# JSC Isbank Georgia

## Financial Statements

*For the year ended 31 December 2019*

*Together with Independent Auditor's Report*

**Contents**

**Independent auditor's report**

**Financial statements**



**Notes to, and forming part of, the financial statements**

## INDEPENDENT AUDITOR'S REPORT

To the shareholders and Supervisory Council of JSC Isbank Georgia

### *Opinion*

We have audited the accompanying financial statements of JSC Isbank Georgia (hereinafter the "Bank"), which comprise the statement of financial position as at 31 December 2019, 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 2019, 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 (the "IESBA Code") together with the ethical requirements that are relevant to our audit of the financial statements in Georgia, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the "IESBA Code".

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### *Other Matter*

The financial statements of the Bank for the years ended 31 December, 2018 and 2017 were audited by another auditor who expressed unmodified opinions on those statements on 24 May 2019 and 15 May 2018 respectively.

### *Other Information included in the Bank's Management Report*

Management is responsible for the other information. Other information consists of the information included in the Bank's 2019 Management Report, other than the financial statements and our auditor's report thereon. The Bank's 2019 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 do 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 is materially incompliant with the requirements of the respective regulatory acts or otherwise appears to be materially misstated based on our knowledge obtained in the audit.

### *Responsibilities of Management and the Audit Committee for the Financial Statement*

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.



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***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 scepticism 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.

The partner in charge of the audit resulting in this independent auditor's report is Sujata Jaffer.

Malkhaz Ujmajuridze

For and on behalf of Nexia TA LLC

Tbilisi, Georgia

25 March 2020



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*(In thousands of GEL)*

| | Notes | 2019 | 2018 | 2017 |
|---|---|---|---|---|
| Interest income calculated using effective interest rate | | **17,003** | 14,672 | 18,850 |
| Interest expense | | **(4,542)** | (6,284) | (10,595) |
| **Net interest income** | 6 | **12,461** | 8,388 | 8,255 |
| Fee and commission income | | **2,559** | 1,457 | 970 |
| Fee and commission expense | | **(1,149)** | (1,366) | (878) |
| **Net fee and commission income** | 7 | **1,410** | 91 | 92 |
| Dealing | | **801** | 706 | 719 |
| Translation differences | | **97** | 1,042 | 89 |
| **Net foreign exchange gain** | | **898** | 1,748 | 808 |
| **Operating income** | | **14,769** | 10,227 | 9,155 |
| Credit loss (expense) / reversal | 8 | **(210)** | 443 | 380 |
| **Operating income after credit loss (charge) / reversal** | | **14,559** | 10,670 | 9,535 |
| Personnel expenses | 9 | **(4,555)** | (4,635) | (4,568) |
| Other general administrative expenses | 10 | **(2,548)** | (2,808) | (3,229) |
| **Profit before income tax** | | **7,456** | 3,227 | 1,738 |
| Income tax expense | 11 | **(1,394)** | (677) | (214) |
| **Profit for the year** | | **6,062** | 2,550 | 1,524 |
| Unrealized net gains from investment securities available-for-sale | | **-** | - | 65 |
| Net change in fair value and expected credit losses for debt securities as fair value through other comprehensive income | | **(282)** | (621) | - |
| Income tax effect on other comprehensive income | 11 | **42** | 94 | (10) |
| **Net other comprehensive income/ (loss) to be reclassified subsequently to profit or loss when specific conditions are met** | | **(240)** | (527) | 55 |
| **Other comprehensive income/ (loss) for the year, net of tax** | | **(240)** | (527) | 55 |
| **Total comprehensive income for the year** | | **5,822** | 2,023 | 1,579 |

The financial statements as set out on pages 5 to 62 were approved for issue and signed on behalf of the Management on 25 March 2020 by:

**Ozan Gür**
**Chief Executive Officer**

**Ucha Saralidze**
**Chief Financial Office**

**JSC Isbank Georgia**
**Statement of Financial Position**
**For the year ended 31 December 2019**
*(In thousands of GEL)*

| | Notes | 2019 | 2018 | 2017 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and cash equivalents | 12 | **57,013** | 38,031 | 21,579 |
| Amounts due from banks | 13 | **1,627** | 5,155 | 434 |
| Mandatory reserves at the National Bank of Georgia | 14 | **24,609** | 26,567 | 28,897 |
| Loans to customers | 15 | **155,420** | 156,471 | 157,004 |
| Investment securities | 16 | **33,704** | 25,461 | 24,633 |
| Property, equipment, Intangible and Right-of-Use Asset | 17 | **2,541** | 984 | 1,529 |
| Other assets | 18 | **812** | 11,257 | 3,351 |
| **Total assets** | | **275,726** | **263,926** | **237,427** |
| | | | | |
| **Liabilities** | | | | |
| Amounts due to banks | 19 | **133,656** | 106,509 | 54,456 |
| Amounts due to customers | 20 | **36,862** | 38,352 | 74,023 |
| Other borrowed fund and subordinated debt | 21 | **15,674** | 31,916 | 68,638 |
| Deferred tax liabilities | 11 | **1,013** | 649 | 209 |
| Other liabilities | 18 | **4,499** | 8,300 | 3,238 |
| **Total liabilities** | | **191,704** | **185,726** | **200,564** |
| | | | | |
| **Equity** | | | | |
| Share capital | 22 | **69,162** | 69,162 | 30,000 |
| Fair value reserve for investment securities | | **(644)** | (404) | 55 |
| Retained earnings | | **15,504** | 9,442 | 6,808 |
| **Total equity** | | **84,022** | **78,200** | **36,863** |
| **Total liabilities and equity** | | **275,726** | **263,926** | **237,427** |

*(In thousands of GEL)*

| | Notes | Share capital | Fair value reserve for investment securities | Retained earnings | Total equity |
|---|---|---|---|---|---|
| **Balances as at 1 January 2017** | | 30,000 | - | 5,284 | **35,284** |
| Profit for the year | | - | - | 1,524 | **1,524** |
| Other comprehensive income for the year | | - | 55 | - | **55** |
| **Total comprehensive income for the year** | | | **55** | **1,524** | **1,579** |
| **Balances as at 31 December 2017** | | **30,000** | **55** | **6,808** | **36,863** |
| Impact of adopting IFRS 9 | 3 | - | 68 | 84 | **152** |
| **Balances as at 1 January 2018** | | **30,000** | **123** | **6,892** | **37,015** |
| Profit for the year | | - | - | 2,550 | **2,550** |
| Other comprehensive loss for the year | | - | (527) | - | **(527)** |
| **Total comprehensive income for the year** | | **-** | **(527)** | **2,550** | **2,023** |
| Increase in share capital | 21 | 39,162 | - | - | **39,162** |
| **Balances as at 31 December 2018** | | **69,162** | **(404)** | **9,442** | **78,200** |
| Profit for the year | | - | - | 6,062 | **6,062** |
| Other comprehensive loss for the year | | - | (240) | - | **(240)** |
| **Total comprehensive income for the year** | | - | **(240)** | **6,062** | **5,822** |
| **Balances as at 31 December 2019** | | **69,162** | **(644)** | **15,505** | **84,022** |

# JSC Isbank Georgia
## Statement of cash flows
## For the year ended 31 December 2019
*(In thousands of GEL)*

| | Notes | 2019 | 2018 | 2017 |
|---|---|---|---|---|
| **Cash flows from operating activities** | | | | |
| Profit before income tax | | **7,456** | 3,227 | 1,738 |
| Adjustment for: | | | | |
| Depreciation and amortization | 17 | **1,286** | 805 | 770 |
| Interest revenue calculated using effective interest rate | 6 | **(17,003)** | (14,672) | (18,850) |
| Interest expense | 6 | **4,542** | 6,284 | 10,595 |
| Impairment loss | 8 | **210** | (446) | (380) |
| Net foreign exchange gain | | **(898)** | (1,748) | (808) |
| Other non-cash movements | | **-** | - | 80 |
| | | **(4,407)** | (6,550) | (6,855) |
| Change in operating assets and liabilities | | | | |
| Decrease in mandatory reserves at the National Bank of Georgia | | **4,033** | 2,895 | 16,383 |
| Increase/ (decrease) in amounts due from banks | | **3,802** | (3,117) | (434) |
| Decrease/ (increase) in loans to customers | | **7,441** | (3,281) | 16,624 |
| Decrease/ (increase) in other assets | | **10,674** | (8,535) | (1,326) |
| Increase/(decrease) in deposits and balances from banks | | **21,209** | 47,442 | (113,335) |
| (Decrease)/ increase in current accounts and Deposits from customers | | **(3,280)** | (31,453) | 8,135 |
| (Decrease)/ increase in other liabilities | | **(6,720)** | 5,654 | 2,192 |
| **Cash flows from/ (used in) operations before interest and income tax** | | **32,752** | 3,055 | (71,761) |
| Interest receipts | | **16,652** | 18,988 | 17,438 |
| Interest payments | | **(3,749)** | (10,535) | (6,796) |
| Income tax paid | | **(317)** | (137) | (594) |
| **Cash flows from/ (used in) operations** | | **45,338** | 11,371 | (68,568) |
| **Cash flows from investing activities** | | | | |
| Purchases of investment securities | | **(14,038)** | (5,028) | (22,915) |
| Receipts from investment securities | | **6,000** | 4,125 | - |
| Purchases of property, equipment and intangible assets | 17 | **(109)** | (260) | (46) |
| **Cash flows used in investing activities** | | **(8,147)** | (1,163) | (22,961) |
| **Cash flows from financing activities** | | | | |
| Receipts from other borrowed fund and subordinated debt | 21 | - | 26,303 | 68,155 |
| Repayments from other borrowed funds and subordinated debt | 21 | **(17,708)** | (20,132) | - |
| Repayments of principal portion of lease liabilities | | **(849)** | - | - |
| **Cash flows (used in)/ from financing activities** | | **(18,557)** | 6,171 | 68,155 |
| **Net increase/(decrease) in cash and cash equivalents** | | **18,634** | 16,379 | (23,374) |
| Effect of changes in exchange rates and expected credit losses on cash and cash equivalents | | **348** | 74 | 855 |
| Cash and cash equivalents as at the beginning of the year | 12 | **38,031** | 21,578 | 44,098 |
| **Cash and cash equivalents as at the end of the year** | 12 | **57,013** | 38,031 | 21,579 |

## 1 Principal Activities

### (a) Organization and operations

JSC Isbank Georgia (hereinafter the "Bank") is a joint stock company, incorporated on 29 June 2015 in accordance with legislation of Georgia. The Bank operates under a general banking license (N: 368) issued by the National Bank of Georgia ("NBG") on 1 August 2015. The Bank is registered by the LEPL National Agency of Public Registry and the registration number is 404496611.

Before reorganization (1 August 2015) the Bank was presented as Batumi Branch of JSC Isbank Turkey (the "Branch") 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.

