CARTU BANK GROUP

Consolidated Financial Statements and Independent Auditor's Report

For the Year Ended December 31, 2018

CARTU BANK GROUP

TABLE OF CONTENTS

Page

Statement of management's responsibilities for the preparation and approval of the consolidated financial statements for the year ended December 31, 2018 ... 1

Independent auditor's report ... 2-3

Consolidated financial statements for the year ended December 31, 2018:

Consolidated statement of financial position ... 4
Consolidated statement of profit or loss ... 5
Consolidated statement of changes in equity ... 6
Consolidated statement of cash flows ... 7-8

Notes to the consolidated financial statements:

1. Organisation ... 9
2. Basis of preparation ... 9
3. Application of new and revised international financial reporting standards (IFRSs) ... 11
4. Significant accounting policies ... 19
5. Critical accounting judgements and key sources of estimation uncertainty ... 36
6. Cash and cash equivalents ... 39
7. Mandatory balances with nbg ... 39
8. Financial assets at fair value through profit or loss ... 39
9. Due from financial institutions ... 40
10. Loans to customers ... 40
11. Investments in equity instruments ... 43
12. Investments in debt instruments ... 44
13. Property and equipment ... 44
14. Other assets ... 45
15. Deposits by banks ... 46
16. Deposits by customers ... 47
17. Other borrowed funds ... 48
18. Other liabilities ... 48
19. Subordinated debt ... 49
20. Share capital ... 51
21. Net interest income ... 52
22. Provision for impairment losses on interest bearing assets and other provisions ... 53
23. Net gain on financial assets at fair value through profit or loss ... 54
24. Net loss on foreign exchange operations ... 54
25. Fee and commission income and expense ... 55
26. Other income, net ... 55
27. Operating expenses ... 56
28. Income taxes ... 56
29. Commitments and contingencies ... 57
30. Transactions with related parties ... 59
31. Fair value of financial instruments ... 60
32. Capital risk management ... 62
33. Risk management policies ... 64
34. Subsequent events ... 83

Cartu Bank Group

Statement of Management's Responsibilities for the Preparation and Approval of the Consolidated Financial Statements for the Year Ended December 31, 2018

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of Joint Stock Company Cartu Bank (the "Bank") and its subsidiaries (the "Group") as at December 31, 2018, the consolidated results of its operations, cash flows and changes in equity for the year then ended, in compliance with International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance;
- Making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls throughout the Group;
- Maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with Georgian legislation and accounting standards of Georgia;
- Taking such steps that are reasonably available to them to safeguard the assets of the Group; and
- Preventing and detecting fraud and other irregularities.

The consolidated financial statements for the year ended December 31, 2018 were authorized for issue on May 13, 2019 by the Management Board of the Group.

On behalf of the Management Board:

Nato Khaindrava
General Director

13 May, 2019
Tbilisi, Georgia

Givi Lebanidze
Chief Financial Officer

13 May, 2019
Tbilisi, Georgia

Deloitte.

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King David Business Center
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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and the Board of Directors of Joint Stock Company Cartu Bank:

Opinion

We have audited the consolidated financial statements of Joint Stock Company Cartu Bank (the "Bank") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at December 31, 2018, and the consolidated statement of profit or loss, consolidated statement of other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at December 31, 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs").

Basis for Opinion

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

Other Information

Management is responsible for the other information. The other information comprises the information included in the Management Report but does not include the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

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

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

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

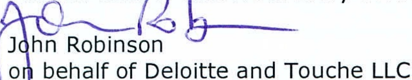
Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

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

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

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

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



John Robinson
on behalf of Deloitte and Touche LLC

May 13, 2019
Tbilisi, Georgia

CARTU BANK GROUP

Consolidated Statement of Financial Position for the Year Ended December 31, 2018 (in thousands of Georgian Lari)

	Notes	December 31, 2018	December 31, 2017
ASSETS:			
Cash and cash equivalents	6	124,535	224,644
Mandatory cash balance with the NBG	7	138,155	120,479
Financial assets at fair value through profit or loss	8	-	18,253
Due from financial institutions	9	12,380	18,800
Loans to customers	10	821,895	794,886
Investments in debt instruments*	12	19,295	27,978
Investments in equity instruments*	11	57	57
Property and equipment	13	12,583	14,062
Current income tax asset		7,225	1,537
Other assets	14	77,369	81,445
TOTAL ASSETS		**1,213,494**	**1,302,141**
LIABILITIES AND EQUITY			
LIABILITIES:			
Deposits by banks	15	15,106	18,398
Deposits by customers	16	641,862	690,657
Other borrowed funds	17	-	26,289
Other provisions	22	3,797	2,408
Deferred income tax liability	28	8,637	6,362
Other liabilities	18	7,380	7,953
Subordinated debt	19	190,595	208,368
Total liabilities		**867,377**	**960,435**
EQUITY:			
Equity attributable to owners of the parent:			
Share capital	20	114,430	114,430
Additional paid in capital	19	12,667	13,795
Retained earnings		218,946	213,496
Total equity attributable to owners of the parent		346,043	341,721
Non-controlling interest		74	(15)
Total equity		**346,117**	**341,706**
TOTAL LIABILITIES AND EQUITY		**1,213,494**	**1,302,141**

*The Group has introduced changes to the description of financial position line items as at December 31, 2017 as a result of adoption of new accounting policies on 1 January, 2018. Further details on the adoption of new accounting policies can be found in note 4.

On behalf of the Management Board:

Nato Khaindrava
General Director

13 May, 2019
Tbilisi, Georgia

Givi Lebanidze
Chief Financial Officer

13 May, 2019
Tbilisi, Georgia

The notes on pages 9-83 form an integral part of these consolidated financial statements.

CARTU BANK GROUP

Consolidated Statement of Profit or Loss and Other Comprehensive Income for the Year Ended December 31, 2018
(in thousands of Georgian Lari)

	Notes	2018	2017
Interest income	21	91,686	99,520
Interest expense	21	(30,691)	(31,529)
Net interest income before (impairment losses)/recovery of impairment losses on interest bearing assets		60,995	67,991
(Impairment losses)/recovery of impairment losses on interest bearing assets	22	(3,026)	6,522
Net interest income		**57,969**	**74,513**
Fee and commission income	25	6,803	6,552
Fee and commission expense	25	(6,362)	(5,088)
Net loss on foreign exchange operations	24	(3,959)	3,148
Provision for other operations	22	(1,830)	(142)
Recovery of impairment losses on non-interest bearing assets	22	47	-
Net gain on financial assets at fair value through profit or loss	23	-	2,717
Other income, net	26	8,085	4,122
Net non-interest income		**2,784**	**11,309**
Operating income		60,753	85,822
Operating expenses	27	(28,235)	(29,156)
Profit before income tax		**32,518**	**56,666**
Income tax expense	28	(6,314)	(6,948)
Net profit for the year		**26,204**	**49,718**
Other comprehensive income		-	-
Total comprehensive income		**26,204**	**49,718**
Attributable to:			
Owners of the parent		26,200	49,676
Non-controlling interest		4	42
		26,204	**49,718**

On behalf of the Management Board:

Nato Khaindrava
General Director

13 May, 2019
Tbilisi, Georgia

Givi Lebanidze
Chief Financial Officer

13 May, 2019
Tbilisi, Georgia

The notes on pages 9-83 form an integral part of these consolidated financial statement

CARTU BANK GROUP

Consolidated Statement of Changes in Equity for the Year Ended December 31, 2018
(in thousands of Georgian Lari)

	Notes	Share capital	Additional paid in capital	Retained earnings	Total equity attributable to owners of the parent	Non-controlling interest	Total Equity
January 1, 2017		**114,430**	**9,424**	**154,422**	**278,276**	**(83)**	**278,193**
Net profit for the year		-	-	49,676	49,676	42	49,718
Decrease in non-controlling interest from acquisition of additional interest in JSC Insurance Company Cartu		-	-	(26)	(26)	26	-
Transferred to retained earning		-	(9,424)	9,424	-	-	-
Additional paid in capital		-	16,230	-	16,230	-	16,230
Income tax on additional paid in capital		-	(2,435)	-	(2,435)	-	(2,435)
December 31, 2017		**114,430**	**13,795**	**213,496**	**341,721**	**(15)**	**341,706**
Adjustment on initial application of IFRS 9, net of tax		-	-	(2,515)	(2,515)	-	(2,515)
January 1, 2018 (restated)		**114,430**	**13,795**	**210,981**	**339,206**	**(15)**	**339,191**
Net profit for the year		-	-	26,200	26,200	4	26,204
Decrease in non-controlling interest from acquisition of additional interest in JSC Insurance Company Cartu		-	-	(85)	(85)	85	-
Dividends declared and disbursed		-	-	(20,000)	(20,000)	-	(20,000)
Transferred to retained earning	19	-	(1,572)	1,572	-	-	-
Additional paid in capital	19	-	522	-	522	-	522
Income tax on additional paid in capital	19	-	(78)	278	200	-	200
December 31, 2018		**114,430**	**12,667**	**218,946**	**346,043**	**74**	**346,117**

On behalf of the Management Board:

Nato Khaindrava
General Director

13 May, 2019
Tbilisi, Georgia

Givi Lebanidze
Chief Financial Officer

13 May, 2019
Tbilisi, Georgia

The notes on pages 9-83 form an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows
for the Year Ended December 31, 2018
(in thousands of Georgian Lari)

