JSC Liberty Bank and Subsidiaries

Consolidated financial statements

Year ended 31 December 2019
together with independent auditor's report

Contents

Independent auditor's report

Consolidated financial statements

Notes to the consolidated financial statements

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Independent auditor's report

To the Shareholders and the Supervisory Board of JSC Liberty Bank

Opinion

We have audited the consolidated financial statements of JSC Liberty Bank and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2019, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2019 and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

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

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For the matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to this matter. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matter below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

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Key audit matter	How our audit addressed the key audit matter
Allowance for expected credit losses on loans to customers	
Given the significance of the allowance for expected credit losses on loans to customers to the Group's financial position, the complexity and judgements related to the estimation of expected credit losses under newly adopted IFRS 9 *Financial instruments* ("IFRS 9"), we considered this area as a key audit matter. The impairment for loan losses is calculated using a combination of a collective provisioning model and individual loan provisions based on discounted cash flow analyses and regression-based forward-looking estimates. Both collective and individual provisioning depend on a number of assumptions and judgments such as: ▸ Accounting interpretations and modelling assumptions used to build the models for calculating the expected credit loss (ECL); ▸ Allocation of loans to stage 1, 2 or 3 using criteria set in accordance with IFRS 9; ▸ Inputs and assumptions used to estimate the impact of multiple economic scenarios; ▸ Estimation of probability of default (PD), loss given default (LGD) and exposure at default (EAD), including the valuation of collateral; and ▸ Measurement of individually assessed provisions, including expected future cash flows and the valuation of collateral; ▸ Accuracy and adequacy of financial statement disclosures. As a consequence of the judgment involved in establishing the allowance, the use of different modelling techniques, assumptions and forecasts could produce significantly different estimates of the allowance for expected credit losses. Information on the impairment of loans to customers is included in Note 8, *Loans to Customers* and Note 23, *Risk Management*, to the consolidated financial statements.	We obtained an understanding of the ECL process and with support of our internal modelling specialists we evaluated the methodology developed by the Group. We focused on analysis of the following areas during our audit: ▸ evaluating credit risk models and assumptions used to estimate key provisioning parameters, and determine expected credit losses on a portfolio basis; ▸ assessing management's judgement in relation to the identification of significant increases in credit risk and event of default on an individual and collective basis based on quantitative and qualitative criteria; evaluation consistency of application of the criteria selected by the management as of the reporting date; ▸ testing allocation of loans to respective impairment stages based on the criteria predefined in the Group's ECL methodology. To test allowance calculated on a collective basis, with the support of our internal modelling specialists, we evaluated underlying statistical models, key inputs and assumptions used and assessed incorporation of forward-looking information in the calculation of expected credit losses. For a sample of significant credit-impaired corporate exposures, we challenged assumptions on estimated future cash flows, including value of collaterals and probabilities of expected outcomes. We assessed the disclosures in the consolidated financial statements on the impairment of loans to customers.

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Other information included in the Group's 2019 Annual report

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

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

In connection with our audit of the consolidated 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 consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

Responsibilities of management and the Supervisory Board for the consolidated financial statements

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

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

The Supervisory Board is responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Supervisory Board 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.

We also provide the Supervisory Board with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

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From the matters communicated with the Supervisory Board, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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

Ruslan Khoroshvili

For and on behalf of EY LLC

Tbilisi, Georgia

3 July 2020

Consolidated statement of financial position

As of 31 December 2019

(thousands of Georgian Lari)

	Notes	2019	2018
Assets			
Cash and cash equivalents	6	415,766	392,899
Amounts due from credit institutions	7	124,482	99,731
Loans to customers	8	1,177,581	953,544
Investment securities	9	146,506	197,504
Property and equipment	10	154,255	128,936
Intangible assets	11	48,500	32,651
Right of use assets	12	34,217	–
Prepayments	14	6,933	11,995
Current income tax asset		6,568	2,568
Other assets	14	20,164	20,405
Total assets		**2,134,972**	**1,840,233**
Liabilities			
Amounts due to credit institutions	16	97,401	8,213
Amounts due to customers	17	1,565,088	1,482,249
Deferred income tax liabilities	13	4,182	2,089
Lease liability	12	37,080	–
Other liabilities	14	23,385	29,194
Subordinated debt	18	100,031	48,122
Total liabilities		**1,827,167**	**1,569,867**
Equity	19		
Share capital		54,629	54,629
Additional paid-in capital		35,558	35,558
Treasury shares		(10,138)	(10,138)
Convertible preferred shares		4,565	4,565
Retained earnings		206,301	169,839
Other reserves		16,890	15,913
Total equity		**307,805**	**270,366**
Total liabilities and equity		**2,134,972**	**1,840,233**

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

Vasil Khodeli — Chief Executive Officer

Davit Tsiklauri — Chief Financial Officer

3 July 2020

The accompanying notes on pages 5 to 69 are an integral part of these consolidated financial statements.

Consolidated statement of financial position

As of 31 December 2019

(thousands of Georgian Lari)

	Notes	*2019*	*2018*
Assets			
Cash and cash equivalents	6	415,766	392,899
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Signed and authorized for release on behalf of the Management Board of the Bank:

Vasil Khodeli Chief Executive Officer

Davit Tsiklauri Chief Financial Officer

3 July 2020

The accompanying notes on pages 5 to 69 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December 2019

(thousands of Georgian Lari)

	Notes	2019	2018
Interest income calculated using EIR method			
Loans to customers		243,178	266,146
Investment securities		13,296	19,994
Amounts due from credit institutions		13,428	15,681
Other interest income		283	188
		270,185	**302,009**
Interest expense			
Amounts due to customers		(96,411)	(111,669)
Amounts due to credit institutions		(673)	(11)
Subordinated debt		(7,454)	(7,785)
		(104,538)	**(119,465)**
Net interest income		**165,647**	**182,544**
Credit loss expense	15	(26,246)	(35,820)
Net interest income after loan impairment charge		**139,401**	**146,724**
Net fee and commission income	21	22,200	22,998
Net gains/(losses) from foreign currencies:			
- Dealing		15,178	5,322
- Translation differences		(4,957)	(695)
Other income	22	12,645	19,031
Non-interest income		**45,066**	**46,656**
Personnel expenses	23	(71,133)	(67,472)
General and administrative expenses	23	(29,135)	(33,095)
Depreciation and amortisation	10, 11	(29,998)	(21,723)
Other operating expenses		(14,677)	(5,883)
Other impairment and provisions reversal	15	(754)	218
Non-interest expense		**(145,697)**	**(127,955)**
Profit before income tax expense		**38,770**	**65,425**
Income tax expense	13	(1,857)	(8,225)
Profit for the year		**36,913**	**57,200**
Other comprehensive income			
Other comprehensive income not to be reclassified subsequently to profit or loss			
Revaluation of buildings		1,537	–
Deferred tax effect		(236)	–
Other comprehensive income for the year, net of tax		**1,301**	**–**
Total comprehensive income for the year		**38,214**	**57,200**
Earnings per share:	19		
- Basic earnings per share (in ₾ full amount)		0.00801	0.01260
- Diluted earnings per share (in ₾ full amount)		0.00805	0.01257

The accompanying notes on pages 5 to 69 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2019

(thousands of Georgian Lari)

	Attributable to shareholders of the Bank						
	Share capital	*Additional paid-in capital*	*Treasury shares*	*Convertible preferred shares*	*Retained earnings*	*Other reserves*	*Total*
31 December 2017	**54,405**	**34,300**	**(10,454)**	**6,139**	**116,529**	**16,414**	**217,333**
Impact of adopting IFRS 9	–	–	–	–	*(3,439)*	–	*(3,439)*
Restated opening balance under IFRS 9	**54,405**	**34,300**	**(10,454)**	**6,139**	**113,090**	**16,414**	**213,894**
Total comprehensive income for the year	–	–	–	–	57,200	–	**57,200**
Depreciation of revaluation reserve *(Note 19)*	–	–	–	–	325	(325)	**–**
Revaluation reserve of fixed assets sold *(Note 19)*	–	–	–	–	–	(176)	**(176)**
Dividends paid on the convertible preferred shares *(Note 19)*	–	–	–	–	(776)	–	**(776)**
Conversion of shares *(Note 19)*	–	1,258	316	(1,574)	–	–	**–**
Issue of share capital *(Note 19)*	224	–	–	–	–	–	**224**
31 December 2018	**54,629**	**35,558**	**(10,138)**	**4,565**	**169,839**	**15,913**	**270,366**
Total comprehensive income for the year	–	–	–	–	36,913	1,301	**38,214**
Depreciation of revaluation reserve (*Note 19*)	–	–	–	–	324	(324)	**–**
Dividends paid on the convertible preferred shares *(Note 19)*	–	–	–	–	(775)	–	**(775)**
31 December 2019	**54,629**	**35,558**	**(10,138)**	**4,565**	**206,301**	**16,890**	**307,805**

The accompanying notes on pages 5 to 69 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2019

(thousands of Georgian Lari)

	Notes	*2019*	*2018*
Cash flows from operating activities			
Interest received		204,644	264,533
Interest paid		(143,588)	(147,792)
Fees and commissions received		32,652	31,003
Fees and commissions paid		(10,377)	(8,060)
Net realised gains from dealing in foreign currencies		12,696	7,685
Recoveries of assets previously written off		–	4,400
Other income received		11,952	18,335
Personnel expenses paid		(76,975)	(66,830)
Finance lease interest paid		(2,143)	–
General, administrative and other operating expenses paid		(34,670)	(40,835)
Cash flows from operating activities before changes in operating assets and liabilities		**(5,809)**	**62,439**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		(17,813)	(26,025)
Loans to customers		(167,253)	(192,825)
Prepayments and other assets		7,831	(6,117)
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		88,492	1,617
Amounts due to customers		95,899	152,547
Other liabilities		(9,458)	6,991
Net cash flows used in operating activities before income tax		**(8,111)**	**(1,373)**
Income tax paid		(3,765)	(10,408)
Net cash used in operating activities		**(11,876)**	**(11,781)**
Cash flows from investing activities			
Purchase of investment securities		(36,211)	(128,930)
Proceeds from redemption of investment securities		86,254	153,002
Purchase of intangibles, property and equipment		(63,196)	(27,590)
Proceeds from sale of property and equipment		172	458
Proceeds from sale of repossessed property		176	–
Net cash used in investing activities		**(12,805)**	**(3,060)**
Cash flows from financing activities			
Proceeds from issue of share capital	19	–	224
Finance lease paid		(8,368)	–
Proceeds from subordinated debt	18	121,933	66,051
Redemption of subordinated debt	18	(74,218)	(122,196)
Dividends paid to holders of the convertible preferred shares	19	(775)	(776)
Net cash from/(used in) financing activities		**38,572**	**(56,697)**
Effect of exchange rates changes on cash and cash equivalents		8,976	35
Net increase/(decrease) in cash and cash equivalents		**22,867**	**(71,503)**
Cash and cash equivalents, beginning	6	392,899	464,402
Cash and cash equivalents, ending	6	**415,766**	**392,899**

The accompanying notes on pages 5 to 69 are an integral part of these consolidated financial statements.

(thousands of Georgian Lari)

1. Principal activities

JSC Liberty Bank (the "Bank") is a joint stock company, formed in accordance with legislation of Georgia in 1993. The Bank operates under a general banking license No. 3500/10 issued by the National Bank of Georgia (the "NBG"), the central bank of Georgia, on 10 February 1993.

On October 13, 2017, European Financial Group B.V. ("EFG"), a company established and organised under the laws of the Kingdom of Netherlands, purchased 77.64% of equity interest in the Group. The ultimate beneficial owners of the Bank are Irakli Rukhadze, Ben Marson and Igor Alexeev.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its retail and corporate customers. Its main office is in Tbilisi, Georgia and it had as of December 31 2019, 426 branches, service centers, distribution outlets and mobile banking units operating in Georgia (31 December 2018: 444). The Bank's registered legal address is Liberty Tower, 74, I. Chavchavadze Avenue, 0162 Tbilisi, Georgia.

As of 31 December 2019 and 2018, the following shareholders owned more than 5% of the outstanding ordinary shares. Other shareholders individually owned less than 5% of the outstanding ordinary shares.

	2019		*2018*	
Shareholder	***Ownership interest, %***	***Voting rights, %***	***Ownership interest, %***	***Voting rights, %***
Georgian Financial Group	74.38%	91.18%	61.18%	75.00%
Liberty Bank (Treasury Shares)	18.43%	–	18.43%	–
JSC Heritage Securities (NOMINEE Holder)	1.62%	–	13.98%	17.13%
Other shareholders (individually holding less than 5%)	5.57%	8.82%	6.41%	7.87%
Total	**100.00%**	**100.00%**	**100.00%**	**100.00%**

The Bank is a publicly traded company and its ordinary shares are traded on the Georgian Stock Exchange. The free float amounted to 7.9% as of 31 December 2019 (31 December 2018: 24.1%).

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

The Bank is the parent company of the group (the "Group") which consists of the following entities consolidated in the financial statements:

		The Group ownership interest			
Name	***Country of incorporation***	***31 December 2019***	***31 December 2018***	***Date of incorporation***	***Activities***
Bus Stop LLC	Georgia	100.00%	100.00%	27 August 2009	Outdoor Advertising
JSC Smartex*	Georgia	21.47%	21.47%	5 January 2009	Early–stage VC investments

* *It is accounted for in the Group's financial statements under the equity method.*

(thousands of Georgian Lari)

2. Basis of preparation

General

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

The Bank and its subsidiaries maintain their accounting records in accordance with IFRS.

The consolidated financial statements have been prepared under the historical cost convention except for derivative financial instruments, investment properties and buildings as disclosed in the accounting policies below.

These consolidated financial statements are presented in thousands of Georgian Lari ("₾"), except per share amounts and unless otherwise indicated.

3. Summary of accounting policies

Changes in accounting policies

In these consolidated financial statements the Group has applied IFRS 16, Leases for the first time. The nature and effect of these changes as a result of adoption of this new accounting standard are described below. Several other amendments and interpretations apply in 2019, but do not have impact on the Group's consolidated financial statements. The Group has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective.

IFRS 16 Leases

IFRS 16 supersedes 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 standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for most leases under a single on–balance sheet model.

Lessor accounting under IFRS 16 is substantially unchanged from IAS 17. Lessors will continue to classify leases as either operating or finance leases using similar principles as in IAS 17. Therefore, IFRS 16 did not have an impact for leases where the Group is the lessor.

The Group adopted IFRS 16 using the modified retrospective method of adoption with the date of initial application of 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 Group elected to use the transition practical expedient allowing the standard to be applied only to contracts that were previously identified as leases applying IAS 17 and IFRIC 4 at the date of initial application. The Group also elected to use the recognition exemptions for 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').

The effect of adoption IFRS 16 as at 1 January 2019 (increase/(decrease)) is as follows:

Assets	
Right of use assets	42,304
Total assets	**42,304**
Liabilities	
Lease liabilities	42,304
Total liabilities	**42,304**
Total adjustment on equity	–

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

(a) Nature of the effect of adoption of IFRS 16

The Group has lease contracts for various items of property and equipment. Before the adoption of IFRS 16, the Group classified each of its leases (as lessee) at the inception date as either a finance lease or an operating lease. A lease was classified as a finance lease if it transferred substantially all of the risks and rewards incidental to ownership of the leased asset to the Group; otherwise it was classified as an operating lease. Finance leases were capitalised at the commencement of the lease at the inception date fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments were apportioned between interest and reduction of the lease liability. In an operating lease, the leased property was not capitalised and the lease payments were recognised as rent expense in profit or loss on a straight–line basis over the lease term. Any prepaid rent and accrued rent were recognised under Other assets and Other liabilities, respectively.

Upon adoption of IFRS 16, the Group applied a single recognition and measurement approach for all leases, except for short–term leases. The standard provides specific transition requirements and practical expedients, which has been applied by the Group.

Leases previously accounted for as operating leases

The Group 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 for most leases were recognised based on the carrying amount as if the standard had always been applied, apart from the use of incremental borrowing rate at the date of initial application. In some leases, 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.

The Group also applied the available practical expedients wherein it:

- Used a single discount rate to a portfolio of leases with reasonably similar characteristics;
- Relied on its assessment of whether leases are onerous immediately before the date of initial application;
- Applied the short–term leases exemptions to leases with lease term that ends within 12 months at the date of initial application;
- Excluded the initial direct costs from the measurement of the right–of–use asset at the date of initial application;
- Used hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

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 as at 31 December 2018	**54,261**
Weighted average incremental borrowing rate as at 1 January 2019	5.87%
Discounted operating lease commitments at 1 January 2019	**46,939**
Less:	
Contracts excluded from IFRS 16 scope	(2,728)
Commitments relating to short–term leases	(1,017)
VAT	(890)
Lease liabilities as at 1 January 2019	**42,304**

(b) Summary of new accounting policies

Set out below are the new accounting policies of the Group upon adoption of IFRS 16, which have been applied from the date of initial application:

i. Group as a lessee

The Group applies a single recognition and measurement approach for all leases, except for short–term leases and leases of low–value assets. The Group recognises lease liabilities to make lease payments and right–of–use assets representing the right to use the underlying assets.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

Right–of–use assets

The Group recognises right–of–use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). 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. Unless the Group is reasonably certain to obtain ownership of the leased asset at the end of the lease term, the recognised right–of–use assets are depreciated on a straight–line basis over the shorter of its estimated useful life and the lease term. Right–of–use assets are subject to impairment.