The Bank's principal activities include the following: accepts deposits from the public and provide credit, transfers payments in Georgia as well as abroad, exchanges currencies and provides other banking services to its commercial and retail customers. Main office of the Bank is in Tbilisi, Georgia and as at 31 December 2019, 31 December 2018 and 31 December 2017 it has two branches located in Tbilisi and Batumi.

The Bank's registered legal address is D. Aghmashenebeli Ave. 140/B, Tbilisi, Georgia.

As at 31 December 2019, 2018 and 2017 the Bank's 100% shareholder was JSC Isbank Turkey.

The Bank is ultimately controlled by is bank member's Supplementary Pension Fund. Related party transactions are disclosed in Note 26.

### (b) 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.

According to the decree N7/04 of the rule of issuing loans by the commercial banks up to the GEL 200 thousand, issued by the President of the National Bank Of Georgia on 18th of January, 2019, the commercial banks are allowed to issue loans up to the GEL 200 thousand in foreign currency only to the individuals who don't have Georgian citizenship or to the legal entities, which are not registered in Georgia. (According to decree №4/04 which was implemented in 13 January 2017, following limits were GEL 100,000) if a loan / credit limit is issued to a stateless person and / or a legal entity not registered in Georgia.

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.

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

### (c) 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 2018 and 2017. 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.

### (d) Basis measurement

The financial statements are prepared on the historical cost convention, except for investment securities, that are measured at fair value.

### (e) Presentation of financial statements

The Bank presents its statement of financial position in order of liquidity based on the Bank's intention and perceived ability to recover/settle the majority of assets /liabilities of the corresponding financial statement line items. Analysis regarding recovery or settlement within 12 months after the reporting date (current) and more 12 months after the reporting date (non-current) is presented in Note 23.

### (f) Functional and presentation currency

The national currency of Georgia is the Georgian Lari (₾), which is the Bank's functional and presentation currency. These financial statements are presented in thousands of Georgian Lari ("₾") except where otherwise stated.

### *(g) Going Concern*

The Board of Directors of JSC Isbank Georgia has prepared these financial statements on a going concern basis. In making this judgment the management considered the Bank's financial position, current intentions, profitability of operations and access to financial resources. Management assessed the impact of the economic crisis associated with the widespread of the coronavirus (COVID -19) as described in note 29 and they believe that this event will not have a significant impact to the Bank's operational activities in the foreseeable future. The management is not aware of any material uncertainty that may cast significant doubt on the Bank's ability to continue as going concern.

## 3 Summary of Significant Accounting Policies

***Foreign Currency Translation***

The financial statements are presented in Georgian Lari (₾), which is the Bank's functional currency and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated into the functional currency at the official exchange rate Set by the National Bank of Georgia at the reporting date. Gains or losses resulting from the translation of foreign currency transactions are recognized in the statement of profit or loss as gains less losses from foreign currencies – translation differences. 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.

The exchange rates used by the Bank in the preparation of the financial statements as at 31 December 2019, 31 December 2018 and 31 December 2017 are as follows:

| | **2019** | **2018** | **2017** |
|---|---|---|---|
| 1 US Dollar / ₾ | 2.8677 | 2.6766 | 2.5922 |
| 1 Euro / ₾ | 3.2095 | 3.0701 | 3.1044 |
| 1 TRY / ₾ | 0.4821 | 0.5076 | 0.6874 |
| 1 GBP / ₾ | 3.7593 | 3.3955 | 3.5005 |

## 3 Summary of Significant Accounting Policies (continued)

***Determination of fair value***

The Bank measures financial instruments carried at Fair value through profit or loss (FVPL) and Fair value through other comprehensive income (FVOCI) at fair value at each balance sheet date.

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

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

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

In order to show how fair values have been derived, financial instruments are classified based on a fair value hierarchy, as summarised below:

- Level 1 financial instruments - those where the inputs used in the valuation are unadjusted quoted prices from active markets for identical assets or liabilities that the bank has access to the measurement date. The bank considers markets as active only if there are sufficient trading activities with regards to the volume and liquidity of the identical assets or liabilities and when there are binding and exercisable price quotes available on the balance sheet date;

- Level 2 financial instruments - those where the inputs that are used for valuation and are significant, are derived from directly or indirectly observable market data available over the entire period of the instrument's life. Such inputs include quoted prices for similar assets or liabilities in active market, quoted prices such as interest rates yield curves, implied volatilities, and credit spreads. In addition, adjustments may be required for the condition or location of the asset or the extent to which it relates to items that are comparable to the valued instrument. However, if such adjustments are based on unobservable inputs which are significant to the entire measurement, the Bank will classify the instruments as level 3.

- Level 3 financial instruments - those that include one or more unobservable inputs that is significant to the measurement as whole.

The bank periodically reviews its valuation techniques including the adopted methodologies and model calibrations. However, the base models may not fully capture all factors relevant to the valuation of the Bank's financial instruments such as credit risk (CVA), own credit (DVA) and /or funding costs (FVA). Therefore, the Bank applies various techniques

to estimate the credit risk associated with it financial instruments measured at fair value, which include a portfolio-based approach that estimate the expected net exposure per counterparty over the full lifetime of the individual assets, in order to reflect the credit risk of the individual counterparties for non-collateralised financial instruments.

The bank evaluates the levelling at each reporting period on an instrument-by-instrument basis and reclassifies instruments when necessary, based on the facts at the end of reporting period.

***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.

*(In thousands of GEL)*

## 3 Summary of Significant Accounting Policies (continued)

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.

*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*** | ***Category*** | ***Amount*** | ***ECL (accrual)/ recovery*** | ***Amount*** | ***Category*** |
| Cash and cash equivalent | L&R1 | 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 |
| 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.*

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:

| ***Retained earnings*** | **Reserves and 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 FVOC | 68 |
| **Restated opening balance under IFRS 9 (1 January 2018)** | **123** |
| **Total change in equity due to adopting IFRS 9** | **152** |

*(In thousands of GEL)*

## 3 Summary of Significant Accounting Policies (continued)

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.

| Impairment allowance for | Loan loss allowance/ provision under IAS 39 / IAS 37 at 31 December 2017 | Re-measurement | *ECL under IFRS 9 at 1 January* 2018 |
|---|---|---|---|
| Loans to customers at amortised cost | (1,511) | 306 | (1,208) |
| 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)** |

*Amounts due from banks, loans to customers, investments securities at amortised cost*

Before 1 January 2018, amounts due from banks 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 banks, 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.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case'

## 3 Summary of Significant Accounting Policies (continued)

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.

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.

## 3 Summary of Significant Accounting Policies (continued)

*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.

*Loans and borrowings*

Before 1 January 2018, loans and receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. They were not entered into with the intention of immediate or short-term resale and were not classified as trading securities or designated as investment securities available-for-sale. Such assets were carried at amortized cost using the effective interest method. Gains and losses were recognised in profit or loss when the loans and receivables were derecognised or impaired, as well as through the amortization process.

*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.

*Staged approach to the determination of expected credit losses*

IFRS 9 introduced a three-stage approach to impairment for financial instruments that are performing at the date of origination or purchase. This approach is summarised as follows:

- Stage 1: The Bank recognises a credit loss allowance at an amount equal to 12-month expected credit losses. This represents the portion of lifetime expected credit losses from default events that are expected within 12 month of the reporting date, assuming that credit risk has not increased significantly after initial recognition. For those financial assets with a remaining maturity of less than 12 months, a PD is used that corresponds to the remaining maturity;
- Stage 2: The Bank recognises a credit loss allowance at an amount equal to lifetime expected credit losses (LTECL) for those financial instruments which are considered to have experienced a significant increase in credit risk since initial recognition. This requires the computation of ECL based on lifetime probability of default (LTPD) that represents the probability of default occurring over the remaining lifetime of financial instrument. Allowance for credit losses are higher in this stage because of an increase in credit risk and the impact of a longer time horizon being considered compared to 12 months in Stage 1. Financial instruments in stage 2 are not yet deemed to be credit-impaired;
- Stage 3: If the financial instrument is credit-impaired, it is then moved to stage 3. The Bank recognise a loss allowance at an amount equal to lifetime expected credit losses, reflecting a Probability of Defaults (PD) of 100% for financial instruments that are credit-impaired.

Financial instruments within the scope of the impairment requirement of IFRS 9 are classified into one of the above three stages.

Key judgment and estimates used under IFRS 9 are disclosed in NOTE 4.

***Cash and cash equivalents***

Cash and cash equivalents are items which are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. Cash and cash equivalents include notes and coins on hand, amounts due from National Bank of Georgia (NBG), excluding mandatory reserves, and other highly liquid financial assets with original maturities of less than three month. Cash and cash equivalent are carried at amortised cost.

## 3 Summary of Significant Accounting Policies (continued)

***Amounts due from banks***

Amounts due from banks are recorded when the Bank advances money to counterparty banks. Amounts due from banks are initially recognized at fair value and are subsequently measured at amortized cost (AC) using the effective interest method when: they are held for the purposes of collecting contractual cash flows and cash flows represent SPPI, and they are not designated at FVTPL. Otherwise they are carried at Fair value (FV). Amounts due from banks are carried net of any allowances for impairment losses.

***Mandatory reserve with National Bank of Georgia (NBG)***

Mandatory reserves with NBG, as financial assets are carried at amortised cost and represent mandatory reserve deposits that are not available to finance the Bank's day to day operations.

***Investments securities***

Investment securities include Government bonds. The Bank classifies investment securities as carried at AC or FVOCI. Securities are carried at AC if they are held for collection of contractual cash flows and where those cash flows represent SPPI. Securities are carried at FVOCI if they are held for collection of contractual cash flows and for selling, where those cash flows represent SPPI, and if they are not designated at FVTPL. Interest income from these assets is calculated using the effective interest method and recognised in profit of loss for the year. All other changes in the carrying value are recognised in OCI. When the security are derecognised, the cumulative gain or loss previously recognised in OCI is classified from OCI to profit or loss.

***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 as net gains/ (losses) from financial instruments at fair value through profit or loss or net gains/ (losses) from foreign currencies dealing, depending on the nature of the instrument.

***Borrowings including subordinated debt***

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to credit institutions, amounts due to customers, debt securities issued and subordinated debt. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the statement of profit or loss when the borrowings are derecognised as well as through the amortisation process. If the Bank purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is recognised in the statement of profit or loss.

***Derecognition of financial assets and liabilities***

*Financial assets*

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.

## 3 Summary of Significant Accounting Policies (continued)

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.

*Financial liabilities*

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

***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 each reporting date whether there was any objective evidence that a financial asset or a group of financial assets was impaired. A financial asset or a group of financial assets was deemed to be impaired if, and only if, there was objective evidence of impairment as a result of one or more events that had occurred after the initial recognition of the asset (an incurred “loss event”) and that loss event (or events) had an impact on the estimated future cash flows of the financial asset or the group of financial assets that could be reliably estimated. Evidence of impairment may have included indications that the borrower or a group of borrowers was experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they would enter bankruptcy or other financial reorganisation and where observable data indicated that there was a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlated with defaults. For available-for-sale financial instruments, evidence of impairment also included significant or prolonged decline in fair value of investment below its cost.