	Notes	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income tax:		32,518	56,666
Adjustments for:			
Impairment losses/(recovery of impairment losses)/provision on interest bearing assets	22	3,026	(6,522)
Provision for other operations	22	1,830	142
Recovery of impairment losses on non-interest bearing assets	22	(47)	-
Net loss on foreign exchange operations	24	10,319	3,432
Depreciation and amortization expense	27	2,640	2,818
Change in interest accruals, net		(15,364)	(9,463)
Modification gain on subordinated debt	19	(848)	-
Gain on disposal of repossessed assets and property and equipment	26	(5,700)	(667)
Net change in fair value of financial assets and liabilities at fair value through profit or loss		-	9,622
Cash inflow from operating activities before changes in operating assets and liabilities		**28,374**	**56,028**
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Mandatory cash balance with the NBG		(11,229)	12,595
Due from financial institutions		6,832	(13,761)
Loans to customers		19,108	13,432
Other assets		(6,621)	5,851
Increase/(decrease) in operating liabilities:			
Deposits by banks		(4,346)	205
Deposits by customers		(78,488)	(21,297)
Other liabilities		(723)	(6,120)
Cash (used in)/generated from operations		**(47,093)**	**46,933**
Income tax paid		(9,060)	(10,479)
Net cash (outflow)/inflow from operating activities		**(56,153)**	**36,454**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment, and intangible assets		(219)	(5,405)
Proceeds from disposal of property and equipment and intangible assets		-	47
Proceeds from disposal of financial assets at fair value through profit or loss		-	2,108
Proceeds from disposal of repossessed assets		15,142	-
Purchase of investments in debt instruments		27,692	19,008
Proceeds from investments in debt instruments		(19,023)	(27,281)
Net cash inflow / (outflow) from investing activities		**23,592**	**(11,523)**

CARTU BANK GROUP

Consolidated Statement of Cash Flows
for the Year Ended December 31, 2018 (continued)
(in thousands of Georgian Lari)

	Notes	2018	2017
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from other borrowed funds		-	89,341
Repayment of other borrowed funds		(24,953)	(190,542)
Acquisition of subsidiary's interests from the non-controlling interest		(85)	(450)
Payment of dividends		(20,000)	-
Proceeds from subordinated debt		4,303	-
Repayment of subordinated debt		(29,987)	-
Net cash outflow from financing activities		**(70,722)**	**(101,651)**
Effect of exchange rate changes on the balance of cash held in foreign currencies		3,174	2,748
NET DECREASE IN CASH AND CASH EQUIVALENTS		(103,283)	(76,720)
CASH AND CASH EQUIVALENTS, beginning of the year		**224,644**	**298,616**
CASH AND CASH EQUIVALENTS, end of the year		**124,535**	**224,644**

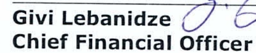
Interest paid and received by the Group during the year ended December 31, 2018 amounted to GEL 25,531 thousands and GEL 70,395 thousands, respectively.

Interest paid and received by the Group during the year ended December 31, 2017 amounted to GEL 33,373 thousands and GEL 95,006 thousands, respectively.

On behalf of the Management Board:

Nato Khaindrava
General Director

13 May, 2019
Tbilisi, Georgia



Givi Lebanidze
Chief Financial Officer

13 May, 2019
Tbilisi, Georgia

The notes on pages 9-83 form an integral part of these consolidated financial statements.

1. Organisation

Joint Stock Company Cartu Bank (the "Bank") was incorporated in Georgia in 1996. The Bank is regulated by the National Bank of Georgia (the "NBG") and conducts its business under general license number 229. The Bank's primary business consists of commercial activities, originating loans and guarantees, trading with securities, foreign currencies and taking deposits.

The registered office of the Bank is located on 39a Chavchavadze Avenue, Tbilisi, Georgia.

As at December 31, 2018, the Bank had five service centers operating in Tbilisi, division in Shekvetili and service centers in Gori, Telavi, Kutaisi and Batumi regions.

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

		Ownership interest (%)		
Name	**Country of operation**	**2018**	**2017**	**Type of operation**
Cartu Broker LLC	Georgia	100.00%	100.00%	Brokerage
Insurance Company Cartu JSC	Georgia	91.39%	88.77%	Insurance
Investment Company Cartu Invest LLC	Georgia	100.00%	100.00%	Dormant
Geoplast LLC	Georgia	100.00%	100.00%	Dormant

As at December 31, 2018 and 2017 JSC Cartu Group owned 100% of the Bank's shares.

Ultimate individual shareholder having control over the operation of JSC Cartu Group is Uta Ivanishvili, the son of Bidzina Ivanishvili.

These consolidated financial statements were authorized for issue on May 13, 2019 by the Management Board of the Group.

2. Basis of preparation

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

These consolidated financial statements have been prepared assuming that the Group is a going concern and will continue operation for the foreseeable future.

These consolidated financial statements are presented in thousands of Georgian Lari ("GEL thousand"), unless otherwise indicated.

These consolidated financial statements have been prepared on the historical cost basis except for the measurement at fair value of certain financial instruments, as explained in the accounting policies below. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

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, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Group takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis.

In addition, for financial reporting purposes, fair value measurements are categorized into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

The Bank and its consolidated companies are registered in Georgia and maintain their accounting records in accordance with the Georgian law. These consolidated financial statements have been prepared from the statutory accounting records and have been adjusted to conform to IFRS.

The Group presents its consolidated statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the consolidated statement of financial position date (current) and more than 12 months after the consolidated statement of financial position date (non-current) is presented in Note 33.

Functional currency. Items included in the consolidated financial statements of each of the Group's entities are measured using the currency of the primary of the economic environment in which the entity operates ("the functional currency"). The functional currency of the parent of the Group is the Georgian Lari ("GEL"). The presentational currency of the consolidated financial statements of the Group is the GEL. All values are rounded to the nearest thousand GEL, except when otherwise indicated.

Offsetting. Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liability simultaneously. Income and expense is not offset in the consolidated statement of profit or loss unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

This is the first set of the Group's annual consolidated financial statements in which IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers have been applied. Changes to significant accounting policies are described in Note 3.

Basis of consolidation. The consolidated financial statements incorporate the financial statements of the Bank and entities controlled by the Bank and its subsidiaries. Control is achieved when the Bank:

- Has power over the investee;
- Is exposed, or has rights, to variable returns from its involvement with the investee; and
- Has the ability to use its power to affect its returns.

The Bank reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Bank has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Bank considers all relevant facts and circumstances in assessing whether or not the Bank's voting rights in an investee are sufficient to give it power, including:

- The size of the Bank's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- Potential voting rights held by the Bank, other vote holders or other parties;
- Rights arising from other contractual arrangements; and

- Any additional facts and circumstances that indicate that the Bank has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

Consolidation of a subsidiary begins when the Bank obtains control over the subsidiary and ceases when the Bank loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statement of profit or loss from the date the Bank gains control until the date when the Bank ceases to control the subsidiary.

When necessary, adjustments are made to the consolidated financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

All intra-group liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

Non-controlling interests. Non-controlling interests represent the portion of profit or loss and other comprehensive income and net assets of subsidiaries not owned, directly or indirectly, by the Group.

Non-controlling interests are presented separately in the consolidated statement of profit or loss and consolidated statement of other comprehensive income and within equity in the consolidated statement of financial position, separately from parent shareholders' equity.

Changes in the Group's ownership interests in existing subsidiaries*.* Changes in the Group's ownership interests in subsidiaries that do not result in the Group losing control over the subsidiaries are accounted for as equity transactions. The carrying amounts of the Group's interests and the non-controlling interest are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interest are adjusted and the fair value of the consideration paid or received is recognized directly in equity and attributed to owners of the Group.

3. Application of new and revised international financial reporting standards (IFRSs)

Amendments to IFRSs affecting amounts reported in the financial statements

The Bank has initially adopted IFRS 9 and IFRS 15 from 1 January 2018.

IFRS 9 Financial Instruments

The Bank has adopted IFRS 9 as issued by the IASB in July 2014 with a date of initial application of January 1, 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognized in the financial statements.

As permitted by the transitional provisions of IFRS 9, the Bank elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognized in the opening retained earnings and other reserves of the current period. Consequently, for notes disclosures, the consequential amendments to IFRS 7 disclosures have also only been applied to the current period except as described below.

The Bank introduced presentation changes to the statement of financial position and disclosures as at December 31, 2017 as a result of adoption of IFRS 9 as at January 1, 2018. Presentation changes were limited to financial assets at fair value through profit or loss that has been included in loans to customers compared to separate disclosure in previously issued consolidated financial statements for the year ended December 31, 2017.

The adoption of IFRS 9 has resulted in changes in accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of

financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments such as IFRS 7: Financial Instruments: Disclosures.

The effect of initially applying IFRS 9 is mainly attributed to the following:

- an increase/decrease in impairment losses recognized on financial assets due to new impairment model;
- additional disclosures related to IFRS 9

Further details on the new accounting policies can be found in Note 4.

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9

The Bank performed a detailed analysis of its business models for managing financial assets and analysis of their cash flow characteristics.

