

# JSC ProCredit Bank

International Financial Reporting Standards

Consolidated and Separate Financial Statements and

Independent Auditors' Report

31 December 2017

# TABLE OF CONTENTS

## INDEPENDENT AUDITOR'S REPORT

## CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

CONSOLIDATED AND SEPARATE STATEMENTS OF FINANCIAL POSITION	1
CONSOLIDATED AND SEPARATE STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME	2
CONSOLIDATED AND SEPARATE STATEMENTS OF CHANGES IN EQUITY	3
CONSOLIDATED AND SEPARATE STATEMENTS OF CASH FLOWS	4

## NOTES TO THE CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

1. ORGANIZATION AND OPERATIONS .....	5
2. BUSINESS ENVIRONMENT.....	5
3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES .....	6
4. USE OF ASSUMPTIONS AND ESTIMATES .....	19
5. ACCOUNTING DEVELOPMENTS.....	20
6. CASH AND BALANCES WITH THE NBG .....	23
7. DUE FROM BANKS.....	23
8. INVESTMENT SECURITIES AVAILABLE-FOR-SALE.....	24
9. LOANS AND ADVANCES TO CUSTOMERS .....	25
10. INVESTMENT PROPERTIES.....	31
11. INTANGIBLE ASSETS .....	32
12. PROPERTY AND EQUIPMENT.....	32
13. OTHER ASSETS.....	33
14. DUE TO BANKS .....	34
15. CUSTOMERS ACCOUNTS .....	34
16. OTHER BORROWED FUNDS .....	35
17. OTHER LIABILITIES .....	36
18. OTHER PROVISIONS.....	36
19. INCOME TAXES .....	37
20. SUBORDINATED DEBT .....	38
21. SHARE CAPITAL AND SHARE PREMIUM .....	38
22. NET DEBT RECONCILIATION.....	39
23. NET INTEREST INCOME .....	39
24. FEE AND COMMISSION INCOME AND EXPENSES.....	40
25. OTHER ADMINISTRATIVE EXPENSES.....	40
26. FINANCIAL RISK AND CAPITAL MANAGEMENT .....	41
27. FAIR VALUE OF FINANCIAL INSTRUMENTS.....	62
28. CONTINGENT LIABILITIES AND COMMITMENTS.....	64
29. RELATED PARTY TRANSACTIONS .....	65



## *Independent Auditor's Report*

To the Shareholder and Management of ProCredit Bank JSC

### *Our opinion*

In our opinion, the consolidated and separate financial statements (the 'financial statements') present fairly, in all material respects, the consolidated and separate financial position of ProCredit Bank JSC (the 'Bank') and its subsidiary (together - the 'Group') as at 31 December 2017, and their consolidated and separate financial performance and their consolidated and separate cash flows for the year then ended in accordance with International Financial Reporting Standards and with the Law of Georgia on Accounting, Reporting and Auditing.

### **What we have audited**

The financial statements comprise:

- the consolidated and separate statements of financial position as at 31 December 2017;
- the consolidated and separate statements of profit or loss and other comprehensive income for the year then ended;
- the consolidated and separate statements of changes in equity for the year then ended;
- the consolidated and separate statements of cash flows for the year then ended; and
- the notes to the financial statements, which include summary of significant accounting policies.

### *Basis for opinion*

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

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

### **Independence**

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

### *Other information*

Management is responsible for the other information. Other information comprises Management Report prepared in accordance with the Law of Georgia on Accounting, Reporting and Auditing (but does not include the financial statements and our auditor's report thereon), which is expected to be made available to us after the date of this auditor's report.

Our opinion on the financial statements does not cover the other information, including the Management Report.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. In addition, we are required to express an opinion whether certain parts of Management Report comply with respective regulatory normative





acts and to consider whether the Management Report includes the information required by the Law of Georgia on Accounting, Reporting and Auditing.

We will issue our updated report where we will either state that we have nothing to report in respect of the above or describe any material misstatements identified by us in the Management Report based on our knowledge of the reporting entity and its circumstances, which we obtained during our audit. Our updated report will include also our opinion mentioned in the preceding paragraph.

### *Responsibilities of management and those charged with governance for the financial statements*

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards and with the Law of Georgia on Accounting, Reporting and Auditing, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Those charged with governance are responsible for overseeing the Group's and the Bank's financial reporting process.

### *Auditor's responsibilities for the audit of the financial statements*

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

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

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



- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- 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 those charged with governance 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.

*PricewaterhouseCoopers Georgia LLC*

*For and on behalf of PricewaterhouseCoopers Georgia LLC (Reg.# SARAS-F-775813)*

Lasha Janelidze (Reg.#SARAS-A-562091)

3 May 2018  
Tbilisi, Georgia



# PROCREDIT BANK GROUP

## Consolidated and Separate Statements of Financial Position

in '000 GEL	Notes	Consolidated		Separate	
		31 December 2017	31 December 2016	31 December 2017	31 December 2016
<b>Assets</b>					
Cash and balances with the NBG	6	140,141	255,930	140,141	255,930
Mandatory reserve deposits with NBG	6	125,962	131,547	125,962	131,547
Investment securities available-for-sale	8	5,177	17,043	11,277	23,143
Due from banks	7	16,171	38,033	16,168	38,032
Financial assets at fair value through profit or loss		339	175	339	175
Loans and advances to customers	9	987,337	856,225	987,337	856,225
Current tax asset		1,532	-	1,571	-
Investment properties	10	7,102	1,697	5,513	-
Intangible assets	11	1,393	1,676	1,394	1,676
Property and equipment	12	63,152	75,522	63,152	75,522
Other assets	13	10,232	17,013	6,303	12,861
<b>Total assets</b>		<b>1,358,538</b>	<b>1,394,862</b>	<b>1,359,157</b>	<b>1,395,113</b>
<b>Liabilities</b>					
Due to banks	14	48,639	2,857	48,639	2,857
Customer accounts	15	629,059	732,575	630,657	752,844
Other borrowed funds	16	411,946	387,612	411,946	387,612
Subordinated debt	20	64,967	66,752	64,967	66,752
Current tax liability		-	836	-	1,075
Other liabilities	17	4,309	3,717	4,155	3,433
Other provisions	18	577	477	577	476
Deferred tax liability	19	937	3,903	937	3,904
<b>Total liabilities</b>		<b>1,160,434</b>	<b>1,198,729</b>	<b>1,161,880</b>	<b>1,198,952</b>
<b>Equity</b>					
Share capital	21	88,915	88,915	88,915	88,915
Share premium	21	36,388	36,388	36,388	36,388
Retained earnings		72,801	70,830	71,974	70,857
<b>Total equity</b>		<b>198,104</b>	<b>196,133</b>	<b>197,277</b>	<b>196,160</b>
<b>Total equity and liabilities</b>		<b>1,358,538</b>	<b>1,394,862</b>	<b>1,359,157</b>	<b>1,395,113</b>

Approved for issue and signed on behalf of the Board of Directors on 3 May 2018.

David Gabelashvili  
Director

Nana Chikvaдзе  
Chief Accountant

## PROCREDIT BANK GROUP

### Consolidated and Separate Statements of Profit or Loss and Other Comprehensive Income

in '000 GEL	Notes	Consolidated		Separate	
		2017	2016	2017	2016
Interest income	23	84,858	104,532	84,858	104,532
Interest expense	23	(32,131)	(36,215)	(32,131)	(36,215)
<b>Net interest income</b>		<b>52,727</b>	<b>68,317</b>	<b>52,727</b>	<b>68,317</b>
Provision for loan impairment	9	(4,911)	(13,662)	(4,911)	(13,662)
<b>Net interest income after provision for loan impairment</b>		<b>47,816</b>	<b>54,655</b>	<b>47,816</b>	<b>54,655</b>
Fee and commission income	24	10,204	10,835	10,204	10,835
Fee and commission expenses	24	(5,174)	(4,836)	(5,174)	(4,836)
Net gain from trading in foreign currency		9,520	5,570	9,520	5,570
Net foreign exchange translation gain		(3,160)	1,265	(3,160)	1,397
Personnel expenses		(13,177)	(16,950)	(13,104)	(16,875)
Other administrative expenses	25	(25,137)	(26,735)	(25,065)	(26,685)
Other operating income		3,418	5,881	1,959	9,144
Other operating expenses		(1,508)	(1,637)	(1,120)	(1,107)
<b>Profit before income tax</b>		<b>22,802</b>	<b>28,048</b>	<b>21,877</b>	<b>32,098</b>
Income tax expense	19	(141)	(3,777)	(69)	(3,543)
<b>Profit and total comprehensive income for the year</b>		<b>22,661</b>	<b>24,271</b>	<b>21,808</b>	<b>28,555</b>

Approved for issue and signed on behalf of the Board of Directors on 3 May 2018.

\_\_\_\_\_  
David Gabelashvili  
Director

\_\_\_\_\_  
Nana Chikvaidze  
Chief Accountant

## PROCREDIT BANK GROUP

### Consolidated and Separate Statements of Changes in Equity

in '000 GEL		Consolidated				Separate				
		Notes	Share capital	Share premium	Retained earnings	Total	Share capital	Share premium	Retained earnings	Total
<b>Balance at 1 January 2016</b>			88,915	36,388	46,559	171,862	88,915	36,388	42,302	167,605
<b>Total comprehensive income</b>										
Profit for the year			-	-	24,271	24,271	-	-	28,555	28,555
<b>Total comprehensive income for the year</b>			-	-	24,271	24,271	88,915	36,388	28,555	28,555
<b>Balance at 31 December 2016</b>			88,915	36,388	70,830	196,133	88,915	36,388	70,857	196,160
<b>Total comprehensive income</b>										
Profit for the year			-	-	22,661	22,661	-	-	21,808	21,808
<b>Total comprehensive income for the year</b>			-	-	22,661	22,661	88,915	36,388	21,808	21,808
<b>Transactions with owners, recorded directly in equity</b>										
Dividends declared		21	-	-	(20,692)	(20,692)	-	-	(20,692)	(20,692)
<b>Total transactions with owners</b>			-	-	(20,692)	(20,692)	-	-	(20,692)	(20,692)
<b>Balance at 31 December 2017</b>			88,915	36,388	72,801	198,102	88,915	36,388	71,974	197,277

Approved for issue and signed on behalf of the Board of Directors on 3 May 2018.

\_\_\_\_\_  
David Gabelashvili  
Director

\_\_\_\_\_  
Nana Chikvaidze  
Chief Accountant



## PROCREDIT BANK GROUP

### Consolidated and Separate Statements of Cash Flows in '000 GEL

	Notes	Consolidated		Separate	
		2017	2016	2017	2016
<b>Profit before income tax</b>		<b>22,802</b>	<b>28,048</b>	<b>21,877</b>	<b>32,098</b>
Provision for loan impairment	9	4,911	13,662	5,328	13,662
Depreciation and amortization		6,123	6,672	6,093	6,658
Net foreign exchange translation gain		3,160	(1,265)	3,160	(1,265)
Accrual / (release) of other provisions		101	38	101	38
Gain from disposal of property and equipment, investment properties and intangible assets		2,406	(685)	2,406	302
Net interest income		(52,727)	(68,317)	(52,727)	(68,317)
<b>Operating cash flows before changes in operating assets and liabilities</b>		<b>(13,224)</b>	<b>(21,847)</b>	<b>(13,763)</b>	<b>(16,824)</b>
<i>Net change in assets and liabilities from operating activities after non-cash items:</i>					
Mandatory reserve deposit with the NBG		5,097	(25,500)	5,096	(25,500)
Loans and advances to customers		(149,841)	101,042	(150,258)	101,042
Other assets		6,303	(3,839)	6,080	(4,987)
Due to banks		45,783	(2,118)	45,782	(2,118)
Financial liabilities at fair value through profit or loss		(164)	(222)	(164)	(222)
Customer accounts		(98,967)	12,233	(97,638)	7,654
Other liabilities		592	764	722	914
Interest received		83,305	106,964	83,305	106,964
Interest paid		(34,822)	(35,403)	(34,821)	(35,403)
Income tax paid		(5,476)	(2,470)	(5,682)	(1,966)
<b>Net cash (used in)/from operating activities</b>		<b>(161,414)</b>	<b>129,604</b>	<b>(161,339)</b>	<b>129,554</b>
Purchase of property and equipment and intangible assets		(971)	(5,511)	(971)	(5,511)
Purchase of investment properties		(120)	(1,065)	(8)	-
Proceeds from sale of property and equipment and investment properties		287	1,114	99	99
Purchase of investment securities available-for-sale	8	(30,000)	(32,178)	(30,000)	(32,178)
Proceeds from sale of investment securities available-for-sale	8	41,866	34,995	41,866	34,995
<b>Cash flows from/(used in) investing activities</b>		<b>11,062</b>	<b>(2,645)</b>	<b>10,985</b>	<b>(2,595)</b>
Dividends paid	21	(20,692)	-	(20,692)	-
Proceeds from other borrowed funds		82,618	136,192	82,618	136,192
Repayments of other borrowed funds		(88,034)	(102,422)	(88,034)	(102,422)
<b>Cash flows (used in)/from financing activities</b>		<b>(26,108)</b>	<b>33,770</b>	<b>(26,108)</b>	<b>33,770</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(176,460)</b>	<b>160,729</b>	<b>(176,461)</b>	<b>160,729</b>
Cash and cash equivalents at the beginning of the year		293,963	113,686	293,963	113,686
Effects of exchange rate changes		38,808	19,548	38,808	19,548
<b>Cash and cash equivalents at the end of the year</b>	6	<b>156,311</b>	<b>293,963</b>	<b>156,310</b>	<b>293,963</b>

Approved for issue and signed on behalf of the Board of Directors on 3 May 2018.

David Gabelashvili  
Director

Nana Chikvaidze  
Chief Accountant

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

---

**1. ORGANIZATION AND OPERATIONS**

These consolidated and separate financial statements (hereafter the “Financial Statements”) include the financial statements of JSC ProCredit Bank (the Bank) and its subsidiary (together referred to as the Group). The Bank and its subsidiary are joint stock and limited liability companies as it is defined under the Law of Georgia on Entrepreneurs and are incorporated and domiciled in Georgia. The Bank was registered by Vake District Court on 04 January 1999, registration number is 204851197.

JSC ProCredit Bank is a development-oriented bank specialized for small and medium enterprises operating on the territory of Georgia. For supervisory purposes the Bank qualifies as a bank according to the general banking licence number 233 and is therefore supervised by the National Bank of Georgia (the NBG).

The address of the Bank’s registered office is: 21 Al. Kazbegi Avenue, 0160, Tbilisi, Georgia. The Bank’s head office is located in Tbilisi. The Bank serves its clients through 4 branches, 5 service points and 12 Self-service areas in Tbilisi, Kutaisi, Batumi, Gori and Zugdidi.

The Bank has one wholly-owned subsidiary, LLC ProCredit Properties, which was formed as a limited liability company under Georgian law on 23 July 2007 with the principal activity of holding and managing movable and immovable properties acquired through auctions resulting from defaults of the Bank’s customers.

The Bank’s immediate and ultimate parent company is ProCredit Holding AG & Co. KGaA (Parent). As of 31 December 2017 and 31 December 2016, the following shareholders directly owned more than 5% of the total outstanding shares of the Parent. Other shareholders individually owned less than 5% of the outstanding shares. As of 31 December 2017 and 31 December 2016 the Group had no ultimate controlling party.

	% of ownership interest held as of 31 December	
	<b>2017</b>	<b>2016</b>
Zeitinger Invest GmbH	16.8	18.4
KfW - Kreditanstalt für Wiederaufbau	13.2	13.6
DOEN Foundation	12.5	13.3
IFC - International Finance Corporation	10	10.3
TIAA-CREF - Teachers Insurance and Annuity Association	8.6	9.9
Other	38.9	34.4
<b>Total</b>	<b>100</b>	<b>100</b>

Refer to Note 29 for related party transactions.

**2. BUSINESS ENVIRONMENT**

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

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies set out below have been applied consistently to all periods presented in these financial statements, and have been applied consistently by the Group entities.

#### **Statement of compliance**

The accompanying financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) and Law of Georgia on Accounting, Reporting and Auditing.

#### **Measurement basis**

These financial statements were prepared on the historic cost basis except that financial instruments at fair value through profit or loss and available-for-sale financial assets, except for which are stated at cost, are stated at fair value. IFRS defines a hierarchy of fair value determination which reflects the relative reliability of different methods of determining a fair value:

*(a) Active market: Quoted price (Level 1)*

Observed quoted prices for identical financial instruments in active markets.

*(b) Valuation technique using observable inputs (Level 2)*

Observed quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets or use of valuation models where all significant inputs are observable.

*(c) Valuation technique with significant non-observable inputs (Level 3)*

Use valuation models where one or more significant inputs are not observable.

Only if the best way of determining the fair value is not available may the next best determination method be applied. If possible, the Group obtains fair values from quoted market prices; otherwise, the next best available measurement technique is applied.

Reporting and valuation are conducted according to the going concern principle.

The measurement techniques applied to the statement of financial position are specified in Notes 3 and 27.

#### **Basis of consolidation**

Subsidiaries are investees controlled by the Group. The Group controls an investee when it is exposed to, 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. In particular the Group consolidates investees that it controls on the basis of de facto circumstances. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Financial instruments - key measurement terms**

Depending on their classification financial instruments are carried at fair value or amortized cost as described below.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Group has access at that date. Fair value is the current bid price for financial assets and the current asking price for financial liabilities which are quoted in an active market. The fair value of a liability reflects its non-performance risk.

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

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

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

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Group on the basis of the net exposure to either market or credit risk, are measured on the basis of a price that would be received to sell the net long position (or paid to transfer the net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

The Group recognizes transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

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

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.



### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The effective interest method is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest reprising date, except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

#### **Financial assets**

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, and available-for-sale financial assets. There are no assets in the held-to-maturity category. Management determines the classification of financial assets at initial recognition.

##### *Financial assets at fair value through profit or loss*

This category has two sub-categories: financial assets held for trading (trading assets), including derivatives held, and financial assets designated at fair value through profit or loss at inception. The Group does not apply hedge accounting.

Financial assets may be designated at fair value through profit or loss when they are part of a separate portfolio that is managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy. The fair values reported are usually observable market prices; as a guideline, the Group prefers to invest in securities for which market prices in active markets can be observed. Only in rare circumstances the fair value is calculated based on current observable market data by using a valuation technique. The valuation techniques applied are references to the current fair value of other instruments that are substantially the same, and discounted cash flow analysis using observable market parameters, e.g. interest rates and foreign exchange rates.

Financial assets at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the profit or loss. Subsequently, they are carried at fair value. Gains and losses arising from changes in their fair value are immediately recognised in the profit or loss of the period. Together with interest earned on financial instruments designated as at fair value through profit and loss they are shown as “net result from financial assets at fair value through profit or loss”.