The Bank assessed whether objective evidence of impairment existed individually for financial assets that were individually significant, or collectively for financial assets that were not individually significant if there was an objective evidence that an impairment loss had been incurred, the amount of the loss was measured as the difference between the assets’ carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred), discounted using original effective interest rate, or, for financial assets available-for-sale, as the difference between cost of investment and its fair value. The carrying amount of the asset was reduced and the amount of the loss was recognised in profit or loss. Interest revenue continued to be accrued on the reduced carrying amount based on the original effective interest rate of the asset, or, for financial assets available-for-sale, using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Assets together with the associated allowance were written off when there is no realistic prospect of future recovery and all collateral had been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss decreased because of an event occurring after the impairment had been recognised, the previously recognised impairment loss was reversed in consolidated statement of profit or loss, except for equity investments available-for-sale, for which increase in their fair value after impairment were recognised in other comprehensive income. For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank’s internal product monitoring system that considers credit risk characteristics such as asset type, industry, collateral type, past-due status and other relevant factors. Future cash flows on a group of financial assets that were collectively evaluated for impairment were estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience was adjusted on the basis of current

## 3 Summary of Significant Accounting Policies (continued)

observable data to reflect the effects of current conditions that had not affected the years on which the historical loss experience was based and to remove the effects of conditions in the historical period that did not exist currently. Estimates of changes in future cash flows reflected, and were directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that were indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows were reviewed regularly to reduce any differences between loss estimates and actual loss experience. Information on impairment assessment under IFRS 9 is presented in Note 23.

***Property and equipment***

Property and equipment is stated at cost excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. Changes in the expected useful life are accounted for by changing the amortisation period or methodology, as appropriate, and treated as changes in estimates. Right-of-use assets are presented together with property and equipment in the statement of financial position-refer to the accounting policy in below. Right-of-use assets are depreciated on a straight-line basis over the lease term.

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 |
| Right-of-use assets | lease term |

Leasehold improvements are depreciated over the shorter of the lease term and their useful lives.
An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected its use of disposal. Any gain or loss arising on derecognition of the assets is included in the statement of profit or loss when the asset is derecognised.

The residual values, useful lives and methods of depreciation of property, plant and equipment are reviewed at each financial year end and adjusted prospectively, 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.

***Share capital***

*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.

*Dividends*

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

## 3 Summary of Significant Accounting Policies (continued)

***Contingencies***

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

***Taxation***

Income taxes are provided in the financial statements in accordance with the legislation enacted or substantively enacted by the end of reporting period in the respective territories that the Bank operates. The income tax comprises of current tax and deferred tax and is recognised in profit or loss except if it is recognised directly in the other comprehensive income because it is related to transactions that are also recognised, in the same or a different period, directly in other comprehensive income.

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 income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill and subsequently for goodwill that is not deductible for tax purposes. Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period that are expected to apply to the extent of time when the temporary differences will reverse or the tax loss carry forwards will be utilised.

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***

*Interest and similar revenue and expense*

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:

Under IFRS 9, interest income is recorded using the EIR method for all financial assets measured at amortised cost. Interest income on interest bearing financial assets measured at FVOCI under IFRS 9 is also recorded using the EIR method. Interest expense is also calculated using the EIR method for all financial liabilities held at amortised cost. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial assets or liabilities, or, when appropriate, a shorter period, to the gross carrying amount of the financial asset.

The EIR (and therefore, the amortised cost of the financial asset) is calculated by taking into account transaction costs and any discount or premium on the acquisition of the financial assets, as well as fees and costs are an integral part of the EIR. The bank recognises interest income using a rate of return that represents the best estimate of a constant rate of return over the expected life of the loan. Hence, the EIR calculation also takes into account the effect of potentially different interest rates that may be charged at various stages of the financial asset’s expected life, and other characteristics of the of the product life cycle (including prepayments, penalty interest and charges).
If expectations of fixed rate financial assets or liabilities cash flows are revised for reasons other than credit risk, than changes to future contractual cash flows are discounted at the original EIR with a consequential adjustment to the carrying amount. The difference from the previous carrying amount is booked as a positive or negative adjustment to the carrying amount of the financial asset or liability on the balance sheet with a corresponding increase or decrease in interest revenue/ expense calculated using the effective interest method.

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 credit impaired, the Bank reverts to calculating interest revenue on a gross basis.

## 3 Summary of Significant Accounting Policies (continued)

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*

The bank earns fee and commission income from a diverse range of financial services it provides to its customers. Fee and commission income is recognised at an amount that reflects the considerations to which the Bank expects to be entitled in exchange for providing services.

- *Fee income earned from services provided over a certain period of time*

Fees earned for the provision of services over a period of time are accrued over that period as respective performance obligations are satisfied. 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.

- *Fee income earned at a point in time*

Other fees, commissions and other income and expense items are recognized in profit or loss when the corresponding service is provided. Each operation is treated as a separate performance obligation.

***Leases***

The bank assesses at contract inception whether a contract is or contains, a lease. That is, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The bank applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The bank recognise lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

***Right-of-use assets***

The Bank recognises right-of-use assets at the commencement date of the lease. Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Right-of-use assets are depreciated on a straight-line basis over the shorter of the lease term and the estimated useful lives of the assets. Right-of-use assets are also subject to impairment.

***Lease liabilities***

At the Commencement date of the lease, the Bank recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the bank and payments of penalties for terminating the lease, if the lease term reflects the Bank exercising the option to terminate.
In calculating the present value of lease payments, the Bank uses its incremental borrowing rate at the lease commencement date because the interest rate implicit in the lease is not readily determinable. The carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the lease payments or a change in the assessment of an option to purchase the underlying asset.

***Short-term leases and leases of low-value assets***

The Bank applies the lease of low-value assets recognition exemption to leases of placement of ATM that are considered to be low value. Lease payments on leases of low-value assets are recognised as expense on a straight-line basis over the lease term.

***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

## 3 Summary of Significant Accounting Policies (continued)

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.

***Retirement and other benefit obligations***

The Bank does not have any pension arrangements separate from the state pension system of Georgia. In addition, the Bank has no post-retirement benefits.

***Application of new standards, interpretations and amendments***

The new and amended standards and interpretations are effective for annual periods beginning on or after 1 January 2019, unless otherwise stated. The Bank has adopted all of the new and amended Accounting Standards and Interpretations issued by IASB that are mandatory for the current reporting period.
The Bank has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective.
In these financial statements, the Bank has applied IFRS 16 Leases for the first time. Several other amendments and interpretations apply for the first time in 2019, but do not have an impact on the Bank's financial statements.

***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. The scope of IFRS 16 includes leases of all assets, with certain exceptions. A lease is defined as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. IFRS 16 requires lessees to account for all leases under a single on- balance sheet model in a similar way to finance leases under lAS 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 recognize 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 recognize the interest expense on the lease liability and the depreciation expense on the right-of-use asset. Lessor accounting is substantially unchanged from today's accounting under lAS 17. Lessors will continue to classify all leases using the same classification principle as in lAS 17 and distinguish between two types of leases: operating and finance leases.
The Bank adopted IFRS 16 using the modified retrospective method of adoption with the date of initial application of the 1 January 2019. Under this method, the standard is applied retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application. The Bank elected to use the transition practical expedient to not reassess whether a contract is or contains a lease at 1 January 2019. Instead, the Bank applied the standard only to contract that were previously identified as lease applying IAS and IFRIC 4 at the date of initial application.

The bank has lease contracts for branches and for placement of ATM. Before the adoption of IFRS 16, the Bank classified each of its leases at the inception date as operating lease. The standard provides specific transition requirements and practical expedients, which have been applied by the Bank. The Bank recognised right-of-use assets and lease liabilities for those leases previously classified as operating leases, except for short-term leases and leases of low-value assets. The right-of-use assets were recognised based on the amount equal to the lease liabilities, adjusted for any related prepaid and accrued lease payments previously recognised. Lease liabilities were recognised based on the present value of the remaining lease payments, discounted using the incremental borrowing rate at the date of initial application. Based on the above, as at 1 January 2019:

- Right-of-use assets of GEL 2,737 thousands were recognised and presented in the statement of financial position within "Property, plant and right-of-use assets".
- Additional lease liabilities of 2,737 thousand were recognised.

*(In thousands of GEL)*

## 3 Summary of Significant Accounting Policies (continued)

The adoption of IFRS 16 had no impact on the Bank's retained earnings.

The lease liabilities as at 1 January 2019 can be reconciled to the operating lease commitments as of 31 December 2018, as follows:

| | |
|---|---|
| **Operating lease commitments at 31 December 2018** | 3,036 |
| The effect of discounting using the incremental borrowing rate at 1 January 2019 | (275) |
| Discounted lease commitments as at 1 January 2019 | **2,761** |
| Less: | |
| Commitments relating to short-term leases | - |
| Commitments relating to low-value assets | (24) |
| Add: | |
| Lease payments to renewal periods not included in operating | - |
| Lease commitments as at 31 December 2018 | - |
| **Lease liabilities as at 1 January 2019** | **2,737** |

The Bank also elected to use recognition exemptions for some lease contracts that, at the commencement date, have a lease term of 12 months or less and do not contain a purchase option (short-term leases), and lease contracts for which the underlying asset is of low value (low-value assets).

***Amendments to IFRS 9: Prepayment Features with Negative Compensation***

Under IFRS 9, a debt instrument can be measured at amortised cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of an event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.

These amendments had no impact on the financial statements of the Bank.

***Amendments to IAS 19: Plan Amendment, Curtailment or Settlement***

The amendments to IAS 19 address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments specify that when a plan amendment, curtailment or settlement occurs during the annual reporting period, an entity is required to determine the current service cost for the remainder of the period after the plan amendment, curtailment or settlement, using the actuarial assumptions used to remeasure the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event. An entity is also required to determine the net interest for the remainder of the period after the plan amendment, curtailment or settlement using the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event, and the discount rate used to remeasure that net defined benefit liability (asset).

The amendments had no impact on the financial statements of the Bank as it did not have any plan amendments, curtailments, or settlements during the period.

## 4 Critical Accounting Estimates and Judgements

The preparation of the Bank's financial statements requires management to make judgments, estimates and assumptions that affect the reported amount or revenues, expenses, assets and liabilities, and the accompanying disclosures, as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could results in outcomes that require a material adjustment to the carrying amount of assets and liabilities affected in future periods. In the process of applying the Bank's accounting policies, management has made the following judgements and assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

## 4 Critical Accounting Estimates and Judgment (continued)

**Significant Increase in Credit Risk (SIRC)**

A significant increase in credit risk is not a defined term per IFRS 9, and is determined by management, based on their experience and judgment. In assessing whether the credit risk has significantly increased the Bank has identified a series of qualitative and quantitative criteria based on undertaking the holistic analysis of various factors including those which specific to a particular financial instrument or to a borrower as well as those applicable to particular sub-portfolios. The Bank has established general trigger events for individually significant and collectively assessed loans.

