transition.

Other standards issued but not yet effective are not expected to have significant impact on the Bank’s financial statements.