Purchases and sales of financial assets for regular way transactions at fair value through profit or loss are recognised on the trade-date – the date on which the Group commits to purchase or sell the asset. Financial assets at fair value through profit or loss are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

##### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Loans and receivables are initially recognised at fair value plus transaction costs; subsequently they are measured at amortised cost using the effective interest method. At each reporting date and whenever there is evidence of potential impairment, the Group assesses the value of its loans and receivables. Their carrying amount may be reduced as a consequence through the use of an allowance account (see Note 9 for details on impairment of loans). If the amount of the impairment loss decreases, the impairment allowance is reduced accordingly, and the amount of the reduction is recognised in the profit or loss. The upper limit on the reduction of the impairment is equal to the amortised costs which would have been incurred as of the valuation date if there had not been any impairment.

Loans are recognised when the principal is advanced to the borrowers. The Group derecognises loans and receivables when (a) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control.

*Available-for-sale financial assets*

Available-for-sale financial assets are those intended to be held for an indefinite amount of time and may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

At initial recognition, available-for-sale financial assets are recorded at fair value. Subsequently they are carried at fair value unless it cannot be determined. The fair values reported are either observable market prices or values calculated with a valuation technique based on currently observable market data. Gains and losses arising from changes in fair value of available-for-sale financial assets are recognised directly in other comprehensive income in “revaluation reserve from available-for-sale financial asset”, until the financial asset is derecognised or impaired. At this time, the cumulative gain or loss previously recognised in other comprehensive income is recognised in profit or loss as “gains and losses from available-for-sale financial assets”. Interest calculated using the effective interest method and foreign currency gains and losses on monetary assets classified as available-for-sale are recognised in the profit or loss. Dividends on available-for-sale equity instruments are recognised in the profit or loss within other operating income when the entity’s right to receive the payment is established.

Purchases and sales for regular way transactions of available-for-sale financial assets are recorded on the trade date. The Group derecognises available-for-sale financial assets when (a) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control.

**Financial liabilities**

Financial liabilities are recognized in the statement of financial position when the Group becomes a party to the contractual provisions of the instrument.

A financial liability is initially measured at its fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the issue of the financial liability. All financial liabilities, other than those at fair value through profit or loss and financial liabilities that arise when a transfer of a financial asset carried at fair value does not qualify for derecognition, are measured at amortized cost.\

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The Group derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

The financial liabilities at fair value through profit or loss consist solely of negative fair values arising from derivative financial instruments used for hedging, but not as hedging arrangements under the terms of hedge accounting as defined by IAS 39.

When the terms of an existing liability are substantially modified, such 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.

#### **Financial instruments – offsetting**

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

#### **Foreign currency translation**

##### *(a) Functional and presentation currency*

The national currency of Georgia is the Georgian lari (GEL), which is the Bank's and its subsidiary's functional currency and the currency in which these financial statements are presented. Management has determined the functional currency to be the GEL as it reflects the economic substance of the underlying events and circumstances of the Group. The GEL is not convertible outside Georgia.

All financial information presented in GEL has been rounded to the nearest thousand except when otherwise indicated.

##### *(b) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the profit or loss.

Monetary items denominated in foreign currency are translated with the closing rate as at the reporting date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period.

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.

Non-monetary items measured at historical cost denominated in foreign currency are translated with the exchange rate as of the date of initial recognition.

Foreign currency differences arising on retranslation are recognized in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, unless the difference is due to impairment,

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

in which case foreign currency differences that have been recognized in other comprehensive income are reclassified to profit or loss.

The reporting exchange rates and average rates for the period used in the statement of financial position and the statement of profit or loss and other comprehensive income are listed in Note 26.

**Cash and cash equivalents**

For the purposes of the statement of financial position, cash and cash equivalents comprise notes and coins on hand, balances with less than three months' maturity from the date of acquisition when eligible for discounting with the NBG, other money market instruments that are highly liquid and readily convertible to known amounts of cash with insignificant risk of changes in value, and certificates of deposits of the NBG. Cash and cash equivalents are carried at amortized cost in the statement of financial position.

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including notes and coins on hand and non-restricted balances with the NBG, non-pledged treasury bills and certificates of deposit and amounts due from banks. The mandatory reserve deposit with the NBG is not considered to be a cash equivalent due to restrictions on its withdraw ability.

**Loans and advances to customers and banks**

The amounts reported under receivables from customers consist mainly of loans and advances issued. In addition to overnight and term deposits, the amounts reported under receivables from banks include current account balances.

All loans and receivables to banks as well as loans and receivables to customers fall under the category "loans and receivables" and are carried at amortised cost, using the effective interest method. Premiums and discounts, including initial transactions costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument. Impairment of loans is recognised in separate allowance accounts.

For the purposes of the statement of cash flows, claims to banks with an original maturity of less than three months are recognised under cash and cash equivalents.

**Impairment of loans and advances**

The Group assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that impairment of a loan or a portfolio of loans has occurred which influences the future cash flows of the financial asset(s), the respective losses are immediately recognised. Depending on the size of the loan, such losses are either calculated on an individual loan basis or are collectively assessed for a portfolio of loans. The carrying amount of the loan is reduced through the use of an allowance account and the amount of the loss is recognised in the profit or loss. Group does not recognise losses from expected future events.



**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

• Individually assessed loans and advances

Credit exposures for which the sum of the on-balance sheet part and the off-balance sheet part exceeds the GEL equivalent of USD 50,000 are considered individually significant and as a bank-wide rule are individually assessed for impairment. For such credit exposures, it is assessed whether objective evidence of impairment exists, i.e. any factors which might influence the customer's ability to fulfil contractual payment obligations towards the Group.

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

When deciding on the allowance for impairment the aggregate exposure to the client and the realisable value of collateral held are taken into account.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of its estimated future cash flows discounted at the financial asset's original effective interest rate (specific impairment). If a credit exposure has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

• Collectively assessed loans and advances

There are two cases in which loans are collectively assessed for impairment:

- individually insignificant loans that show objective evidence of impairment;
- the group of individually significant and insignificant loans which do not show signs of impairment, in order to cover all losses which have already been incurred but not detected on an individual loan basis.

For the purposes of the evaluation of impairment of individually insignificant loans, the loans are grouped on the basis of similar credit risk characteristics, i.e. according to the number of days they are overdue in arrears. Arrears of 30 or more days are considered to be a sign of impairment. This characteristic is relevant for the estimation of future cash flows for such assets, based on historical loss experiences with loans that showed similar characteristics.

The collective assessment of impairment for individually insignificant credit exposures (lump-sum impairment) and for unimpaired significant credit exposures (portfolio-based impairment) belonging to a group of financial assets is based on a quantitative analysis of historical default rates for loan portfolios with similar risk characteristics with a comparable risk profile (migration analysis). After a qualitative analysis of this statistical data, management prescribed appropriate rates as the basis for the portfolio-based impairment allowances.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

#### Reversal of impairment

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the profit or loss.

#### Writing off loans and advances

When a loan is written off according to the internal policies, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the allowance for loan impairment in the profit or loss.

#### Restructured loans

Restructured loans which show signs of impairment and which are considered to be individually significant are assessed for impairment on an individual basis. The amount of the loss is measured as the difference between the restructured loan's carrying amount and the present value of its estimated future cash flows discounted at the loan's original effective interest rate (specific impairment). Restructured loans with arrears of more than 30 days overdue, which are individually insignificant, are collectively assessed for impairment.

#### **Reposessed collateral**

Reposessed collateral represents financial and non-financial assets acquired by the Group in settlement of overdue loans. The Group recognises reposessed assets in the statement of financial position when it has the full and final settlement rights to the collateral, and when it is entitled to retain any excess proceeds from the realisation of the collateral.

At initial recognition reposessed assets are measured at the lower of the carrying amount and the fair value less costs to sell and are included in premises and equipment, other financial assets or inventories within other assets depending on their nature and the Group's intention with respect to recovery of these assets. They are subsequently re-measured and accounted for in accordance with the accounting policies for these categories of assets.

The carrying amount of the reposessed assets is measured based on the value of the defaulted loan, including expenditure incurred in the process of collateral foreclosure. Fair value less costs to sell is the estimated selling price of the collateral in the ordinary course of business, less the related selling costs.

#### **Impairment of financial assets classified as available for sale**

The Group assesses at each reporting date whether there is objective evidence that a financial asset classified as available for sale is impaired based on the same criteria of impairment indicators as for loans and advances to customers.

In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. Impairment losses recognised in the profit or loss on equity instruments are not reversed through the profit or loss at any point thereafter. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the profit or loss.

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The Group primarily invests in government securities with fixed or variable interest rates. Impairments on these investments are recognised when objective evidence exists that the government is unable or unwilling to service these obligations.

#### **Property and equipment**

All property and equipment are stated at historical cost less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Component parts of an asset are recognised separately if they have different useful lives or provide benefits to the enterprise in a different pattern.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the profit or loss during the financial period in which they are incurred.

Land and assets under construction are not depreciated. Depreciation on other major classes of assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

- Buildings 2-3%
- Furniture and fixtures 20-25%
- IT and other equipment 20-25%

The assets' residual carrying values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These are included in the statement of profit or loss and other comprehensive income.

#### **Assets held for sale**

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. Immediately before classification as held for sale, the assets are remeasured in accordance with the Group's accounting policies. Thereafter generally the assets are measured at the lower of their carrying amount and fair value less cost to sell.

#### **Investment properties**

Investment properties are properties which are held either to earn rental income or for capital appreciation, or for both. These include properties with currently undetermined future use. Investment properties are measured initially at cost, including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met, and excludes the costs of day-to-day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at cost less accumulated depreciation and any impairment.

Investment properties are derecognised when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognised in profit or loss in the year of retirement or disposal.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Transfers are made to investment property when, and only when, there is a change in use, evidenced by ending of owner-occupation or commencement of an operating lease to another party. Transfers are made from investment properties when, and only when, there is a change in use, evidenced by commencement of owner-occupation or commencement of development with a view to sale.

**Intangible assets**

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Acquired intangible assets are stated at cost less accumulated amortisation and impairment losses.

Amortisation is charged to profit or loss on a straight-line basis over the estimated useful lives of intangible assets. Software has an expected useful life of five to eight years.

**Impairment of non-financial assets**

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

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

**Leases**

A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership. Group companies are party only to operating lease agreements (IAS 17). The properties leased out under operating leases are included in "investment properties". Lease income on operating leases is recognised over the term of the lease on a straight-line basis. Lease incentives are recognised as a reduction of rental income on a straight-line basis over the lease term.



### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### **Income tax**

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

#### **Current tax**

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

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

The new system of corporate income taxation does not imply exemption from Corporate Income Tax (CIT), rather CIT taxation is shifted from the moment of earning the profits to the moment of their distribution; i.e. the main tax object is distributed earnings. The Tax Code of Georgia defines Distributed Earnings (DE) to mean profit distributed to shareholders as a dividend. However some other transactions are also considered as DE, for example non-arm's length cross-border transactions with related parties and/or with persons exempted from tax are also considered as DE for CIT purposes. In addition, the tax object includes expenses or other payments not related to the entity's economic activities, free of charge supply and over-limit representative expenses.

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

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

#### **Deferred tax**

Deferred tax is provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit and temporary differences related to investments in subsidiaries, branches and associates where the parent is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities until 1 January 2019, using tax rates enacted or substantially enacted at the reporting date.

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

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

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### **Liabilities to banks and customers and other borrowed funds**

Liabilities to banks and customers and other borrowed funds are recognised initially at fair value net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the profit or loss over the period of the borrowings using the effective interest method.

All financial liabilities are derecognised when they are extinguished – that is, when the obligation is discharged, cancelled or expired.

#### **Provisions**

Provisions are recognised if

- there is a present legal or constructive obligation resulting from past events;
- it is more likely than not that an outflow of resources will be required to settle the obligation;
- and the amount can be reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow of resources will be required in a settlement is determined by considering the class of obligations as a whole.

Provisions for which the timing of the outflow of resources is known are measured at the present value of the expenditures, if the outflow will be no earlier than in one year's time. The increase in the present value of the obligation due to the passage of time is recognised as interest expense.

#### **Credit related commitments**

In the normal course of business, the Group enters into credit related commitments, comprising undrawn loan commitments, letters of credit and performance guarantees, and provides other forms of credit insurance. Financial guarantee contracts are contracts that require the Group to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. A financial guarantee liability is recognised initially at fair value net of associated transaction costs, and is measured subsequently at the higher of the amount initially recognised less cumulative amortisation or the amount of provision for losses under the guarantee. Provisions for losses under financial guarantees and other credit related commitments are recognised when losses are considered probable and can be measured reliably. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgement of management.

When the Group has the contractual right to revert to its customer for recovering amounts paid to settle the financial guarantee contracts, such amounts are recognised as loans and receivables in the statement of financial position. Any increase in the liability relating to guarantees is taken to the profit or loss under "other operating expenses".

Loan commitments are not recognised, except for the following:

- loan commitments that the Bank designates as financial liabilities at fair value through profit or loss;
- if the Bank has a past practice of selling the assets resulting from its loan commitments shortly after origination, then the loan commitments in the same class are treated as derivative instruments;
- loan commitments that can be settled net in cash or by delivering or issuing another financial instrument;
- commitments to provide a loan at a below-market interest rate.
-

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### **Subordinated debt**

Subordinated debt consists mainly of liabilities to shareholders and other international financial institutions which in the event of insolvency or liquidation are not repaid until all non-subordinated creditors have been satisfied. There is no obligation to repay early.

Following initial recognition at fair value, the subordinated debt is measured at amortised cost. Premiums and discounts are accounted for over the respective terms in the profit or loss under “net interest income”.

#### **Share capital and share premium**

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects. When share capital is increased, any difference between the registered amount of share capital and the actual consideration received is recognized as share premium.

#### **Dividends**

Dividends on ordinary shares are recognised as a distribution from equity in the period in which they are approved by the Bank’s shareholders.

#### **Interest income and expense**

Interest income and expenses (excluding capitalized borrowing costs) for all interest-bearing financial instruments, except for those classified as at fair value through profit or loss, are recognised within “interest income” and “interest expense” in the profit or loss using the effective interest method. Interest income and expense are recognised in the profit or loss in the period in which they arise.

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that is not carried at fair value and that necessarily takes a substantial period of time to be prepared for its intended use form part of the cost of that asset. The Group capitalizes borrowing costs that would have been avoided if it had not made capital expenditure on qualifying assets. The commencement date for capitalization is when the Group (a) incurs expenditures for the qualifying asset; (b) incurs borrowing costs; and (c) undertakes activities that are necessary to prepare the asset for its intended use or sale.

Capitalization ceases when all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Interest or other investment income is not deducted in arriving at the amount of borrowing costs available for capitalization, except where the Group obtains specific borrowings for the purpose of acquiring a qualifying asset and has investment income on the temporary investment of funds obtained through such specific borrowings.

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

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Payments received in respect of written-off loans are not recognised in net interest income.

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### **Fee and commission income and expenses**

Fee and commission income and expenses are generally recorded on an accrual basis by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Commissions for payment transfers and cash transactions and debit/credit card issuance fees, which are earned on execution of the underlying transaction, are recorded upon completion of the transaction. Account maintenance, internet bank and SMS service fees are recognized based on the applicable service contracts, usually on a time-proportion basis.

Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate of the loan. Loan syndication fees are recognised as revenue when the syndication has been completed and the Group has retained no part of the loan package for itself or has retained a part at the same effective interest rate as the other participants.

### **4. USE OF ASSUMPTIONS AND ESTIMATES**

The Group's financial reporting and its financial results are influenced by accounting policies, assumptions, estimates, and management judgement which necessarily have to be made in the course of preparation of the financial statements.

All estimates and assumptions required in conformity with IFRS are best estimates undertaken in accordance with the applicable standard. Estimates and judgements are evaluated on a continuous basis, and are based on past experience and other factors, including expectations with regard to future events and are considered appropriate under the given circumstances. Accounting policies and management's judgments for certain items are especially critical for the Group's results and financial situation due to their materiality. This applies to the allowances for impairment of loans.

A 10 % increase or decrease between actual loss experience and the loss estimates used will result in an additional or lower charge for loan loss impairment of GEL 1,838 thousand (2016: GEL 1,926 thousand).

The Bank applies different collective loan loss provisioning rates to the restructured and non-restructured loan portfolios. Impairment losses for individually significant loans are based on estimates of discounted future cash flows of the individual loans, taking into account repayments and realisation of any assets held as collateral against the loans.

To determine the Bank-wide rates to be applied for collective loan loss provisioning for the restructured exposures, the Bank performed an evaluation of the quality of the loan portfolio, taking into account historical loss experiences of most of the ProCredit institutions. This migration analysis is based on statistical data up to 2016 and therefore it reflects both average losses during a period of constant growth and favourable economic environments as well as average losses during a period of global recession in nearly all of the ProCredit group's countries of operations. Therefore management considered it appropriate to use the results of the migration analysis with a confidence level of 60% to cover incurred losses. For non-restructured loan portfolio, the Bank determines the collective loan loss provisioning in a manner that the migration analysis is based on the historical loss experience of the Bank, rather than all ProCredit institutions. The Bank believes this approach is more appropriate as reflects Bank specific historical loss experience.

Further information on the Bank's accounting policy on loan loss provisioning can be found in Notes 3 and 26.

## **5. ACCOUNTING DEVELOPMENTS**

### **(a) Adoption of New or Revised Standards and Interpretations**

The adopted accounting policies are consistent with those of the previous financial year. There were no new or amended standards or interpretations that resulted in a change of the accounting policy. The new disclosures are included in Note 22 in accordance with Disclosure Initiative – Amendments to IAS 7 (issued on 29 January 2016 and effective for annual periods beginning on or after 1 January 2017).

### **(b) Standards, amendments and interpretations issued but not yet effective**

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2018 or later, and which the Group has not early adopted.

***IFRS 9 “Financial Instruments” (amended in July 2014 and effective for annual periods beginning on or after 1 January 2018).*** Key features of the new standard are:

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).
- Classification for debt instruments is driven by the entity’s business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets’ cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.
- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.
- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a ‘three stage’ approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.
- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

## **5. ACCOUNTING DEVELOPMENTS (CONTINUED)**

In 2017, the Parent management has engaged an internationally recognised professional services firm to assist in implementing IFRS 9, including putting relevant systems, processes and controls in place. The Group relies on uniform policies and models developed at Parent company level. Currently Group is at the stage of finalisation its analysis of the Group's financial assets and financial liabilities as at 31 December 2017 and on the basis of the facts and circumstances that existed at that date to assess the likely impact on its financial statements from the adoption of the new standard on 1 January 2018.

The new standard is expected to impact measurement of financial assets, including an increase in loan loss provision, and financial liabilities and also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Group's disclosures about its financial instruments particularly in the year of the adoption of the new standard.

***IFRS 15, Revenue from Contracts with Customers (issued on 28 May 2014 and effective for the periods beginning on or after 1 January 2018).*** The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. The Group is currently assessing the impact of the new standard on its financial statements.

***IFRS 16, Leases (issued on 13 January 2016 and effective for annual periods beginning on or after 1 January 2019).*** The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. The Group is currently assessing the impact of the new standard on its financial statements.