Lease liabilities

At the commencement date of the lease, the Group recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in–substance 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 Group and payments of penalties for terminating a lease, if the lease term reflects the Group exercising the option to terminate. The variable lease payments that do not depend on an index or a rate are recognised as expense in the period on which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Group uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the in–substance fixed lease payments or a change in the assessment to purchase the underlying asset.

Short–term leases

The Group applies the short–term lease recognition exemption to its short–term leases GEL 2,895 (Note 20). (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). Lease payments on short–term leases are recognised as expense on a straight–line basis over the lease term.

Significant judgement in determining the lease term of contracts with renewal options

The Group determines the lease term as the non–cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised.

The Group has the option, under some of its leases to lease the assets for additional terms of three to five years. The Group applies judgement in evaluating whether it is reasonably certain to exercise the option to renew. That is, it considers all relevant factors that create an economic incentive for it to exercise the renewal. After the commencement date, the Group reassesses the lease term if there is a significant event or change in circumstances that is within its control and affects its ability to exercise (or not to exercise) the option to renew (e.g., a change in business strategy).

ii. Operating – Group as a lessor

Leases in which the Group does not transfer substantially all the risks and rewards incidental to ownership of an asset are classified as operating leases. Rental income arising is accounted for on a straight–line basis over the lease terms and is included in revenue in the statement of profit or loss due to its operating nature. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

iii. Finance – Group as a lessor

The Group recognises lease receivables at value equal to the net investment in the lease, starting from the date of commencement of the lease term. Finance income is based on a pattern reflecting a constant periodic rate of return on the net investment outstanding. Initial direct costs are included in the initial measurement of the lease receivables.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 Income Taxes. It does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation specifically addresses the following:

- Whether an entity considers uncertain tax treatments separately;
- The assumptions an entity makes about the examination of tax treatments by taxation authorities;
- How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates;
- How an entity considers changes in facts and circumstances.

The Group determines whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments and uses the approach that better predicts the resolution of the uncertainty.

Upon adoption of the Interpretation, the Group considered whether it has any uncertain tax positions, particularly those relating to transfer pricing. The Bank's and the subsidiaries' tax filings in different jurisdictions include deductions related to transfer pricing and the taxation authorities may challenge those tax treatments. The Group determined, based on its tax compliance and transfer pricing study, that it is probable that its tax treatments (including those for the subsidiaries) will be accepted by the taxation authorities. The Interpretation did not have an impact on the consolidated financial statements of the Group.

Basis of consolidation

Subsidiaries, which are those entities which are controlled by the Group, are consolidated. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if, and only if, the Group has:

- Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee).
- Exposure, or rights, to variable returns from its involvement with the investee.
- The ability to use its power over the investee to affect its returns.

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement(s) with the other vote holders of the investee.
- Rights arising from other contractual arrangements.
- The Group's voting rights and potential voting rights.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All intra–group transactions, balances and unrealised gains on transactions between group companies are eliminated in full; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses are attributed to the non–controlling interests even if that results in a deficit balance.

If the Group loses control over a subsidiary, it derecognises the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non–controlling interests, the cumulative translation differences, recorded in equity; recognises the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in profit or loss and reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Investments in associates

Associates are entities in which the Group generally has between 20% and 50% of the voting rights, or is otherwise able to exercise significant influence, but which it does not control or jointly control. Investments in associates are accounted for under the equity method and are initially recognised at cost, including goodwill. Subsequent changes in the carrying value reflect the post–acquisition changes in the Group's share of net assets of the associate. The Group's share of its associates' profits or losses is recognised in profit or loss, and its share of movements in reserves is recognised in other comprehensive income. However, when the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses, unless the Group is obliged to make further payments to, or on behalf of, the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Fair value measurement

The Group measures financial instruments carried at FVPL and FVOCI and non–financial assets such as investment property, at fair value at each balance sheet date.

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

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

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

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

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

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

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

3. Summary of accounting policies (continued)

Financial assets and liabilities

Initial recognition

Date of recognition

All regular way purchases and sales of financial assets and liabilities are recognised on the trade date i.e. the date that the Group commits to purchase the asset or liabilities. Regular way purchases or sales are purchases or sales of financial assets and liabilities that require delivery of assets and liabilities within the period generally established by regulation or convention in the marketplace.

Initial measurement

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.

Measurement categories of financial assets and liabilities

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

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

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

The Group only measures amounts due from credit institutions, loans to customers and other financial investments at amortised 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 details of these conditions are outlined below.

Business model assessment

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

The Group'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 Group's assessment.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Group's original expectations, the Group 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 Group 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 amortisation 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 Group 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.

Financial guarantees, letters of credit and undrawn loan commitments

The Group issues financial guarantees, letters of credit and loan commitments.

Financial guarantees are initially recognised in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the consolidated statement of profit or loss, and an ECL provision.

Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Group is required to provide a loan with pre–specified terms to the customer. Similar to financial guarantee contracts these contracts are in the scope of the ECL requirements.

Performance guarantees

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Performance guarantees do not transfer credit risk. The risk under performance guarantee contracts is the possibility that the failure to perform the contractual obligation by another party occurs. Therefore, performance guarantees are not considered financial instruments and thus do not fall in scope of IFRS 9.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the NBG, excluding obligatory reserves, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Amounts due from credit institutions

In the normal course of business, the Group maintains advances or deposits for various periods of time with other banks. Amounts due from credit institutions are initially recognised at fair value and are subsequently measured at amortised cost using the effective interest method. Amounts due from credit institutions are carried net of any allowance for impairment losses.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Derivative financial instruments

In the normal course of business, the Group enters into various derivative financial instruments including forwards and swaps 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 consolidated 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.

Financial assets are classified based on the business model and SPPI assessments.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Group 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 consolidated statement of profit or loss when the borrowings are derecognised as well as through the amortisation process.

If the Group 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 consolidated statement of profit or loss.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the consolidated statement of financial position.

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.

The Group derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI. When assessing whether or not to derecognise a loan to a customer, amongst others, the Group considers the following factors:

- Change in currency of the loan;
- Change in counterparty;
- If the modification is such that the instrument would no longer meet the SPPI criterion.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Group records a modification gain or loss, presented within interest revenue calculated using EIR in the consolidated statement of profit or loss, to the extent that an impairment loss has not already been recorded.

According to the Group's policy, only a limited number of products are subject to restructuring. All restructured loans are classified as Stage 2 loans and Lifetime PD rates are applied for the purpose of ECL calculation.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

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

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

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Write–off

Financial assets are written off either partially or in their entirety only when the Group 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.

Financial liabilities

A financial liability is derecognised 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 recognised in profit or loss.

Taxation

The current income tax expense is calculated in accordance with the regulations of Georgia. It represents the sum of the current and deferred tax expenses.

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

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

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Georgia also has various operating taxes, which are assessed on the Group's activities. These taxes are included as a component of other operating expenses.

3. Summary of accounting policies (continued)

Property and equipment

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

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

Following initial recognition at cost, buildings are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Any revaluation surplus is credited to the revaluation reserve for property and equipment included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss, in which case the increase is recognised in profit or loss. A revaluation deficit is recognised in profit or loss, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

An annual transfer from the revaluation reserve for property and equipment to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original cost. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight–line basis at the following annual prescribed rates:

Land and buildings	2%–5%
Furniture and fixtures	10%–20%
Computer and office equipment	15%–25%
Motor vehicles	20%–25%
Leasehold improvements	10%–25%

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

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

Land is not amortised and carried at fair value. Leasehold improvements are amortised over the life of the related leased assets.

Assets under construction comprise costs directly related to construction of property and equipment including an appropriate allocation of directly attributable variable and fixed overheads that are incurred in construction. Depreciation of these assets, on the same basis as similar property assets, commences when the assets are put into operation.

Compensation from third parties for items of property and equipment that were impaired, lost or given up is included in other income when the compensation becomes receivable.

Investment properties

The Group holds certain properties as investments to earn rental income, generate capital appreciation or both and which are not used or held for the sale in the ordinary course of business. Investment properties are initially recognised at cost, including transaction costs, and subsequently remeasured at fair value reflecting market conditions at the end of the reporting period. Fair value of the Group's investment properties is determined on the base of various sources including reports of independent appraisers, who hold a recognised and relevant professional qualification and who have recent experience in valuation of property of similar location and category. Earned rental income is recorded in the profit or loss within income arising from non–banking activities. Gains and losses resulting from changes in the fair value of investment properties are recorded in consolidated statement of profit or loss and presented within other income or other operating expenses lines.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be finite. Intangible assets with finite lives are amortised over the useful economic lives of 1 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Provisions

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

Retirement and other benefit obligations

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

Share capital

Share capital and additional paid in capital

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

Treasury shares

Where the Bank purchases the Bank's shares, the consideration paid, including any attributable transaction costs, net of income taxes, is deducted from total equity as treasury shares until they are cancelled or reissued. Where such shares are subsequently sold or reissued, any consideration received is included in equity. Treasury shares are stated at the weighted average cost.

Dividends

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.

Segment reporting

The Group's segment reporting is based on the following operating segments: Retail Banking, Corporate and SME (Small & Medium Enterprise) Banking, Private Banking and Corporate Centre functions.

Contingencies

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

Recognition of income and expenses

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

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

Interest and similar revenue and expense

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

When a financial asset becomes credit–impaired, the Group 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 Group reverts to calculating interest revenue on a gross basis.

For purchased or originated credit–impaired (POCI) financial assets, the Group 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.

Interest revenue on all financial assets at FVPL is recognised using the contractual interest rate in "Other interest revenue" in the consolidated statement of profit or loss.

Fee and commission income

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

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

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

- *Fee income earned at a point in time*

Fees arising from settlement, remittances, bill payments and cash operations are recognized upon completion of underlying transactions. Each operation is treated as a separate performance obligation.

- *Fee income from providing transaction services*

Fees arising from negotiating or participating in the negotiation of a transaction for a third party – such as the where the Group's performance obligation is the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance obligations are recognised after fulfilling the corresponding criteria. When the contract provides for a variable consideration, fee and commission income is only recognized to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur until the uncertainty associated with the variable consideration is subsequently resolved.

Dividend income

Revenue is recognised when the Group's right to receive the payment is established.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Foreign currency translation

The consolidated financial statements are presented in Georgian Lari, which is the Bank's and subsidiaries' functional 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 are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the consolidated statement of profit or loss as gains less losses from foreign currencies – translation differences. Non–monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non–monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the NBG exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies.

The exchange rates used by the Group in the preparation of the consolidated financial statements as of 31 December 2019 and 31 December 2018 are as follows:

	2019	*2018*
₾ / 1 US Dollar	2.8677	2.6766
₾ / 1 Euro	3.2095	3.0701

4. Significant accounting judgments and estimates

The preparation of the Group's consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the balance sheet date and the reported amount of income and expenses during the year ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The following estimates and judgments are considered important to the Group's financial condition.

Impairment losses on financial assets

The measurement of impairment losses both under IFRS 9 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. The Group's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Group's internal credit grading model, which assigns PDs to the individual grades;
- The Group's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment;
- The segmentation of financial assets when their ECL is assessed on a collective basis;
- Development of ECL models, including the various formulae and the choice of inputs;
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs;
- Selection of forward–looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

The Group regularly reviews its loans to assess for impairment and uses its experienced judgment to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers. Management uses probability estimates based on historical borrower experience including default familiarities and loss given defaults. The Group uses its experienced judgment to adjust observable data for a group of homogenous loans to reflect current circumstances and forward looking macroeconomic variables.

4. Significant accounting judgments and estimates (continued)

Impairment losses on financial assets (continued)

The allowances for impairment of financial assets in the consolidated financial statements have been determined on the basis of existing economic conditions. The Group is not in a position to predict what changes in conditions will take place in Georgia and what effect such changes might have on the adequacy of the allowances for impairment of financial assets in future periods.

Measurement of fair value of investment properties and buildings

Investment properties and buildings are stated at fair value. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards Committee standards.

Buildings of the Group are subject to revaluation on a regular basis. The date of latest revaluation was 31 December 2019 (*Note 10).*

As of 31 December 2019, fair value of investment properties was determined by independent professionally qualified appraisers. Fair value was determined by applying income approach based on discounted cash flow method, supported by the terms of any existing lease and other contracts and, when available, by external evidence such as current market rents for similar properties in a comparable location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows. The estimates of future cash flows include projections of cash outflows for rent or purchase of the land.

The estimates described above are subject to change as new transaction data and market evidence become available.

Taxation

Tax legislation in Georgia is subject to varying interpretations, and changes can occur frequently. Management interpretation of such legislation and changes as applied to the transactions and activity of the Group may be challenged by the relevant authorities. As such, additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three years including the year of review. Management believes that as of 31 December 2019 its interpretation of the relevant legislation is appropriate and that the Group's tax position will be sustained.

5. Segment information

For management purposes, the Group is organised into the following operating segments based on products and service:

Retail Banking	Principally handling individual customers' deposits, and providing consumer loans, overdrafts, credit card facilities, funds transfer payments and electronic banking services.
Corporate and SME Banking	Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers.
Private Banking	Principally providing private banking and wealth management services to high net worth individuals.
Corporate Centre	Principally providing treasury and back office services to all operating segments of the Group.
Other	Segments not classified above, comprising non–banking operations.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance, as explained in the table below, is measured differently from profit or loss in the consolidated financial statements. Income taxes are managed on a group basis and are not allocated to operating segments.

(thousands of Georgian Lari)

5 Segment information (continued)

The Group operates in one geographical market – Georgia. Since the Group's assets are located in single geographical area, the Group's external income, total assets and capital expenditure are allocated to a single location.

2019	*Retail banking*	*Corporate & SME banking*	*Private banking*	*Corporate centre*	*Adjustments and eliminations*	*Other*	*Total*
Net interest income	124,509	12,510	2,812	25,809	5	2	**165,647**
Net fee and commission income	18,756	1,204	219	2,021	–	–	**22,200**
Net gains from foreign currencies	6,010	2,943	1,158	110	–	–	**10,221**
Other income	11,263	237	53	438	654	–	**12,645**
	160,538	**16,894**	**4,242**	**28,378**	**659**	**2**	**210,713**
Credit loss expense	(24,877)	(1,331)	(38)	–	–	–	**(26,246)**
Personnel expenses	(55,522)	(5,082)	(1,143)	(9,357)	(30)	1	**(71,133)**
Depreciation and amortisation	(22,935)	(2,304)	(518)	(4,241)	–	–	**(29,998)**
Other impairment and provisions reversal	(576)	(58)	(13)	(107)	–	–	**(754)**
General and administrative and other operating expenses	(33,482)	(3,365)	(757)	(6,194)	(14)	–	**(43,812)**
Segment results	**23,146**	**4,754**	**1,773**	**8,479**	**615**	**3**	**38,770**
Income tax expense	–	–	–	–	–	–	**(1,857)**
Profit for the year	–	–	–	–	–	–	36,913
Revaluation of buildings	816	345	6	134	–	–	1,301
Total comprehensive income for the year	–	–	–	–	–	–	38,214
Segment assets	1,338,353	567,159	9,555	219,905	–	–	**2,134,972**
Segment liabilities	1,071,788	507,639	208,844	38,896	–	–	**1,827,167**
Other segment information							
Investments in associates	–	–	–	804	–	–	**804**
Share of profit of associates	–	–	–	35	–	–	**35**

(thousands of Georgian Lari)

5. Segment information (continued)

2018	*Retail banking*	*Corporate & SME banking*	*Private banking*	*Corporate centre*	*Other*	*Adjustments and eliminations*	*Total*
Net interest income	**143,604**	**3,151**	**365**	**35,424**	**22**	**(22)**	**182,544**
Net fee and commission income	19,521	375	32	3,070	–	–	**22,998**
Net gains from foreign currencies	2,841	1,254	514	18	–	–	**4,627**
Other income	17,743	101	11	1,125	51	–	**19,031**
	183,709	**4,881**	**922**	**39,637**	**73**	**(22)**	**229,200**
Credit loss expense	(35,087)	(644)	(89)	–	–	–	**(35,820)**
Personnel expenses	(54,849)	(1,030)	(116)	(11,436)	(41)	–	**(67,472)**
Depreciation and amortisation	(17,082)	(380)	(43)	(4,218)	–	–	**(21,723)**
Other impairment and provisions reversal	173	4	–	41	–	–	**218**
General and administrative and other operating expenses	(30,640)	(682)	(76)	(7,568)	(12)	–	**(38,978)**
Segment results	**46,224**	**2,149**	**598**	**16,456**	**20**	**(22)**	**65,425**
Income tax expense	–	–	–	–	–	–	**(8,225)**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**57,200**
Segment assets	1,246,595	291,757	14,207	287,674	–	–	**1,840,233**
Segment liabilities	928,884	475,707	157,240	8,036	–	–	**1,569,867**
Other segment information							
Investments in associates	–	–	–	1,524	–	–	**1,524**
Share of profit of associates	–	–	–	695	–	–	**695**

Segment breakdown of revenue from contracts with customers in scope of IFRS 15 for the year ended 31 December 2019 is as follows:

2019	*Retail banking*	*Corporate & SME banking*	*Private banking*	*Corporate centre*	*Total*
Commission income					
Plastic card operations	13,001	–	–	–	13,001
Settlements operations	7,723	776	174	1,602	10,275
Remittances	4,639	–	–	–	4,639
Fee income received from bill payments	1,137	114	26	235	1,512
Cash operations	2,015	202	46	418	2,681
Guarantees and letters of credit	–	225	–	–	225
Other revenue from contracts with customers	183	18	4	39	244
Total revenue from contracts with customers	**28,698**	**1,335**	**250**	**2,294**	**32,577**

(thousands of Georgian Lari)

5. Segment information (continued)

Revenue from contracts with customers (continued)

2018	*Retail banking*	*Corporate & SME banking*	*Private banking*	*Corporate centre*	*Total*
Commission income					
Plastic card operations	9,749	–	–	–	**9,749**
Settlements operations	4,836	555	133	1,178	**6,702**
Remittances	3,704	–	–	–	**3,704**
Fee income received from bill payments	1,747	201	48	426	**2,422**
Cash operations	1,646	189	45	401	**2,281**
Guarantees and letters of credit	–	102	–	–	**102**
Other revenue from contracts with customers	4,400	505	121	1,072	**6,098**
Total revenue from contracts with customers	**26,082**	**1,552**	**347**	**3,077**	**31,058**

6. Cash and cash equivalents

Cash and cash equivalents comprise:

	2019	*2018*
Cash on hand	208,693	205,705
Current accounts with the NBG	27,909	29,572
Current accounts with other credit institutions	20,333	110,625
Time deposits with credit institutions up to 90 days	158,833	47,000
	415,768	**392,902**
Less – allowance for impairment	(2)	(3)
Cash and cash equivalents	**415,766**	**392,899**

As of 31 December 2019 ₾ 12,455 (31 December 2018: ₾ 98,516) was placed on current accounts with internationally recognised OECD banks that are the counterparties of the Group in performing international settlements.

