

**JSC ProCredit Bank**  
International Financial Reporting Standards  
Consolidated and Separate Financial Statements and  
Independent Auditors' Report  
31 December 2018



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## Independent Auditor's Report

To the Shareholder and Management of JSC ProCredit Bank

### 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 JSC ProCredit Bank (the 'Bank') and its subsidiary (together - the 'Group') as at 31 December 2018, and its consolidated and separate financial performance and its consolidated and separate cash flows for the year then ended in accordance with International Financial Reporting Standards and with the requirements of 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 2018;
- 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 significant accounting policies and other explanatory information.

### 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 and the Bank 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 (but does not include the financial statements and our auditor's report thereon).

Our opinion on the financial statements does not cover the Management Report.

In connection with our audit of the financial statements, our responsibility is to read the Management Report and, in doing so, consider whether the Management Report 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 by the Law of Georgia on Accounting, Reporting and Auditing to express an opinion whether certain parts of the 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.



If, based on the work we have performed, we conclude that there is a material misstatement in the Management Report, we are required to report that fact. We have nothing to report in this regard.

Based on the work performed in the course of our audit, in our opinion, in all material respects:

- the information given in the Management Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Management Report includes the information required by the Law of Georgia on Accounting, Reporting and Auditing and complies with respective regulatory normative acts.

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### *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 requirements of 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.

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

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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)

A handwritten signature in blue ink, consisting of a stylized 'L' and 'J' followed by a circular flourish, is written over the printed name.

2 April 2019  
Tbilisi, Georgia



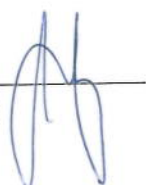
# PROCREDIT BANK GROUP

## Consolidated and Separate Statements of Financial Position

in '000 GEL	Notes	Consolidated		Separate	
		31 December 2018	31 December 2017	31 December 2018	31 December 2017
<b>Assets</b>					
Cash and balances with the NBG	7	167,842	140,141	167,842	140,141
Mandatory reserve deposits with NBG	7	170,806	125,962	170,806	125,962
Investment securities available-for-sale	9	-	4,943	-	4,943
Investments in debt securities	9	29,767	-	29,767	-
Investments in equity securities	11	234	234	234	234
Investments in subsidiaries		-	-	6,100	6,100
Due from banks	8	32,143	16,171	32,140	16,168
Financial assets at fair value through profit or loss		-	339	-	339
Loans and advances to customers	11	1,023,256	987,337	1,023,256	987,337
Current tax asset		-	1,532	-	1,571
Investment properties	12	6,985	7,102	5,401	5,513
Intangible assets	13	1,287	1,393	1,287	1,394
Property and equipment	14	55,591	63,152	55,591	63,152
Other assets	15	10,998	10,232	7,834	6,303
<b>Total assets</b>		<b>1,498,909</b>	<b>1,358,538</b>	<b>1,500,258</b>	<b>1,359,157</b>
<b>Liabilities</b>					
Due to banks	16	71,608	48,639	71,608	48,639
Financial liabilities at fair value through profit or loss		224	-	224	-
Customer accounts	17	696,377	629,059	699,694	630,659
Other borrowed funds	18	457,234	411,946	457,234	411,946
Subordinated debt	22	82,978	64,967	82,978	64,967
Current tax liability		1,775	-	1,775	-
Other liabilities	19	1,321	4,309	1,198	4,155
Other provisions	20	813	577	813	577
Deferred tax liability	21	639	937	639	937
<b>Total liabilities</b>		<b>1,312,969</b>	<b>1,160,434</b>	<b>1,316,163</b>	<b>1,161,880</b>
<b>Equity</b>					
Share capital	23	88,915	88,915	88,915	88,915
Share premium	23	36,388	36,388	36,388	36,388
Retained earnings		60,636	72,801	58,792	71,974
<b>Total equity</b>		<b>185,939</b>	<b>198,104</b>	<b>184,095</b>	<b>197,277</b>
<b>Total equity and liabilities</b>		<b>1,498,908</b>	<b>1,358,538</b>	<b>1,500,258</b>	<b>1,359,157</b>

Approved for issue and signed on behalf of the Board of Directors on 2 April 2019.

Ketevan Khuskivadze  
Director



Nana Chikvaidze  
Chief Accountant





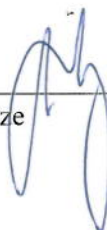
## PROCREDIT BANK GROUP

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

in '000 GEL	Notes	Consolidated		Separate	
		2018	2017	2018	2017
Interest income calculated using effective interest rate method	25	86,339	84,858	86,339	84,858
Interest expense	25	(34,732)	(32,131)	(34,732)	(32,131)
<b>Net interest income</b>		<b>51,607</b>	<b>52,727</b>	<b>51,607</b>	<b>52,727</b>
Provision for loan impairment	26	311	(4,911)	311	(4,911)
<b>Net interest income after provision for loan impairment</b>		<b>51,918</b>	<b>47,816</b>	<b>51,918</b>	<b>47,816</b>
Fee and commission income	27	11,586	10,204	11,586	10,204
Fee and commission expenses	27	(6,057)	(5,174)	(6,057)	(5,174)
Net gain from trading in foreign currency		9,255	9,520	9,255	9,520
Net foreign exchange translation gain		(926)	(3,160)	(918)	(3,159)
Personnel expenses		(12,320)	(13,177)	(12,244)	(13,104)
Other administrative expenses	28	(22,991)	(25,137)	(22,919)	(25,065)
Other operating income		3,613	3,418	2,499	1,959
Other operating expenses		(3,021)	(1,508)	(2,891)	(1,120)
<b>Profit before income tax</b>		<b>31,057</b>	<b>22,802</b>	<b>30,229</b>	<b>21,877</b>
Income tax expense	21	(4,659)	(141)	(4,849)	(69)
<b>Profit and total comprehensive income for the year</b>		<b>26,398</b>	<b>22,661</b>	<b>25,380</b>	<b>21,808</b>

Approved for issue and signed on behalf of the Board of Directors on 2 April 2019.

Ketevan Khuskivadze  
Director



Nana Chikvaidze  
Chief Accountant



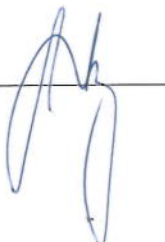
# PROCREDIT BANK GROUP

## 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 2017</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	-	-	21,808	21,808
Dividends declared					(20,692)	(20,692)			(20,691)	(20,691)
<b>Balance at 31 December 2017</b>			88,915	36,388	72,799	198,102	88,915	36,388	71,974	197,277
Change on initial application of IFRS 9		4			(8,238)	(8,238)			(8,238)	(8,238)
<b>Restated balance at 1 January 2018</b>			88,915	36,388	64,561	189,864	88,915	36,388	63,736	189,039
<b>Total comprehensive income</b>										
Profit for the year			-	-	26,398	26,398	-	-	25,380	25,380
<b>Total comprehensive income for the year</b>			-	-	26,398	26,398	-	-	25,380	25,380
<b>Transactions with owners, recorded directly in equity</b>										
Dividends declared		23	-	-	(30,323)	(30,323)	-	-	(30,323)	(30,323)
<b>Total transactions with owners</b>			-	-	(30,323)	(30,323)	-	-	(30,323)	(30,323)
<b>Balance at 31 December 2018</b>			88,915	36,388	60,636	185,939	88,915	36,388	58,793	184,096

Approved for issue and signed on behalf of the Board of Directors on 2 April 2019.

Ketevan Khuskivadze  
Director



Nana Chikvaidze  
Chief Accountant




# PROCREDIT BANK GROUP

## Consolidated and Separate Statements of Cash Flows

in '000 GEL	Notes	Consolidated		Separate	
		2018	2017	2018	2017
<b>Profit before income tax</b>		<b>31,057</b>	<b>22,802</b>	<b>30,2294</b>	<b>21,877</b>
Accrual / (release) of provision for loan impairment	11	(311)	4,911	(311)	5,327
Depreciation and amortization		4,805	6,123	4,775	6,093
Net foreign exchange translation gain		925	3,160	918	3,160
Accrual of other provisions		164	101	164	101
Gain from disposal of property and equipment, investment properties and intangible assets		4,043	2,406	4,043	2,406
Net interest income		(51,607)	(52,727)	(51,607)	(52,727)
<b>Operating cash flows before changes in operating assets and liabilities</b>		<b>(10,925)</b>	<b>(13,224)</b>	<b>(11,789)</b>	<b>(13,763)</b>
<i>Net change in assets and liabilities from operating activities after non-cash items:</i>					
Mandatory reserve deposit with the NBG		(40,415)	5,097	(40,415)	5,096
Loans and advances to customers		(16,298)	(149,841)	(16,298)	(150,256)
Other assets		(1,053)	6,303	(1,818)	6,080
Due to banks		22,969	45,783	22,969	45,782
Financial liabilities at fair value through profit or loss		562	(164)	562	(164)
Customer accounts		54,381	(98,967)	56,099	(97,638)
Other liabilities		(2,989)	592	(2,957)	722
Interest received		85,788	83,305	86,254	83,305
Interest paid		(34,678)	(34,822)	(34,678)	(34,821)
Income tax paid		(1,650)	(5,476)	(1,801)	(5,682)
<b>Net cash (used in)/from operating activities</b>		<b>55,692</b>	<b>(161,414)</b>	<b>55,662</b>	<b>(161,339)</b>
Purchase of property and equipment and intangible assets		(2,065)	(971)	(2,065)	(971)
Purchase of investment properties		(609)	(120)	(585)	(8)
Proceeds from sale of property and equipment and investment properties		785	287	785	98
Purchase of investment securities available-for-sale	9	-	(30,000)	-	(30,000)
Purchase of investments in debt securities	9	(87,227)	-	(87,227)	-
Proceeds from sale of investment securities available-for-sale	9	-	41,866	-	41,866
Proceeds from sale of investments in debt securities	9	62,609	-	62,609	-
<b>Cash flows from/(used in) investing activities</b>		<b>(25,681)</b>	<b>11,062</b>	<b>(25,657)</b>	<b>10,985</b>
Dividends paid	23	(30,323)	(20,692)	(30,323)	(20,692)
Proceeds from other borrowed funds		139,789	82,618	139,789	82,618
Repayments of other borrowed funds		(89,396)	(88,034)	(89,396)	(88,034)
Proceeds of subordinated debts		15,218	-	15,218	-
<b>Cash flows (used in)/from financing activities</b>		<b>35,288</b>	<b>(26,108)</b>	<b>35,288</b>	<b>(26,108)</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>65,299</b>	<b>(176,460)</b>	<b>65,293</b>	<b>(176,462)</b>
Cash and cash equivalents at the beginning of the year		156,312	293,963	156,310	293,964
Effects of exchange rate changes		(21,409)	38,808	(21,401)	38,808
<b>Cash and cash equivalents at the end of the year</b>	7	<b>200,206</b>	<b>156,311</b>	<b>200,203</b>	<b>156,310</b>

Approved for issue and signed on behalf of the Board of Directors on 2 April 2019.

  
Ketevan Khushivadze  
Director

  
Nana Chikvaidze  
Chief Accountant



## PROCREDIT BANK GROUP

### Notes to the financial statements - 31 December 2018

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#### 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, 4 service points and 11 Self-service areas in Tbilisi, Kutaisi, Batumi 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 2018 and 31 December 2017, 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 2018 and 31 December 2017 the Group had no ultimate controlling party.

	% of ownership interest held as of	
	31 December 2018	2017
Zeitinger Invest GmbH	17	16.8
KfW - Kreditanstalt für Wiederaufbau	13.2	13.2
DOEN Foundation	12.5	12.5
IFC - International Finance Corporation	10	10
TIAA-CREF - Teachers Insurance and Annuity Association	8.6	8.6
Other	38.7	38.9
<b>Total</b>	<b>100</b>	<b>100</b>

Refer to Note 32 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.

For the purpose of measurement of expected credit losses (“ECL”) the Group uses supportable forward-looking information, including forecasts of macroeconomic variables. As with any economic forecast, however, the projections and likelihoods of their occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different from those projected.

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

#### **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.

#### **Basis of preparation.**

These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value, and by the revaluation of financial instruments categorised at fair value through profit or loss (“FVTPL”) and at fair value through other comprehensive income (“FVOCI”). The principal accounting policies applied in the preparation of these financial statements are set out below. Apart from the accounting policy changes resulting from the adoption of IFRS 9 and IFRS 15 effective from 1 January 2018, these policies have been consistently applied to all the periods presented, unless otherwise stated. Refer to Note **Error! Reference source not found.**

#### **Basis of consolidation**

Subsidiaries are those investees, including structured entities, that the Group controls because the Group (i) has power to direct relevant activities of the investees that significantly affect their returns, (ii) has exposure, or rights, to variable returns from its involvement with the investees, and (iii) has the ability to use its power over the investees to affect the amount of investor’s returns. The existence and effect of substantive rights, including substantive potential voting rights, are considered when assessing whether the Group has power over another entity. For a right to be substantive, the holder must have practical ability to exercise that right when decisions about the direction of the relevant activities of the investee need to be made. The Group may have power over an investee even when it holds less than majority of voting power in an investee. In such a case, the Group assesses the size of its voting rights relative to the size and dispersion of holdings of the other vote holders to determine if it has de-facto power over the investee. Protective rights of other investors, such as those that relate to fundamental changes of investee’s activities or apply only in exceptional circumstances, do not prevent the Group from controlling an investee. Subsidiaries are consolidated from the date on which control is transferred to the Group, and are deconsolidated from the date on which control ceases.