***IFRS 17 "Insurance Contracts" (issued on 18 May 2017 and effective for annual periods beginning on or after 1 January 2021).*** IFRS 17 replaces IFRS 4, which has given companies dispensation to carry on accounting for insurance contracts using existing practices. As a consequence, it was difficult for investors to compare and contrast the financial performance of otherwise similar insurance companies. IFRS 17 is a single principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds. The standard requires recognition and measurement of groups of insurance contracts at: (i) a risk-adjusted present value of the future cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information; plus (if this value is a liability) or minus (if this value is an asset) (ii) an amount representing the unearned profit in the group of contracts (the contractual service margin). Insurers will be recognising the profit from a group of insurance contracts over the period they provide insurance coverage, and as they are released from risk. If a group of contracts is or becomes loss-making, an entity will be recognising the loss immediately. The Group is currently assessing the impact of the new standard on its financial statements.

***IFRIC 22 "Foreign currency transactions and advance consideration" (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).*** This interpretation considers how to determine the date of the transaction when applying the standard on foreign currency transactions, IAS 21. The interpretation applies where an entity either pays or received consideration in advance for foreign currency-denominated contracts. The interpretation specifies that the date of transaction is the date on which the entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the Interpretation requires an entity to determine the date of transaction for each payment or receipt of advance consideration. The Group is currently assessing the impact of the interpretation on its financial statements.



## **5. ACCOUNTING DEVELOPMENTS (CONTINUED)**

**IFRIC 23 "Uncertainty over Income Tax Treatments"** (issued on 7 June 2017 and effective for annual periods beginning on or after 1 January 2019). IAS 12 specifies how to account for current and deferred tax, but not how to reflect the effects of uncertainty. The interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments. An entity should determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments based on which approach better predicts the resolution of the uncertainty. An entity should assume that a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations. If an entity concludes it is not probable that the taxation authority will accept an uncertain tax treatment, the effect of uncertainty will be reflected in determining the related taxable profit or loss, tax bases, unused tax losses, unused tax credits or tax rates, by using either the most likely amount or the expected value, depending on which method the entity expects to better predict the resolution of the uncertainty. An entity will reflect the effect of a change in facts and circumstances or of new information that affects the judgments or estimates required by the interpretation as a change in accounting estimate. Examples of changes in facts and circumstances or new information that can result in the reassessment of a judgment or estimate include, but are not limited to, examinations or actions by a taxation authority, changes in rules established by a taxation authority or the expiry of a taxation authority's right to examine or re-examine a tax treatment. The absence of agreement or disagreement by a taxation authority with a tax treatment, in isolation, is unlikely to constitute a change in facts and circumstances or new information that affects the judgments and estimates required by the Interpretation. The Group is currently assessing the impact of the interpretation on its financial statements.

The following other new pronouncements are not expected to have any material impact on the Group when adopted:

- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture - Amendments to IFRS 10 and IAS 28 (issued on 11 September 2014 and effective for annual periods beginning on or after a date to be determined by the IASB).
- Amendments to IFRS 15, Revenue from Contracts with Customers (issued on 12 April 2016 and effective for annual periods beginning on or after 1 January 2018).
- Amendments to IFRS 2, Share-based Payment (issued on 20 June 2016 and effective for annual periods beginning on or after 1 January 2018).
- Amendments to IFRS 4, Insurance Contracts (issued on 12 September 2016 and effective for annual periods beginning on or after 1 January 2018).
- Transfers of Investment Property – Amendments to IAS 40 (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).
- Annual Improvements to IFRSs 2014-2016 cycle – Amendments to IFRS 1 and IAS 28 (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**6. CASH AND BALANCES WITH THE NBG**

Cash and balances with the NBG comprise the following items:

in '000 GEL	31 December 2017	31 December 2016
Cash on hand	49,798	70,626
Balances at the NBG excluding mandatory reserves	11,579	10,749
Certificates of deposit of the NBG	22,785	38,435
Nostro accounts other than with NBG	55,980	136,120
<b>Total cash and balances with the NBG in the statement of financial position</b>	<b>140,141</b>	<b>255,930</b>

No cash and balances with the NBG are impaired or past due. In 2017, Fitch Ratings affirmed the Government of Georgia's short term Issuer Default Rating of "B" and long-term Issuer Default Rating of "BB-" with the stable outlook (2016: short term "B" and long-term "BB-").

The following cash equivalents were considered as cash for the cash flow statement:

in '000 GEL	31 December 2017	31 December 2016
Cash and balances with NBG	140,141	255,930
Due from banks with a maturity up to three months (Note 7)	16,171	38,033
<b>Total cash and cash equivalents in the statement of cash flows</b>	<b>156,312</b>	<b>293,963</b>

Balances with the NBG above exclude the mandatory reserve deposit which is a non-interest bearing deposit calculated in accordance with regulations issued by the NBG. Refer to Note 27 for the estimated fair value of cash and cash equivalents. The interest rate analysis of cash and cash equivalents is disclosed in Note 26.

**7. DUE FROM BANKS**

in '000 GEL	31 December 2017	31 December 2016
Due from Banks in OECD* countries	446	607
Due from Banks in non-OECD countries	15,724	37,426
<b>Total due from banks</b>	<b>16,171</b>	<b>38,033</b>

The following table details the credit ratings of due from banks as assessed by Fitch Ratings:

in '000 GEL	AA	A	BBB	<BBB	Not Rated	Total
Neither past due nor impaired						
<b>31 December 2017</b>	446	-	-	15,724	-	<b>16,171</b>
<b>31 December 2016</b>	607	-	-	37,426	-	<b>38,033</b>

As at 31 December 2017 the Group had 1 related party bank, whose balance of GEL 34,492 thousand exceeded 10% of equity. As at 31 December 2016 none of the Group's counterparty bank balances exceeded 10% of equity.

Refer to Note 27 for the estimated fair value of each class of amounts due from banks. The interest rate analysis is disclosed in Note 26. Information on related party balances is disclosed in Note 29.

\* Organisation for Economic Cooperation and Development

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**8. INVESTMENT SECURITIES AVAILABLE-FOR-SALE**

All securities which are not designated as financial assets at fair value through profit or loss are classified as available-for-sale financial assets.

in '000 GEL	31 December 2017	31 December 2016
Treasury bills issued by the Government of Georgia	4,943	16,809
<b>Equity investments</b>		
Shares in companies situated in OECD countries	35	35
Shares in companies situated in non-OECD countries	199	199
<b>Total equity investments</b>	<b>234</b>	<b>234</b>
<b>Total investment securities available-for-sale</b>	<b>5,177</b>	<b>17,043</b>

Shares in companies comprise:

in '000 GEL	Ownership interest	At 31 December 2017	Ownership interest	At 31 December 2016
JSC Creditinfo Georgia	16.63%	95	16.63%	95
JSC United Clearing Center Georgia	6.25%	54	6.25%	54
JSC American Academy in Tbilisi	4.85%	50	4.85%	50
S.W.I.F.T.SCRL	0.01%	35	0.01%	35
<b>Total</b>		<b>234</b>		<b>234</b>

Equity investments are carried at cost of GEL 234 thousand (2016: GEL 234 thousand). The investees have not published recent financial information about their operations, their shares are not quoted and recent trade prices are not publicly accessible. Management could not reliably estimate the fair value of the equity investment securities.

Movements in investment securities available-for-sale:

in '000 GEL	Treasury bills issued by the Government of Georgia	Shares	Total
<b>Balance at 1 January 2017</b>	<b>16,809</b>	<b>234</b>	<b>17,043</b>
Purchases net of discounts	29,799	-	30,000
Interest accrued	466	-	579
Interest paid	(466)	-	(579)
Disposals net of discounts	(41,665)	-	(41,866)
<b>Balance at 31 December 2017</b>	<b>4,943</b>	<b>234</b>	<b>5,177</b>

in '000 GEL	Treasury bills issued by the Government of Georgia	Shares	Total
<b>Balance at 1 January 2016</b>	<b>19,753</b>	<b>234</b>	<b>19,987</b>
Purchases net of discounts	32,178	-	32,178
Interest accrued	741	-	741
Interest paid	(868)	-	(868)
Disposals net of discounts	(34,995)	-	(34,995)
<b>Balance at 31 December 2016</b>	<b>16,809</b>	<b>234</b>	<b>17,043</b>

None of the investment securities available-for-sale are past due or impaired.

The fair values reported are either observable market prices in active market or values calculated with a valuation technique based in currently observable market data. Valuation method used is then discounted cash flow technique. Main inputs used for valuation are variables of government bond yield curve. Fair value estimate for available for sale instruments is categorized into Level 2 fair value hierarchy.

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**9. LOANS AND ADVANCES TO CUSTOMERS**

The table below presents contractual size and outstanding amounts of loans and advances to customers as at 31 December 2017:

in '000 GEL

(except for number of  
outstanding loans and loan  
sizes)

<b>At 31 December 2017</b>	<b>Gross amount</b>	<b>Allowance for impairment</b>	<b>Net amount</b>	<b>Share of total portfolio</b>
<b>Wholesale and trade loans</b>				
loan size up to USD 50,000	45,113	(1,304)	43,809	4.44%
loan size USD 50,000 to USD 250,000	156,196	(3,283)	152,914	15.49%
loan size more than USD 250,000	168,078	(2,059)	166,019	16.81%
<b>Total wholesale and trade loans</b>	<b>369,387</b>	<b>(6,646)</b>	<b>362,741</b>	<b>36.74%</b>
<b>Agricultural, forestry and fishing loans</b>				
loan size up to USD 50,000	3,562	(167)	3,395	0.35%
loan size USD 50,000 to 250,000 USD	16,380	(656)	15,724	1.59%
loan size more than USD 250,000	30,910	(379)	30,532	3.09%
<b>Total agricultural, forestry and fishing loans</b>	<b>50,853</b>	<b>(1,202)</b>	<b>49,651</b>	<b>5.03%</b>
<b>Production loans</b>				
loan size up to USD 50,000	14,462	(518)	13,944	1.41%
loan size USD 50,000 to 250,000 USD	55,695	(1,260)	54,435	5.51%
loan size more than USD 250,000	59,727	(800)	58,927	5.97%
<b>Total production loans</b>	<b>129,884</b>	<b>(2,578)</b>	<b>127,306</b>	<b>12.89%</b>
<b>Transportation and storage loans</b>				
loan size up to USD 50,000	4,724	(139)	4,584	0.47%
loan size USD 50,000 to 250,000 USD	13,679	(241)	13,439	1.36%
loan size more than USD 250,000	902	(10)	892	0.09%
<b>Total transportation and storage loans</b>	<b>19,306</b>	<b>(390)</b>	<b>18,915</b>	<b>1.92%</b>
<b>Other economic activities</b>				
loan size up to USD 50,000	41,013	(707)	40,307	4.08%
loan size USD 50,000 to 250,000 USD	144,456	(3,342)	141,114	14.29%
loan size more than USD 250,000	178,539	(2,122)	176,417	17.87%
<b>Total other economic activities loans</b>	<b>364,009</b>	<b>(6,171)</b>	<b>357,838</b>	<b>36.24%</b>
<b>Total Business loans</b>	<b>933,438</b>	<b>(16,987)</b>	<b>916,452</b>	<b>92.82%</b>
<b>Housing loans</b>				
loan size up to USD 50,000	31,116	(573)	30,543	3.09%
loan size USD 50,000 to 250,000 USD	34,084	(606)	33,478	3.39%
<b>Total housing loans</b>	<b>65,200</b>	<b>(1,179)</b>	<b>64,021</b>	<b>6.48%</b>
<b>Investment loans</b>				
loan size up to USD 50,000	5,179	(153)	5,026	0.51%
loan size USD 50,000 to 250,000 USD	954	(11)	943	0.10%
loan size more than USD 250,000	490	(5)	485	0.05%
<b>Total investment loans</b>	<b>6,623</b>	<b>(169)</b>	<b>6,454</b>	<b>0.65%</b>
<b>Other loans</b>	<b>461</b>	<b>(49)</b>	<b>412</b>	<b>0.04%</b>
<b>Total Private loans</b>	<b>72,283</b>	<b>(1,397)</b>	<b>70,886</b>	<b>7.18%</b>
<b>Total</b>	<b>1,005,722</b>	<b>(18,384)</b>	<b>987,337</b>	<b>100.00%</b>

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**9. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)**

The table below presents contractual size and outstanding amounts of loans and advances to customers as at 31 December 2016:

in '000 GEL

(except for number of  
outstanding loans and loan  
sizes)

<b>At 31 December 2017</b>	<b>Gross amount</b>	<b>Allowance for impairment</b>	<b>Net amount</b>	<b>Share of total portfolio</b>
<b>Wholesale and trade loans</b>				
loan size up to USD 50,000	51,672	(2,517)	49,155	5.74%
loan size USD 50,000 to USD 250,000	159,707	(3,815)	155,892	18.21%
loan size more than USD 250,000	133,454	(1,884)	131,570	15.37%
<b>Total wholesale and trade loans</b>	<b>344,833</b>	<b>(8,216)</b>	<b>336,617</b>	<b>39.31%</b>
<b>Agricultural, forestry and fishing loans</b>				
loan size up to USD 50,000	4,972	(362)	4,610	0.54%
loan size USD 50,000 to 250,000 USD	15,733	(826)	14,907	1.74%
loan size more than USD 250,000	31,884	(689)	31,196	3.64%
<b>Total agricultural, forestry and fishing loans</b>	<b>52,589</b>	<b>(1,877)</b>	<b>50,712</b>	<b>5.92%</b>
<b>Production loans</b>				
loan size up to USD 50,000	16,2446	(505)	15,741	1.83%
loan size USD 50,000 to 250,000 USD	52,154	(798)	51,356	6.00%
loan size more than USD 250,000	37,712	(484)	37,228	4.35%
<b>Total production loans</b>	<b>106,113</b>	<b>(1,788)</b>	<b>104,325</b>	<b>12.18%</b>
<b>Transportation and storage loans</b>				
loan size up to USD 50,000	5,663	(462)	5,200	0.61%
loan size USD 50,000 to 250,000 USD	12,833	(197)	12,637	1.48%
loan size more than USD 250,000	1,678	(33)	1,645	0.19%
<b>Total transportation and storage loans</b>	<b>20,174</b>	<b>(692)</b>	<b>19,482</b>	<b>2.28%</b>
<b>Other economic activities</b>				
loan size up to USD 50,000	47,473	(1,060)	46,413	5.42%
loan size USD 50,000 to 250,000 USD	125,851	(2,807)	123,044	14.37%
loan size more than USD 250,000	127,472	(1,722)	125,751	14.69%
<b>Total other economic activities loans</b>	<b>300,796</b>	<b>(5,588)</b>	<b>295,208</b>	<b>34.48%</b>
<b>Total Business loans</b>	<b>824,504</b>	<b>(18,160)</b>	<b>806,344</b>	<b>94.17%</b>
<b>Housing loans</b>				
loan size up to USD 50,000	24,376	(437)	23,939	2.80%
loan size USD 50,000 to 250,000 USD	13,544	(352)	13,192	1.54%
loan size more than USD 250,000	704	(8)	697	0.08%
<b>Total housing loans</b>	<b>38,625</b>	<b>(796)</b>	<b>37,828</b>	<b>4.42%</b>
<b>Investment loans</b>				
loan size up to USD 50,000	8,965	(250)	8,715	1.02%
loan size USD 50,000 to 250,000 USD	1,794	(19)	1,774	0.21%
loan size more than USD 250,000	878	(9)	868	0.10%
<b>Total investment loans</b>	<b>11,637</b>	<b>(279)</b>	<b>11,358</b>	<b>1.33%</b>
<b>Other loans</b>	<b>721</b>	<b>(26)</b>	<b>695</b>	<b>0.08%</b>
<b>Total Private loans</b>	<b>50,982</b>	<b>(1,101)</b>	<b>49,881</b>	<b>5.83%</b>
<b>Total</b>	<b>875,486</b>	<b>(19,261)</b>	<b>856,225</b>	<b>100.00%</b>

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**9. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)**

The size categories above refer to the amounts originally disbursed to one single borrower.

As at 31 December 2017 and 2016 the Group had no borrowers or groups of connected borrowers whose loan balances exceeded 10% of equity.

**Allowance for losses on loans and advances to customers**

Credit risks that arise from loans and advances to customers are covered by allowance for impairment losses. In addition to the allowance for specific impairment losses for receivables for which there is objective evidence of impairment, allowances were formed to cover impairment losses relating to the customer loan portfolio which are incurred but not identified. The composition of allowances for loan impairment was as follows:

in '000 GEL	31 December 2017	31 December 2016
Allowance for individually significant impaired loans	5,794	6,983
Allowance for individually insignificant impaired loans	1,247	2,287
Allowance for unimpaired loans	11,343	9,991
<b>Total</b>	<b>18,384</b>	<b>19,261</b>

The following table shows the development of allowances for impairment losses for loans and advances to customers by classes of loans:

in '000 GEL	Wholesale and retail trade	Agriculture, forestry and fishing	Production	Transportation and storage	Other economic activities	Housing	Investment	Other	Total
<b>Allowance for loan impairment at 1 January 2016</b>	11,298	2,301	2,573	1,674	7,906	1,094	949	38	27,834
Charge to provision for loan impairment during the year	9,533	3,109	1,445	1,463	4,804	720	774	79	21,927
Unwinding of discount on impaired loans	(1,094)	(306)	(397)	(132)	(630)	(70)	(38)	-	(2,666)
Amount written off during the year	(11,521)	(3,228)	(1,833)	(2,313)	(6,492)	(949)	(1,406)	(92)	(27,834)
<b>Allowance for loan impairment at 31 December 2016</b>	8,216	1,877	1,788	692	5,588	796	279	26	19,261
Charge to provision for loan impairment during the year	3,911	1,309	2,178	95	2,394	647	71	97	10,701
Unwinding of discount on impaired loans	(536)	(155)	(152)	(43)	(278)	(52)	(5)	-	(1,221)
Amount written off during the year	(4,945)	(1,828)	(1,235)	(353)	(1,534)	(212)	(175)	(73)	(10,356)
<b>Allowance for loan impairment at 31 December 2017</b>	6,646	1,202	2,578	390	6,171	1,179	169	49	18,384



**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**9. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)**

Charge to provision for loan impairment in the table above differs from the amount in statement of profit or loss by GEL 5,790 (2016: GEL 8,265) attributable to recoveries of assets previously written off.

Further analysis for each group of loans is detailed in Note 26.