The following table reconciles the carrying amounts of financial assets, from their previous measurement category in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018:

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Cash and cash equivalents	Loan and receivables	Amortised cost	224,644	224,602
Mandatory cash balances with the NBG	Loan and receivables	Amortised cost	120,479	120,447
Financial assets at fair value through profit or loss [1]	Financial assets at fair value through profit or loss	Not Applicable	18,253	-
Due from financial institutions	Loan and receivables	Amortised cost	18,800	18,779
Loans to customers	Loan and receivables	Amortised cost	794,886	810,327
Investments in equity instruments	Available for sale	FVOCI – equity	57	57
Investments in debt instruments	Held to maturity	Amortised cost	27,978	27,951
Other financial assets	Loan and receivables	Amortised cost	4,889	4,423
Total financial assets			**1,209,986**	**1,206,586**
Deposits by banks	Amortised cost	Amortised cost	18,398	18,398
Deposits by customers	Amortised cost	Amortised cost	690,657	690,657
Other borrowed funds	Amortised cost	Amortised cost	26,289	26,289
Other financial liabilities	Amortised cost	Amortised cost	3,327	3,327
Subordinated debt	Amortised cost	Amortised cost	208,368	208,368
Total financial liabilities			**947,039**	**947,039**
Net financial assets			**262,947**	**259,547**

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Bank's financial assets and financial liabilities as at January 1, 2018:

	IAS 39 carrying amount as at 31 December 2017	**Reclassifications**	**Remeasurements**	**IFRS 9 carrying amount as at 1 January 2018**
Financial assets				
From loans and receivables	**1,163,696**	**(1,163,696)**	-	-
Cash and cash equivalents	224,644	-	(42)	224,602
Mandatory cash balances with the NBG	120,479	-	(32)	120,447
Due from financial institutions	18,800	-	(21)	18,779
Loans to customers	794,886	-	(10,141)	784,745
Other financial assets	4,889	-	(466)	4,423
To amortised cost	**-**	**(1,163,696)**	**(10,702)**	**1,152,996**
From financial assets at FVTPL	18,253	**(18,253)**	**-**	**-**
Loans to customers [1]		18,253	7,329	25,582
To amortised cost		**18,253**	**7,329**	**25,582**
From available for sale	**57**	**(57)**	**-**	**-**
Investments in equity instruments	-	57	-	57
To FVOCI – equity	-	**57**	-	**57**
From held to maturity investments	**27,978**	**(27,978)**	-	-
Investments in debt instruments	-	27,978	(27)	27,951
To amortised cost	**-**	**27,978**	**(27)**	**27,951**
Financial liabilities				
From IAS 39 amortised cost	**947,039**	**(947,039)**	-	-
Deposits by banks	18,398	-	-	18,398
Deposits by customers	690657	-	-	690,657
Other borrowed funds	26,289	-	-	26,289
Other financial liabilities	3,327	-	-	3,327
Subordinated debt	208,368	-	-	208,368
To IFRS 9 amortised cost	-	**(947,039)**	-	**947,039**

[1] – Certain Georgian Lari denominated lending contracts with customers include foreign currency feature that links payments of interest and principal to National Bank of Georgia official exchange rate. This feature under IAS 39 was considered as not closely related embedded derivative to the host contract and respectively accounted for separately at fair value through profit or loss.

IFRS 9 precludes the separation of any embedded derivatives from a hybrid contract when the host contract is a financial asset within its scope. Instead, the entire hybrid financial asset is classified into one of the three measurement categories.

The management of the Bank performed analysis of the contractual cash flows and variability of cash flows in amount over the over the life of the instrument. Linking payments of principal and interest on the principal amount outstanding to an unleveraged foreign exchange rate resets the time value of money to a current level. In other words, the interest rate on the instrument reflects 'real' interest and risks associated to the variability of the cash flows is consistent with a basic lending arrangement. Thus, these contracts meet contractual cash flow characteristics test and under IFRS 9 hybrid contract is measured at amortised cost.

The following table reconciles the prior period's closing impairment allowance measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected loss model at 1 January 2018:

	Allowance for impairment losses under IAS 39/Provision under IAS 37	**Reclassifications**	**Remeasurements**	**Allowance for ELC under IFRS 9**
Cash and cash equivalents	-	-	42	42
Mandatory cash balances with the NBG	-	-	32	32
Loans to customers	74,837	-	15,273	90,110
Held to maturity investments (IAS 39)	-	-	-	-
Available for sale financial assets (IAS 39)	-	-	-	-
Due from financial institutions	-	-	21	21
Investments in debt instruments	-	-	27	27
Investments in equity instruments	-	-	-	-
Other financial assets	-	-	466	466
Loan Commitments and financial guarantee contracts	2,408	-	(441)	1,967
Total	**77,245**	**-**	**15,420**	**92,665**

The following table analyses the impact, net of tax, of transition to IFRS 9 on allowance for impairment losses and retained earnings. The impact relates to the retained earnings. There is no impact on other components of equity.

Retained earnings	
Closing balance under IAS 39 (December 31, 2017)	**213,496**
Re-measurement of previously separately recognized embedded derivative within loans to customers at amortised cost	7,329
Re-measurement of loans to customers under IFRS 9	5,132
Recognition of expected credit losses under IFRS 9	(15,861)
Recognition of expected credit losses under IFRS 9 for guarantees and loan commitments	441
Deferred income tax benefit	444
Restated opening balance under IFRS 9 (January 1, 2018)	**210,981**

IFRS 15 *Revenue from Contracts with Customers*

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and the related Interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the Standard introduces a 5-step approach to revenue recognition:

- Identify the contract with the customer;
- Identify the performance obligations in the contract;
- Determine the transaction price;
- Allocate the transaction price to the performance obligations in the contracts;
- Recognise revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognises revenue when or as a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

In April 2016, the IASB issued *Clarifications to IFRS 15* in relation to the identification of performance obligations, principal versus agent considerations, as well as licensing application guidance.

The adoption of IFRS 15 did not impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognised by the Bank.

New and revised IFRSs in issue but not yet effective

The Bank has not applied the following new and revised IFRSs that have been issued but are not yet effective:

- IFRS 16 Leases;
- IFRS 17 Insurance Contracts;
- Amendments to IAS 28 – *Long-Term Interests in Associates and Joint Ventures*;
- Annual Improvements to IFRSs 2015-2017 Cycle
- Amendments to IAS 19 Employee benefits
- Amendments to IFRS 10 Consolidated Financial Statements
- IFRIC 23 Uncertainty Over Income Tax Treatments;

The management of the Bank does not expect that the adoption of the Standards listed above will have a material impact on the consolidated financial statements of the Bank in future periods, except for IFRS 16 as described below.

IFRS 16 Leases

The Bank is required to adopt IFRS 16 Leases from January 1, 2019. The Bank has assessed the estimated impact that the initial application of IFRS 16 will have on its financial statements, as described below. The actual impact of adopting the standard on January 1, 2019 may change because:

- the Bank has not finalised the testing and assessment of controls over its new IT systems; and
- the new accounting policies are subject to change until the Bank presents its first consolidated financial statements that include the date of initial application.

IFRS 16 introduces a comprehensive model for the identification of lease arrangements and accounting treatments for both lessors and lessees. IFRS 16 will supersede the current lease guidance including IAS 17 Leases and the related interpretations when it becomes effective.

IFRS 16 distinguishes leases and service contracts on the basis of whether an identified asset is controlled by a customer. Distinctions of operating leases (off balance sheet) and finance leases (on balance sheet) are removed for lessee accounting, and is replaced by a model where a right-of-use asset and a corresponding liability have to be recognised for all leases by lessees (i.e. all on balance sheet) except for short-term leases and leases of low value assets.

The right-of-use asset is initially measured at cost and subsequently measured at cost (subject to certain exceptions) less accumulated depreciation and impairment losses, adjusted for any remeasurement of the lease liability. The lease liability is initially measured at the present value of the lease payments that are not paid at that date. Subsequently, the lease liability is adjusted for interest and lease payments, as well as the impact of lease modifications, amongst others. Furthermore, the classification of cash flows will also be affected as operating lease payments under IAS 17 are presented as operating cash flows; whereas under the IFRS 16 model, the lease payments will be split into a principal and an interest portion which will be presented as financing and operating cash flows respectively.

In contrast to lessee accounting, IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17, and continues to require a lessor to classify a lease either as an operating lease or a finance lease.

The Bank has completed an initial assessment of the potential impact on its consolidated financial statements but has not yet completed its detailed assessment. The actual impact of applying IFRS 16 on the consolidated financial statements in the period of initial application will depend on future economic conditions, the development of the Bank's lease portfolio, the Bank's assessment of whether it will exercise any lease renewal options and the extent to which the Bank chooses to use practical expedients and recognition exemptions.

A preliminary analysis indicates that as at 31 December 2018, the Bank has non-cancellable operating lease commitments of GEL 8,981 on undiscounted basis.

Under IFRS 16, right-of-use assets will be tested for impairment in accordance with IAS 36 *Impairment of Assets*. This will replace the previous requirement to recognise a provision for onerous lease contracts.

For short-term leases (lease term of 12 months or less) and leases of low-value assets (such as personal computers and office furniture), the Bank will opt to recognise a lease expense on a straight-line basis as permitted by IFRS 16.

Previously, the Bank recognised operating lease expense on a straight-line basis over the term of the lease, and recognised assets and liabilities only to the extent that there was a timing difference between actual lease payments and the expense recognised.

The Bank plans to apply IFRS 16 initially on January 1, 2019, using a modified retrospective approach. Therefore, the cumulative effect of adopting IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings at January 1, 2019, with no restatement of comparative information.

The Bank plans to apply the practical expedient to grandfather the definition of a lease on transition. This means that it will apply IFRS 16 to all contracts entered into before 1 January 2019 and identified as leases in accordance with IAS 17 and IFRIC 4.

IFRS 17 Insurance Contracts

The new Standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts and supersedes IFRS 4 Insurance Contracts.

The Standard outlines a General Model, which is modified for insurance contracts with direct participation features, described as the Variable Fee Approach. The General Model is simplified if certain criteria are met by measuring the liability for remaining coverage using the Premium Allocation Approach.