The acquisition method of accounting is used to account for the acquisition of subsidiaries. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

The Group measures non-controlling interest that represents present ownership interest and entitles the holder to a proportionate share of net assets in the event of liquidation on a transaction by transaction basis, either at: (a) fair value, or (b) the non-controlling interest's proportionate share of net assets of the acquiree. Non-controlling interests that are not present ownership interests are measured at fair value.

Goodwill is measured by deducting the net assets of the acquiree from the aggregate of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and fair value of an interest in the acquiree held immediately before the acquisition date. Any negative amount (“negative goodwill”) is recognised in profit or loss, after management reassesses whether it identified all the assets acquired and all liabilities and contingent liabilities assumed, and reviews appropriateness of their measurement.

The consideration transferred for the acquiree is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed, including fair value of assets or liabilities from contingent consideration arrangements, but excludes acquisition related costs such as advisory, legal, valuation and similar professional services. Transaction costs incurred for issuing equity instruments are deducted from equity; transaction costs incurred for issuing debt are deducted from its carrying amount and all other transaction costs associated with the acquisition are expensed.

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

#### **Basis of consolidation (continued)**

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Bank and all of its subsidiaries use uniform accounting policies consistent with the Group's policies.

Non-controlling interest is that part of the net results and of the equity of a subsidiary attributable to interests which are not owned, directly or indirectly, by the Bank. Non-controlling interest forms a separate component of the Group's equity.

#### **Financial instruments - key measurement terms**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the quantity held by the entity. This is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

A portfolio of financial derivatives or other financial assets and liabilities that are not traded in an active market is measured at the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (ie an asset) for a particular risk exposure or paid to transfer a net short position (ie a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date.

Valuation techniques such as discounted cash flow models or models based on recent arm's length transactions or consideration of financial data of the investees, are used to measure fair value of certain financial instruments for which external market pricing information is not available. Fair value measurements are analysed by level in the fair value hierarchy as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based on solely observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period. Refer to Note **Error! Reference source not found.**

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.

Amortised cost ("AC") is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any allowance for expected credit losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related items in the statement of financial position.

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 gross carrying amount of the financial instrument.

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

#### **Financial instruments - key measurement terms (continued)**

The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing 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. For assets that are purchased or originated credit impaired ("POCI") at initial recognition, the effective interest rate is adjusted for credit risk, i.e. it is calculated based on the expected cash flows on initial recognition instead of contractual payments.

#### **Financial instruments – initial recognition**

Financial instruments at FVTPL are initially recorded at fair value. All other financial instruments are initially recorded at fair value adjusted for transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets. After the initial recognition, an ECL allowance is recognised for financial assets measured at AC and investments in debt instruments measured at FVOCI, resulting in an immediate accounting loss.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date on which the Group commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

#### **Financial assets – classification and subsequent measurement – measurement categories**

The Group classifies financial assets in the following measurement categories: FVTPL, FVOCI and AC. The classification and subsequent measurement of debt financial assets depends on: (i) the Group's business model for managing the related assets portfolio and (ii) the cash flow characteristics of the asset.

#### **Financial assets – classification and subsequent measurement – business model**

The business model reflects how the Group manages the assets in order to generate cash flows – whether the Group's objective is: (i) solely to collect the contractual cash flows from the assets ("hold to collect contractual cash flows"), or (ii) to collect both the contractual cash flows and the cash flows arising from the sale of assets ("hold to collect contractual cash flows and sell") or, if neither of (i) and (ii) is applicable, the financial assets are classified as part of "other" business model and measured at FVTPL.

Business model is determined for a group of assets (on a portfolio level) based on all relevant evidence about the activities that the Group undertakes to achieve the objective set out for the portfolio available at the date of the assessment. Factors considered by the Group in determining the business model include the purpose and composition of a portfolio, past experience on how the cash flows for the respective assets were collected, and how risks are assessed and managed. Refer to Note **Error! Reference source not found.** for critical judgements applied by the Group in determining the business models for its financial assets.

#### **Financial assets – classification and subsequent measurement – cash flow characteristics**

Where the business model is to hold assets to collect contractual cash flows or to hold contractual cash flows and sell, the Group assesses whether the cash flows represent solely payments of principal and interest ("SPPI"). Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are consistent with the SPPI feature. In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement, i.e. interest includes only consideration for credit risk, time value of money, other basic lending risks

and profit margin.

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

Where the contractual terms introduce exposure to risk or volatility that is inconsistent with a basic lending arrangement, the financial asset is classified and measured at FVTPL. The SPPI assessment is performed on initial recognition of an asset and it is not subsequently reassessed. Refer to Note **Error! Reference source not found.** for critical judgements applied by the Group in performing the SPPI test for its financial assets.

#### **Financial assets – reclassification**

Financial instruments are reclassified only when the business model for managing the portfolio as a whole changes. The reclassification has a prospective effect and takes place from the beginning of the first reporting period that follows after the change in the business model.

#### **Financial assets impairment – credit loss allowance for ECL**

The Group assesses, on a forward-looking basis, the ECL for debt instruments measured at AC and FVOCI and for the exposures arising from loan commitments and financial guarantee contracts. The Group measures ECL and recognises credit loss allowance at each reporting date. The measurement of ECL reflects: (i) an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, (ii) time value of money and (iii) all reasonable and supportable information that is available without undue cost and effort at the end of each reporting period about past events, current conditions and forecasts of future conditions.

Debt instruments measured at AC are presented in the consolidated statement of financial position net of the allowance for ECL. For loan commitments and financial guarantees, a separate provision for ECL is recognised as a liability in the consolidated statement of financial position. For debt instruments at FVOCI, changes in amortised cost, net of allowance for ECL, are recognised in profit or loss and other changes in carrying value are recognised in OCI as gains less losses on debt instruments at FVOCI.

The Group applies a three stage model for impairment, based on changes in credit quality since initial recognition. A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial assets in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that results from default events possible within the next 12 months or until contractual maturity, if shorter (“12 Months ECL”). If the Group identifies a significant increase in credit risk (“SICR”) since initial recognition, the asset is transferred to Stage 2 and its ECL is measured based on ECL on a lifetime basis, that is, up until contractual maturity but considering expected prepayments, if any (“Lifetime ECL”). Refer to Note **Error! Reference source not found.** for a description of how the Group determines when a SICR has occurred. If the Group determines that a financial asset is credit-impaired, the asset is transferred to Stage 3 and its ECL is measured as a Lifetime ECL. The Group’s definition of credit impaired assets and definition of default is explained in Note 28 **Error! Reference source not found.** For financial assets that are purchased or originated credit-impaired (“POCI Assets”), the ECL is always measured as a Lifetime ECL. Note 28 **Error! Reference source not found.** provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Group incorporates forward-looking information in the ECL models.

As an exception, for certain financial instruments, such as credit cards, that may include both a loan and an undrawn commitment component, the Group measures expected credit losses over the period that the Group is exposed to credit risk, that is, until the expected credit losses would be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period. This is because contractual ability to demand repayment and cancel the undrawn commitment does not limit the exposure to credit losses to such contractual notice period.

#### **Financial assets – write-off**

Financial assets are written-off, in whole or in part, when the Group exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a derecognition event. The Group may write-off financial assets that are still subject to enforcement activity when the Group seeks to recover amounts that

are contractually due, however, there is no reasonable expectation of recovery.

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

#### **Financial assets – derecognition**

The Group derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets 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 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. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

#### **Financial assets – modification**

The Group sometimes renegotiates or otherwise modifies the contractual terms of the financial assets. The Group assesses whether the modification of contractual cash flows is substantial considering, among other, the following factors: any new contractual terms that substantially affect the risk profile of the asset, significant change in interest rate, change in the currency denomination, new collateral or credit enhancement that significantly affects the credit risk associated with the asset or a significant extension of a loan when the borrower is not in financial difficulties.

If the modified terms are substantially different, the rights to cash flows from the original asset expire and the Group derecognises the original financial asset and recognises a new asset at its fair value. The date of renegotiation is considered to be the date of initial recognition for subsequent impairment calculation purposes, including determining whether a SICR has occurred. The Group also assesses whether the new loan or debt instrument meets the SPPI criterion. Any difference between the carrying amount of the original asset derecognised and fair value of the new substantially modified asset is recognised in profit or loss, unless the substance of the difference is attributed to a capital transaction with owners.

In a situation where the renegotiation was driven by financial difficulties of the counterparty and inability to make the originally agreed payments, the Group compares the original and revised expected cash flows to assets whether the risks and rewards of the asset are substantially different as a result of the contractual modification. If the risks and rewards do not change, the modified asset is not substantially different from the original asset and the modification does not result in derecognition. The Group recalculates the gross carrying amount by discounting the modified contractual cash flows by the original effective interest rate (or credit-adjusted effective interest rate for POCI financial assets), and recognises a modification gain or loss in profit or loss.

#### **Financial liabilities – measurement categories**

Financial liabilities are classified as subsequently measured at AC, except for (i) financial liabilities at FVTPL: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in securities), contingent consideration recognised by an acquirer in a business combination and other financial liabilities designated as such at initial recognition and (ii) financial guarantee contracts and loan commitments.

#### **Financial liabilities – derecognition**

Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

An exchange between the Group and its original lenders of debt instruments with substantially different terms, as well as substantial modifications of the terms and conditions of existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and

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discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust

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

**Financial liabilities – derecognition (continued)**

the carrying amount of the liability and are amortised over the remaining term of the modified liability.

Modifications of liabilities that do not result in extinguishment are accounted for as a change in estimate using a cumulative catch up method, with any gain or loss recognised in profit or loss, unless the economic substance of the difference in carrying values is attributed to a capital transaction with owners.

**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,

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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 29.

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

**Cash and cash equivalents**

Cash and cash equivalents are items which are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. Cash and cash equivalents include cash on hand, amounts due from the National Bank of Georgia (NBG), excluding mandatory reserves, and all interbank placements and interbank receivables with original maturities of less than three months. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents. Cash and cash equivalents are carried at AC because: (i) they are held for collection of contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL. Features mandated solely by legislation, such as the bail-in legislation in certain countries, do not have an impact on the SPPI test, unless they are included in contractual terms such that the feature would apply even if the legislation is subsequently changed.

The payments or receipts presented in the statement of cash flows represent the Group's transfers of cash and cash equivalents, including amounts charged or credited to current accounts of the Group's counterparties held with the Group, such as loan interest income or principal collected by charging the customer's current account or interest payments or disbursement of loans credited to the customer's current account, which represent cash or cash equivalent from the customer's perspective.

**Mandatory reserve deposits with the National Bank of Georgia**

Mandatory reserve deposits with the NBG are carried at AC and are not available to finance the Group's day to day operations. Hence they are not considered as part of cash and cash equivalents for the purposes of the consolidated statement of cash flows.

**Due from banks**

Amounts due from banks include placements with the banks with original maturities of more than three months. Amounts due from banks are recorded when the Group advances money to counterparty banks. Amounts due from banks are carried at AC when: (i) they are held for the purposes of collecting contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL. Otherwise they are carried at FV.

**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.



### **Investments in debt securities**

Based on the business model and the cash flow characteristics, the Group classifies investments in debt securities as carried at AC, FVOCI or FVTPL. Debt securities are carried at AC if they are held for collection of contractual cash flows and where those cash flows represent SPPI, and if they are not voluntarily designated at FVTPL in order to significantly reduce an accounting mismatch.

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

### **Investments in debt securities (continued)**

Debt securities are carried at FVOCI if they are held for collection of contractual cash flows and for selling, where those cash flows represent SPPI, and if they are not designated at FVTPL. Interest income from these assets is calculated using the effective interest method and recognised in profit or loss. An impairment allowance estimated using the expected credit loss model is recognised in profit or loss for the year. All other changes in the carrying value are recognised in OCI. When the debt security is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from OCI to profit or loss.

Investments in debt securities are carried at FVTPL if they do not meet the criteria for AC or FVOCI. The Group may also irrevocably designate investments in debt securities at FVTPL on initial recognition if applying this option significantly reduces an accounting mismatch between financial assets and liabilities being recognised or measured on different accounting bases.

### **Loans and advances to customers**

Loans and advances to customers are recorded when the Group advances money to purchase or originate a loan due from a customer. Based on the business model and the cash flow characteristics, the Group classifies loans and advances to customers into one of the following measurement categories: (i) AC: loans that are held for collection of contractual cash flows and those cash flows represent SPPI and loans that are not voluntarily designated at FVTPL, and (ii) FVTPL: loans that do not meet the SPPI test or other criteria for AC or FVOCI are measured at FVTPL.

Impairment allowances are determined based on the forward-looking ECL models. Note 28 **Error! Reference source not found.** provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Group incorporates forward-looking information in the ECL models.

### Increase of loss allowances

For the recognition of loss allowances, a three-stage model is used based on expected credit losses.