Credit rating of current accounts with other credit institutions is as follows:

	2019	*2018*
A–	1	–
BBB+	7	98,516
BBB	16,181	–
BBB–	–	2,678
BB–	3,892	9,120
B+	12	28
Not rated	240	283
Total	**20,333**	**110,625**

Credit rating of time deposits with credit institutions up to 90 days is as follows:

	2019	*2018*
BB–	158,833	47,000
Total	**158,833**	**47,000**

The tables contain ratings of Fitch Ratings international agency. All balances of cash equivalents are allocated to Stage 1.

(thousands of Georgian Lari)

7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2019	*2018*
Obligatory reserve with the NBG	113,880	85,968
Time deposits for more than 90 days	11,032	13,954
	124,912	**99,922**
Less – allowance for impairment	(430)	(191)
Amounts due from credit institutions	**124,482**	**99,731**

Credit institutions are required to maintain an interest–earning cash deposit (obligatory reserve) with the NBG, the amount of which depends on the level of funds attracted by the credit institution. The Group's ability to withdraw these deposits is restricted by the statutory legislature.

As of 31 December 2019 ₾ 10,131 (31 December 2018: ₾ 13,123) was placed as the guarantee deposit placed for variation and safety margins defined in the Credit Support Annex (the "CSA") to the Schedule to the ISDA Master Agreement for funding swaps. Variation margin is modified from time to time based on the mark–to–market revaluation of the forward contracts. More details are provided in *Note 14*.

An analysis of changes in the gross carrying value and corresponding ECL in relation to time deposits for more than 90 days during the year ended 31 December 2019 and 31 December 2018 is as follows:

	Gross caring value	*ECL*
As at 1 January 2019	**13,954**	**(191)**
New assets originated	6,236	(15)
Assets repaid	(11,653)	30
Foreign exchange and other movements	2,495	(254)
At 31 December 2019	**11,032**	**(430)**

	Gross caring value	*ECL*
As at 1 January 2018	**12,332**	**(140)**
New assets originated	100	(1)
Assets repaid	(95)	1
Foreign exchange and other movements	1,617	(51)
At 31 December 2018	**13,954**	**(191)**

All balances of amounts due from credit institutions are allocated to Stage 1.

(thousands of Georgian Lari)

8. Loans to customers

Loans to customers comprise:

	2019	*2018*
Loans to retail clients with regular inflows	418,136	450,382
Corporate and SME loans	335,690	190,539
Consumer loans	202,205	162,772
Micro loans	103,231	108,854
Gold pawn loans	121,702	86,439
Residential mortgage loans	87,172	61,864
Gross loans to customers at amortised cost	**1,268,136**	**1,060,850**
Less – allowance for impairment	(91,634)	(108,102)
Loans to customers at amortised cost	**1,176,502**	**952,748**
Loans to customers at FVTPL	1,079	796
Loans to customers	**1,177,581**	**953,544**

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 Loans to retail clients with regular inflows during the year ended 31 December 2019 and 31 December 2018 is as follows:

Loans to retail clients with regular inflows	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**402,711**	**5,520**	**42,151**	**450,382**
New assets originated or purchased	1,507,099	–	–	**1,507,099**
Assets repaid	(1,501,978)	(21,792)	(79,386)	**(1,603,156)**
Transfers to Stage 1	9,566	(6,928)	(2,638)	**–**
Transfers to Stage 2	(30,569)	30,735	(166)	**–**
Transfers to Stage 3	(28,032)	(9,051)	37,083	**–**
Unwinding of discount	–	–	1,974	**1,974**
Recoveries	–	–	780	**780**
Amounts written off	–	–	(36,382)	**(36,382)**
Foreign exchange and other movements	30,475	6,577	60,387	**97,439**
At 31 December 2019	**389,272**	**5,061**	**23,803**	**418,136**

Loans to retail clients with regular inflows	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**361,835**	**6,968**	**34,548**	**403,351**
New assets originated or purchased	1,268,658	–	–	**1,268,658**
Assets repaid	(1,245,532)	(3,020)	(545)	**(1,249,097)**
Transfers to Stage 1	2,275	(2,275)	–	**–**
Transfers to Stage 2	(17,167)	17,382	(215)	**–**
Transfers to Stage 3	–	(13,438)	13,438	**–**
Unwinding of discount	–	–	1,360	**1,360**
Recoveries	–	–	553	**553**
Amounts written off	–	–	(4,970)	**(4,970)**
Foreign exchange and other movements	32,642	(97)	(2,018)	**30,527**
At 31 December 2018	**402,711**	**5,520**	**42,151**	**450,382**

(thousands of Georgian Lari)

8. Loans to customers (continued)

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

Loans to retail clients with regular inflows	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**9,481**	**1,982**	**38,545**	**50,008**
New assets originated or purchased	25,068	–	–	**25,068**
Assets repaid	(28,910)	(5,981)	(60,044)	**(94,935)**
Transfers to Stage 1	2,716	(1,355)	(1,361)	**(0)**
Transfers to Stage 2	(326)	424	(98)	**–**
Transfers to Stage 3	(1,086)	(4,478)	5,564	**–**
Impact on period end ECL of exposures transferred between stages during the period	(2,576)	9,635	18,263	**25,322**
Unwinding of discount (recognised in interest revenue)	–	–	1,974	**1,974**
Recoveries	–	–	780	**780**
Amounts written off	–	–	(36,382)	**(36,382)**
Foreign exchange and other movements	690	2,705	52,664	**56,059**
At 31 December 2019	**5,057**	**2,932**	**19,905**	**27,894**

Loans to retail clients with regular inflows	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**7,483**	**2,540**	**29,918**	**39,941**
New assets originated or purchased	32,999	–	–	**32,999**
Assets repaid	(27,920)	(494)	(489)	**(28,903)**
Transfers to Stage 1	924	(924)	–	**–**
Transfers to Stage 2	(2,293)	2,479	(186)	**–**
Transfers to Stage 3	–	(2,056)	2,056	**–**
Impact on period end ECL of exposures transferred between stages during the period	(910)	839	7,887	**7,816**
Unwinding of discount (recognised in interest revenue)	–	–	1,360	**1,360**
Recoveries	–	–	553	**553**
Amounts written off	–	–	(4,970)	**(4,970)**
Foreign exchange and other movements	(802)	(402)	2,416	**1,212**
At 31 December 2018	**9,481**	**1,982**	**38,545**	**50,008**

An analysis of changes in the gross carrying value and corresponding ECL in relation to Corporate and SME loans during the year ended 31 December 2019 and 31 December 2018 is as follows:

Corporate and SME loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**189,502**	**52**	**985**	**190,539**
New assets originated or purchased	356,032	–	–	**356,032**
Assets repaid	(199,609)	(31,820)	(380)	**(231,809)**
Transfers to Stage 1	729	(676)	(53)	**–**
Transfers to Stage 2	(51,446)	51,798	(352)	**–**
Transfers to Stage 3	–	(741)	741	**–**
Unwinding of discount	–	–	1,583	**1,583**
Recoveries	–	–	16	**16**
Amounts written off	–	–	(947)	**(947)**
Foreign exchange and other movements	19,331	2,078	(1,133)	**20,276**
At 31 December 2019	**314,539**	**20,691**	**460**	**335,690**

(thousands of Georgian Lari)

8. Loans to customers (continued)

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

Corporate and SME loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**3,057**	**149**	**1,130**	**4,336**
New assets originated or purchased	423,843	–	–	**423,843**
Assets repaid	(242,263)	(9)	(486)	**(242,758)**
Transfers to Stage 1	208	(208)	–	**–**
Transfers to Stage 2	(298)	393	(95)	**–**
Transfers to Stage 3	–	(272)	272	**–**
Unwinding of discount	–	–	52	**52**
Recoveries	–	–	78	**78**
Amounts written off	–	–	(21)	**(21)**
Foreign exchange and other movements	4,955	(1)	55	**5,009**
At 31 December 2018	**189,502**	**52**	**985**	**190,539**

Corporate and SME loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**2,256**	**22**	**774**	3,052
New assets originated or purchased	4,255	–	–	**4,255**
Assets repaid	(2,790)	(3,865)	(338)	**(6,993)**
Transfers to Stage 1	140	(107)	(33)	**–**
Transfers to Stage 2	(1,031)	1,276	(245)	**–**
Transfers to Stage 3		(148)	148	**–**
Impact on period end ECL of exposures transferred between stages during the period	(231)	3,447	301	**3,517**
Unwinding of discount (recognised in interest revenue)	–	–	1,583	**1,583**
Recoveries	–	–	16	**16**
Amounts written off	–	–	(947)	**(947)**
Foreign exchange and other movements	229	471	(1,068)	**(368)**
At 31 December 2019	**2,828**	**1,096**	**191**	**4,115**

Corporate and SME loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**609**	**57**	**701**	**1,367**
New assets originated or purchased	7,835	–	–	**7,835**
Assets repaid	(10,304)	–	(242)	**(10,546)**
Transfers to Stage 1	137	(137)	–	**–**
Transfers to Stage 2	(5)	100	(95)	**–**
Transfers to Stage 3		(17)	17	**–**
Impact on period end ECL of exposures transferred between stages during the period	(136)	19	252	**135**
Unwinding of discount (recognised in interest revenue)	–	–	52	**52**
Recoveries	–	–	78	**78**
Amounts written off	–	–	(21)	**(21)**
Foreign exchange and other movements	4,120	–	32	**4,152**
At 31 December 2018	**2,256**	**22**	**774**	**3,052**

(thousands of Georgian Lari)

8. Loans to customers (continued)

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

Consumer loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**112,937**	**11,861**	**37,974**	**162,772**
New assets originated or purchased	229,945	–	–	**229,945**
Assets repaid	(205,243)	(15,603)	(10,451)	**(231,297)**
Transfers to Stage 1	2,996	(2,996)	–	**–**
Transfers to Stage 2	(22,443)	24,325	(1,882)	**–**
Transfers to Stage 3	(2,202)	(13,231)	15,433	**–**
Unwinding of discount	–	–	948	**948**
Recoveries	–	–	524	**524**
Amounts written off	–	–	(8,406)	**(8,406)**
Foreign exchange and other movements	35,211	2,594	9,914	**47,719**
At 31 December 2019	**151,201**	**6,950**	**44,054**	**202,205**

Consumer loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**194,011**	**9,832**	**60,430**	**264,273**
New assets originated or purchased	294,249	–	–	**294,249**
Assets repaid	(336,292)	(11,257)	(6,703)	**(354,252)**
Transfers to Stage 1	600	(600)	–	**–**
Transfers to Stage 2	(43,471)	43,471	–	**–**
Transfers to Stage 3	–	(29,765)	29,765	**–**
Unwinding of discount	–	–	3,555	**3,555**
Recoveries	–	–	907	**907**
Amounts written off	–	–	(45,358)	**(45,358)**
Foreign exchange and other movements	3,840	180	(4,622)	**(602)**
At 31 December 2018	**112,937**	**11,861**	**37,974**	**162,772**

Consumer loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**5,204**	**4,482**	**31,458**	**41,144**
New assets originated or purchased	2,673	–	–	**2,673**
Assets repaid	(6,297)	(5,409)	(4,208)	**(15,914)**
Transfers to Stage 1	726	(726)	–	**–**
Transfers to Stage 2	(1,309)	2,301	(992)	**–**
Transfers to Stage 3	(228)	(5,812)	6,040	**–**
Impact on period end ECL of exposures transferred between stages during the period	(523)	5,911	6,150	**11,538**
Unwinding of discount (recognised in interest revenue)	–	–	948	**948**
Recoveries	–	–	524	**524**
Amounts written off	–	–	(8,406)	**(8,406)**
Foreign exchange and other movements	1,036	616	8,551	**10,203**
At 31 December 2019	**1,282**	**1,363**	**40,065**	**42,710**

(thousands of Georgian Lari)

8. Loans to customers (continued)

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

Consumer loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**8,950**	**4,170**	**51,275**	**64,395**
New assets originated or purchased	14,825	–	–	**14,825**
Assets repaid	(14,355)	(2,538)	(1,795)	**(18,688)**
Transfers to Stage 1	198	(198)	–	**–**
Transfers to Stage 2	(3,398)	3,399	(1)	**–**
Transfers to Stage 3	–	(4,404)	4,404	**–**
Impact on period end ECL of exposures transferred between stages during the period	(188)	3,208	15,417	**18,437**
Unwinding of discount (recognised in interest revenue)	–	–	3,555	**3,555**
Recoveries	–	–	907	**907**
Amounts written off	–	–	(45,358)	**(45,358)**
Foreign exchange and other movements	(828)	845	3,054	**3,071**
At 31 December 2018	**5,204**	**4,482**	**31,458**	**41,144**

An analysis of changes in the gross carrying value and corresponding ECL in relation to Micro loans during the year ended 31 December 2019 and 31 December 2018 is as follows:

Micro loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**93,298**	**3,746**	**11,810**	**108,854**
New assets originated or purchased	67,466	–	–	67,466
Assets repaid	(101,395)	(3,194)	(3,794)	(108,383)
Transfers to Stage 1	2,898	(2,622)	(276)	**–**
Transfers to Stage 2	(10,937)	11,117	(180)	**–**
Transfers to Stage 3	(1,052)	(5,756)	6,808	**–**
Unwinding of discount	–	–	488	488
Recoveries	–	–	161	161
Amounts written off	–	–	(3,281)	(3,281)
Foreign exchange and other movements	36,197	991	738	37,926
At 31 December 2019	**86,475**	**4,282**	**12,474**	**103,231**

Micro loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**107,891**	**1,690**	**7,622**	**117,203**
New assets originated or purchased	92,098	–	–	**92,098**
Assets repaid	(97,615)	(1,342)	(3,248)	**(102,205)**
Transfers to Stage 1	437	(437)	–	**–**
Transfers to Stage 2	(10,511)	10,514	(3)	**–**
Transfers to Stage 3	–	(6,779)	6,779	**–**
Unwinding of discount	–	–	1,533	**1,533**
Recoveries	–	–	63	**63**
Amounts written off	–	–	(1,573)	**(1,573)**
Foreign exchange and other movements	998	100	637	**1,735**
At 31 December 2018	**93,298**	**3,746**	**11,810**	**108,854**

(thousands of Georgian Lari)

8. Loans to customers (continued)

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

Micro loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**1,185**	**1,598**	**8,794**	**11,577**
New assets originated or purchased	633	–	–	**633**
Assets repaid	(1,033)	(1,051)	(1,972)	**(4,056)**
Transfers to Stage 1	1,453	(1,293)	(160)	**–**
Transfers to Stage 2	(224)	334	(110)	**–**
Transfers to Stage 3	(93)	(2,543)	2,636	**–**
Impact on period end ECL of exposures transferred between stages during the period	(1,249)	4,272	1,919	**4,942**
Unwinding of discount (recognised in interest revenue)	–	–	488	**488**
Recoveries	–	–	161	**161**
Amounts written off	–	–	(3,281)	**(3,281)**
Foreign exchange and other movements	1,729	408	517	**2,654**
At 31 December 2019	**2,401**	**1,725**	**8,992**	**13,118**

Micro loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**1,849**	**654**	**5,888**	**8,391**
New assets originated or purchased	2,301	–	–	**2,301**
Assets repaid	(1,138)	(236)	(1,961)	**(3,335)**
Transfers to Stage 1	165	(165)	–	**–**
Transfers to Stage 2	(885)	887	(2)	**–**
Transfers to Stage 3	–	(471)	471	**–**
Impact on period end ECL of exposures transferred between stages during the period	(161)	925	3,549	**4,313**
Unwinding of discount (recognised in interest revenue)	–	–	1,533	**1,533**
Recoveries	–	–	63	**63**
Amounts written off	–	–	(1,573)	**(1,573)**
Foreign exchange and other movements	(946)	4	826	**(116)**
At 31 December 2018	**1,185**	**1,598**	**8,794**	**11,577**

An analysis of changes in the gross carrying value and corresponding ECL in relation to Gold pawn loans during the year ended 31 December 2019 and 31 December 2018 is as follows:

Gold pawn loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**84,348**	**701**	**1,390**	**86,439**
New assets originated or purchased	216,571	–	–	**216,571**
Assets repaid	(196,711)	(1,118)	(1,544)	**(199,373)**
Transfers to Stage 1	1,891	(1,296)	(595)	**–**
Transfers to Stage 2	(3,097)	3,097	–	**–**
Transfers to Stage 3	(1,787)	(1,201)	2,988	**–**
Unwinding of discount	–	–	573	**573**
Recoveries	–	–	1	**1**
Amounts written off	–	–	(1,040)	**(1,040)**
Foreign exchange and other movements	18,314	94	123	**18,531**
At 31 December 2019	**119,529**	**277**	**1,896**	**121,702**

(thousands of Georgian Lari)

8. Loans to customers (continued)

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

Gold pawn loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**58,018**	**635**	**1,930**	**60,583**
New assets originated or purchased	134,478	–	–	**134,478**
Assets repaid	(107,591)	(334)	(849)	**(108,774)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(775)	775	–	**–**
Transfers to Stage 3	–	(377)	377	**–**
Unwinding of discount	–	–	178	**178**
Recoveries	–	–	–	**–**
Amounts written off	–	–	(258)	**(258)**
Foreign exchange and other movements	218	2	12	**232**
At 31 December 2018	**84,348**	**701**	**1,390**	**86,439**

Gold pawn loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**91**	**2**	**1,004**	**1,097**
New assets originated or purchased	26	–	–	**26**
Assets repaid	(159)	(12)	(738)	**(909)**
Transfers to Stage 1	384	–	(384)	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	–	(1)	1	**–**
Impact on period end ECL of exposures transferred between stages during the period	(384)	11	2,344	**1,971**
Unwinding of discount (recognised in interest revenue)	–	–	573	**573**
Recoveries	–	–	1	**1**
Amounts written off	–	–	(1,040)	**(1,040)**
Foreign exchange and other movements	80	–	48	**128**
At 31 December 2019	**38**	**–**	**1,809**	**1,847**

Gold pawn loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**65**	**1**	**1,249**	**1,315**
New assets originated or purchased	468	–	–	**468**
Assets repaid	(2,272)	(2)	(300)	**(2,574)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(3)	3	–	**–**
Transfers to Stage 3	–	(1)	1	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	1	1	**2**
Unwinding of discount (recognised in interest revenue)	–	–	178	**178**
Recoveries	–	–	–	**–**
Amounts written off	–	–	(258)	**(258)**
Foreign exchange and other movements	1,833	–	133	**1,966**
At 31 December 2018	**91**	**2**	**1,004**	**1,097**

(thousands of Georgian Lari)

8. Loans to customers (continued)

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

An analysis of changes in the gross carrying value and corresponding ECL in relation to Residential mortgage loans during the year ended 31 December 2019 and 31 December 2018 is as follows:

Residential mortgage loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**60,094**	**658**	**1,112**	**61,864**
New assets originated or purchased	57,696	–	–	**57,696**
Assets repaid	(37,737)	(1,351)	(435)	**(39,523)**
Transfers to Stage 1	1,709	(1,642)	(67)	**–**
Transfers to Stage 2	(4,185)	4,905	(720)	**–**
Transfers to Stage 3	(3)	(1,353)	1,356	**–**
Unwinding of discount (recognised in interest revenue)	–	–	411	**411**
Recoveries	–	–	44	**44**
Amounts written off	–	–	(311)	**(311)**
Foreign exchange and other movements	6,510	167	314	**6,991**
At 31 December 2019	**84,084**	**1,384**	**1,704**	**87,172**

Residential mortgage loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**18,866**	**348**	**785**	**19,999**
New assets originated or purchased	60,891	–	–	**60,891**
Assets repaid	(19,184)	(222)	(477)	**(19,883)**
Transfers to Stage 2	(1,200)	1,200	–	**–**
Transfers to Stage 3	–	(699)	699	**–**
Unwinding of discount	–	–	61	**61**
Amounts written off	–	–	(1)	**(1)**
Foreign exchange and other movements	721	31	45	**797**
At 31 December 2018	**60,094**	**658**	**1,112**	**61,864**

Residential mortgage loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**494**	**108**	**622**	**1,224**
New assets originated or purchased	356	–	–	**356**
Assets repaid	(243)	(194)	(190)	**(627)**
Transfers to Stage 1	319	(294)	(25)	**–**
Transfers to Stage 2	(65)	364	(299)	**–**
Transfers to Stage 3	–	(252)	252	**–**
Impact on period end ECL of exposures transferred between stages during the period	(301)	446	415	**560**
Unwinding of discount (recognised in interest revenue)	–	–	411	**411**
Recoveries	–	–	44	**44**
Amounts written off	–	–	(311)	**(311)**
Foreign exchange and other movements	79	26	188	**293**
At 31 December 2019	**639**	**204**	**1,107**	**1,950**

(thousands of Georgian Lari)

8. Loans to customers (continued)

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

Residential mortgage loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**216**	**34**	**436**	**686**
New assets originated or purchased	215	–	–	**215**
Assets repaid	(151)	(27)	(225)	**(403)**
Transfers to Stage 2	(38)	38	–	**–**
Transfers to Stage 3	–	(23)	23	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	74	267	**341**
Unwinding of discount (recognised in interest revenue)	–	–	61	**61**
Amounts written off	–	–	(1)	**(1)**
Foreign exchange and other movements	252	12	61	**325**
At 31 December 2018	**494**	**108**	**622**	**1,224**

No collateral as of 31 December 2019 and 2018 is used as credit enhancement for credit impaired stage 3 loans ECL calculation process.

Concentration of loans to customers

As of 31 December 2019, the concentration of loans granted by the Group to ten largest third party borrowers comprised ₾ 130,306 accounting for 10.3% of the gross loan portfolio of the Group (2018: ₾ 121,051 and 11.5% respectively). An allowance of ₾ 467 (2018: ₾ 850) was established against these loans.

Loans have been extended to the following types of customers:

	2019	*2018*
Individuals	934,225	870,167
Private companies	334,990	191,479
Loans to customers, gross	**1,269,215**	**1,061,646**
Less – allowance for loan impairment	(91,634)	(108,102)
Loans to customers, net	**1,177,581**	**953,544**

Loans are made principally within Georgia in the following industry sectors:

	2019	*2018*
Individuals	934,225	870,167
Trade and service	179,514	41,026
Non–banking credit organization	38,191	22,676
Construction	26,851	53,470
Healthcare	36,591	7,221
Manufacturing	15,264	14,431
Transportation and communication	–	26,847
Tourism and hospitality	18,865	15,869
Energy	10,083	–
Other	9,631	9,939
Loans to customers, gross	**1,269,215**	**1,061,646**
Less – allowance for loan impairment	(91,634)	(108,102)
Loans to customers, net	**1,177,581**	**953,544**

(thousands of Georgian Lari)

9. Investment securities

Investment securities comprise:

Debt securities at amortised cost	***2019***	***2018***
Treasury bills of the Ministry of Finance of Georgia	12,102	32,721
Treasury bonds of the Ministry of Finance of Georgia	129,880	160,508
Corporate bonds	5,244	5,245
	147,226	**198,474**
Less – allowance for impairment	(720)	(970)
Debt securities at amortised cost	**146,506**	**197,504**

As of 31 December 2019 and 2018, no investment securities were pledged as a collateral.

An analysis of changes in the gross carrying value in relation to investment securities during the year ended 31 December 2019 and 31 December 2018 is as follows:

	Corporate bonds	*Certificates of deposits of National Bank of Georgia*	*Treasury bills of the Ministry of Finance of Georgia*	*Treasury bonds of the Ministry of Finance of Georgia*	*Total*
Gross carrying value as at 1 January 2019	**5,245**	**–**	**32,721**	**160,508**	**198,474**
New assets originated	–	3,048	12,504	32,033	**47,585**
Assets repaid	–	(3,048)	(33,952)	(62,748)	**(99,748)**
Other movements	(1)	–	829	87	**915**
At 31 December 2019	**5,244**	**–**	**12,102**	**129,880**	**147,226**

	Corporate bonds	*Certificates of deposits of National Bank of Georgia*	*Treasury bills of the Ministry of Finance of Georgia*	*Treasury bonds of the Ministry of Finance of Georgia*	*Total*
Gross carrying value as at 1 January 2018	**–**	**–**	**83,207**	**139,593**	**222,800**
New assets originated	5,200	16,452	59,569	38,465	**103,234**
Assets repaid	–	(16,745)	(115,263)	(32,628)	**(147,891)**
Other movements	45	293	5,208	15,078	**20,331**
At 31 December 2018	**5,245**	**–**	**32,721**	**160,508**	**198,474**

All balances of investment securities are allocated to stage 1. An analysis of changes in the ECL allowances during the year ended 31 December 2019 is, as follows:

	Corporate bonds	*Certificates of deposits of National Bank of Georgia*	*Treasury bills of the Ministry of Finance of Georgia*	*Treasury bonds of the Ministry of Finance of Georgia*	*Total*
ECL as at 1 January 2019	**(26)**	**–**	**(155)**	**(789)**	**(970)**
New assets originated	–	(15)	(61)	(157)	**(233)**
Assets repaid	–	15	166	307	**488**
Other movements	(1)	–	(4)	**–**	**(5)**
At 31 December 2019	**(27)**	**–**	**(54)**	**(639)**	**(720)**

(thousands of Georgian Lari)

9. Investment securities (continued)

	Corporate bonds	*Certificates of deposits of National Bank of Georgia*	*Treasury bills of the Ministry of Finance of Georgia*	*Treasury bonds of the Ministry of Finance of Georgia*	*Total*
ECL as at 1 January 2018	**–**	**–**	**(410)**	**(686)**	**(1,096)**
New assets originated	(26)	81	(293)	(190)	**(509)**
Assets repaid	–	(82)	574	161	**735**
Other movements	–	1	(26)	(74)	**(100)**
At 31 December 2018	**(26)**	**–**	**(155)**	**(789)**	**(970)**

10. Property and equipment

The movements in property and equipment were as follows:

	Land and buildings	*Furniture and fixtures*	*Computers and office equipment*	*Motor vehicles*	*Leasehold improve–ments*	*Assets under construction*	*Total*
Cost or revalued amount							
31 December 2018	**83,659**	**79,982**	**33,340**	**16,530**	**9,590**	**–**	**223,101**
Additions	2,486	20,845	6,185	1,437	5,461	2,569	**38,983**
Disposals	–	(454)	(1,158)	(546)	–	–	**(2,158)**
Revaluation	(3,368)	–	–	–	–	–	**(3,368)**
31 December 2019	**82,777**	**100,373**	**38,367**	**17,421**	**15,051**	**2,569**	**256,558**
Accumulated depreciation and impairment							
31 December 2018	3,263	46,261	**25,815**	**13,620**	**5,206**	**–**	**94,165**
Depreciation charge	1,676	7,694	3,578	1,104	1,132	–	**15,184**
Disposals	–	(403)	(1,158)	(546)	–	–	**(2,107)**
Revaluation	(4,939)	–	–	–	–	–	**(4,939)**
31 December 2019	**–**	**53,552**	**28,235**	**14,178**	**6,338**	**–**	**102,303**
Net book value							
31 December 2018	**80,396**	**33,721**	**7,525**	**2,910**	**4,384**	–	**128,936**
31 December 2019	**82,777**	**46,821**	**10,132**	**3,243**	**8,713**	**2,569**	**154,255**

	Land and buildings	*Furniture and fixtures*	*Computers and office equipment*	*Motor vehicles*	*Leasehold improvements*	*Total*
Cost or revalued amount						
31 December 2017	**82,372**	**78,904**	**29,844**	**15,123**	**8,728**	**214,971**
Additions	1,632	2,284	4,551	1,789	862	**11,118**
Disposals	(345)	(1,206)	(1,055)	(382)	–	**(2,988)**
31 December 2018	**83,659**	**79,982**	**33,340**	**16,530**	**9,590**	**223,101**
Accumulated depreciation						
31 December 2017	**1,642**	**40,568**	**23,268**	**12,587**	**4,324**	**82,389**
Depreciation charge	1,629	6,899	3,600	1,381	879	**14,388**
Disposals	(8)	(1,206)	(1,052)	(346)	–	**(2,612)**
31 December 2018	**3,263**	**46,261**	**25,816**	**13,622**	**5,203**	**94,165**
Net book value						
31 December 2017	**80,730**	**38,336**	**6,576**	**2,536**	**4,404**	**132,582**
31 December 2018	**80,396**	**33,721**	**7,524**	**2,908**	**4,387**	**128,936**

(thousands of Georgian Lari)

10. Property and equipment (continued)

Buildings and land of the Group are subject to revaluation on a regular basis. The date of the latest revaluation was 31 December 2019. As a result of revaluation of land and buildings, the carrying value increased by ₾ 1,571, out of which ₾ 34 applied to previously impaired buildings, therefore respective revaluation gain was recognized in the statement profit or loss.

The gross carrying amount of fully depreciated property and equipment that is still in use is as follows:

	Furniture and fixtures	*Computers and office equipment*	*Motor vehicles*	*Leasehold improvements*	*Total*
Cost or revalued amount					
31 December 2019	17,059	22,330	11,314	918	**51,621**
31 December 2018	15,685	19,555	11,728	230	**47,198**

The Group's buildings are classified to Level 3 of the fair value hierarchy. There were no transfers among the levels of the fair value hierarchy in 2018.

If the land and buildings were measured using the cost model, the carrying amounts would be as follows:

	2019	*2018*
Cost	55,675	53,189
Accumulated depreciation and impairment	(11,589)	(10,475)
Net carrying amount	**44,086**	**42,714**

11. Intangible assets

The movements in intangible assets, which comprised computer software and licenses, were as follows:

	Computer software and licenses
Cost	
31 December 2017	**48,159**
Additions	13,637
31 December 2018	**61,796**
Additions	22,473
31 December 2019	**84,269**
Accumulated amortisation	
31 December 2017	**21,810**
Amortisation charge	7,335
31 December 2018	**29,145**
Amortisation charge	6,624
31 December 2019	**35,769**
Net book value	
31 December 2017	**26,349**
31 December 2018	**32,651**
31 December 2019	**48,500**

(thousands of Georgian Lari)

12. Right of use Assets and Lease liabilities

Set out below, are the carrying amounts of the Group's right–of–use assets and lease liabilities and the movements during the period:

	Right–of–use assets–buildings	*Lease liabilities*
As at 1 January 2019	**42,304**	**42,304**
Additions	5,317	5,034
Depreciation expense	(8,190)	–
Interest expense	–	2,215
Payments	–	(10,511)
Payment of VAT	–	890
Disposal	(5,989)	(5,652)
Depreciation of disposal	775	–
Foreign exchange	–	2,800
As at 31 December 2019	**34,217**	**37,080**

Group recognized rent expense from short–term leases of GEL 2,062.

The Group had total cash outflows for leases of GEL 10,511 in 2019 (2018: GEL 6,319).

13. Taxation

The corporate income tax expense comprised:

	2019	*2018*
Current year tax charge	–	5,463
Deferred tax charge – origination and reversal of temporary differences	1,857	2,762
Income tax expense	**1,857**	**8,225**

On 12 June 2018 amendment to the current corporate taxation model applicable to financial institutions, including banks and insurance business became effective. The change implies a zero corporate tax rate on retained earnings and a 15% corporate tax rate on distributed earnings starting from 1 January 2023, instead of 1 January 2019, as previously enacted in 2016. The change had an immediate impact on deferred tax asset and liability balances attributable to previously recognized temporary differences arising from prior periods. As at 31 December 2018, the deferred tax assets and liabilities were remeasured in line with the new date for the change to be implemented. During the transitional period the Group will only continue to recognize the portion of deferred tax assets and liabilities arising on items charged or credited to income statement during the same period, which it expects to utilize before 1 January 2023. The Group used 0% tax rate applicable for undistributed profits in respect of assets and liabilities expected to be realised or settled in the periods after January 2023.

The tax rate for banks for profits other than on state securities was 15% for 2019 and 2018. The tax rate for interest income on state securities and the NBG deposits is 0%.

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2019	*2018*
Profit before income tax expense	**38,770**	**65,425**
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	**5,815**	**9,814**
Non–taxable income	(4,085)	(3,359)
Effect of changes in income tax legislation	–	1,653
Non–tax deductible expenses	127	117
Income tax expense	**1,857**	**8,225**

(thousands of Georgian Lari)

13. Taxation (continued)

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

	2017	*Effect of adoption of IFRS 9*	*In the statement of profit or loss*	*2018*	*In the statement of profit or loss*	*In the statement of comprehen–sive income*	*2019*
Tax effect of deductible temporary differences							
Loans to customers	–	607	(600)	7	(7)	–	–
Tax loss carried forward	–	–	–	–	684	–	684
Other assets	8	–	351	359	145	–	504
Lease liabilities	–	–	–	–	5,562	–	5,562
Other liabilities	2,094	–	301	2,395	(1,715)	–	680
Deferred tax asset	**2,102**	**607**	**52**	**2,761**	**4,669**	**–**	**7,430**
Tax effect of taxable temporary differences							
Loans to customers	(747)	–	747	–	(973)	–	(973)
Right of use assets	–	–	–	–	(5,132)	–	(5,132)
Property and equipment and intangible assets	(1,289)	–	(3,561)	(4,850)	(421)	(236)	(5,507)
Deferred tax liabilities	**(2,036)**	**–**	**(2,814)**	**(4,850)**	**(6,526)**	**(236)**	**(11,612)**
Net deferred tax assets/ (liabilities)	**66**	**607**	**(2,762)**	**(2,089)**	**(1,857)**	**(236)**	**(4,182)**

14. Other assets, prepayments and other liabilities

Other assets comprise:

	2019	*2018*
Guarantee deposits placed	2,748	2,427
Investment properties	2,619	2,583
Inventories	2,539	2,369
Prepaid taxes other than income tax	2,496	1,496
Derivative asset	2,433	707
Repossessed property	936	933
Receivable from guarantees paid	900	899
Receivables from remittances systems operators	183	1,362
Investment in associate	805	1,524
Other	6,859	8,738
Total	**22,518**	**23,038**
Less – allowance for impairment of other assets	(2,354)	(2,633)
Other assets	**20,164**	**20,405**

Investment properties primarily comprise of class B office space located in downtown Zugdidi with total rental space of 1,582 square meters and several other properties located outside of Tbilisi.