Analysis by credit quality of loans outstanding at 31 December 2017 is as follows:

in '000 GEL	Wholesale and retail trade	Agriculture, forestry and fishing	Production	Transportation and storage	Other economic activities	Housing	Investment	Other	Total
<b>Neither past due nor impaired</b>									
< 50,000 USD	42,572	3,124	13,143	4,165	39,595	30,480	4,586	366	138,031
50,000 to 250,000 USD	148,815	15,440	51,636	13,072	136,139	33,138	954	-	399,193
Over 250,000 USD	167,025	30,910	58,711	902	176,990	-	490	-	435,029
<b>Total neither past due but not impaired loans</b>	<b>358,412</b>	<b>49,474</b>	<b>123,490</b>	<b>18,139</b>	<b>352,724</b>	<b>63,618</b>	<b>6,030</b>	<b>366</b>	<b>972,253</b>
<b>Past due but not impaired</b>									
<b>Loans collectively determined to be impaired</b>									
- 31 to 90 days overdue	73	64	-	52	31	42	19	14	296
- 91 to 180 days overdue	205	-	94	25	7	106	31	48	515
- 181 to 365 days overdue	196	59	181	-	-	97	15	2	549
<b>Total collectively impaired loans</b>	<b>474</b>	<b>123</b>	<b>275</b>	<b>77</b>	<b>39</b>	<b>245</b>	<b>65</b>	<b>63</b>	<b>1,360</b>
<b>Loans individually determined to be impaired</b>									
- less than 30 days overdue	1,044	-	133	-	93	83	-	-	1,353
- 31 to 90 days overdue	2,243	-	997	-	848	-	-	-	4,088
- 91 to 180 days overdue	1,186	448	104	269	935	-	-	-	2,942
- 181 to 365 days overdue	1,955	119	2,908	175	1,843	801	63	-	7,864
- over 365 days overdue	417	179	-	165	861	169	-	-	1,791
<b>Total individually impaired loans</b>	<b>6,845</b>	<b>747</b>	<b>4,142</b>	<b>609</b>	<b>4,578</b>	<b>1,054</b>	<b>63</b>		<b>18,038</b>
<b>Less impairment provisions</b>	<b>(6,646)</b>	<b>(1,202)</b>	<b>(2,578)</b>	<b>(390)</b>	<b>(6,171)</b>	<b>(1,179)</b>	<b>(169)</b>	<b>(49)</b>	<b>(18,384)</b>
<b>Total loans and advances to customers</b>	<b>362,741</b>	<b>49,651</b>	<b>127,306</b>	<b>18,915</b>	<b>357,838</b>	<b>64,021</b>	<b>6,454</b>	<b>412</b>	<b>987,337</b>

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**9. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)**

Analysis by credit quality of loans outstanding at 31 December 2016 is as follows:

in '000 GEL	Wholesale and retail trade	Agriculture, forestry and fishing	Production	Transportation and storage	Other economic activities	Housing	Investment	Other	Total
<b>Neither past due nor impaired</b>									
< 50,000 USD	46,819	3,988	14,987	4,642	44,695	23,973	8,603	661	148,370
50,000 to 250,000 USD	152,231	13,541	49,616	12,481	120,650	12,676	1,737	-	362,933
Over 250,000 USD	131,643	30,135	37,069	1,678	126,466	704	878	-	328,574
<b>Total neither past due but not impaired loans</b>	<b>330,693</b>	<b>47,665</b>	<b>101,672</b>	<b>18,801</b>	<b>291,812</b>	<b>37,354</b>	<b>11,218</b>	<b>661</b>	<b>839,876</b>
<b>Past due but not impaired</b>	<b>3,445</b>	<b>1,668</b>	<b>1,725</b>	<b>165</b>	<b>5,675</b>	<b>287</b>	<b>232</b>	<b>18</b>	<b>13,214</b>
<b>Loans collectively determined be impaired</b>	253	125	81	59	114	17	50	20	720
- 31 to 90 days overdue	2,069	1,107	-	388	81	5	-	-	3,651
- 91 to 180 days overdue	348	11	15	74	219	17	86	20	790
- 181 to 365 days overdue	604	46	53	218	145	87	51	-	1,205
<b>Total collectively impaired loans</b>	<b>1,205</b>	<b>183</b>	<b>148</b>	<b>351</b>	<b>479</b>	<b>121</b>	<b>188</b>	<b>40</b>	<b>2,715</b>
<b>Loans individually determined to be impaired</b>									
- less than 30 days overdue	316	-	1,112	-	764	601	-	-	2,793
- 31 to 90 days overdue	2,069	1,107	-	388	81	5	-	-	3,651
- 91 to 180 days overdue	4,274	1,608	292	354	1,022	199	-	-	7,749
- 181 to 365 days overdue	1,893	358	1,046	115	176	57	-	-	3,644
- over 365 days overdue	937	-	118	165	788	169	-	1	1,845
<b>Total individually impaired loans</b>	<b>9,489</b>	<b>3,073</b>	<b>2,568</b>	<b>857</b>	<b>2,831</b>	<b>862</b>	<b>-</b>	<b>1</b>	<b>19,681</b>
<b>Less impairment provisions</b>	<b>(8,216)</b>	<b>(1,877)</b>	<b>(1,788)</b>	<b>(692)</b>	<b>(5,588)</b>	<b>(796)</b>	<b>(279)</b>	<b>(26)</b>	<b>(19,261)</b>
<b>Total loans and advances to customers</b>	<b>336,617</b>	<b>50,712</b>	<b>104,325</b>	<b>19,482</b>	<b>295,208</b>	<b>37,828</b>	<b>11,358</b>	<b>695</b>	<b>856,225</b>

Loans in arrears more than 30 days are classified as impaired loans. Loans in arrears with less than or equal to 30 days overdue are considered unimpaired.

The size categories above refer to the amounts originally disbursed to the groups of connected borrowers.

**9. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)**

**Collateral**

The general creditworthiness of a customer tends to be the most relevant indicator of credit quality of the loan extended to it. However, collateral provides additional security and the Group generally requests the borrowers to provide it.

For loans to customers which are neither past due nor impaired, the fair value of collateral was estimated at the inception of the loans and was not adjusted for subsequent changes to the reporting date. The recoverability of these loans is primarily dependent on the creditworthiness of the borrowers rather than the value of collateral, and the Group does not necessarily update the valuation of collateral as at each reporting date. For loans secured by multiple types of collateral, collateral that is most relevant for impairment assessment is disclosed.

The following tables provide information on collateral securing loans and advances to customers by type of collateral as at 31 December 2017 and 2016:

in '000 GEL

<b>At 31 December 2017</b>	<b>Real estate</b>	<b>Cash collateral</b>	<b>Other</b>	<b>No collateral</b>	<b>Total</b>
Wholesale and trade	335,133	5,199	5,035	17,437	362,804
Agriculture,forestry and fishing	42,778	1,906	4,260	707	49,651
Production	109,628	-	9,579	8,099	127,306
Transportation and storage	17,475	-	818	623	18,915
Other economic activities	336,811	5	3,208	17,752	357,775
Housing	61,568	-	5	2,447	64,021
Investment loans	6,081	-	13	359	6,454
Other	412	-	-	-	412
<b>Total</b>	<b>909,886</b>	<b>7,109</b>	<b>22,918</b>	<b>47,424</b>	<b>987,337</b>

in '000 GEL

<b>At 31 December 2016</b>	<b>Real estate</b>	<b>Cash collateral</b>	<b>Other</b>	<b>No collateral</b>	<b>Total</b>
Wholesale and trade	332,008	3,273	768	568	336,617
Agriculture,forestry and fishing	48,624	1,731	-	357	50,712
Production	94,214	3	3,129	6,979	104,325
Transportation and storage	18,590	-	166	727	19,482
Other economic activities	279,640	490	7,065	8,012	295,208
Housing	34,309	272	-	3,248	37,828
Investment loans	7,521	-	-	3,837	11,358
Other	482	103	-	110	695
<b>Total</b>	<b>815,387</b>	<b>5,872</b>	<b>11,128</b>	<b>23,838</b>	<b>856,225</b>

The tables above exclude overcollateralization.

Refer to Note 27 for the estimated fair value of each class of loans and advances to customers. For more information on credit risk management and interest rate analysis of loans and advances to customers refer to Note 26.

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

---

**10. INVESTMENT PROPERTIES**

**Consolidated**

in '000 GEL	2017	2016
<b>Net book value at 1 January</b>	<b>1,697</b>	<b>673</b>
Transfers	6,374	
Additions	120	1,065
Disposals	(188)	(29)
Depreciation for the year	(129)	(14)
Disposal of depreciation	3	2
Transfers(Additions)Depreciation	(775)	-
<b>Net book value at 31 December</b>	<b>7,102</b>	<b>1,697</b>
Total acquisition costs	8,044	1,739
Accumulated depreciation	(942)	(42)
<b>Net book value at 31 December</b>	<b>7,102</b>	<b>1,697</b>

Rental income in 2017 under operating leases was GEL 357 thousand (2016: GEL 65 thousand).

**Separate**

in '000 GEL	2017	2016
<b>Net book value at 1 January</b>	<b>-</b>	<b>-</b>
Transfers	6,374	-
Additions	8	-
Disposals	-	-
Depreciation for the year	(95)	-
Disposal of depreciation	-	-
Transfers(Additions)Depreciation	(775)	-
<b>Net book value at 31 December</b>	<b>5,513</b>	<b>-</b>
Total acquisition costs	6,382	-
Accumulated depreciation	(870)	-
<b>Net book value at 31 December</b>	<b>5,513</b>	<b>-</b>

Management estimates that the fair value of the investment properties approximates their carrying amount. The fair value estimate is categorized into Level 3 of the fair value hierarchy, because of significant unobservable adjustments used in the valuation method. The fair value was determined based on market prices in recent transactions or announced asking prices of similar properties. Key unobservable input used for sales comparison approach is price per square meter of similar properties. Prices are applied adjustments based on the difference between subject assets and analogues.

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**11. INTANGIBLE ASSETS**

The development of intangible assets is shown in the following table:

in '000 GEL	2017	2016
<b>Net book value as at 1 January</b>	1,676	<b>2,287</b>
Additions	152	84
Disposal	(2)	-
Amortisation for the year	(435)	(695)
Disposal of amortisation	2	-
<b>Net book value as at 31 December</b>	1,393	<b>1,676</b>
Total acquisition costs as at 31 December	9,555	9,405
Accumulated amortisation as at 31 December	(8,162)	(7,729)
<b>Net book value as at 31 December</b>	1,393	<b>1,676</b>

**12. PROPERTY AND EQUIPMENT**

The development of property and equipment was as follows:

in '000 GEL	Land & buildings	Leasehold improvements	Assets under construction	Furniture and fixtures	IT and other equipment	Total
Total acquisition costs	61,884	3,054	593	14,548	24,619	104,698
Accumulated depreciation	(5,409)	(1,389)	-	(6,360)	(15,558)	(28,716)
<b>Net book value at 1 January 2016</b>	<b>56,475</b>	<b>1,665</b>	<b>593</b>	<b>8,188</b>	<b>9,061</b>	<b>75,982</b>
Transfers	607	735	(1,342)	-	-	-
Additions	66	63	1,133	2,241	2,402	5,905
Disposals - at cost	-	(606)	-	(1,058)	(1,077)	(2,741)
Depreciation for the year	(1,255)	(477)	-	(1,595)	(2,636)	(5,963)
Disposals - accumulated depreciation	-	425	-	857	1,057	2,339
<b>Net book value at 31 December 2016</b>	<b>55,893</b>	<b>1,805</b>	<b>384</b>	<b>8,633</b>	<b>8,807</b>	<b>75,522</b>
Total acquisition costs	62,557	3,246	384	15,731	25,944	107,862
Accumulated depreciation	(6,664)	(1,441)	-	(7,098)	(17,137)	(32,340)
<b>Net book value at 1 January 2016</b>	<b>55,893</b>	<b>1,805</b>	<b>384</b>	<b>8,633</b>	<b>8,807</b>	<b>75,522</b>
Transfers	(6,374)	-	-	-	-	(6,374)
Additions	44	-	187	532	534	1,297
Disposals - at cost	(1,725)	(1,830)	-	(726)	(2,667)	(6,947)
Depreciation for the year	(1,168)	(412)	-	(1,781)	(2,202)	(5,563)
Disposals - accumulated depreciation	353	891	-	634	2,564	4,442
Transfer(Additions)Depreciation	775	-	-	-	-	775
<b>Net book value at 31 December 2016</b>	<b>47,797</b>	<b>455</b>	<b>571</b>	<b>7,292</b>	<b>7,037</b>	<b>63,152</b>
Total acquisition costs	54,502	1,415	571	15,536	23,813	95,836
Accumulated depreciation	(6,705)	(960)	-	(8,244)	(16,776)	(32,684)
<b>Net book value at 31 December 2017</b>	<b>47,797</b>	<b>455</b>	<b>571</b>	<b>7,292</b>	<b>7,037</b>	<b>63,152</b>

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**13. OTHER ASSETS**

At 31 December 2017 and 2016, other assets were as follows:

**Consolidated**

in '000 GEL	31 December 2017	31 December 2016
Accounts receivable from credit card and online payment system companies and money transfer agencies	1,968	5,255
Other	71	414
<b>Total other financial assets</b>	<b>2,039</b>	<b>5,669</b>
<i>Non-current</i>		
Repossessed properties	3,863	4,363
Prepayments for court fees and charges, net of provision	929	1,068
Prepayments for fixed assets	189	52
<i>Current</i>		
Prepayments for various services	1,153	2,482
Assets classified as held for sale	1,350	2,582
Inventory and other	708	797
<b>Total other non-financial assets</b>	<b>8,192</b>	<b>11,344</b>
<b>Total</b>	<b>10,232</b>	<b>17,013</b>

**Separate**

in '000 GEL	31 December 2017	31 December 2016
Accounts receivable from credit card and online payment system companies and money transfer agencies	1,968	5,255
Other	71	414
<b>Total other financial assets</b>	<b>2,039</b>	<b>5,669</b>
<i>Non-current</i>		
Repossessed properties	313	398
Prepayments for court fees and charges, net of provision	929	1,068
Prepayments for fixed assets	189	52
<i>Current</i>		
Prepayments for various services	792	2,315
Assets classified as held for sale	1,350	2,582
Inventory and other	689	776
<b>Total other non-financial assets</b>	<b>4,263</b>	<b>7,191</b>
<b>Total</b>	<b>6,303</b>	<b>12,861</b>

As at the date of initial recognition and as at 31 December 2017, management believes that the carrying value of the assets held for sale was not materially different from their fair value less costs to sell at those dates. The fair value estimate is categorized into Level 3 of the fair value hierarchy, because of significant unobservable adjustments used in the valuation method. The fair value was determined based on market prices in recent transactions or announced asking prices of similar properties.

None of the other financial assets are impaired or past due. Refer to Note 27 for the estimated fair value of other financial assets. Information on related party balances is disclosed in Note 29.



**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

---

**14. DUE TO BANKS**

Due to banks consists of short-term loans obtained on the interbank market, as well as funds kept by other banks on correspondent accounts with the Bank.

The funds for short term needs have been provided to the Group by ProCredit Bank Germany in 2017.

in '000 GEL	31 December 2017	31 December 2016
Banks in OECD countries	41,285	0
Banks in non-OECD countries	7,355	2,857
<b>Total</b>	<b>48,639</b>	<b>2,857</b>

Refer to Note 27 for the estimated fair value of due to banks. Information on related party balances is disclosed in Note 29.

**15. CUSTOMERS ACCOUNTS**

Customer accounts consist of deposits due on demand, savings deposits and term deposits. The following table shows a breakdown by customer groups:

in '000 GEL	31 December 2017	31 December 2016
<b>Current accounts</b>	<b>205,840</b>	<b>200,491</b>
- private individuals	55,638	55,306
- legal entities	150,202	145,185
<b>Savings accounts</b>	<b>220,504</b>	<b>246,026</b>
- private individuals	139,764	178,352
- legal entities	80,740	67,674
<b>Term deposit accounts</b>	<b>198,715</b>	<b>283,964</b>
- private individuals	159,001	231,035
- legal entities	39,714	52,929
<b>Other liabilities to customers</b>	<b>4,000</b>	<b>2,094</b>
<b>Total</b>	<b>629,059</b>	<b>732,575</b>

The category “legal entities” includes liabilities to non-governmental organisations (NGOs) and public-sector institutions.

The following table shows a breakdown of customer accounts by economic sector:

in '000 GEL	31 December 2017	31 December 2016
Private individuals	354,404	464,693
Trade and services	170,712	168,360
Construction	19,177	18,600
Government	4,760	4,760
Transportation and communications	3,160	2,734
Agriculture and forestry	7,079	3,403
Mining and mineral processing	1,727	1,734
Other	68,039	68,291
<b>Total</b>	<b>629,059</b>	<b>732,575</b>

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**15. CUSTOMER ACCOUNTS (CONTINUED)**

At 31 December 2017, the Group had 78 customers (2016: 65 customers) with balances above GEL 1,000 thousand. The aggregate balance of these customers was GEL 171,171 thousand (2016: GEL 174,446 thousand) or 27 % (2016: 24 %) of total customer accounts.

At 31 December 2017, customer accounts included deposits of GEL 7,109 thousand (2016: GEL 5,872 thousand) held as collateral for on-balance exposures and GEL 5,240 thousand (2016: GEL 2,154 thousand) held as collateral for irrevocable commitments under financial and performance guarantees and letters of credit. Refer to Note 28.

Interest rate analysis is disclosed in Note 26. Information on related party balances is disclosed in Note 29. Refer to Note 27 for the estimated fair value of each class of customer accounts.

**16. OTHER BORROWED FUNDS**

Liabilities to international financial institutions are an important source of financing for the Group. Below are reported medium- to long-term loans from international financial institutions:

in '000 GEL

<b>Liabilities with fixed interest rates</b>	<b>Due</b>	<b>31 December 2017</b>	<b>31 December 2016</b>
ProCredit Holding AG & Co. KGaA	June 2021	12,921	13,280
ProCredit Holding AG & Co. KGaA	May 2021	12,958	13,319
Ministry of Finance of Georgia	December 2026	2,522	2,535
European Investment Bank (EIB)	October 2024	15,281	-
European Investment Bank (EIB)	April 2022	6,196	7,783
European Investment Bank (EIB)	July 2022	26,239	32,261
European Investment Bank (EIB)	February 2024	6,039	7,288
European Investment Bank (EIB)	April 2024	25,037	29,692
Oesterreichische Entwicklungsbank AG (OeEB)	March 2018	7,820	24,090
Council of Europe Development Bank (CEB)	August 2022	13,921	17,170
European Investment Bank (EIB)	March 2023	28,700	29,498
ProCredit Holding AG & Co. KGaA	February 2018	40,193	-
ProCredit Holding AG & Co. KGaA	August 2027	13,065	-
ProCredit Holding AG & Co. KGaA	August 2027	13,065	-
ProCredit Holding AG & Co. KGaA	April 2018	7,787	8,004
ProCredit Holding AG & Co. KGaA	May 2021	25,917	27,134
ProCredit Holding AG & Co. KGaA	June 2021	18,072	18,572
ProCredit Holding AG & Co. KGaA	July 2021	26,475	26,961
ProCredit Bank AG, Frankfurt am Main	June 2021	20,654	26,532
<b>Total liabilities with fixed interest rates</b>		<b>322,863</b>	<b>284,119</b>
<b>Liabilities with variable interest rates</b>			
Overseas Private Investment Corporation (OPIC)	October 2017	-	12,259
GREEN FOR GROWTH FUND, SOUTHEAST EUROPE S.A., SICAV-SIF(GGF)	January-2019	30,940	-
The European Fund for Southeast Europe S.A., SICAV-SIF (EFSE)	September 2017	-	15,771
ProCredit Holding AG & Co. KGaA	April 2016	-	-
ProCredit Bank AG, Frankfurt am Main	April 2019	20,807	21,387
Council of Europe Development Bank (CEB)	August 2021	11,485	14,212
ProCredit Holding AG & Co. KGaA	April 2017	-	2,674
responsAbility SICAV (Lux) Microfinanz-Fonds	December 2018	11,633	11,951

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

---

**16. OTHER BORROWED FUNDS (CONTINUED)**

Credit Suisse Microfinance Fund Management Group (CSMFMC) (responsAbility Global Microfinance Fund)	December 2018	6,463	6,640
responsAbility SICAV (Lux) Financial Inclusion Fund	December 2018	3,878	3,984
responsAbility SICAV (Lux) Microfinance Leaders	December 2018	3,878	3,984
ProCredit Bank AG, Frankfurt am Main	February 2017	-	10,631
<b>Total liabilities with variable interest rates</b>		<b>89,083</b>	<b>103,493</b>
<b>Total liabilities</b>		<b>411,946</b>	<b>387,612</b>

Refer to Note 27 for the estimated fair value of other borrowed funds. The interest rate analysis is disclosed in Note 26. Information on related party balances is disclosed in Note 29.