For further details on significant increase in credit risk see NOTE 23.

**Measurement of expected credit losses (ECL)**

ECL reflects an unbiased, probability-weighted estimate based on a combination of the following principal factors: probability of defaults (PD), loss given defaults (LGD), exposure of default (EAD) and loss given liquidation of collateralized exposure (LGL) which are further explained below:

Probability of Defaults (PD): The bank estimates PD based on a combination of rating model calibration results and a migration matrices approach which is further adjusted for macroeconomic expectations for all portfolios, to represent the forward-looking estimators of the PD parameters. 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. Since stage 3 financial instruments are defaulted, the probability of default in this case is equal to 100%.

Exposure of Defaults (EAD): The EAD represents an estimate of the exposure to credit risk at the time of a potential default occurring during the life of a financial asset. It represents the cash flows outstanding at the time of default, considering expected repayments, interest payments and accruals discounted at the EIR. 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 (LGD): LGD is defined as the likely loss in case of a counterparty default. It provides an estimation of the exposure that cannot be recovered in 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%.

Details of ECL measurement methodology are disclosed in Note 23.

**Macro-economic scenarios**

Under IFRS 9, the allowance for credit losses is based on reasonable and supportable forward-looking information obtainable without undue costs of effort, which takes into considerations past events, current conditions and forecasts of future economic conditions.

To incorporate forward-looking information into the Bank's allowance for credit losses, the Bank uses the macroeconomic forecasts provided By National Bank of Georgia. Macroeconomic variables covered by these forecasts and which the Bank incorporated in its ECL assessment model include GDP growth, foreign exchange rate and unemployment rate. The determination of the probability weighted ECL requires evaluating a range of diverse and relevant future economic conditions. To accommodate this requirement, the Bank uses three different economic scenarios in the ECL calculation: an upside (weight 0.25), a baseline (weight 0.50) and downside (weight 0.25) scenario relevant for each respective portfolio. A weight is computed for each scenario by using a probabilistic economic model that considers recent information as well as historical data provided by National Bank of Georgia.

*(In thousands of GEL)*

## 4 Critical Accounting Estimates and Judgment (continued)

**Estimating the incremental borrowing rate**

The bank cannot readily determine the interest rate implicit in the lease, therefore, it uses its incremental borrowing rate (IBR) to measure lease liabilities. The IBR is the rate of interest that the bank would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The Bank estimates the IBR using observable inputs such as market rates.

**Income tax**

The Bank is subject to income tax and significant judgment is required in determining the provision for income taxes. During the ordinary course of business, there are transactions and calculations for which the ultimate tax determination is uncertain. As a result, the Bank recognizes tax liabilities based on estimates of whether additional taxes and interest will be due. These tax liabilities are recognized when, despite the Bank's belief that its tax return positions are supportable, the Bank believes that certain positions are likely to be challenged and may not be fully sustained upon review by tax authorities.

## 5 Previous period reclassifications

The Bank has made certain reclassifications to the balances of the comparative figures for better presentation purposes, which do not represent an adjustment or correction of an error. The tables below summarised the total effect of reclassifications to prior period balances.

The reclassifications have had the following effect on the statement of financial position as of December 31.2018:

| 31 December 2018 | Original Statements | Reclassification | As reclassified |
|---|---|---|---|
| Other assets | 12,089 | (832) | 11,257 |
| Other liabilities | 9,132 | (832) | 8,300 |

The reclassifications have had the following effect on the statement of financial position as of December 31.2017:

| 31 December 2017 | Original Statements | Reclassification | As reclassified |
|---|---|---|---|
| Other assets | 3,498 | (147) | 3,351 |
| Other liabilities | 3,384 | (147) | 3,238 |

The reclassifications have had the following effect on the statement of cash flows for the year ended 31 December.2018:

| 31 December 2018 | Original Statements | Reclassification | As reclassified |
|---|---|---|---|
| Cash flows from operations | 9,269 | 2,102 | 11,371 |
| Cash flows from financing activities | 6,336 | (165) | 6,171 |

*(In thousands of GEL)*

## 6 Net interest income

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| ***Interest income*** | | | |
| **Financial assets measured as amortized cost** | | | |
| Loans to customers | **14,207** | 12,213 | 17,205 |
| Cash and cash equivalent and due from banks | **1,163** | 811 | 1,028 |
| **Financial assets measured at fair value through other comprehensive income (2017: investment securities available-for-sale)** | | | |
| Investment securities | **1,633** | 1,648 | 617 |
| **Interest income calculated using effective interest rate** | **17,003** | 14,672 | 18,850 |
| ***Interest expense*** | | | |
| Amounts due to banks | **(2,301)** | (1,838) | (4,475) |
| Other borrowed funds and subordinated debt | **(1,306)** | (3,356) | (3,515) |
| Amounts due to customers | **(935)** | (1,090) | (2,605) |
| **Interest expenses** | **(4,542)** | (6,284) | (10,595) |
| **Net interest income** | **12,461** | 8,388 | 8,255 |

## 7 Net Fee and commission income

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| **Fee and commission income** | | | |
| Commission from guarantees | **1,706** | 596 | 250 |
| Settlement operations | **341** | 506 | 458 |
| Card operations | **438** | 306 | 215 |
| Other operations | **74** | 49 | 47 |
| **Total fee and commission income** | **2,559** | 1,457 | 970 |
| **Fee and commission expense** | | | |
| Card operations | **757** | 851 | 543 |
| Settlement operations | **312** | 437 | 254 |
| Other operations | **80** | 78 | 81 |
| **Total fee and commission expense** | **1,149** | 1,366 | 878 |
| **Total net fee and commission income** | **1,410** | 91 | 92 |

## 8 Credit loss expense on financial assets

The table below shows the net ECL charges (reversal) on financial instruments recorded in the statement of profit or loss for the year ended 31 December 2019:

| | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
|---|---|---|---|---|
| Cash and cash equivalents | - | - | - | **-** |
| Amounts due from banks | 1 | - | - | **1** |
| Loans to customers | 24 | (48) | 59 | **35** |
| Investment securities | 115 | - | - | **115** |
| Financial guarantees | 59 | - | - | **59** |
| **Total credit loss** | **199** | **(48)** | **59** | **210** |

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:

*(In thousands of GEL)*

## 8 Credit loss expense on financial assets (continued)

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

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 | Loans to individuals | Total |
|---|---|---|---|
| **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 |

## 9 Personnel expenses

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| Salaries and bonuses | **4,202** | 4,109 | 3,874 |
| Other compensation cost | **353** | 526 | 694 |
| | **4,555** | 4,635 | 4,568 |

In the 2019 the total number of persons employed by the Bank was 68 people respectively (2018: 66; 2017: 60)

## 10 Other general administrative expense

Other general administrative expenses of the Bank are as follows:

| | | **2019** | 2018 | 2017 |
|---|---|---|---|---|
| Depreciation and amortization* | (Note 17) | **1,286** | 805 | 770 |
| Penalty fee | | **218** | - | - |
| Interest expense on lease liability | | **134** | - | - |
| Travel expenses | | **113** | 86 | 76 |
| Professional services | | **158** | 146 | 197 |
| Royalty | | **92** | 72 | 85 |
| Entertainment expenses | | **75** | 95 | 94 |
| Repairs and maintenance | | **49** | 45 | 34 |
| Communication and information services | | **46** | 53 | 65 |
| Utilities | | **46** | 49 | 47 |
| Operating lease* | | **17** | 1,063 | 1,058 |
| Office supplies | | **16** | 14 | 15 |
| Deposit insurance expense | | **10** | 10 | 100 |
| Taxes other than on income | | **10** | 15 | 21 |
| Write-off of other assets | | **-** | - | 349 |
| Advertising and marketing | | **-** | 6 | 23 |
| Other | | **278** | 349 | 295 |
| | | **2,548** | 2,808 | 3,229 |

Remuneration of the Bank's auditor for the audit of the Bank's annual financial statements for the year ended 31 December 2019 comprised GEL 75 thousand (2018: GEL 90 thousand, 2017: GEL 87 thousand) (net of VAT).

***** As disclosed in note 3, the bank adopted IFRS 16 on 1 January 2019 and recognised relevant right-of-use assets, which explains the drop in operating lease expenses.

*(In thousands of GEL)*

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

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 2019 and made the relevant recognition of deferred tax expense in the profit and loss statement for 2019.

The corporate income tax expense comprises:

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| **Current year tax expense** | (987) | (157) | (594) |
| **Deferred tax benefit/(expense)** | | | |
| Movement in deferred tax assets and liabilities due to origination and reversal of temporary differences | (407) | (520) | 380 |
| Write off tax loss carried forward | - | - | - |
| | **(407)** | (520) | 380 |
| **Total income tax expense** | **(1,394)** | (677) | (214) |

In 2019, the applicable tax rate for current and deferred tax is 15% (2018: 15%; 2017: 15%)

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

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| **Profit before tax** | **7,457** | 3,227 | 1,738 |
| **Income tax at the applicable Tax rate (15%)** | **(1,119)** | (484) | (261) |
| Non-taxable income and other differences | **712** | (36) | 47 |
| | **(407)** | (520) | (214) |

### Deferred tax assets and liabilities

Movements in temporary differences during the years ended 31 December 2019, 2018 and 2017 are presented as follows.

| | **Balance 1 January 2019** | **Recognized in profit or loss** | **Recognized in other comprehensive income** | **Balance 31 December 2019** |
|---|---|---|---|---|
| Property, equipment, Intangible and ROU assets | (102) | (221) | - | (323) |
| Loans to customers | (581) | (73) | - | (654) |
| Investment securities | 88 | (81) | 42 | 49 |
| Other liabilities | (54) | (32) | - | (85) |
| **Net tax (liabilities)/assets** | **(649)** | **(407)** | **42** | **(1,013)** |

*(In thousands of GEL)*

## 11 Income tax expense (continued)

| | 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)** |

| | 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)** |

## 12 Cash and cash equivalents

Cash and cash equivalents as at 31 December 2019, 31 December 2018 and December 2017 comprise of following:

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| **Cash on hand** | **2,752** | 5,109 | 4,249 |
| | | | |
| **Cash equivalents** | | | |
| Correspondent accounts with the NBG | 498 | 370 | 530 |
| Nostro accounts with other banks | 39,734 | 17,445 | 12,707 |
| Term deposits with NBG | 1,400 | 10,502 | - |
| Term deposits with other banks | 12,630 | 4,606 | 4,093 |
| Less-allowance for impairment | (1) | (1) | - |
| **Total cash equivalents** | **54,261** | 32,922 | 17,330 |
| **Total cash on hand and cash equivalents** | **57,013** | 38,031 | 21,579 |

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

As at 31 December 2019 the Bank has a placement with one bank (2018: one bank; 2017: one bank) with carrying value that individually exceeds 10% of equity. The gross value of that balance as at 31 December 2019 is GEL 38,190 thousand (2018: GEL 14,148 thousand; 2017: GEL 14,862 thousand).