Investment properties are stated at fair value. The fair value represents the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The date of latest revaluation was 31 December 2019. The valuation was performed by an accredited independent valuator with a recognised and relevant professional qualification and with recent experience in the locations and categories of the investment properties being valued. The valuation models in accordance with those recommended by the International Valuation Standards Committee have been applied and are consistent with the principles in IFRS 13. Refer to *Note 25* for details.

There were no significant movements in investment properties except for the fair value revaluation.

(thousands of Georgian Lari)

14. Other assets, prepayments and other liabilities (continued)

The Group's investment properties items are classified to Level 3 of the fair value hierarchy. There were no transfers among the levels of the fair value hierarchy in 2019.

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

	2019				*2018*			
	Notional amount		*Fair values*		*Notional amount*		*Fair value*	
	Asset	*Liability*	*Asset*	*Liability*	*Asset*	*Liability*	*Asset*	*Liability*
Foreign exchange contracts								
Forwards and swaps – domestic	208,742	(206,863)	2,068	(1,562)	95,651	(94,871)	707	(192)
Forwards and swaps – foreign	17,765	(45,697)	365	(6,340)	–	(69,688)	–	(8,407)
Total derivative assets/liabilities	**226,507**	**(252,560)**	**2,433**	**(7,902)**	**95,651**	**(164,559)**	**707**	**(8,599)**

As of 31 December 2019 the Group has positions in the following types of derivatives:

Forwards

Forward contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customized contracts transacted in the over–the–counter market.

The Group's forward is classified to Level 2 of the fair value hierarchy. There were no transfers among the levels of the fair value hierarchy in 2019.

Prepayments comprise:

	2019	*2018*
Prepayments for fixed and intangible assets	5,284	9,188
Prepayments for professional services	494	1,534
Prepaid insurance	314	399
Prepaid rent	202	–
Other	639	874
Total prepayments	**6,933**	**11,995**

Other liabilities comprise:

	2019	*2018*
Derivative liability	7,902	8,599
Funds pending settlements	3,476	4,771
Bonus accrual	4,385	10,663
Taxes payable other than income tax	2,297	771
Sundry creditors	997	1,143
Provision for various contingencies including guarantees and commitments	–	211
Other	4,328	3,036
Other liabilities	**23,385**	**29,194**

(thousands of Georgian Lari)

15. Credit loss expense and other impairment and provisions

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

31 December 2019	*Note*	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Amounts due from credit institutions	7	239	–	–	**239**
Loans to customers at amortised cost	8	(6,466)	(874)	33,736	**26,396**
Debt securities measured at amortised cost	9	(250)	–	–	**(250)**
Financial guarantees	20	(139)	–	–	**(139)**
Total credit loss expense		**(6,616)**	**(874)**	**33,736**	**26,246**

31 December 2018	*Note*	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Amounts due from credit institutions	7	51	–	–	**51**
Loans to customers at amortised cost	8	(461)	738	35,571	**35,848**
Debt securities measured at amortised cost	9	(126)	–	–	**(126)**
Financial guarantees	20	47	–	–	**47**
Total credit loss expense		**(489)**	**738**	**35,571**	**35,820**

The movements in other impairment allowances and provisions were as follows:

	Other assets	*Provision for various contingencies including guarantees and commitments*	*Total*
31 December 2018	**2,633**	**164**	**2,797**
Charge/(reversal)	857	(103)	**754**
Write–offs	(1,136)	78	**(1,058)**
31 December 2019	**2,354**	**139**	**2,493**

	Other assets	*Provision for various contingencies including guarantees and commitments*	*Total*
31 December 2017	**2,792**	**215**	**3,007**
Reversal	(170)	(48)	**(218)**
Write–offs	–	(3)	**(3)**
Recoveries	11	–	**11**
31 December 2018	**2,633**	**164**	**2,797**

Provisions for claims, guarantees and commitments are recorded in other liabilities.

(thousands of Georgian Lari)

16. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2019	*2018*
Current accounts	9,586	7,414
Time deposits and loans	87,815	799
Amounts due to credit institutions	**97,401**	**8,213**

On 26 December 2019 the Group obtained a loan from the NBG in amount of GEL 60,000 maturing on 3 January 2020. Deposits of GEL 27,000 were placed by three commercial banks on 31 December 2019, maturing on 3 January 2020. The loan and deposits were fully repaid at the maturity date.

17. Amounts due to customers

Amounts due to customers comprise:

	2019	*2018*
Current accounts	887,487	841,516
Time deposits (including certificates of deposits)	677,601	640,733
Amounts due to customers	**1,565,088**	**1,482,249**
Held as security against guarantees issued (Note 20)	4,829	3,884

At 31 December 2019, amounts due to customers of ₾ 200,247 (12.8%) were due to the ten largest customers (31 December 2018: ₾ 229,976 (15.6%)).

Amounts due to customers include accounts with the following types of customers:

	2019	*2018*
Individuals	1,081,749	996,169
State and public sector	228,340	281,711
Private enterprises	254,999	204,369
Amounts due to customers	**1,565,088**	**1,482,249**

Amounts due to customers by economic sector are as follows:

	2019	*2018*
Individuals	1,081,749	996,169
State and public sector	228,340	281,711
Trade and service	67,910	41,615
Non–banking financial organisations	36,844	30,456
Transportation and communication	29,859	35,350
Real estate constructions	6,552	3,559
Agriculture	1,323	226
Energy	571	754
Mining industry	346	–
Other	111,594	92,409
Amounts due to customers	**1,565,088**	**1,482,249**

(thousands of Georgian Lari)

18. Subordinated debt

In November 2014, the Group commenced the sale of unsecured Subordinated Loan Contracts (the "SLCs") to high net worth individuals and corporate clients. The Group does not have subordinated liabilities, that exceed 10% of total subordinated debt. The primary reason for the issuance of the SLCs was to attract Tier 2 qualified capital to support the Group's capitalization.

As of 31 December 2019, the Group had ₾ 100,031 (31 December 2018: ₾ 48,122) of Subordinated Debt outstanding, of which the amortised value of qualified for the inclusion in the Tier 2 capital under the NBG Basel III requirements, were ₾ 92,835 (31 December 2018: ₾ 41,715), respectively.

	Subordinated debt
Carrying amount at 1 January 2018	**105,753**
Proceeds from issue	66,051
Repayment	(122,196)
Foreign currency translation	(1,109)
Other	(377)
Carrying amount at 31 December 2018	**48,122**
Proceeds from issue	121,983
Repayment	(74,218)
Foreign currency translation	3,917
Other	277
Carrying amount at 31 December 2019	**100,031**

19. Equity

Share capital

As of 31 December 2019, the authorised share capital of the Bank comprised 7,500,000,000 ordinary shares, of which 5,502,254,354 were issued, 5,462,874,502 ordinary shares were fully paid of which 1,013,828,327 shares represented treasury shares (31 December 2018: the authorised share capital was 7,500,000,000 ordinary shares, of which 5,502,254,354 were issued and 5,462,874,502 were fully paid including 1,013,828,327 treasury shares). Each share has nominal value of ₾ 0.01. From the total number of ordinary shares issued, 39,379,845 (2018: 39,379,845) shares have been sold on a deferred payment basis to Stichting Liberty ESOP and are attributable to the share based compensation programme.

Movements in the fully paid and repurchased ordinary and the convertible preferred shares are described below:

	Number of shares		***Nominal amount***		
	Convertible preferred	***Ordinary***	***Convertible preferred***	***Ordinary***	***Total***
1 January 2018	**6,139,064**	**4,395,051,697**	**6,139**	**43,951**	**50,090**
Increase in share capital	–	22,394,500	–	224	224
Conversion of convertible preferred shares into ordinary	(1,573,680)	31,600,000	(1,574)	316	(1,258)
31 December 2018	**4,565,384**	**4,449,046,197**	**4,565**	**44,491**	**49,056**
31 December 2019	**4,565,384**	**4,449,046,197**	**4,565**	**44,491**	**49,056**

The share capital of the Bank was contributed by the shareholders in ₾ and they are entitled to dividends and any capital distribution in ₾.

As of 31 December 2019 and 2018, the book value per ordinary share comprised ₾ 0.0705 and ₾ 0.0593, respectively.

(thousands of Georgian Lari)

19. Equity (continued)

Treasury shares

On 12 November 2015, the Group commenced the buyback of ordinary shares (the "Buyback") at ₾ 0.0179 per ordinary share, with the maximum number of 1,045,428,327 ordinary shares or 19.00% of the total number of issued and outstanding ordinary shares.

The Buyback period was set as 90 calendar days from announcement date, up until 10 February 2016. As of 31 December 2016, the Group bought back and fully settled 1,045,428,327 ordinary shares (19.00% of the total number of shares issued and outstanding).

In 2018, the Group converted 1,573,680 preferred shares into 31,600,000 ordinary shares, which resulted in reduction of treasury shares down to 2018: 1,013,828,327. In 2019 there have been no conversions.

The consideration paid, including any attributable transaction costs is deducted from total equity as treasury shares until they are cancelled or reissued. Treasury shares are stated at the weighted average cost.

Convertible preferred shares

In August 2012, the Bank issued and made available for sale to the general public in a public offer in Georgia 10,000,000 non–redeemable convertible preferred shares at the gross placement price of ₾ 1 per convertible preferred share (with the permissible size of the public offer subsequently increased to 30,000,000 convertible preferred shares), of which 4,565,384 convertible preferred shares were outstanding and fully paid–up as of 31 December 2019 (2018: 4,565,384). The public offer period expired on 31 December 2015. The convertible preferred shares are perpetual and can be converted, at the holder's discretion, into ordinary shares of the Bank at the conversion price based on 1.05 times the IFRS audited ordinary equity book value of the Bank per ordinary share outstanding (net of any treasury shares) as of the end of the preceding calendar year.

The dividend rate on the convertible preferred shares is 17% per annum, payable annually, subject to the AGM approval in each given year. The dividends are non–cumulative. The conversion option was classified as equity component as of the initial recognition date.

The ability to pay dividends is subject to the Bank's financial condition and results of operations and compliance with the prudential capital adequacy requirements and may be restricted by, among other things, applicable laws and regulations, and by the NBG.

Basic/diluted earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period (net of any treasury shares). Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding of the effect of all dilutive potential ordinary shares (but ignoring any treasury shares), which comprise share options granted to employees and the convertible preferred shares.

In 2019, net profit attributable to ordinary shareholders of the Bank comprised ₾ 36,913 (2018: ₾ 57,200) and the weighted average number of ordinary shares outstanding during the year was 4,509,550,410 (2018: 4,477,950,410), resulting in earnings per share of ₾ 0.00801 for 2019 (2018: ₾ 0.01260).

At 31 December 2019, the convertible preferred shares did not have a dilutive effect as the conversion price of ₾ 0.050 exceeded the quoted weighted average market price for the period of ₾ 0.032. At 31 December 2018, the convertible preferred shares did not have a dilutive effect as the conversion price of ₾ 0.050 exceeded the quoted weighted average market price as of the end of reporting period ₾ 0.039. Thus, the potential dilution did not include the potential effect from the conversion of 4,565,384 convertible preferred shares into ordinary shares as of 31 December 2018.

Dividends

The Bank did not pay dividends on its ordinary shares in 2019 (2018: nill). The Bank paid dividends on the convertible preferred shares in the amount of ₾ 775 in 2019 (2018: ₾776).

(thousands of Georgian Lari)

19. Equity (continued)

Other reserves

Movements in other reserves were as follows:

	Revaluation reserve for property and equipment
At 1 January 2018	**16,414**
Revaluation reserve of sold assets, net of tax	(176)
Depreciation of revaluation reserve, net of tax	(325)
At 31 December 2018	**15,913**
Revaluation reserve, net of tax	1,301
Depreciation of revaluation reserve, net of tax	(324)
At 31 December 2019	**16,890**

Nature and purpose of other reserves

Revaluation reserve for property and equipment

The revaluation reserve for property and equipment is used to record increases in the fair value of the buildings and decreases to the extent that such decrease relates to an increase on the same asset previously recognised in equity.

20. Commitments and contingencies

Operating environment

As an emerging market, Georgia does not possess a well–developed business and regulatory infrastructure that would generally exist in a more mature market economy. Operations in Georgia may involve risks that are not typically associated with those in developed markets (including the risk that the Georgian Lari is not freely convertible outside the country, and undeveloped debt and equity markets). However, over the last few years the Georgian government has made a number of developments that positively affect the overall investment climate of the country, specifically implementing the reforms necessary to create banking, judicial, taxation and regulatory systems. This includes the adoption of a new body of legislation (including new Tax Code and procedural laws). In the view of the Board, these steps contribute to mitigate the risks of doing business in Georgia.

The existing tendency aimed at the overall improvement of the business environment is expected to persist. The future stability of the Georgian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Government. However, the Georgian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world.

Legal

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

(thousands of Georgian Lari)

20. Commitments and contingencies (continued)

Financial commitments and contingencies

The Group's commitments and contingencies comprised the following:

	2019	*2018*
Credit related commitments		
Guarantees	17,948	8,039
Undrawn loan commitments	93,613	73,303
	111,561	**81,342**
Operating lease commitments		
Not later than 1 year	1,653	11,412
Later than 1 year but not later than 5 years	1,012	29,470
Later than 5 years	230	13,379
	2,895	**54,261**
Capital expenditure commitments	4,190	7,622
Commitments and contingencies (before deducting collateral)	**118,646**	**143,225**
Less – cash held as security against guarantees issued *(Note 17)*	(4,829)	(3,884)
Commitments and contingencies	**113,817**	**139,341**

As of 31 December 2019 and 31 December 2018, the Bank had Bankers Blanket Bond insurance, Directors and Officers liability insurance, and Property and Vehicle insurance coverage.

All commitments are allocated to stage 1 and there were no significant movements in ECL during the year.

21. Net fee and commission income

Net fee and commission income comprise:

	2019	*2018*
Plastic card operations	13,001	9,749
Settlements operations	11,844	12,657
Remittances	3,070	3,704
Cash operations	2,681	2,281
Fee income received from bill payments	1,512	2,422
Guarantees and letters of credit	225	102
Other	244	143
Fee and commission income	**32,577**	**31,058**
Plastic card operations	(8,598)	(6,375)
Fee expense paid for bill payments	(591)	(669)
Settlements operations	(941)	(947)
Cash operations	(222)	(69)
Guarantees and letters of credit	(25)	–
Fee and commission expense	**(10,377)**	**(8,060)**
Net fee and commission income	**22,200**	**22,998**

(thousands of Georgian Lari)

21. Net fee and commission income (continued)

Revenue from contracts with customers

The Group's revenue from contracts with customers is mostly represented by fee and commission income. Revenue from contracts with customers recognized in the statement of profit or loss for the year ended 31 December 2019 amounted to ₾ 32,578 (2018: ₾ 31,058).

The Group recognised the following contract assets and liabilities in consolidated statement of financial position related to its contracts with customers:

	2019	*2018*
Accrued income receivable (presented within other assets)	–	120

The Group applies the practical expedient in paragraph 121 of IFRS 15 and does not disclose information about remaining performance obligations that have original expected durations of one year or less.

22. Other income

Other income comprise:

	2019	*2018*
Income from penalty on late payments on customer loans and advances	9,555	13,188
Modification gain from right of use assets	524	–
Gain from sale of assets	366	286
Income from rent	18	289
Other	2,182	5,268
Total other income	**12,645**	**19,031**

23. Personnel and general and administrative expenses

Personnel and general and administrative expenses comprise:

	2019	*2018*
Salaries	61,433	52,996
Variable monthly bonuses	5,315	7,281
Performance based discretionary bonus pool	4,385	7,193
Personnel expenses	**71,133**	**67,472**

Average number of employees for the year:

	2019	*2018*
Permanent employment:		
Top Management	7	7
Middle Management	213	286
Other employees	4,569	4,663
Temporary employment:		
Other employees	519	703
Total	**5,308**	**5,659**

(thousands of Georgian Lari)

23. Personnel and general and administrative expenses (continued)

	2019	*2018*
Office supplies	4,199	3,009
Marketing and advertising	3,606	1,978
Legal and other professional services	3,082	2,657
Communications	3,078	3,332
Occupancy and rent	2,788	10,327
Operating taxes	2,320	1,382
Utility expense	2,286	2,203
Repair and maintenance	1,675	1,613
Security	852	965
Corporate hospitality and entertainment	686	575
Travel expenses	623	580
Insurance	580	832
Audit, audit related and other service expenses	400	300
Other	2,960	3,342
General and administrative expenses	**29,135**	**33,095**

Remuneration of the Bank's auditor for the years ended 31 December 2019 and 2018 comprises (net of VAT):

	2019	*2018*
Fees for the audit of the Bank's annual financial statements for the year ended 31 December	306	268
Expenditures for other professional services	111	–
Total fees and expenditures	**417**	**268**

Fees and expenditures payable to other auditors and audit firms in respect of other professional services comprised ₾ 79 (2018: ₾ 76).