**17. OTHER LIABILITIES**

in '000 GEL	<b>31 December 2017</b>	<b>31 December 2016</b>
Accounts payable	2,081	3,305
Other	192	218
<b>Total other financial liabilities</b>	<b>2,273</b>	<b>3,523</b>
Received prepayments and deferred fees from guarantees issued	2,037	194
<b>Total other liabilities</b>	<b>4,309</b>	<b>3,717</b>

Refer to Note 27 for the estimated fair value of other financial liabilities.

**18. OTHER PROVISIONS**

in '000 GEL	<b>31 December 2017</b>	<b>31 December 2016</b>
Provisions for unused annual leave	319	347
Others	259	130
<b>Total provisions</b>	<b>578</b>	<b>477</b>

Movement in provisions during the year was as follows:

in '000 GEL	<b>2017</b>	<b>2016</b>
<b>As at 1 January</b>	<b>477</b>	<b>438</b>
Provisions recorded during the year	448	428
Releases/Utilization of provisions	(347)	(389)
<b>As at 31 December</b>	<b>578</b>	<b>477</b>

The outflow of economic benefits relating to the provisions for unused annual leave and off-balance sheet items is expected during the next one or two years.

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**19. INCOME TAXES**

The applicable tax rate is the income tax rate of 15% for Georgian companies. Income tax expenses recorded in profit or loss for the year comprise the following:

in '000 GEL	2017	2016
Current tax charge	3,108	4,442
Deferred tax charge	(2,967)	(665)
<b>Income tax expense for the year</b>	<b>141</b>	<b>3,777</b>

As described in Note 3 to these financial statements following tax reform approved by government of Georgia in May 2016 the deferred tax balances are recognised only to the extent of possibility of being realised until 1 June 2018. Management did not apply respective effect of change in legislation for reporting on the financial statements for the year ended 31 December 2016. Correction entry to deferred tax amounts was booked in 2017 and deferred tax balances as at 31 December 2017 are measured appropriately. The correction mainly relates to derecognition of deferred tax liability. Management believes that this delay in derecognition does not materially effect the presentation of the financial statements for its users. Financial statements 2016 have not been restated in this respect. Had the deferred tax liability been derecognised in 2016 instead of 2017, the effect would have been increase of net profit for 2016 by GEL 2,368 thousand and decrease of net profit for 2017 by the same amount.

Reconciliation between the expected and the actual taxation charge is provided below:

in '000 GEL	2017	2016
<b>Profit before tax</b>	<b>22,802</b>	<b>28,048</b>
Theoretical tax charge at statutory rate of 15%	3,420	4,207
Tax effect of items which are not deductible:		
– Effects of change of Tax legislation	(2,891)	-
– Net non-taxable income	(388)	(430)
<b>Income tax expense for the year</b>	<b>141</b>	<b>3,777</b>

The tax effect of the movements in the temporary differences is detailed below and is recorded at the rate of 15% (2016:15%).

in '000 GEL	31 December 2017	Charge to profit or loss	31 December 2016	Credit to profit or loss	1 January 2016
<b>Deferred tax on:</b>					
Allowances for losses on loans and advances to customers	631	(1,812)	2,443	(752)	3,195
Other temporary differences	306	(1,154)	1,460	87	1,373
<b>Total deferred tax liability</b>	<b>937</b>	<b>(2,967)</b>	<b>3,903</b>	<b>(665)</b>	<b>4,568</b>

There are no material unrecognised deferred tax assets or liabilities, or any taxes recognised directly in equity or other comprehensive income.

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**20. SUBORDINATED DEBT**

The subordinated debt can be broken down as follows:

in '000 GEL	Due	31 December 2017	31 December 2016
<b>Subordinated debt with variable interest rates</b>			
Overseas Private Investment Corporation (OPIC)	December 2019	38,701	39,767
<b>Subordinated debt with fixed interest rates</b>			
ProCredit Holding AG & Co. KGaA	April 2025	19,700	20,239
ProCredit Holding AG & Co. KGaA	April 2025	6,566	6,746
<b>Sub-total: ProCredit Holding AG &amp; Co. KGaA</b>		<b>26,266</b>	<b>26,985</b>
<b>Total</b>		<b>64,967</b>	<b>66,752</b>

Creditors' claims to repayment of these liabilities are subordinated to the claims of other creditors. There is no obligation to repay early. In the case of liquidation or insolvency, these creditors will only be paid after the claims of all non-subordinated creditors have first been satisfied.

Refer to Note 27 for the disclosure of the fair value of subordinated debt. The interest rate analysis is disclosed in Note 26. Information on related party balances is disclosed in Note 29.

**21. SHARE CAPITAL AND SHARE PREMIUM**

As at 31 December 2017 the shareholder structure was as follows:

in '000 GEL (except for the number of shares)	31 December 2017			31 December 2016		
Shareholder	Size of stake in %	Number of shares	Amount of share capital	Size of stake in %	Number of shares	Amount of share capital
ProCredit Holding AG & Co. KGaA	100%	17,782,963	88,915	100%	17,782,963	88,915
<b>Total</b>	<b>100%</b>	<b>17,782,963</b>	<b>88,915</b>	<b>100%</b>	<b>17,782,963</b>	<b>88,915</b>

The par value per share is GEL 5.00.

in '000 GEL (except for the number of shares)	Number of ordinary shares issued	Share capital Amount	Share premium Amount
<b>At 31 December 2015</b>	<b>17,782,963</b>	<b>88,915</b>	<b>36,388</b>
<b>At 31 December 2016</b>	<b>17,782,963</b>	<b>88,915</b>	<b>36,388</b>
<b>At 31 December 2017</b>	<b>17,782,963</b>	<b>88,915</b>	<b>36,388</b>

**Dividends**

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at annual and general meetings of the Bank. Dividends payable are restricted to the maximum retained earnings of the Bank, which are determined according to the Georgian legislation.

In 2017 dividend of GEL 20,691 thousand (GEL 1.16 per share) were declared, (2016: no dividends were declared ).

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**22. NET DEBT RECONCILIATION**

The table below sets out an analysis of our debt and the movements in our debt for each of the periods presented. The debt items are those that are reported as financing in the statement of cash flows.

in '000 GEL	Liabilities from financing activities		Total
	Other borrowed funds	Subordinated debt	
<b>Net debt at 1 January 2016</b>	306,544	60,434	366,978
Cash flows	19,220	(3,271)	15,949
Foreign exchange adjustments	46,599	6,298	52,897
Other non-cash movements	15,249	3,291	18,540
<b>Net debt at 31 December 2016</b>	387,612	66,751	454,364
Cash flows	(20,739)	(3,582)	(24,321)
Foreign exchange adjustments	30,301	(1,790)	28,511
Other non-cash movements	17,772	3,588	18,360
<b>Net debt at 31 December 2017</b>	411,946	64,967	476,914

**23. NET INTEREST INCOME**

Included within “net interest income” are interest income and expenses, as well as the unwinding of premiums and discounts on financial instruments at amortised cost.

in '000 GEL	2017	2016
<b>Interest and similar income</b>		
Loans and advances to customers	79,111	99,568
Cash and cash equivalents and due from banks	4,046	2,888
Available-for-sale assets	1,701	2,076
<b>Total interest income</b>	<b>84,858</b>	<b>104,532</b>
<b>Interest and similar expenses</b>		
Customer accounts	(13,771)	(17,675)
Other borrowed funds	(14,555)	(15,236)
Subordinated debt	(3,587)	(3,291)
Due to banks	(218)	(13)
<b>Total interest expenses</b>	<b>(32,131)</b>	<b>(36,215)</b>
<b>Net interest income</b>	<b>52,727</b>	<b>68,317</b>

In 2017, interest income from loans and advances to customers included unwinding of discount on impaired loans of GEL1,221 thousand (2016: GEL 2,666 thousand) (Note 9).



**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

---

**24. FEE AND COMMISSION INCOME AND EXPENSES**

in '000 GEL

<b>Fee and commission income</b>	<b>2017</b>	<b>2016</b>
Payment transfers and cash transactions	4,577	5,596
Debit/credit card issuance fee	2,260	2,365
Account maintenance fee	1,554	1,069
Letters of credit and guarantees	1,249	1,018
Internet bank fee	318	387
SMS service fee	131	260
Other fee and commission income	115	140
<b>Total fee and commission income</b>	<b>10,204</b>	<b>10,835</b>
<b>Fee and commission expenses</b>		
Debit/credit card issuance fee	(3,898)	(3,598)
Account maintenance fee	(760)	(567)
Payment transfers and transactions	(294)	(355)
Service fee	(154)	(243)
Letters of credit and guarantees	(68)	(73)
<b>Total fee and commission expenses</b>	<b>(5,174)</b>	<b>(4,836)</b>
<b>Net fee and commission income</b>	<b>5,030</b>	<b>5,999</b>

The item “other fee and commission income” consists of transactions carried out on behalf of third parties, e.g. Western Union.

**25. OTHER ADMINISTRATIVE EXPENSES**

Other administrative expenses include the following items:

in '000 GEL	<b>2017</b>	<b>2016</b>
Depreciation and amortization	5,997	6,521
Office rent	2,565	3,266
Communication and IT expenses	4,366	3,877
Personnel recruitment, training and other staff-related expenses	2,909	2,611
Consulting services	1,667	1,485
Marketing, advertising and entertainment	884	1,130
Repair and maintenance	628	1,064
Transport	858	872
Other	5,263	5,909
<b>Total</b>	<b>25,137</b>	<b>26,735</b>

Administrative expenses above includes GEL 181 thousand (2016: GEL 239 thousand) - fees incurred for audit and other professional services provided by Auditor/Audit Firm as defined in the Law of Georgia on Accounting, Reporting and Auditing.

Of the total personnel and administrative expenses, expenses of GEL 2,540 thousand were incurred on staff training and related activities during 2017 (2016: GEL 2,255 thousand).

## **26. FINANCIAL RISK AND CAPITAL MANAGEMENT**

### **Management of the Overall Group Risk Profile – Capital Management**

#### **Objectives**

Overall, the Group is not allowed to take on more risk than it is capable of bearing. The capital management of the Group has the following objectives:

- Ensuring that the Group is equipped with a sufficient volume and quality of capital at all times to cope with (potential) losses arising from different risks even under extreme circumstances.
- Ensuring full compliance by the Bank with external capital requirements set by the regulator of the Georgian banking sector.
- Meeting the internally defined minimum capital adequacy requirements.
- Enabling the Group to implement its plans for growth while following its business strategy.

#### **Processes and procedures**

The capital management of the Group is governed by the Policy on Capital Management and the Policy on ICAAP (Internal Capital Adequacy Process). To ensure that the above stated objectives are met, the Group uses four indicators. Aside from regulatory and Basel III/Capital Requirements Regulation (CRR) ratios, the Tier1 leverage ratio and risk bearing capacity are monitored on a monthly basis by the General Risk Unit and the Parent’s General Risk Management Committee.

#### **Compliance with external and internal capital requirements**

External minimum capital requirements are imposed and monitored by the local banking supervision authorities of Georgia. Capital adequacy is calculated and reported to the members of the Group General Risk Management Committee on a monthly basis. These reports include rolling forecasts to ensure not only current but also future compliance (quarterly).

As at 31 December 2017 the Group was in compliance with the regulatory capital adequacy requirements imposed by the NBG according to the guidelines of the Basel Committee (Basel I).

The following table shows the capital adequacy ratios as calculated in accordance with NBG requirements:

<b>As at 31 December</b>	<b>2017</b>	<b>2016</b>
Tier 1 Capital /Risk Weighted Assets (RWA) (required to be above 6.4%)*	10.21%	10.29%
Tier 1 + Tier 2 Capital / RWA (required to be above 9.6%)*	14.55%	16.33%

As at 31 December 2017 the Bank was also in compliance with the regulatory capital adequacy requirements imposed by the NBG according to the guidelines of the Basel Committee (Basel II /III). The following table shows the capital adequacy ratios as calculated in accordance with those requirements:

<b>As at 31 December</b>	<b>2017</b>	<b>2016</b>
Tier 1 Capital /RWA (required to be above 8.5%)*	14.38%	11.19%
Tier 1 + Tier 2 Capital /RWA (required to be above 10.5%)*	18.28%	15.04%

<b>As at 31 December, 2017 (Pillar I + Pillar II)</b>	<b>2017</b>
Tier 1 Capital /RWA (required to be above 11.52%)*	14.38%
Tier 1 + Tier 2 Capital /RWA (required to be above 14.52%)*	18.28%

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

In order to ensure the comparability of the capital adequacy ratios, a retrospective calculation of capital adequacy ratios for 2016 was conducted considering the recent changes in the capital adequacy regulations of the National bank of Georgia.

<b>As at 31 December</b>	<b>2017</b>	<b>2016</b>
Tier 1 Capital /RWA	14.38%	14.21%
Tier 1 + Tier 2 Capital /RWA	18.28%	18.79%

NBG introduced Pillar II buffers which are to be maintained from December, 2017. As of December, 2017 the minimum requirements including set buffers for Tier 1 equals to 11.52% and for Regulatory capital 14.52% of the total risk weighted assets. Unhedged credit risk is excluded from total risk weighted assets for Pillar I.

Additionally, capital adequacy is monitored by using a uniform capital adequacy calculation across the Parent in compliance with the Basel III requirements as set forth under the European Capital Requirements Directive and Capital Requirements Regulation (CRR).

The following table shows the Basel III / CRR capital adequacy ratios of the Group:

<b>As at 31 December</b>	<b>2017</b>	<b>2016</b>
Tier 1 Capital / RWA*	18.4%	16.90%
Tier 1 + Tier 2 Capital / RWA*	22.36%	21.87%

in '000 GEL

<b>As at 31 December</b>	<b>2017</b>	<b>2016</b>
Ordinary share capital	88,915	88,915
Share premium	36,388	36,388
Prior period retained earnings	70,830	46,559
Profit for first nine months*	16,020	15,054
Less other adjustments*	(28)	(56)
Less dividends paid in current year	-	-
Less dividends budgeted for the next year*	(20,691)	(21,201)
Less intangible assets	(1,394)	(1,676)
<b>Tier I capital*</b>	<b>190,040</b>	<b>163,983</b>
Adjustment due to dividends budgeted for the next year exceeding profit for first nine months:		
Profit for first nine months*	-	(15,054)
Dividends budgeted for the next year*	-	21,201
<b>Adjusted Tier I capital*</b>	<b>190,040</b>	<b>170,130</b>
Subordinated loans*	40,877	49,950
<b>Tier II capital</b>	<b>40,877</b>	<b>49,950</b>
<b>Total regulatory capital</b>	<b>230,917</b>	<b>220,080</b>

in '000 GEL

<b>As at 31 December</b>	<b>2017</b>	<b>2016</b>
RWA on balance*	861,972	845,510
RWA off balance*	22,342	19,210
RWA from open currency position*	5,754	1,308
RWA from operational risk*	142,825	140,363
<b>Total RWA*</b>	<b>1,032,892</b>	<b>1,006,391</b>

## 26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)

The Group uses a combination of straight equity and subordinated debt, mainly issued by the Parent for capital management purposes.

With respect to leveraging, a lower limit for the ratio of Tier 1 capital to recognized and unrecognized exposures (Tier 1 leverage ratio) was introduced in 2011 according to which the leverage ratio of the Group should not fall below 5%. As at 31 December 2017 and 2016 the Group's leverage ratio was above 10%.

### ICAAP

In addition to regulatory capital ratios, the Group assesses its capital adequacy by using the concept of risk bearing capacity to reflect the specific risk profile of the Group, i.e. comparing potential losses arising from its operations with its risk bearing capacity.

The risk bearing capacity of the Group is defined as equity (net of intangibles) plus subordinated debt, which amounted to GEL 261 million as at December 2017 (2016: GEL 261 million). The Resources Available to Cover Risk (RAAtCR) was set at 60% of the risk-taking potential, i.e. GEL 157 million\* for 2017 (2016: GEL 157 million\*). For calculating potential losses in the different risk categories the following concepts are used:

- Credit risk (clients): Based on a regularly updated migration analysis on the loan portfolio, the historical loss rates are calculated and applied to the current loan portfolio as well as the off-balance portfolio to calculate potential loan losses;
- Counterparty risk: The calculation of potential losses due to counterparty risk is based on the probability of default arising from the respective international rating of the counterparty or its respective country of operation;
- Market risks: Whereas historical currency fluctuations are statistically analysed and the highest variances (99% confidence level) are applied to current currency positions, interest rate risk is calculated by determining the 12-months interest earnings at a standard interest rate shock for EUR/USD (two percentage points, Basel interest rate shock) and higher (historical) shock levels for local currency;
- Operational risk: The Basel II Standard approach is used to calculate the respective value.

The volume of economic capital to cover credit risk stayed stable as at 31 December 2017 and 2016. The underlying portfolio quality showed improvement throughout 2017. Counterparty, interest rate and currency risk limit utilisation remained low. All risks combined, as quantified by the methods established in the Group Standards for Bank ICAAP, are below 60% of the Group's total risk taking potential as defined. Other risks have been assessed as not sufficiently relevant for the Group or as relevant, but not quantifiable.

The table below shows the distribution of the RAAtCR among the different risk categories as determined by the Parent's Risk Management Committee and the level of utilisation for the Group as at the end of December 2017. The economic capital required to cover operational risk is calculated according to the Basel II standard approach.

