

JSC PASHA Bank Georgia

Financial statements

*Year ended 31 December 2017
together with independent auditor's report*

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Independent auditor's report

To the Shareholders and Board of Directors of JSC Pasha Bank Georgia

Opinion

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

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants (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 the audit committee for the financial statements

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

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

The audit committee is responsible for overseeing the Bank's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered

material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

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

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



Ruslan Khoroshvili
On behalf of EY Georgia LLC

28 February 2018

STATEMENT OF FINANCIAL POSITION**As at 31 December 2017***(Amounts in tables are in thousands of Georgian lari)*

	Notes	2017	2016
Assets			
Cash and cash equivalents	5	43,908	7,599
Amounts due from credit institutions	6	51,445	83,261
Loans to customers	7	111,679	95,090
Investment securities	8	62,033	91,880
Property and equipment	9	906	1,108
Intangible assets	10	2,122	2,060
Deferred income tax assets	14	—	924
Other assets	11	711	563
Total assets		272,804	282,485
Liabilities			
Amounts due to credit institutions	12	106,402	131,681
Amounts due to customers	13	58,181	46,024
Provisions for guarantees and letters of credit		135	85
Other liabilities	11	1,279	1,411
Total liabilities		165,997	179,201
Equity			
Share capital	15	103,000	103,000
Retained earnings		3,807	354
Other reserves		—	(70)
Total equity		106,807	103,284
Total equity and liabilities		272,804	282,485

Signed on behalf of the Board of Directors of the Bank on 28 February 2018:

Arda Yusuf Arkun



Chairman of the Board of Directors

Chingiz Abdullayev

Chief Financial Officer,
Member of the Board of Directors*The accompanying selected explanatory notes on pages 7 to 42 are an integral part of these financial statements.*

STATEMENT OF COMPREHENSIVE INCOME**For the year ended 31 December 2017***(Amounts in tables are in thousands of Georgian lari)*

	Notes	2017	2016
Interest income			
Loans to customers		11,765	12,785
Investment securities		5,292	8,382
Amounts due from credit institutions		2,385	2,153
		19,442	23,320
Interest expense			
Amounts due to credit institutions		(3,099)	(5,949)
Amounts due to customers		(869)	(784)
		(3,968)	(6,733)
Net interest income		15,474	16,587
Provision for impairment losses on interest bearing assets	7,8	(1,023)	(1,010)
Net interest income after impairment losses		14,451	15,577
Net gains/(losses) from foreign currencies			
- dealing		1,190	1,146
- translation differences		402	(199)
Net fee and commission income	17	255	244
Other operating income		230	387
Non-interest income		2,077	1,578
Personnel expenses	18	(5,420)	(5,183)
General and administrative expenses	18	(5,302)	(4,309)
Depreciation and amortisation	9,10	(1,351)	(2,098)
Provision for impairment losses on guarantees and letters of credit	16	(50)	(85)
Other operating expenses		(28)	—
Non-interest expenses		(12,151)	(11,675)
Profit before income tax		4,377	5,480
Income tax expense	14	(924)	(599)
Net profit for the period		3,453	4,881
Other comprehensive income			
<i>Other comprehensive income to be reclassified to profit or loss in subsequent periods</i>			
Net unrealized gain on investments securities available for sale		70	221
Income tax effect on net gain on investments available for sale	14	—	1
Total comprehensive profit for the year		3,523	5,103

The accompanying selected explanatory notes on pages 7 to 42 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY**For the year ended 31 December 2017***(Amounts in tables are in thousands of Georgian lari)*

	<i>Share capital</i>	<i>Retained earnings/ (accumulated deficit)</i>	<i>Other reserves</i>	<i>Total equity</i>
1 January 2016	103,000	(4,527)	(292)	98,181
Profit for the year	–	4,881	–	4,881
Other comprehensive income for the year	–	–	222	222
Total comprehensive income for the year	–	4,881	222	5,103
31 December 2016	103,000	354	(70)	103,284
Profit for the year	–	3,453	–	3,453
Other comprehensive income for the year	–	–	70	70
Total comprehensive income for the year	–	3,453	70	3,523
31 December 2017	103,000	3,807	–	106,807

The accompanying selected explanatory notes on pages 7 to 42 are an integral part of these financial statements.

STATEMENT OF CASH FLOWS**For the year ended 31 December 2017***(Amounts in tables are in thousands of Georgian lari)*

	Notes	2017	2016
Cash flows from operating activities			
Interest received		19,832	21,074
Interest paid		(3,919)	(6,522)
Fees and commissions received		214	591
Fees and commissions paid		(411)	(342)
Realised gains less losses from dealing in foreign currencies		1,190	1,146
Personnel expenses paid		(5,459)	(4,813)
General and administrative expenses paid		(5,557)	(4,205)
Other income received		230	387
Cash flows from operating activities before changes in operating assets and liabilities		6,120	7,316
<i>Net (increase)/decrease in operating assets</i>			
Amounts due from credit institutions		30,971	(49,840)
Loans to customers		(16,021)	16,233
<i>Net increase/(decrease) in operating liabilities</i>			
Amounts due to credit institutions		(24,414)	(46,506)
Amounts due to customers		12,539	22,243
Net cash from/(used in) operating activities		9,195	(50,554)
Cash flows from investing activities			
Purchase of investment securities		(47,941)	(40,151)
Proceeds from redemption of investment securities		77,027	74,994
Purchase of property and equipment		(803)	(118)
Proceeds from sale of property and equipment		61	–
Purchase of intangible assets		(339)	(308)
Net cash from investing activities		28,005	34,417
Effect of exchange rates changes on cash and cash equivalents		(891)	1,454
Net increase/(decrease) in cash and cash equivalents		36,309	(14,683)
Cash and cash equivalents, beginning	5	7,599	22,282
Cash and cash equivalents, ending	5	43,908	7,599

The accompanying selected explanatory notes on pages 7 to 42 are an integral part of these financial statements.