The General Model will use current assumptions to estimate the amount, timing and uncertainty of future cash flows and it will explicitly measure the cost of that uncertainty, it takes into account market interest rates and the impact of policyholders' options and guarantees.

The implementation of the Standard is likely to bring significant changes to an entity's processes and systems, and will require much greater co-ordination between many functions of the business, including finance, actuarial and IT.

The Standard is effective for annual reporting periods beginning on or after 1 January 2021, with early application permitted. It is applied retrospectively unless impracticable, in which case the modified retrospective approach or the fair value approach is applied.

For the purpose of the transition requirements, the date of initial application is the start if the annual reporting period in which the entity first applies the Standard, and the transition date is the beginning of the period immediately preceding the date of initial application.

The management of the Bank does not anticipate that the application of these amendments will have a material impact on the Bank's consolidated financial statements as the insurance company comprises immaterial part of the Bank.

Amendments to IAS 28 Long-term Interests in Associates and Joint Ventures

The amendment clarifies that IFRS 9, including its impairment requirements, applies to long-term interests. Furthermore, in applying IFRS 9 to long-term interests, an entity does not take into account adjustments to their carrying amount required by IAS 28 (i.e., adjustments to the carrying amount of long-term interests arising from the allocation of losses of the investee or assessment of impairment in accordance with IAS 28).

The amendments apply retrospectively to annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted. Specific transition provisions apply depending on whether the first-time application of the amendments coincides with that of IFRS 9.

The management of the Bank does not anticipate that the application of the amendments in the future will have an impact on the Bank’s financial statements.

Annual Improvements to IFRS Standards 2015–2017 Cycle

The Annual Improvements include amendments to four Standards.

IAS 12 Income Taxes
The amendments clarify that an entity should recognise the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised the transactions that generated the distributable profits. This is the case irrespective of whether different tax rates apply to distributed and undistributed profits.

IAS 23 Borrowing Costs
The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings.

IFRS 3 Business Combinations
The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, the entity applies the requirements for a business combination achieved in stages, including remeasuring its previously held interest (PHI) in the joint operation at fair value. The PHI to be remeasured includes any unrecognised assets, liabilities and goodwill relating to the joint operation.

IFRS 11 Joint Arrangements
The amendments to IFRS 11 clarify that when a party that participates in, but does not have joint control of, a joint operation that is a business obtains joint control of such a joint operation, the entity does not remeasure its PHI in the joint operation.

All the amendments are effective for annual periods beginning on or after 1 January 2019 and generally require prospective application. Earlier application is permitted.

The management of the Bank does not anticipate that the application of these amendments will have a material impact on the Bank's separate financial statements.

Amendments to IAS 19 Employee Benefits

The amendments clarify that the past service cost (or of the gain or loss on settlement) is calculated by measuring the defined benefit liability (asset) using updated assumptions and comparing benefits offered and plan assets before and after the plan amendment (or curtailment or settlement) but ignoring the effect of the asset ceiling (that may arise when the defined benefit plan is in a surplus position). IAS 19 is now clear that the change in the effect of the asset ceiling that may result from the plan amendment (or curtailment or settlement) is determined in a second step and is recognised in the normal manner in other comprehensive income.

The paragraphs that relate to measuring the current service cost and the net interest on the net defined benefit liability (asset) have also been amended. An entity will now be required to use the updated assumptions from this remeasurement to determine current service cost and net interest

for the remainder of the reporting period after the change to the plan. In the case of the net interest, the amendments make it clear that for the period post plan amendment, the net interest is calculated by multiplying the net defined benefit liability (asset) as remeasured under IAS 19.99 with the discount rate used in the remeasurement (also taking into account the effect of contributions and benefit payments on the net defined benefit liability (asset)).

The amendments are applied prospectively. They apply only to plan amendments, curtailments or settlements that occur on or after the beginning of the annual period in which the amendments to IAS 19 are first applied.

The amendments to IAS 19 must be applied to annual periods beginning on or after 1 January 2019, but they can be applied earlier if an entity elects to do so.

The management of the Bank does not anticipate that the application of the Standard in the future will have an impact on the Bank's financial statements.

IFRS 10 Consolidated Financial Statements and IAS 28 (amendments)

The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognised in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. Similarly, gains and losses resulting from the remeasurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognised in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

The effective date of the amendments has yet to be set by the IASB; however, earlier application of the amendments is permitted.

The management of the Bank does not anticipate that the application of the Standard in the future will have an impact on the Bank's financial statements.

IFRIC 23 Uncertainty over Income Tax Treatments

IFRIC 23 sets out how to determine the accounting tax position when there is uncertainty over income tax treatments. The Interpretation requires an entity to:

- determine whether uncertain tax positions are assessed separately or as a group; and
- assess whether it is probable that a tax authority will accept an uncertain tax treatment used, or proposed to be used, by an entity in its income tax filings:
  - If yes, the entity should determine its accounting tax position consistently with the tax treatment used or planned to be used in its income tax filings.
  - If no, the entity should reflect the effect of uncertainty in determining its accounting tax position.

The Interpretation is effective for annual periods beginning on or after 1 January 2019. Entities can apply the Interpretation with either full retrospective application or modified retrospective application without restatement of comparatives retrospectively or prospectively.

The management of the Bank does not anticipate that the application of the Standard in the future will have an impact on the Bank's financial statements.

4. Significant Accounting policies

The principal accounting policies are set out below:

Recognition of interest income and expense - applicable after January 1, 2018

Interest income and expense are recognized in profit or loss using the effective interest method by applying the effective interest rate.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of a financial asset except for:

- purchased or originated credit-impaired financial assets. For those financial assets, the Bank applies the credit-adjusted effective interest rate to the amortised cost of the financial asset from initial recognition.
- Financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become credit-impaired financial assets. For those financial assets, the Bank applies the effective interest rate to the amortised cost of the financial asset in subsequent reporting periods.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability.

When calculating the effective interest rate, the Bank estimates the expected cash flows by considering all the contractual terms of the financial instrument excluding expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts.

Recognition of interest income and expense - applicable before January 1, 2018

Interest income from a financial asset is recognized when it is probable that the economic benefits will flow to the Bank and the amount of income can be measured reliably.

Interest income and expense are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Once a financial asset or a group of similar financial assets has been written down (partly written down) as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Recognition of fee and commission income

Financial instrument origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the financial instrument.

Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in profit or loss over the remaining period of the loan commitment. Where a loan commitment

expires without resulting in a loan, the loan commitment fee is recognized in profit or loss on expiry. Loan servicing fees are recognized as revenue as the services are provided.

All other fee and commissions are recognized when services are provided.

Financial instruments

Initial recognition of financial instruments

Financial assets and financial liabilities are recognised in the Bank's financial position when the Bank becomes a party to the contractual provisions of the instrument.

Recognised financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at FVTPL) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition.

Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at FVTPL are recognised immediately in profit or loss.

If the transaction price differs from fair value at initial recognition, the Bank accounts for such difference as follows:

- If fair value is evidenced by a quoted price in an active market for an identical asset or liability or based on a valuation technique that uses only data from observable markets, then the difference is recognised in profit or loss on initial recognition (i.e. day 1 profit or loss).
- In all other cases, the fair value will be adjusted to bring it in line with the transaction price (i.e. day 1 profit or loss will be deferred by including it in the initial carrying amount of the asset or liability).

After initial recognition, the deferred gain or loss will be released to profit or loss on a rational basis, only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

***Financial assets* - applicable after January 1, 2018**

Classification and subsequent measurement

On initial recognition, a financial asset is classified into one of the following measurement categories: amortised cost; fair value through other comprehensive income (FVOCI); or fair value through profit or loss (FVTPL).

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest ("SPPI") on the principal amount outstanding.

A financial asset is measured at FVOCI if it meets both of the following conditions and is not designated as at FVTPL:

- The asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in the investment's fair value in OCI. This election is made on an investment-by-investment basis. The Bank elected to present subsequent changes of fair value in its investment in "United Billing Center" in OCI.

All financial assets not classified as measured at amortised cost or FVOCI as described above are measured at FVTPL.

On initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

The Bank's financial assets classified into the measurement categories are as following:

Financial assets	Business model	SPPI	Measurement category
Cash and cash equivalents	Hold to collect contractual cash flows	Cash flows are solely payments of principal and interest	Amortised Cost
Mandatory cash balance with the NBG	Hold to collect contractual cash flows	Cash flows are solely payments of principal and interest	Amortised Cost
Due from financial institutions	Hold to collect contractual cash flows	Cash flows are solely payments of principal and interest	Amortised Cost
Investments in debt instruments	Hold to collect contractual cash flows	Cash flows are solely payments of principal and interest	Amortised Cost
Investments in equity instruments	Other business model	Cash flows are not solely payments of principal and interest	FVOCI
Loans to customers	Hold to collect contractual cash flows	Cash flows are solely payments of principal and interest	Amortised Cost
Other receivables	Hold to collect contractual cash flows	Cash flows are solely payments of principal and interest	Amortised Cost

Business model assessment

The Bank makes an assessment of the objective of the business model in which a financial asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- The stated policies and objectives for the portfolio and the operation of those policies in practice. These include whether management's strategy focuses on earning contractual interest income, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of any related liabilities or expected cash outflows or realising cash flows through the sale of the assets;
- How the performance of the portfolio is evaluated and reported to the Bank's management;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- How managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- The frequency, volume and timing of sales of financial assets in prior periods, the reasons for such sales and expectations about future sales activity.

Financial assets that are held for trading or are managed and whose performance is evaluated on a fair value basis are measured at FVTPL, because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Assessment whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making this assessment, the Bank considers:

- Contingent events that would change the amount or timing of cash flows;
- Terms that may adjust the contractual coupon rate, including variable rate features;
- Prepayment and extension features; and
- Terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse features).

Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with National Bank of Georgia and highly liquid financial assets with original maturities of three months or less from the date of initial recognition that are subject to an insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments.

Mandatory cash balance with the NBG

Mandatory cash balances with the NBG are carried at amortised cost and represent mandatory reserve deposits that are not available to finance the Bank's day to day operations. Hence they are not considered as part of cash and cash equivalents for the purposes of the statement of cash flows.

Due from financial institutions

Amounts due from other banks are recorded when the Bank advances money to counterparty banks with original maturity of more than three months. Amounts due from financial institutions are carried at amortised cost.

Loans to customers

Loans to customers are initially measured at fair value plus incremental transaction costs and subsequently at their amortised cost using the effective interest method.

Investments in debt instruments

Investments in debt instruments include investments in certificate of deposits issued by National Bank of Georgia and Treasury bills issued by Ministry of Finance. These are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

Investments in equity instruments

The Bank elected to present in OCI changes in the fair value of investment in equity instrument that are not held for trading. The election is made on an instrument-by-instrument basis on initial recognition and is irrevocable.

Gains and losses on such equity instruments are never reclassified to profit or loss and no impairment is recognised in profit or loss.

Dividends are recognised in profit or loss unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in OCI. Cumulative gains and losses recognised in OCI are transferred to retained earnings on disposal of an investment.

Reclassification

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets. If the business model under which the Bank holds financial assets changes, the financial assets affected are reclassified. The classification and measurement requirements related to the new category apply prospectively from the first day of the first reporting period following the change in business model that results in reclassifying the Bank's financial assets. During the current financial year and previous accounting period there was no change in the business model under which the Bank holds financial assets and therefore no reclassifications were made. Changes in contractual cash flows are considered under the accounting policy on Modification and derecognition of financial assets described below.

Impairment

The Bank recognises loss allowances for expected credit losses (ECLs) on the financial assets that are not measured at FVTPL.

With the exception of purchased or originated credit-impaired ("POCI") financial assets, ECLs are required to be measured through a loss allowance at an amount equal to:

- 12-month ECL, i.e. lifetime ECL that result from those default events on the financial instrument that are possible within 12 months after the reporting date, (referred to as Stage 1); or
- Full lifetime ECL, i.e. lifetime ECL that result from all possible default events over the life of the financial instrument, (referred to as Stage 2 and Stage 3).

A loss allowance for full lifetime ECL is required for a financial instrument if the credit risk on that financial instrument has increased significantly since initial recognition. For all other financial instruments, ECLs are measured at an amount equal to the 12-month ECL.

Loss allowances for other receivables are always measured at an amount equal to lifetime ECL.

ECLs are a probability-weighted estimate of the present value of credit losses. These are measured as the present value of the difference between the cash flows due to the Bank under the contract and the cash flows that the Bank expects to receive arising from the weighting of multiple future economic scenarios, discounted at the asset's EIR.

More information on measurement of ECLs is provided in Note 33 including details on how instruments are grouped when they are assessed on a collective basis.

Credit-impaired financial assets

A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred. Credit-impaired financial assets are referred to as Stage 3 assets. Evidence of credit-impairment includes observable data about the following events:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the lender of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession that the lender would not otherwise consider;
- the disappearance of an active market for a security because of financial difficulties; or
- the purchase of a financial asset at a deep discount that reflects the incurred credit losses.

It may not be possible to identify a single discrete event—instead, the combined effect of several events may have caused financial assets to become credit-impaired. The Bank assesses whether debt instruments that are financial assets measured at amortised cost or FVTOCI are credit-impaired at each reporting date.

A loan is considered credit-impaired when a concession is granted to the borrower due to a deterioration in the borrower's financial condition, unless there is evidence that as a result of granting the concession the risk of not receiving the contractual cash flows has reduced significantly and there are no other indicators of impairment. For financial assets where concessions are contemplated but not granted the asset is deemed credit impaired when there is observable evidence of credit-impairment including meeting the definition of default.

The definition of default (see below) includes unlikeliness to pay indicators and a back-stop if amounts are overdue for 90 days or more.

Purchased or originated credit-impaired financial assets

POCI financial assets are treated differently because the asset is credit-impaired at initial recognition. For these assets, the Bank recognises all changes in lifetime ECL since initial recognition as a loss allowance with any changes recognised in profit or loss. A favourable change for such assets creates an impairment gain.

Definition of default

Critical to the determination of ECL is the definition of default. The definition of default is used in measuring the amount of ECL and in the determination of whether the loss allowance is based on 12-month or lifetime ECL, as default is a component of the probability of default (PD) which affects both the measurement of ECLs and the identification of a significant increase in credit risk.

The Bank considers the following as constituting an event of default:

- the borrower is past due more than 90 days on any material credit obligation to the Bank; or
- the borrower has loan loss provision rate per national bank of Georgia 30% or more; or
- the borrower is transferred to the problem asset management division, or
- the borrower is unlikely to pay its credit obligations to the Bank in full.

The definition of default is appropriately tailored to reflect different characteristics of different types of assets. When assessing if the borrower is unlikely to pay its credit obligation, the Bank takes into account both qualitative and quantitative indicators. Quantitative indicators, such as overdue status and non-payment on another obligation of the same counterparty are key inputs in this analysis. The Bank uses a variety of sources of information to assess default which are either developed internally or obtained from external sources.

Significant increase in credit risk

The Bank monitors all financial assets that are subject to the impairment requirements to assess whether there has been a significant increase in credit risk since initial recognition. If there has been a significant increase in credit risk the Bank will measure the loss allowance based on lifetime rather than 12-month ECL.

As a back-stop when an asset becomes 30 days past due or Loan Loss Provision rate determined based on National Bank of Georgia's guideline increases to 10%, the Bank considers that a significant increase in credit risk has occurred and the asset is in stage 2 of the impairment model, i.e. the loss allowance is measured as the lifetime ECL.

The Bank's accounting policy is not to use the practical expedient that financial assets with 'low' credit risk at the reporting date are deemed not to have had a significant increase in credit risk. As a result the Bank monitors all financial assets that are subject to impairment for significant increase in credit risk.

See Note 33 for more details about significant increase in credit risk.

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

- for financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- for loan commitments and financial guarantee contracts: as a provision; and
- where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision.

Modification and derecognition of financial assets

A modification of a financial asset occurs when the contractual terms governing the cash flows of a financial asset are renegotiated or otherwise modified between initial recognition and maturity of the financial asset. A modification affects the amount and/or timing of the contractual cash flows either immediately or at a future date.

The Bank renegotiates loans to customers in financial difficulty to maximise collection and minimise the risk of default. A loan terms is modified in cases where although the borrower made all reasonable efforts to pay under the original contractual terms, there is a high risk of default or default has already happened and the borrower is expected to be able to meet the revised terms. The revised terms in most of the cases include an extension of the maturity of the loan, changes to the timing of the cash flows of the loan (principal and interest repayment), reduction in the amount of cash flows due (principal and interest forgiveness) and amendments to other terms.

When a financial asset is modified the Bank assesses whether this modification results in derecognition. In accordance with the Bank's policy a modification results in derecognition when it gives rise to substantially different terms. To determine if the modified terms are substantially different from the original contractual terms the Bank considers the following:

- Qualitative factors, such as contractual cash flows after modification are no longer SPPI, change in currency or change of counterparty, the extent of change in interest rates, maturity, covenants. If these do not clearly indicate a substantial modification, then;
- A quantitative assessment is performed to compare the present value of the remaining contractual cash flows under the original terms with the contractual cash flows under the revised terms, both amounts discounted at the original effective interest. If the difference in present value is greater than 10% the Bank deems the arrangement is substantially different leading to derecognition.

In the case where the financial asset is derecognised the loss allowance for ECL is remeasured at the date of derecognition to determine the net carrying amount of the asset at that date. The difference between this revised carrying amount and the fair value of the new financial asset with the new terms will lead to a gain or loss on derecognition. The new financial asset will have a loss allowance measured based on 12-month ECL except in the rare occasions where the new loan is considered to be originated-credit impaired. This applies only in the case where the fair value of the new loan is recognised at a significant discount to its revised par amount because there remains a high risk of default which has not been reduced by the modification. The Bank monitors credit risk of modified financial assets by evaluating qualitative and quantitative information, such as if the borrower is in past due status under the new terms.

When the contractual terms of a financial asset are modified and the modification does not result in derecognition, the Bank determines if the financial asset's credit risk has increased significantly since initial recognition.

For financial assets modified as part of the Bank's restructuring policy, where modification did not result in derecognition, the estimate of PD reflects the Bank's ability to collect the modified cash flows taking into account the Bank's previous experience of similar restructuring action, as well as various behavioural indicators, including the borrower's payment performance against the modified contractual terms. If the credit risk remains significantly higher than what was expected at initial recognition the loss allowance will continue to be measured at an amount equal to lifetime ECL. The loss allowance on forborne loans will generally only be measured based on 12-month ECL when there is evidence of the borrower's improved repayment behaviour following modification leading to a reversal of the previous significant increase in credit risk.

Where a modification does not lead to derecognition the Bank calculates the modification gain/loss comparing the gross carrying amount before and after the modification (excluding the ECL allowance). Then the Bank measures ECL for the modified asset, where the expected cash flows arising from the modified financial asset are included in calculating the expected cash shortfalls from the original asset.