<b>Risk Factor</b>	<b>Risk Detail</b>	<b>Limit</b> (in %)*	<b>Limit</b> (in '000 GEL)*	<b>Actual</b> (in '000 GEL)*	<b>Limit Used</b> (in % of risk bearing capacity)*
Credit Risk (Clients)		33.0%	86,249	25,894	9.9%
Counterparty Risk	Commercial Banks	5.0%	13,068	3,422	1.3%
Market Risk	Interest Rate Risk	10.0%	26,136	7,288	2.8%
	Currency Risk	2.0%	5,227	2,067	0.8%
Operational Risk		10.0%	26,136	11,426	4.4%
<b>Resources Available to Cover Risk</b>		<b>60.0%</b>	<b>156,815</b>	<b>50,097</b>	<b>19.2%</b>

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

As at the end of December 2016 the distribution of RAAtCR was as follows:

<b>Risk Factor</b>	<b>Risk Detail</b>	<b>Limit</b> (in %)*	<b>Limit</b> (in '000 GEL)*	<b>Actual</b> (in '000 GEL)*	<b>Limit Used</b> (in % of risk bearing capacity)*
Credit Risk (Clients)		33.0%	86,007	23,776	9.1%
Counterparty Risk		5.0%	13,031	3,800	1.5%
Market Risk	Interest Rate Risk	10.0%	26,063	8,921	3.4%
	Currency Risk	2.0%	5,213	416	0.2%
Operational Risk		10.0%	26,063	11,229	4.3%
<b>Resources Available to Cover Risk</b>		<b>60.0%</b>	<b>156,377</b>	<b>48,142</b>	<b>18.5%</b>

**Management of individual risks**

In 2017, the Group further developed the policies and tools in managing of individual risks that serve the further enhancement of the risk management of the Group. In particular, strengthened processes were introduced for the management of:

- Credit risk
- Counterparty risk
- Market risk
- Liquidity risk
- Operational risk and
- Anti-money laundering activities.

The Group places emphasis on a general understanding of the factors driving risk and an ongoing analysis and group-wide discussion of possible developments/scenarios and their potential adverse impacts. The objectives of risk management include ensuring that all material risks are recognised in a timely manner, understood completely and managed appropriately. This includes, for example, ensuring that no products or services are offered unless they are thoroughly understood by all parties and can be properly managed.

Deviations from limits used for individual risks within which the Group positions its own risk strategies are only allowed upon approval of the Parent's General Risk Management Committee, but under consideration of being in compliance with stricter limits (e.g. in cases where such limits are stipulated by local regulations).

**Credit risk**

Credit risk is defined as the danger that the party to a credit transaction will not be able, or will only partially be able, to meet its contractually agreed obligations towards the Group. Credit risk arises from customer credit exposures (classic credit risk), credit exposure from interbank placements and issuer risk. It is further divided into credit default risk and credit portfolio risk in order to facilitate focused risk management. Credit risk is the single largest risk faced by the Group.

\* These amounts are unaudited.

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

The following table shows the maximum exposure to credit risk:

in '000 GEL As at 31 December	2017	2016
<b>Interbank placements</b>		
Balances at NBG(including mandatory reserve)	160,326	180,732
Due from banks	16,171	174,153
<b>Total interbank placements</b>	<b>176,496</b>	<b>354,885</b>
<b>Loans and advances to customers</b>		
Loans and advances to customers	1,005,722	875,486
Allowance for impairment	(18,384)	(19,261)
<b>Loans and advances to customers</b>	<b>987,337</b>	<b>856,225</b>
<b>Treasury bills issued by the Government of Georgia</b>	<b>4,943</b>	<b>16,809</b>
<b>Other financial assets</b>	<b>2,039</b>	<b>5,669</b>
<b>Financial guarantees and stand-by letters of credit</b>	<b>11,408</b>	<b>13,321</b>
<b>Performance guarantees</b>	<b>32,035</b>	<b>19,810</b>
<b>Commitments to extend credit</b>	<b>32,823</b>	<b>48,147</b>

**Credit default risk from customer credit exposures**

Credit default risk from customer credit exposures is defined as the risk of losses due to a potential non-fulfilment of the contractual payment obligations associated with a customer credit exposure.

The management of credit default risk from customer credit exposures is based on a thorough implementation of the following lending principles:

- analysis of the debt capacity of borrowers
- documentation of the credit risk assessments, assuring that the analysis performed can be understood by knowledgeable third parties
- avoidance of over indebtedting the Group's borrowers
- regular monitoring of borrower's capacity
- monitoring of loan repayment, fulfilment of covenants
- practising effective arrears management
- exercising strict collateral collection in the event of default
- investing in staff training
- implementing carefully designed and well-documented processes
- application of the "four-eyes principle"

The differentiation between individually significant and insignificant credit exposures leads to distinct processes in lending for the different types of credit exposures. The processes are distinguished mainly in terms of segregation of duties; the information collected from the clients, ranging from audited financial statements to self-declarations; the key criteria for credit exposure decisions based on the financial situation of the borrower;. All credit decisions are taken by a credit committee.

Loans in arrears are defined as loans for which contractual interest and/or principal payments are overdue. Once arrears occur, the Group rigorously follows-up on the non-repayment of credit exposures, and identifies any potential for default on a credit exposure. Recovery and collection efforts are performed by specialised employees, typically with either a lending or a legal background.

## **26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

The quality of the loan portfolio is monitored on an ongoing basis. The measure for loan portfolio quality is the portfolio at risk (PAR), which the Group defines as all outstanding credit exposures with one or more interest and/or principal payment overdue by more than 30 days. This measure was chosen because the vast majority of all credit exposures have fixed instalments with monthly payment of principal and interest. Exceptions are seasonal agricultural loans and investment loans, which typically have a grace period. No collateral is deducted and no other exposure-reducing measures are applied when determining the PAR of such loans.

Additionally, the quality of credit operations is assured by the Head of Business Operations Control Group, which is responsible for monitoring the Group's credit operations and compliance with its procedures.

in '000 GEL	PAR (> 30 days based on the exposure)	PAR (> 30 days based on individual loans)
<b>At 31 December 2017</b>	<b>1.79%</b>	<b>1.62%</b>
<b>At 31 December 2016</b>	<b>2.24%</b>	<b>1.85%</b>

The restructuring of credit exposures is generally necessitated by economic problems encountered by the borrower. If a credit exposure is restructured, amendments are made to the parameters of the loan. Otherwise, the credit exposures for which the terms have been renegotiated would be past due or impaired.

The Group regularly analyses the level of credit exposure defaults that are expected within a given year, based on past experience. The management estimates that incurred losses are fully covered with loan loss provisions.

According to the policies of the Parent, usually only short-term credit exposures may be issued without being fully collateralised. Credit exposures with a higher risk profile are always covered with solid collateral, typically real estate.

The Parent's policy on the treatment of repossessed property requires that all goods obtained due to customers' defaults be sold to third parties in order to avoid any conflict of interest arising from the below-market valuation of collateral. Also, repossessed property is sold at the highest possible price via public auction, and any remaining balance after the payment of principal, interest and penalty is credited to the customer's account. Most repossessed property consists of land and buildings. A smaller part is composed of inventory, equipment and vehicles.

### **Credit portfolio risk from customer lending**

The granularity of the credit exposure portfolio is an effective credit risk mitigating factor. The core business of the Group, lending to small and medium enterprises, necessitated a high degree of standardisation in lending processes and ultimately led to a high degree of diversification of these exposures in terms of geographic distribution and economic sectors. Nevertheless, lending to medium-sized enterprises, i.e. larger credit exposures exceeding the threshold of USD 250,000 constitutes a supplementary area of the Group's business in terms of its overall strategic focus. Many of these clients are dynamically growing enterprises that have been clients of the Group for many years. Nonetheless, the higher complexity of these businesses requires an appropriate analysis of the business, the project that is to be financed and any connected entities. A strict division of front and back office functions is applied and requirements for both documentation and collateral are typically more stringent.

Overall, the loan portfolio of the Group includes 348 borrower group credit exposures of more than USD 250,000 (2016: 318 borrower group credit exposures).

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

The structure of the loan portfolio is regularly reviewed by the Credit Risk Department, in order to identify potential events which could have an impact on large portion of the loan portfolio (common risk factors) and, if necessary, limit the exposure towards certain sectors of the economy.

The Bank's loan portfolio grouped according to the common risk factors is as follows:

in '000 GEL At 31 December 2017	Wholesale and Trade	Agricultur e, forestry and fishing	Production	Transportation and storage	Other economic activities	Housing	Investment loans	Others	Total
< 50,000 USD	45,113	3,562	14,462	4,724	41,013	31,116	5,179	461	145,630
50,000 to 250,000 USD	156,196	16,380	55,695	13,679	144,456	34,083	954	-	421,444
>250,000 USD	168,078	30,910	59,727	902	178,539	-	490	-	438,647
<b>Total</b>	<b>369,387</b>	<b>50,853</b>	<b>129,884</b>	<b>19,306</b>	<b>364,009</b>	<b>65,200</b>	<b>6,623</b>	<b>461</b>	<b>1,005,722</b>

in '000 GEL At 31 December 2016	Wholesale and Trade	Agriculture, forestry and fishing	Production	Transportation and storage	Other economic activities	Housing	Investment loans	Others	Total
< 50,000 USD	51,672	4,972	16,246	5,663	47,473	24,376	8,965	721	160,087
50,000 to 250,000 USD	159,707	15,733	52,154	12,833	125,851	13,544	1,794	-	381,616
>250,000 USD	133,454	31,884	37,712	1,678	127,472	704	878	-	333,783
<b>Total</b>	<b>344,833</b>	<b>52,589</b>	<b>106,113</b>	<b>20,174</b>	<b>300,796</b>	<b>38,625</b>	<b>11,637</b>	<b>721</b>	<b>875,486</b>

The Group follows a guideline that limits concentration risk in its loan portfolio by ensuring that large credit exposures (those exceeding 10% of regulatory capital) must be approved by the Parent's Credit Risk Committee and Supervisory Board. No single large credit exposure may exceed 25% of the Group's regulatory capital

Larger credit exposures are analysed and monitored, both by the responsible employees through regular monitoring activities enabling early detection of risks, and through the regular reviews carried out by the Credit Committee. Information about related parties of the borrowers is typically collected prior to lending.

Individually significant credit exposures are monitored by the respective Credit Committee and Business Client Adviser or Credit Analyst. For such credit exposures, the committee assesses whether objective evidence of impairment exists, i.e.:

- more than 30 days in arrears
- delinquencies in contractual payments of interest or principal
- breach of covenants or conditions
- initiation of bankruptcy proceedings
- any specific information on the customer's business (e.g. reflected by cash flow difficulties experienced by the client)
- changes in the customer's market environment
- the general economic situation



## **26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

In addition, individual credit exposures which are regarded as insignificant, or groups of individually insignificant credit exposures, may be classified as impaired if events, such as political unrest, a significant economic downturn, a natural disaster or other external events occur in the country.

For individually significant exposures a discounted cash flow approach is applied in order to calculate the respective impairment allowance. Expectations regarding both the timing and the amount of future cash flows are conservative and adequately reflects the uncertainties of the future. This concerns any net expected future payments from the customer and its guarantor (s), as well as expected net recoveries on collateral. The expected direct costs of collateral recoveries is based on actually incurred costs in previous, comparable cases as well as

on external standards such as established costs for presenting cases to the court, execution costs as percentages of the collateral value etc. The expected cash inflows from the customer or its guarantor (s) are based on the assessment of the payment capacity of the respective customer or guarantor (s). In cases where a relevant financial analysis showing the payment capacity of the customer or guarantor (s) is not available, only cash flows from collateral are assumed. The amount that can be recovered on collateral and the expected time until recovery is estimated based on the previous relevant experience of the Bank with collateral enforcement on comparable collateral items. If the Bank's internal data is not reliable or comparable enough, the Bank uses sufficient and reliable information from external sources that supports the assumptions used for the timing and value of expected future cash flows from collateral.

As at 31 December 2017 and 2016 more than 90% of the carrying amount of the loans to customers was fully collateralized by the real estate. The bank has changed its approach regarding the process of collateralization. In order to avoid a potential conflict of interests, the bank applied a segregation of functions – the front-office staff, generally staff involved in customer acquisition and in the assessment of clients' creditworthiness, are no longer involved in the collateral appraisals. Back-office staff in the Credit Risk Department who are specialized in collateral valuation are responsible for the process of collateral valuation and for proposing the collateral value. As a general principle, all collateral valuations, regardless of the value of the individual item and the size of the credit exposure, are performed by a professional external appraiser. Therefore, the collateral valuation process is fully independent and unbiased. The bank contracts professional external appraisal companies, whose main responsibility is to determine the fair market value of collateralized items.

Individually significant non-restructured credit exposures for which there is no need for an individual impairment allowance are covered by collective assessment allowances. Different allowance rates are applied for non-restructured and standard and non-standard restructured credit exposures. Additionally allowance rates differentiates based on overdue days of credit exposure. The key determining factors in differentiating between the different types of restructured credit exposures are the number of days in arrears at the time of restructuring, the magnitude of the payment problems and the nominal value of the interest rate after restructuring took place.

For individually insignificant credit exposures which show objective evidence of impairment, i.e. which are in arrears for more than 30 days (as well as insignificant restructured credit exposures not being in arrears but qualified as impaired), the impairment is determined depending on the number of days in arrears.

### **Credit risk from interbank placements and issuer risk**

#### *Conceptual risk management framework*

The objective of counterparty and issuer risk management is to prevent the Group from incurring losses caused by the unwillingness or inability of a financial counterparty (e.g. a commercial bank) or issuer to fulfil its obligations towards the Group. This type of risk is further divided into:

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

- principal risk: the risk of losing the amount invested due to the counterparty's failure to repay the principal in full on time;
- replacement risk: the risk of loss of an amount equal to the incurred cost of replacing an outstanding deal with an equivalent one on the market;
- settlement risk: the risk of loss due to the failure of a counterparty to honour its obligation to deliver assets as contractually agreed;
- issuer risk: the probability of loss resulting from the default and insolvency of the issuer of a security;
- market price risk: the risk of loss due to the drop of the market value of securities as interest rates increase.

Counterparty and issuer risks evolve especially from the Group's need to invest its liquidity reserve, to conclude foreign exchange transactions, or to buy protection on specific risk positions. Excess liquidity is placed in the interbank market with short maturities, typically up to three months. Foreign exchange transactions are also concluded with short maturities, typically up to two days. Derivative contracts, which are used to protect the Group against foreign currency risk, may have maturity of up to one year. Furthermore, as a result of the Group's efforts to finance its lending activities with retail deposits, there is also an exposure towards the NBG. This is because the NBG requires banks operating in its territory to hold a mandatory reserve on a NBG account, the size of which depends on the amount of deposits taken from customers or other funds used to fund the Group's operations.

The counterparty and issuer risks are managed according to the Counterparty Risk Management Policy (incl. Issuer Risk), which describes the counterparty/issuer selection and the limit setting process, as well as by the Treasury Policy, which specifies the set of permissible transactions and rules for their processing. As a matter of principle, only large international banks of systemic importance and, for local currency business, local banks with a good reputation and financial standing are eligible counterparties. As a general rule, the Group applies limits of up to 10% of its regulatory capital for exposures to banking groups in non-OECD countries and up to 25% for those in OECD countries with maximum remaining maturity of 3 months. Higher limits and longer maturities are subject to approval by the Parent's General Risk Management Committee.

The Asset Liability Committee (ALCO) ensures that every counterparty is subject to a thorough analysis, typically conducted by the General Risk Unit in collaboration with the Compliance and Anti-Money Laundering (AML) Unit. If the counterparty is approved, a limit for the maximum exposure is set.

According to the Counterparty Risk Management Policy the Group is not supposed to conduct any speculative trading activities. However, for liquidity management purposes, the Group is allowed to buy and hold securities (treasury bills and certificates of deposits). The inherent issuer risk is managed by the provisions of the Treasury Policy. Among other requirements, the policy stipulates that the securities in GEL should preferably be issued by the Government of Georgia or the NBG, or in case of foreign currency by international and/or multinational institutions with very high credit ratings (i.e. an international rating of AA- or better).

The following table provides an overview of the types of counterparties and issuers with whom the Group concludes transactions.

in '000 GEL	2017	In %	2016	In %
<b>Banking groups</b>	<b>16,171</b>	<b>9%</b>	<b>38,033</b>	<b>16%</b>
OECD banks	446	0%	607	0%
Non-OECD banks	15,724	9%	37,426	16%
<b>NBG</b>	<b>160,326</b>	<b>88%</b>	<b>192,598</b>	<b>82%</b>
Mandatory reserve	125,962	69%	131,548	56%
Other exposures	34,364	19%	61,050	26%
<b>Government of Georgia</b>	<b>4,943</b>	<b>3%</b>	<b>4,943</b>	<b>2%</b>
Treasury bills	4,943	3%	4,943	2%
<b>Total counterparty and issuer exposure</b>	<b>181,440</b>	<b>100%</b>	<b>235,573</b>	<b>100%</b>

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

The exposure to the NBG is primarily related to the mandatory reserve requirement which makes up 68% (2016: 52%) of the Group's counterparty and issuer exposure. The distribution of the NBG and government exposures across currencies can be seen in the following table:

in '000 GEL

<b>31 December 2017</b>	<b>GEL</b>	<b>EUR</b>	<b>USD</b>	<b>Total</b>
<b>NBG</b>	<b>34,364</b>	<b>30,121</b>	<b>95,841</b>	<b>160,326</b>
Mandatory reserve	-	30,121	95,841	125,962
Balances at NBG excluding mandatory reserves	11,579	-	-	11,579
Certificates of deposits of NBG	22,785	-	-	22,785
<b>Government of Georgia</b>	<b>4,943</b>	<b>-</b>	<b>-</b>	<b>4,943</b>
	<b>39,306</b>	<b>30,121</b>	<b>95,841</b>	<b>165,268</b>

in '000 GEL

<b>31 December 2016</b>	<b>GEL</b>	<b>EUR</b>	<b>USD</b>	<b>Total</b>
<b>NBG</b>	<b>60,743</b>	<b>17,985</b>	<b>113,870</b>	<b>192,598</b>
Mandatory reserve	-	17,919	113,629	131,548
Balances at NBG excluding mandatory reserves	10,442	66	241	10,749
Certificates of deposits of NBG	50,301	-	-	50,301
<b>Government of Georgia</b>	<b>4,943</b>	<b>-</b>	<b>-</b>	<b>4,943</b>
	<b>65,686</b>	<b>17,985</b>	<b>113,870</b>	<b>197,541</b>

**Liquidity risk**

The Group's liquidity risk management (LRM) system is tailored to the specific characteristics of the Group. The loan portfolio is comprised of a large number of short- and medium-term exposures to small and medium sized businesses. The majority of the loans are disbursed as annuity term loans and have low default rates. This leads to highly diversified, reliable cash inflows. The usage of financial markets instruments is low. All of these factors limit possible liquidity risk concentrations and warrant a relatively simple and straightforward LRM system.