(Amounts in tables are in thousands of Georgian lari)

1. Principal activities

JSC PASHA Bank Georgia (the "Bank") was formed on 17 December 2012 as a joint stock company under the laws of Georgia. The Bank operates under a general banking license issued by the National Bank of Georgia (the "NBG") on 17 January 2013.

The Bank accepts deposits and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its commercial customers. The shareholders of the Bank have approved a new strategy of the Bank for the next three year strategic period, based on which, several initiatives will be implemented by the Bank's management during 2018 and in the subsequent years to enter into MSME and retail markets.

The Bank has one service office in Georgia as of 31 December 2017. The Bank's registered legal address is 15 Rustaveli Avenue, Tbilisi, 0108, Georgia.

As at 31 December 2017 and 2016, the Bank's 100% owner was OJSC PASHA Bank (the "Parent"), the Republic of Azerbaijan. The Bank is ultimately owned by Mrs. Leyla Aliyeva and Mrs. Arzu Aliyeva, who exercise joint control over the Bank.

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

2. Basis of preparation

General

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

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below.

These financial statements are presented in Georgian lari ("GEL"), unless otherwise indicated.

3. Summary of accounting policies

Changes in accounting policies

The Bank applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2017. The Bank 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). Due to the fact that the Bank does not have financing cash flows in 2017 or in 2016, the disclosure was not applicable in these financial statements.

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

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

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

may include the recovery of some assets for more than their carrying amount. Application of the amendments has no effect on the Bank's financial position and performance as the Bank's current accounting policy is consistent with the amendments.

Fair value measurement

Fair values of financial instruments measured at amortised cost are disclosed in Note 20.

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

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

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

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

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

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

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

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. The Bank 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 Bank commits to purchase 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 profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process. Loans and receivables include investment securities and loans to customers.

Measurement of loans and receivables originated through acquisition

In the case of loans and receivables originated through acquisition the fair value at initial recognition is measured using discounting of future cash flows expected from the financial asset. The difference between the acquisition price and the fair value is recognized in the statement of comprehensive income as gain/(loss) on initial recognition. This policy is applied equally to transactions with third parties, related parties, entities under common control and shareholders.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- ▶ A financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity;
- ▶ Other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Reclassification of financial assets (continued)

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

Measurement of financial instruments at initial recognition

When financial instruments are recognised 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.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Bank 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 Bank 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 Bank recognises that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. The right of set-off must not be contingent on a future event and must be legally enforceable in all of the following circumstances:

- ▶ The normal course of business;
- ▶ The event of default; and
- ▶ The event of insolvency or bankruptcy of the entity and all of the counterparties.

These conditions are not generally met in master netting agreements, and the related assets and liabilities are presented gross in the statement of financial position.

Impairment of financial assets

The Bank 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

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

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.

Amounts due from credit institutions, investment securities: loans and receivables and loans to customers

For amounts due from credit institutions, investment securities: loans and receivables and loans to customers carried at amortised cost, the Bank 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 Bank 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 profit or loss. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. 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. If a future write-off is later recovered, the recovery is credited to the statement of profit or loss.

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. Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of industrial average of historical loss experience for assets with credit risk characteristics similar to those in the group, due to the reason that the Bank does not have sufficient statistical data.

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

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

- ▶ The rights to receive cash flows from the asset have expired;
- ▶ The Bank 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 Bank 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 Bank 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 Bank'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 Bank 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 Bank's continuing involvement is the amount of the transferred asset that the Bank 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 Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

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

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

Cash and cash equivalents

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

Mandatory reserve deposit with the NBG

Mandatory reserve deposits with the NBG are carried at amortised cost and represent interest bearing mandatory reserve deposits which are not available to finance the Bank's day to day operations and hence are not considered as part of cash and cash equivalents for the purposes of the statement of cash flows. Mandatory reserve is included in amounts due from credit institutions.

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Leases

Operating – Bank 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.

Financial guarantees

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

Any increase in the liability relating to financial guarantees is taken to the statement of profit or loss. The premium received is recognised in profit or loss 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 undistributed profits) and tax laws, that have been enacted or substantively enacted by the end of the reporting period.

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

Property and equipment

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

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

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Property and equipment (continued)

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:

	<u>Years</u>
Furniture and fixtures	4
Computers and equipment	4
Motor vehicles	4
Other equipment	5
Leasehold improvements	4

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.

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. 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 10 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 indefinite useful lives are reviewed at least at each financial year-end.

Contingencies

Contingent liabilities are not recognised in the 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 statement of financial position but disclosed when an inflow of economic benefits is probable.

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.

Recognition of income and expenses

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

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading or 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 Bank 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

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

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

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

- ▶ *Fee income from providing transaction services*

Fees arising from negotiating or participating in the negotiation of a transaction for a third party – such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

Foreign currency translation

The financial statements are presented in Georgian lari ("GEL"), which is the Bank'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 statement of profit or loss as gains less losses from foreign currencies – translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Foreign currency translation (continued)

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 GEL exchange rates at 31 December 2017 and 2016 were 2.5922 GEL and 2.6468 GEL to 1 USD, respectively, 3.1044 GEL and 2.7940 GEL to 1 EUR, respectively and 1.5249 GEL and 1.4678 GEL to 1 AZN, respectively.

Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements which may have impact on the Bank's financial statements are disclosed below. The Bank intends to adopt this standard, when it becomes effective. Management does not expect application of other new standards and interpretations to have significant impact on financial statements.

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.

The Bank 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 Bank 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

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

IFRS 9 Financial Instruments (continued)

(a) Classification and measurement (continued)

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 Bank 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 Bank does not expect any non-derivative financial assets to be measured at FVPL.

(b) Impairment

IFRS 9 requires the Bank 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 (POCI), the allowance is based on the change in the lifetime ECL.

The Bank has established a methodology for assigning rating to customer in following segments of portfolio: Corporate customers, SME customers, Financial Institutions and Retail/Individual customers. Assigned rating is returning PD on "customer by customer" base.