Credit rating of correspondent accounts and placements with other banks with original maturities of less than three month stands as follow:

| | **2019** | **2018** | **2017** |
|---|---|---|---|
| BB | **1,898** | 58 | 104 |
| BB- | **38,546** | 28,259 | 15,726 |
| B+ | **9,645** | 4,605 | - |
| B | **-** | - | 1,500 |
| Not Rated | **4,172** | - | - |
| **Total** | **54,261** | 32,922 | 17,330 |

The table illustrates the ratings by international agency Fitch Ratings.

*(In thousands of GEL)*

## 13 Amounts due from banks

Amounts due from banks as at 31 December 2019, 31 December 2018 and 31 December 2017 comprise of following:

| | 2019 | 2018 | 2017 |
|---|---|---|---|
| With less than 1 year contractual maturity | 1,630 | 4,572 | 434 |
| With more than 1 year contractual maturity | - | 586 | - |
| Expected credit loss | (3) | (3) | |
| **Total amount due from banks** | **1,627** | **5,155** | **434** |

For the purpose of ECL measurement due from banks are included in stage 1. The ECL recognised for the amounts due from banks as at 31 December 2019 was GEL 3 thousand and there were no significant movements in ECL during the year (NOTE 8).

Credit rating of Amounts due from banks stands as follow:

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| BB+ | **-** | 513 | 434 |
| BB | **-** | 4,642 | - |
| B+ | **1,627** | - | - |
| | **1,627** | 5,155 | 434 |

The table illustrates the ratings by international agency Fitch Ratings.

## 14 Mandatory reserves at the National Bank of Georgia

Mandatory reserves at the National Bank of Georgia (NBG) represents amounts deposits with the NBG. 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 Bank’s ability to withdraw these deposits is restricted by regulations.

| | 2019 | 2018 | 2017 |
|---|---|---|---|
| Mandatory reserves at the NBG | 24,609 | 26,567 | 28,897 |
| | **24,609** | **26,567** | **28,897** |

## 15 Loans to customers

Loans to customers as at 31 December 2019, 31 December 2018 and 31 December 2017 comprise of following:

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| **Loans to legal entities** | | | |
| Corporate lending | **128,516** | 132,010 | 142,636 |
| Small and medium business lending | **18,594** | 12,480 | 8,223 |
| **Total loans to legal entities** | **147,110** | 144,490 | 150,859 |
| | | | |
| **Loans to individuals** | | | |
| Residential mortgage | **5,619** | 8,867 | 2,710 |
| Consumer lending | **3,505** | 3,892 | 4,946 |
| **Total loans to individuals** | **9,124** | 12,759 | 7,656 |
| | | | |
| **Gross loans to customers** | **156,234** | 157,249 | 158,515 |
| Less-allowance for impairment | **(814)** | (778) | (1,511) |
| **Loans to customers** | **155,420** | 156,471 | 157,004 |

*(In thousands of GEL)*

## 15 Loans to customers (continued)

### (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 2019 is as follows:

| Corporate lending | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **Gross carrying values as at 1 January 2019** | **130,484** | **1,526** | **-** | **132,010** |
| New assets originated or purchased | 89,498 | - | - | **89,498** |
| Assets repaid | (94,617) | (3) | - | **(94,620)** |
| Transfers to stage 3 | - | (1,523) | 1,523 | **-** |
| Foreign exchange adjustments | 1,519 | - | 109 | **1,628** |
| **At 31 December 2019** | **126,884** | **-** | **1,632** | **128,516** |

| Corporate lending | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **ECL as 1 January 2019** | **(175)** | **-** | **-** | **(175)** |
| New assets originated or purchased | (178) | - | - | **(178)** |
| Assets repaid | 167 | - | - | **167** |
| Net remeasurement of ECL | (26) | - | - | **(26)** |
| **At 31 December 2019** | **(212)** | **-** | **-** | **(212)** |

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 2019 is as follows:

| Small and medium business | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **Gross carrying values as at 1 January 2019** | **9,467** | **463** | **2,550** | **12,480** |
| New assets originated or purchased | 13,839 | - | 1,174 | **15,013** |
| Assets repaid | (8,227) | (351) | (372) | **(8,950)** |
| Transfers to stage 1 | 112 | (112) | - | **-** |
| Foreign exchange adjustments | 45 | - | 6 | **51** |
| **At 31 December 2019** | **15,236** | **-** | **3,358** | **18,594** |

| Small and medium business | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **ECL as 1 January 2019** | **(27)** | **(46)** | **(240)** | **(313)** |
| New assets originated or purchased | (23) | - | (74) | **(97)** |
| Assets repaid | 23 | 44 | 17 | **84** |
| Transfers to stage 2 | (2) | 2 | - | **-** |
| Net remeasurement of ECL | 3 | - | 67 | **70** |
| **At 31 December 2019** | **(26)** | **-** | **(230)** | **(256)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to Residential mortgages during the year ended 31 December 2019 is as follows:

| Residential mortgages | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **Gross carrying values as at 1 January 2019** | **8,634** | **18** | **215** | **8,867** |
| New assets originated or purchased | 1,092 | - | - | **1,092** |
| Assets repaid | (4,467) | (18) | (58) | **(4,543)** |
| Transfers to stage 2 | (153) | 153 | - | **-** |
| Transfers to stage 3 | (118) | - | 118 | **-** |
| Foreign exchange adjustments | 187 | 3 | 13 | **203** |
| **At 31 December 2019** | **5,175** | **156** | **288** | **5,619** |

*(In thousands of GEL)*

## 15 Loans to customers (continued)

| Residential mortgages | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **ECL as 1 January 2019** | **(14)** | **-** | **-** | **(14)** |
| New assets originated or purchased | (7) | 1 | - | **(6)** |
| Assets repaid | 5 | - | - | **5** |
| Transfers to stage 1 | 1 | (1) | - | **-** |
| Net remeasurement of ECL | 1 | (1) | (7) | **(7)** |
| **At 31 December 2019** | **(14)** | **(1)** | **(7)** | **(22)** |

An analysis of changes in the gross carrying value and corresponding ECL in relation to consumer lending during the year ended 31 December 2019 is as follows

| Consumer lending | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **Gross carrying values as at 1 January 2019** | **3,078** | **195** | **619** | **3,892** |
| New assets originated or purchased | 1,607 | 41 | 91 | **1,739** |
| Assets repaid | (1,890) | (122) | (129) | **(2,141)** |
| Transfers to stage 1 | 18 | (18) | - | **-** |
| Transfers to stage 2 | (29) | 29 | - | **-** |
| Transfers to stage 3 | (87) | (50) | 137 | **-** |
| Foreign exchange adjustments | 8 | 2 | 5 | **15** |
| **At 31 December 2019** | **2,705** | **77** | **723** | **3,505** |

| Consumer lending | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **ECL as at 1 January 2019** | **(30)** | **(33)** | **(212)** | **(275)** |
| New assets originated or purchased | (20) | (1) | (101) | **(122)** |
| Assets repaid | 15 | 16 | 107 | **138** |
| Transfers to stage 1 | 9 | - | (9) | **-** |
| Transfers to stage 2 | (3) | 12 | (9) | **-** |
| Net remeasurement of ECL | 8 | (4) | (69) | **(65)** |
| **At 31 December 2019** | (21) | (10) | (293) | **(324)** |

### (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.

*(In thousands of GEL)*

## 15 Loans to customers (continued)

The following table provides information on the credit quality of loans to customers as at 31 December 2019:

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **Loans to legal entities** | | | | |
| ***Corporate lending*** | **126,884** | **-** | **1,632** | **128,516** |
| not overdue | 126,884 | - | - | **126,884** |
| overdue more than 90 days | - | - | 1,632 | **1,632** |
| ***Small and medium business lending*** | **15,236** | **-** | **3,358** | **18,594** |
| not overdue | 15,236 | - | 1,174 | **16,410** |
| overdue more than 90 days | - | - | 2,184 | **2,184** |
| **Total loans to legal entities** | **142,120** | **-** | **4,990** | **147110** |
| **Loans to individuals** | | | | |
| ***Residential mortgages*** | **5,175** | **156** | **288** | **5,619** |
| not overdue | 4,804 | - | 155 | **4,959** |
| overdue less than 30 days | 371 | - | - | **370,566** |
| overdue more than 30 days and less than 90 days | - | 156 | - | **156** |
| overdue more than 90 days | - | - | 133 | **133** |
| ***Consumer lending*** | **2,705** | **77** | **723** | **3,505** |
| not overdue | 2,669 | 29 | 376 | **3,074** |
| overdue less than 30 days | 36 | - | 6 | **42** |
| overdue more than 30 days and less than 90 days | - | 48 | - | **-** **48** |
| overdue more than 90 days | - | - | 341 | **341** |
| **Total loans to individuals** | **7,880** | **233** | **1,011** | **9,124** |
| **Total gross loans to customers** | **149,150** | **233** | **6,001** | **156,234** |

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

| | 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** |

*(In thousands of GEL)*

## 15 Loans to customers (continued)

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

| | Gross loans | Impairment allowance | Net loans | Impairment 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%** |

### (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.

| | | ***Maximum Fair value of collateral held under the base scenario*** | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | ***exposure to credit risk*** | ***Real estate property*** | ***Other**** | ***Surplus collateral*** | ***Total collateral*** | ***Net exposure*** | | ***Associated ECL*** |
| **31 December 2019** | **6,001** | **11,491** | **5,029** | **(10,855)** | **5,665** | **335** | | **530** |
| Corporate lending | 1,632 | 2,810 | 1,632 | (2,810) | 1,632 | - | - | **-** |
| Small and medium business lending | 3,358 | 7,297 | 3,137 | (7,083) | 3,351 | 6 | | **230** |
| Residential mortgages | 288 | 540 | 33 | (285) | 288 | - | | **7** |
| Consumer lending | 723 | 844 | 227 | (677) | 394 | 329 | | **293** |

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

*(In thousands of GEL)*

## 15 Loans to customers (continued)

| | *Maximum exposure to credit risk* | *Fair value of collateral held under the base scenario* | | | | | |
|---|---|---|---|---|---|---|---|
| | | *Real estate property* | *Other** | *Surplus collateral* | *Total collateral* | *Net exposure* | *Associated ECL* |
| **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) | **2524** | 26 | **240** |
| Residential mortgages | 215 | 449 | 41 | (279) | **209** | 6 | **-** |
| Consumer lending | 619 | 662 | 238 | (493) | **407** | 212 | **212** |

.

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

The following table shows carrying value of loans on which no ECL was recognized because of existence of collateral as at 31 December 2019:

| | |
|---|---|
| **Loans to legal entities** | ***2019*** |
| Corporate lending | 29,398 |
| Small and medium business lending | 6,630 |
| **Total loans to legal entities** | **36,028** |
| **Loans to individuals** | |
| Residential mortgages | 3,160 |
| Consumer lending | 1,098 |
| **Total loans to individuals** | 4,258 |
| **Gross loans to customers** | **40,286** |

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

| | |
|---|---|
| **Loans to legal entities** | ***2018*** |
| 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** |

### Loan 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 as at December 2017:

*(In thousands of GEL)*

## 15 Loans to customers (continued)

| *31 December 2017* | *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** |

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.