24. Risk management

Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. The Group is exposed to credit risk, liquidity risk, market risk, operational risk and other non–financial risks. The risk management framework adopted by the Group sets the boundaries of risk bearing capacity for each risk and business line and ensures its compliance.

The responsibility of the individuals responsible for risk management is to ensure the compliance of the Group to the Risk Appetite Statement ("RAS") set by the Supervisory Board of the Bank. The compliance is ensured by continuous monitoring of the RAS parameters and proposing any changes to these parameters when circumstances change. The Enterprise Risk Management ("ERM") Division has the overall responsibility for monitoring of the RAS set by the Supervisory Board. RAS establishes escalation routes for trigger events and limits breaches in order to timely and effectively initiate and implement pre–defined mitigation actions. For the purposes of effective inclusion into daily activities of the Group, RAS parameters are detailed into more granular business unit and transactional levels. With the active involvement of Management Board risk management functions ensure proper communication and clarity at all levels regarding risk objectives, constant monitoring of risk profile against risk appetite, timely escalation of risk–related alerts and design of mitigating actions.

(thousands of Georgian Lari)

24. Risk management (continued)

Risk management framework and structure

The Supervisory Board of the Bank has overall responsibility for the establishment and oversight of the Group's risk management framework. The Supervisory Board has established committees, which are responsible for developing and monitoring Group risk management policies in relevant specified areas, which are communicated through RAS.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Group, through its management standards, procedures and trainings aims, has a disciplined and constructive control environment, in which all employees understand their roles and obligations.

Audit Committee

The Audit Committee is responsible for monitoring compliance with the Group's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Group. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions. The Audit Committee is assisted in these functions by Internal Audit.

Internal Audit

Risk management processes throughout the Group are audited by the internal audit function, which examines, by undertaking regular and ad–hoc reviews, both the adequacy of the procedures and the Group's compliance with the procedures. Internal Audit discusses the results of all assessments with the Management Board, and reports its findings and recommendations to the Audit Committee.

Other structural units

The Supervisory Board is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks. Risk Appetite metrics are set by the Supervisory Board and monitored by the following committees and units with the active involvement of Management Board:

- Credit risk is managed by the Credit Risk Committees;
- Liquidity risk is managed by Asset–Liability Committee ("ALCO");
- Market risk is managed by ALCO;
- Operational risk is managed by the Operational Risk Management Department with close cooperation of Management Board;
- Information security and technology risks are managed by Information Security Department.

All committees have representatives of all relevant business units and report regularly to the Management Board.

Business lines represent the primary owners of risks affecting daily activities and operations within the Group. Business processes incorporate controlling activities performed by the relevant risk unit representatives. Units with risk management functions represent the second line of defense. The following departments are responsible for day–to–management of credit, liquidity, market, operational and other financial risks:

- Enterprise Risk Management;
- Credit Underwriting;
- Credit Administration;
- Credit Controlling;
- Collections;
- Operational Risk Management;
- Information Security.

Anti–Money Laundering ("AML") and Compliance Risks are managed by Operational Risk Management Department. Collections function is divided into two broad sub–functions, each responsible for leading and monitoring collection process per types of outstanding receivables.

Business lines represent the primary owners of risks affecting daily activities and operations within the Group. Business processes incorporate day–to–day involvement of risk management representatives, with focus on risk identification, analysis, evaluation and treatment.

(thousands of Georgian Lari)

24. Risk management (continued)

Risk measurement and reporting systems

The Group's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience.

Monitoring and controlling risks is primarily performed based on limits established by the RAS. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Management Board, and the head of each business division. Senior management assesses the appropriateness of the allowance for expected credit losses on a monthly basis.

For all levels throughout the Group, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up–to–date information.

Risk mitigation

The Group uses collaterals (precious metals, real estate, deposits, securities, movable property, receivables and company shares) and diversification to mitigate its credit risks.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location. The Group risk management functions ensure that potential negative impact from concentration is identified in a timely manner, respective risks properly measured and evaluated, and, ultimately, responsive actions planned and realised. RAS sets overall limits on excessive credit risk, liquidity and market risk concentrations.

Credit risk

Credit risk is the risk that the Group will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Group manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. The credit quality review process allows the Group to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Actual exposure per borrower against limits is monitored on loans granted. The Credit Committee may initiate a change in the limits.

Where appropriate, the Group obtains collateral and corporate guarantees. The credit risks are monitored on a continuous basis and are subject to annual or more frequent reviews.

Credit–related commitments risks

The Group makes available to its customers guarantees which may require that the Group make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Group to similar risks to loans and these are mitigated by the same control processes and policies.

(thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

Impairment assessment

The Group 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, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

The ECL allowance is based on the 12 months' expected credit loss (12mECL), unless there has been significant increase in credit risk since origination or other impairment indicators were identified, in which case 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). The 12mECL 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 either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments.

The Group 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 Group groups its loans into Stage 1, Stage 2, Stage 3 and POCI, as described below:

Stage 1:	When loans are first recognised, the Group recognises an allowance based on 12mECL. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.
Stage 2:	When a loan has shown a significant increase in credit risk since origination, the Group 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 Group 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 Group considers a financial instrument defaulted and therefore Stage 3 (credit–impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Group considers amounts due from banks defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

(thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

As a part of a qualitative assessment of whether a customer is in default, the Group also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Group carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include:

- Internal rating of the borrower indicating default or near–default for individually significant exposures;
- The borrower requesting emergency funding from the Group;
- The death of the borrower;
- A material decrease in the underlying collateral value where the recovery of the loan is expected from the sale of the collateral;
- A material decrease in the borrower's turnover or the loss of a major customer;
- A covenant breach not waived by the Group;
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy;

It is the Group's policy to consider a financial instrument as 'cured' and therefore re–classified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

Internal rating and PD estimation process

The Group's independent Credit Risk Department operates through the S&P rating models based on scorecards for the significant exposures. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilise supplemental external information that could affect the borrower's behaviour. Where practical, they also build on information from the national and international external rating agencies. PDs, incorporating forward looking information and the IFRS 9 stage classification of the exposure, are assigned for each grade. This is repeated for each economic scenario as appropriate.

Treasury and interbank relationships

The Group's treasury and interbank relationships and counterparties comprise financial services institutions, banks, broker–dealers, exchanges and clearing–houses. For these relationships, the Group's credit risk department analyses publicly available information such as financial information and other external data, e.g., the external ratings, and assigns the internal rating, as shown in the table below.

Corporate and small business lending

For corporate loans, the borrowers are assessed by specialised credit risk employees of the Group. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward–looking information such as:

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention.
- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies, independent analyst reports, publicly traded bond prices or press releases and articles.
- Any macro–economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

The complexity and granularity of the rating techniques varies based on the exposure of the Group and the complexity and size of the customer. Some of the less complex small business loans are rated within the Group's models for retail products.

(thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

Consumer lending and residential mortgages

Homogenous retail loan groups are modeled based on the most relevant macroeconomic variables. Subsequently, each individual product is assigned an individual macroeconomic scenario. Each retail product is assigned a minimum of 3 macroeconomic variables. Other key inputs into the models are GDP growth, unemployment rates, changes in personal income/salary levels, personal indebtedness, monetary policy rate, nominal effective exchange rate (NEE), CPI inflation and for residential mortgages, LTV ratios.

Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too. To calculate the EAD for a Stage 1 loan, the Group assesses the possible default events within 12 months for the calculation of the 12mECL. For Stage 2, Stage 3 and POCI financial assets, the exposure at default is considered for events over the lifetime of the instruments.

Loss given default

For corporate lending assets, LGD values are assessed at semi–annually by account managers and reviewed and approved by the Group's credit risk department.

The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The Group segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type, wider range of collateral types) as well as borrower characteristics.

Where appropriate, further recent data and forward–looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward–looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in, collateral values including property prices for mortgages, commodity prices, payment status or other factors that are indicative of losses in the group.

LGD rates are estimated for the Stage 1, Stage 2, Stage 3 and POCI segment of each asset class. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries. These are repeated for each economic scenario as appropriate.

Significant increase in credit risk

The Group continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Group assesses whether there has been a significant increase in credit risk since initial recognition. This assessment involves analysis of various parameters including but not limited to deterioration of financial position and performance. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

Grouping financial assets measured on a collective basis

Dependent on the factors below, the Group calculates ECLs either on a collective or on an individual basis.

Asset classes where the Group calculates ECL on an individual basis include:

- From Stage 3 assets, only individually significant risk exposures, regardless of the class of financial assets;
- Stage 2 and Stage 3 Corporate and SME loans with exposures per borrower exceeding ₾ 300;
- Individually significant risk exposures are evaluated for credit losses on individual basis. According to the Group's methodology the minimum limit for individually significant risk exposures is ₾ 300.
- The exposures less than ₾ 300 can be subject to individual assessment based on the Group's management decision.
- The treasury and interbank relationships (such as amounts due from banks, cash equivalents and debt investment securities at amortised cost and FVOCI);

(thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

Asset classes where the Group calculates ECL on a collective basis include:

- ► The smaller and more generic balances of the Group's small business lending;
- ► All retail products.

The Group groups these exposures into smaller homogeneous portfolios, based on a combination of internal and external characteristics of the loans, for example overdue bucket, product type, loan–to–value ratios, or borrower's industry.

Forward–looking information and multiple economic scenarios

In its ECL models, the Group relies on a broad range of forward looking information as economic inputs, such as:

- ► GDP growth;
- ► Unemployment rates;
- ► Monetary policy rate;
- ► Foreign exchange rates.

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

The Group obtains the forward–looking information published by the National Bank of Georgia). Experts of the Group's Credit Risk Department determine the weights attributable to the multiple scenarios. The tables show the values of the key forward looking economic variables/assumptions used in each of the economic scenarios for the ECL calculations.

Key drivers	*ECL scenario*	*Assigned probabilities, %*	*2020*	*2021*	*2022*
Change in Country Sovereign Risk Premium*					
	Upside	25%	Unchanged	Unchanged	Unchanged
	Base case	50%	Unchanged	Unchanged	Unchanged
	Downside	25%	+1.5pp	+0.0pp	+0.0pp
GEL/USD Nominal Exchange Rate					
	Upside	25%	Appreciation 5%	Appreciation 3%	Unchanged
	Base case	50%	Appreciation 3%	Appreciation 3%	Appreciation 3%
	Downside	25%	Depreciation 10%	Appreciation 5%	Appreciation 5%
Real GDP Growth(YoY)					
	Upside	25%	5.5%	5.5%	5.0%
	Base case	50%	4.5%	5.0%	5.0%
	Downside	25%	2.5%	4.0%	4.5%
Change in Unemployment rate					
	Upside	25%	–0.5pp	–0.5pp	–0.25pp
	Base case	50%	–0.0pp	–0.25pp	–0.25pp
	Downside	25%	+1.0pp	+0.25pp	–0.0pp
CPI Inflation (YoY)					
	Upside	25%	3.5%	3.0%	3.0%
	Base case	50%	4.0%	2.5%	3.0%
	Downside	25%	5.0%	4.0%	3.0%
Monetary Policy Rate (%)					
	Upside	25%	–0.0pp	–0.50pp	–0.50pp
	Base case	50%	–0.50pp	–0.50pp	–0.50pp
	Downside	25%	–0.00pp	–1.00pp	–0.50pp
Nominal Effective Exchange Rate (NEER)	Upside	25%	Appreciation 3%	Appreciation 2%	Unchanged
	Base case	50%	Appreciation 2%	Appreciation 2%	Appreciation 2%
	Downside	25%	Depreciation 6%	Appreciation 3%	Appreciation 3%

(thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group internal credit ratings, as described above. The table below shows the credit quality by class of asset for loan–related lines in the consolidated statement of financial position, based on categories specified in the tables.

As of 31 December 2019	*Note*		*High grade*	*Standard grade*	*Sub–standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	7	Stage 1	207,077	–	–	–	**207,077**
Amounts due from credit institutions	9	Stage 1	124,482	–	–	–	**124,482**
Loans to customers at amortised cost	8		1,149,905	13,784	4,163	10,438	**1,178,290**
– Loans to clients with regular inflows		Stage 1	381,476	2,614	125	–	**384,215**
		Stage 2	1,215	371	543	–	**2,129**
		Stage 3	997	69	143	2,689	**3,898**
– Micro Loans		Stage 1	82,480	1,594	–	–	**84,074**
		Stage 2	1,781	213	563	–	**2,557**
		Stage 3	114	35	72	3,261	**3,482**
– Consumer Loans		Stage 1	145,294	4,625	–	–	**149,919**
		Stage 2	3,335	1,360	892	–	**5,587**
		Stage 3	281	64	64	3,580	**3,989**
– Residential mortgage loans		Stage 1	82,904	541	–	–	**83,445**
		Stage 2	646	109	425	–	**1,180**
		Stage 3	44	1	–	552	**597**
		Stage 1	118,628	863	–	–	**119,491**
– Gold Pawn Loans		Stage 2	–	–	277	–	**277**
		Stage 3	–	–	–	87	**87**
– Corporate and SME loans		Stage 1	310,386	1,325	–	–	**311,711**
		Stage 2	18,536	–	1,059	–	**19,595**
		Stage 3	–	–	–	269	**269**
Debt investment securities – Measured at amortised cost	9	Stage 1	146,506	–	–	–	**146,506**
Undrawn loan commitments	20	Stage 1	93,613	–	–	–	**93,613**
Financial guarantees	20	Stage 1	17,948	–	–	–	**17,948**
Total			**1,737,743**	**13,784**	**4,163**	**10,438**	**1,766,128**

(thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

As of 31 December 2018	*Note*		*High grade*	*Standard grade*	*Sub–standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	7	Stage 1	187,194	–	–	–	**187,194**
Amounts due from credit institutions	9	Stage 1	99,731	–	–	–	**99,731**
Loans to customers at amortised cost	8		916,803	15,842	5,878	14,225	**952,748**
– Loans to clients with regular inflows		Stage 1	391,516	1,661	53	–	**393,230**
		Stage 2	1,944	639	955	–	**3,538**
		Stage 3	–	–	–	3,606	**3,606**
– Micro Loans		Stage 1	89,220	2,893	–	–	**92,113**
		Stage 2	927	50	1,171	–	**2,148**
		Stage 3	–	–	–	3,016	**3,016**
– Consumer Loans		Stage 1	102,035	5,698	–	–	**107,733**
		Stage 2	3,341	1,485	2,553	–	**7,379**
		Stage 3	–	–	–	6,516	**6,516**
– Residential mortgage loans		Stage 1	58,798	802	–	–	**59,600**
		Stage 2	133	–	417	–	**550**
		Stage 3	–	–	–	490	**490**
		Stage 1	83,529	728	–	–	**84,257**
– Gold Pawn Loans		Stage 2	–	–	699	–	**699**
		Stage 3	–	–	–	386	**386**
– Corporate and SME loans		Stage 1	185,360	1,886	–	–	**187,246**
		Stage 2	–	–	30	–	**30**
		Stage 3	–	–	–	211	**211**
Debt investment securities – Measured at amortised cost	9	Stage 1	197,504	–	–	–	**197,504**
Undrawn loan commitments	20	Stage 1	73,002	–	–	–	**73,002**
Financial guarantees	20	Stage 1	7,978	–	–	–	**7,978**
Total			**1,482,212**	**15,842**	**5,878**	**14,225**	**1,518,157**

(thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

The credit risk assessment policy for financial assets has been determined by the Group for balance sheet exposures as follows:

- A financial asset that is not past due at the reporting date is assessed as a financial asset with high grade;
- A financial asset that is less than 30 days past due at the reporting date is assessed as a financial asset with standard grade;
- A financial asset that is past due more than 30 days and less than 90 day past the reporting date is assessed as a financial asset with sub–standard grade.

The credit risk assessment policy for financial assets has been determined by the Group for balance sheet exposures as follows:

- Grading for Undrawn loan commitments for clients, who have loans or any other balance sheet exposures are in line with balance sheet grade. For other undrawn loan commitments, conditional undrawn loan commitments are considered to be High grade. Unconditional undrawn loan commitments are graded in line with clients' credibility monitored by the Group's experts.
- Financial guarantees are considered High grade if the client performs under contractual conditions. If the client mostly performs well under the contract, it is classified as standard grade, while poor performance is considered sub–standard and breach of contract impaired.

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories. The attributable risk ratings are assessed and updated regularly.

Past due loans to customers include those that are only past due by a few days. An analysis of past due loans as at 31 December 2018, by age, is provided below.

The geographical concentration of the Group's assets and liabilities is set out below:

	2019				*2018*			
	Georgia	*OECD*	*CIS and other foreign countries*	*Total*	*Georgia*	*OECD*	*CIS and other foreign countries*	*Total*
Assets								
Cash and cash equivalents	399,334	12,455	3,977	**415,766**	291,306	98,517	3,076	**392,899**
Amounts due from credit institutions	124,482	–	–	**124,482**	99,731	–	–	**99,731**
Loans to customers	1,177,581	–	–	**1,177,581**	953,544	–	–	**953,544**
Investment securities	146,506	–	–	**146,506**	197,504	–	–	**197,504**
Other assets	263,811	3,635	3,191	**270,637**	188,253	7,087	1,215	**196,555**
	2,111,714	**16,090**	**7,168**	**2,134,972**	**1,730,338**	**105,604**	**4,291**	**1,840,233**
Liabilities								
Amounts due to credit institutions	94,745	–	2,656	**97,401**	3,564	–	4,649	**8,213**
Amounts due to customers	1,416,600	69,453	79,035	**1,565,088**	1,341,860	65,219	75,170	**1,482,249**
Subordinated debt	63,720	24,347	11,964	**100,031**	20,089	18,958	9,075	**48,122**
Lease liability	37,080	–	–	**37,080**	–	–	–	–
Other liabilities	21,669	3,166	2,732	**27,567**	29,419	1,295	569	**31,283**
	1,633,814	**96,966**	**96,387**	**1,827,167**	**1,394,932**	**85,472**	**89,463**	**1,569,867**
Net assets/(liabilities)	**477,900**	**(80,876)**	**(89,219)**	**307,805**	**335,406**	**20,132**	**(85,172)**	**270,366**

(thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

Prepayment risk

Prepayment risk is the risk that the Group will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall.