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition. The Bank groups its loans into Stage 1, Stage 2, Stage 3 and POCI. The Bank calculates ECLs based on a three probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. In its ECL models, the Bank relies on a broad range of forward looking information as economic inputs, integrated in estimates of credit risk components (PD, LGD and EAD). Impairment losses and releases are accounted for and disclosed separately from modification losses or gains that are accounted for as an adjustment of the financial asset's gross carrying value.

The Bank considers that there has been a significant increase in credit risk when the credit rating has deteriorated significantly since initial recognition. Level of significant deterioration differs from segment to segment and varies from 2 to 3 notches or defined score threshold. The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming forborne. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations when the borrower becomes 90 days past due on its contractual payments depending on segment. The Bank considers treasury and interbank balances defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements. As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay.

The Bank calculates ECLs on an individual basis for POCI assets, significant assets with factors of credit impairment and certain assets with factors of significant increase of credit risk. The Bank calculates ECL on a collective basis for all other classes of assets which it groups into homogeneous borrowers.

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

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 Bank 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 Bank's income will not be impacted by the adoption of this standard.

The Bank currently does not expect a material effect from initial application of IFRS 15.

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 recognise 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 recognise 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 Bank will continue to assess the potential effect of IFRS 16 on its financial statements.

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

Annual Improvements 2014-2016 Cycle (issued in December 2016) include:

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 Bank's current practice is in line with the Interpretation, the Bank does not expect any effect on its financial statements.

4. Significant accounting judgments and estimates

Estimation uncertainty

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognized in the financial statements. The most significant use of judgments and estimates are as follows:

Allowance for loan impairment

In 2017 the Bank continued to use the methodology on financial asset impairment adopted in 2016. This methodology was applied to calculate allowances for loans to customer and investment securities as at 31 December 2017 and 2016. The methodology is based on loan default probability assessments. The amount of allowance for loans to customers and investment securities recognized in statement of financial position at 31 December 2017 was GEL 3,098 thousand (2016: GEL thousand 2,120) and GEL 246 thousand (2016: GEL 201 thousand) respectively.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the 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 20.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2017	2016
Cash on hand	673	656
Current accounts with the NBG	714	665
Current accounts with other credit institutions	13,253	3,778
Time deposits with credit institutions up to 90 days	29,268	2,500
Cash and cash equivalents	43,908	7,599

(Amounts in tables are in thousands of Georgian lari)

5. Cash and cash equivalents (continued)

As at 31 December 2017, current accounts and time deposit accounts with credit institutions denominated in GEL and USD represent 40.68% and 54.12% of total current and time deposit accounts respectively (31 December 2016: GEL 46.03%, USD 14.31%).

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2017	2016
Mandatory reserve with the NBG	28,803	52,576
Time deposits for more than 90 days	22,642	30,685
Amounts due from credit institutions	51,445	83,261

In 2017 and 2016 the credit institutions are required to maintain a mandatory interest earning cash deposit with the NBG at the level of 7% and 20% of the average of funds attracted from customers and non-resident financial institutions by a credit institution for the appropriate two-week period in GEL and foreign currencies, respectively.

Time deposits comprise of deposits in USD and GEL placed with resident commercial banks with maturities ranging from January 2018 to June 2018 (31 December 2016: deposits in USD and GEL placed with resident and non-resident commercial banks with maturities ranging from February 2017 to December 2017).

7. Loans to customers

Loans to customers comprise:

	2017	2016
Private entities	77,831	66,767
Foreign state controlled entities	36,302	30,129
Individuals	644	314
Loans to customers	114,777	97,210
Less – allowance for impairment	(3,098)	(2,120)
Loans to customers	111,679	95,090

The movement in allowance for impairment losses for loans to customers was as follows:

	2017		
	Legal entities	Individuals	Total
At 1 January 2017	2,049	71	2,120
Charge for the year	968	10	978
At 31 December 2017	3,017	81	3,098
Collective impairment	1,301	5	1,306
Individual impairment	1,716	76	1,792
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	9,500	76	9,576

(Amounts in tables are in thousands of Georgian lari)

7. Loans to customers (continued)

	2016		
	Legal entities	Individuals	Total
At 1 January 2016	1,253	58	1,311
Charge for the year	796	13	809
At 31 December 2016	2,049	71	2,120
Collective impairment	1,204	5	1,209
Individual impairment	845	66	911
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	8,788	66	8,854

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters. The main types of collateral obtained are charges over real estate properties and guarantees from the Parent.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

Concentration of loans to customers

As at 31 December 2017, the Bank had a concentration of loans due from three major group of borrowers in the total exposure of GEL 61,621 thousand that represented 53.69% of the total gross loan portfolio (31 December 2016: loans from three major groups of GEL 53,847 thousand with 55.39% of the gross loan portfolio). An allowance of GEL 1,957 thousand (31 December 2016: GEL 1,121 thousand) was recognised against these loans. Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2017, comprised GEL 1,716 thousand, (2016: GEL 845 thousand).

Loans are made in the following industry sectors:

	2017	2016
Energy	54,902	30,129
Non-banking credit organizations	21,921	20,664
Trade and services	16,110	18,752
Construction	12,593	8,778
Mining	4,611	3,644
Utility	3,996	14,929
Individuals	644	314
	114,777	97,210

(Amounts in tables are in thousands of Georgian lari)

8. Investment securities

As at 31 December 2017, investment securities comprised of debt securities of the Ministry of Finance of Georgia and debt securities of companies and commercial banks registered in Georgia.

Investment securities comprise:

	2017	2016
Investment securities:		
Certificates of deposit of financial institutions	26,849	26,543
Bonds of financial institutions	22,079	21,541
Corporate bonds	12,177	12,969
Treasury bonds of the Ministry of Finance of Georgia	1,174	31,028
Investment securities:	62,279	92,081
Less: allowance for impairment (a)	(246)	(201)
Total investment securities:	62,033	91,880

(a) The allowance for impairment relates to the collectively impaired exposures of corporate bonds. The charge for 2017 is GEL 45 thousand (2016: GEL 201 thousand).