**Loans to individual**

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 as at December 2017:

| *31 December 2017* | *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** |

*(In thousands of GEL)*

## 15 Loans to customers (continued)

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.

### (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:

| | **2019** | | 2018 | | 2017 | |
|---|---|---|---|---|---|---|
| Financial institutions | **25,806** | **17%** | 16,192 | 10% | 1,701 | 1% |
| Construction and land development | **24,307** | **16%** | 27,766 | 18% | 17,554 | 11% |
| Consumer goods | **23,776** | **15%** | 27,715 | 18% | 31,507 | 20% |
| Energy | **18,458** | **12%** | 21,241 | 14% | 21,026 | 13% |
| Real estate management | **15,264** | **10%** | 4,497 | 3% | 5,526 | 3% |
| Hotels, restaurant and tourism | **9,842** | **6%** | 10,487 | 7% | 7,025 | 4% |
| Service | **8,384** | **5%** | 15,274 | 10% | - | 0% |
| Production and trade of clothes, shoes and textiles | **6,077** | **4%** | 4,108 | 3% | 10,101 | 6% |
| Healthcare | **5,003** | **3%** | 3,001 | 2% | 51,237 | 32% |
| Agriculture | **4,761** | **3%** | 1,988 | 1% | 1,988 | 1% |
| Telecommunication | **1,179** | **1%** | 10,831 | 7% | - | 0% |
| Other sector | **4,253** | **3%** | 1,390 | 1% | 3,194 | 2% |
| Loan to individuals | **9,124** | **6%** | 12,759 | 8% | 7,656 | 5% |
| **Total loan to customers** | **156,234** | **100%** | 157,249 | 100% | 158,515 | 100% |
| Less -allowance for impairment | **(814)** | | (778) | | (1,511) | |
| **Total net loans to customers** | **155,420** | | 156,471 | | 157,004 | |

### (e) Significant credit exposures

As at 31 December 2019 the Bank has loans issued to five borrowers or groups of connected borrowers (2018: seven; 2017: eleven) with carrying values that individually exceed 10% of equity. The gross value of these loans as at 31 December 2019 is GEL 54,261 thousand (2018: GEL 73,033 thousand; 2017: GEL 136,138 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 23 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.

*(In thousands of GEL)*

## 16 Investment securities

Investment securities as at 31 December are as follows:

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| **Debt securities at FVOCI (2017: investment securities available for sale)** | | | |
| Treasury bonds of Ministry of Finance Georgia | **21,868** | 15,022 | 13,843 |
| Treasury bonds of Republic of Turkey | **11,836** | 10,439 | 10,790 |
| **Total investment securities** | **33,704** | 25,461 | 24,633 |

All Investment securities are allocated to Stage 1. The ECL recognized for investment securities as at 31 December 2019 was GEL 114 thousand and there were no significant movements in ECL during the year (Note 8).

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

| | **2019** | **2018** | **2017** |
|---|---|---|---|
| **Available-for-sale** | | | |
| Treasury bonds of Ministry of Finance of Georgia | - | - | 4,101 |
| **Total investment securities** | **-** | **-** | **4,101** |

Credit rating of Investment securities stands as follow:

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| BB+ | **-** | - | 10,790 |
| BB | **21,868** | 10,439 | - |
| BB- | **11,836** | 15,022 | 13,843 |
| | **33,704** | 25,461 | 24,633 |

Country rating for Republic of Georgia stands at BB with stable outlook as assigned by international rating Country rating for Republic of turkey stands at BB- With stable outlook as assigned by international rating agency.

*(In thousands of GEL)*

## 17 Property, equipment, Intangible and Right-of-use assets

| | Leasehold Improvements | Computers and office equipment | Furniture and fixtures | Motor vehicles | Intangible assets | Right-of-use assets<br>Building | 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** |
| Additions | 2 | 75 | 12 | 171 | - | - | 260 |
| **Balance at 31 December 2018** | **2,056** | **893** | **382** | **338** | **729** | **-** | **4,398** |
| Effect of adoption of IFRS 16 as at 1 January 2019 | **-** | **-** | **-** | **-** | **-** | 2,737 | 2,737 |
| Additions | - | 12 | 14 | 83 | - | - | 109 |
| Write off | - | (12) | - | (52) | - | - | (64) |
| **Balance at 31 December 2019** | **2,056** | **893** | **396** | **369** | **729** | **2,737** | **7,180** |
| | | | | | | | |
| **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 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)** |
| Depreciation and Amortization For the year | (62) | (138) | (48) | (48) | (109) | (881) | (1,286) |
| Write off | - | 9 | - | 52 | - | - | 61 |
| **Balance at 31 December 2019** | **(1,851)** | **(752)** | **(365)** | **(186)** | **(604)** | **(881)** | **(4,639)** |
| | | | | | | | |
| **Carrying amount at 31 December 2017** | **658** | **364** | **128** | **36** | **343** | **-** | **1,529** |
| **Carrying amount at 31 December 2018** | **267** | **270** | **65** | **148** | **234** | **-** | **984** |
| **Carrying amount at 31 December 2019** | **205** | **141** | **31** | **183** | **125** | **1,856** | **2,541** |

*(In thousands of GEL)*

## 17 Property, equipment, Intangible assets and Right-of-use assets (continued)

Set out below are the carrying amounts of lease liabilities and the movements during the period:

| | **2019** |
|---|---|
| **As at 1 January - effect of adoption of IFRS 16** | 2,737 |
| | |
| Accrued of interest | 134 |
| Foreign exchange adjustments | 44 |
| Payments | (983) |
| **As at 31 December 2019** | **1,932** |

The bank had total cash outflow for lease with amount GEL 983 thousand. The initial application of IFRS 16 resulted in non-cash additions to right-of-use assets and lease liabilities with amount GEL 2,737 thousand as at 1 January 2019.

## 18 Other assets and liabilities

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| **Other assets** | | | |
| Settlement operations | 625 | 11,084 | 3,289 |
| Income tax asset | - | 107 | - |
| Receivables from problematic borrowers | 135 | 63 | 48 |
| Other | 52 | 3 | 14 |
| **Total other assets** | **812** | **11,257** | **3,351** |
| | | | |
| **Other liabilities** | | | |
| Settlement operations | 311 | 8,272 | 2,614 |
| Finance Lease | 1,932 | - | - |
| Cash Cover | 1,051 | - | - |
| Other | 351 | 28 | 35 |
| Income tax liability | 854 | - | 589 |
| **Total other liabilities** | **4,499** | **8,300** | **3,238** |

## 19 Amounts due to credit institutions

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| Vostro accounts | **33,131** | 13,672 | 5,265 |
| Term deposits | **100,525** | 92,837 | 46,189 |
| Short-term loan from NBG | **-** | - | 3,002 |
| | **133,656** | 106,509 | 54,456 |

As at 31 December 2019 the Bank has placements from three banks (2018: three banks; 2017: two banks) with carrying values that individually exceed 10% of equity. The gross value of these balances as at 31 December 2019 is GEL 129,486 thousand (2018: GEL 106,509 thousand; 2017: GEL 48,342 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 thousand.

*(In thousands of GEL)*

## 20 Amounts due to customers

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| **Current accounts and demand deposits** | | | |
| Retail | **4,312** | 2,877 | 3,471 |
| SME | **1,486** | 2,895 | 3,837 |
| Corporate | **11,124** | 6,202 | 7,400 |
| | **16,922** | 11,974 | 14,708 |
| **Term deposits** | | | |
| Retail | **16,075** | 16,236 | 50,510 |
| SME | **2,991** | 3,993 | 7,112 |
| Corporate | **874** | 6,149 | 1,693 |
| | **19,940** | 26,378 | 59,315 |
| **Total amounts due to customers** | **36,862** | 38,352 | 74,023 |

As at 31 December 2019 the bank does not have any customer deposits balances (2018: GEL 225 thousand; 2017: GEL 49,786 thousand) that serve as collateral for loans granted by the Bank. As at 31 December 2019 the Bank does not have placements from any customers (2018: none of customers; 2017: five customers) with carrying value that individually exceed 10% of equity. That balance as at 31 December 2017 was GEL 49,003 thousand.

## 21 Other borrowed funds and subordinated debt

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| Borrowings from Parent | **-** | 13,093 | 12,918 |
| Other financial institutions | **15,674** | 18,823 | 12,568 |
| **Total other borrowed funds** | **15,674** | 31,916 | 25,486 |
| Subordinated loan from the Parent | **-** | - | 43,152 |
| **Total other borrowed funds and subordinated debt** | **15,674** | 31,916 | 68,638 |

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:

| | **Other borrowed funds** | **Subordinated loans** | **Total liabilities form financing activities** |
|---|---|---|---|
| **Carrying amounts at 31 December 2107** | **25,486** | **43,152** | **68,638** |
| Proceed 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** |
| Proceed from issue | - | - | **-** |
| Redemption | (17,708) | - | **(17,708)** |
| Foreign currency translation | 1,405 | - | **1,405** |
| Other | 61 | - | **61** |
| **Carrying amount at 31 December 2019** | **15,674** | **-** | **15,674** |

*(In thousands of GEL)*

## 22 Capital management

The Bank maintains an activity managed capital base to cover risks inherent in the business and is meeting the capital adequacy requirements of the local banking supervisor, National Bank of Georgia. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by Basel Committee on Banking Supervision (BIS rules/ratios) and adopted by the National Bank of Georgia in supervising 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 2017 minimal requirement of capital to risk weighted exposures was as follow:

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

### *Basel III*

In December 2017, the NBG has introduced approved 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 Bank's capital adequacy ratios for the year ended 31 December calculated in accordance with NBG Basel II/III requirements were as follows:

| | 2019 | 2018 | 2017 |
|---|---|---|---|
| Share capital | 69,162 | 69,162 | 30,000 |
| Retained earnings | 11,357 | 5,549 | 4,129 |
| Deductions | (111) | (220) | (330) |
| **Total common equity and Tier 1 Capital** | **80,408** | **74,491** | **33,799** |

*(In thousands of GEL)*

| | | | |
|---|---|---|---|
| Subordinated debt (included in regulatory capital) | - | - | 41,475 |
| General loans loss provision (up to 1.25% of risk-weighted exposures) | 3,208 | 3,394 | 2,072 |
| **Total regulatory capital** | **83,616** | **77,885** | **77,346** |
| **Risk-weighted exposures** | | | |
| Credit risk-weighted exposure (balance and off-balance items) | 256,660 | 271,488 | 166,595 |
| Market risk-weighted exposures | 1,503 | 346 | 2,495 |
| Operational risk-weighted exposures | 22,161 | 18,304 | 13,094 |
| **Total risk-weighted exposures** | **280,324** | **290,138** | **182,184** |
| **Common equity Tier 1 ratio** | **28.68%** | **25.67%** | **18.6%** |
| **Trial 1 capital ratio** | **28.68%** | **25.67%** | **18.6%** |
| **Total regulatory capital ratio** | **29.83%** | **26.84%** | **42.60%** |
| **Common equity Tier 1 ratio minimum requirements** | **9.14%** | **9.31%** | **8.60%** |
| **Trial 1 capital ratio minimum requirement** | **11.35%** | **11.59%** | **10.63%** |
| **Total regulatory capital minimum requirement** | **19.90%** | **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.

