JSC VTB Bank (Georgia)

Consolidated financial statements

For the year ended 31 December 2017
together with independent auditor's report

Contents

Independent auditor's report

Consolidated financial statement

Notes to the consolidated financial statements

EY
Building a better working world

EY Georgia LLC
Kote Abkhazi Street, 44
Tbilisi, 0105, Georgia
Tel: +995 (32) 215 8811
Fax: +995 (32) 215 8822
www.ey.com/ge

შპს იუაი საქართველო
საქართველო, 0105 თბილისი
კოტე აფხაზის ქუჩა 44
ტელ: +995 (32) 215 8811
ფაქსი: +995 (32) 215 8822

Independent auditor's report

To the shareholders and Board of Directors of
JSC VTB Bank (Georgia)

Opinion

We have audited the consolidated financial statements of JSC VTB Bank (Georgia) and its subsidiary ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2017, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2017 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

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

Responsibilities of management and supervisory board for the consolidated financial statements

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

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

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

EY
Building a better working world

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

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

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

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

Building a better
working world

We communicate with supervisory board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Ruslan Khoroshvili

On behalf of EY Georgia LLC

Tbilisi, Georgia

15 March 2018

Consolidated statement of financial position

As of 31 December

(Thousands of Georgian lari)

	Notes	*2017*	*2016*
Assets			
Cash and cash equivalents	6	211,642	316,336
Amounts due from banks and international financial institutions	7	230,470	142,175
Loans and advances to customers	8	950,476	933,764
Investment securities available-for-sale	9	120,724	80,513
Property and equipment	10	34,650	35,434
Investment property	11	24,556	20,336
Deferred income tax assets	12	1,189	1,219
Other assets	13	22,485	16,237
Total assets		**1,596,192**	**1,546,014**
Liabilities			
Amounts due to banks and international financial institutions	14	112,893	286,175
Amounts due to customers	15	895,757	831,274
Debt securities issued	16	38,193	31,690
Other borrowed funds	17	262,985	139,022
Current income tax liabilities		1,694	1,940
Other liabilities	13	19,503	21,726
Subordinated loan	26	37,362	37,759
Total liabilities		**1,368,387**	**1,349,586**
Equity			
Share capital	18	209,008	191,293
Land and buildings revaluation reserve		3,104	3,160
Perpetual subordinated loan	18	13,481	12,900
Unrealised gains on investment securities available-for-sale	9	568	1,550
Retain earnings		1,644	(12,475)
Total equity		**227,805**	**196,428**
Total liabilities and equity		**1,596,192**	**1,546,014**

Signed and authorised for issue on behalf of the Management Board of the Bank on 15 March 2018:

Archil Kontselidze
Chief Executive Officer

Mamuka Menteshashvili
Chief Financial Officer

The accompanying selected explanatory notes on pages 9 to 53 are an integral part of these consolidated financial statements.

Consolidated income statement

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	2017	2016
Interest income			
Loans and advances to customers		110,646	107,594
Investment securities available-for-sale		7,636	5,195
Cash and cash equivalents		2,898	4,012
Amounts due from banks and international financial institutions		1,722	15
		122,902	116,816
Interest expense			
Amounts due to customers		(43,338)	(40,869)
Amounts due to banks, international financial institutions and other borrowed funds		(13,889)	(8,903)
Interest expenses on debt securities issued		(1,612)	(1,155)
Subordinated loan		(2,937)	(2,584)
		(61,776)	(53,511)
Expense due to assets with negative interest rates (NIR)		(130)	(66)
Payments to deposit insurance system		(100)	–
Net interest income		60,896	63,239
Reversal of allowance/(allowance) for impairment	8	1,653	(660)
Net interest income after allowance for loan impairment		62,549	62,579
Net fee and commission income	20	6,540	5,125
Net gains/(losses) from foreign currencies:			
- Dealing		16,132	7,687
- Translation differences		(2,659)	(3,649)
Net gains/(losses) from investment securities available-for-sale	9	1,394	66
Net gains on investment property revaluation	11	2,430	2,975
Other income	21	6,568	7,767
Non-interest income		30,405	19,971
Personnel expenses	22	(37,734)	(36,751)
Depreciation	10	(3,571)	(3,726)
Other operating expenses	22	(15,706)	(14,360)
Other impairment and provision reversal/(charge)		435	(560)
Non-interest expenses		(56,576)	(55,397)
Profit before income tax expense		36,378	27,153
Income tax (expense)/benefit	12	(4,009)	291
Profit for the year		32,369	27,444

The accompanying selected explanatory notes on pages 9 to 53 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	2017	2016
Profit for the year		32,369	27,444
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Unrealised gains on investment securities available-for-sale	9	412	2,223
Realised gain on investment securities available-for-sale reclassified to the income statement of profit or loss	9	(1,394)	(66)
Net other comprehensive (loss)/ income to be reclassified to profit or loss in subsequent periods		(982)	2,157
Other comprehensive income not to be reclassified to profit or loss in subsequent periods			
Income tax effect	12	–	457
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods		–	457
Other comprehensive (loss)/income for the year, net of tax		(982)	2,614
Total comprehensive income for the year		31,387	30,058

The accompanying selected explanatory notes on pages 9 to 53 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	Share capital	Land and buildings revaluation reserve	Unrealized gains/ (losses) on investment securities available-for-sale	Perpetual subordinated loan	Retain earnings	Total equity
As of 31 December 2015		191,293	2,758	(607)	–	(31,932)	161,512
Total comprehensive income for the year		–	457	2,157	–	27,444	30,058
Issuance of perpetual subordinated loan		–	–	–	13,089	–	13,089
Foreign exchange translation on perpetual subordinated loan		–	–	–	(189)	189	–
Dividends declared		–	–	–	–	(8,231)	(8,231)
Depreciation of revaluation reserve, net of tax		–	(55)	–	–	55	–
As of 31 December 2016	18	191,293	3,160	1,550	12,900	(12,475)	196,428
Total comprehensive income for the year		–	–	(982)	–	32,369	31,387
Amounts paid on Perpetual Subordinated Loan	18	–	–	–	–	(10)	(10)
Foreign exchange translation on perpetual subordinated loan			–	–	581	(581)	–
Issuance of share capital	18	17,715	–	–	–	–	17,715
Dividends declared	18	–	–	–	–	(17,715)	(17,715)
Depreciation of revaluation reserve, net of tax		–	(56)	–	–	56	–
As of 31 December 2017		209,008	3,104	568	13,481	1,644	227,805

The accompanying selected explanatory notes on pages 9 to 53 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	2017	2016
Cash flows from operating activities			
Interest received		124,689	112,558
Interest paid		(59,267)	(53,045)
Fees and commissions received		17,972	15,042
Fees and commissions paid		(9,789)	(9,023)
Realised net gains from dealing in foreign currencies		14,740	6,361
Other income received		5,962	7,339
Personnel expenses paid		(38,309)	(35,008)
Other operating expenses paid		(18,526)	(12,856)
Cash flows from operating activities before changes in operating assets and liabilities		37,472	31,368
Net (increase)/decrease in operating assets			
Amounts due from banks and international financial institutions		(88,021)	(55,471)
Loans and advances to customers		(31,900)	(131,420)
Other assets		(835)	(3,199)
Net increase/(decrease) in operating liabilities			
Amounts due to banks and international financial institutions		(166,749)	41,917
Amounts due to customers		73,988	138,267
Debt securities issued		6,066	25,729
Other liabilities		(1,930)	4,146
Net cash flows from operating activities before income tax		(171,909)	51,337
Income tax paid		(3,443)	–
Net cash (used in)/received from operating activities		(175,352)	51,337
Cash flows from investing activities			
Acquisition of investment securities available-for-sale		(196,952)	(75,153)
Proceeds from sale and redemption of investment securities available-for-sale		155,496	54,754
Purchase of property, equipment and intangible assets		(5,348)	(9,767)
Proceeds from sale of property and equipment		26	7
Proceeds from disposal of investment property		4,833	11,795
Purchases of investment property		(2,072)	(2,179)
Net cash used in investing activities		(44,017)	(20,543)
Cash flows from financing activities			
Proceeds from issuance of share capital	18	17,715	–
Other borrowed funds received		1,615,546	280,457
Repayments of other borrowed funds		(1,501,531)	(271,087)
Dividends paid	18	(17,246)	(8,013)
Proceeds from / (interest paid on) perpetual subordinated loan	18	(10)	13,089
Net cash received from financing activities		114,474	14,446
Effect of exchange rates changes on cash and cash equivalents		201	3,320
Net change in cash and cash equivalents		(104,694)	48,560
Cash and cash equivalents, beginning	6	316,336	267,776
Cash and cash equivalents, ending	6	211,642	316,336

The accompanying selected explanatory notes on pages 9 to 53 are an integral part of these consolidated financial statements.

(Thousands of Georgian lari)

1. Introduction

JSC VTB Bank (Georgia) (hereafter the "Bank") was formed as a joint stock company on 7 April 1995 under the laws of Georgia under the name of United Georgian Bank. The Bank changed its name to VTB Bank (Georgia) on 7 December 2006. The Bank operates under a general banking licence issued by the National Bank of Georgia (the "NBG") on 19 May 1995.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its corporate and retail customers. Its main office is in Tbilisi, Georgia. As of 31 December 2017, the Bank has 20 branches (10 of them in Tbilisi) and 18 service centres. As of 31 December 2016, the Bank had 20 branches (10 of them in Tbilisi) and 16 service centres.

The Bank's registered legal address is 14, Chanturia str., Tbilisi, Georgia.

As of 31 December 2017 and 2016, the following shareholders owned more than 1% of the outstanding shares:

Shareholder	2017 %	2016 %
VTB Bank OJSC	97.38	97.14
Lacarpa Enterprises Limited	1.47	1.61
Other	1.14	1.25
Total	100.0	100.0

VTB Bank OJSC ("the Parent bank") is the immediate parent of the Bank. The ultimate controlling party for the Group is the Government of the Russian Federation ("RF"), acting through the Federal Property Agency, which holds 60.93% of issued and outstanding shares of the Parent bank as of 31 December 2017 (2016: 60.93%).

As of 31 December 2017 and 2016, none of the Supervisory Council and Management Board members owned shares of the Bank.

As of 31 December 2017, the Bank had 1,209 employees (2016: 1,160).

These consolidated financial statements have been prepared for JSC VTB Bank (Georgia) and its subsidiary (together referred to as "the Group").

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

Name	Country of incorporation	The Group ownership interest 2017	2016	Date of Incorporation	Activities
Georgian Fund Company LLC	Georgia	100%	100%	24 June 1999	Financial services (Dormant)

2. Basis of preparation and significant accounting policies

Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention except for land and buildings, investment property, derivative financial instruments, investment securities available-for-sale and financial instruments at fair value through profit or loss, which are carried at fair value.

These consolidated financial statements are presented in thousands of Georgian lari ("GEL"), unless otherwise indicated. GEL is utilised as the functional currency as the majority of the Group's transactions are denominated or funded in GEL. Transactions in other currencies are treated as transactions in foreign currencies.

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Subsidiaries

Subsidiaries, which are those entities in which the Bank has an interest of more than one half of the voting rights, or otherwise has power to exercise control over their operations, are consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Bank and are no longer consolidated from the date that control ceases. All intra-group transactions, balances and unrealised gains on transactions between group companies are eliminated in full; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Bank.

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group determines the classification of its financial assets upon initial recognition and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

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

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 are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the consolidated income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any other category. After initial recognition available-for-sale financial assets are measured at fair value with gains or losses being recognised in other comprehensive income until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to the consolidated income statement. However, interest calculated using the effective interest method is recognised in the consolidated income statement.