9. Property and equipment

The movements in property and equipment were as follows:

	<i>Furniture and fixtures</i>	<i>Computers and equipment</i>	<i>Motor vehicles</i>	<i>Other equipment</i>	<i>Leasehold improve- ments</i>	<i>Total</i>
Cost						
1 January 2016	1,840	2,390	247	459	1,912	6,848
Additions	3	37	66	27	–	133
Disposals	–	(15)	–	–	–	(15)
31 December 2016	1,843	2,412	313	486	1,912	6,966
Additions	9	607	135	11	4	766
Disposals and write-offs	–	(6)	(68)	–	–	(74)
31 December 2017	1,852	3,013	380	497	1,916	7,658
Accumulated depreciation						
1 January 2016	(1,173)	(1,447)	(108)	(232)	(1,199)	(4,159)
Depreciation charge	(461)	(616)	(77)	(95)	(461)	(1,710)
Disposals and write-offs	–	11	–	–	–	11
31 December 2016	(1,634)	(2,052)	(185)	(327)	(1,660)	(5,858)
Depreciation charge	(193)	(348)	(72)	(98)	(252)	(963)
Disposals and write-offs	–	1	68	–	–	69
31 December 2017	(1,827)	(2,399)	(189)	(425)	(1,912)	(6,752)
Net book value						
1 January 2016	667	943	139	227	713	2,689
31 December 2016	209	360	128	159	252	1,108
31 December 2017	25	614	191	72	4	906

(Amounts in tables are in thousands of Georgian lari)

10. Intangible assets

The movements in intangible assets were as follows:

	<i>Licenses</i>	<i>Computer software</i>	<i>Total</i>
Cost			
1 January 2016	488	1,829	2,317
Additions	425	90	515
Disposals and write offs	(16)	(90)	(106)
31 December 2016	897	1,829	2,726
Additions	284	166	450
Write offs	(192)	(2)	(194)
31 December 2017	989	1,993	2,982
Accumulated amortization			
1 January 2016	(108)	(185)	(293)
Amortisation charge	(214)	(174)	(388)
Disposals and write offs	14	1	15
31 December 2016	(308)	(358)	(666)
Amortisation charge	(204)	(184)	(388)
Write offs	192	2	194
31 December 2017	(320)	(540)	(860)
Net book value			
1 January 2016	380	1,644	2,024
31 December 2016	589	1,471	2,060
31 December 2017	669	1,453	2,122

11. Other assets and liabilities

Other assets comprise:

	<i>2017</i>	<i>2016</i>
Other non-financial assets		
Prepaid expenses	399	365
Prepayments for operating lease	218	170
Prepaid taxes other than income tax	10	16
Prepayments for acquisition of intangible assets	4	4
Other	18	8
	649	563
Other financial assets		
Derivative financial assets	62	—
	62	—
Total other assets	711	563

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

(Amounts in tables are in thousands of Georgian lari)

11. Other assets and liabilities (continued)

	2017	
	Notional amount	Fair Value asset
Foreign exchange contracts		
Forward – domestic	2,592	62
Total derivative assets	2,592	62
Other liabilities comprise:		
	2017	2016
Other financial liabilities		
Other financial liabilities	131	223
	131	223
Other non-financial liabilities		
Payable to employees	1,111	1,150
Deferred income	36	38
Taxes other than income tax	1	–
	1,148	1,188
Total other liabilities	1,279	1,411

12. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2017	2016
Time deposits of the Parent	52,069	37,617
Time deposits of non-resident commercial banks	27,122	39,956
Time deposits of resident commercial banks	22,688	14,478
Short-term loan from the NBG	3,002	28,030
Current accounts of the Parent	1,511	8,597
Overdraft from the Parent	10	3,003
Amounts due to credit institutions	106,402	131,681

As at 31 December 2017 the time deposits of non-resident commercial banks are comprised of USD and EUR denominated deposits of an entity under common control and other non-resident bank (2016: USD denominated deposits of an entity under common control). As at 31 December 2017 time deposits placed by three resident commercial banks were denominated in GEL and EUR and matured in January and February 2018 (2016: time deposits placed by four resident commercial banks denominated in GEL and USD, matured in January 2017).

13. Amounts due to customers

The amounts due to customers include the following:

	2017	2016
Time deposits	38,948	33,492
Current accounts	19,233	12,532
Amounts due to customers	58,181	46,024
Held as security against guarantees issued (Note 16)	4,342	757

(Amounts in tables are in thousands of Georgian lari)

13. Amounts due to customers (continued)

As at 31 December 2017, amounts due to customers included balances with three major customers of GEL 28,726 thousand that constituted 49.37% of the total of customer accounts (31 December 2016: 27,561 thousand that constituted 59.88% of the total of customer accounts).

An analysis of customer accounts by economic sector follows:

	2017	2016
Trade and services	27,724	24,279
Individuals	11,016	13,356
Insurance	6,360	4,491
Energy	5,204	256
Construction	4,816	2,052
Non-banking credit organizations	3,050	37
Transportation and telecommunication	11	1,239
Pharmacy	–	314
Amounts due to customers	58,181	46,024

14. 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, 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 2016 the Bank 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 Bank used 0% tax rate applicable for undistributed profits in respect of assets and liabilities expected to be realized or settled in the periods when the new regulation becomes effective 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 Bank's financial statements for the year ended 31 December 2017.

The corporate income tax expense for the year ended 31 December 2017 comprises of deferred tax expense of GEL 924 thousand (31 December 2016: GEL 599 thousand).