## 23 Risk management, corporate governance and internal control

### (a) Corporate governance framework

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

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

### (b) Internal control policies and procedures

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

The purpose of internal controls is to ensure:

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

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

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

## 23 Risk management, corporate governance and internal control (continued)

### (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 Bank's strong risk governance reflects the importance placed by Bank's Risks, Ethics and Compliance Committee on shaping the risk strategy and managing credit, financial and non-financial risks. All components necessary for comprehensive risk governance are embedded into risk organization structure: enterprise risk management; credit, financial and non-financial risks management; risk reporting and supporting IT infrastructure; cross-risk analytical tools and techniques such as capital adequacy management and stress-testing. The bank is exposed to credit risk, liquidity risk and market risk. It is also subject to various operating and business risks.

The risk management policies aim to identify, analyse 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. Such control arrangements guarantee that the Bank takes informed risk-taking decisions that are adequately priced, avoiding taking risks that are beyond the Bank's established threshold.

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 financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates and equity prices. 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. Interest rate risk arises from potential changes in the market interest rates that can adversely affect the fair value or future cash flows of the financial instruments. This risk can arise from maturity mismatches of assets and liabilities, as well as from the re-pricing characteristics of such assets and liabilities. Interest margins may increase as a result of such changes, but may also reduce or create losses in the event that unexpected movements occur.

**Interest rate gap analysis**

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

*(In thousands of GEL)*

## 23 Risk management, corporate governance and internal control (continued)

| | Less than 3 months | 3-6 months | 6-12 months | 1-5 years | More than 5 years | Carrying amount |
|---|---|---|---|---|---|---|
| **31 December 2019 Assets** | | | | | | |
| Cash and cash equivalents | 57,013 | - | - | - | - | **57,013** |
| Amounts due from banks | - | 1,627 | - | - | - | **1,627** |
| Mandatory reserves at the NBG | 24,609 | - | - | - | - | **24,609** |
| Investment securities | - | 9,613 | 4,961 | 15,991 | 3,139 | **33,704** |
| Loans to customers | 22,209 | 23,876 | 28,099 | 52,778 | 28,458 | **155,420** |
| | **103,831** | **35,116** | **33,060** | **68,769** | **31,597** | **272,373** |
| **Liabilities** | | | | | | |
| Accounts and deposits form banks | 82,763 | 16,146 | 34,747 | - | - | 133,656 |
| Current accounts and deposits from customers | 25,067 | 3,526 | 6,360 | 1,909 | - | 36,862 |
| Other borrowed funds and subordinated debt | - | 2,291 | 2,230 | 11,153 | - | 15,674 |
| | **107,830** | **21,963** | **43,337** | **13,062** | **-** | **186,192** |
| | **(3,999)** | **13,153** | **(10,277)** | **55,707** | **31,597** | **86,181** |

| | 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 form 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** | **49,868** | **74,837** |

| | 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 form 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** |

*(In thousands of GEL)*

## 23 Risk management, corporate governance and internal control (continued)

### Average nominal interest rates

The table below displays average nominal interest rates for interest-bearing assets and liabilities as at 31 December 2019, 2018 and 2017. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

| | 2019 Average nominal interest rate % | | | 2018 Average nominal interest rate % | | | 2017 Average nominal interest rate % | | |
|---|---|---|---|---|---|---|---|---|---|
| | **GEL** | **USD** | **EUR** | **GEL** | **USD** | **EUR** | **GEL** | **USD** | **EUR** |
| **Interest bearing assets** | | | | | | | | | |
| Cash and cash equivalents | 8.8% | 1.8% | 1.2% | 5.9% | - | 1.5% | 7.4% | 1.0% | - |
| Amounts due from banks | - | 7% | - | - | 6.5% | 3.9% | - | 6.5% | - |
| Investment securities | 8.2% | 5.7% | 0.0% | 7.7% | 5.7% | - | 7.4% | 5.8% | - |
| Loans to customers | 11.4% | 7.4% | 5.3% | 11.7% | 8.3% | 5.7% | 13.1% | 6.9% | 5.5% |
| **Interest bearing liabilities** | | | | | | | | | |
| Deposits and balances from banks | - | 3.76% | 0.9% | - | 4.2% | 1.0% | 7.3% | 3.4% | 1.2% |
| Deposits from customers | 3.54% | 2.9% | 0.5% | 8.9% | 3.4% | 0.6% | 7.2% | 3.9% | - |
| Other borrowed funds and subordinated debt | - | 5.4% | - | - | 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, assuming that all other variables, such as foreign currency exchange rates remain constant) 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 2019, 2018 and 2017, is as follows:

| | ***2019*** | ***2018*** | ***2017*** |
|---|---|---|---|
| 100 bps parallel fall | (125) | (84) | (83) |
| 100 bps parallel rise | 125 | 84 | 83 |

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

| | ***2019*** | ***2018*** | ***2017*** |
|---|---|---|---|
| 100 bps parallel fall | (106) | (72) | (71) |
| 100 bps parallel rise | 106 | 72 | 71 |

### Currency risk

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

*(In thousands of GEL)*

## 23 Risk management, corporate governance and internal control (continued)

The following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2019:

| | *EUR* | *USD* | *TRY* | *GBP* | *Total* |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and cash equivalents | 17,516 | 32,655 | 56 | 600 | **50,827** |
| Amounts due from banks | - | 1,630 | - | - | **1,630** |
| Mandatory reserve at the NBG | 8,262 | 16,348 | - | - | **24,610** |
| Investment securities | - | 11,836 | - | - | **11,836** |
| Loans to customers | 42,988 | 48,076 | - | - | **91,064** |
| Other financial assets | 155 | 95 | - | - | **250** |
| **Total assets** | **68,921** | **110,640** | **56** | **600** | **180,217** |
| | | | | | |
| **Liabilities** | | | | | |
| Deposits and balances form banks | 68,605 | 64,453 | - | 598 | **133,656** |
| Current accounts and deposits from customers | 1,128 | 29,285 | 39 | 2 | **30,454** |
| Other borrowed funds and subordinated debt | - | 15,674 | - | - | **15,674** |
| Other liabilities | 689 | 848 | - | - | **1,537** |
| **Total liabilities** | **70,422** | **110,260** | **39** | **600** | **181,321** |
| **Net position** | **(1,501)** | **380** | **17** | **-** | **(1,104)** |

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

| | *EUR* | *USD* | *TRY* | *GBP* | *Total* |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and cash equivalents | 17,775 | 6,993 | 146 | 344 | **25,258** |
| Amounts due from banks | 509 | 4,646 | - | - | **5,155** |
| Mandatory reserve 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 form 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** |

*(In thousands of GEL)*

## 23 Risk management, corporate governance and internal control (continued)

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

| | *EUR* | *USD* | *TRY* | *GBP* | *Total* |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and cash equivalents | 11,988 | 5,568 | 137 | 349 | **18,042** |
| Amounts due from banks | - | 434 | - | - | **434** |
| Mandatory reserve 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 form 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** |

A weakening of the Gel, as indicated below, against the following currencies at 31 December 2019, 2018 and 2017, 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.

| | ***2019*** | *2018* | *2017* |
|---|---|---|---|
| 20% appreciation of USD against GEL | **65** | 340 | 284 |
| 20% appreciation of EUR against GEL | **(256)** | 4 | (61) |
| 20% appreciation of TRY against GEL | **3** | 11 | 22 |
| 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;

## 23 Risk management, corporate governance and internal control (continued)

- 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. 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.

*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.

## 23 Risk management, corporate governance and internal control (continued)

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.

*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 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

## 23 Risk management, corporate governance and internal control (continued)

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.

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 months from the reporting date.

For Stage 2 and 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.

## 23 Risk management, corporate governance and internal control (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%, according to the foundation approach of the Basel document. For corporate securities LGD is taken at 45.02%. 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.

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 2019.

*(In thousands of GEL)*

## 23 Risk management, corporate governance and internal control (continued)

| Key drivers | ECL scenario | Assigned probabilities, % | 2020 | 2021 | 2022 | Subsequent years |
|---|---|---|---|---|---|---|
| **GDP growth, %** | | | | | | |
| | Upside | 25% | 5.5% | 5.5% | 5.0% | 5.0% |
| | Base case | 50% | 4.5% | 5.0% | 5.0% | 5% |
| | Downside | 25% | 2.5% | 4.0% | 4.5% | 4.5% |
| **USD/GEL exchange rate, % change** | | | | | | |
| | Upside | 25% | -5% | -3% | 0% | 0% |
| | Base case | 50% | -3% | -3% | -3% | 0% |
| | Downside | 25% | 10.0% | -5% | -5% | 0% |
| **Unemployment rate, %** | | | | | | |
| | Upside | 25% | 12.0% | 11.5% | 11.2% | 11.2% |
| | Base case | 50% | 12.7% | 12.5% | 12.2% | 12.2% |
| | Downside | 25% | 14.2% | 14.5% | 14.5% | 14.5% |

### (f) Liquidity risk

Liquidity risk is defined as the risk that the Bank does not have sufficient liquid financial resources to meet obligations associated with financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk arises because of the possibility that the Bank might be unable to meet its payment obligations when they fall due as a result of mismatches in the timing of the cash flows under both normal and stress circumstances. The Bank maintains liquidity management with the objective of ensuring that funds will be available at all times to honour 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.