If the Group has both the intention and ability to hold investment securities available-for-sale to maturity, they may be reclassified as investment securities held-to-maturity. In this case the fair value of securities, as of the date of reclassification, becomes their new amortised cost. For instruments with a fixed maturity the revaluation reserve as of the date of reclassification is amortised to profit or loss during the period until maturity using the effective interest rate method.

Determination of fair value

When financial instruments are recognized initially, they are measured at fair value, adjusted, in the case of instruments not at fair value through profit or loss, for directly attributable fees and costs.

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Financial assets (continued)

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Group determines that the fair value at initial recognition differs from the transaction price, then:

- If the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets, the Group recognises the difference between the fair value at initial recognition and the transaction price as a gain or loss;
- In all other cases, the initial measurement of the financial instrument is adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the Group recognises that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

Cash and cash equivalents

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

Derivative financial instruments

In the normal course of business, the Group enters into certain derivative financial instruments contracts primarily including foreign exchange forwards and swaps. Such financial instruments are recorded at fair value. The fair values are estimated based on pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in net gains/(losses) from foreign currency dealing in consolidated income statement.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to banks and international financial institutions, amounts due to customers, other borrowed funds and subordinated loans. These are initially recognized at fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are measured at amortised cost using the effective interest method. Gains and losses are recognised in the consolidated income statement when the borrowings are derecognised as well as through the amortisation process.

Amounts due to banks and international financial institutions represent funds attracted to manage the Group's liquidity, while other borrowed funds comprises funds received for general capital working purposes and under basic agreements with international credit institutions to finance activities of the Group's customers.

Operating lease – Group as lessee

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognised as expenses on a straight-line basis over the lease term and included into other operating expenses.

Operating lease – Group as lessor

The Group presents assets subject to operating leases in the consolidated statement of financial position according to the nature of the asset. Lease income from operating leases is recognised in profit or loss on a straight-line basis over the lease term. The aggregate cost of incentives provided to lessees is recognised as a reduction of rental income over the lease term on a straight-line basis. Initial direct costs incurred specifically to earn revenues from an operating lease are added to the carrying amount of the leased asset.

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Impairment of financial assets

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Loans and advances to customers, amounts due from banks and international financial institutions

For assets carried at amortised cost, the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised, are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the consolidated income statement. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. 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, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group's internal credit grading system that considers credit risk characteristics such as asset type, industry, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of 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 years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Available-for-sale financial investments

For available-for-sale financial investments, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the consolidated income statement – is reclassified from other comprehensive income and recognised in the consolidated income statement. Impairment losses on equity investments are not reversed through the consolidated income statement; increases in their fair value after impairment are recognised directly in other comprehensive income.

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Impairment of financial assets (continued)

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in the consolidated income statement. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the consolidated income statement, the impairment loss is reversed through the consolidated income statement.

Restructuring of financial assets

The Group from time to time restructures some of its financial assets. This mostly relates to loans and receivables.

The accounting treatment of such restructuring is conducted in 3 basic scenarios:

- If the currency of the loan has been changed, the old loan is derecognized and the new loan is recognized, which requires the estimation of a new effective interest rate. If the new effective interest rate is below the market interest rate, the loss on initial recognition is recognized in the reporting period;
- If the loan restructuring is not caused by the financial difficulties of the borrower but the cash flows were renegotiated, the loan is not recognized as impaired. The loan is not derecognised but the new effective interest rate is determined based on the remaining cash flows under the loan agreement till maturity. If the new effective interest rate is below the market rate at the date of restructuring, the new carrying amount is calculated as the fair value of the loan after restructuring, being the present value of the future cash flows discounted using the market rate at the date of restructuring. In this case, the difference between the carrying amount before restructuring and the fair value of the loan after restructuring is recognized as a loss on loans restructuring;
- If the loan is impaired after restructuring, the Group uses the original effective interest rate in respect of new cash flows to estimate the recoverable amount of the loan. The difference between the recalculated present value of the new cash flows taking into account collateral and the carrying amount before restructuring is included in loan impairment charge for the period.

Derecognition of financial assets and liabilities

Financial assets

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

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

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

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

Non-performing loans

According to the Group's policy, non-performing loans are derecognized as follows:

- Individually significant loans are being written off based on respective decision of the Bank's Credit committee;
- Uncollectible loans are written-off against the related allowance for impairment after all necessary procedures to recover the loans have been completed and the amount of the irretrievable loss has been determined.

In case the Group receives any amounts from the borrower subsequently to the loan write off, respective amounts are recognized within allowance for loan impairment as recoveries.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the consolidated income statement.

Offsetting

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

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, primarily consisting of letters of credit and guarantees. Financial guarantees are initially recognised in the consolidated financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required settling any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the consolidated income statement. The premium received is recognised in the consolidated income statement on a straight-line basis over the life of the guarantee.

Taxation

The current income tax expense is calculated in accordance with the regulations of Georgia.

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

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

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

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

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Property and equipment

Property and equipment, except for land and buildings, are carried at cost, excluding costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met. Buildings are measured at fair value less depreciation and impairment charged subsequent to the date of the revaluation. Land is measured at fair value and not depreciated. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Any revaluation surplus is credited to the revaluation reserve for land and buildings included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in the consolidated income statement, in which case the increase is recognised in the consolidated income statement. A revaluation deficit is recognised in the consolidated income statement, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

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

Construction in progress is carried at cost, less provision for impairment where required. Upon completion, assets are transferred to office premises or other premises at their carrying amount. Construction in progress is not depreciated until the asset is available for use.

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

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	35-50
Utility systems and related features	10-40
Computers and communication equipment	4
Furniture, fixtures and office equipment	2-8
Motor vehicles	5
Leasehold improvements	Over the term of the underlying lease

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

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

Investment property

Investment property is land or building or a part of a building held to earn rental income or for capital appreciation and which is not used by the Group or held for sale in the ordinary course of business.

Investment property is initially recognized at cost, including transaction costs, and subsequently remeasured at fair value reflecting market conditions at the end of the reporting period. Fair value of the Group's investment property is determined on the basis of various sources including reports of independent appraisers, who hold a recognized and relevant professional qualification and who have recent experience in valuation of property of similar location and category.

Revaluation of investment property is performed on each reporting date and recognised in the consolidated income statement as gains/losses on investment property revaluation. Rental income earned is recorded in the consolidated income statement within other operating income.

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Repossessed assets

Repossessed collateral represents non-financial assets acquired by the Group in settlement of overdue loans. The assets are initially recognised at fair value when acquired and included in premises and equipment, investment property or inventories within other assets depending on their nature and the Group's intention in respect of recovery of these assets and are subsequently re-measured and accounted for in accordance with the accounting policies for these categories of assets. Inventories of repossessed collateral are recorded at the lower of cost or net realisable value.

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 2 to 20 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end.

Provisions

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

Retirement and other employee benefit obligations

The Group does not have any pension arrangements separate from the State pension system of the Republic of Georgia.

Equity

Share capital

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

Dividends

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

Perpetual subordinated loan

Due to undefined maturity and an option for non-cumulative cancellation of coupon payments, the Group accounts the Perpetual Subordinated Loan as an equity instrument and as a Tier I eligible instrument for the purpose of capital adequacy ratio calculation. The Group accounts for the Perpetual Subordinated Loan denominated in the RUB in the amount equivalent of GEL, using the foreign exchange rate at the reporting date with foreign exchange translation effects recorded in retained earnings.

(Thousands of Georgian lari)

2. Basis of preparation and significant accounting policies (continued)

Contingencies

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

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured.

Interest income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Fee and commission income

Commission income on settlements and cash operations are recognized when the service is delivered to the customer.

Loan commitment fees for loans that are likely to be drawn down and other credit related fees, including fee on guarantees and letters of credit issued, are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

Dividend income

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

Foreign currency translation

The consolidated financial statements are presented in Georgian lari, which is the Group’s functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the consolidated income statement as gains less losses from foreign currencies – translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as of the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the NBG exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official NBG exchange rates at 31 December 2017 and 2016 were 2.5922 GEL and 2.6468 GEL to 1 USD, respectively.

(Thousands of Georgian lari)

3. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the amounts recognised in the consolidated financial statements and the carrying values 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 in the process of applying the accounting policies. Judgements that have the most 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:

Going concern

The Group's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources and the financial support of the Parent bank to continue in business for the foreseeable future. Furthermore, the Management is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 24.

Allowance for loan impairment

The Group regularly reviews its loans and receivables to assess impairment. The Group uses its judgement to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Group uses its judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

According to the current methodology, the Loss Rate is calculated with consideration of the recovery rate, which is based on statistics, indicating recoverability of losses after credits reach more than 90 overdue days.

Revaluation of property

The Group regularly reviews the value of its property (land, office buildings, leasehold improvements and investment property) for compliance with fair value and performs revaluation to ensure that the current carrying value of property does not materially differ from its fair value. The Group performs revaluation using special valuation techniques and information about real estate transactions entered into in the local market.

Land and buildings have been revalued to market value at 31 December 2015. Revalued buildings are depreciated in accordance with their remaining useful life since 1 January 2016. The Group's management believes that carrying value of land and buildings does not differ materially from that which would be determined using fair value as of 31 December 2017.

As of 31 December 2017, an independent appraiser determined the fair value of the Group's investment property. The market value of the property was determined based on the active market data. Additional details are provided in Note 10 and Note 11.

Taxation

The current income tax expense is calculated in accordance with the regulations in force in Georgia where the Bank and its Subsidiaries operate.

The recognised deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded in the consolidated statement of financial position. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are probable in the future are based on management expectations that are believed to be reasonable under the circumstances. Refer to Note 12.

(Thousands of Georgian lari)

3. Critical accounting estimates and judgements in applying accounting policies (continued)

Changes in presentation

Reclassifications

Starting from 2017 Group changed the presentation of some items in the consolidated income statement. Accordingly, the presentation of the comparative figures has been adjusted to the consistent with the new presentation. The reclassification and its impact on comparative period information for the year ended 31 December 2016 on the consolidated income statement:

	As previously reported	Reclassification	As reclassified
Net gain/(loss) from disposal of investment property	2,449	(2,449)	–
Net gains on investment property revaluation	526	2,449	2,975

4. Changes in accounting policies and adoption of new or revised standards and interpretations

Adoption of new or revised standards and interpretations

The Group applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2017. The Group has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective. The nature and the impact of each amendment is described below:

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

The amendments require entities to provide disclosure of changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). The Group provides the information about non-cash changes in their liabilities arising from financing activities with respective comparative information for preceding periods as additional disclosure to the consolidated financial statements. Refer to Note 27.

Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealised Losses

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of deductible temporary difference related to unrealised losses. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount. Group’s current accounting policy is consistent with the amendments.

Amendments to IFRS 12 Disclosure of Interests in Other Entities: Clarification of the Scope of Disclosure Requirements

The amendments clarify that certain disclosure requirements in IFRS 12 apply to an entity’s interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified as held for sale or included in a disposal group. These amendments did not affect the Group’s financial statements.

5. New accounting pronouncements

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group’s consolidated financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

IFRS 9 Financial Instruments

In July 2014, the IASB issued IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 addresses classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018. Except for hedge accounting, retrospective application is required but restating comparative information is not compulsory.

(Thousands of Georgian lari)

5. New accounting pronouncements (continued)

IFRS 9 Financial Instruments (continued)

The Group plans to adopt the new standard by recognizing the cumulative transition effect in opening retained earnings on 1 January 2018 and will not restate comparative information. The Group is in the process of quantifying the effect of adoption of IFRS 9, however no reasonable estimate of this effect is yet available.