In 2017 and 2016 the income tax rate applicable to the Bank'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:

(Amounts in tables are in thousands of Georgian lari)

14. Taxation (continued)

	2017	2016
Profit before income tax	4,377	5,480
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	(657)	(822)
Tax exempt income	131	243
Non-deductible expenses	(3)	(20)
Effect from change in tax legislation	61	–
Tax losses utilized during the year	(456)	–
Income tax expense	(924)	(599)

Deferred tax assets and liabilities as at 31 December 2017 and 31 December 2016 and their movements for the respective period:

	2015	Through statement of profit and loss	Through statement of OCI	2016	Through statement of profit and loss	2017
Tax effect of deductible temporary differences						
Tax losses carried forward	1,818	(1,014)	–	804	(804)	–
Other liabilities	68	67	–	135	(135)	–
Deferred tax asset	1,886	(947)	–	939	(939)	–
Tax effect of taxable temporary differences						
Property and equipment	73	153	–	226	(226)	–
Intangible assets	(49)	(3)	–	(52)	52	–
Loans to customers	(394)	217	–	(177)	177	–
Investment securities	6	(19)	1	(12)	12	–
Deferred tax liability	(364)	348	1	(15)	15	–
Deferred tax asset/ (liability)	1,522	(599)	1	924	(924)	–

The Bank's accumulated tax losses at 31 December 2017 equal GEL 7,140 thousand which expire by 1 January 2019. The management evaluated the probability of recovery of deferred tax assets on past tax losses and also probability of reversal of temporary taxable and deductible differences in year 2018 and concluded that the deferred tax asset should be fully derecognized as at 31 December 2017.

15. Equity

The share capital of the Bank was contributed by the Parent in GEL and they entitle to dividends and any capital distribution in GEL.

As at 31 December 2017 and 2016, the Bank's authorized, issued and fully paid capital amounted to GEL 103,000 thousand comprising of 103,000,000 common shares with nominal value of GEL 1.00 each. Each share entitles one vote to the shareholder.

In accordance with Georgian legislation, dividends may only be declared by the Bank's Parent from the net income as shown in the Bank's financial statements prepared in compliance with the NBG requirements. The Bank is obliged to officially inform the NBG of any dividends declared and the NBG reserves the right to suspend or restrict the disbursement of dividends should the Bank be in breach of the NBG regulations.

(Amounts in tables are in thousands of Georgian lari)

15. Equity (continued)

No dividends were declared or paid during the year ended 31 December 2017 (2016: nil).

Nature and purpose of other reserves

On 1 July 2015 the Bank reclassified all of the Bank's investment securities from available-for-sale category into category of loans and receivables. The revaluation gain/(loss) on the available-for-sale securities has been fully transferred to profit and loss by 31 December 2017 as all of the financial instruments reclassified have matured by this date.

16. Commitments and contingencies

Taxation

Georgian tax legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant tax authorities. It is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Management believes that its interpretation of the relevant legislation as at 31 December 2017 is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Commitments and contingencies

As at 31 December 2017 and 2016, the Bank's commitments and contingencies comprised the following:

	2017	2016
Credit related commitments		
Unused credit lines	23,341	5,230
Guarantees issued	22,566	13,026
Letters of credit	1,478	318
	47,385	18,574
Operating lease commitments		
Not later than 1 year	1,831	1,723
More than 1 year but less than 5 years	6,553	8,016
Contingency over 5 years	—	868
	8,384	10,607
Less: provisions for guarantees and letters of credit	(135)	(85)
Commitments and contingencies (before deducting collateral)	55,634	29,096
Less: deposits held as security against guarantees issued (Note 13)	(4,342)	(757)
Commitments and contingencies	51,292	28,339

(Amounts in tables are in thousands of Georgian lari)

17. Net fee and commission income

Net fee and commission income comprises:

	2017	2016
Guarantees and letters of credits issued	397	285
Settlement operations	127	126
Brokerage operations	48	152
Cash operations	17	21
Plastic cards	5	–
Currency conversion operations	4	2
Other commission income	71	–
Fee and commission income	669	586
Settlement operations	(189)	(161)
Plastic cards	(108)	(82)
Guarantees and letters of credits issued	(111)	(82)
Cash operations	(5)	(16)
Brokerage operations	(1)	(1)
Fee and commission expense	(414)	(342)
Net fee and commission income	255	244

18. Personnel, general and administrative expenses

Personnel, general and administrative expenses comprise:

	2017	2016
Salaries	3,870	3,658
Bonuses and other employee benefits	1,550	1,525
Personnel expenses	5,420	5,183
Operating leases	1,679	1,479
Professional services	2,065	1,214
Advertising costs	469	587
Personnel training	191	253
Corporate hospitality and entertainment	169	146
Transportation and business trip expenses	123	84
Utilities	119	112
Deposit insurance fee	100	–
Insurance	71	77
Security expenses	58	58
Maintenance and exploitation	49	37
Membership fees	38	35
Charity costs	29	11
Taxes other than income tax	10	19
Communication	5	3
Other	127	194
General and administrative expenses	5,302	4,309

(Amounts in tables are in thousands of Georgian lari)

19. Risk management

Introduction

The process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. Regardless of the sophistication of the measures, the Bank distinguishes between expected and unexpected losses. Expected losses are typically reserved for as described in credit risk policy. For unexpected losses the Bank relies on its capital as a buffer to absorb such losses. The Bank is exposed to financial risk, being subdivided into credit and liquidity risk, operational risk and market risk, being subdivided into trading and non-trading risks.

Risk management structure

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles. The Board of Directors is ultimately responsible for identifying and controlling risks and different departments and committees which are responsible for managing and monitoring risks.

Risk management

The Risk Management Department is responsible for determining, implementing and maintaining risk management framework.

Asset and Liability Committee

Asset and Liability Committee (ALCO) is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding, liquidity, interest rate, and capital adequacy risks of the Bank.

Internal Audit

Risk management processes throughout the Bank are audited by the internal audit function on a constant basis, which examines the adequacy of the procedures, their design and operational effectiveness, and the Bank's compliance both with the regulatory requirements and internal procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Audit Committee

Audit committee functions are undertaken by the relevant audit committee members of the Parent. The Audit Committee is responsible for the fundamental risk issues and manages and monitors relevant risk decisions and performance of control functions by other departments in the Bank pertaining to general control environment, manual, IT dependent or application controls, intentional or unintentional misstatement risks, risk of fraud or misappropriation of assets, information security, anti-money laundering, etc.