Liquidity risk in the narrowest sense (risk of insolvency) is the danger that the Group will no longer be able to meet its current and future payment obligations in full, or in a timely manner. Liquidity risk in a broader sense (funding risk) is the danger that additional funding can no longer be obtained, or can only be obtained at increased market interest rates.

The ALCO determines the liquidity strategy of the Group and sets the liquidity risk limits. The Treasury and Cash Management Unit manage the Group's liquidity on a daily basis and is responsible for the execution of the ALCO's decisions. Compliance with strategies, policies and limits are constantly monitored by the General Risk Unit.

In addition to the requirements set by the local regulatory authorities, the standards that the Group applies in this area are guided by the Liquidity Risk Management Policy and the Treasury Policy. Both policies were first implemented by the Group in 2009 and are updated on an annual basis. These policies are also in line with the Principles for Sound Liquidity Risk Management defined by the Basel Committee on Banking Supervision EU regulation 575/2013 [Capital Requirement Regulation -CRR] and EU directive 2013/36/EU [Capital Requirement Directive - CRD IV]. Limit breaches and exceptions to these policies are subject to decisions of the Parent's ALCO and Parent's General Risk Management Committee.

The Treasury and Cash Management Unit manages liquidity on a daily basis using a cash flow analysis tool. This tool is designed to provide a realistic picture of the future liquidity situation. It includes assumptions about deposit and loan developments and helps to forecast liquidity risk indicators.

## **26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

The key tools for measuring liquidity risks includes a forward looking liquidity gap analysis, which shows the contractual maturity structure of assets and liabilities and estimates future funding needs based on certain assumptions. Starting with the estimation of future liquidity in a normal financial environment, the assumptions are increasingly tightened in order to analyse the Group's liquidity situation in adverse scenarios (stress tests). Based on the gap analyses, a set of key liquidity risk indicators and early warning indicators are calculated on daily and monthly basis and are closely monitored. The main indicator of short-term liquidity is the sufficient liquidity indicator (SLI), which compares the amounts of assets available and liabilities assumed to be due within the next 30 days. The indicator must be above 1, which implies that the Group has sufficient funds to repay the liabilities simulated to be due within the next 30 days. This is complemented by the early warning indicators, especially the highly liquid assets indicator, which correlates highly liquid assets to customer deposits.

The Group also analyses its liquidity situation from a more structural perspective, taking into account the liquidity gaps of the later time buckets and additional sources of potential liquidity. The respective key indicator is defined as the Liquidity Position. This analysis also takes into account credit lines which can be drawn by the Group with some time delay, and other assets which take some time to liquidate.

In addition to prescribing the close monitoring of these early warning indicators, the Liquidity Risk Management Policy also defines reporting triggers related to HLAs, negative short-term liquidity gap, deposit concentration and Liquidity Coverage Ratio (set forth under Basel III). If one of the reporting triggers is passed the ALCO and the Parent's ALCO or General Risk Management Committee must be involved in decisions on appropriate measures.

In order to safeguard the liquidity of the Group even in stress situations, the potential liquidity needs in different scenarios are determined. The result is analysed and on this basis the Group's liquidity reserve target is determined by the ALCO. The results of these stress tests are also used to determine liquidity standby lines provided by the Parent to the Group if necessary.

The Group also aims to diversify its funding sources. Depositor concentrations are monitored in order to avoid dependencies on a few large depositors.

The Group also minimises its dependency on the interbank market. The Group's policies stipulate that the total amount of interbank liabilities may not exceed 40% of its available lines and overnight funding may not exceed 4% of total liabilities. Higher limits need to be approved by the Parent's ALCO.

The following tables show the remaining contractual maturities of the undiscounted financial assets and financial liabilities. The remaining contractual maturity is defined as the period between the reporting date and the contractually agreed due date of the asset or liability, or the due date of a partial payment under the contract for an asset or liability.

**PROCREDIT BANK GROUP**

**Notes to the financial statements - 31 December 2017**

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

in '000 GEL At 31 December 2017	Up to 1 month	1 – 3 months	3 – 6 months	6 – 12 months	1 -5 years	More than 5 years	Total
<b>Financial Assets</b>							
Cash and balances with the NBG(including mandatory reserve)	223,072	4,993	9,287	15,597	9,380	3,774	266,103
Due from banks	16,171	-	-	-	-	-	16,171
Unused unconditional credit commitments	-	-	-	-	-	-	-
Loans and advances to customers	32,170	52,657	90,447	211,432	545,134	274,730	1,206,570
Investment securities available-for-sale	116	125	-	257	5,140	234	5,872
Gross settled forwards	-	37,061	-	-	-	-	37,061
Other financial assets	2,039	-	-	-	-	-	2,039
<b>Total Financial Assets</b>	<b>273,568</b>	<b>94,836</b>	<b>99,734</b>	<b>227,286</b>	<b>559,653</b>	<b>278,739</b>	<b>1,533,815</b>
<b>Financial Liabilities</b>							
Due to banks	7,355	-	-	-	-	-	7,355
Customer accounts	439,252	23,210	43,163	72,493	43,598	17,543	639,258
Other borrowed funds	4,339	65,293	19,741	70,185	287,735	49,758	497,051
Gross settled forwards	-	36,955	-	-	-	-	36,955
Financial and performance guarantees and letters of credit	43,443	-	-	-	-	-	43,443
Commitments to extend credit	32,823	-	-	-	-	-	32,823
Other financial liabilities	2,273	-	-	-	-	-	2,273
Subordinated debt	-	73	514	-	38,628	25,752	64,967
<b>Total Financial Liabilities</b>	<b>529,484</b>	<b>125,530</b>	<b>63,419</b>	<b>142,678</b>	<b>369,961</b>	<b>93,053</b>	<b>1,324,125</b>
<b>Liquidity Gap</b>	<b>(255,916)</b>	<b>(30,694)</b>	<b>36,315</b>	<b>84,608</b>	<b>189,692</b>	<b>185,686</b>	
<b>Cumulative Liquidity Gap</b>	<b>(255,916)</b>	<b>(286,610)</b>	<b>(250,295)</b>	<b>(165,687)</b>	<b>24,005</b>	<b>209,691</b>	
<b>in '000 GEL</b>							
<b>At 31 December 2016</b>	<b>Up to 1 month</b>	<b>1 – 3 months</b>	<b>3 – 6 months</b>	<b>6 – 12 months</b>	<b>1 -5 years</b>	<b>More than 5 years</b>	<b>Total</b>
<b>Financial Assets</b>							
Cash and balances with the NBG (including mandatory reserve)	335,330	8,720	11,082	16,671	12,781	2,894	387,478
Due from banks	38,033	-	-	-	-	-	38,033
Unused unconditional credit commitments	26,468	-	-	-	-	-	26,468
Loans and advances to customers	27,251	51,156	81,873	188,297	501,163	212,821	1,062,561
Investment securities available-for-sale	8,114	209	4,105	245	5,606	234	18,513
Gross settled forwards	-	33,528	-	-	-	-	33,528
Other financial assets	5,669	-	-	-	-	-	5,669
<b>Total Financial Assets</b>	<b>440,865</b>	<b>93,613</b>	<b>97,060</b>	<b>205,213</b>	<b>519,550</b>	<b>215,949</b>	<b>1,572,250</b>
<b>Financial Liabilities</b>							
Due to banks	2,857	-	-	-	-	-	2,857
Customer accounts	473,563	45,965	58,419	87,881	67,371	15,254	748,453
Other borrowed funds	4,571	31,610	18,152	39,977	303,279	33,512	431,101
Gross settled forwards	-	33,353	-	-	-	-	33,353
Financial and performance guarantees and letters of credit	33,131	-	-	-	-	-	33,131
Commitments to extend credit	48,147	-	-	-	-	-	48,147
Other financial liabilities	3,523	-	-	-	-	-	3,523
Subordinated debt	-	461	1,537	1,592	49,749	28,846	82,185
<b>Total Financial Liabilities</b>	<b>565,792</b>	<b>111,389</b>	<b>78,108</b>	<b>129,450</b>	<b>420,399</b>	<b>77,612</b>	<b>1,382,750</b>
<b>Liquidity Gap</b>	<b>(124,927)</b>	<b>(17,776)</b>	<b>18,952</b>	<b>75,763</b>	<b>99,151</b>	<b>138,337</b>	
<b>Cumulative Liquidity Gap</b>	<b>(124,927)</b>	<b>(142,703)</b>	<b>(123,751)</b>	<b>(47,988)</b>	<b>51,163</b>	<b>189,500</b>	

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

The Group does not use the above maturity analysis, which includes future contractual interest, for the purpose of managing liquidity risk. Instead, the Group monitors the expected remaining maturities (excluding accrued interest, and provision for impairment and deferred fees) and the resulting expected liquidity gap as follows:

in '000 GEL At 31 December 2017	Up to 1 month	1 - 3 months	3 - 6 months	6 - 12 months	More than 1 year	Total
<b>Assets</b>						
Cash on hand and balances with NBG (including mandatory reserve)	186,775	-	-	-	-	186,775
Due from banks	65,691	-	-	-	-	65,691
Unused irrevocable and unconditional credit commitments	-	-	-	-	-	-
Treasury bills	6,995	15,790	-	-	4,760	27,545
Loans and advances to customers	12,933	35,252	61,886	148,303	741,947	1,000,321
Currency derivatives	-	37,061	-	-	-	37,061
<b>Total Assets</b>	<b>272,394</b>	<b>88,103</b>	<b>61,886</b>	<b>148,303</b>	<b>746,707</b>	<b>1,317,393</b>
<b>Liabilities</b>						
Current liabilities to banks	1,145	-	-	-	-	1,145
Current liabilities to customers	46,424	21,102	31,652	42,203	280,652	422,033
Contingent liabilities from financial and performance guarantees	2,172	-	-	-	-	2,172
Unused irrevocable credit commitments	3,282	-	-	-	-	3,282
Liabilities to related party banks	-	55,591	12,876	25,752	157,087	251,306
Liabilities to external banks	5,150	-	-	-	-	5,150
Liabilities to International Financial Institutions	414	10,779	2,733	37,057	147,741	198,724
Liabilities to customers	30,529	13,877	20,815	27,754	184,563	277,539
Subordinated debt	-	-	-	-	64,380	64,380
Currency derivatives	-	36,955	-	-	-	36,955
<b>Total Liabilities</b>	<b>89,117</b>	<b>138,304</b>	<b>68,077</b>	<b>132,766</b>	<b>834,423</b>	<b>1,262,687</b>
<b>Expected Liquidity Gap</b>	<b>183,277</b>	<b>(50,201)</b>	<b>(6,192)</b>	<b>15,537</b>	<b>(87,716)</b>	
<b>Expected Cumulative Liquidity Gap</b>	<b>183,277</b>	<b>133,076</b>	<b>126,884</b>	<b>142,422</b>	<b>54,705</b>	

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

in '000 GEL At 31 December 2016	Up to 1 month	1 - 3 months	3 - 6 months	6 - 12 months	More than 1 year	Total
<b>Assets</b>						
Cash on hand and balances with NBG (including mandatory reserve)	212,923	-	-	-	-	212,923
Due from banks	167,950	-	-	-	-	167,950
Unused irrevocable and unconditional credit commitments	26,468	-	-	-	-	26,468
Treasury bills	26,996	19,404	3,901	-	4,760	55,061
Loans and advances to customers	9,218	33,560	54,797	129,576	625,881	853,032
Currency derivatives	-	33,528	-	-	-	33,528
<b>Total Assets</b>	<b>443,555</b>	<b>86,492</b>	<b>58,698</b>	<b>129,576</b>	<b>630,641</b>	<b>1,348,962</b>
<b>Liabilities</b>						
Current liabilities to banks	1,353	-	-	-	-	1,353
Current liabilities to customers	49,345	22,430	33,645	44,859	298,316	448,595
Contingent liabilities from financial and performance guarantees	1,657	-	-	-	-	1,657
Unused irrevocable credit commitments	4,815	-	-	-	-	4,815
Liabilities to related party banks	-	10,587	7,940	-	148,221	166,748
Liabilities to external banks	150	-	-	-	-	150
Liabilities to International Financial Institutions	3,429	18,622	5,846	33,322	156,153	217,372
Liabilities to customers	30,529	13,877	20,816	27,754	184,563	277,539
Subordinated debt	-	-	-	-	66,170	66,170
Currency derivatives	-	33,353	-	-	-	33,353
<b>Total Liabilities</b>	<b>91,278</b>	<b>98,869</b>	<b>68,247</b>	<b>105,935</b>	<b>853,423</b>	<b>1,217,752</b>
<b>Expected Liquidity Gap</b>	<b>352,277</b>	<b>(12,377)</b>	<b>(9,549)</b>	<b>23,641</b>	<b>(222,782)</b>	
<b>Expected Cumulative Liquidity Gap</b>	<b>352,277</b>	<b>339,900</b>	<b>330,351</b>	<b>353,992</b>	<b>131,210</b>	

The expected liquidity gap quantifies the potential liquidity needs within a time bucket if it has a negative value, and it shows a potential excess liquidity if it has a positive one. This calculation includes positive excess values from the previous time buckets. On an operational level, the gap report is broken down into the liquidity risk relevant currencies (GEL, USD and EUR). The goal is to always have sufficient liquidity in order to serve all expected liabilities within the next month. From a technical point of view this implies that the Group's available assets should always exceed the expected liabilities.

As at 31 December 2017, the Group was in compliance with the sufficient liquidity indicator limit set at 1 according to the Liquidity Risk Management Policy.

## **26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

In order to ensure that the Group has a sufficient level of funds in the event that its customers suddenly wish to withdraw their deposits, the Group monitors the ratio of highly liquid assets to customer deposits. These amounts are held in highly liquid assets, which can quickly be converted into cash. As at the end of 2017 the highly liquid assets indicator was at 23% (2016: 41%), being above the reporting trigger of 15%.

As mentioned above, the Group also performs stress test calculations in order to safeguard its liquidity. The result is analysed and the Group's liquidity reserve target is determined by ALCO. The results of the stress tests are also used to determine liquidity stand-by lines provided by the Parent to the Group if necessary.

The Group aims to rely primarily on customer deposits for its funding. This source is supplemented by funding received from international financial institutions (IFIs), such as the GGF, OPIC, CEB, OeEB, responsAbility and EIB which provide earmarked funds under targeted financing programmes (e.g. for lending to SMEs). In order to further diversify its sources of funds, the Group also maintains relationships with other banks, especially for short-term liquidity lines. In addition, the Parent and also ProCredit Bank Germany provide short- and long-term funding.

In order to maintain a high level of diversification among its customer deposits, the Group has implemented a concentration trigger, which aims at ensuring that the ten largest customer deposits do not exceed 15% of total deposits.

The table below shows the approximate distribution of funding sources as at 31 December 2017 and 2016. It shows that, as mentioned above, customer deposits are by far the largest source of funds. Other main sources of funding are liabilities to the companies under Parent's control and IFIs.

<b>In %</b>	<b>31 December 2017</b>	<b>31 December 2016</b>
Liabilities to banks	0.6%	0.2%
Customer deposits	54.3%	61.4%
Liabilities to the companies under Parent's control	24.2%	16.4%
Liabilities to IFIs	20.6%	21.7%
Other liabilities	0.4%	0.3%

Overall, the Group considers its funding sources to be sufficiently diversified, especially given that the bulk of the funds are provided by a large number of customer deposits.

### **Funding risk**

The business plan, which is reviewed annually, serves as the basis for determining medium-term funding needs in regard to both equity and debt financing for the Group. In order to ensure sufficient liquidity at all times, the Parent holds a liquidity reserve, which can be tapped in case of emergency.

The Group still considers funding risk to be low due to strong reliance on customer deposits as well as the fact that the Group continues to access funding from various international sources.

### **Market price risk**

Market price risk for the Group is defined as currency risk and interest rate risk.



**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

Currency risk

The assets and liabilities of the Group are denominated in more than one currency. If the assets and liabilities in one currency do not match, the Group has an open currency position (OCP) and is exposed to potentially unfavourable changes in exchange rates.

Due to the still developing financial market, a history of high inflation and exchange rate fluctuations a considerable part of private savings in Georgia is held in USD or EUR. Also, loans in USD which are available at (nominally) lower interest rates and have longer maturities (as compared to GEL loans) still play an important role in the financing of many of the country's businesses. As a result, foreign currencies play a major role in the Group's operations.

Currency risk management is guided by the Foreign Currency Risk Management Policy. This policy was first implemented by the Group in 2009 and is updated on an annual basis. Its adherence to this policy is constantly monitored by the Parent's financial risk team at the group level, and amendments as well as exceptions to this policy are decided by the Parent's ALCO or General Risk Management Committee.

The Treasury and Cash Management Unit is responsible for continuously monitoring the developments of exchange rates and foreign currency markets. The Treasury and Cash Management Unit also manages the currency positions of the Group on a daily basis. As a general principle, all currency positions should be kept as low as possible at end-of-day; long or short positions for speculative purposes are not permitted. According to the Treasury Policy, derivatives may only be used for hedging purposes to close positions of the Group as well as for liquidity purposes. Permissible foreign exchange derivatives are currency forwards (including non-deliverable forwards) and currency swaps. The Group's foreign currency exposures are monitored and controlled on a daily basis by the Treasury back office and General Risk Unit.

Developments in the foreign exchange markets and the currency positions are regularly reported to the ALCO, which is authorised to take strategic decisions with regard to Treasury activities. In cases where exceptions to the Group's policy may be necessary or violations to the limits may have occurred, the General Risk Unit reports to the Parent's ALCO or General Risk Management Committee and proposes appropriate measures.

The Group aims to keep currency positions as low as possible and ensures that an open currency position remains within the limits at all times. For the purpose of currency risk management the Group has established two levels of control: early warning indicators and limits. In cases where the positions cannot be brought back below 5% of the regulatory capital for a single currency, or 7.5% for the aggregate of all currencies, the bank's ALCO and the Parent's ALCO have to be informed and appropriate measures taken. This mechanism helps to ensure that the Group's total OCP does not exceed 10% of regulatory capital. Exemptions from the limit or strategic positions are subject to approval by the Parent's ALCO or General Risk Management Committee.

The Group's OCPs were within the aforementioned limits as at 31 December 2017.