(a) Classification and measurement

Under IFRS 9, all debt financial assets that do not meet a "solely payment of principal and interest" (SPPI) criterion, are classified at initial recognition as fair value through profit or loss (FVPL). Under this criterion, debt instruments that do not correspond to a "basic lending arrangement", such as instruments containing embedded conversion options or "non-recourse" loans, are measured at FVPL. For debt financial assets that meet the SPPI criterion, classification at initial recognition is determined based on the business model, under which these instruments are managed:

- Instruments that are managed on a "hold to collect" basis are measured at amortized cost;
- Instruments that are managed on a "hold to collect and for sale" basis are measured at fair value through other comprehensive income (FVOCI);
- Instruments that are managed on other basis, including trading financial assets, will be measured at FVPL.

Equity financial assets are required to be classified at initial recognition as FVPL unless an irrevocable designation is made to classify the instrument as FVOCI. For equity investments classified as FVOCI, all realized and unrealized gains and losses, except for dividend income, are recognized in other comprehensive income with no subsequent reclassification to profit and loss.

The classification and measurement of financial liabilities remain largely unchanged from the current IAS 39 requirements. Derivatives will continue to be measured at FVPL.

The Group expects to continue measuring financial assets currently classified as loans and receivables at amortised cost as vast majority of the instruments satisfied the SPPI criterion. The Group does not expect any non-derivative financial assets to be measured at FVPL.

Debt securities currently classified as available-for-sale are expected to be measured at amortized cost under IFRS 9 as the Group expects to hold these assets only to collect contractual cash flows. Equity securities will continue to be measured at FVOCI.

(b) Impairment

IFRS 9 requires the Group to record an allowance for expected credit losses (ECL) on all of its debt financial assets at amortised cost or FVOCI, as well as loan commitments and financial guarantees. The allowance is based on the ECL associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case the allowance is based on the ECL over the life of the asset. If the financial asset meets the definition of purchased or originated credit impaired, the allowance is based on the change in the lifetime ECL.

According to the new model for the recognition of impairment losses, introduced by IFRS 9, there is "three stage" approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired. Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL.

IFRS 15 Revenue from Contracts with Customers

IFRS 15, issued in May 2014, and amended in April 2016, will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. The Group plans to adopt the new standard using the modified retrospective method by recognizing the cumulative transition effect in opening retained earnings on 1 January 2018, without restating comparative information.

IFRS 15 establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. However, interest and fee income integral to financial instruments and leases will fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (IFRS 9 and IFRS 16 Leases). As a result, the majority of the Group's income will not be impacted by the adoption of this standard. The Group currently does not expect a material effect from initial application of IFRS 15.

(Thousands of Georgian lari)

5. New accounting pronouncements (continued)

Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely, but an entity that early adopts the amendments must apply them prospectively. The Group does not expect a material effect from application of these amendments. The amendments are not expected to have any impact on the consolidated financial statements of the Group.

IFRS 2 Classification and Measurement of Share-based Payment Transactions – Amendments to IFRS 2

The IASB issued amendments to IFRS 2 Share-based Payment that address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled. On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and other criteria are met. The amendments are effective for annual periods beginning on or after 1 January 2018, with early application permitted. The amendments are not expected to have any impact on the consolidated financial statements of the Group.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 Leases, IFRIC 4 Determining whether an Arrangement Contains a Lease, SIC-15 Operating Leases – Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets and short-term leases (i.e., leases with a lease term of 12 months or less).

At the commencement date of a lease, a lessee will recognize a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognize the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

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

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

IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs. In 2018, the Group will continue to assess the potential effect of IFRS 16 on its consolidated financial statements.

(Thousands of Georgian lari)

5. New accounting pronouncements (continued)

IFRS 17 Insurance Contracts

In May 2017, the IASB issued IFRS 17 Insurance Contracts (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 Insurance Contracts (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features.

A few scope exceptions will apply. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in IFRS 4, which are largely based on grandfathering previous local accounting policies, IFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects.

IFRS 17 is effective for reporting periods beginning on or after 1 January 2021, with comparative figures required. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17. The Group will assess the potential effect of IFRS 17 on its consolidated financial statements, including treatment of non-financial guarantees issued by the Group.

Transfers of Investment Property – Amendments to IAS 40

The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. Entities should apply the amendments prospectively to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. An entity should reassess the classification of property held at that date and, if applicable, reclassify property to reflect the conditions that exist at that date. Retrospective application in accordance with IAS 8 is only permitted if it is possible without the use of hindsight. Effective for annual periods beginning on or after 1 January 2018. The Group does not expect a material effect from application of these amendments.

Annual improvements 2014-2016 cycle

These improvements include:

IFRS 1 First-time Adoption of International Financial Reporting Standards – Deletion of short-term exemptions for first-time adopters

Short-term exemptions in paragraphs E3-E7 of IFRS 1 were deleted because they have now served their intended purpose. The amendment is effective from 1 January 2018. This amendment is not applicable to the Group.

IAS 28 Investments in Associates and Joint Ventures – Clarification that measuring investees at fair value through profit or loss is an investment-by-investment choice

The amendments clarify that:

- An entity that is a venture capital organisation, or other qualifying entity, may elect, at initial recognition on an investment-by-investment basis, to measure its investments in associates and joint ventures at fair value through profit or loss.
- If an entity, that is not itself an investment entity, has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which: (a) the investment entity associate or joint venture is initially recognised; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent.

The amendments should be applied retrospectively and are effective from 1 January 2018. Group does not expect any effect from application of these amendments.

(Thousands of Georgian lari)

5. New accounting pronouncements (continued)

Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts – Amendments to IFRS 4

The amendments address concerns arising from implementing the new financial instruments standard, IFRS 9, before implementing IFRS 17 Insurance Contracts, which replaces IFRS 4. The amendments introduce two options for entities issuing insurance contracts: a temporary exemption from applying IFRS 9 and an overlay approach. The temporary exemption is first applied for reporting periods beginning on or after 1 January 2018. An entity may elect the overlay approach when it first applies IFRS 9 and apply that approach retrospectively to financial assets designated on transition to IFRS 9. The entity restates comparative information reflecting the overlay approach if, and only if, the entity restates comparative information when applying IFRS 9. There is no effect on the Group from these amendments.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. The Interpretation is effective for annual periods beginning on or after 1 January 2018. Since the Group's current practice is in line with the Interpretation, the Group does not expect any effect on its consolidated financial statements.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

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

An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The Interpretation also addresses the assumptions an entity makes about the examination of tax treatments by taxation authorities, as well as how it considers changes in facts and circumstances.

The interpretation is effective for annual reporting periods beginning on or after 1 January 2019, but certain transition reliefs are available. The Group will apply interpretation from its effective date. Since the Group operates in a complex tax environment, applying the Interpretation may affect its consolidated financial statements and the required disclosures. In addition, the Group may need to establish processes and procedures to obtain information that is necessary to apply the Interpretation on a timely basis.

6. Cash and cash equivalents

	2017	2016
Current accounts with other credit institutions	56,502	210,489
Current accounts with the NBG	52,786	51,705
Cash on hand	52,690	49,426
Time deposits with credit institutions	49,664	4,716
Cash and cash equivalents	211,642	316,336

As of 31 December 2017, 75.24% of total current accounts with credit institutions are placed with two non-resident credit institutions (2016: 90.42%).

As of 31 December 2017, GEL 49,664 was placed on five time deposits with credit institutions that had maturity period in January 2018 (as of 31 December 2016: GEL 4,716 time deposits with credit institutions consist from two time deposits with maturity period in January 2017) and bear annual interest rates from 0.2% to 2.5% (2016: annual interest rates from 0.01% to 1.5%).

As of 31 December 2017 and 2016, the Bank's cash and cash equivalents were of high and standard credit grade, were not either past due, or individually impaired, or renegotiated.

(Thousands of Georgian lari)

7. Amounts due from banks and international financial institutions

	2017	2016
Obligatory reserve with the NBG	116,302	141,920
Restricted nostro accounts	114,006	–
Time deposits with credit institutions	162	255
Amounts due from banks and international financial institutions	230,470	142,175

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

In 2017 the obligatory reserve on USD account bears interest at the rate of upper limit of U.S. Federal Reserve System of less 0.5% (2016 – the rate of U.S. Federal Reserve System of less 0.5%) and on EUR account – the rate of the European Central Bank of less 0.2% (2016 – the rate of the European Central Bank).

As of 31 December 2017, amount of GEL 162 (2016: GEL 255) included in time deposits was placed on long term deposits and pledged as security for settlement operations to the international financial institutions.

The restricted cash on nostro account represents the funds denominated in USD placed in the VTB Ukraine. The Bank's ability to withdraw such deposit is restricted by the local regulation enacted by the Government of Ukraine started from March 2017. The Parent bank explicitly confirmed its intention to issue guarantee to the Bank for the whole investment placed in VTB Ukraine in case the restriction is not be removed by the end of March 2018. In addition, as at 31 December 2017 borrowings from Parent bank contains the funds obtained to finance this investment. Refer Note 17.

8. Loans and advances to customers

	2017	2016
Corporate lending	369,015	422,386
Consumer lending	394,144	333,381
Small business lending	209,409	203,531
Loans to individuals secured by deposits	9,234	5,612
Gross loans and advances to customers	981,802	964,910
Less – allowance for impairment	(31,326)	(31,146)
Loans and advances to customers, net	950,476	933,764

Allowance for impairment of loans and advances to customers

A reconciliation of the allowance for impairment of loans and advances to customers by class is as follows:

	Corporate lending 2017	Consumer lending 2017	Small business lending 2017	Total 2017
At 1 January 2017	23,797	6,041	1,308	31,146
Net (reversal)/charge for the year	(7,213)	6,087	(527)	(1,653)
Foreign currencies translation	(236)	(96)	14	(318)
Recoveries of previously written off loans and advances	1,676	1,014	490	3,180
Amounts written off	(627)	(359)	(43)	(1,029)
At 31 December 2017	17,397	12,687	1,242	31,326
Individual impairment	11,575	–	120	11,695
Collective impairment	5,822	12,687	1,122	19,631
	17,397	12,687	1,242	31,326
Gross amount of loans and advances, individually determined to be impaired, before deducting any individually assessed impairment allowance	20,117	–	450	20,567

(Thousands of Georgian lari)

8. Loans and advances to customers (continued)

Allowance for impairment of loans and advances to customers (continued)

	Corporate lending 2016	Consumer lending 2016	Small business lending 2016	Total 2016
At 1 January 2016	24,778	9,381	1,569	35,728
Net charge/(reversal) for the year	(5,135)	5,559	236	660
Foreign currencies translation	1,896	277	97	2,270
Recoveries of previously written off loans and advances	2,558	581	418	3,557
Amounts written off	(300)	(9,757)	(1,012)	(11,069)
At 31 December 2016	23,797	6,041	1,308	31,146
Individual impairment	16,196	93	100	16,389
Collective impairment	7,601	5,948	1,208	14,757
	23,797	6,041	1,308	31,146
Gross amount of loans and advances, individually determined to be impaired, before deducting any individually assessed impairment allowance	19,931	371	401	20,703

Individually impaired loans

Interest income of loans and advances, which individual impairment allowances have been recognized, as at 31 December 2017, comprised GEL 1,019 (2016: GEL 541).

Collateral and other credit enhancements

The amount and type of required collateral depends on the counterparty Credit Risk assessment, for which the Bank has implemented guidelines and policies defining valuation parameters and acceptability of the collateral.

Accepted collateral types are as follows:

- For commercial lending: Real estate properties, inventories, bank deposits, trade receivables and bank guarantees;
- For Retail lending: bank deposits, mortgages over residential properties, inventories, household assets and third party personal guarantees.

The Group also accepts guarantees from customer's parent companies issued to insure the loans to their subsidiaries.

As of 31 December 2017, the Group repossessed collateral (land and buildings) during the year with value as of repossession date of GEL 10,404 (2016: GEL 3,098), which were classified as investment property and inventories with the amount of GEL7,245 and GEL 3,159 of repossessed collateral, respectively (2016: GEL 2,478 and GEL 620). Refer to Note 11 and 13.

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for business use.