- Stage 1: All financial assets are generally classified as “Stage 1” at initial recognition. The Group establishes loss allowances in an amount equivalent to the 12 month expected credit losses, insofar as there has not been a significant increase in credit risk since initial recognition.
- Stage 2: If the credit risk increases significantly, then “Stage 2” classification is assigned, and loss allowances are established in an amount equivalent to the lifetime expected credit losses.
- Stage 3: Defaulted financial assets are assigned to “Stage 3” and loss allowances are likewise established in an amount equivalent to the lifetime expected credit losses. For significant exposures, risk provisioning is determined on the basis of recoverable cash flows. For insignificant exposures, loss allowances are determined on the basis of portfolio-based parameters. Interest income is recognised at net book value (less loss allowances). Stage 3 also includes financial assets which are already impaired at initial recognition (“POCI”). These are measured initially at fair value and without loss allowances. Regardless of future changes in the credit risk, POCI assets remain in Stage 3 until their disposal.

### Release of loss allowances

In the event of decrease of credit risk, the already recognised loss allowance is reduced accordingly.

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Write-offs, recoveries and direct write-offs

When a loan is uncollectible, it is written off against the related loss allowance set aside. Such write-offs occur after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised in the Statement of Profit or Loss under "Loss allowances". Uncollectible loans for which no loss allowances have been set aside in full are recognised as direct write-offs.

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

**Loans and advances to customers (continued)**

Non-substantial modification

Non-substantial modification is a modification event that does not result in derecognition of the original asset. The effect is recognised through profit or loss as a modification gain or modification loss. The modification gain or loss is calculated as the difference between the original gross carrying amount and the present value of the modified contractual cash flows discounted at the original effective interest rate.

**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,

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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)**

**Investment properties (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.

Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit or loss for the year (rental expense) on a straight-line basis over the period of the lease.

## **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.

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

#### **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 was to enter into force from 1 January 2019, but the government postponed the launch of the Estonian model of taxation for the financial sector till 2023.

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.

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 2023, 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 2023 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.

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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 2023 and hence, no deferred income tax assets and liabilities will arise, there on.

**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.

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

**Liabilities to banks and customers and other borrowed funds (continued)**

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**

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate or cash deposits and, therefore, carry less risk than a direct borrowing.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments, if the unused amounts were to be drawn down. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards.

**Subordinated debt**

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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".

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

#### **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 expense are recorded for all debt instruments, other than those at FVTPL, on an accrual basis using the effective interest method. As part of interest income or expense this method defers all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. The group does not have Interest income on debt instruments at FVTPL calculated at nominal interest rate during 2018.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Group to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Group does not designate loan commitments as financial liabilities at FVTPL. Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for (i) financial assets that have become credit impaired (Stage 3), for which interest income is calculated by applying the effective interest rate to their AC, net of the ECL provision, and (ii) financial assets that are purchased or originated credit impaired, for which the original credit-adjusted effective interest rate is applied to the AC.

All other fees, commissions and other income and expense items 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.

#### **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.

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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.

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

**Principles applied before 1 January 2018 under IAS 39 (comparatives only)**

**Financial instruments - key measurement terms (comparatives only)**

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 settle 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)**

#### **Financial instruments - key measurement terms (comparatives only) (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 (comparatives only)**

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”.



**Financial assets (comparatives only)**

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.

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

**Financial assets (comparatives only) (continued)**

*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.

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 11 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.

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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.

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

**Cash and cash equivalents (comparatives only)**

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.

**Impairment of financial assets classified as available for sale (comparatives only)**

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.

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.

**Loans and advances to customers and banks (comparatives only)**

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.

**Impairment of loans and advances (comparatives only)**

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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)**

#### **Impairment of loans and advances (comparatives only) (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)**

#### **Impairment of loans and advances (comparatives only) (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.

#### **Derivative financial instruments.**

Derivative financial instruments, including foreign exchange contracts, interest rate futures, forward rate agreements, currency and interest rate swaps, and currency and interest rate options are carried at their fair value.

All derivative instruments are carried as assets when fair value is positive, and as liabilities when fair value is negative. Changes in the fair value of derivative instruments are included in profit or loss for the year (gains less losses on derivatives). The Group does not apply hedge accounting.

Certain derivative instruments embedded in financial liabilities and other non-financial contracts are treated as separate derivative instruments when their risks and characteristics are not closely related to those of the host contract.

### **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. The Group makes estimates and assumptions that affect the amounts recognised in the consolidated financial statements, and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most

#### **4. USE OF ASSUMPTIONS AND ESTIMATES (CONTINUED)**

significant effect on the amounts recognised in the consolidated financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

**ECL measurement.** Measurement of ECLs is a significant estimate that involves determination of methodology, models and data inputs. The following components have a major impact on credit loss allowance: definition of default, SICR, probability of default ("PD"), exposure at default ("EAD"), and loss given default ("LGD"), as well as models of macro-economic scenarios. The Group regularly reviews and validates the models and inputs to the models to reduce any differences between expected credit loss estimates and actual credit loss experience.

**Significant increase in credit risk ("SICR").** In order to determine whether there has been a significant increase in credit risk, the Group compares the risk of a default occurring over the life of a financial instrument at the end of the reporting date with the risk of default at the date of initial recognition. The assessment considers relative increase in credit risk rather than

achieving a specific level of credit risk at the end of the reporting period. The Group considers all reasonable and supportable forward looking information available without undue cost and effort, which includes a range of factors, including behavioural aspects of particular customer portfolios. The Group identifies behavioural indicators of increases in credit risk prior to delinquency and incorporated appropriate forward looking information into the credit risk assessment, either at an individual instrument, or on a portfolio level.

**Assessment whether cash flows are solely payments of principal and interest ("SPPI").** Determining whether a financial asset's cash flows are solely payments of principal and interest required judgement.

The time value of money element may be modified, for example, if a contractual interest rate is periodically reset but the frequency of that reset does not match the tenor of the debt instrument's underlying base interest rate, for example a loan pays three months interbank rate but the rate is reset every month. The effect of the modified time value of money was assessed by comparing relevant instrument's cash flows against a benchmark debt instrument with SPPI cash flows, in each period and cumulatively over the life of the instrument. The assessment was done for all reasonably possible scenarios, including reasonably possible financial stress situation that can occur in financial markets. In case of a scenario with cash flows that significantly differ from the benchmark, the assessed instrument's cash flows are not SPPI and the instrument then carried at FVTPL.

The Group identified and considered contractual terms that change the timing or amount of contractual cash flows. The SPPI criterion is met if a loan allows early settlement and the prepayment amount substantially represents principal and accrued interest, plus a reasonable additional compensation for the early termination of the contract. The asset's principal is the fair value at initial recognition less subsequent principal repayments, ie instalments net of interest determined using the effective interest method. As an exception to this principle, the standard also allows instruments with prepayment features that meet the following condition to meet SPPI: (i) the asset is originated at a premium or discount, (ii) the prepayment amount represents contractual par amount and accrued interest and a reasonable additional compensation for the early termination of the contract, and (iii) the fair value of the prepayment feature is immaterial at initial recognition.

The Group's loan agreements allow adjusting interest rates in response to certain macro-economic or regulatory changes. Management applied judgement and assessed that competition in the banking sector and the practical ability of the borrowers to refinance the loans would prevent it from resetting the interest rates at an above-market level and hence cash flows were assessed as being SPPI.

**Modification of financial assets.** When financial assets are contractually modified (e.g. renegotiated), the Group assesses whether the modification is substantial and should result in derecognition of the original asset and recognition of a new asset at fair value. This assessment is based primarily on qualitative factors, described in the relevant accounting policy and it requires significant judgment. In particular, the Group applies judgment in deciding whether credit impaired renegotiated loans should be derecognised and whether the new recognised loans should be considered as credit impaired on initial recognition. The derecognition assessment depends on whether the risks and rewards, that is, the variability of expected (rather than contractual) cash flows, change as a result of such modifications. Management determined that risks and rewards

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**4. USE OF ASSUMPTIONS AND ESTIMATES (CONTINUED)**

**Modification of financial assets (continued)**

did not change as a result of modifying such loans and therefore in substantially all such modifications, the loans were neither derecognised nor reclassified out of the credit-impaired stage.

Further information on the Bank's accounting policy on loan loss provisioning can be found in Notes 26 and 299.

**5. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS**

**Adoption of IFRS 9 "Financial Instruments"**. The Group adopted IFRS 9, Financial Instruments, from 1 January 2018. The Group elected not to restate comparative figures and recognised any adjustments to the carrying amounts of financial assets and liabilities in the opening retained earnings as of the date of initial application of the standard, 1 January 2018. Consequently, the revised requirements of the IFRS 7, Financial Instruments: Disclosures, have only been applied to the current period. The comparative period disclosures repeat those disclosures made in the prior year.

The significant new accounting policies applied in the current period are described in Note **Error! Reference source not found.** Accounting policies applied prior to 1 January 2018 and applicable to the comparative information are also disclosed in Note 3.

The following table reconciles the carrying amounts of each class of financial assets as previously measured in accordance with IAS 39 and the new amounts determined upon adoption of IFRS 9 on 1 January 2018.

<i>In thousands of GEL</i>	Measurement category		Carrying value per IAS 39 (closing balance at 31 December 2017)	Effect				Carrying value per IFRS 9 (opening balance at 1 January 2018)
	IAS 39	IFRS 9		Remeasurement		Reclassification		
				ECL	Other	Mandatory	Voluntary	
<b>Cash and balances with the NBG</b>	Loans and receivables	Amortised cost	140,141	(264)	-	-	(22,785)	<b>117,092</b>
<b>Investments in debt securities</b>	Available-for-sale	Fair value through other comprehensive income	4,943	-	-	-	22,785	<b>27,728</b>
<b>Due from banks</b>	Loans and receivables	Amortised cost	16,171	(57)	-	-	-	<b>16,114</b>
<b>Loans and advances to customers</b>	Loans and receivables	Amortised cost	987,338	(8,295)	430	-	(63)	<b>979,410</b>
<b>Other financial assets</b>	Loans and receivables	Amortised cost	2,039	(52)	-	-	63	<b>2,050</b>
<b>Total financial assets</b>			<b>1,150,632</b>	<b>(8,668)</b>	<b>430</b>	<b>-</b>	<b>-</b>	<b>1,142,394</b>

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**5. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS (CONTINUED)**

**Cash and cash equivalents.** All classes of cash and cash equivalents as disclosed in Note 5 were reclassified from loans and receivables (“L&R”) measurement category under IAS 39 to AC measurement category under IFRS 9 at the adoption date of the standard. The Group recognised credit loss allowance as disclosed above.

**Investments in debt securities.** Debt instruments previously classified as AFS have been reclassified to new category and measured at FVOCI under IFRS 9, as their previous categories under IAS 39 were retired, with no changes to their measurement basis.

**Due from other banks.** All classes of due from other banks balances were reclassified from L&R measurement category under IAS 39 to AC measurement category under IFRS 9.

**Loans and advances to customers.** All classes of Loans and advances to customers’ balances were reclassified from L&R measurement category under IAS 39 to AC measurement category under IFRS 9. The Group does not hold such kind of portfolio of loans and advances to customers that failed to meet the SPPI requirement.

**Other financial assets.** All classes of other financial assets balances were reclassified from L&R measurement category under IAS 39 to AC measurement category under IFRS 9.

**Reconciliation of provision for impairment at 31 December 2017 and credit loss allowance at 1 January 2018.** The following table reconciles the prior period's closing provision for impairment measured in accordance with incurred loss model under IAS 39 to the new credit loss allowance measured in accordance with expected loss model under IFRS 9 at 1 January 2018:

	Provision under IAS 39 or IAS 37 at 31 Dec 2017	Effect			Credit loss allowance under IFRS 9 at 1 January 2018
		Reclassi- fication to FVTPL	Reclassi- fication to FVOCI	Remeasu- rement from incurred to expected loss	
<i>In thousands of GEL</i>					
<b>Loans and receivables measurement category</b>					
- Cash and balances with the NBG	-	-	-	264	264
- Due from banks	-	-	-	57	52
- Loans and advances to customers	18,384	-	-	7,865	26,679
- Other financial assets	-	-	-	52	52
<b>Credit related commitments and performance guarantees</b>					
	168	-	-	71	239

At 31 December 2017, all of the Group’s financial liabilities except for derivatives were carried at AC. The derivatives belonged to the FVTPL measurement category under IAS 39. There were no changes to the classification and measurement of financial liabilities.

**Adoption of IFRS 15 “Revenue from Contracts with Customers” (issued on 28 May 2014 and effective for the periods beginning on or after 1 January 2018) and 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).** The Group has adopted IFRS 15, *Revenue from Contracts with Customers*, with the date of initial application of 1 January 2018. The new standard was applied using the modified retrospective method, with the cumulative effect recognised in retained earnings on 1 January 2018. The standard introduced 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



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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

**5. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS (CONTINUED)**

secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. The standard did not have a material impact on the Group.

The following amended standards became effective for the Group from 1 January 2018, but did not have any material impact on the Group:

- 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 - “Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts” (issued on 12 September 2016 and effective, depending on the approach, for annual periods beginning on or after 1 January 2018 for entities that choose to apply temporary exemption option, or when the entity first applies IFRS 9 for entities that choose to apply the overlay approach).
- 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).
- 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).
- Amendments to IAS 40 – “Transfers of Investment Property” (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).

**6. NEW ACCOUNTING PRONOUNCEMENTS**

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2019 or later, and which the Group has not early adopted.

***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 decided that it will apply the standard using the modified retrospective method, without restatement of comparatives. The Group recognised a right of use asset of RR 1,888 against a corresponding lease liability on 1 January 2019.