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Risk management structure (continued)

Risk measurement and reporting systems

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept. The main body to which the risks are reported is ALCO. The respective meetings are held once a month.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls 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.

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

Actual exposure per borrower against limits is monitored on loans granted. The Credit Committee may initiate a change in the limits. Where appropriate, the Bank obtains collateral and corporate guarantees. The credit risks are monitored on a continuous basis and are subject to annual or more frequent reviews.

Credit-related commitments risks

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

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank's internal credit review process.

Loans to customers of High grade are those for which the principal and interest are paid in a timely manner and are supported by the sound capital and paying capability of the borrower. This classification is proper when the borrower is financially strong and has sufficient capital to cushion unforeseen adverse impacts, is within its profit targets and produces cash flows sufficient to satisfy a liability on time, including the subject asset.

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Credit risk (continued)

Standard grade is assigned to loans when they are adequately protected but potentially weak because while there was to be stable financial condition and paying capability of the borrower at the time of the loan's origination, some deficiencies or trends are now apparent which, if not corrected, might cause concern about the borrower's ability to continue to serve the loan in a timely manner.

Loans are classified as Sub-standard if they are inadequately protected by the capital and paying capability of the borrower or by the value of any supporting collateral. Sub-standard loan has such weaknesses or problems which jeopardize payments of the indebtedness or makes full repayment questionable.

	<i>Notes</i>	<i>Neither past due nor impaired</i>			<i>Total 2017</i>
		<i>High grade 2017</i>	<i>Standard grade 2017</i>	<i>Individually impaired</i>	
Amounts due from credit institutions	6	51,445	–	–	51,445
Loans to customers	7	105,201	–	9,576	114,777
Investment securities	8	62,279	–	–	62,279
Total		218,925	–	9,576	228,501

	<i>Notes</i>	<i>Neither past due nor impaired</i>			<i>Total 2016</i>
		<i>High grade 2016</i>	<i>Standard grade 2016</i>	<i>Individually Impaired</i>	
Amounts due from credit institutions	6	83,261	–	–	83,261
Loans to customers	7	88,356	–	8,854	97,210
Investment securities	8	89,050	3,031	–	92,081
Total		260,667	3,031	8,854	272,552

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 30 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Bank 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 pay out should bankruptcy ensue, 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.

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Credit risk (continued)

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to customers that are not individually significant and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Collective assessment is performed by applying the delinquency roll rate model approach, where impairment allowances are estimated based on the percentage of assets with similar characteristics that become increasingly delinquent.

Impairment losses on off balance sheet commitments such as guarantees and letters of credit are estimated by applying the parameters sources from on balance sheet portfolio.

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

	2017				2016			
	Georgia	OECD	Other Non-OECD	Total	Georgia	OECD	Other Non-OECD	Total
Assets								
Cash and cash equivalents	35,380	6,474	2,054	43,908	5,164	–	2,435	7,599
Amounts due from credit institutions	51,445	–	–	51,445	78,236	5,025	–	83,261
Loans to customers	111,679	–	–	111,679	95,090	–	–	95,090
Investment securities	62,033	–	–	62,033	88,860	–	3,020	91,880
Other assets	62	–	–	62	–	–	–	–
	<u>260,599</u>	<u>6,474</u>	<u>2,054</u>	<u>269,127</u>	<u>267,350</u>	<u>5,025</u>	<u>5,455</u>	<u>277,830</u>
Liabilities								
Amounts due to credit institutions	25,690	–	80,712	106,402	3,500	–	128,181	131,681
Amounts due to customers	41,081	–	17,100	58,181	27,677	–	18,347	46,024
Other liabilities	131	–	–	131	223	–	–	223
	<u>66,902</u>	<u>–</u>	<u>97,812</u>	<u>164,714</u>	<u>31,400</u>	<u>–</u>	<u>146,528</u>	<u>177,928</u>
Net assets/(liabilities)	<u>193,697</u>	<u>6,474</u>	<u>(95,758)</u>	<u>104,413</u>	<u>235,950</u>	<u>5,025</u>	<u>(141,073)</u>	<u>99,902</u>

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. Funds attracted from the Parent provide sufficient sources for the Bank's operations in the foreseeable future. The Bank 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 Bank maintains a portfolio of state securities that can be pledged to the NBG in the event of an unforeseen interruption of cash flow. In addition, the Bank maintains a cash deposit (obligatory reserve) with the NBG, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratios established by the NBG. As at 31 December, these ratios were as follows:

	2017, %	2016, %
LK "Average Liquidity Ratio" (Average volume of liquid assets / Average volume of liabilities)	47.41	39.05

Analysis of financial liabilities by remaining contractual maturities

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

As at 31 December 2017	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	67,309	40,420	–	–	107,729
Amounts due to customers	37,674	16,212	4,682	–	58,568
Other financial liabilities	131	–	–	–	131
Total undiscounted financial liabilities	105,114	56,632	4,682	–	166,428
As at 31 December 2016	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	105,866	26,474	–	–	132,340
Amounts due to customers	29,084	15,578	1,714	–	46,376
Other financial liabilities	223	–	–	–	223
Total undiscounted financial liabilities	135,173	42,052	1,714	–	178,939

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Liquidity risk and funding management (continued)

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

	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total</i>
2017	47,385	–	–	–	47,385
	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total</i>
2016	18,256	–	318	–	18,574

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments. The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than three months in the tables above.

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, the Bank has no significant concentration of market risk.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank has set limits on positions by currency based on the NBG regulations. Positions are monitored on a daily basis.