The Bank derecognises a financial asset only when the contractual rights to the asset's cash flows expire (including expiry arising from a modification with substantially different terms), or when the financial asset and substantially all the risks and rewards of ownership of the asset are transferred to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognise the financial asset.

Write-off

Loans and advances are written off against the allowance for impairment losses when deemed uncollectible. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Bank. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the statement of profit or loss in the period of recovery.

Financial assets – applicable before January 1, 2018

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- The financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Bank's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives, and IAS 39 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognized in profit or loss. The net gain or loss recognized in profit or loss incorporates any dividend and interest earned on the financial asset and is included in the 'other gains and losses' and 'interest income' line item, respectively, in the statement of profit or loss.

Investments held to maturity

Investments held to maturity including investments in debt instruments are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Bank has the positive intent and ability to hold to maturity. Investments held to maturity are measured at amortized cost using the effective interest method less any impairment.

If the Bank were to sell or reclassify more than an insignificant amount of investments held to maturity before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as available-for-sale. Furthermore, the Bank would be prohibited from classifying any financial asset as held to maturity during the current financial year and following two financial years.

Available-for-sale financial assets

Available-for-sale financial assets including investments in equity instruments are non-derivatives that are either designated as available-for-sale or are not classified as (a) loans and receivables, (2) held to maturity investments or (c) financial assets at fair value through profit or loss.

Listed shares held by the Bank that are traded in an active market are classified as AFS and are stated at fair value. Gains and losses arising from changes in fair value are recognized in other comprehensive income and accumulated in the investments revaluation reserve, with the exception of other-than-temporary impairment losses, interest calculated using the effective interest method, dividend income and foreign exchange gains and losses on monetary assets, which are recognized in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.
The fair value of AFS monetary assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the end of the reporting period. The foreign exchange gains and losses that are recognized in profit or loss are determined based on the amortised cost of the monetary asset. Other foreign exchange gains and losses are recognized in other comprehensive income.

AFS equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less any identified impairment losses at the end of each reporting period.

Loans and receivables

Loans and receivables (including due from financial institutions, loans to customers and other financial assets) that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Embedded derivatives – applicable before January 1,2018

An embedded derivative is part of a financial instrument that also includes a non-derivative host contract. The embedded derivative requires that some portion of the contract's cash flows be modified in relation to changes in a variable, such as:

- Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract;
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and
- It is settled at a future date.

Derivatives embedded in non-derivative host contracts are treated as separate derivatives when they meet the definition of a derivative, their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at FVTPL.

Embedded derivatives – applicable after January 1, 2018

IFRS 9 precludes the separation of any embedded derivatives from a hybrid contract when the host contract is a financial asset within its scope. Instead, the entire hybrid financial asset is classified into one of the three measurement categories. More information on reclassification and remeasurement of embedded derivatives under IFRS 9 is provided in Note 3.

Impairment of financial assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For unlisted equity investments classified as AFS, a significant or prolonged decline in the fair value of the security below its cost would be considered to be objective evidence of impairment.

For all other financial assets, objective evidence of impairment could include:

- Significant financial difficulty of the issuer or counterparty; or
- Breach of contract, such as default or delinquency in interest or principal payments; or
- Default or delinquency in interest or principal payments; or
- It becoming probable that the borrower will enter bankruptcy or financial re-organisation; or
- Disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial asset, such as loans and receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of loans and receivables could include the Bank's past experience of collecting payments, an increase in the number of delayed payments in the portfolio, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of loans and receivables, where the carrying amount is reduced through the use of an allowance account. When a loan or a receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

For financial assets measured at amortized cost, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no

longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

Write off

Loans and advances are written off against the allowance for impairment losses when deemed uncollectible. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Bank. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the statement of profit or loss in the period of recovery.

Derecognition of financial assets

The Bank derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another party. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain of loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit or loss.

On derecognition of a financial asset other than in its entirety (e.g. when the Bank retains an option to repurchase part of a transferred asset), the Bank allocates the previous carrying amount of the financial asset between the part it continues to recognize under continuing involvement, and the part it no longer recognizes on the basis of the relative fair values of those parts on the date of the transfer. The difference between the carrying amount allocated to the part that is no longer recognized and the sum of the consideration received for the part no longer recognized and any cumulative gain or loss allocated to it that had been recognized in other comprehensive income is recognized in profit or loss. A cumulative gain or loss that had been recognized in other comprehensive income is allocated between the part that continues to be recognized and the part that is no longer recognized on the basis of the relative fair values of those parts.

Financial liabilities and equity instruments issued

Classification as debt or equity

Debt and equity instruments issued by entity are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Bank are recognized at the proceeds received, net of direct issue costs.

Compound instruments

The components parts of compound instruments issued by the Bank are classified separately as financial liabilities and equity in accordance with the substance of the contractual agreement. At the date of issue, the fair value of the liability component is estimated using prevailing market interest rate for a similar non-convertible instrument. This amount is recorded as a liability on an amortized cost basis using the effective interest method until extinguished upon conversion or at the instrument's maturity date.

Financial liabilities

A financial liability is a contractual obligation to deliver cash or another financial asset or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Bank or a contract that will or may be settled in the Bank's own equity instruments and is a non-derivative contract for which the Bank is or may be obliged to deliver a variable number of its own equity instruments, or a derivative contract over own equity that will or may be settled other than by the exchange of a fixed amount of cash (or another financial asset) for a fixed number of the Bank's own equity instruments.

Derivative financial instruments.

The Bank enters into offsetting deposits with its counterparty banks to exchange currencies. Such deposits, while legally separate, are aggregated and accounted for as a single derivative financial instrument (currency swap) on a net basis where (i) the deposits are entered into at the same time and in contemplation of one another, (ii) they have the same counterparty, (iii) they relate to the same risk and (iv) there is no apparent business purpose for structuring the transactions separately that could not also have been accomplished in a single transaction.

Derivatives are initially recognized at fair value at the date the derivative contract is entered into and are subsequently remeasured to their fair value at the end of each reporting period.

All derivative instruments are carried as assets when fair value is positive and as liabilities when fair value is negative. Changes in the fair value of derivative instruments are included in profit or loss as gains/(losses) on derivative financial instruments or as gain/(losses) from foreign currencies operations, depending on the nature of the instrument.

Other financial liabilities

Other financial liabilities (including deposits by banks, deposits by customers, borrowed funds, subordinated debt and other financial liabilities) are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognized on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Derecognition of financial liabilities

The Bank derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability derecognised and consideration paid is recognised in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss.

For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

The Bank derecognises a financial liability when its terms were modified and the cash flows of the modified liability were substantially different. In this case, a new financial liability based on the modified terms was recognised at fair value. The difference between the carrying amount of the financial liability extinguished and consideration paid was recognised in profit or loss.

Consideration paid included non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability. If the modification of a financial liability was not accounted for as derecognition, then any costs and fees incurred were recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

Due to financial instititutions, deposits by customers and subordinated debt

Financial liabilities include due to financial institutions, deposits by customers and subordinated debt that are the Bank's sources of debt funding. Financial liabilities are initially measured at fair value, net of incremental direct transaction costs. Financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Bank are recognised at the proceeds received, net of direct issue costs.

Financial guarantees and loan commitments – applicable after January 1, 2018

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. Loan commitments are firm commitments to provide credit under pre-specified terms and conditions.

Financial guarantees issued or commitments to provide a loan at a below-market interest rate are initially measured at fair value. Subsequently, they are measured at the higher of the loss allowance determined in accordance with IFRS 9 and the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15;

The Bank has issued no loan commitments that are measured at FVTPL.

For other loan commitments: the Bank recognises a loss allowance in accordance with IFRS 9.

Financial guarantees and loan commitments – *applicable before January 1, 2018*

Financial guarantee contracts issued by the Bank are initially measured at their fair values and, if not designated as at FVTPL, are subsequently measured at the higher of:

- The amount of the obligation under the contract, as determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* ; and
- The amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Bank as lessor

Rental income from operating leases is recognized on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognized on a straight-line basis over the lease term.

The Bank as lessee

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognized as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognized as a liability. The aggregate benefit of incentives is recognized as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

Repossessed assets

In certain circumstances, assets are repossessed following the foreclosure on loans that are in default. The Bank views the repossessed assets as a form of settlement of amounts due under the defaulted loan and that it is an asset acquired and held for sale in the ordinary course of business.

Repossessed assets are initially recognized at fair value and subsequent measured at the lower of carrying amount and fair value less costs to sell.

Collateral

The Bank obtains collateral in respect of customer liabilities where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Bank a claim on these assets for both existing and future customer liabilities.

Property and equipment

Initial cost of property and equipment is assessed based on actual expenses for their acquisition that comprise purchase price, including non-refundable purchase taxes and any directly attributed costs of bringing the assets to its working condition and location for intended use. Subsequent to initial recognition property and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses, if any.
Depreciation is recognized so as to write off the cost or valuation of assets (other than freehold land and construction in progress) less their residual values over their useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following annual rates:

Buildings and other real estate	2%-3%
Furniture and office fixtures	10%-20%
Computer and office equipment	10%-33%
Other	5%-20%
Intangible assets	10%

Freehold land is not depreciated.

Leasehold improvements are amortized over the life of the related leased asset. Expenses related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization.

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss and other comprehensive income.

Intangible assets

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives. The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Derecognition of intangible assets

An intangible asset is derecognized on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognized in profit or loss and other comprehensive income when the asset is derecognized.

Impairment of non-financial assets other than goodwill

At the end of each reporting period, the Bank reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Bank estimates the recoverable amount of the cash-generating unit to which the asset belongs. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

Current tax. The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of profit or loss and other comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Bank's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax. Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax assets arising from deductible temporary differences associated with other assets and liabilities are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Current and deferred tax for the year

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively.