<i>In thousands of GEL</i>	<b>31 December 2018 / 1 January 2019</b>
Total future minimum lease payments for non-cancellable operating leases	2,188
- Effect of discounting to present value	(300)
<b>Right of the Use asset and Lease Liability</b>	<b>1,888</b>

**6. NEW ACCOUNTING PRONOUNCEMENTS (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 does not expect a material impact of the amendments on its financial statements.

*Amendments to the Conceptual Framework for Financial Reporting (issued on 29 March 2018 and effective for annual periods beginning on or after 1 January 2020).* The revised Conceptual Framework includes a new chapter on measurement; guidance on reporting financial performance; improved definitions and guidance - in particular the definition of a liability; and clarifications in important areas, such as the roles of stewardship, prudence and measurement uncertainty in financial reporting. Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Group's financial statements.

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

Cash and balances with the NBG comprise the following items:

in '000 GEL	31 December 2018	31 December 2017
Cash on hand	51,948	49,798
Balances at the NBG excluding mandatory reserves	21,539	11,579
Certificates of deposit of the NBG	-	22,785
Nostro accounts other than with NBG	94,577	55,979
Loss allowance for balances with NBG and Nostro accounts	(222)	-
<b>Total cash and balances with the NBG in the statement of financial position</b>	<b>167,842</b>	<b>140,141</b>

In 2018, 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 positive outlook (2017: 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 2018	31 December 2017
Cash and balances with NBG	167,842	140,141
Due from banks with a maturity up to three months (Note 8)	32,142	16,171

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**Notes to the financial statements - 31 December 2018**

Loss allowance for balances with NBG and Nostro accounts	222	-
<b>Total cash and cash equivalents in the statement of cash flows</b>	<b>200,206</b>	<b>156,312</b>

**7. CASH AND BALANCES WITH THE NBG (CONTINUED)**

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 309 for the estimated fair value of cash and cash equivalents. The interest rate analysis of cash and cash equivalents is disclosed in Note 28.

**8. DUE FROM BANKS**

in '000 GEL	31 December 2017	31 December 2017
Due from Banks in OECD* countries	15,796	446
Due from Banks in non-OECD countries	16,395	15,725
Loss allowance for loans to banks	(48)	-
<b>Total due from banks</b>	<b>32,143</b>	<b>16,171</b>

The following table contains an analysis of due from banks balances by credit quality at 31 December 2018 based on credit risk grades.

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 2018</b>	471	10,724	-	20,948	-	<b>32,143</b>
<b>31 December 2017</b>	446	-	-	15,725	-	<b>16,171</b>

As at 31 December 2018 the Group had 1 related party bank, whose balance of GEL 39,282 thousand (including Nostro accounts and deposits) exceeded 10% of equity. As at 31 December 2017 the Group had 1 related party bank, whose balance of GEL 34,492 thousand exceeded 10% of equity.

Refer to Note 29 for the estimated fair value of each class of amounts due from banks. The interest rate analysis is disclosed in Note 298. Information on related party balances is disclosed in Note 32.

\* Organisation for Economic Cooperation and Development

**9. INVESTMENTS IN DEBT SECURITIES**

Figures below represent Investment securities measured at FVOCI under IFRS 9 since 1 January 2018, previously classified under available-for-sale and cash and balances with the NBG category under IAS 39.

in '000 GEL	31 December 2018	31 December 2017
Certificates of deposit of the NBG	24,824	-
Treasury bills issued by the Government of Georgia	4,943	4,943
<b>Total investments in debt securities</b>	<b>29,767</b>	<b>4,943</b>

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**9. INVESTMENTS IN DEBT SECURITIES (CONTINUED)**

Movement in investments in debts securities is as follows:

in '000 GEL	Treasury bills issued by the Government of Georgia	Certificates of Deposit of NBG	Total
<b>Balance at 1 January 2018</b>	<b>4,943</b>	-	<b>4,943</b>
Reclassification	-	22,785	22,785
Purchases net of discounts	9,010	55,665	64,675
Interest accrued	466	-	466
Interest paid	(466)	-	(466)
Disposals net of discounts	(9,010)	(53,626)	(62,636)
<b>Balance at 31 December 2018</b>	<b>4,943</b>	<b>24,824</b>	<b>29,767</b>

in '000 GEL	Treasury bills issued by the Government of Georgia
<b>Balance at 1 January 2017</b>	<b>16,809</b>
Purchases net of discounts	30,000
Interest accrued	579
Interest paid	(579)
Disposals net of discounts	(41,866)
<b>Balance at 31 December 2017</b>	<b>4,943</b>

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 investments in debt securities is categorized into Level 2 fair value hierarchy.

**10. INVESTMENTS IN EQUITY SECURITIES**

Equity investments comprise shares in the following companies:

in '000 GEL	Ownership interest	At 31 December 2018	Ownership interest	At 31 December 2017
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>

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**11. LOANS AND ADVANCES TO CUSTOMERS**

The table below presents contractual size and outstanding amounts of loans and advances to customers as at 31 December 2018:

in '000 GEL (except for number of outstanding loans and loan sizes) At 31 December 2018	Gross amount	Allowance for impairment	Net amount	Share of total portfolio
<b>Wholesale and trade loans</b>				
loan size up to USD 50,000	31,614	(1,706)	29,908	2.92%
loan size USD 50,000 to USD 250,000	145,150	(4,997)	140,153	13.70%
loan size more than USD 250,000	169,598	(1,690)	167,908	16.41%
<b>Total wholesale and trade loans</b>	<b>346,362</b>	<b>(8,393)</b>	<b>337,969</b>	<b>33.03%</b>
<b>Agricultural, forestry and fishing loans</b>				
loan size up to USD 50,000	2,655	(109)	2,546	0.25%
loan size USD 50,000 to USD 250,000	14,105	(1,256)	12,849	1.26%
loan size more than USD 250,000	29,737	(280)	29,457	2.88%
<b>Total agricultural, forestry and fishing loans</b>	<b>46,497</b>	<b>(1,645)</b>	<b>44,852</b>	<b>4.38%</b>
<b>Production loans</b>				
loan size up to USD 50,000	11,801	(634)	11,167	1.09%
loan size USD 50,000 to USD 250,000	61,871	(2,879)	58,992	5.77%
loan size more than USD 250,000	69,200	(496)	68,704	6.71%
<b>Total production loans</b>	<b>142,872</b>	<b>(4,009)</b>	<b>138,863</b>	<b>13.57%</b>
<b>Transportation and storage loans</b>				
loan size up to USD 50,000	3,562	(130)	3,432	0.34%
loan size USD 50,000 to USD 250,000	14,961	(224)	14,737	1.44%
loan size more than USD 250,000	2,849	(25)	2,824	0.28%
<b>Total transportation and storage loans</b>	<b>21,372</b>	<b>(379)</b>	<b>20,993</b>	<b>2.05%</b>
<b>Other economic activities</b>				
loan size up to USD 50,000	29,158	(788)	28,370	2.77%
loan size USD 50,000 to USD 250,000	145,519	(5,519)	140,000	13.68%
loan size more than USD 250,000	203,609	(2,828)	200,781	19.62%
<b>Total other economic activities loans</b>	<b>378,286</b>	<b>(9,135)</b>	<b>369,151</b>	<b>36.08%</b>
<b>Total Business loans</b>	<b>935,389</b>	<b>(23,561)</b>	<b>911,828</b>	<b>89.11%</b>
<b>Housing loans</b>				
loan size up to USD 50,000	36,573	(707)	35,866	3.51%
loan size USD 50,000 to USD 250,000	71,029	(2,123)	68,906	6.73%
loan size more than USD 250,000	2,851	(26)	2,825	0.28%
<b>Total housing loans</b>	<b>110,453</b>	<b>(2,856)</b>	<b>107,597</b>	<b>10.52%</b>
<b>Investment loans</b>				
loan size up to USD 50,000	3,405	(129)	3,276	0.32%
loan size USD 50,000 to USD 250,000	340	(3)	337	0.03%
<b>Total investment loans</b>	<b>3,745</b>	<b>(132)</b>	<b>3,613</b>	<b>0.35%</b>
<b>Other loans</b>	<b>227</b>	<b>(7)</b>	<b>220</b>	<b>0.02%</b>
<b>Total Private loans</b>	<b>114,425</b>	<b>(2,995)</b>	<b>111,430</b>	<b>10.89%</b>
<b>Total</b>	<b>1,049,814</b>	<b>(26,556)</b>	<b>1,023,256</b>	<b>100.00%</b>

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**11 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 2017:

in '000 GEL (except for number of outstanding loans and loan sizes) At 31 December 2017	Gross amount	Allowance for impairment	Net amount	Share of total portfolio
<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)	152,913	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 USD 250,000	16,380	(656)	15,724	1.59%
loan size more than USD 250,000	30,910	(379)	30,531	3.09%
<b>Total agricultural, forestry and fishing loans</b>	<b>50,852</b>	<b>(1,202)</b>	<b>49,650</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 USD 250,000	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)	4,585	0.47%
loan size USD 50,000 to USD 250,000	13,679	(241)	13,438	1.36%
loan size more than USD 250,000	902	(10)	892	0.09%
<b>Total transportation and storage loans</b>	<b>19,305</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)	40,306	4.08%
loan size USD 50,000 to USD 250,000	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>364,008</b>	<b>(6,171)</b>	<b>357,837</b>	<b>36.24%</b>
<b>Total Business loans</b>	<b>933,436</b>	<b>(16,987)</b>	<b>916,449</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 USD 250,000	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 USD 250,000	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>72,284</b>	<b>(1,397)</b>	<b>70,887</b>	<b>7.18%</b>
<b>Total</b>	<b>1,005,720</b>	<b>(18,384)</b>	<b>987,337</b>	<b>100.00%</b>

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

As at 31 December 2018 and 2017 the Group had no borrowers or Groups of connected borrowers whose loan balance exceeded 10% of equity.

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

The following table discloses the changes in the credit loss allowance and gross carrying amount for loans and advances to customers carried at amortised cost between the beginning and the end of the reporting period

in '000 GEL	Stage 1	Stage 2	Stage 3	POCI	Total
<b>Gross outstanding amount as at 1 January 2018</b>	942,132	32,758	31,171	51	1,006,112
New financial assets originated	433,718	1,735	300	-	435,753
Modification of contractual cash flows of financial assets	(230)	13	(19)	-	(236)
Derecognitions (including write-offs)	(281,621)	(10,533)	(14,211)	(51)	(306,416)
Changes in interest accrual	213	139	(111)	-	241
Repayments	(105,113)	(3,981)	(2,831)	-	(111,925)
Transfer from stage 1 to Stage 2	(8,077)	8,077	-	-	-
Transfer from stage 1 to Stage 3	(6,622)	-	6,622	-	-
Transfer from stage 2 to Stage 1	4,522	(4,522)	-	-	-
Transfer from stage 2 to Stage 3	-	(4,090)	4,090	-	-
Transfer from stage 3 to Stage 2	-	1,035	(1,035)	-	-
Transfer from stage 3 to Stage 1	785	-	(785)	-	-
Foreign exchange and other movements	17,352	3,355	5,577	-	26,284
<b>Gross outstanding amount as at end of period</b>	<b>997,059</b>	<b>23,986</b>	<b>28,768</b>	<b>-</b>	<b>1,049,813</b>

The following table shows the development of allowances for losses on loans and advances to customers as at 31 December 2018:

in '000 GEL	Stage 1	Stage 2	Stage 3	POCI	Total
<b>Balance at 1 January 2018</b>	<b>(10,847)</b>	<b>(3,934)</b>	<b>(11,898)</b>	<b>-</b>	<b>(26,679)</b>
New financial assets originated	3,588	(267)	(141)	-	(3,996)
Release due to derecognition	3,258	1,162	2,635	-	7,055
Transfer from stage 1 to Stage 2	99	(99)	-	-	-
Transfer from stage 1 to Stage 3	82	-	(82)	-	-
Transfer from stage 2 to Stage 1	(656)	656	-	-	-
Transfer from stage 2 to Stage 3	-	483	(483)	-	-
Transfer from stage 3 to Stage 2	-	(368)	368	-	-
Transfer from stage 3 to Stage 1	(349)	-	349	-	-
Changes to ECL measurement model assumptions	2,497	13	(11,85)	-	(9,344)
Write-offs	68	127	6,744	-	6,939
Foreign exchange and other movements	753	(466)	(822)	-	(535)
<b>As at end of period</b>	<b>(8,683)</b>	<b>(2,693)</b>	<b>(15,184)</b>	<b>-</b>	<b>(26,558)</b>

The total amount of loans recovered during the year 2018 was GEL 6,399 (2017: GEL 5,790).

Further analysis for each Group of loans is detailed in Note 29.