<i>Currency</i>	<i>Change in currency rate 2017</i>	<i>Effect on profit before tax 2017</i>	<i>Change in currency rate 2016</i>	<i>Effect on profit before tax 2016</i>
USD	15%/(15%)	261/(261)	15%/(15%)	1,070/(1,070)
EUR	15%/(15%)	19/(19)	15%/(15%)	75/(75)

Prepayment risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected.

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Market risk (continued)

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

	<i>Decrease of net interest income</i>
2017	1,208
2016	1,159

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 Bank's statement of profit or loss.

The sensitivity of the statement of profit or loss is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2017.

<i>Currency</i>	<i>Increase/(decrease) in basis points 2017</i>	<i>Sensitivity of net interest income 2017</i>
GEL	100/(100)	115/(115)

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 Bank cannot expect to eliminate all operational risks, but a control framework and monitoring and responding to potential risks could be effective tools to manage the risks. Controls should include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

(Amounts in tables are in thousands of Georgian lari)

20. Fair value measurements**Fair value hierarchy**

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

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

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

At 31 December 2017	Fair value measurement using			
	Level 1	Level 2	Level 3	Total
Assets for which fair values are disclosed				
Cash and cash equivalents	43,908	–	–	43,908
Amounts due from credit institutions	–	–	51,445	51,445
Loans to customers	–	–	111,679	111,679
Investment securities	–	–	62,033	62,033
Assets measured at fair value				
Other assets - derivative financial assets	–	62	–	62
Fair value measurement using				
At 31 December 2017	Level 1	Level 2	Level 3	Total
Liabilities for which fair values are disclosed				
Amounts due to credit institutions	–	–	106,402	106,402
Amounts due to customers	–	–	58,181	58,181
Fair value measurement using				
At 31 December 2016	Level 1	Level 2	Level 3	Total
Assets for which fair values are disclosed				
Cash and cash equivalents	7,599	–	–	7,599
Amounts due from credit institutions	–	–	83,261	83,261
Loans to customers	–	–	95,090	95,090
Investment securities	–	3,020	88,860	91,880
Fair value measurement using				
At 31 December 2016	Level 1	Level 2	Level 3	Total
Liabilities for which fair values are disclosed				
Amounts due to credit institutions	–	–	131,681	131,681
Amounts due to customers	–	–	46,024	46,024

(Amounts in tables are in thousands of Georgian lari)

20 Fair value measurements (continued)

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 Bank's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	<i>Carrying value 2017</i>	<i>Fair value 2017</i>	<i>Unrecog- nised gain/(loss) 2017</i>	<i>Carrying value 2016</i>	<i>Fair value 2016</i>	<i>Unrecog- nised gain/(loss) 2016</i>
Financial assets						
Cash and cash equivalents	43,908	43,908	–	7,599	7,599	–
Amounts due from credit institutions	51,445	51,445	–	83,261	83,261	–
Loans to customers	111,679	111,679	–	95,090	95,090	–
Investment securities	62,033	63,071	1,038	91,880	94,704	2,824
Other financial assets	62	62	–	–	–	–
Financial liabilities						
Amounts due to credit institutions	106,402	106,402	–	131,681	131,681	–
Amounts due to customers	58,181	58,181	–	46,024	46,024	–
Total unrecognised change in fair value			1,038			2,824

Valuation techniques and assumptions

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 financial statements.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. All of the Bank's financial assets excluding loans to customers (i.e. cash and cash equivalents and amounts due from credit institutions) and financial liabilities (amounts due to customers) are either liquid or are maturing within 3 months from the reporting date.

The fair value of loans to customers is estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial assets. The majority of loans to customers outstanding as at 31 December were issued within 12 months period ended 31 December 2017 at market interest rates, while the contractual interest rates of those loans issued in 2016 approximate market interest rates as at 31 December 2017. Hence their carrying value approximates their fair value.

Forward foreign exchange contracts are derivatives valued using a valuation technique with market observable inputs. The applied valuation technique for such derivatives includes forward pricing models using present value calculations.

Investment securities

As at 31 December 2017 investment securities represent fixed rated financial assets carried at amortized cost. The fair value for investment securities loans and receivables is derived by discounting the future cash flows using current market rates for similar financial assets.

(Amounts in tables are in thousands of Georgian lari)

21. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 19 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2017			2016		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Cash and cash equivalents	43,908	–	43,908	7,599	–	7,599
Amounts due from credit institutions	51,445	–	51,445	83,261	–	83,261
Loans to customers	83,719	27,960	111,679	50,747	44,343	95,090
Investment securities	21,105	40,928	62,033	63,163	28,717	91,880
Property and equipment	–	906	906	–	1,108	1,108
Intangible assets	–	2,122	2,122	–	2,060	2,060
Deferred income tax assets	–	–	–	–	924	924
Other assets	495	216	711	384	179	563
Total	200,672	72,132	272,804	205,154	77,331	282,485
Amounts due to credit institutions	106,402	–	106,402	131,681	–	131,681
Amounts due to customers	53,682	4,499	58,181	44,404	1,620	46,024
Provisions for guarantees and letters of credit	135	–	135	85	–	85
Other liabilities	1,279	–	1,279	1,411	–	1,411
Total	161,498	4,499	165,997	177,581	1,620	179,201
Net	39,174	67,633	106,807	27,573	75,711	103,284

22. Related party disclosures

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

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

(Amounts in tables are in thousands of Georgian lari)

22. Related party disclosures (continued)

The outstanding balances of related party transactions are as follows:

	2017			2016		
	<i>The Parent</i>	<i>Key management personnel</i>	<i>Entities under common control</i>	<i>The Parent</i>	<i>Key management personnel</i>	<i>Entities under common control</i>
Cash and cash equivalents	2,053	–	5,018	2,435	–	–
Property plant and equipment	–	–	–	21	–	–
Loans to customers	–	166	–	–	–	–
Amounts due from credit institutions	–	–	–	–	–	5,025
Amounts due to credit institutions	(53,589)	–	(24,530)	(49,218)	–	(39,956)
Amounts due to customers	–	(6,579)	(28,140)	–	(2,293)	(23,027)
Other liabilities	(12)	–	–	(2)	–	–