The Group monitors actual and expected loan prepayments or potential late repayment requests and takes necessary actions to prevent or minimize potential loss by taking best possible actions. The group proactive conducts negotiations to new potential borrowers to compensate the interest income shortage due to early repayment. Any extra liquidity is invested in interest earning assets based on the internal liquidity management practices.

The effect on profit before tax for one year and on equity, assuming 10% of repayable financial instruments were to prepay at the beginning of the year, with all other variables held constant, is as follows:

	Effect on net interest income	*Effect on equity*
2019	(24,369)	(20,714)
2018	(29,722)	(25,263)

Liquidity risk and funding management

Liquidity risk management and supervision

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. Other objectives include securing a balanced financing mix for the Group's activities, compliance with standards set by the NBG, managing crisis situations and controlling the cost of funding.

The main liquidity risk mitigation techniques are building liquidity reserves, diversifying funding sources and extending financing maturities. However, significant liquidity in excess of statutory requirements due to unexpected net cash inflows should be avoided and the Management Board should examine options to reduce liquidity to an appropriate level.

The Treasury Department is responsible for the management of the liquidity and funding risk within targets, boundaries and limits being set out in the RAS. The Treasury Department manages the liquidity risk on a centralised level and reports to the Management Board at least weekly. Key decisions on liquidity risk management and monitoring are taken by the ALCO. Input for analysis for ALCO purposes is presented by Treasury Department and ERM Division. ERM performs additional monthly stress–tests on liquidity position of the Bank and reports the results to the ALCO.

The Bank maintains a Recovery Plan which includes pressure on liquidity triggers and recovery plan strategy. Since the precise nature of any stress event cannot be known in advance, the plans are designed to be flexible to the nature and severity of the stress event and provide a menu of options that could be used as appropriate at the time. The liquidity triggers are monitored by Treasury Department and ERM Division on a daily basis. Any potential trigger event is escalated to the Management Board level and should be discussed at the ALCO meeting. Recovery Plan contains step–by–step actions, to generate additional liquidity in order to facilitate recovery in a severe stress, and is executed by the Head of Treasury Department under the supervision of ALCO and Management Board.

The Group uses stress testing and scenario analysis to evaluate the impact of a sudden and severe stress events on its liquidity position. The scenarios cover the Group–specific and market related risk events.

Statutory requirement

The NBG requires all banks in Georgia to maintain average liquidity ratio, calculated as the ratio of average liquid assets to average liabilities for the respective month, including borrowings from financial institutions and part of off–balance sheet liabilities with residual maturity of up to 6 months, of no less than 30.0%. The Bank's average liquidity ratio for the month was 43.0% as of 31 December 2019 (31 December 2018: 45.4%).

Approved and published on 15 May 2017 by the NBG (Decree N70/04), liquidity coverage ratio (LCR) regulation, became effective on 1 September 2017. The LCR is calculated following Basel III framework, however, higher run–off rates apply. The NBG requires all banks to maintain the LCR of 75.0% in ₾, and LCR of 100.0% in foreign currency and total LCR of 100% on a daily basis. As of 31 December 2019, the Bank's total LCR stood at 159.6%, the LCR in ₾ was 121.6% and the LCR in foreign currency was 216.6% (31 December 2018: total LCR stood at 184.6%, the LCR in ₾ was 183.5% and the LCR in foreign currency was 186.5%).

(thousands of Georgian Lari)

24. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis by remaining contractual maturities

The tables below summarise the maturity profile of the Group's financial liabilities as of 31 December 2019 and as of 31 December 2018 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

As of 31 December 2019	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Non–derivative financial liabilities					
Amounts due to credit institutions	96,724	819	–	–	**97,543**
Amounts due to customers	1,061,212	406,950	134,442	747	**1,603,351**
Lease liability	2,218	5,986	23,955	11,913	**44,072**
Subordinated debt	1,837	6,508	59,487	74,834	**142,666**
Total undiscounted financial liabilities	**1,161,991**	**420,263**	**217,884**	**87,494**	**1,887,632**
Derivative financial instruments – gross settled					
Positive fair value of derivatives					
(Inflow)	(58,852)	(23,340)	(18,247)	–	**(100,439)**
Outflow	57,213	21,988	17,765	–	**96,966**
Derivative financial instruments – gross settled					
Negative fair value of derivatives					
(Inflow)	(117,178)	(15,283)	(32,566)	–	**(165,027)**
Outflow	117,667	16,911	38,781	–	**173,359**

As of 31 December 2018	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Non–derivative financial liabilities					
Amounts due to credit institutions	7,415	798	–	–	**8,213**
Amounts due to customers	1,012,791	327,695	186,544	1,009	**1,518,039**
Subordinated debt	712	2,693	44,024	17,515	**64,944**
Total undiscounted financial liabilities	**1,020,918**	**331,186**	**230,568**	**18,524**	**1,601,196**
Derivative financial instruments – gross settled					
Positive fair value of derivatives					
(Inflow)	(54,097)	–	–	–	**(54,097)**
Outflow	53,258	–	–	–	**53,258**
Derivative financial instruments – gross settled					
Negative fair value of derivatives					
(Inflow)	(41,554)	(5,466)	(54,093)	–	**(101,113)**
Outflow	41,613	6,226	63,462	–	**111,301**

(thousands of Georgian Lari)

24. Risk management (continued)

Liquidity risk and funding management (continued)

The table below shows the contractual expiry by maturity of the Group's financial commitments and contingencies. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
2019	102,757	9,889	5,766	231	**118,643**
2018	82,393	14,067	33,335	13,430	**143,225**

The Group expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than three months in the tables above.

Maturity analysis of assets and liabilities

Treasury Department manages the maturity analysis of assets and liabilities. Modeling of assets and liabilities is necessary where contractual maturity does not adequately reflect the liquidity risk position. The most significant example in this context for the Group would be current and savings accounts from retail, corporate and municipal and other state entities. Although, contractually, current accounts are repayable on demand and savings accounts at short notice, the Bank's broad base of customers – numerically and by depositor type – helps protect against unexpected fluctuations in balances. Such accounts form a stable funding base for the Group's operations and liquidity needs. Table below shows the maturity analysis of the Group's monetary assets and liabilities according to when they are expected to be recovered or settled.

	2019			*2018*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	415,766	–	**415,766**	392,899	–	**392,899**
Amounts due from credit institutions	124,482	–	**124,482**	99,731	–	**99,731**
Loans to customers	532,041	645,540	**1,177,581**	549,027	404,517	**953,544**
Investment securities	40,461	106,045	**146,506**	87,173	110,331	**197,504**
Total	**1,112,750**	**751,585**	**1,864,335**	**1,128,830**	**514,848**	**1,643,678**
Amounts due to credit institutions	97,401	–	**97,401**	8,213	–	**8,213**
Amounts due to customers, of which:	772,238	792,850	**1,565,088**	778,605	703,644	**1,482,249**
– Current accounts	209,892	677,595	**887,487**	304,276	537,240	**841,516**
– Time deposits (including certificates of deposit)	562,346	115,255	**677,601**	474,329	166,404	**640,733**
Lease liability	5,940	31,140	**37,080**	–	–	–
Subordinated debt	–	100,031	**100,031**	113	48,009	**48,122**
Total	**875,579**	**924,021**	**1,799,600**	**786,931**	**751,653**	**1,538,584**
Net	**237,171**	**(172,436)**	**64,735**	**341,899**	**(236,805)**	**105,094**

(thousands of Georgian Lari)

24. Risk management (continued)

Liquidity risk and funding management (continued)

The maturity of the assets is based on their carrying amounts and upon earliest legally exercisable maturity as of 31 December of the year concerned. The maturity of liabilities is based on the earliest contractual maturity or first call. The portion of current and savings accounts is presented in more than one year maturity range due to their stability. Customer deposits diversification by number and type of depositors and the past experience of the Group indicate that such accounts and deposits provide a long term and stable source of funding, and as a result they are allocated per expected time of the funds outflow in the gap analysis table on the basis of the statistical data accumulated by the Group during the previous periods and assumptions made regarding the "permanent" part of current account balances.

As of 31 December 2019, total Amounts due to customers amounted to ₾ 1,565,088 (as of 31 December 2018: ₾ 1,482,249), of which current accounts comprised 604,470 (as of 31 December 2018: ₾ 841,516). The Bank conducts the analysis of the stability of the current account balances for the period of the preceding two years on a daily basis. These balances have not fallen below ₾ 542,168 (2018: ₾ 537,240) for the respective periods of the preceding 24 months. As such, it is reasonable to present these funds in Amounts due to customers in more than one year maturity range in the above schedule. If the contractual maturities of Amounts due to customers were considered, the cumulative liquidity gap within one year as of 31 December 2019 would have been negative 318,409 (31 December 2018: negative ₾ 195,341).

As of 31 December 2019, the Bank had sufficient liquid collateral to additionally draw down ₾ 93,579 (2018: ₾ 181,403) from the NBG at immediate notice.

Market risk

Market risk is the risk that affect the overall performance of the financial market. The main types of market risks include interest rates risk, currency risk and their levels of volatility. Market risk arises mainly from trading activities. The Group is not exposed to market risk related to trading activities, since the Bank, in line with its risk appetite, is not engaged in trading activities. The market risk related to the banking activities encompasses the risk of loss on equity holdings, and the interest rate and foreign exchange risk stemming from banking intermediation activities. The Bank is exposed to interest rate and foreign exchange risks in its banking books.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments.

The sensitivity of the consolidated statement of profit or loss is the effect of the assumed changes in interest rates on the net interest income for one year, due to re–pricing or maturity period characteristics of financial instruments. The Group is exposed to interest rate risk in case of material drop in interest rates from competitors on loan products or rise in the cost of funds due to macro and Group specific events.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The NBG requires the Bank to monitor both balance–sheet and total aggregate (including off–balance sheet) open currency positions and to maintain the later one within 20.0% of the Bank's total regulatory capital. As at 31 December 2019, the Bank maintained an aggregate open currency position of 3.5% of regulatory capital (31 December 2018: 0.2%).

The Bank has approved Foreign Currency Risk Management Policy, which is intended to establish parameters for the Bank for the management of foreign currency exposures.

The process of foreign currency risk management includes, but is not limited to:

- Selection of adequate methodology for foreign currency risk identification and quantitative measurement;
- Daily monitoring of the open foreign currency position;
- Minimising currency risk through compliance with established limits;
- Revealing existing and anticipated negative tendencies of increased currency risk followed by the analysis of its causes and implications;
- Making recommendations on the currency risk management strategy;
- Determining the types and limits on instruments used in the foreign currency risk operations.

(thousands of Georgian Lari)

24. Risk management (continued)

Liquidity risk and funding management (continued)

RAS sets limits on the level of exposure by currency as well as on aggregate exposure positions which are more conservative than those set by the NBG. The Bank's compliance with such limits is monitored daily by Treasury and ERM Division.

The tables below indicate the currencies to which the Group had significant exposure at 31 December on its non–trading monetary assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the currency rate against the ₾, with all other variables held constant on the consolidated statement of profit or loss (due to the fair value of currency sensitive non–trading monetary assets and liabilities). The effect on equity does not differ from the effect on the consolidated statement of profit or loss. A negative amount in the table reflects a potential net reduction in consolidated statement of profit or loss or equity, while a positive amount reflects a net potential increase.

Currency	*Appreciation/ (depreciation) of the exchange rate of ₾ against the respective currency in % 2019*	*Effect on profit before tax 2019*	*Appreciation/ (depreciation) of the exchange rate of ₾ against the respective currency in % 2018*	*Effect on profit before tax 2018*
US Dollar	3.94%	(370)	1.88%	(5)
EUR	3.31%	(93)	12.37%	2

Operational risk

Operational risk is defined as the risk of a financial loss resulting from the inadequacy or failure of internal processes, systems or people, or from external events, whether deliberate, accidental or natural occurrences. External events include, but are not limited to fraud, floods, fire, earthquakes and terrorist or hacker attacks. Credit or market events such as default or fluctuations in value do not fall in the scope of operational risk. Compliance risk is included under operational risk. Compliance risk is the potential that the Bank may incur regulatory sanctions, financial loss and/or reputational damage arising from its failure to comply with applicable laws, rules and regulations. The operational risk does not cover the reputational and strategic risk.

The overall objective of the operational risk management is to identify risks arising from inadequate or failed internal processes, people and systems or from external events and mitigate them where feasible and to the extent economically reasonable.

The Bank has established the Operational Risk Management (ORM) framework and takes all possible steps to understand exposure of the business to the variety of operational risks arising from inadequate or failed internal processes, people and systems or from external events. The aim of the ORM framework is to enable the Bank to collect, assess, manage, and report operational risk efficiently and effectively.

The responsibilities of the Operational Risk Management Department, Department of Physical Security, Problem Loans and Court Disputes, Internal Audit and Business Owners within ORM framework are defined in the Operational Risk Management Policy.

In general, the Bank has no appetite towards the operational risks and aims to reduce the losses resulting from risk events to the point where the Bank is not materially impacted by them. The Bank has low appetite towards operational risks related to fraud, information security (including IT) and compliance breaches, therefore the Bank makes all efforts to eliminate these types of risks, majority of cases are directed to Low Enforcement Bodies.

The Risk Event Database (RED) is developed and maintained to ensure that all incidents, losses and near misses are evidenced and treated appropriately. It provides the Bank with a technical tool to systematically collect realized. This information is used to refine the identification of risks and the appropriate approaches to managing them. The collection of the data and a corresponding analysis is carried out by the Operational Risk Management Department in a centralized manner. Operational risk events from the RED database with material impacts, direct and indirect losses are reported to the Management Board.

Compliance with Group standards is supported by a program of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of respective business lines, with summaries submitted to the Audit Committee and Supervisory Board.

The key mitigation controls the Bank deploys stem from its Operational Risk Profile (ORP) and the RAS of the Supervisory Board. The Bank actively uses corporate insurance to mitigate its operational risks.

(thousands of Georgian Lari)

25. Fair value disclosures

Fair value measurement procedures

External Appraisers are involved for valuation of significant assets, such as properties. Involvement of external Appraisers is decided upon annually by the management after discussion with and approval by the Bank's audit committee. The selection criteria include market knowledge, reputation, independence and whether professional standards are maintained. Valuators are normally rotated every three years. The management decides, after discussions with the Group's external Appraisers, which valuation techniques and inputs to use for each case.

At each reporting date, the management analyses the movements in the values of assets and liabilities which are required to be re–measured or re–assessed as per the Group's accounting policies. For this analysis, the management verifies the major inputs applied in the latest valuation by agreeing the information in the valuation computation to contracts and other relevant documents. The management, in conjunction with the Group's external Valuators, also compares each the changes in the fair value of each asset and liability with relevant external sources to determine whether the change is reasonable. On an interim basis, the management and the Group's external Valuators present the valuation results to the audit committee and the Group's independent auditors. This includes a discussion of the major assumptions used in the valuations.

Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

For the purpose of fair value disclosures, the Group's 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.

		Fair value measurement using			
At 31 December 2019	***Date of valuation***	***(Level 1)***	***(Level 2)***	***(Level 3)***	***Total***
Assets measured at fair value					
Loans to customers at FVTPL	31 December 2019	–	–	1,079	**1,079**
Foreign exchange forwards and swaps	31 December 2019	–	2,433	–	**2,433**
Investment properties	31 December 2019	–	–	2,619	**2,619**
Property and equipment – land and buildings	31 December 2019	–	–	82,777	**82,777**
		–	**2,433**	**86,475**	**88,908**
Assets for which fair values are disclosed					
Investment securities	31 December 2019	–	144,951	–	144,951
		–	**144,951**	**–**	**144,951**
Liabilities measured at fair value					
Foreign exchange forwards and swaps	31 December 2019	–	7,902	–	**7,902**
		–	**7,902**	**–**	**7,902**
Liabilities for which fair values are disclosed					
Subordinated debt	31 December 2019	–	100,031	–	**100,031**
		–	**100,031**	–	**100,031**

(thousands of Georgian Lari)

25. Fair value disclosures (continued)

At 31 December 2018	*Date of valuation*	*Fair value measurement using* (Level 1)	(Level 2)	(Level 3)	*Total*
Assets measured at fair value					
Loans to customers at FVTPL	31 December 2018	–	–	796	**796**
Foreign exchange forwards and swaps	31 December 2018	–	707	–	**707**
Investment properties	31 December 2018	–	–	2,583	**2,583**
Property and equipment – land and buildings	31 December 2016	–	–	80,396	**80,396**
		–	**707**	**83,775**	**84,482**
Assets for which fair values are disclosed					
Investment securities:	31 December 2018	–	204,829	–	**204,829**
Liabilities measured at fair value		**–**	**204,829**	**–**	**204,829**
Foreign exchange forwards and swaps	31 December 2018	–	8,599	–	**8,599**
Liabilities for which fair values are disclosed		**–**	**8,599**	**–**	**8,599**
Subordinated debt	31 December 2018	–	48,122	–	**48,122**
		–	**48,122**	**–**	**48,122**

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Group's financial instruments that are carried in the consolidated statement of financial position and their fair value is materially different from their carrying amount. The table does not include the fair values of non–financial assets and non–financial liabilities.