(Thousands of Georgian lari)

8. Loans and advances to customers (continued)

Concentration of loans and advances to customers

As of 31 December 2017, the Bank had a concentration of loans represented by GEL 180,590 due from the ten largest third party borrowers of 18.39% of gross loan portfolio (2016: GEL 221,507 or 22.96%). An allowance of GEL 1,841 (2016: GEL 2,525) was recognised against these loans.

Included in total loans to customers is an exposure to a single borrower of GEL 26,384 or 2.69% of total loan portfolio (2016 – GEL 34,532 or 3.58%), that bears an annual interest rate of 10% p.a. and matures in May 2018.

Loans have been issued to the following types of customers:

	2017	2016
Commercial legal entities	525,179	585,865
Individuals	442,847	375,022
State-owned companies	13,776	4,023
Gross loans and advances to customers	981,802	964,910

As of 31 December 2017 and 2016, loans and advances to customers are principally issued within Georgia and their allocation by industry sectors is as follows:

	2017	2016
Individuals	442,847	375,022
Trading and service enterprises	245,793	334,637
Manufacturing	83,816	55,512
Energy	64,415	27,900
Agriculture and food processing	47,366	51,859
Real estate construction	42,097	55,702
Financial	18,108	21,173
Telecommunication and transportation	12,824	11,131
Other	24,536	31,974
Gross loans and advances to customers	981,802	964,910

9. Investment securities available-for-sale

As of 31 December 2017 investment securities available-for-sale comprised of securities of the Ministry of Finance of Georgia with total carrying value of GEL 107,437 (2016: GEL 68,494), securities of NBG with total carrying value of GEL 13,233 (2016: GEL 11,965) and corporate shares of 1 Georgian company engaged in clearance of utility payments with total carrying value of GEL 54 (2016: GEL 54). The above mentioned securities have unrealized gain/loss from revaluation amounted to GEL 568 (2016: GEL 1,550).

During the year unrealized gains recognized in other comprehensive income on all investment securities were GEL 412 (2016: GEL 2,223), realized losses were GEL 1,394 (2016: GEL 66).

(Thousands of Georgian lari)

10. Property and equipment

The movements in property and equipment during 2017 and 2016 were as follows:

	Land and buildings	Computers and com-munication equipment	Furniture, fixtures and office equipment	Utility systems and related features	Motor vehicles	Leasehold improve-ments	Construc-tion in progress	Total
Cost or revalued amount								
31 December 2015	25,035	10,844	9,346	1,938	1,790	2,152	–	51,105
Additions	–	1,056	754	–	38	–	1,182	3,030
Transfer	979	–	–	–	–	203	(1,182)	–
Disposals	–	(428)	(202)	–	(17)	(12)	–	(659)
31 December 2016	26,014	11,472	9,898	1,938	1,811	2,343	–	53,476
Additions	–	743	827	–	280	9	950	2,809
Transfer	322	–	–	–	–	628	(950)	–
Disposals	–	(316)	(134)	–	(185)		–	(635)
31 December 2017	26,336	11,899	10,591	1,938	1,906	2,980	–	55,650
Accumulated depreciation and impairment								
31 December 2015	–	(7,471)	(6,061)	(296)	(1,092)	–	–	(14,920)
Depreciation charge	(532)	(1,294)	(1,214)	(68)	(234)	(384)	–	(3,726)
Disposals	–	405	181	–	17	1	–	604
31 December 2016	(532)	(8,360)	(7,094)	(364)	(1,309)	(383)	–	(18,042)
Depreciation charge	(553)	(1,292)	(1,045)	(68)	(213)	(400)	–	(3,571)
Disposals	–	295	133	–	185	–	–	613
31 December 2017	(1,085)	(9,357)	(8,006)	(432)	(1,337)	(783)	–	(21,000)
Net book value								
31 December 2015	25,035	3,373	3,285	1,642	698	2,152	–	36,185
31 December 2016	25,482	3,112	2,804	1,574	502	1,960	–	35,434
31 December 2017	25,251	2,542	2,585	1,506	569	2,197	–	34,650

As of 31 December 2015, an independent appraiser determined the fair value of the Group's land and buildings. The appraiser is an industry specialist in valuing these types of property and equipment.

The market value of the property was determined based on the active market data. The market approach was used to determine the fair value, the income approach was used to validate the obtained value estimates, and the cost approach was used to determine the value of real property where no information on recent sales or lease rates for similar properties within the same area was available.

As of 31 December 2017 the Group analysed market prices for its premises and concluded that the market price of premises was not materially different from their carrying value. Refer to Note 24 for details on fair value measurements of the Group's land and buildings.

If no revaluation of land and buildings had been performed, the original cost as of 31 December 2017 and 31 December 2016, would have amounted to GEL 32,597 (2016: GEL 32,275) and accumulated depreciation would have amounted to GEL 11,316 (2016: GEL 10,626).

The total value of fully depreciated property and equipment in use as of 31 December 2017 and 2016, amounted to GEL 13,358 and GEL 8,946 respectively.

(Thousands of Georgian lari)

11. Investment property

	2017	2016
Opening balance at 1 January	20,336	26,678
Additions	7,245	2,478
Disposals	(5,455)	(11,795)
Unrealized gain on revaluation	2,430	2,975
Closing balance at 31 December	24,556	20,336

Investment property is a real estate property comprised of land and buildings, which was obtained by the Group through repossession of collateral on defaulted loans. Refer to Note 8.

As of 31 December 2017, an independent appraiser determined the fair value of the Group's investment properties. The appraiser is an industry specialist in valuing these types of investment properties. The fair value represents the amount at which the asset could be exchanged between knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards Committee standards.

The fair value of investment property was determined based on the active market data. The market approach was used to determine the fair value, the income approach was used to validate the obtained value estimates, and the cost approach was used to determine the value of real property where no information on recent sales or lease rates for similar properties within the same area was available.

12. Taxation

In June 2016, amendments to the Georgian tax law in respect of corporate income tax became enacted. The amendments become effective from 1 January 2017 for all Georgian companies except the banks, insurance companies and microfinance organization, for which the effective date is 1 January 2019. Under the new regulation, corporate income tax will be levied on profit distributed as dividends to the shareholders that are individuals or non-residents of Georgia, rather than on profit earned as under the current regulation. The amount of tax payable on a dividend distribution will be calculated as 15/85 of the amount of net distribution. The companies will be able to offset corporate income tax liability arising from dividend distributions out of profits earned in 2008-2016 by the amount of corporate income tax paid for the respective period under the current regulation. Dividends distributions between Georgian resident companies will not be subject to corporate income tax.

Following the enactment of the amendments, as at 31 December 2017 the Group remeasured its deferred tax assets and liabilities at the tax rates that were expected to apply to the period when the asset is realised or the liability is settled. As IAS 12 Income Taxes requires, the Group used 0% tax rate applicable for undistributed profits in respect of assets and liabilities expected to be realized or settled in the periods when the new regulation becomes effective starting from 1 January 2019.

The amendments to the Georgian tax law described above also provide for charging corporate income tax on certain transactions that are considered deemed profit distributions, e.g. some transactions at non-market prices, non-business related expenses or supply of goods and services free of charge. Taxation of such transaction is outside scope of IAS 12 Income Taxes and will be accounted similar to operating taxes starting from 1 January 2019. Tax law amendments related to such deemed profit distribution did not have any effect on the Group's financial statements for the year ended 31 December 2017.

In 2017 and 2016 the income tax rate applicable to the Group's income is 15%. The effective income tax rate differs from the statutory income tax rate. A reconciliation of the income tax benefit expense on statutory rates with actual is as follows:

The corporate income tax expense comprises:

	2017	2016
Current tax expense	(3,979)	(2,045)
Deferred expense – origination and reversal of temporary differences	(30)	2,793
Less: deferred tax recognised in other comprehensive income	–	(457)
Income tax (expense)/ benefit	(4,009)	291

(Thousands of Georgian lari)

12. Taxation (continued)

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

	2017	2016
Income before income tax expense	36,378	27,153
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	(5,457)	(4,073)
Non-deductible expenses	(39)	(31)
Tax exempt income less income recognized for tax purposes only	1,631	1,000
Effect of change in tax legislation	(144)	3,395
Income tax (expense)/ benefit	(4,009)	291

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

	Origination and reversal of temporary differences			Origination and reversal of temporary differences		
	2015	In the income statement	Directly in other comp-rehensive income	2016	In the income statement	2017
Tax effect of deductible temporary differences						
Financial instruments adjustment for effective interest rates	1,127	341	–	1,468	(102)	1,366
Accrued expenses	1,206	234	–	1,440	(80)	1,360
Securities available-for-sale	161	(161)	–	–	–	–
Other	292	(280)	–	12	15	27
Deferred tax assets	2,786	134	–	2,920	(167)	2,753
Tax effect of taxable temporary differences						
Allowance for loan impairment	(2,359)	1,230	–	(1,129)	(135)	(1,264)
Property and equipment	(1,513)	713	457	(343)	168	(175)
Investment property	(162)	162	–	–	–	–
Allowances for impairment and provision for other losses	(326)	97	–	(229)	104	(125)
Deferred tax liabilities	(4,360)	2,202	457	(1,701)	137	(1,564)
Net deferred tax assets/ (liabilities)	(1,574)	2,336	457	1,219	(30)	1,189

13. Other assets and liabilities

Other assets comprise:

	2017	2016
Financial assets		
Unsettled transactions on money transfers	3,490	4,179
Derivative financial assets	1,290	142
Accrued commission receivable on guarantees and letters of credit	58	65
Other	9	15
Total financial assets	4,847	4,401
Non-financial assets		
Intangible assets	8,183	7,927
Prepaid expenses	3,734	2,230
Inventories of repossessed collateral	3,159	620
Advances paid	1,472	688
Inventories in stock	633	367
Prepaid operational taxes	301	–
Other	156	4
Total non-financial assets	17,638	11,836
Other assets	22,485	16,237

(Thousands of Georgian lari)

13. Other assets and liabilities (continued)

The movement in intangible assets during 2017 and 2016 were as follows:

	Intangible assets
At cost	
1 January 2016	4,194
Additions	6,158
31 December 2016	10,352
Additions	1,528
Disposals and write-offs	(2)
31 December 2017	11,878
Accumulated amortisation and impairment	
1 January 2016	(1,856)
Amortization charge for the year (Note 22)	(569)
31 December 2016	(2,425)
Amortization charge for the year (Note 22)	(1,270)
31 December 2017	(3,695)
Net book value	
31 December 2016	7,927
31 December 2017	8,183

Other liabilities comprise:

	2017	2016
Financial liabilities		
Accrued bonuses	7,528	8,165
Settlements on plastic cards	3,373	2,147
Accrued expenses	1,502	1,506
Unsettled transactions on money transfers	1,435	4,621
Payables for unused vacations	1,044	978
Derivative financial liabilities	38	251
Other	35	77
Total financial liabilities	14,955	17,745
Non-financial liabilities		
Advances received	2,947	1,354
Dividends payable to shareholders of the Bank	1,075	605
Provisions for off-BS commitments	424	872
Provision for legal claims	102	102
Operational taxes payable	–	1,048
Total non-financial liabilities	4,548	3,981
Other liabilities	19,503	21,726

As of 31 December 2017 and 2016, the Group's derivative financial instruments comprised of foreign exchange forwards and swaps and were attributable to the Level 2 of fair value hierarchy.