The income and expense arising from related party transactions are as follows:

	2017			2016		
	<i>The Parent</i>	<i>Key management personnel</i>	<i>Entities under common control</i>	<i>The Parent</i>	<i>Key management personnel</i>	<i>Entities under common control</i>
Fee and commission income	–	–	1	50	–	–
Fee and commission expense	171	–	–	84	–	–
Interest income on loans to customers	–	16	–	–	–	–
Interest income on amounts due from credit institutions	(2)	–	360	–	–	72
Interest expense on amounts due to credit institutions	1,643	–	362	1,911	–	277
Interest expense on amounts due to customers	–	175	449	–	105	396
Professional fees	79	–	–	–	–	–

Compensation of key management personnel was comprised of the following:

	2017	2016
Salaries and other short-term benefits	1,548	1,029

Key management personnel as at 31 December 2017 comprised of 5 members of the Supervisory Board (31 December 2016: 4 members) and 3 members of the Board of Directors of the Bank (31 December 2016: 3 members).

23. 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.

(Amounts in tables are in thousands of Georgian lari)

23. Capital adequacy (continued)

The primary objectives of the Bank's capital management are (i) to ensure that the Bank complies with externally imposed capital requirements set by the NBG (capital adequacy ratio of at least 9.6% (2016: 10.8%)) and (ii) to safeguard the Bank's ability to continue as a going concern. Compliance with capital adequacy ratios set by the NBG is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Chief Accountant or Chief Financial Officer and subsequently submitted to the NBG.

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.

NBG capital adequacy ratio

The NBG requires banks to maintain a capital adequacy ratio of 9.6% (2016: 10.8%) of risk-weighted assets and Tier 1 Capital adequacy ratio of 6.4%. (2016: 7.2%). As at 31 December 2017 and as at 31 December 2016, the Bank's capital adequacy ratios on this basis were as follows:

	Notes	31 December 2017	Adjustments	31 December 2017 Per the NBG
Share capital	15	103,000	–	103,000
Prior years accumulated deficit		354	(2,149)	(1,795)
Less: intangible assets, net	10	(2,122)	–	(2,122)
Other adjustments		–	(3,888)	(3,888)
Main capital		101,232	(6,037)	95,195
Current year income		3,453	554	4,007
General reserves		3,479	(523)	2,956
Additional capital		6,932	31	6,963
Less: deductions from capital		–	–	–
Total capital		108,164	(6,006)	102,158
Risk weighted assets				261,848
Capital adequacy ratio				39.01%
Tier 1 capital adequacy ratio				36.36%

	Notes	31 December 2016	Adjustments	31 December 2016 Per the NBG
Share capital	15	103,000	–	103,000
Prior years accumulated deficit	10	(4,527)	(4,632)	(9,159)
Less: intangible assets, net		(2,060)	–	(2,060)
Main capital		96,413	(4,632)	91,781
Current year income		4,881	2,483	7,364
General reserves	7	2,406	(356)	2,050
Additional capital		7,287	2,127	9,414
Less: deductions from capital		–	–	–
Total capital		103,700	(2,505)	101,195
Risk weighted assets				218,136
Capital adequacy ratio				46.39%
Tier 1 capital adequacy ratio				42.08%

(Amounts in tables are in thousands of Georgian lari)

23. Capital adequacy (continued)**NBG capital adequacy ratio (continued)**

Regulatory capital consists of main capital, which comprises share capital and retained earnings including current year profit. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the NBG.

In December 2017, the NBG adopted amendments to the regulations 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 2.

Starting from 30 June 2014 the NBG requires that all banks comply with Basel II regulations in their capital adequacy assessment. This implies the minimum ratio of 10.50% for total regulatory capital coefficient, minimum 7.00% of the core Tier 1 capital coefficient and minimum 8.50 % for Tier 1 capital coefficient. As at 31 December 2017 and 31 December 2016, the Bank's capital adequacy ratios on the Basel II basis were as follows:

	<i>Notes</i>	<i>31 December 2017</i>	<i>Adjustments</i>	<i>31 December 2017 Per the NBG</i>
Additional tier 1 capital	15	103,000	–	103,000
Prior years accumulated deficit		354	(2,149)	(1,795)
Less: intangible assets, net	10	(2,122)	–	(2,122)
Other adjustments		–	(3,888)	(3,888)
Current year income		3,453	554	4,007
Core tier 1 capital		104,685	(5,483)	99,202
Tier 1 capital		104,685	(5,483)	99,202
Supplementary capital		3,479	(523)	2,956
Total regulatory capital		108,164	(6,006)	102,158
Risk weighted assets				283,322
Capital adequacy ratio				36.06%
Core Tier 1 capital/Tier 1 capital adequacy ratio				35.01%

	<i>Notes</i>	<i>31 December 2016</i>	<i>Adjustments</i>	<i>31 December 2016 Per the NBG</i>
Additional tier 1 capital	15	103,000	–	103,000
Prior years accumulated deficit		(4,527)	(4,632)	(9,159)
Less: intangible assets, net	10	(2,060)	–	(2,060)
Current year income		4,881	2,483	7,364
Core tier 1 capital		101,294	(2,149)	99,145
Tier 1 capital		101,294	(2,149)	99,145
Supplementary capital		2,406	(356)	2,050
Total regulatory capital		103,700	(2,505)	101,195
Risk weighted assets				296,917
Capital adequacy ratio				34.08%
Core Tier 1 capital/Tier 1 capital adequacy ratio				33.39%

(Amounts in tables are in thousands of Georgian lari)

24. Subsequent events

On 1 February 2018, Mr. Arda Arkun replaced Mr. Shahin Mammadov at the position of the Chairman of the Board of Directors of the Bank.

On 31 January 2018 the Bank used the cash cover provided by the Parent to write off one individually impaired loan with a net book value of GEL 7,784 thousand as at 31 December 2017.