On 13 May 2016 the Parliament of Georgia passed the bill on corporate income tax reform (also known as the Estonian model of corporate taxation), which mainly moves the moment of taxation from when taxable profits are earned to when they are distributed.

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

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

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

The law has entered into force in 2016 and is effective for tax periods starting after January 1, 2017 for all entities except for financial institutions (such as banks, insurance companies, microfinance organizations, pawnshops), for which the law initially was effective for financial institutions from January 1, 2019. On December 27, 2018, the parliament of Georgia extended effective date of application of the law to January 1, 2023.

Operating taxes

Georgia also has various other taxes, which are assessed on the Bank's activities. These taxes are included as a component of operating expenses in the statement of profit or loss.

Provisions

Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of a past event, it is probable that the Bank will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Contingencies

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

Foreign currencies

In preparing the consolidated financial statements of the Bank, transactions in currencies other than the Bank's functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are translated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not translated.

The exchange rates used by the Bank in the preparation of the consolidated financial statements as at year-end are as follows:

	December 31, 2018	**December 31, 2017**
GEL/1 US Dollar	2.6766	2.5922
GEL/1 Euro	3.0701	3.1044

5. Critical accounting judgements and key sources of estimation uncertainty

In the application of the Bank's accounting policies, which are described in Note 4, the Bank management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Critical judgments in applying accounting policies. The following are the critical judgments, apart from those involving estimations (see below), that the management has made in the process of applying the Bank's accounting policies and that have the most significant effect on the amounts recognized in the separate financial statements.

Classification of financial assets - applicable after January 1, 2018

Assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding.

Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification. Judgement is needed in assessing what is the risk that leads to the variability in contractual cash flows and whether that risk is consistent with risks associated with a basic lending arrangement. As described in Note 3, the Bank considers that foreign currency feature embedded in the lending contracts is a risk consistent with basis lending arrangement.

Further details of the financial assets classification are set out in Note 4;

Investments in debt instruments – applicable before January 1, 2018

The management reviewed the Bank's investments held to maturity in the light of its capital maintenance and liquidity requirements and confirmed the Bank's positive intention and ability to hold those assets to maturity. As at December 31, 2017 and 2018 the carrying amount of the investments held to maturity is GEL 27,978 and 19,295 thousands, respectively. Details of these assets are set out in Note 12.

Key sources of estimation uncertainty. The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Loss allowances for expected credit losses - applicable after January 1, 2018

The following are key estimations that the management have used in the process of applying the Bank's accounting policies and that have the most significant effect on the loss allowances for expected credit losses:

- **Establishing forward-looking scenarios:** When measuring ECL the Bank uses reasonable and supportable forward looking information for individually assessed borrowers, which is based on assumptions for the future movement of different economic drivers and how these drivers will affect each other.

  See Note 33 for more details, including analysis of the sensitivity of the reported ECL to changes in estimated forward looking information.

- **Significant increase in credit risk:** As explained in note 3, ECL are measured as an allowance equal to 12-month ECL for stage 1 assets, or lifetime ECL for stage 2 or stage 3 assets. An asset moves to stage 2 when its credit risk has increased significantly since initial recognition. IFRS 9 does not define what constitutes a significant increase in credit risk. In assessing whether the credit risk of an asset has significantly increased the Bank takes into account qualitative and quantitative reasonable and supportable forward looking information.

  See Note 33 for more details, including analysis of the sensitivity of the reported ECL to changes in estimated forward looking information.

- **Probability of default:** PD constitutes a key input in measuring ECL. PD is an estimate of the likelihood of default over a given time horizon, the calculation of which includes historical data, and assumptions.

  See Note 33 for more details, including analysis of the sensitivity of the reported ECL to changes in PD.

- **Loss Given Default:** LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, taking into account cash flows from collateral and integral credit enhancements.

  See Note 33 for more details, including analysis of the sensitivity of the reported ECL to changes in LGD.

Impairment of loans and receivables - applicable before January 1, 2018.

Impairment of loans and receivables. The Bank regularly reviews its loans and receivables to assess for impairment. The Bank's loan impairment provisions are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Bank considers accounting estimates related to allowance for impairment of loans and receivables a key source of estimation uncertainty because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and receivables are based on recent performance experience, and (ii) any significant difference between the Bank's estimated losses and actual losses would require the Bank to record provisions which could have a material impact on its consolidated financial statements in future periods.

The Bank uses management's judgment to estimate the amount of any impairment loss in cases where a borrower has financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on past performance, past customer behavior, observable data indicating an adverse change in the payment status of borrowers in a group, and national or local economic conditions that correlate with defaults on assets in the group. The management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans. The Bank uses management's judgment to adjust observable data for a group of loans to reflect current circumstances not reflected in historical data.

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

As at December 31, 2017 the gross loans to customers totalled GEL 869,723 and allowance for impairment losses amounted to GEL 74,837 respectively.

Useful lives of property and equipment. The Bank reviews the estimated useful lives of property and equipment at the end of each annual reporting period. During the year 2018, the Bank's management did not revise useful lives property and equipment.

Valuation of repossessed assets. Repossessed assets are initially recognized at fair value and subsequently measured at the lower of carrying amount and fair value less costs to sell.

The valuation was carried out by an independent firm of valuators which holds a recognised and relevant professional qualification and who have recent experience in valuation of assets of similar location and category. In the process of comparison, they have used three comparative analogues (registered sale and/or offer for sale), in which prices were applied adjustments based on the difference between subject assets and analogues. Most of the assets have been estimated by using the market approach/method due to the market situation, namely by existence of a sufficient number of registered sales and proposals by the date of valuation.

Measurement of deferred tax assets/liabilities

On June, 2018 the Parliament of Georgia enacted the changes in the Tax Code of Georgia effective from January 1, 2023, for commercial banks, credit unions, insurance organizations, microfinance organizations and pawnshops. The new code impacts the recognition and measurement principles of the Bank's income tax and it also affects the Bank's deferred income tax assets/liabilities. Commercial banks do not have to pay income tax on their profit before tax (earned since 1 January 2023) until that profit is distributed in a form of dividend or other forms of profit distributions.

Whist this law will come into effect for the banking sector from January 2023, it has a more immediate impact on deferred tax calculations.

The management of the Bank is confident deferred tax assets/liabilities balances at the reporting will be fully utlised or the effect will be immaterial for the users of financial statements.

The carrying value of deferred tax liabilities amounted to GEL 6,963 thousand and GEL 6,362 thousand as at December 31, 2018 and 2017, respectively.

Valuation of embedded foreign currency derivative - - applicable before January 1, 2018.

Embedded foreign currency derivative feature to the loans to customers contracts are not closely related to the host contract and accounted for as a separate derivative financial instrument. Embedded foreign currency derivative financial instrument is measured at fair value through profit or loss.

Embedded derivatives – applicable after January 1,2018

IFRS 9 precludes the separation of any embedded derivatives from a hybrid contract when the host contract is a financial asset within its scope. Instead, the entire hybrid financial asset is classified into one of the three measurement categories. More information on reclassification and remeasurement of embedded derivatives under IFRS 9 is provided in Note 3.

Initial recognition of related party transactions

In the normal course of business the Bank enters into transactions with its related parties. IAS 39 and IFRS 9 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

The information on related party balances is disclosed in Note 30.

6. Cash and cash equivalents

	December 31, 2018	December 31, 2017
Cash	18,226	16,478
Balances with the NBG	2,130	63,150
Balances with banks with original maturities up to 90 days	104,225	145,016
Less: allowance for expected credit loss/impairment losses	(46)	-
Total cash and cash equivalents	**124,535**	**224,644**

Cash and cash equivalents are non-past due financial assets as at December 31, 2018 and 2017. The allowance for expected credit losses as at December 31, 2018 was estimated based on counterparty ratings determined by international rating agencies.

7. Mandatory Balances with NBG

Mandatory cash balance with the National Bank of Georgia ("NBG") represent amounts deposited with the NBG. Resident financial institutions are required to maintain an interest-earning obligatory reserve with the NBG, the amount of which depends on the level of funds attracted by the financial institutions. Mandatory balances with the NBG is interest bearing financial asset.

	December 31, 2018	December 31, 2017
Mandatory balances with the NBG	138,191	120,479
Less: allowance for expected credit losses/impairment losses	(36)	-
Total mandatory Balances with the NBG	**138,155**	**120,479**

Mandatory balances with the NBG are non-past due financial assets as at December 31, 2018 and 2017. The allowance for expected credit losses as at December 31, 2018 was estimated based on counterparty ratings determined by international rating agencies. According to Fitch credit rating agency country rating for Georgia stands at BB- with positive outlook.

8. Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss comprise:

	December 31, 2018	December 31, 2017
Embedded foreign currency derivative financial instrument	-	18,253
Total financial assets at fair value through profit or loss	**-**	**18,253**

As described in Note 3, under IFRS 9 embedded derivative in a host financial asset contract is not separated rather the whole hybrid instrument is assessed for classification.

Embedded foreign currency derivative in the certain loans to customers contracts, did not result in failure of SPPI test, therefore the whole hybrid instrument is measured at amortised cost.

9. Due from financial institutions

As at December 31, 2018 and December 31, 2017 included in balances due from financial institutions are guarantee deposits placed by the Bank for its operations with plastic cards totalling GEL 3,845 and GEL 4,048, respectively.