The following significant exchange rates applied during the year:

in GEL	Average rate	Average rate	Reporting date	Reporting date
	2017	2016	spot rate	spot rate
			31 December 2017	31 December 2016
USD 1	2.5059	2.3667	2.5752	2.6468
EUR 1	2.8292	2.6172	3.0884	2.7940

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

The following tables show the distribution of financial monetary assets and liabilities across its material operating currencies:

in '000 GEL					
<b>As at 31 December 2017</b>	<b>EUR</b>	<b>USD</b>	<b>Other currencies</b>	<b>Local currency</b>	<b>Total</b>
<b>Assets</b>					
Cash and balances with the NBG (including mandatory reserve)	50,755	155,382	1,257	58,710	266,103
Due from banks	1,482	678	-	14,010	16,171
Investment securities available-for-sale	-	-	-	4,943	4,943
Loans and advances to customers	65,133	726,792	-	195,412	987,337
Other financial assets	830	194	1	1,015	2,039
<b>Total financial assets</b>	<b>118,200</b>	<b>883,047</b>	<b>1,257</b>	<b>274,089</b>	<b>1,276,593</b>
<b>Open forward position (assets)</b>	<b>33,528</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Liabilities</b>					
Due to banks	3	7,196	156	-	7,355
Customer accounts	95,599	385,912	1,117	146,430	629,059
Other borrowed funds	58,488	394,743	-	-	453,231
Other financial liabilities	1,294	14	-	965	2,273
Subordinated debt	-	64,967	-	-	64,967
<b>Total financial liabilities</b>	<b>155,385</b>	<b>852,832</b>	<b>1,273</b>	<b>147,395</b>	<b>1,156,885</b>
<b>Open forward position (liabilities)</b>	<b>-</b>	<b>36,955</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net position</b>	<b>(124)</b>	<b>(6,740)</b>	<b>(15)</b>	<b>126,693</b>	<b>119,814</b>
Financial and performance guarantees and letters of credit	5,199	17,576	-	20,668	43,443
Commitments to extend credit	7,248	14,031	-	11,543	32,823

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

in '000 GEL					
<b>As at 31 December 2016</b>	<b>EUR</b>	<b>USD</b>	<b>Other</b>	<b>Local</b>	<b>Total</b>
			<b>currencies</b>	<b>currency</b>	
<b>Assets</b>					
Cash and balances with the NBG (including mandatory reserve)	33,850	267,096	2,425	84,107	387,478
Due from banks	2,179	691	-	35,163	38,033
Investment securities available-for-sale	-	-	-	16,809	16,809
Loans and advances to customers	27,439	699,835	-	128,951	856,225
Other financial assets	961	694	-	4,014	5,669
<b>Total financial assets</b>	<b>64,429</b>	<b>968,316</b>	<b>2,425</b>	<b>269,044</b>	<b>1,304,214</b>
<b>Open forward position (assets)</b>	<b>33,528</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Liabilities</b>					
Due to banks	-	2,703	-	154	2,857
Customer accounts	93,007	482,660	2,243	154,665	732,575
Other borrowed funds	2,809	384,803	-	-	387,612
Other financial liabilities	2,266	16	-	1,240	3,522
Subordinated debt	-	66,752	-	-	66,752
<b>Total financial liabilities</b>	<b>98,082</b>	<b>936,934</b>	<b>2,243</b>	<b>156,059</b>	<b>1,193,318</b>
<b>Open forward position (liabilities)</b>	<b>-</b>	<b>33,353</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net position</b>	<b>(125)</b>	<b>(1,971)</b>	<b>182</b>	<b>112,985</b>	<b>111,071</b>
Financial and performance guarantees and letters of credit	3,459	19,323	-	10,349	<b>33,131</b>
Commitments to extend credit	7,109	30,294	-	10,744	<b>48,147</b>

In order to identify maximum expected losses associated with currency fluctuations, seven years of historical currency movements are statistically analysed and the highest variances (99% and 95% confidence levels, 1-year holding period) are applied to current currency positions:

in '000 GEL		
<b>As at 31 December 2017</b>	<b>95% confidence</b>	<b>99% confidence</b>
Maximum loss (VaR)	(1,799)	(2,048)
Average loss in case confidence interval is exceeded	(1,276)	(1,395)

in '000 GEL		
<b>As at 31 December 2016</b>	<b>95% confidence</b>	<b>99% confidence</b>
Maximum loss (VaR)	(361)	(413)
Average loss in case confidence interval is exceeded	(261)	(285)

**Interest rate risk**

Interest rate risk arises from structural differences between the maturities of assets and those of liabilities. The average maturity of loans typically exceeds that of customer deposits, thus exposing the Group to interest rate risk as described above. In order to keep the interest rate risk at acceptable level, the most of the Group's short-term loans are offered at fixed interest rates while loans with longer maturities are disbursed with floating interest rates. Given that financial instruments to mitigate interest rate risks (hedges) are only available for hard currencies such as EUR and USD, this requires the Group to closely monitor interest rate risk.

The Group's approach to measuring and managing interest rate risk is guided by the Interest Rate Risk Management Policy.

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

The main indicator (Interest Earning Indicator) for managing interest rate risk measures how the profit or loss may be influenced by interest rate movements under a short-term perspective, up to one year. The indicator analyses the potential loss that the Group would incur in the event of very unfavourable movements (shocks) of the interest rates on assets and liabilities. For EUR or USD, a parallel shift of the interest rate curve by +/- 200 bps is assumed. For the local currency, the definition of a shock is derived from historic interest rate volatilities over the last seven years. Non-netted, total 12 months interest earnings impact must not exceed 10% of its regulatory capital for all currencies. A reporting trigger is set at 5%, providing an early warning signal. Also the potential impact on the economic value of all assets and liabilities (Economic Value impact) is regularly monitored and analysed.

Deviations from the Interest Rate Risk Policy and violations of interest rate limits are subject to approval by the Parent's General Risk Management Committee.

The Group's interest rate risk position is monitored by the General Risk Management Committee. The indicators are also reported to the Parent's General Risk Management Committee.

Beyond monitoring and limiting interest rate risk in the sense of re-pricing risk, the Group also aims to align the maturities of its assets and liabilities which generate interest earnings and interest expenses.

The table below presents the aggregated amounts of the Group's financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest re-pricing or maturity dates.

in '000 GEL As at 31 December 2017	Up to 1 month	1 - 3 months	3 - 6 months	6 -12 months	1 -5 years	More than 5 years	Non- interest bearing	Total
<b>Assets</b>								
Cash and balances with the NBG (including mandatory reserve)	156,018	15,790	-	-	-	-	94,295	266,103
Due from banks	16,171	-	-	-	-	-	-	16,171
Investment securities available-for-sale	-	-	-	-	4,760	-	418	5,177
Loans and advances to customers	49,871	51,385	83,661	180,296	399,778	214,426	7,921	987,337
Other financial assets	-	-	-	-	-	-	2,039	2,039
<b>Total financial assets</b>	<b>222,060</b>	<b>67,175</b>	<b>83,661</b>	<b>180,296</b>	<b>404,538</b>	<b>214,426</b>	<b>104,672</b>	<b>1,276,827</b>
<b>Liabilities</b>								
Due to banks	5,150	-	-	-	-	-	2,204	7,355
Customer accounts	234,094	20,428	39,575	67,861	43,097	12,233	211,771	629,059
Other borrowed funds	33,490	74,819	61,963	34,298	201,138	43,909	3,615	453,231
Other financial liabilities	-	-	-	-	-	-	2,273	2,273
Subordinated debt	-	38,628	-	-	-	25,752	587	64,967
<b>Total liabilities</b>	<b>272,734</b>	<b>133,875</b>	<b>101,538</b>	<b>102,159</b>	<b>244,235</b>	<b>81,893</b>	<b>220,450</b>	<b>1,156,885</b>
<b>Net interest sensitivity gap</b>	<b>(50,674)</b>	<b>(66,699)</b>	<b>(17,877)</b>	<b>78,137</b>	<b>160,303</b>	<b>132,532</b>		

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)**

in '000 GEL	Up to	1 - 3	3 - 6	6 -12	1 -5	More	Non-	
As at 31 December 2016	1 month	months	months	months	years	than	interest	Total
						5 years	bearing	
<b>Assets</b>								
Cash and balances with the NBG (including mandatory reserve)	172,879	19,404	-	-	-	-	195,195	387,478
Due from banks	38,033	-	-	-	-	-	-	38,033
Investment securities available-for-sale	7,964	-	3,901	-	4,760	-	418	17,043
Loans and advances to customers	22,266	37,374	65,819	156,398	340,711	227,771	5,886	856,225
Other financial assets	-	-	-	-	-	-	5,669	5,669
<b>Total financial assets</b>	<b>241,143</b>	<b>56,778</b>	<b>69,720</b>	<b>156,398</b>	<b>345,471</b>	<b>227,771</b>	<b>207,167</b>	<b>1,304,448</b>
<b>Liabilities</b>								
Due to banks	150	-	-	-	-	-	2,707	2,857
Customer accounts	266,894	46,961	55,926	87,940	68,453	18,154	188,246	732,574
Other borrowed funds	12,212	51,064	71,609	16,707	200,062	32,093	3,866	387,613
Other financial liabilities	-	-	-	-	-	-	3,523	3,523
Subordinated debt	-	39,702	-	-	-	26,468	582	66,752
<b>Total liabilities</b>	<b>279,256</b>	<b>137,727</b>	<b>127,535</b>	<b>104,647</b>	<b>268,515</b>	<b>76,715</b>	<b>198,924</b>	<b>1,193,319</b>
<b>Net interest sensitivity gap</b>	<b>(38,113)</b>	<b>(80,949)</b>	<b>(57,815)</b>	<b>51,751</b>	<b>76,956</b>	<b>151,056</b>		

In quantitative terms, the risks associated with interest rate fluctuations are currently limited by stipulating that the interest rate risk exposure (economic value impact in present value) of the Group following an interest rate shock of +/- 200 bps on EUR/USD and historical worst case for local currency, may not exceed 15% of regulatory capital for all currencies. As at 31 December 2017, the Group was in compliance with these requirements. Cumulative interest earnings impact for 12 months shows the following figures as at 31 December 2017:

	<b>Impact on profit or loss (equals impact on equity)</b>					
	Probable adverse case scenario			Stress scenario		
	2%	-2%		5%	-5%	
USD	-	1,233	1,233	-	3,084	3,084
EUR		405	-	405	1,012	-
GEL		2,038	-	2,038	5,096	-
		<b>3,676</b>	<b>3,676</b>		<b>9,191</b>	<b>9,191</b>

As at 31 December 2016, the impact of cumulative interest earnings was as follows:

	<b>Impact on profit or loss (equals impact on equity)</b>					
	Probable adverse case scenario			Stress scenario		
	2%	-2%		5%	-5%	
USD	-	1,680	1,680	-	4,199	4,199
EUR		759	-	759	1,897	-
GEL		2,173	-	2,173	5,431	-
		<b>4,611</b>	<b>4,611</b>		<b>11,527</b>	<b>11,527</b>

## 26. FINANCIAL RISK AND CAPITAL MANAGEMENT (CONTINUED)

The Group monitors interest rates for its financial instruments by each major currency. The table below summarises average interest rates based on reports reviewed by key management personnel:

<b>At 31 December 2017</b>			
in % p.a.	<b>EUR</b>	<b>USD</b>	<b>Local currency</b>
<b>Financial assets</b>			
Due from banks	-	-	6.59
Loans and advances to customers	6.57	7.51	10.85
<b>Financial liabilities</b>			
Due to other banks	1.22	3.08	-
Customer accounts	0.65	1.80	2.56
Other borrowed funds	2.50	3.81	-
Subordinated debt	-	5.92	-
<b>At 31 December 2016</b>			
in % p.a.	<b>EUR</b>	<b>USD</b>	<b>Local currency</b>
<b>Financial assets</b>			
Due from banks	-	-	6.28
Loans and advances to customers	7.33	8.34	11.33
<b>Financial liabilities</b>			
Customer accounts	1.36	2.39	3.11
Other borrowed funds	2.50	3.88	-
Subordinated debt	-	5.54	-

### Country risk

Country risk is defined as the risk that the Group may not be able to enforce rights over certain assets in a foreign country (expropriation risk) or that a counterparty in a foreign country is unable to perform an obligation because specific political, economic or social risks prevailing in that country have an adverse effect on the credit exposures (transfer and convertibility risk). Given the nature of the Group's business and the environment in which it operates, the Group defines country risk more broadly to refer to the possible adverse impact that significant country-specific external macroeconomic, socio-political or regulatory factors can have on the Group's earnings, capital or liquidity. In particular, it includes the risk of direct or indirect government intervention in the business operations of the Group in the form of nationalisation or seizure of assets, or significant market or regulatory intervention.

The Group's business strategy is to focus on meeting the demand for credit exhibited by small and medium businesses in the local market. Therefore, it does not normally enter into cross-border transactions or incur country risks. However, as stated above, for the purpose of financial risk management the Group may need to enter into cross-border transactions, e.g. for the purpose of investing excess liquidity in bond exposures to highly rated international or multinational institutions.

Broader country risk issues are addressed by, and inherent in the Group's policies and methodologies for the management of credit, market, liquidity, counterparty/issuer and operational risk. As cross-border exposures are controlled by the Group's and the Parent's risk management functions, the Group is exposed to country risk only to a limited degree.

## **27. FAIR VALUE OF FINANCIAL INSTRUMENTS**

A number of accounting policies and disclosures require the determination of fair values for financial assets and liabilities. Fair values have been determined for measurement and disclosure purposes. The Group measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

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

The Group estimates the fair value of financial assets and liabilities to be not materially different from their carrying values. The fair value estimate for financial assets at fair value through profit or loss, financial liabilities at fair value through profit or loss and investment securities available-for-sale are categorized into Level 2 of the fair value hierarchy, because of the use of valuation models where all significant inputs are observable.

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

The Group has determined fair values using valuation techniques. The objective of valuation techniques is to arrive at a fair value determination that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date. The valuation technique used is the discounted cash flow model.

The fair value of floating rate instruments that are not quoted in an active market was estimated to be equal to their carrying amount. The fair value of unquoted fixed interest rate instruments was estimated based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. In case observable market rates are not available to determine the fair value of financial liabilities measured at amortized cost, the Parent's Treasury rates are used as an input for a discounted cash flow model. The Parent's Treasury rates are determined considering the cost of capital depending on currencies and maturities plus a risk margin that depends on an internal risk rating for each institution. These internal rates are regularly compared to those applied for third party transactions.

Where available, the fair value of loans and advances is based on observable market transactions. Where observable market transactions are not available, fair value is estimated using the Group's own fair value model, such as the discounted cash flow technique. Input using the valuation technique includes expected lifetime credit losses, interest rates and prepayment rates. The fair value of deposits from banks and customers is estimated using discounted cash flow techniques, applying the rates that are offered for deposits of similar maturities and terms. The fair value of deposits payable on demand is the amount payable at the reporting date.

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**27. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)**

The following table gives an overview of the carrying amounts and fair values of the financial assets and liabilities according to the classes of financial instruments, defined in accordance with the business of the Group.

in '000 GEL	Level	2017		2016	
		Carrying value	Fair value	Carrying value	Fair value
<b>Financial assets</b>					
Cash and cash equivalents	Level 2	140,141	140,141	255,930	255,930
Mandatory reserve deposits with NBG	Level 2	125,962	125,962	131,547	131,547
Due from other banks	Level 2	16,171	16,171	38,033	38,033
Loans and advances to customers	Level 3	987,337	983,815	856,225	860,122
Other financial assets	Level 3	2,039	2,039	5,669	5,669
<b>Total financial assets</b>		<b>1,271,651</b>	<b>1,268,128</b>	<b>1,287,406</b>	<b>1,291,302</b>
<b>Financial liabilities</b>					
Due to other banks	Level 2	48,639	48,639	2,857	2,857
Customer accounts					
Current accounts	Level 2	205,840	205,840	200,491	200,491
Savings accounts	Level 2	220,504	220,504	246,026	246,026
Term accounts	Level 3	198,715	198,683	283,964	286,026
Other liabilities to customers	Level 2	4,000	4,000	2,094	2,094
Other borrowed funds	Level 3	411,946	400,994	387,612	366,080
Other financial liabilities	Level 3	2,273	2,273	3,523	3,523
Subordinated debt	Level 3	64,967	62,836	66,752	60,723
<b>Total financial liabilities</b>		<b>1,156,885</b>	<b>1,143,768</b>	<b>1,193,318</b>	<b>1,167,819</b>



## 28. CONTINGENT LIABILITIES AND COMMITMENTS

The Group has outstanding commitments to extend credit. These commitments take the form of approved loans limits and overdraft facilities. The Group provides financial guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to five years.

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

in '000 GEL		
<b>As at 31 December</b>	<b>2017</b>	<b>2016</b>
Financial guarantees and stand-by letters of credit	11,408	13,321
Performance guarantees	32,035	19,810
Commitments to extend credit:		
- Original term to maturity of one year or less	22,484	29,921
- Original term to maturity of more than one year	10,338	18,226
<b>Total</b>	<b>76,265</b>	<b>81,278</b>

The above table discloses the nominal principal amounts of contingent liabilities, commitments and guarantees, i.e. the amounts at risk, should contracts be fully drawn upon and clients default. The management believes that a significant portion of guarantees and commitments will expire without being drawn upon; therefore the total of the contractual amounts is not representative of future liquidity requirements. An estimate of amount and timing of outflow is not practicable. Provisions for credit related commitments and performance guarantees are disclosed in Note 18.

### Operating lease commitments

Where the Group is the lessee, the future minimum lease payments under non-cancellable operating leases are as follows:

in '000 GEL		
	<b>2017</b>	<b>2016</b>
- No later than one year	453	979
- Later than one year and no later than five years	320	320
<b>Total</b>	<b>773</b>	<b>1,299</b>

### Tax legislation

The taxation system in Georgia is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes unclear, contradictory and subject to varying interpretation. In the event of a breach of tax legislation, no liabilities for additional taxes, fines or penalties may be imposed by the tax authorities after three years have passed since the end of the year in which the breach occurred.

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

### Litigation

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.

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2017**

**29. RELATED PARTY TRANSACTIONS**

The Group's immediate and ultimate parent company is ProCredit Holding AG & Co. KGaA, which produces publicly available financial statements.

Parties are generally considered to be related if the parties are under common control, or one party has the ability to control the other party or can 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. The key management personnel include the executive directors of the Group and their close family members .

The Group had the following balances outstanding as at 31 December 2017 and 2016 with related parties:

in '000 GEL	Contractual interest rate, p.a.	2017	2016
<b>Assets</b>			
<b>Due from banks</b>			
- Entities under common control	-0.45%-1.35 %	34,569	31,189
<b>Due to banks</b>			
- Entities under common control	0.0%	554	533
<b>Customer accounts</b>			
- Key management	0.0%-4.5%	309	260
<b>Other borrowed funds</b>			
- Parent	1.22%-4.7%	170,452	109,944
- entities under common control	1.22%-4.35%	82,745	58,550
<b>Subordinated debt</b>			
- Parent	7.9%	26,266	26,985

Included in the profit or loss for the year ended 31 December 2017 and 2016 are the following amounts which arose due to transactions with related parties:

in '000 GEL	2017	2016
<b>Interest expense</b>		
- Parent	7,856	6,167
- entities under common control	2,184	1,534
- key management	-	10
<b>Fees and commission expenses</b>		
- entities under common control	-	1,951
<b>Other operating income</b>		
- Parent	16	11
<b>Personnel expenses</b>		
- Key management	612	431
<b>Other administrative expenses</b>		
- Parent	2,107	1,713
- entities under common control	2,743	2,758

The transactions leading to the above balances were made in the ordinary course of business and on substantially the same terms as for comparable transactions with entities or persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of payment defaults nor did they comprise other unfavourable features.