*(In thousands of GEL)*

## 23 Risk management, corporate governance and internal control (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.

| | 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 form banks | (74,094) | (8,769) | (16,245) | (35,346) | - | - | (134,454) | **(133,656)** |
| Current accounts and deposits from customers | (20,293) | (4,801) | (3,573) | (6,565) | (2,016) | - | (37,248) | **(36,862)** |
| Other borrowed funds and subordinated debt | - | - | - | - | (18,601) | - | (18,601) | **(15,674)** |
| Other liabilities * | (3,653) | (145) | (221) | (452) | (1,041) | - | (5,512) | **(5,512)** |
| **Total financial liabilities** | **(98,040)** | **(13,715)** | **(20,039)** | **(42,363)** | **(21,658)** | **-** | **(195,815)** | **(191,704)** |
| **Credit related commitments** | **(60,363)** | **-** | **-** | **-** | **-** | **-** | **-** | **(60,363)** |

**As disclosed in note 3, the bank adopted IFRS 16 on 1 January 2019 and recognised relevant lease liabilities.*

The maturity analysis for financial liabilities as at 31 December 2018 is as follows:

| | 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 form 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 | (8,949) | - | - | - | - | - | **(8,949)** | (8,949) |
| **Total financial liabilities** | **(61,388)** | **(20,494)** | **(9,904)** | **(54,334)** | **(47,161)** | **-** | **(193,281)** | **(185,726)** |
| **Credit related commitments** | **(42,820)** | - | - | - | - | - | **(42,820)** | **(42,820)** |

*(In thousands of GEL)*

## 23 Risk management, corporate governance and internal control (Continued)

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

| | Demand and less than 1 months | 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 form banks | (25,038) | (169) | (254) | (26,358) | (4,116) | - | **(55,935)** | (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 | (3,447) | - | - | - | - | - | **(3,447)** | (3,447) |
| **Total financial liabilities** | **(46,545)** | **(5,271)** | **(6,451)** | **(37,512)** | **(37,092)** | **(111,091)** | **(243,962)** | **(200,564)** |
| **Credit related commitments** | **(9,652)** | - | - | - | - | - | **(9,652)** | **(9,652)** |

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 stated maturity dates is presented below:

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| Demand and less than 1 month | **6,308** | 6,135 | 1,512 |
| From 1 to 3 month | **4,629** | 8,235 | 616 |
| From 3 to 12 month | **7,541** | 4,444 | 3,811 |
| From 1 to 5 years | **1,909** | 300 | - |
| More than 5 years | **-** | - | 44,572 |
| | **20,387** | 19,114 | 50,510 |

*(In thousands of GEL)*

## 23 Risk management, corporate governance and internal control (Continued)

The table below shows an analysis, by expected maturities, of amounts recognized in the statement of financial position as at 31 December 2019:

| | Demand and less than 1 month | From 1 to 3 month | From 3 to 12 month | From 1 to 5 years | More than 5 years | No maturity | Total |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and cash equivalents | 57,013 | - | - | - | - | - | **57,013** |
| Amounts due from banks | - | 1,627 | - | - | - | - | **1,627** |
| Mandatory reserves at the NBG | 24,609 | - | - | - | - | - | **24,609** |
| Investment securities | - | - | 14,574 | 15,991 | 3,139 | - | **33,704** |
| Loans to customers | 3,356 | 18,965 | 51,974 | 52,667 | 28,458 | - | **155,420** |
| Property, equipment and intangible assets | | | | | | | |
| Other assets | - | - | - | - | - | 2,541 | **2,541** |
| **Total assets** | 812 | - | - | - | - | - | **812** |
| | **85,790** | **20,592** | **66,548** | **68,658** | **31,597** | **2,541** | **275,726** |
| **Liabilities** | | | | | | | |
| Deposits and balance from banks | 74,058 | 8,705 | 50,893 | - | - | - | **133,656** |
| Current accounts and deposits from customers | 20,290 | 4,777 | 9,886 | 1,909 | - | - | **36,862** |
| Other borrowed funds and Subordinated debt | - | - | 4,521 | 11,153 | - | - | **15,674** |
| Other liabilities* | 3,653 | 145 | 673 | 1,041 | - | - | **5,512** |
| **Total liabilities** | **98,001** | **13,627** | **65,973** | **14,103** | **-** | **-** | **191,704** |
| **Net position** | **(12,211)** | **6,965** | **575** | **54,555** | **31,597** | **2,541** | **84,022** |

**As disclosed in note 3, the bank adopted IFRS 16 on 1 January 2019 and recognised relevant lease liabilities.*

*(In thousands of GEL)*

## 23 Risk management, corporate governance and internal control (Continued)

The table below shows an analysis, by expected maturities, of amounts recognized in the statement of financial position as at 31 December 2018:

| | Demand and less than 1 months | 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 | 11,257 | - | - | - | - | - | **11,257** |
| **Total assets** | **83,515** | **11,626** | **76,189** | **71,657** | **19,955** | **984** | **263,926** |
| **Liabilities** | | | | | | | |
| Deposits and balance 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 | 12,360 | 16,812 | - | - | **31,916** |
| Other liabilities | 8,949 | - | - | - | - | - | **8,949** |
| **Total liabilities** | **61,481** | **22,061** | **69,258** | **32,656** | **-** | **-** | **186,726** |
| **Net position** | **22,866** | **(10,435)** | **6,931** | **39,001** | **19,955** | **984** | **78,200** |

*(In thousands of GEL)*

## 23 Risk management, corporate governance and internal control (Continued)

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

| | Demand and less than 1 months | 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 | 3,351 | - | - | - | - | - | **3,351** |
| **Total assets** | **56,815** | **2,409** | **36,202** | **63,543** | **76,929** | **1,529** | **237,427** |
| **Liabilities** | | | | | | | |
| Deposits and balance 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 | 3,447 | - | - | - | - | - | **3,447** |
| **Total liabilities** | **46,110** | **3,391** | **34,203** | **29,135** | **87,725** | **-** | **200,564** |
| **Net position** | **10,705** | **(982)** | **1,999** | **34,408** | **(10,796)** | **1,529** | **36,863** |

*(In thousands of GEL)*

## 23 Risk management, corporate governance and internal control (Continued)

### (g) Operational and business risk

Operational risk is the risk of loss arising from system failure, human error, fraud and external events. When controls fail to operate effectively, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The bank cannot expect to eliminate all operational risks, but it endeavours to manage these risks through a control framework and by monitoring and responding to potential risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment procedures, such as the use of internal audit.

## 24 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 recognised at the reporting date if the counterparties failed completely to perform as contracted.

| | 2019 | 2018 | 2017 |
|---|---|---|---|
| **Contracted amount** | | | |
| Undrawn overdraft facilities | 72 | 89 | 108 |
| Guarantees | 60,291 | 42,731 | 9,544 |
| | **60,363** | **42,820** | **9,652** |

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 as at 31 December 2019 accounting GEL 28,487 thousand are to five banks (2018: GEL 23,668 thousand; 2017: nil) and GEL 27,146 thousand to seven counterparties (2018: GEL 14,861 thousand to five counterparties; 2017: GEL 6,437 thousand to five 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 2019 was GEL 178 thousand and there were no significant movements in ECL during the year (Note 8).

## 25 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.

*(In thousands of GEL)*

## 25 Contingencies (Continued)

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.

### (d) Spread of Pandemic and related contingencies

As indicated in Note 29 about the widespread of coronavirus (COVID-19) it has an impact on the global and local markets. The extent, magnitude and duration of the impact is not exactly certain. Based on the current situation on the market on which the Bank operates, Management believes that, this event will not have any significant impact to the Bank's operations.

## 26 Related party transaction

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

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties. All transactions with related parties disclosed below have been conducted on an arm's length basis.

### (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 2019, 2018 and 2017 is as follows:

| | 2019 | 2018 | 2017 |
|---|---|---|---|
| Short-term employee benefits | 1,653 | 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 2019, 2018 and 2017 and for the years then ended.

### (c) Transactions with the Parent.

The outstanding balances and related profit or loss amounts of transactions as at and for the year ended 31 December 2019,2018 and 2017 are as follows:

| | 2019 | 2018 | 2017 |
|---|---|---|---|
| **Statement of financial position** | | | |
| **Assets** | | | |
| Cash and cash equivalents | | | |
| - In TRY | 33 | 44 | 74 |
| - In EUR | 19 | 13 | 26 |
| - In USD | 7 | - | 4 |
| **Liabilities** | | | |
| Deposits and balances from banks | | | |
| - In EUR | 32,144 | 7,074 | 13,436 |
| - In USD | 26,386 | 24,889 | 8,550 |
| - In GBP | 598 | 345 | 355 |
| - In TRY | - | 51 | - |
| Other borrowed funds and subordinated debt | | | |
| - In EUR | - | 108 | 43,152 |
| - In USD | - | 12,985 | 12,918 |
| **Income/(expanse)** | | | |
| Interest income | 12 | 10 | 12 |
| Interest expense | (493) | (4,161) | (5,802) |

## 26 Related party transactions (Continued)

The deposits from the Parent as at 31 December 2019 mature according to contractual maturity as follows: GEL 59,128 thousand matures in less than 12 months. (2018: GEL 37,569 thousand in less than 12 months, GEL 7,883 thousand during 1 to 5 years; 2017: GEL 18,744 thousand in less than 12 months, GEL 16,168 thousand during 1 to 5 years and GEL 24,715 thousand in more than 5 years).

## 27 Fair Value measurement

### *(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.

*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.

*(In thousands of GEL)*

## 27 Fair value measurement (Continued)

- 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 2019** | **Level 1** | **Level 2** | **Level 3** | **Total fair Value** | **Carrying amount** |
|---|---|---|---|---|---|
| **Assets measured at fair value** | | | | | |
| Debt securities measured at FVOCI | 33,704 | - | - | 33,704 | **33,704** |
| **Assets for which fair values are disclosed** | | | | | |
| Loans to customers | - | - | 155,420 | 155,420 | **155,420** |
| **Liabilities for which fair values are disclosed** | | | | | |
| Amounts due to customers | - | 170,518 | - | 170,518 | **170,518** |

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 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** |

| **31 December 2017** | **Level 1** | **Level 2** | **Level 3** | **Total fair Value** | **Carrying amount** |
|---|---|---|---|---|---|
| **Assets measured at fair value** | | | | | |
| Debt securities measured at FVOCI | 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** |

*(In thousands of GEL)*

## 28 Presentation of financial instruments by measurement category

For the measurement purposes, IFRS 9, classified financial assets into the categories discussed in Note 3.The following table provides a reconciliation of classes of financial assets with these measurement categories as of 31 December 2019:

| | Amortized cost | FVOCI | FVPL | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | 57,013 | - | - | 57,013 |
| Amounts due from banks | 1,627 | - | - | 1,627 |
| Mandatory reserves at NBG | 24,609 | - | - | 24,609 |
| Investment Securities | - | 33,704 | - | 33,704 |
| Loans to customers | 155,420 | - | - | 155,420 |
| Other assets | 812 | - | - | 812 |
| **Total financial assets** | **239,481** | **33,704** | **-** | **273,185** |

The following table provides a reconciliation of classes of financial assets with these measurement categories as of 31 December 2018:

| | Amortized cost | FVOCI | FVPL | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | 38,031 | - | - | 38,031 |
| Amounts due from banks | 5,155 | - | - | 5,155 |
| Mandatory reserves at NBG | 26,567 | - | - | 26,567 |
| Investment Securities | - | 25,461 | - | 25,461 |
| Loans to customers | 156,471 | - | - | 156,471 |
| Other assets | 11,257 | - | - | 11,257 |
| **Total financial assets** | **237,481** | **25,461** | **-** | **262,942** |

## 29 Events after reporting date

Since the beginning of 2020, the coronavirus (COVID-19) has become widespread worldwide and on 12 March 2020 the World Health Organization has declared the virus as a pandemic. The situation is changing quickly with widespread impacts. This has had a significant impact on both the global and local financial markets. However it has not had any significant direct consequences to the Bank as of the date of these financial statements.