	Carrying value 2019	*Fair value 2019*	*Unrecognised gain/(loss) 2019*	*Carrying value 2018*	*Fair value 2018*	*Unrecognised gain/(loss) 2018*
Financial assets						
Investment securities	146,505	144,951	(1,554)	197,504	204,829	7,325
Lease liability	37,080	37,451	371	–	–	–
Total unrecognised change in unrealised fair value			**(1,183)**			**7,325**

Valuation techniques and assumptions

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

Assets for which fair value approximates carrying amount

The carrying amounts of cash and cash equivalents, amounts due from credit institutions, loans to customers, amounts due to credit institutions and amounts due to customers (including current and savings accounts), are considered to approximate their respective fair values due to their short–term maturities, liquid nature and as such continues repricing to market terms. Considering the nature and characteristics, the cash and cash equivalents are classified as Level 1 of the fair value hierarchy.

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.

(thousands of Georgian Lari)

25. Fair value disclosures (continued)

Loans at fair value through profit or loss

Loans at fair value through profit or loss are valued using a combination of approaches. Where appropriate, loans are valued with reference to observable prices of debt securities issued by the borrower or by comparable entities. In other cases, valuation is performed using internal models based on present value techniques or, in some circumstances (for example, in respect of cash flow from assets held as collateral), external valuation reports. The non–observable inputs to the models include adjustments for credit, market and liquidity risks associated with the expected cash flows from the borrower's operations or in respect of collateral valuation.

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, as such they fall under Level 2 fair value hierarchy. 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, is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

Investment properties and buildings

There are three main approaches to valuation of real property:

Market approach

Establishes limits on the market value for the real estate by examining the prices commonly paid for properties that compete with the subject property for buyers. Sales are investigated to ensure that the parties to the transaction were adequately motivated. Sale prices reflecting motivation other than that of a typical market participant, i.e. transactions of special purchasers who are willing to pay a premium for a particular property, should be eliminated. The method involves analysing units of comparison such as a price per square metre of gross building area. Adjustments are made to the sales/listing for differences in location, size, age and condition, financing and various other factors which may have any influence on the value.

In the analysis of the market value of appraised properties by the sales comparison (market data) approach, it is utilised the sales/listing measured to the best available, most recent and overall similar sales/listing available as of the report date.

Information on the comparable sales and listing is obtained from brokerage companies, agents and brokers, as well as public information, including commercial broker listings on websites and published data. Then such information is further confirmed with owners and/or principles or brokers involved in the listed transactions.

Cost approach

Establishes the value of the real estate by estimating the cost of acquiring the land and building a new property or renovating an old property for equivalent utilisation purposes with no undue cost due to delay. An estimate of entrepreneurial incentive or developer's profit/loss is commonly added to the land and construction costs. For mature properties, the cost approach is used to estimate the depreciation cost, including items of physical deterioration and functional obsolescence.

The main approach of the cost replacement method reflects the idea that one will not pay for the given property more than he/she would pay for the construction of that property.

The cost approach involves the following steps:

- Estimate land value;
- Estimate reproduction or replacement cost of the improvements;
- Estimate accrued depreciation from all sources (physical deterioration, functional obsolescence, external and economic obsolescence);
- Deduct accrued depreciation from the reproduction or replacement cost to arrive at the depreciated improvement cost;
- Estimate equipment cost and deduct depreciation;
- Add the depreciated improvement cost to depreciated equipment cost and to the land value to arrive at a total property value indication.

(thousands of Georgian Lari)

25. Fair value disclosures (continued)

Valuation techniques and assumptions (continued)

Income capitalisation approach

The income generation methodology is based on the hypothetical incomes generated through the use of the property being valued. The estimation of the real estate market value is based on the capitalisation coefficient which is calculated based on the long–term rate of the alternative investment methodology.

Discount cash flow (DCF)

The fair value of completed investment properties is determined using a discounted cash flow (DCF). Based on the actual and projected market demand, types of goods/services to be produced/provided, pricing policy and expected competitive environment in the market, the strategic financial projections for the business is developed. Using DCF method, a property's fair value is estimated using explicit assumptions regarding the benefits and liabilities of ownership over the asset's life including an exit or terminal value. As an accepted method within the income approach to valuation, the DCF method involves the projection of a series of cash flows on a real property interest. To this projected cash flow series, an appropriate, market–derived discount rate is applied to establish the present value of the cash inflows associated with the real property. The duration of the cash flow and the specific timing of inflows and outflows are determined by events such as rent reviews, lease renewal and related lease up periods, re–letting, redevelopment, or refurbishment. The appropriate duration is typically driven by market behaviour that is a characteristic of the class of real property.

In the case of investment properties, periodic cash flow is typically estimated as gross income less vacancy, non–recoverable expenses, collection losses, lease incentives, maintenance cost, agent and commission costs and other operating and management expenses. The series of periodic net cash inflows, along with an estimate of the terminal value anticipated at the end of the projection period, is then discounted.

Movements in Level 3 assets and liabilities at fair value

The following tables show a reconciliation of the opening and closing amount of investment properties in Level 3 assets and liabilities which are recorded at fair value. For the reconciliation of property and equipment – buildings refer to *Note 10*:

	At 1 January 2019	*Total gain recorded in profit or loss*	*At 31 December 2019*
Assets			
Investment properties	2,583	36	2,619
	2,583	**36**	**2,619**

	At 1 January 2018	*Total loss recorded in profit or loss*	*At 31 December 2018*
Assets			
Investment properties	2,597	(14)	2,583
	2,597	**(14)**	**2,583**

(thousands of Georgian Lari)

25. Fair value disclosures (continued)

Valuation techniques and assumptions (continued)

The following table shows the quantitative information about significant unobservable inputs used in the fair value measurement categorised within Level 3 of the fair value hierarchy:

As of 31 December 2019	*Carrying amount*	*Valuation techniques*	*Unobservable input*	*Range (weighted average)*
Land and buildings – head office	43,691	– Income Capitalisation Approach (DCF)	– 10% increase/decrease of rent price – 10% increase/decrease of Occupancy rate	(11.76%) up to 9.80%
Land and buildings	21,688	– Income Capitalisation Approach (DCF)	– 10% increase/decrease of rent price – 10% increase/decrease of Occupancy rate	(12.36%) up to 11.16%
Land and buildings		– Cost approach	– 10% increase/decrease of land price – 10% increase/decrease of Replacement cost	
Land and buildings	17,398	– Market approach	– Price volatility adjustment: 10% increase/decrease of market prices	(10.02%) up to 9.96%
Investment properties – commercial building	774	– Cost approach	– 10% increase/decrease of land price – 10% increase/decrease of Replacement cost	(3.70%) up to 3.7%
Investment properties – commercial building	1,772	– Market approach	– Price volatility/adjustment: 10% increase/decrease of market prices	(10.03%) up to 10.03%
Investment properties – commercial building	72	– Market approach	– Price volatility adjustment: 10% increase/decrease of market prices	(12.00%) up to 8.00%

As of 31 December 2018	*Carrying amount*	*Valuation techniques*	*Unobservable input*	*Range (weighted average)*
Land and buildings – head office	45,540	– Income Capitalisation Approach (DCF)	– 10% increase/decrease of rent price – 10% increase/decrease of Occupancy rate	(11.49%) up to 8.05%
Land and buildings	13,050	– Income Capitalisation Approach (DCF)	– 10% increase/decrease of rent price – 10% increase/decrease of Occupancy rate	(13.18%) up to 13.57%
Land and buildings	4,208	– Cost approach	– 10% increase/decrease of land price – 10% increase/decrease of Replacement cost	(6.49%) up to 6.36%
Land and buildings	17,932	– Market approach	– Price volatility adjustment: 10% increase/decrease of market prices	(9.31%) up to 9.63%
Investment properties – commercial building	776	– Cost approach	– 10% increase/decrease of land price – 10% increase/decrease of Replacement cost	(3.13%) up to 6.90%
Investment properties – commercial building	1,740	– Market approach	– Price volatility/adjustment: 10% increase/decrease of market prices	(10.30%) up to 10.30%
Investment properties –commercial building	67	– Market approach	– Price volatility adjustment: 10% increase/decrease of market prices	(9.1%) up to 9.1%

(thousands of Georgian Lari)

26. Related party disclosures

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

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.

The outstanding balances at the period end of and related income and expense arising from related party transactions are as follows:

	2019			*2018*		
	Parent	*Entities under common control*	*Key management personnel*	*Parent*	*Entities under common control*	*Key management personnel*
Loans outstanding at 1 January, gross	**5,384**	**7,214**	**157**	**–**	**–**	**218**
Loans issued during the year	–	13,899	240	5,384	15,892	188
Loan repayments during the year	(5,384)	(10,196)	(387)	–	(8,678)	(48)
Other movements**	–	–	–	–	–	201
Loans outstanding at 31 December, gross	**–**	**10,917**	**10**	**5,384**	**7,214**	**559**
Less: allowance for impairment at 31 December	–	(71)	(1)	(64)	(86)	(1)
Loans outstanding at 31 December, net	**–**	**10,846**	**9**	**5,320**	**7,128**	**558**
Interest income on loans	331	857	9	372	356	9
Credit loss expense/(reversal)	–	–	–	64	86	(5)
Deposits* at 1 January	**–**	**–**	**80**	**–**	**–**	**354**
Deposits received during the year	24,782	523,333	21,060	–	–	–
Deposits repaid during the year	(24,782)	(523,333)	(21,140)	–	–	(274)
Other movements**	–	–	–	–	–	–
Deposits at 31 December	**–**	**–**	**–**	–	–	**80**
Subordinated debt at 1 January	–	–	–	**–**	**–**	**2,043**
Subordinated debt repaid during the year	–	–	–	–	–	(2,043)
Subordinated debt at 31 December	**–**	**–**	**–**	**–**	**–**	**–**
Current accounts at 31 December	**619**	**32,338**	**1,434**	**468**	**34,332**	**1,080**
Interest expense on deposits and current accounts	3	1,040	44	1	372	103
Interest expense on subordinated debt	–	–	–	–	–	–
Fee and commission income	1	83	8	1	–	2
Other operating expenses	–	–	1	1	–	2

* *Deposits include Time Deposits and CDs as well as Savings Account.*

** *Other movements include amounts that were included in the balances as at 31 December 2018, however did not constitute related parties as at 31 December 2019.*

Entities under common control comprises of organisations in which shareholders of the Group exercise control which represent related parties to the Group.

(thousands of Georgian Lari)

26. Related party disclosures (continued)

The number of key management personnel during the year ended 31 December 2019 was 10 (2018: 7) and their compensation comprised the following:

	2019	*2018*
Salaries, bonuses and other short term benefits	8,091	6,546
Total key personnel compensation	**8,091**	**6,546**

27. Capital management

The Bank's capital management objectives consist of ensuring its solvency at all times, complying with the supervisory and internal capital requirements, and maintaining a prudent capital cushion in order to protect the Bank from known (and, to some extent, the unknown) risks.

The Bank's management of its total capital is based on the Internal Capital Adequacy Assessment Process (ICAAP), which represents its main capital management tool. Besides, as an additional capital management tool, the Bank maintains Recovery Plan which includes regulatory capital alert thresholds and recovery strategies.

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

NBG Basel III Capital adequacy ratio

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

As at 31 December 2019 Common Equity Tier 1 Capital (CET I), Tier I Capital (Tier I) and Total Capital ratios were set at 4.50%, 6.00% and 8.00% respectively in addition to which the Bank had to maintain Pillar I Buffers and Pillar II requirements.

Systemic Risk buffer is designed as a build–up manner and is allocated over upcoming three years. Effective from 31 December 2018, first year is set at 0.6%, and increases every year by 0.3% throughout 31 December 2021. Capital Conservation and Countercyclical buffers are set at 2.50% and 0.00%, respectively. Any adjustment of Pillar I Buffers is at NBG's discretion.

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

For Total Regulatory Capital as of 31 December 2019, the Bank had to maintain CICR buffer of 1.01%, primary due to percentage share of foreign currency denominated loans to customers, Credit Portfolio Concentration Risk of 0.11% (HHI Buffer), Net Grape of 5.50% and Net Stress–Test buffer of 0%. For Tier 1 Capital and CET 1 Capital, Net Grape and Credit Portfolio Concentration Risk buffers stayed the same 20% and 15% of total, respectively, and CICR – 75% and 56%, respectively.

On 19 December 2019, the NBG made an important adjustment regarding the residential property LTV and changed the limit from 50% to 80%.

As of 31 December 2019, under total Basel III requirements the Bank was required to maintain a minimum Total Capital adequacy ratio of 18.02% of the risk–weighted exposures (RWE), minimum Tier 1 Capital adequacy ratio of 11.28% of the RWE and Common Equity Tier 1 Capital adequacy ratio of 9.31% of the RWE computed based on the Bank's stand–alone financial statements prepared in accordance with the NBG requirements (as at 31 December 2019 the Bank maintained minimum capital requirements in accordance to capital adequacy regulation approved and published on 28 October 2013 by the NBG (Decree N100/04) and adjusted for NBG's discretionary items, became effective on 30 June 2014. As of 31 December 2019 Total Capital adequacy ratio, Tier 1 Capital adequacy ratio and Common Equity Tier 1 Capital adequacy ratios were 18.30%, 12.19% and 11.94% respectively).

(thousands of Georgian Lari)

27. Capital management (continued)

The Bank's capital adequacy ratios calculated in accordance with NBG Basel II/III requirement were as follows:

	2019	*2018*
Common Equity Tier 1 capital	**215,359**	**210,610**
Additional Tier 1 capital	4,565	4,565
Tier 1 capital	**219,924**	**215,175**
Tier 2 capital	110,217	55,994
Total regulatory capital	**330,141**	**271,169**
Risk–weighted exposures	**1,803,852**	**1,531,726**
Common Equity Tier 1 capital ratio	11.94%	13.75%
Tier 1 capital ratio	12.19%	14.05%
Total regulatory capital ratio	18.30%	17.70%

28. Events after the reporting period

In March 2020 the World Health Organization confirmed the novel coronavirus ("COVID–19") as a global pandemic. There is uncertainty over the magnitude of the global slowdown that will result from this pandemic and its impact on Georgian economy. First COVID–19 infection was confirmed by the National Center for Disease Control ("GNCC") in February 2020. The Government of Georgia has introduced number of measures aimed at containment of the spread of COVID–19, which have significant social and economic impact. The Bank is monitoring impact of coronavirus (COVID–19) outbreak on its business, customers and employees and follows the official guidance introduced by the Government of Georgia to safeguard its people and to maintain business continuity.

The measures implemented by the Group since the beginning of March 2020 have allowed the Group to alter its day–to–day operations in order to adapt to the current unprecedented operating environment, and at the same time maintain the health, safety and well–being of staff and customers. The group introduced a number of additional health and infection prevention measures in branch network, including all appropriate assistance for elderly clients. The group operates remotely where it is possible in the head office and back office, IT infrastructure and info security standards were adequately set up to support uninterrupted working environment from home.

In order to support customers, in coordination with the Government, NBG and the banking sector, the group has introduced a three–month grace period on principle and interest payments for all individuals and most vulnerable micro and small enterprise borrowers. At the same time, NBG has introduced the measures that allow banks to use existing prudential buffers to support customers in the current financially stressed circumstances and to support the overall economy through ongoing lending operations

Capital adequacy initiatives:

- Combined buffer – the conservation buffer requirement of 2.5% of risk–weighted assets reduced to 0% indefinitely;
- Pillar 2 requirements:
- Currency induced credit risk buffer (CICR) requirement reduced by 2/3rds indefinitely;
- The phase–in of all capital buffers planned at the end of March, 2020, has been postponed indefinitely;
- The possibility of fully or partially releasing the remaining requirements of Pillar 2 buffers, if necessary, remains open.

Liquidity initiatives:

- GEL 400m swap line facility has been introduced for local commercial banks and MFOs;
- Liquidity coverage ratio (LCR) requirements (for local and foreign currency, as well as total requirement) are being revisited and reduced;

(thousands of Georgian Lari)

28. Events after the reporting period (continued)

Other initiatives:

- NBG will not impose any monetary sanctions in case of breach of any regulatory limits driven by external factors (e.g. exchange rate deprecation);
- Almost all new regulatory changes and requirements are postponed till September, 2020, or until further communicated by NBG.

The Group's capital position and liquidity remains strong, that said as of 31 March 2020, management decided to create an extra buffer and increase loan loss provisions by approximately 1.6–1.8% of gross loan book under local prudential regulations. This resulted in reduction of the Group's CET1, Tier1 and Total Capital Ratios to 10.41%, 10.66% and 17.01% vs the minimum requirement of 6.43%, 8.28% and 14.83% respectively.

Apart from the above, Government of Georgia while introducing approximately GEL 2 billion worth of stimulus package in form of benefits for individuals and tax holidays for vulnerable companies, is working in close cooperation with the NBG, actively mobilize larger borrowings from IMF and partner organizations to support Economic activity, as government officials declared around USD 3 billion financial support package is available by the international financial organizations.

The Group's management continues to monitor the situation daily and act accordingly, that said the long–term goals remain unchanged.

The further spread of COVID–19 in Georgia and globally, is expected to have a negative impact on the economy, however it is too early to fully understand the impact this may have on the Bank's business. The Group considers coronavirus (COVID–19) outbreak to be a non–adjusting post balance sheet event.