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

Analysis by credit quality of loans outstanding at 31 December 2018 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>Stage 1</b>									
Not in Arrears	332,047	39,903	135,328	19,206	352,012	103,929	3,390	213	986,028
- less than 30 days overdue	332,047	39,903	135,328	19,206	352,012	103,929	3,390	213	986,028
<b>Total Stage 1 loans</b>	<b>333,668</b>	<b>42,701</b>	<b>135,448</b>	<b>20,386</b>	<b>356,276</b>	<b>104,969</b>	<b>3,395</b>	<b>217</b>	<b>997,059</b>
<b>Stage 2</b>									
Not in Arrears	2,146	1,936	2,137	-	11,205	2,147	168	1	19,740
- less than 30 days overdue	761	-	-	143	80	262	9	-	1,255
- 31 to 90 days overdue	1,111	-	24	597	1,119	125	14	2	2,991
<b>Total Stage 2 loans</b>	<b>4,018</b>	<b>1,936</b>	<b>2,161</b>	<b>740</b>	<b>12,404</b>	<b>2,534</b>	<b>191</b>	<b>3</b>	<b>23,986</b>
<b>Stage 3</b>									
Not in Arrears	3,372	235	2,128	127	2,207	806	31	1	8,907
- less than 30 days overdue	173	343	1,048	-	492	623	-	-	2,679
- 31 to 90 days overdue	1,052	830	383	34	729	50	31	-	3,108
- over 90 days overdue	4,078	451	1,705	86	6,179	1,472	96	6	14,074
<b>Total Stage 3 loans</b>	<b>8,675</b>	<b>1,859</b>	<b>5,264</b>	<b>247</b>	<b>9,607</b>	<b>2,951</b>	<b>158</b>	<b>7</b>	<b>28,768</b>
<b>Less impairment provisions</b>	<b>(8,393)</b>	<b>(1,645)</b>	<b>(4,009)</b>	<b>(379)</b>	<b>(9,135)</b>	<b>(2,856)</b>	<b>(133)</b>	<b>(7)</b>	<b>(26,558)</b>
<b>Total loans and advances to customers</b>	<b>337,969</b>	<b>44,852</b>	<b>138,863</b>	<b>20,993</b>	<b>369,151</b>	<b>107,597</b>	<b>3,612</b>	<b>220</b>	<b>1,023,256</b>

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	-	399,194
Over 250,000 USD	167,025	30,910	58,711	902	176,990	-	490	-	435,028
<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>3,657</b>	<b>510</b>	<b>1,977</b>	<b>481</b>	<b>6,667</b>	<b>283</b>	<b>464</b>	<b>32</b>	<b>14,071</b>
<b>Loans collectively determined to be impaired</b>									
- 31 to 90 days overdue	73	64	-	52	31	42	19	14	295
- over 90 days overdue	401	59	275	25	7	203	46	49	1,065
<b>Total collectively impaired loans</b>	<b>474</b>	<b>123</b>	<b>275</b>	<b>77</b>	<b>38</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
- over 90 days overdue	3,558	746	3,012	609	3,639	970	63	-	12,597
<b>Total individually impaired loans</b>	<b>6,845</b>	<b>746</b>	<b>4,142</b>	<b>609</b>	<b>4,580</b>	<b>1,053</b>	<b>63</b>	<b>-</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>362,742</b>	<b>49,651</b>	<b>127,306</b>	<b>18,916</b>	<b>357,838</b>	<b>64,020</b>	<b>6,453</b>	<b>412</b>	<b>987,337</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.



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**11. 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 performing, 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 2018 and 2017:

in '000 GEL At 31 December 2018	Real estate	Financial guarantees	Cash collateral	Other	No collateral	Total
Wholesale and trade	302,686	13,117	628	8,480	13,058	337,969
Agriculture, forestry and fishing	38,815	143	936	4,372	585	44,851
Production	115,135	9,361	-	10,748	3,619	138,863
Transportation and storage	17,436	1,134	-	2,028	395	20,993
Other economic activities	343,831	6,815	765	5,109	12,631	369,151
Housing	106,153	-	302	-	1,142	107,597
Investment loans	2,539	-	75	-	998	3,612
Other	3	-	-	-	217	220
<b>Total</b>	<b>926,598</b>	<b>30,570</b>	<b>2,706</b>	<b>30,737</b>	<b>32,645</b>	<b>1,023,256</b>

The European Investment Fund (“EIF”), Parent company and Group have entered into Guarantee Agreement. The InnovFin SME Guarantee Programme and DCFTA (Deep and Comprehensive Free Trade Area) are facilities under which EIF(European Investment Fund ) provides EU-supported guarantees to selected financial institutions to cover 50 - 75% of the Defaulted Amounts (which include principal and accrued interest up to 90 days net of recoveries from loans to SMEs).

in '000 GEL At 31 December 2017	Real estate	Cash collateral	Other	No collateral	Total
Wholesale and trade	335,133	5,199	5,035	17,437	362,804
Other economic activities	336,811	5	3,208	17,752	357,776
Production	109,628	-	9,579	8,099	127,306
Housing	61,568	-	5	2,447	64,020
Agriculture, forestry and fishing	42,778	1,906	4,260	707	49,651
Transportation and storage	17,475	-	818	623	18,916
Investment loans	6,081	-	13	359	6,453
Other	412	-	-	-	412
<b>Total</b>	<b>909,886</b>	<b>7,110</b>	<b>22,918</b>	<b>47,424</b>	<b>987,338</b>

The tables above exclude overcollateralization.

Refer to Note 30 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 29.

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**12. INVESTMENT PROPERTIES**

**Consolidated**

in '000 GEL	2018	2017
<b>Net book value at 1 January</b>	<b>7,102</b>	<b>1,697</b>
Transfers	-	6,374
Additions	609	120
Disposals	(686)	(188)
Depreciation for the year	(185)	(129)
Disposal of depreciation	145	3
Transfers(Additions)Depreciation	-	(775)
<b>Net book value at 31 December</b>	<b>6,985</b>	<b>7,102</b>
Total acquisition costs	7,967	8,044
Accumulated depreciation	(983)	(942)
<b>Net book value at 31 December</b>	<b>6,985</b>	<b>7,102</b>

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

**Separate**

in '000 GEL	2018	2017
<b>Net book value at 1 January</b>	<b>5,513</b>	-
Transfers	-	6,374
Additions	585	8
Disposals	(686)	-
Depreciation for the year	(155)	(95)
Disposal of depreciation	145	-
Transfers Depreciation	-	(775)
<b>Net book value at 31 December</b>	<b>5,401</b>	<b>5,513</b>
Total acquisition costs	6,281	6,382
Accumulated depreciation	(880)	(870)
<b>Net book value at 31 December</b>	<b>5,401</b>	<b>5,513</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. Adjustments are applied to the observable prices based on the difference between subject assets and analogues.

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**13. INTANGIBLE ASSETS**

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

in '000 GEL	2018	2017
<b>Net book value as at 1 January</b>	1,393	1,676
Additions	320	152
Disposal	-	(2)
Amortisation for the year	(427)	(435)
Disposal of amortisation	-	2
<b>Net book value as at 31 December</b>	<b>1,286</b>	<b>1,393</b>
Total acquisition costs as at 31 December	9,876	9,555
Accumulated amortisation as at 31 December	(8,589)	(8,162)
<b>Net book value as at 31 December</b>	<b>1,287</b>	<b>1,393</b>

**14. 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	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)	(6,948)
Depreciation for the year	(1,168)	(412)	-	(1,781)	(2,202)	(5,563)
Disposals - accumulated depreciation	353	891	-	634	2,564	4,442
Transfers Depreciation	776	-	-	-	-	776
<b>Net book value at 31 December 2017</b>	<b>47,799</b>	<b>454</b>	<b>571</b>	<b>7,292</b>	<b>7,036</b>	<b>63,152</b>
Total acquisition costs	54,502	1,415	571	15,536	23,813	95,837
Accumulated depreciation	(6,705)	(960)	-	(8,244)	(16,776)	(32,685)
<b>Net book value at 1 January 2018</b>	<b>47,797</b>	<b>455</b>	<b>571</b>	<b>7,292</b>	<b>7,037</b>	<b>63,152</b>
Transfers	579	127	(705)	-	-	1
Additions	15	9	478	176	1,067	1,744
Disposals - at cost	(3,863)	(860)	(341)	(4,376)	(3,974)	(13,414)
Depreciation for the year	(1,034)	(141)	-	(1,465)	(1,697)	(4,337)
Disposals - accumulated depreciation	672	674	-	3,293	3,805	8,444
<b>Net book value at 31 December 2018</b>	<b>44,166</b>	<b>264</b>	<b>3</b>	<b>4,920</b>	<b>6,238</b>	<b>55,590</b>
Total acquisition costs	51,233	691	3	11,336	20,906	84,167
Accumulated depreciation	(7,067)	(427)	-	(6,416)	(14,668)	(28,578)
<b>Net book value at 31 December 2018</b>	<b>44,166</b>	<b>264</b>	<b>3</b>	<b>4,920</b>	<b>6,238</b>	<b>55,590</b>

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**15. OTHER ASSETS**

At 31 December 2018 and 2017, other assets were as follows:

**Consolidated**

in '000 GEL	31 December 2018	31 December 2017
Accounts receivable from credit card and online payment system companies and money transfer agencies	3,598	1,968
Other	132	71
Loss allowance for account receivables	(81)	-
<b>Total other financial assets</b>	<b>3,649</b>	<b>2,039</b>
<i>Non-current</i>		
Repossessed properties	2,890	3,863
Prepayments for court fees and charges, net of provision	927	929
Prepayments for fixed assets	90	189
<i>Current</i>		
Prepayments for various services	2,483	1,154
Assets classified as held for sale	192	1,350
Inventory and other	767	708
<b>Total other non-financial assets</b>	<b>7,349</b>	<b>8,193</b>
<b>Total</b>	<b>10,998</b>	<b>10,232</b>

**Separate**

in '000 GEL	31 December 2018	31 December 2017
Accounts receivable from credit card and online payment system companies and money transfer agencies	3,598	1,968
Other	132	71
Loss allowance for account receivables	(81)	-
<b>Total other financial assets</b>	<b>3,649</b>	<b>2,039</b>
<i>Non-current</i>		
Repossessed properties	-	313
Prepayments for court fees and charges, net of provision	927	929
Prepayments for fixed assets	90	189
<i>Current</i>		
Prepayments for various services	2,209	794
Assets classified as held for sale	192	1,350
Inventory and other	767	689
<b>Total other non-financial assets</b>	<b>4,185</b>	<b>4,264</b>
<b>Total</b>	<b>7,834</b>	<b>6,303</b>

As at the date of initial recognition and as at 31 December 2018 and 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 30 for the estimated fair value of other financial assets. Information on related party balances is disclosed in Note 32.

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**16. 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.

in '000 GEL	31 December 2018	31 December 2017
Banks in OECD countries	51,763	41,285
Banks in non-OECD countries	19,845	7,355
<b>Total</b>	<b>71,608</b>	<b>48,640</b>

Refer to Note 30 for the estimated fair value of due to banks. Information on related party balances is disclosed in Note 32.

**17. 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 2017
<b>Current accounts</b>	<b>221,694</b>	<b>205,840</b>
- private individuals	52,569	55,638
- legal entities	169,125	150,202
<b>Savings accounts</b>	<b>230,271</b>	<b>220,504</b>
- private individuals	136,323	139,764
- legal entities	93,948	80,740
<b>Term deposit accounts</b>	<b>238,302</b>	<b>198,715</b>
- private individuals	177,798	159,001
- legal entities	60,504	39,714
<b>Other liabilities to customers</b>	<b>6,110</b>	<b>4,000</b>
<b>Total</b>	<b>696,377</b>	<b>629,059</b>

**PROCREDIT BANK GROUP**  
**Notes to the financial statements - 31 December 2018**

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**16. CUSTOMER ACCOUNTS (CONTINUED)**

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 2018	31 December 2017
Private individuals	366,689	354,405
Trade and services	210,016	170,712
Construction	22,912	19,177
Government	4,760	4,760
Transportation and communications	22,938	3,160
Agriculture and forestry	8,911	7,079
Mining and mineral processing	2,397	1,727
Other	57,754	68,039
<b>Total</b>	<b>696,377</b>	<b>629,059</b>

At 31 December 2018, the Group had 84 customers (2017: 78 customers) with balances above GEL 1,000 thousand. The aggregate balance of these customers was GEL 234,927 thousand (2017: GEL 171,171 thousand) or 33 % (2017: 27 %) of total customer accounts.

At 31 December 2018, customer accounts included deposits of GEL 2,706 thousand (2017: GEL 7,109 thousand) held as collateral for on-balance exposures and GEL 5,898 thousand (2017: GEL 5,240 thousand) held as collateral for irrevocable commitments under financial and performance guarantees and letters of credit. Refer to Note 31.

Interest rate analysis is disclosed in Note 29. Information on related party balances is disclosed in Note 32. Refer to Note 30 for the estimated fair value of each class of customer accounts.