Derivatives are valued using a valuation technique with market observable inputs. The applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves. Derivatives comprise:

	2017				2016			
	Notional amount		Fair values		Notional amount		Fair values	
	Asset	Liability	Asset	Liability	Asset	Liability	Asset	Liability
Foreign exchange contracts								
Forwards and Swaps – foreign	141,642	140,210	1,290	38	20,320	20,429	142	251
Total derivative assets/liabilities	141,642	140,210	1,290	38	20,320	20,429	142	251

(Thousands of Georgian lari)

14. Amounts due to banks and international financial institutions

	2017	2016
Loans received from the Parent bank	85,518	260,738
Time deposits and loans	26,039	25,175
Current accounts	1,336	262
Amounts due to banks and international financial institutions	112,893	286,175

As of 31 December 2017, loans received from the Parent bank had maturities ranging from August 2018 till January 2020 (2016: January 2017 till March 2019) and bear annual interest rates from 2.89% to 3.73% (2016: from 1.1% to 3.73%).

As of 31 December 2017, time deposits and loans had maturities ranging from January 2018 till December 2018 (as of 31 December 2016 time deposits and loans had maturities ranging from January 2017 till June 2017) and bear annual interest rates from 4% to 7% (2016: from 0% to 7%).

15. Amounts due to customers

	2017	2016
Individuals		
Current/demand accounts	102,611	121,821
Term deposits	265,890	191,156
Total due to individuals	368,501	312,977
State and budgetary organisations		
Current/settlement accounts	28,083	136,454
Term deposits	4,702	7,147
Total due to state and budgetary organisations	32,785	143,601
Commercial legal entities		
Current/settlement accounts	371,087	259,220
Term deposits	123,384	115,476
Total due to commercial legal entities	494,471	374,696
Total due to legal entities	527,256	518,297
Total amounts due to customers	895,757	831,274
Held as security against undrawn loan facilities	104	1,311
Held as security against guarantees issued	12,491	14,656
Held as security against letters of credit issued	84	–
Total amounts of cash held as security against letters of credit, undrawn loan facility and guarantees issued	12,679	15,967
Held as security against settlement operations	510	7,725

At 31 December 2017, amounts due to customers of GEL 305,127 (34.06%) were due to the ten largest third party customers (2016: GEL 331,786 (39.91%)).

An analysis of customer accounts by industry follows:

	2017	2016
Individuals	368,501	312,977
Energy	142,547	71,162
Trade and service	96,908	67,883
Transport and communication	92,896	112,833
Finance	86,663	58,777
Real estate constructions	40,866	39,042
Government	32,785	143,601
Manufacturing	18,399	13,009
Education	7,004	4,977
Agriculture	1,301	1,238
Other	7,887	5,775
Amounts due to customers	895,757	831,274

(Thousands of Georgian lari)

16. Debt securities issued

From July 2016, Group had started issuance of debt security deposits. As of 31 December 2017, debt securities comprised of discount certificate deposits with amount of GEL 27,167 with maturities ranging from 3 January 2018 till 17 December 2022 (2016: GEL 26,006, from 9 January 2017 till 15 June 2021) and coupon certificate deposits with amount of GEL 11,026 with maturities ranging from 3 January 2018 till 31 October 2022 (2016: GEL 5,684, 3 January 2017 till 3 April 2021). Certificates of deposit may be freely resold or otherwise assigned to any third party without prior notification of the Bank.

17. Other borrowed funds

	2017	2016
Borrowings from the Parent bank	203,537	79,340
Borrowings from NBG	45,393	35,009
Borrowings from international financial institutions	12,377	22,197
Borrowings from government organizations	1,678	2,476
Other borrowed funds	262,985	139,022

As of 31 December 2017, out of borrowings from the Parent bank GEL 131,345 represents funds obtained to finance the investment placed in VTB Ukraine and this borrowing is not going to be repaid until the investment placed in VTB Ukraine is collected by the Bank. Refer Note 7.

As of 31 December 2017, maturities of borrowings from the Parent bank were ranging from July 2019 till May 2022 (2016: from February 2017 till December 2021), annual interest rates from 3.21% to 8.84% (2016: from 2.07% to 6.28%). Refer to Note 26.

As of 31 December 2017, GEL 45,393 (2016: GEL 35,009) borrowings from NBG were received under the securities of Ministry of Finance of Georgia with total nominal value of GEL 42,350 and under the Loans to customers with total nominal value of GEL 6,709 was pledged as collateral (2016: borrowings from NBG were received under the securities of Ministry of Finance of Georgia with total nominal value of GEL 36,900 pledged as collateral). The borrowings were matured in January 2018 (2016: January 2017) and bears annual interest rates 7.25% to 7.43% (2016: from 6.7% to 8%).

As of 31 December 2017 borrowings from international financial institutions included facilities in U.S. dollars and Euro with maturities ranging from February 2018 to December 2032 (2016: from January 2017 to December 2032) and interest rates from Libor + 5% to CD rate of NBG + margin 1.2% + TCX spread 0.13% and one loan bearing annual interest at 0.75% (2016: from Libor + 5% to Libor + 5.25%; 0.75%).

As of 31 December 2017 borrowings from government organizations contained facilities received from Municipal Development Fund of Georgia to finance energy sector companies. The borrowings are denominated in EUR, bear annual interest rate of 3% (2016: 3%) and with maturities ranging from May 2018 to November 2021 (2016: from May 2018 to November 2021).

18. Equity

Share capital

Movements in ordinary shares authorized and fully paid were as follows:

	Number of shares authorized	Number of shares fully paid	Nominal amount, GEL
31 December 2015	191,292,701	191,292,701	191,293
31 December 2016	191,292,701	191,292,701	191,293
Increase in share capital	17,715,576	17,715,576	17,715
31 December 2017	209,008,277	209,008,277	209,008

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

On 2 June 2017 the Shareholders made a decision to increase the number of authorized ordinary shares by 17,715,576. Related share issue prospectus was approved by the NBG on 4 July 2017. The consideration received for these shares comprised of cash for the total amount of GEL 17,715.

(Thousands of Georgian lari)

18. Equity (continued)

Perpetual subordinated loan

On 29 December 2016, the Group received perpetual subordinated loan for RUB 300,000. As at 31 December 2017, the carrying amount of the perpetual subordinated loan was GEL 13,481 (31 December 2016: GEL 12,900). During 2017 the Bank paid interest payment in amount of GEL 10. The perpetual subordinated loan has an unlimited term and are redeemable at the Group's option. Coupon rate comprises Central Bank of Russia key rate + 2.5%. The Group has, at its sole discretion, an unconditional right to cancel interest payments by giving notice to the issuer before the payment date.

Dividends

In accordance with the Georgian legislation, dividends may only be declared to the shareholders of the Bank from the net income as shown in the Bank's separate financial statements prepared in accordance with the NBG requirements. The NBG shall be informed regarding declaration of dividends and also shall be authorized to suspend or restrict payment of dividends, if a commercial bank has violated regulatory requirements of the NBG.

On 19 June 2017, the annual general meeting of shareholders of the Bank declared 2016 dividends comprising GEL 17,715 or Georgian lari 0.09 per share, based on 2016 separate financial statements prepared in accordance with the NBG requirements. Dividends in the amount of GEL 17,246 were paid to shareholders in 2017.

19. Commitments and contingencies

Operating environment

As a small-scale and open economy, the Georgian Economy is sensitive to regional and global challenges. Reduced exports to Georgia's main trading partners, combined with falling remittances, cause income and domestic demand to decline, which puts pressure on the exchange rate. The economic growth rate is still low in the region, mainly effected by the global economic situation.

However, over the last few years the Georgian government has made a number of developments that positively affect the overall investment climate of the country, specifically implementing the reforms necessary to create banking, judicial, taxation and regulatory systems. This includes the adoption of a new body of legislation (including new Tax Code started from 2017 and procedural laws)

In year 2017, economic of Georgia experienced growth of 4.4% (2016: 2.2%), and inflation rate ended up at 6.7%.

Legal

From time to time and in the normal course of business, claims against the Group are received. At the reporting date the Group had several unresolved legal claims. Management is of the opinion that there would be outflow of resources and accordingly provisions have been made in these consolidated financial statements. Refer to Note 13.

As of 31 December, the Group's financial commitments and contingencies comprised the following:

	2017	2016
Credit related commitments		
Guarantees issued	61,672	81,197
Undrawn loan facilities	47,136	68,409
Other credit-related commitments	11,854	8,657
Letters of credit	1,705	1,565
Financial commitments and contingencies (before deducting collateral)	122,367	159,828
Less – cash held as security against letters of credit, undrawn loan facility and guarantees issued (Note 15)	(12,679)	(15,967)
Financial commitments and contingencies	109,688	143,861
Operating lease commitments		
Not later than 1 year	1,274	1,250
Later than 1 year but not later than 5 years	4,171	4,246
Later than 5 years	1,179	1,549
	6,624	7,045

(Thousands of Georgian lari)

20. Net fee and commission income

	2017	2016
Commission on settlements operations	10,132	8,657
Commission on guarantees and other credit related commitments	3,818	3,324
Commission on cash operations	2,174	2,015
Other	254	260
Fee and commission income	16,378	14,256
Commission on settlements operations	(7,518)	(6,301)
Commission on cash operations	(1,893)	(1,955)
Commission on guarantees and other credit related commitments	(306)	(824)
Other	(121)	(51)
Fee and commission expense	(9,838)	(9,131)
Net fee and commission income	6,540	5,125

21. Other income

	2017	2016
Penalties received from lending operations	5,041	6,615
Penalties received for deposit redemption before maturity	815	430
Income from operating lease	426	525
Reimbursement of integrated marketing communication campaign costs	177	141
Other	109	56
Other income	6,568	7,767

22. Personnel and other operating expenses

	2017	2016
Salaries	26,683	25,059
Bonuses and premiums	11,051	11,692
Personnel expenses	37,734	36,751
Occupancy and rent	3,194	2,852
Marketing and advertising	1,950	1,922
Amortisation of intangible assets	1,270	569
Computer software maintenance	1,261	1,545
Repairs and maintenance of property and equipment	1,090	911
Legal and consultancy	1,173	650
Utilities	941	880
Office supplies	906	961
Communications	831	732
Representation expenses	738	595
Operating taxes	610	606
Business travel and related expenses	463	485
Professional service expenses	364	367
Other operating expenses on plastic cards operation	315	200
Insurance	156	169
Security	105	99
Charity	91	85
Other	248	732
Other operating expenses	15,706	14,360

(Thousands of Georgian lari)

23. Risk management

The Group is required to manage financial risks that arise as a consequence of its operations to deliver its policy objectives as well as in the course of managing the Group's statement of financial position. These risks primarily include credit risk, liquidity risk and funding management, market risk, prepayment risk and operational risk.

Risk is inherent to the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Group's strategic planning process.

Risk management structure

The Bank's Board of Directors is ultimately responsible for identifying and controlling risks of the Group; however, there are separate independent bodies responsible for managing and monitoring risks.

Supervisory Council

The Supervisory Council is responsible for the overall risk management approach and for approving the risk strategies and principles.

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Group. The Asset – liability and Risk management Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

The Risk Management Unit (Risk Department) – is responsible for implementing and maintaining risk related procedures to ensure an independent control process. As at the end of 2017 Risk Department consisted of the following sub-divisions:

- Consolidated risk analysis division;
- Corporate credit risk division;
- Retail credit risk division;
- Market and operational risks division;
- Collateral evaluation and monitoring group;
- Credit deals monitoring group.

Risk Controlling Unit

The Risk Controlling Unit is responsible for monitoring compliance with risk principles, policies and limits, across the Group. Each business group has a decentralised unit which is responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This unit also ensures the complete capture of the risks in risk measurement and reporting systems.

Bank Treasury

Bank Treasury is responsible for managing the Group's assets and liabilities. It is also primarily responsible for the funding and liquidity risks of the Group.

Internal Audit

Risk management processes throughout the Group are audited annually by the internal audit function that examines both the adequacy of the procedures and the Group's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Supervisory Council through the Audit Committee.