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**18. 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

	Due	31 December 2018	31 December 2017
<b>Liabilities with fixed interest rates</b>			
Ministry of Finance of Georgia	December 2026	2,228	2,522
European Investment Bank (EIB)	October 2024	15,905	15,281
European Investment Bank (EIB)	April 2022	5,016	6,196
European Investment Bank (EIB)	July 2022	21,848	26,239
European Investment Bank (EIB)	February 2024	5,325	6,039
European Investment Bank (EIB)	April 2024	22,050	25,037
Oesterreichische Entwicklungsbank AG (OeEB)	March 2018	-	7,820
Council of Europe Development Bank (CEB)	August 2022	11,623	13,921
European Investment Bank (EIB)	March 2023	29,871	28,700
ProCredit Holding AG & Co. KGaA	June 2021	13,484	12,921
ProCredit Holding AG & Co. KGaA	May 2021	13,450	12,958
ProCredit Holding AG & Co. KGaA	February 2018	-	40,193
ProCredit Holding AG & Co. KGaA	August 2027	13,598	13,065
ProCredit Holding AG & Co. KGaA	August 2027	13,598	13,065
ProCredit Holding AG & Co. KGaA	April 2018	-	7,787
ProCredit Holding AG & Co. KGaA	May 2021	26,974	25,917
ProCredit Holding AG & Co. KGaA	June 2021	18,812	18,072
ProCredit Holding AG & Co. KGaA	July 2021	27,846	26,475
ProCredit Bank AG, Frankfurt am Main	June 2021	16,082	20,654
<b>Total liabilities with fixed interest rates</b>		<b>257,710</b>	<b>322,862</b>
<b>Liabilities with variable interest rates</b>			
European Bank for Reconstruction and Development (EBRD)	February 2024	47,177	-
European Bank for Reconstruction and Development (EBRD)	September 2023	30,790	-
GREEN FOR GROWTH FUND, SOUTHEAST EUROPE S.A., SICAV-SIF (GGF)	January-2019	32,755	30,940
The European Fund for Southeast Europe S.A., SICAV-SIF (EFSE)	September 2017	-	-
ProCredit Holding AG & Co. KGaA	April 2016	-	-
ProCredit Bank AG, Frankfurt am Main	April 2019	21,442	20,807
Council of Europe Development Bank (CEB)	August 2021	8,657	11,485
ProCredit Holding AG & Co. KGaA	March 2019	9,242	-
ProCredit Holding AG & Co. KGaA	March 2019	16,285	-
ProCredit Holding AG & Co. KGaA	April 2019	33,176	-
responsAbility SICAV (Lux) Microfinanz-Fonds	December 2018	-	19,388
Responsibility Global Microfinance Fund	December 2018	-	6,463
<b>Total liabilities with variable interest rates</b>		<b>199,524</b>	<b>89,083</b>
<b>Total liabilities</b>		<b>457,234</b>	<b>411,945</b>

Refer to Note 30 for the estimated fair value of other borrowed funds. The interest rate analysis is disclosed in Note 29. Information on related party balances is disclosed in Note 32.

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**19. OTHER LIABILITIES**

in '000 GEL	31 December 2018	31 December 2017
Accounts payable	940	2,081
Other	190	192
<b>Total other financial liabilities</b>	<b>1,130</b>	<b>2,273</b>
Received prepayments and deferred fees from guarantees issued	191	2,036
<b>Total other liabilities</b>	<b>1,321</b>	<b>4,309</b>

Refer to Note 30 for the estimated fair value of other financial liabilities.

**20. OTHER PROVISIONS**

in '000 GEL	31 December 2018	31 December 2017
Provisions for unused annual leave	567	319
Others	246	258
<b>Total provisions</b>	<b>813</b>	<b>577</b>

Movement in provisions during the year was as follows:

in '000 GEL	2018	2017
<b>As at 1 January</b>	<b>578</b>	<b>477</b>
IFRS 9 adjustment	71	-
Provisions recorded during the year	685	447
Releases/Utilization of provisions	(521)	(347)
<b>As at 31 December</b>	<b>813</b>	<b>577</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.

**21. INCOME TAXES**

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

in '000 GEL	2018	2017
Current tax charge	4,857	3,108
Deferred tax charge	(198)	(2,967)
<b>Income tax expense for the year</b>	<b>4,659</b>	<b>141</b>

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

in '000 GEL	2018	2017
<b>Profit before tax</b>	<b>31,032</b>	<b>22,802</b>
Theoretical tax charge at statutory rate of 15%	4,655	3,420
Tax effect of items which are not deductible:		
- Effects of change of Tax legislation	(1,458)	(2,891)
- Non-tax deductible expenses/(income)	1,462	(388)
<b>Income tax expense for the year</b>	<b>4,659</b>	<b>141</b>



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**20. INCOME TAXES (CONTINUED)**

The tax effect of the movements in the temporary differences is detailed below and is recorded at the rate of 15% (2017:15%).

in '000 GEL	31 December	Charge to	31 December	Credit to profit	1 January
Deferred tax on:	2018	profit or loss	2017	or loss	2017
IFRS9 adjustment as at 1 January	(100)	-	-	-	-
Allowances for losses on loans and advances to customers	880	249	631	(1,812)	2,444
Other temporary differences	(141)	(447)	306	(1,154)	1,460
<b>Total deferred tax liability</b>	<b>639</b>	<b>(198)</b>	<b>937</b>	<b>(2,966)</b>	<b>3,904</b>

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

**22. SUBORDINATED DEBT**

The subordinated debt can be broken down as follows:

in '000 GEL	Due	31 December	31 December
		2018	2017
<b>Subordinated debt with variable interest rates</b>			
Overseas Private Investment Corporation (OPIC)	December 2019	40,293	38,701
<b>Subordinated debt with fixed interest rates</b>			
ProCredit Holding AG & Co. KGaA	April 2025	20,504	19,700
ProCredit Holding AG & Co. KGaA	April 2025	6,835	6,566
ProCredit Holding AG & Co. KGaA	September 2028	15,346	-
<b>Sub-total: ProCredit Holding AG &amp; Co. KGaA</b>		<b>42,685</b>	<b>26,266</b>
<b>Total</b>		<b>82,978</b>	<b>64,967</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 30 for the disclosure of the fair value of subordinated debt. The interest rate analysis is disclosed in Note 29. Information on related party balances is disclosed in Note 32.

**23. SHARE CAPITAL AND SHARE PREMIUM**

Shareholder structure is as follows:

in '000 GEL (except for the number of shares)	31 December 2018			31 December 2017		
	Size of stake in %	Number of shares	Amount of share capital	Size of stake in %	Number of shares	Amount of share capital
Shareholder						
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.

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**22. SHARE CAPITAL AND SHARE PREMIUM (CONTINUED)**

in '000 GEL (except for the number of shares)	Number of ordinary shares issued	Share capital Amount	Share premium Amount
<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>
<b>At 31 December 2018</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 2018 dividend of GEL 30,323 thousand (GEL 1.7 per share) were declared, (2017: GEL 20,691 thousand, GEL 1.16 per share).

**24. 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 2017</b>	387,612	66,751	454,363
Cash flows	(20,739)	(3,582)	(24,321)
Foreign exchange adjustments	30,301	(1,790)	28,511
Other non-cash movements	14,772	3,588	18,360
<b>Net debt at 31 December 2017</b>	<b>411,946</b>	<b>64,967</b>	<b>476,913</b>
Cash flows	29,203	15,345	44,548
Foreign exchange adjustments	14,658	2,627	17,285
Other non-cash movements	1,426	39	1,465
<b>Net debt at 31 December 2018</b>	<b>457,233</b>	<b>82,978</b>	<b>540,211</b>

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**25. 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

<b>Interest and similar income</b>	<b>2018</b>	<b>2017</b>
Loans and advances to customers	81,868	79,111
Cash and cash equivalents and due from banks	3,209	4,046
Investment in debt securities	1,262	-
Available-for-sale assets	-	1,701
<b>Total interest income</b>	<b>86,339</b>	<b>84,858</b>
<b>Interest and similar expenses</b>		
Customer accounts	(11,895)	(13,771)
Other borrowed funds	(19,220)	(14,555)
Subordinated debt	(1,954)	(3,587)
Due to banks	(1,663)	(218)
<b>Total interest expenses</b>	<b>(34,732)</b>	<b>(32,131)</b>
<b>Net interest income</b>	<b>51,607</b>	<b>52,727</b>

**26. LOSS ALLOWANCES**

The group sets aside loss allowances for the balance sheet items “Cash and balances with the NBG”, “Due from banks”, “Loans and advances to customers”, “Investments in debt securities” and for the financial assets under “Other assets”. These are generally recognised at net value within the corresponding balance sheet positions, except for the item “Investments in debt securities”, which are reported at fair value.

in'000 GEL

	<b>2018</b>	<b>2017</b>
Increase of loss allowance	13,027	18,946
Release of loss allowance	(7,181)	(8,245)
Recovery of written-off loans	(6,399)	(5,790)
Non-substantial modification	242	-
<b>Total</b>	<b>(311)</b>	<b>4,911</b>

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**27. FEE AND COMMISSION INCOME AND EXPENSES**

in '000 GEL	2018	2017
<b>Fee and commission income</b>		
Payment transfers and cash transactions	3,842	4,577
Debit/credit card issuance fee	2,622	2,260
Account maintenance fee	3,581	1,554
Letters of credit and guarantees	1,359	1,249
Internet bank fee	67	318
SMS service fee	13	131
Other fee and commission income	102	115
<b>Total fee and commission income</b>	<b>11,586</b>	<b>10,204</b>
<b>Fee and commission expenses</b>		
Debit/credit card issuance fee	(4,697)	(3,898)
Account maintenance fee	(965)	(760)
Payment transfers and transactions	(112)	(294)
Service fee	(120)	(154)
Letters of credit and guarantees	(163)	(68)
<b>Total fee and commission expenses</b>	<b>(6,057)</b>	<b>(5,174)</b>
<b>Net fee and commission income</b>	<b>5,529</b>	<b>5,030</b>

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

**28. OTHER ADMINISTRATIVE EXPENSES**

Other administrative expenses include the following items:

in '000 GEL	2018	2017
Depreciation and amortization	4,764	5,997
Office rent	910	2,565
Communication and IT expenses	4,910	4,366
Personnel recruitment, training and other staff-related expenses	2,753	2,909
Consulting services	2,206	1,667
Marketing, advertising and entertainment	1,387	884
Repair and maintenance	559	628
Transport	920	858
Other	4,582	5,263
<b>Total</b>	<b>22,991</b>	<b>25,137</b>

Administrative expenses above includes GEL 311 thousand (2017: GEL 181 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 1,789 thousand were incurred on staff training and related activities during 2018 (2017: GEL 2,540 thousand).

## **29. 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 ICAAP 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 2018 the Bank was 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, 2017 (Pillar I + Pillar II)</b>	<b>2018</b>	<b>2017</b>
Tier 1 Capital /RWA (required to be above 11.63%)	13.37%	14.38%
Tier 1 + Tier 2 Capital /RWA (required to be above 15.89%)	17.79%	18.28%

NBG introduced Pillar II buffers which were to be maintained from December, 2017. As of December, 2018 the minimum requirements including set buffers for Tier 1 equals to 11.63% and for Regulatory capital 15.89% of the total risk weighted assets. Unhedged credit risk is excluded from total risk weighted assets for Pillar I and added as a buffer.

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).

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

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

<b>As at 31 December</b>	<b>2018</b>	<b>2017</b>
Tier 1 Capital / RWA	16.25%	18.40%
Tier 1 + Tier 2 Capital / RWA	20.75%	22.36%

in '000 GEL

<b>As at 31 December</b>	<b>2018</b>	<b>2017</b>
Ordinary share capital	88,915	88,915
Share premium	36,388	36,388
Prior period retained earnings	64,560	70,830
Profit for first nine months	21,640	16,020
Less other adjustments	(30)	(28)
Less dividends paid in current year	-	-
Less dividends budgeted for the next year	(30,323)	(20,691)
Less intangible assets	(1,287)	(1,394)
<b>Tier I capital</b>	<b>179,863</b>	<b>190,040</b>
Adjustment due to dividends budgeted for the next year exceeding profit for first nine months:		
Profit for first nine months	-	-
Dividends budgeted for the next year	-	-
<b>Adjusted Tier I capital</b>	<b>179,863</b>	<b>190,040</b>
Subordinated loans	49,854	40,877
<b>Tier II capital</b>	<b>49,854</b>	<b>40,877</b>
<b>Total regulatory capital</b>	<b>229,717</b>	<b>230,917</b>

in '000 GEL

<b>As at 31 December</b>	<b>2018</b>	<b>2017</b>
RWA on balance	953,238	861,972
RWA off balance	19,578	22,342
RWA from open currency position	492	5,753
RWA from operational risk	133,678	142,825
<b>Total RWA</b>	<b>1,106,986</b>	<b>1,032,892</b>

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 2018 and 2017 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 ICAAP to reflect the specific risk profile of the Group, i.e. comparing potential losses arising from its operations with its risk bearing capacity.

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

The risk bearing capacity of the Group is defined as equity (net of intangibles) plus subordinated debt with the maturity of over one year, which amounted to GEL 227 million as at December 2018 (2017: GEL 261 million). The Resources Available to Cover Risk (RAAtCR) was set at 60% of the risk-taking potential, i.e. GEL 136 million\* for 2018 (2017: 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 2018 and 2017. The underlying portfolio quality showed improvement throughout 2018. 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 2018. 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 (in %)*</b>	<b>Limit (in '000 GEL)*</b>	<b>Actual (in '000 GEL)*</b>	<b>Limit Used (in % of risk bearing capacity)*</b>
Credit Risk (Clients)		33.0%	74,844	37,757	16.6%
Counterparty Risk	Commercial Banks	5.0%	11,340	1,997	0.9%
Market Risk	Interest Rate Risk	10.0%	22,680	7,944	3.5%
	Currency Risk	2.0%	4,536	225	0.1%
Operational Risk		10.0%	22,680	10,694	4.7%
<b>Resources Available to Cover Risk</b>		<b>60.0%</b>	<b>136,080</b>	<b>58,617</b>	<b>25.8%</b>

As at the end of December 2017 the distribution of RAAtCR was as follows:

<b>Risk Factor</b>	<b>Risk Detail</b>	<b>Limit (in %)*</b>	<b>Limit (in '000 GEL)*</b>	<b>Actual (in '000 GEL)*</b>	<b>Limit Used (in % of risk bearing capacity)*</b>
Credit Risk (Clients)		33.0%	86,249	25,894	9.9%
Counterparty Risk		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>156,816</b>	<b>50,097</b>	<b>19.2%</b>

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

**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. As house bank for small and medium businesses, ProCredit banks are lending institutions in which loans to customers dominate their balance sheets. Consequently, customer credit risk is the most important risk that the group faces.

\* These amounts are unaudited.

The following table shows the maximum exposure to credit risk:

in '000 GEL		
As at 31 December	2018	2017
<b>Interbank placements</b>		
Balances at NBG(including mandatory reserve)	219,549	160,326
Due from banks	32,143	16,171
<b>Total interbank placements</b>	<b>251,692</b>	<b>176,497</b>
<b>Loans and advances to customers</b>		
Loans and advances to customers	1,049,814	1,005,722
Allowance for impairment	(26,558)	(18,384)
<b>Loans and advances to customers</b>	<b>1,023,256</b>	<b>987,338</b>
<b>Treasury bills issued by the Government of Georgia</b>	<b>29,767</b>	<b>4,943</b>
<b>Other financial assets</b>	<b>3,883</b>	<b>2,039</b>
<b>Financial guarantees and stand-by letters of credit</b>	<b>10,149</b>	<b>11,408</b>
<b>Performance guarantees</b>	<b>28,948</b>	<b>32,035</b>
<b>Commitments to extend credit</b>	<b>26,231</b>	<b>32,823</b>



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

Credit 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 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
- building a personal and long term relationship with the client and maintaining regular contact
- 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 well-trained and highly motivated staff 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 consisting representatives of front and back office staff members.

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 364 borrower group credit exposures of more than USD 250,000 (2017: 348 borrower group credit exposures).

The quality of the loan portfolio is monitored on an ongoing basis.

The bank established a new approach of Asset Quality Indicators (AQI) in order to assess the quality of the loan portfolio in a more detailed and sophisticated way in using risk classification system of all Exposures while accompanying these with traditional indicators like PAR>30 and PAR> 90.

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

The AQIs is used for many different purposes such as Loan loss provisioning and thus allow consistency with IFRS 9. Moreover, they streamline the monitoring process of individual exposures by focusing on early warning signs in order to detect credit risk at an early stage. According to Asset Quality Indicators loan portfolio is divided into performing, underperforming and default loan portfolio.

IFRS 9 Stages correspond to ProCredit classification methodology as

- Stage I – Performing Loan Portfolio
- Stage II – Underperforming Loan Portfolio
- Stage III – Default Loan Portfolio

### **Stage I Performing Loan Portfolio**

The credit risk is considered low in Stage I, if the loan has: a) a low risk of default, b) the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and c) adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. Based on the Group Credit Risk Management Policy, ProCredit Bank limits its financing activities only to clients in Stage I, indicating that all newly originated exposures are performing at the initial stage.

Credit exposures are not considered to have low credit risk simply because of the value of collateral if the loan would not be considered low credit risk without that collateral. Loan contracts are also not considered to have low credit risk simply because they have a lower risk of default than other credit products or relative to the credit risk of the jurisdiction.

All exposures in this stage consist of the portfolio that does not show any signs of increased credit risk.

### **Stage II Underperforming Loan Portfolio**

A **significant increase in credit risk** has occurred when at least one of the following events was detected:

- customer is in arrears more than 30 days (including PAR 30 during month) but less than 90 days
- significant worsening of the financial situation of the customer resulting in a downgrade of the risk classification to 6 or 7
- standard or watch restructuring event(s)
- multiple restructurings

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

### **Stage III Default Loan Portfolio**

Defaulted credit exposures (Stage III) are those exposures for which at least one of the following events occurs:

- client is in arrears more than 90 days
- qualitative and quantitative criteria based on which the bank considers the clients' unlikelihood to pay in full without realising collateral
- client is assigned to Risk Classification 8
- impaired restructuring event(s)
- bankruptcy procedure is initiated
- the bank has started legal proceedings against the client
- credit fraud event
- other signs of impairment

The Group regularly analyses the level of credit exposure by stages.

	<b>Underperforming LP</b>	<b>Default LP</b>
<b>At 31 December 2018</b>	<b>2.6%</b>	<b>2.3%</b>
<b>At 31 December 2017</b>	<b>2.9%</b>	<b>3.3%</b>

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.

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.

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.

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

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

in '000 GEL At 31 December 2018	Wholesale and Trade	Agriculture, forestry and fishing	Production	Transportation and storage	Other economic activities	Housing	Investment loans	Others	Total
< 50,000 USD	31,614	2,655	11,801	3,562	29,158	36,573	3,405	227	118,995
50,000 to 250,000 USD	145,150	14,105	61,871	14,961	145,519	71,029	340	-	452,975
>250,000 USD	169,598	29,737	69,200	2,849	203,609	2,851	-	-	477,844
<b>Total</b>	<b>346,362</b>	<b>46,497</b>	<b>142,872</b>	<b>21,372</b>	<b>378,286</b>	<b>110,453</b>	<b>3,745</b>	<b>227</b>	<b>1,049,814</b>

in '000 GEL At 31 December 2017	Wholesale and Trade	Agriculture, 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	-	421,443
>250,000 USD	168,078	30,910	59,727	902	178,539	-	490	-	438,646
<b>Total</b>	<b>369,387</b>	<b>50,852</b>	<b>129,884</b>	<b>19,305</b>	<b>364,008</b>	<b>65,199</b>	<b>6,623</b>	<b>461</b>	<b>1,005,719</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.

The central element of IFRS 9 Impairment Model approach for the ProCredit group is the expected credit loss model for the recognition and measurement of impairment.

The model requires the recognition of expected credit losses in a timely manner to ensure that the amount of expected credit losses recognised at each reporting date reflects the changes in the credit risk of the financial instruments. As such, the model is forward-looking and it replaces the incurred loss model for recognition of credit losses, by recognising credit losses not necessarily triggered by a potential loss event.

Specifically, the model addresses the IFRS 9 requirements on measurement of expected credit losses based on reasonable and supportable information that is available without undue cost or effort, including historical, current and forecasted information.

This model outlines three stages based on changes in the exposure's credit risk since the date of initial recognition.

**Stage I** includes exposures that have not had a significant increase in credit risk since initial recognition or that have low credit risk at the reporting date, including those that transfer back from Stage II due to decrease in credit risk. For these exposures, one-year expected credit losses are recognised in the profit or loss and a loss allowance is established. One-year expected losses refer to the expected credit losses that result from default events possible within 12 months after the reporting date.

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

**Stage II** includes exposures that have had a significant increase in credit risk since initial recognition (unless they have low credit risk at the reporting date) and there is no objective evidence of impairment. For these assets, lifetime expected losses are recognised. Lifetime expected losses are the expected credit losses that result from all possible default events over the expected life - maturity of a loan.

**Stage III** includes exposures that have objective evidence of impairment at the reporting date. For these assets, lifetime expected losses are recognised and interest revenue is calculated on the net carrying amount (gross carrying amount adjusted for the loss allowance).

Credit exposures for which at the reporting date the sum of the on-balance sheet part and the off-balance sheet part does not exceed EUR 150,000 are **Individually insignificant**. **Individually significant** – are credit exposures for which at the reporting date the sum of the on-balance sheet part and, if approved / authorised, the off-balance sheet part exceeds EUR 150,000.

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.:

- An impaired restructuring event
- The bank has initiated court procedures
- Bankruptcy proceedings have been initiated
- Past due days in arrears of 90 days
- A credit fraud event
- A downgrade of risk classification to 8 for all clients with small and medium credit exposures
- Originated Credit Impairment exposures (POCI) at initial recognition
- Other signs of impairment

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 2018 and 2017 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.

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

### **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:

- 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).

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

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

in '000 GEL	2018	In %	2017	In %
<b>Banking groups</b>	<b>32,142</b>	<b>13%</b>	<b>16,170</b>	<b>9%</b>
OECD banks	15,795	6%	446	0%
Non-OECD banks	16,347	6%	15,724	9%
<b>NBG</b>	<b>217,170</b>	<b>76%</b>	<b>160,326</b>	<b>88%</b>
Mandatory reserve	170,806	67%	125,962	69%
Other exposures	46,364	8%	34,364	19%
<b>Government of Georgia</b>	<b>4,943</b>	<b>12%</b>	<b>4,943</b>	<b>3%</b>
Treasury bills	4,943	12%	4,943	3%
<b>Total counterparty and issuer exposure</b>	<b>254,255</b>	<b>100%</b>	<b>181,439</b>	<b>100%</b>

The exposure to the NBG is primarily related to the mandatory reserve requirement which makes up 67% (2017: 69%) 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 2018</b>	<b>GEL</b>	<b>EUR</b>	<b>USD</b>	<b>Total</b>
<b>NBG</b>	<b>45,501</b>	<b>35,160</b>	<b>136,509</b>	<b>217,170</b>
Mandatory reserve	-	34,304	136,502	170,806
Balances at NBG excluding mandatory reserves	20,676	856	7	21,539
Certificates of deposits of NBG	24,825	-	-	24,825
<b>Government of Georgia</b>	<b>4,942</b>	<b>-</b>	<b>-</b>	<b>4,942</b>
	<b>50,443</b>	<b>35,160</b>	<b>136,509</b>	<b>222,112</b>

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>4,942</b>	<b>-</b>	<b>-</b>	<b>4,942</b>
	<b>39,306</b>	<b>30,121</b>	<b>95,841</b>	<b>165,268</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.

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

### **Liquidity risk (continued)**

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.

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 indicators, which was implemented in 2018 – "survival period", which is the time-period during which the bank can meet all its payments due without needing to generate additional (i.e. still not contracted) funds, i.e. the period within which the bank does not have negative liquidity gaps in any of the time-buckets. The defined minimum survival period limits is at least 90 days on total currency level, as well as on total hard currency level and local currency level.

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 interbank market indicator, 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.



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

**Liquidity risk (continued)**

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.

in '000 GEL At 31 December 2018	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 deposits with NBG)	279,212	7,119	8,665	22,058	18,206	3,387	338,647
Due from banks	32,164	-	-	-	-	-	32,164
Loans and advances to customers	38,642	72,075	94,392	199,037	638,859	186,521	1,229,526
Investments in debt securities	8,697	18,893	-	2,608	-	-	30,198
Gross settled forwards	-	-	-	56,668	-	-	56,668
Other financial assets	3,883	-	-	-	-	-	3,883
<b>Total Financial Assets</b>	<b>362,598</b>	<b>98,087</b>	<b>103,057</b>	<b>280,371</b>	<b>657,065</b>	<b>189,908</b>	<b>1,691,086</b>
<b>Financial Liabilities</b>							
Due to banks	18,991	13,810	9,942	29,455	-	-	72,198
Customer accounts	462,310	29,371	35,752	91,014	75,118	13,977	707,542
Other borrowed funds	35,320	36,877	39,190	20,998	295,227	37,375	464,987
Gross settled forwards	-	-	-	55,240	-	-	55,240
Financial and performance guarantees and letters of credit	39,097	-	-	-	-	-	39,097
Commitments to extend credit	28,948	-	-	-	-	-	28,948
Other financial liabilities	1,130	-	-	-	-	-	1,130
Subordinated debt	-	661	2,652	42,911	12,289	49,757	108,270
<b>Total Financial Liabilities</b>	<b>585,796</b>	<b>80,719</b>	<b>87,536</b>	<b>239,618</b>	<b>382,634</b>	<b>101,109</b>	<b>1,477,412</b>
<b>Liquidity Gap</b>	<b>(223,198)</b>	<b>17,368</b>	<b>15,521</b>	<b>40,753</b>	<b>274,431</b>	<b>88,799</b>	
<b>Cumulative Liquidity Gap</b>	<b>(223,198)</b>	<b>(205,830)</b>	<b>(190,309)</b>	<b>(149,556)</b>	<b>124,875</b>	<b>213,674</b>	

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

**Liquidity risk (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
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>559,654</b>	<b>278,738</b>	<b>1,533,816</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	639,259
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>529,485</b>	<b>125,531</b>	<b>63,418</b>	<b>142,678</b>	<b>369,961</b>	<b>93,053</b>	<b>1,324,126</b>
<b>Liquidity Gap</b>	<b>(255,917)</b>	<b>(30,695)</b>	<b>36,316</b>	<b>84,608</b>	<b>189,693</b>	<b>185,685</b>	
<b>Cumulative Liquidity Gap</b>	<b>(255,917)</b>	<b>(286,612)</b>	<b>(250,296)</b>	<b>(165,688)</b>	<b>24,005</b>	<b>209,690</b>	