(Thousands of Georgian lari)

23. Risk management (continued)

Risk measurement and reporting systems

The Bank's risks are measured using a method which reflects both the expected losses likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Group also runs worst case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Information compiled from all the business divisions is examined and processed to analyse, control and identify risks timely. This information is provided to the Management Board, the Asset – liability and Risk management Committee, and the head of each business division. The report includes aggregate credit exposure, credit metric forecasts, liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Risk management department assesses the appropriateness of the allowance for credit losses on a monthly basis.

A daily summary on liquidity utilisation is provided to the Management Board and all other relevant employees of the Group.

Risk mitigation

The Group uses collateral to reduce its credit risks (see below for more detail).

Credit risk

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

Credit-related commitments risks

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

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

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

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group internal credit ratings.

For the purpose of these consolidated financial statements all not past due collectively assessed loans to legal entities (Corporate lending and small business lending) are classified in three quality groups presented in the tables below.

- The high grade group includes borrowers with sound level of liquidity and profitability. The probability of default is assessed as low;
- The standard grade includes borrowers with average level of liquidity and profitability. The probability of default is assessed as moderate;
- The sub-standard grade group includes borrowers with satisfactory level of liquidity and profitability. The probability of breach of default is assessed as above moderate.

(Thousands of Georgian lari)

23. Risk management (continued)

Credit risk (continued)

For the purpose of these consolidated financial statements all not past due collectively assessed loans to individuals are classified in three quality groups presented in the tables below.

- The high grade group includes borrowers with good debt servicing and excellent financial position of the borrower, loans secured with deposits, loans secured with gold;
- The standard grade group includes borrowers with good/average debt servicing and excellent/moderate financial position of the borrower;
- The sub-standard grade group is represented by loans with average debt servicing and moderate financial position of the borrower.

The table below shows the credit quality by class of credit risk bearing assets:

		Neither past due nor individually impaired				
	Notes	High grade 2017	Standard grade 2017	Sub-standard grade 2017	Past due or individually impaired 2017	Total 2017
Cash in credit organisations	6	152,440	6,512	–	–	158,952
Amounts due from banks and international financial institutions	7	116,432	114,038	–	–	230,470
Investment securities available-for-sale	9	120,670	–	–	–	120,670
Loans and advances to customers	8					
Corporate lending		111,396	203,795	24,462	11,965	351,618
Small business lending		201,677	–	4,813	1,677	208,167
Consumer lending		332,178	26,444	13,144	9,691	381,457
Loans to individuals secured with deposits		9,234	–	–	–	9,234
		654,485	230,239	42,419	23,333	950,476
Other financial assets	13	–	4,838	–	9	4,847
Total		1,044,027	355,627	42,420	23,341	1,465,415

		Neither past due nor impaired				
	Notes	High grade 2016	Standard grade 2016	Sub-standard grade 2016	Past due or individually impaired 2016	Total 2016
Cash in credit organisations	6	110,128	156,782	–	–	266,910
Amounts due from banks and international financial institutions	7	142,053	122	–	–	142,175
Investment securities available-for-sale	9	80,459	–	–	–	80,459
Loans and advances to customers	8					
Corporate lending		91,032	231,314	49,574	26,668	398,588
Small business lending		195,516	–	4,044	2,664	202,224
Consumer lending		284,111	25,063	8,499	9,667	327,340
Loans to individuals secured with deposits		5,612	–	–	–	5,612
		576,271	256,377	62,117	38,999	933,764
Other financial assets	13	–	4,401	–	–	4,401
Total		908,911	417,682	62,117	38,999	1,427,709

(Thousands of Georgian lari)

23. Risk management (continued)

Credit risk (continued)

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

Overdue but not impaired loans and advances include solely loans and advances that are not individually significant. The tables below show aging analysis of overdue loans.

Aging analysis of past due but not individually impaired loans per class of financial assets.

As of 31 December 2017	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
Loans and advances to customers					
Corporate lending	1,583	1,118	–	722	3,423
Consumer lending	4,858	1,163	777	2,893	9,691
Small business lending	431	371	318	227	1,347
Total	6,872	2,652	1,095	3,842	14,461

As of 31 December 2016	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
Loans and advances to customers					
Corporate lending	20,855	494	694	890	22,933
Consumer lending	5,482	1,413	1,372	1,121	9,388
Small business lending	903	507	708	246	2,364
Total	27,240	2,414	2,774	2,257	34,685

For the purpose of these consolidated financial statements a loan is considered overdue when the borrower fails to make any payment due under the loan agreement at the reporting date. In this case the aggregate amount of all amounts due from borrower under the respective loan agreement including accrued interest and commissions is recognised as overdue.

Loans and advances to customers have been assessed for impairment on the collective basis. Details of loan loss allowance of loan portfolio are disclosed in Note 8.

Carrying amount per class of financial assets whose terms have been renegotiated

The table below shows the carrying amount for renegotiated (restructured or refinanced) financial assets, by class.

	2017	2016
Loans and advances to customers		
Corporate lending	6,896	3,920
Consumer lending	12,245	9,338
Small business lending	4,948	4,622
Total	24,089	17,880

Impairment assessment

Impairment losses are recognized in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Group determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Group considers in determining whether a financial asset is impaired include any known financial difficulties of counterparties, infringement of the original terms of the contract, whether any payments of principal or interest is overdue and the reliability of related collateral if any.

(Thousands of Georgian lari)

23. Risk management (continued)

Credit risk (continued)

Individually assessed allowances

The Group determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy occurred, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans and advances to customers that are not individually significant (including consumer lending and small business lending) and for individually significant loans where there is not yet any evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics within classification categories. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

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 and the experience of management in respect of the extent, to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

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

	2017				2016			
	Georgia	OECD	CIS and other foreign countries	Total	Georgia	OECD	CIS and other foreign countries	Total
Assets								
Cash and cash equivalents	153,722	31,952	25,968	211,642	106,358	19,530	190,448	316,336
Amounts due from banks and international financial institutions	116,302	130	114,038	230,470	141,921	132	122	142,175
Loans and advances to customers	924,791	2,678	23,007	950,476	922,465	6,192	5,107	933,764
Investment securities – available-for-sale	120,724	–	–	120,724	80,513	–	–	80,513
Other financial assets	3,084	472	1,291	4,847	4,265	–	136	4,401
	1,318,623	35,232	164,304	1,518,159	1,255,522	25,854	195,813	1,477,189

(Thousands of Georgian lari)

23. Risk management (continued)

Credit risk (continued)

	2017				2016			
	Georgia	OECD	CIS and other foreign countries	Total	Georgia	OECD	CIS and other foreign countries	Total
Amounts due to banks and international financial institutions	26,760	–	86,133	112,893	25,247	–	260,928	286,175
Amounts due to customers	737,940	35,737	122,080	895,757	693,206	31,470	106,598	831,274
Debt securities issued	28,431	104	9,658	38,193	24,646	1,237	5,807	31,690
Other borrowed funds	47,071	12,377	203,537	262,985	37,486	22,196	79,340	139,022
Subordinated loan	–	–	37,362	37,362	–	–	37,759	37,759
Other financial liabilities	14,475	442	38	14,955	17,509	–	236	17,745
	854,677	48,660	458,808	1,362,145	798,094	54,903	490,667	1,343,664
Net assets/ (liabilities)	463,946	(13,428)	(294,504)	156,014	457,428	(29,049)	(294,854)	133,525
Net financial commitments	119,867	17	2,483	122,367	157,792	62	1,975	159,829

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are in place covering the acceptability and valuation of each type of collateral. Management monitors the market value of collateral and will request additional collateral in accordance with the underlying agreement. It is the Group policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim.

The list of acceptable forms of credit support is subject to periodical review. The Group has a set of requirements applicable to each from of credit support. The value of the pledged property is determined by reference to its market value taking into account a liquidity margin.

Collateral is taken to enhance an acceptable credit proposal, rather than being used as the sole rationale for any credit approval. Where facilities are approved against security, full details, including the type, value, and the frequency of review of the security should be detailed in the Application for Credit Facility Form. Where practical, a bank officer conducts inspection the physical existence of collateral offered.

The Group reassesses the fair value of pledged property with frequency stated for each from of pledge and, if necessary, requires additional collateral or acceptable forms of credit support.

Liquidity risk and funding management

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, the Group's Management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Group maintains a portfolio of state securities that can be pledged to the NBG to obtain financing in the event of demand. The Group also has committed lines of credit that it can assess to meet liquidity needs.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratio established by the NBG. As of 31 December 2017 and 2016 the ratio was as follows:

	2017	2016
LK "Average Liquidity Ratio" (average monthly volume of liquid assets / Average monthly volume of liabilities)	40%	44%

In 2017 minimum limit of average liquidity ratio is 30% (2016: 30%).

(Thousands of Georgian lari)

23. Risk management (continued)

Liquidity risk and funding management (continued)

From 1 September 2017 NBG additionally introduced minimum requirement of liquidity Coverage Ratio (LCR) for the Georgian commercial banks. Under the requirement Banks must hold the liquid assets that can be used to meet their liquidity needs for upcoming 30-calendar days.

The Banks are obliged to keep LCR at least equal to 100%, 75% and 100% in foreign currency ("FC"), national currency ("NC") and in total, respectively.

	2017
LK "Liquidity Coverage Ratio" in FC (hold high-quality liquid assets / Total net cash outflow)	158%
LK "Liquidity Coverage Ratio" in NC (hold high-quality liquid assets / Total net cash outflow)	84%
Total LK "Liquidity Coverage Ratio" (hold high-quality liquid assets / Total net cash outflow)	113%

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2017 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

Non-derivative liabilities As of 31 December 2017	On demand and less or equal 1 month	More than 1 month and less or equal 3 months	More than 3 months and less or equal 6 months	More than 6 months and less or equal 1 year	More than 1 year	Total
Amounts due to banks and international financial institutions	27,342	856	774	42,629	45,800	117,401
Amounts due to customers	565,850	60,013	91,692	123,097	67,796	908,448
Debt securities issued	693	2,270	7,659	14,297	18,310	43,229
Other borrowed funds	50,124	5,592	9,142	2,905	227,012	294,775
Subordinated loan	772	–	755	1,535	41,098	44,160
Other liabilities	5,559	3,625	4,016	1,669	86	14,955
Total cash flow payable under non-derivative liabilities	650,340	72,356	114,038	186,132	400,102	1,422,968
Derivative financial instruments-gross settled						
Positive fair value of derivatives						
(Inflow)	(139,661)	–	–	–	–	(139,661)
Outflow	138,188	–	–	–	–	138,188
Derivative financial instruments-gross settled						
Negative fair value of derivatives						
(Inflow)	(1,981)	–	–	–	–	(1,981)
Outflow	2,022	–	–	–	–	2,022

(Thousands of Georgian lari)

23. Risk management (continued)

Liquidity risk and funding management (continued)

Non-derivative liabilities As of 31 December 2016	On demand and less or equal 1 month	More than 1 month and less or equal 3 months	More than 3 months and less or equal 6 months	More than 6 months and less or equal 1 year	More than 1 year	Total
Amounts due to banks and international financial institutions	175,786	913	7,725	983	110,038	295,445
Amounts due to customers	545,355	79,015	48,638	110,713	59,574	843,295
Debt securities issued	2,673	4,276	9,197	6,207	11,687	34,040
Other borrowed funds	41,543	17,580	13,249	12,605	61,218	146,195
Subordinated loan	757	–	740	1,505	44,397	47,399
Other liabilities	10,147	2,272	4,302	944	80	17,745
Total cash flow payable under non-derivative liabilities	776,261	104,056	83,851	132,957	286,994	1,384,119
Derivative financial instruments-gross settled						
Positive fair value of derivatives						
(Inflow)	(566)	(2,795)	–	–	–	(3,361)
Outflow	559	2,660	–	–	–	3,219
Derivative financial instruments-gross settled						
Negative fair value of derivatives						
(Inflow)	(11,825)	(5,134)	–	–	–	(16,959)
Outflow	11,917	5,293	–	–	–	17,210

The table below shows the contractual expiry by maturity of the Group's financial commitments and contingencies.

	On demand and less or equal 1 month	More than 1 month and less or equal 3 months	More than 3 months and less or equal 6 months	More than 6 months and less or equal 1 year	More than 1 year	Total
2017	26,128	15,147	22,752	26,632	31,708	122,367
2016	20,730	17,004	15,866	52,127	54,101	159,828

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

Management believes that this level of funding will remain with the Group for the foreseeable future and that in the event of withdrawal of funds, the Group would be given sufficient notice so as to realise its liquid assets to enable repayment.

The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above.

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. Except for the concentrations within foreign currency and interest rate risks, the Group has no significant concentration of market risk.

Market risk – trading

The Management Board has set limits on the level of risk that may be accepted. The Group's activity in market risks area is limited by NBG Deposit certificates, Ministry of Finance of Georgia Treasury Bills, CDs operations, also interbank loans and deposits, and exchange operations. The Group does not perform derivative trading.

(Thousands of Georgian lari)

23. Risk management (continued)

Market risk (continued)

Market risk – non-trading

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Group's consolidated income statement.

The sensitivity of the consolidated income statement includes the effect of the reasonably possible changes in interest rates on the net interest income for one year based on the assumption that there are parallel shifts in the yield curve.

Currency	Increase in basis points 2017	Sensitivity of profit before tax 2017
USD	0.14%	(53)
USD	(0.14%)	53
GEL	0.24%	(3)
GEL	(0.24%)	3

Currency	Increase in basis points 2016	Sensitivity of profit before tax 2016
USD	0.20%	(89)
USD	(0.20%)	89
GEL	1.25%	(47)
GEL	(1.25%)	47

Currency risk

The Group is exposed to currency risk. Currency risk arises from open position in foreign currencies and adverse movements of market exchange rates that may have a negative impact on financial performance of the Group. The Management Board has set limits on positions by currency based on the NBG's regulations. Positions are monitored on a daily basis.

The tables below indicate the currencies to which the Group had significant exposure at 31 December 2017 and 2016 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the national currency, with all other variables held constant on the consolidated income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on consolidated statement of comprehensive income does not differ from the effect on the consolidated income statement. A negative amount in the table reflects a potential net reduction in consolidated income statement or consolidated statement of comprehensive income, while a positive amount reflects a net potential increase.

Currency	Increase in currency rate in % 2017	Effect on profit before tax 2017	Increase in currency rate in % 2016	Effect on profit before tax 2016
USD	13.5%	3,724	14%	4,206
EUR	16%	75	17.5%	30
RUB	17%	(2,287)	30%	21

Currency	Decrease in currency rate in % 2017	Effect on profit before tax 2017	Decrease in currency rate in % 2016	Effect on profit before tax 2016
USD	9.5%	(2,620)	(7%)	(2,103)
EUR	12%	(56)	(10.5%)	(18)
RUB	17%	2,287	(15%)	(11)

(Thousands of Georgian lari)

23. Risk management (continued)

Prepayment risk

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

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

	Effect on net interest income
2017	11,546
2016	12,689

Operational risk

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

As of 31 December 2017, the Group obtained Banker's Blanket Bond and Computer Crime insurance on a total insured sum of GEL 2,592 (2016: GEL 2,647) from "IC-Group" insurance company. Total sum of insurance was reinsured by "AIG Europe" insurance company.

24. Fair value measurements

The Group's Board of directors determines the policies and procedures for recurring fair value measurement, such as investment property and buildings.

External valuers are involved for valuation of significant assets, such as investment property and buildings. Involvement of external valuers is decided upon annually by the Board of directors. Selection criteria include market knowledge, reputation, independence and whether professional standards are maintained. The Board of directors decides, after discussions with the Bank's Group's external valuers, which valuation techniques and inputs to use for each case.

At each reporting date, the Board of directors analyses the movements in the values of assets and liabilities which are required to be re-measured or re-assessed as per the Group's accounting policies. For this analysis, the board of directors in conjunction with Group's external valuers verifies the major inputs applied in the latest valuation by agreeing the information in the valuation computation to contracts and other relevant documents.

(Thousands of Georgian lari)

24. Fair value measurements (continued)

Fair value hierarchy

For the purpose of fair value disclosures, the Group's has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability. The following tables show analysis of assets and liabilities measured at fair value or for which fair values are disclosed by level of the fair value hierarchy:

As of 31 December 2017	Level 1	Level 2	Level 3	Total
Assets measured at fair value				
Investment securities available for sale	–	120,670	54	120,724
Total investment property	–	–	24,556	24,556
Land	–	–	3,349	3,349
Residential properties	–	–	11,548	11,548
Non-residential properties	–	–	9,659	9,659
Total revalued land and buildings	–	–	25,251	25,251
Land	–	–	186	186
Office buildings	–	–	17,008	17,008
Service Centres/means of production	–	–	8,057	8,057
Derivative financial assets	–	1,290	–	1,290
Assets for which fair values are disclosed				
Cash and cash equivalents	52,690	158,952	–	211,642
Amounts due from banks and international financial institutions	–	230,470	–	230,470
Loans and advances to customers	–	–	964,010	964,010
Liabilities measured at fair value				
Derivative financial liabilities	–	38	–	38
Liabilities for which fair values are disclosed				
Amounts due to banks and international financial institutions	–	112,893	–	112,893
Amounts due to customers	–	–	898,083	898,083
Debt securities issued	–	–	39,064	39,064
Other borrowed funds	–	262,196	–	262,196
Subordinated loan	–	37,362	–	37,362
Assets measured at fair value as of December 2016				
Investment securities available for sale	–	80,459	54	80,513
Total investment property	–	–	20,336	20,336
Land	–	–	3,565	3,565
Residential properties	–	–	8,478	8,478
Non-residential properties	–	–	8,293	8,293
Total revalued land and premises	–	–	25,482	25,482
Land	–	–	186	186
Office buildings	–	–	17,063	17,063
Service centers/means of production	–	–	8,233	8,233
Derivative financial assets	–	142	–	142
Assets for which fair values are disclosed				
Cash and cash equivalents	49,426	266,910	–	316,336
Amounts due from banks and international financial institutions	–	142,175	–	142,175
Loans to customers	–	–	944,233	944,233
Liabilities measured at fair value				
Derivative financial liabilities	–	251	–	251
Liabilities for which fair values are disclosed				
Amounts due to banks and international financial institutions	–	286,175	–	286,175
Amounts due to customers	–	–	833,861	833,861
Debt securities issued	–	–	32,321	32,321
Other borrowed funds	–	137,197	–	137,197
Subordinated loan	–	37,759	–	37,759

(Thousands of Georgian lari)

24. Fair value measurements (continued)

Fair value hierarchy (continued)

During the years ended 31 December 2017 and 2016, there have been no transfers between levels of fair value hierarchy.

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

Set out below is a comparison by class of the carrying amounts and fair values of the Group's financial instruments that are not carried at fair value in the consolidated statement of financial position, except for assets for which fair value approximates carrying value – those assets that are liquid or have a short term maturity (less than three months or bear floating interest rate).

	Carrying value 2017	Fair value 2017	Unrecog-nised gain/(loss) 2017	Carrying value 2016	Fair value 2016	Unrecog-nised gain/(loss) 2016
Financial assets						
Amounts due from banks and international financial institutions	230,470	230,470	–	142,175	142,175	–
Loans and advances to customers	950,476	964,010	13,534	933,764	944,233	10,469
Financial liabilities						
Amounts due to banks and international financial institutions	112,893	112,893	–	286,175	286,175	–
Amounts due to customers	895,757	898,083	(2,326)	831,274	833,861	(2,587)
Debt securities issued	38,193	39,064	(871)	31,690	32,321	(631)
Other borrowed funds	262,985	262,196	789	139,022	137,197	1,825
Subordinated loan	37,362	37,362	–	37,759	37,759	–
Total unrecognised change in unrealised fair value			11,126			9,076

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the consolidated financial statements.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or have a short term maturity (less than three months) or bear floating interest rate, it is assumed that the carrying amounts approximate to their fair value.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognised with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity.

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are already recorded at fair value in the consolidated financial statements.

Investment securities available-for-sale

Investment securities available-for-sale are valued using valuation technique. These securities are valued using models which incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

(Thousands of Georgian lari)

24. Fair value measurements (continued)

Fair value hierarchy (continued)

Derivatives

Derivatives valued using a valuation technique with market observable inputs are mainly interest rate swaps, currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves.

Property and equipment (buildings and land) and investment property

The market value of the property is determined based on the active market data. The market approach is used to determine the fair value, the income approach is used to validate the obtained value estimates, and the cost approach is used to determine the value of real property where no information on recent sales or lease rates for similar properties within the same area is available.

Description of significant unobservable inputs to valuations of non-financial assets

The following tables show descriptions of significant unobservable inputs to level 3 valuations of investment properties and revalued properties and equipment as of 31 December 2017:

	Amount	Valuation technique	Significant unobservable inputs	Range (weighted average) in	Other key information	Range (weighted average)	Sensitivity of the input to fair value
Investment property	24,556						
Land	3,349	Market approach	Price per square metre	0.21-367.5 (42.41) Georgian lari	Square metre	61-2,500 (382)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 343 Georgian lari
Residential properties	11,548	Market approach	Price per square metre	0.6-3,675 (676.89) Georgian lari	Square metre	23-5,400 (194)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,227 Georgian lari
Non-residential properties	9,659						
	9,659	Market approach	Price per square metre	6.02-210,000 (1,711.13) Georgian lari	Square metre	4-2,000 (156)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 995 Georgian lari
Revaluated land and buildings	25,251						
Land	186	Market approach	Price per square metre	0.21-367.5 (42.41) Georgian lari	Square metre	61-2,500 (382)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 19 Georgian lari
Office buildings	17,008	Market approach	Price per square metre	2,380-2,666 (2,475.2) Georgian lari	Square metre	2,000-2,500 (2,333)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,651 Georgian lari
Service centers / means of production	8,057						
	7,894	Market approach	Price per square metre	216-11,965 (2,822.92) Georgian lari	Square metre	61-1,100 (196)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 410 Georgian lari
	163		Cap. rate	13.25%	Square metre		10% increase (decrease) in the cap. rate would result in increase (decrease) in fair value by 12 Georgian lari

(Thousands of Georgian lari)

24. Fair value measurements (continued)

Fair value hierarchy (continued)

The following tables show descriptions of significant unobservable inputs to level 3 valuations of investment properties and revalued properties and equipment as of 31 December 2016:

	Amount	Valuation technique	Significant unobservable inputs	Range (weighted average) in	Other key information	Range (weighted average)	Sensitivity of the input to fair value
Investment property	20,336						
Land	3,565	Market approach	Price per square metre	0.18-260.69 (40.08) Georgian lari	Square metre	79-22,939 (3,238)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 350 Georgian lari
Residential properties	8,478	Market approach	Price per square metre	12-2,520.2 (545.14) Georgian lari	Square metre	21-746 (146)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 851 Georgian lari
Non-residential properties	8,293						
	7,683	Market approach	Price per square metre	3.4-2,520.2 (906.27) Georgian lari	Square metre	8-16,472 (332)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 720 Georgian lari
	610	Income approach	Cap. rate	14.5%			10% increase (decrease) in the cap. rate would result in increase (decrease) in fair value by 54 Georgian lari
Revaluated land and buildings	25,482						
Land	186	Market approach	Price per square metre	0.18-260.69 (40.08) Georgian lari	Square metre	79-22,939 (3,238)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 19 Georgian lari
Office buildings	17,063	Market approach	Price per square metre	2,380-2,666 (2,475.2) Georgian lari	Square metre	2,000-2,500 (2,333)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,656 Georgian lari
Service centers / means of production	8,233						
	8,066	Market approach	Price per square metre	216-11,965 (2,822.92) Georgian lari	Square metre	61-1,100 (196)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 420 Georgian lari
	167		Cap. rate	13.25%	Square metre		10% increase (decrease) in the cap. rate would result in increase (decrease) in fair value by 12 Georgian lari

(Thousands of Georgian lari)

25. Maturity analysis of financial assets and liabilities

The table below shows assets and liabilities at 31 December 2017 by their remaining expected maturity. Refer to Note 23 for the Bank's contractual undiscounted repayment obligations.