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**28. 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 2018	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)	244,293	-	-	-	-	244,293
Due from banks	157,348	-	-	382	61	157,791
Treasury bills	8,682	18,523	-	2,380	-	29,585
Loans and advances to customers	15,152	50,615	64,979	139,250	754,297	1,024,293
Currency derivatives	-	-	-	56,668	-	56,668
<b>Total Assets</b>	<b>425,475</b>	<b>69,138</b>	<b>64,979</b>	<b>198,680</b>	<b>754,358</b>	<b>1,512,630</b>
<b>Liabilities</b>						
Current liabilities to banks	2,571	-	-	-	-	2,571
Current liabilities to customers	50,386	22,903	34,354	45,806	304,608	458,057
Contingent liabilities from financial and performance guarantees	1,955	-	-	-	-	1,955
Unused irrevocable credit commitments	2,623	-	-	-	-	2,623
Liabilities to related party banks	13,454	25,289	68,173	29,155	136,695	272,766
Liabilities to external banks	-	13,810	-	-	-	13,810
Liabilities to International Financial Institutions	32,575	6,473	2,838	15,055	174,803	231,744
Liabilities to customers	30,529	13,877	20,815	27,754	184,563	277,538
Subordinated debt	-	-	-	40,205	42,148	82,353
Currency derivatives	-	-	-	55,240	-	55,240
<b>Total Liabilities</b>	<b>134,093</b>	<b>82,352</b>	<b>126,180</b>	<b>213,215</b>	<b>842,817</b>	<b>1,398,657</b>
<b>Expected Liquidity Gap</b>	<b>291,382</b>	<b>(13,214)</b>	<b>(61,201)</b>	<b>(14,535)</b>	<b>(88,459)</b>	
<b>Expected Cumulative Liquidity Gap</b>	<b>291,382</b>	<b>278,168</b>	<b>216,967</b>	<b>202,432</b>	<b>113,973</b>	

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**28. 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	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
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	277,538
Subordinated debt	-	-	-	-	64,380	64,380
Currency derivatives	-	36,955	-	-	-	36,955
<b>Total Liabilities</b>	<b>89,116</b>	<b>138,304</b>	<b>68,076</b>	<b>132,766</b>	<b>834,423</b>	<b>1,262,685</b>
<b>Expected Liquidity Gap</b>	<b>183,278</b>	<b>(50,201)</b>	<b>(6,190)</b>	<b>15,537</b>	<b>(87,716)</b>	
<b>Expected Cumulative Liquidity Gap</b>	<b>183,278</b>	<b>133,077</b>	<b>126,887</b>	<b>142,424</b>	<b>54,708</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 2018, the Group was in compliance with the sufficient liquidity indicator limit set at 1 according to the Liquidity Risk Management Policy as well, as with "survival period" limit set at 90 days.

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 CEB, OPIC, OeEB, EIB and EBRD 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 deposit concentration indicator, which is the share of deposits of 5 largest non-financial customer depositors or of all non-financial customer depositors having more than 1% share in the total non-financial customer deposit portfolio which can be withdrawn in the next 30 days in the total non-financial customer deposits. The reporting trigger is set at a level of deposit

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

outflow assumptions used in Risk scenario for the deposits of such customers. This indicator shows a possible liquidity risk arising from concentration in funding.

The table below shows the approximate distribution of funding sources as at 31 December 2018 and 2017. 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 2018</b>	<b>31 December 2017</b>
Liabilities to banks	1.4%	0.6%
Customer deposits	53.2%	54.3%
Liabilities to the companies under Parent's control	24.4%	24.2%
Liabilities to IFIs	20.9%	20.6%
Other liabilities	0.1%	0.4%

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.

### **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 and EUR 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

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

**Currency risk (continued)**

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 2018.

The following significant exchange rates applied during the year:

in GEL	Average rate 2018	Average rate 2017	Reporting date spot rate 31 December 2018	Reporting date spot rate 31 December 2017
USD 1	2.5312	2.5059	2.6803	2.5752
EUR 1	2.9899	2.8292	3.0689	3.0884

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**28. 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 2018</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 deposits with NBG)	73,231	221,671	640	43,105	338,647
Due from banks	1,028	16,149	-	14,966	32,143
Investments in debt securities	-	-	-	29,767	29,767
Loans and advances to customers	180,399	608,542	-	234,315	1,023,256
Other financial assets	1,245	1,199	-	1,439	3,883
<b>Total financial assets</b>	<b>255,903</b>	<b>847,561</b>	<b>640</b>	<b>323,592</b>	<b>1,427,696</b>
<b>Open forward position (assets)</b>	<b>-</b>	<b>56,668</b>	<b>-</b>	<b>-</b>	<b>56,668</b>
<b>Liabilities</b>					
Due to banks	56,610	14,998	-	-	71,608
Customer accounts	116,542	407,602	284	171,951	696,379
Other borrowed funds	11,858	414,488	-	30,888	457,234
Other financial liabilities	546	13	-	571	1,130
Subordinated debt	15,347	67,631	-	-	82,978
<b>Total financial liabilities</b>	<b>200,903</b>	<b>904,732</b>	<b>284</b>	<b>203,410</b>	<b>1,309,329</b>
<b>Open forward position (liabilities)</b>	<b>55,240</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>55,240</b>
<b>Net position</b>	<b>(241)</b>	<b>(503)</b>	<b>356</b>	<b>120,184</b>	<b>119,796</b>
Financial and performance guarantees and letters of credit	2,368	11,404	-	25,325	39,097
Commitments to extend credit	4,302	9,419	-	12,510	26,231

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

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	266,104
Due from banks	1,482	678	-	14,010	16,170
Investments in debt securities	-	-	-	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	2,040
<b>Total financial assets</b>	<b>118,200</b>	<b>883,046</b>	<b>1,258</b>	<b>274,090</b>	<b>1,276,594</b>
<b>Open forward position (assets)</b>	<b>37,061</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>37,061</b>
<b>Liabilities</b>					
Due to banks	3	7,196	156	-	7,355
Customer accounts	95,599	385,912	1,117	146,430	629,058
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>155,384</b>	<b>852,832</b>	<b>1,273</b>	<b>147,395</b>	<b>1,156,884</b>
<b>Open forward position (liabilities)</b>	<b>-</b>	<b>36,955</b>	<b>-</b>	<b>-</b>	<b>36,955</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	32,822

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 2018</b>	<b>95% confidence</b>	<b>99% confidence</b>
Maximum loss (VaR)	(151)	(171)
Average loss in case confidence interval is exceeded	(126)	(138)

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)

**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 (hedged) 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.



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

**Interest rate risk (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 2018	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 deposits with NBG)	235,539	-	-	-	-	-	103,108	338,647
Due from banks	25,783	-	-	-	-	-	6,360	32,143
Investments in debt securities	8,682	18,523	-	2,380	-	-	183	29,768
Loans and advances to customers	84,705	88,928	149,722	167,202	372,267	151,028	9,405	1,023,257
Other financial assets	-	-	-	-	-	-	3,883	3,883
<b>Total financial assets</b>	<b>354,709</b>	<b>107,451</b>	<b>149,722</b>	<b>169,582</b>	<b>372,267</b>	<b>151,028</b>	<b>122,939</b>	<b>1,427,698</b>
<b>Liabilities</b>								
Due to banks	13,402	13,810	9,207	29,155	-	-	6,035	71,609
Customer accounts	241,444	25,152	32,924	106,977	49,627	12,434	227,819	696,377
Other borrowed funds	53,606	105,058	53,210	12,322	194,468	33,620	4,951	457,235
Other financial liabilities	-	-	-	-	-	-	1,130	1,130
Subordinated debt	-	40,205	-	-	-	42,148	626	82,979
<b>Total liabilities</b>	<b>308,452</b>	<b>184,225</b>	<b>95,341</b>	<b>148,454</b>	<b>244,095</b>	<b>88,202</b>	<b>240,561</b>	<b>1,309,330</b>
<b>Net interest sensitivity gap</b>	<b>46,257</b>	<b>(76,774)</b>	<b>54,381</b>	<b>21,128</b>	<b>128,172</b>	<b>62,826</b>		

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

**Interest rate risk (Continued)**

in '000 GEL	Up to	1 - 3	3 - 6	6 -12	1 -5	More than	Non-	
As at 31 December 2017	1 month	months	months	months	years	5 years	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	5,178
Loans and advances to customers	49,871	51,385	83,661	180,296	399,778	214,426	7,921	987,338
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>104,673</b>	<b>1,276,829</b>
<b>Liabilities</b>								
Due to banks	5,150	-	-	-	-	-	2,204	7,354
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	453,232
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>81,894</b>	<b>220,450</b>	<b>1,156,885</b>
<b>Net interest sensitivity gap</b>	<b>(50,674)</b>	<b>(66,700)</b>	<b>(17,877)</b>	<b>78,137</b>	<b>160,303</b>	<b>132,532</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 or 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 2018:

	<b>Impact on profit or loss (equals impact on equity)</b>			
	Probable adverse case scenario		Stress scenario	
	2%	-2%	5%	-5%
USD	137	- 137	341	- 341
EUR	1,550	- 1,550	3,875	- 3,875
GEL	3,154	- 3,154	5,272	- 5,272
	<b>4,841</b>	<b>4,841</b>	<b>9,488</b>	<b>9,488</b>

As at 31 December 2017, 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	- 1,233	1,233	- 3,084	3,084
EUR	405	- 405	1,012	- 1,012
GEL	2,038	- 2,038	5,096	- 5,096
	<b>3,676</b>	<b>3,676</b>	<b>9,191</b>	<b>9,191</b>

The scenarios for interest rate sensitivity calculations are taken from Basel regulations.

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**28. 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 2018</b> in % p.a.	<b>EUR</b>	<b>USD</b>	<b>Local currency</b>
<b>Financial assets</b>			
Due from banks	-	-	7.10
Loans and advances to customers	6.21	7.46	11.02
<b>Financial liabilities</b>			
Due to other banks	4.94	5.43	-
Customer accounts	0.56	2.41	2.70
Other borrowed funds	3.71	3.74	8.25
Subordinated debt	5.94	7.19	-
<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	-

**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.

### **30. 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 in debt securities 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.

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**29. 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	2018		2017	
		Carrying value	Fair value	Carrying value	Fair value
<b>Financial assets</b>					
Cash and cash equivalents	Level 2	167,842	167,842	140,141	140,141
Mandatory reserve deposits with NBG	Level 2	170,806	170,806	125,962	125,962
Due from other banks	Level 2	32,143	32,143	16,171	16,171
Loans and advances to customers	Level 3	1,023,256	1,000,294	987,337	983,815
Other financial assets	Level 3	3,907	3,907	2,039	2,039
<b>Total financial assets</b>		<b>1,365,811</b>	<b>1,342,849</b>	<b>1,255,479</b>	<b>1,251,957</b>
<b>Financial liabilities</b>					
Due to other banks	Level 2	71,608	71,608	48,639	48,639
Customer accounts					
Current accounts	Level 2	221,695	221,695	205,840	205,840
Savings accounts	Level 2	230,271	230,271	220,504	220,504
Term accounts	Level 3	238,302	241,892	198,715	198,683
Other liabilities to customers	Level 2	6,110	6,110	4,000	4,000
Other borrowed funds	Level 3	457,234	443,636	411,946	400,994
Other financial liabilities	Level 3	1,130	1,130	2,273	2,273
Subordinated debt	Level 3	82,978	78,594	64,967	62,836
<b>Total financial liabilities</b>		<b>1,309,328</b>	<b>1,294,936</b>	<b>1,156,884</b>	<b>1,143,769</b>

**31. 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	2018	2017
<b>As at 31 December</b>		
Financial guarantees and stand-by letters of credit	10,149	11,408
Performance guarantees	28,948	32,035
Commitments to extend credit:		
- Original term to maturity of one year or less	11,710	22,484
- Original term to maturity of more than one year	14,521	10,338
<b>Total</b>	<b>65,328</b>	<b>76,265</b>

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**30. CONTINGENT LIABILITIES AND COMMITMENTS (CONTINUED)**

The 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 20.

**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	2018	2017
- No later than one year	655	453
- Later than one year and no later than five years	1,183	320
- Later than five years	350	-
<b>Total</b>	<b>2,188</b>	<b>773</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.

**32. 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.

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**31. RELATED PARTY TRANSACTIONS (CONTINUED)**

The Group had the following balances outstanding as at 31 December 2018 and 2017 with related parties:

in '000 GEL	Contractual interest rate, p.a.	2018	2017
<b>Assets</b>			
<b>Due from banks</b>			
- Entities under common control	-0.75%-1.35 %	40,213	34,569
<b>Loans and advance to customers</b>			
- Key management	9%-15 %	31	7
<b>Due to banks</b>			
- Entities under common control	0.0%-5.8%	53,190	554
<b>Customer accounts</b>			
- Key management	0.0%-4.5%	329	309
<b>Other borrowed funds</b>			
- Parent	1.21%-4.7%	186,464	170,452
- entities under common control	4.35%-5.43%	37,524	82,745
<b>Subordinated debt</b>			
- Parent	5.9%-7.9%	42,685	26,266

Included in the profit or loss for the year ended 31 December 2018 and 2017 are the following amounts which arose due to transactions with related parties:

in '000 GEL	2018	2017
<b>Interest expense</b>		
- Parent	10,567	7,856
- entities under common control	3,259	2,184
- key management	11	-
<b>Fees and commission expenses</b>		
- entities under common control	-	-
<b>Other operating income</b>		
- Parent	8	16
<b>Personnel expenses</b>		
- Key management	1,068	612
<b>Other administrative expenses</b>		
- Parent	2,493	2,107
- entities under common control	3,932	2,743

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.

**33. EVENTS AFTER THE END OF THE REPORTING PERIOD**

There have not been identified any subsequent events between the end of the reporting period and the date of approval of these financial statements by the management.