Following principles underlying gap analysis presentation and the Group liquidity risk management are based on the mix of NBG approach and the Bank's practice:

- Cash and cash equivalents represent highly liquid assets and are classified as "On demand and less or equal 1 month";
- Loans and advances to customers, investment securities available-for-sale, amounts due from banks and international financial institutions (except of restricted cash on nostro account that is presented per expected time of funds inflow in the maturity gap analysis), other assets, amounts due to banks and international financial institutions, debt securities issued, other borrowed funds, Subordinated debt and other liabilities are included into gap analysis table based on remaining contractual maturities;
- Diversification of customer deposits of the bank by number and type of depositors and the past experience of the Group indicate that such accounts and deposits provide a long-term and stable source of funding, and as a result they are allocated per expected time of funds outflow in the gap analysis table on the basis of statistical data accumulated by the Group during the previous periods and assumptions regarding the "stable part" of current account balances.

	2017							
	On demand and less or equal 1 month	More than 1 month and less or equal 3 months	More than 3 months and less or equal 6 months	More than 6 months and less or equal 1 year	More than 1 year	Overdue	No stated maturity	Total
Financial assets								
Cash and cash equivalents	211,642	–	–	–	–	–	–	211,642
Amounts due from banks and international financial institutions	23,894	11,982	20,267	152,004	22,323	–	–	230,470
Loans and advances to customers	38,062	67,819	112,797	165,443	554,625	11,730	–	950,476
Investment securities - available-for-sale	21,895	29,136	17,947	35,193	16,499	–	54	120,724
Other financial assets	4,695	2	–	149	1	–	–	4,847
Total	300,188	108,939	151,011	352,789	593,448	11,730	54	1,518,159
Financial liabilities								
Amounts due to banks and international financial institutions	27,240	393	–	41,193	44,067	–	–	112,893
Amounts due to customers	170,274	80,160	96,686	120,798	427,839	–	–	895,757
Debt securities issued	438	2,262	7,495	13,850	14,148	–	–	38,193
Other borrowed funds	47,165	2,953	1,394	3,247	208,226	–	–	262,985
Subordinated loan	576	–	–	–	36,786	–	–	37,362
Other financial liabilities	5,647	3,625	4,016	1,581	86	–	–	14,955
Total	251,340	89,393	109,591	180,669	731,152	–	–	1,362,145
Net	48,848	19,546	41,420	172,120	(137,704)	11,730	54	156,014
Cumulative gap	48,848	68,394	109,814	281,934	144,230	155,960	156,014	–

(Thousands of Georgian lari)

25. Maturity analysis of financial assets and liabilities (continued)

	2016							
	On demand and less or equal 1 month	More than 1 month and less or equal 3 months	More than 3 months and less or equal 6 months	More than 6 months and less or equal 1 year	More than 1 year	Overdue	No stated maturity	Total
Financial assets								
Cash and cash equivalents	316,336	–	–	–	–	–	–	316,336
Amounts due from banks and international financial institutions	42,446	9,769	22,268	22,545	45,147	–	–	142,175
Loans and advances to customers	43,109	103,487	95,044	153,966	532,425	5,733	–	933,764
Investment securities - available-for-sale	37,958	19,686	7,357	9,131	6,327	–	54	80,513
Other financial assets	3,859	315	–	131	96	–	–	4,401
Total	443,708	133,257	124,669	185,773	583,995	5,733	54	1,477,189
Financial liabilities								
Amounts due to banks and international financial institutions	174,844	10	6,772	–	104,549	–	–	286,175
Amounts due to customers	209,003	82,680	48,408	107,035	384,148	–	–	831,274
Debt securities issued	2,666	4,239	9,023	5,966	9,796	–	–	31,690
Other borrowed funds	41,491	17,115	12,561	11,424	56,431	–	–	139,022
Subordinated loan	563	–	–	–	37,196	–	–	37,759
Other financial liabilities	10,147	2,272	4,302	944	80	–	–	17,745
Total	438,714	106,316	81,066	125,369	592,200	–	–	1,343,665
Net	4,994	26,941	43,603	60,404	(8,205)	5,733	54	133,524
Cumulative gap	4,994	31,935	75,538	135,942	127,737	133,470	133,524	–

As of 31 December 2017, total amount of funding obtained from the Parent bank amounted to GEL 326,733 (2016: GEL 378,022). Management believes that this level of funding will remain with the Group for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment. Refer to Note 26.

Long-term loans are generally not available in Georgia. However, in the Georgian marketplace, many short-term credits are granted with the expectation of renewing the loans at maturity. As such, the ultimate maturity of assets may be different from the analysis presented above.

(Thousands of Georgian lari)

26. Related party disclosures

As of 31 December 2017 and 2016, outstanding balances on related party transactions are as follows:

	2017			2016		
	The Parent bank	Entities under common control	Key management personnel	The Parent bank	Entities under common control	Key management personnel
Cash and cash equivalents	18,800	234	–	33,668	167,722	–
Amounts due from banks and international financial institutions		114,006				
Loans and advances to customers, gross	–	–	476	–	–	149
Less: allowance for impairment	–	–	–	–	–	–
Loans and advances to customers, net	–	–	476	–	–	149
Other assets	1,271	–	–	135	–	–
Amounts due to banks and international financial institutions	85,834	139	–	260,923	4	–
Amounts due to customers	–	10,053	8,250	–	19,488	4,253
Debt securities issued	–	–	(147)	–	–	2,903
Other borrowed funds	203,537	–	–	79,340	–	–
Subordinated loan	37,362	–	–	37,759	–	–
Other liabilities	42	–	3,897	269	–	4,191
Commitments and guarantees issued	–	28	58	–	28	88

Entities under common control are companies that directly or indirectly through one or more intermediaries control or are controlled by or are under common control with the Bank (this includes holding companies subsidiaries and fellow subsidiaries). In these consolidated financial statements included into entities under common control are the members of VTB Group and other legal entities controlled by the Russian Federation.

On 25 October 2005, the Group entered into a subordinated loan agreement with the Parent bank for the total amount of USD 12,000 thousand, with interest rate of Libor+6% payable quarterly and maturity on 26 October 2019. On 13 October 2014, the Group entered into a subordinated loan agreement with the Parent bank for the total amount of RUB 126,400, with interest rate of 11% payable quarterly and maturity on 13 October 2021. In the case of a liquidation of the Group, these loans are only repayable after all the obligations to the Group senior creditors have been met.

As of 31 December 2017 other liabilities to key management personnel comprised of accrued bonuses totalling GEL 3,755 (2016: GEL 4,058) and unpaid vacation of GEL 142 (2016: GEL 133).

The income and expense arising from related party transactions are presented in the table below:

	2017			2016		
	The Parent bank	Entities under common control	Key management personnel	The Parent bank	Entities under common control	Key management personnel
Interest income	13	2,157	1,449	7	1,041	25
Interest expense	(13,127)	(544)	(288)	(8,961)	(956)	(258)
Fee and commission income	–	34	5	–	39	3
Fee and commission expense	(186)	(67)	–	(137)	(20)	–
Net gains from foreign currencies dealing	7,220	610	11	355	439	13
Other operating expenses	(11)	(42)	–	–	(33)	–

(Thousands of Georgian lari)

26. Related party disclosures (continued)

For the year ended 31 December 2017, remuneration of the members of the key management personnel comprised salaries, bonuses and other staff related expenses totalling GEL 7,173 (2016: GEL 7,571).

Key management personnel as of 31 December 2017 comprise 5 members of the Supervisory Board and 6 members of the Management Board of the Bank (2016: 5 members of the Supervisory Board and 6 members of the Management Board).

The Group had no significant transactions with members of the Supervisory Board in 2017 and 2016.

27. Changes in liabilities arising from financing activities

	Other borrowed funds	Subordinated loans	Total liabilities from financing activities
Carrying amount at 31 December 2015	114,735	33,329	148,064
Proceeds from issue	280,457		280,457
Redemption	(271,087)		(271,087)
Foreign currency translation	15,126	4,321	19,447
Non-cash transactions	(82)		(82)
Other	(127)	109	(18)
Carrying amount at 31 December 2016	139,022	37,759	176,780
Proceeds from issue	1,615,546		1,615,546
Redemption	(1,501,531)		(1,501,531)
Foreign currency translation	9,159	(410)	8,750
Non-cash transactions	10		10
Other	779	13	792
Carrying amount at 31 December 2017	262,985	37,362	300,347

The “Other” line includes the effect of accrued but not paid interest on perpetual subordinated loans, other borrowed funds and subordinated loans.

28. Capital adequacy

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

The primary objectives of the Bank’s capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders’ value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may return capital to shareholders or issue capital securities.

Capital adequacy ratio

Regulatory capital consists of Tier 1 capital, which comprises common shares, reserve fund and retained earnings excluding current year profit or loss less amount of property revaluation reserve transferred to authorised capital, and intangible assets. The other component of regulatory capital is Tier 2 capital, which includes profit or loss of current year, general reserves (not more than 1.25% of risk weighted assets) and subordinated long-term debt.

Until 31 December 2017 the NBG required banks to maintain a minimum regulatory capital adequacy ratio of 9.6% (2016: 10.8%) of risk-weighted assets, computed based on the NBG guidelines. As of 31 December 2017 the Bank’s statutory regulatory capital adequacy ratio as calculated in accordance with the NBG requirements was 13.33% (2016: 11.69%). The NBG also required banks to maintain a minimum tier one capital adequacy ratio of 6.4% (2016: 7.2%) of risk-weighted assets, computed based on the NBG guidelines. As of 31 December 2017 the Bank’s statutory tier one capital adequacy ratio as calculated in accordance with the NBG requirements was 9.15% (2016: 7.64%).

(Thousands of Georgian lari)

28. Capital adequacy (continued)

Capital adequacy ratio (continued)

Starting from 30 June 2014 the NBG requires that all banks comply with Basel II regulations in their capital adequacy assessment. In December 2017, the NBG adopted amendments to the regulations introduced amendment relating to capital adequacy requirements, including amendments to the regulation on capital adequacy requirements for commercial banks, and introduced new requirements on the determination of the countercyclical buffer rate, on the identification of systematically important banks, on determining systemic buffer requirements and on additional capital buffer requirements for commercial banks within Pillar II.

As at 31 December 2017 the NBG requires banks to maintain a minimum regulatory capital adequacy ratio, the core Tier 1 capital coefficient and Tier 1 coefficient of 12.47%, 8.10% and 9.98%, respectively (December 2016: Minimum regulatory capital adequacy ratio, the core Tier 1 capital coefficient and Tier 1 coefficient of 10.5%, 7.00% and 8.50 % respectively.)

The Bank was in compliance with these capital adequacy ratios as of 31 December 2017 and 2016. The Bank's capital adequacy ratios on this basis were as follows:

	2017	2016
Common Equity Tier 1 capital	160,969	137,666
Additional Tier 1 capital	13,481	12,900
Tier 1 capital	174,450	150,566
Tier 2 capital	23,698	34,822
Total regulatory capital for ratio calculation	198,148	185,388
Risk weighted assets	1,315,638	1,703,103
Common Equity Tier 1 capital adequacy ratio	12.24%	8.08%
Tier 1 capital adequacy ratio	13.26%	8.84%
Total capital adequacy ratio	15.06%	10.89%