	December 31, 2018	December 31, 2017
Due from financial institutions	12,392	18,800
Less: allowance for expected credit losses/impairment losses	(12)	-
Total due from financial institutions	**12,380**	**18,800**

Due from financial institutions include placements with original maturities of more than three months that are non-past due financial assets as at December 31, 2018 and 2017. The allowance for expected credit losses as at December 31, 2018 was estimated based on counterparty ratings determined by international rating agencies.

10. Loans to customers

Loans to customers comprise:

	December 31, 2018	December 31, 2017
Loans to customers	842,807	819,530
Accrued interest	71,929	50,193
Total gross exposure	**914,736**	**869,723**
Less: allowance for expected credit losses/impairment losses	(92,841)	(74,837)
Total loans to customers	**821,895**	**794,886**

All loans to customers are measured at amortised cost. The loans to customers are classified by types based on a combination of factors (mainly the income source of the borrowers and the purpose of the loan). Loans taken by individual business owners for consumer purposes are presented in relevant categories according to the business activity types of the borrowers.

	December 31, 2018	December 31, 2017
Loans collateralized by pledge of real estate	715,979	738,488
Loans collateralized by pledge of cash	10,811	7,290
Loans collateralized by pledge of equipment	47,768	14,499
Loans collateralized by pledge of inventory	19,293	13,414
Other collateral	12,447	5,226
Unsecured loans	15,597	15,969
Total loans to customers	**821,895**	**794,886**

During the years ended December 31, 2018 and December 31, 2017 the Bank received non-financial assets by taking possession of collateral it held as security. As at December 31, 2018 and December 31, 2018 such assets in amount of GEL 63,613 and GEL 66,977 (See Note 14), respectively, are included in other assets of the Bank.

The table below summarizes loans to customers analysed by industries as at December 31, 2018:

	Gross loans to customers	Allowance for ECL	Net loans to customers	Allowance for ECL to gross loans to customers
Analysis by sector:				
Individuals	47,324	(3,507)	43,817	7.41%
Trade and service	337,815	(37,179)	300,636	11.01%
Construction	197,366	(27,010)	170,356	13.69%
Manufacturing	242,285	(19,219)	223,066	7.93%
Agriculture	50,822	(4,783)	46,039	9.41%
Energy	2,735	(1)	2,734	0.04%
Transport and communication	27,064	(1,053)	26,011	3.89%
Other	9,325	(89)	9,236	0.95%
Total	**914,736**	**(92,841)**	**821,895**	**10.15%**

The table below summarizes loans to customers analysed by industries as at December 31, 2017:

	Gross loans to customers	Allowance for impairment losses	Net loans to customers	Allowance for impairment losses to gross loans to customers
Analysis by sector:				
Individuals	46,862	(4,359)	42,503	9.30%
Trade and service	335,329	(25,066)	310,263	7.48%
Construction	182,885	(28,326)	154,559	15.49%
Manufacturing	235,481	(14,932)	220,549	6.34%
Agriculture	48,118	(2,065)	46,053	4.29%
Energy	3,182	-	3,182	0.00%
Transport and communication	3,956	-	3,956	0.00%
Other	13,910	(89)	13,821	0.64%
Total	**869,723**	**(74,837)**	**794,886**	**8.60%**

Loans to individuals comprise the following products:

	December 31, 2018	December 31, 2017
Consumer loans	23,025	22,613
Mortgage loans	21,301	20,687
Other	2,998	3,562
Less: allowance for expected credit losses/impairment losses	(3,507)	(4,359)
Total loans to individuals	**43,817**	**42,503**

Analysis by credit quality of loans to customers outstanding as at December 31, 2018 and December 31, 2017 was as follows:

As at December 31, 2018	**Gross loans to customers**	**Allowance for ECL**	**Net loans to customers**	**Allowance for ECL to gross loans to customers**
Collectively impaired				
Not past due	601,879	(20,903)	580,976	3.47%
Overdue:			-	
up to 30 days	1,574	(9)	1,565	0.57%
31 to 60 days	166	(52)	114	31.33%
61 to 90 days	2,513	(525)	1,988	20.89%
91 to 180 days	20,594	(183)	20,411	0.89%
over 180 days	62,802	(8,556)	54,246	13.62%
Total collectively impaired loans	**689,528**	**(30,228)**	**659,300**	**4.38%**
Individually impaired				
Not past due	73,871	(28,955)	44,916	39.20%
Overdue:				
up to 30 days	1,091	(197)	894	18.06%
31 to 60 days	37	(5)	32	13.51%
61 to 90 days	49,780	(6,675)	43,105	13.41%
91 to 180 days	13,441	(1,679)	11,762	12.49%
over 180 days	86,988	(25,102)	61,886	28.86%
Total individually impaired loans	**225,208**	**(62,613)**	**162,595**	27.80%
Total loans to customers	**914,736**	**(92,841)**	**821,895**	**10.15%**

As at December 31, 2017	**Gross loans**	**Provision for impairment**	**Net loans**	**Provision for impairment to gross loans**
Collectively impaired				
Not past due	635,882	(5,829)	630,053	0.92%
Overdue:				
up to 30 days	815	-	815	0.00%
31 to 60 days	129	-	129	0.00%
61 to 90 days	3,767	-	3,767	0.00%
91 to 180 days	1,909	(25)	1,884	1.31%
over 180 days	87,424	(23,215)	64,209	26.55%
Total collectively impaired loans	**729,926**	**(29,069)**	**700,857**	**3.98%**
Individually impaired				
Not past due	132,400	(43,604)	88,796	32.93%
Overdue:				
up to 30 days	-	-	-	0.00%
31 to 60 days	-	-	-	0.00%
61 to 90 days	14	(3)	11	21.43%
91 to 180 days	113	(23)	90	20.35%
over 180 days	7,270	(2,138)	5,132	29.41%
Total individually impaired loans	**139,797**	**(45,768)**	**94,029**	**32.74%**
Total loans to customers	**869,723**	**(74,837)**	**794,886**	**8.60%**

Allocation of loans to customers to expected credit loss by stages as at December 31, 2018 and January 1, 2018 are as following:

	December 31, 2018			January 1, 2018		
	Gross loans	**Allowance for ECL**	**Net loans**	**Gross loans**	**Allowance for ECL**	**Net loans**
Stage 1- 12 month ECL	**448,371**	**(4,955)**	**443,416**	**488,429**	**(5,161)**	**483,268**
Individually impaired	9,249	(754)	**8,495**	8,559	**-**	**8,559**
Collectively impaired	439,122	(4,201)	**434,921**	479,870	**(5,161)**	**474,709**
Stage 2 - Lifetime ECL – not credit- impaired:	**108,971**	**(7,258)**	**101,713**	**87,436**	**(2,976)**	**84,460**
Individually impaired	*49,807*	*(6,677)*	**43,130**	-	-	-
Collectively impaired	*59,164*	*(581)*	**58,583**	*87,436*	*-2976*	*84,460*
Stage 3 - Lifetime ECL – credit-impaired:	**357,394**	**(80,628)**	**276,766**	**324,572**	**(81,973)**	**242,599**
Individually impaired	*166,152*	*(55,182)*	**110,970**	*128,713*	*(52,400)*	76,313
Collectively impaired	*191,242*	*(25,446)*	**165,796**	*195,859*	*(29,573)*	166,286
Total loans to customers	**914,736**	**(92,841)**	**821,895**	**900,437**	**(90,110)**	**810,327**

As at January 1, 2018 loans to customers include currency risk premium in amount of GEL 25,582 previously classified as financial assets through profit and loss and disclosed separately in the consolidated financial statements at fair value of GEL 18,253;

11. Investments in equity instruments

Investments in equity instruments comprise:

	% of ownership	**December 31, 2018**	**December 31, 2017**
OJSC United Clearing Center	6.25%	54	54
JSC GSCD	0.27%	3	3
JSC United Finance Corporation	1.34%	-	-
Total investments in equity instruments		**57**	**57**

As at December 31, 2018, management estimated fair value of investment equity instruments and concluded that fair value approximates to its cost.

As at December 31, 2017, investments in equity instruments were carried at cost.

12. Investments in debt instruments

	December 31, 2018		December 31, 2017	
	Nominal annual interest rate	Amount	Nominal annual interest rate	Amount
T-bills of the Ministry of Finance of Georgia	7.10% - 7.45%	13,724	7.10% - 7.85%	21,032
Deposit certificates of the Ministry of Finance of Georgia	7.10% - 7.15%	5,585	7.05% - 7.30%	6,946
Less allowance for expected credit losses/impairment losses		(14)		-
Total investments in debt instruments		**19,295**		**27,978**

Investments in debt instruments are non-past due financial assets as at December 31, 2018 and 2017. The allowance for expected credit losses as at December 31, 2018 was estimated based on counterparty ratings determined by international rating agencies.

13. Property and equipment

Property and equipment comprise:

	Buildings and other real estate	Furniture and fixtures	Computer and office equipment	Leasehold improve-ments and other	Construction in progress	Total
At cost						
January 1, 2017	**9,493**	**6,597**	**7,183**	**2,267**	**415**	**25,955**
Additions	611	194	240	-	309	1,354
Transfers	256	81	67	107	(511)	-
Disposals	-	(3)	(319)	(154)	(11)	(487)
December 31, 2017	**10,360**	**6,869**	**7,171**	**2,220**	**202**	**26,822**
Additions	-	41	-	-	34	75
Transfers	-	-	194	-	(194)	-
Disposals	-	(134)	-	-	-	(134)
December 31, 2018	**10,360**	**6,776**	**7,365**	**2,220**	**42**	**26,763**
Accumulated depreciation						
January 1, 2017	**1,656**	**4,646**	**3,570**	**1,528**	**-**	**11,400**
Depreciation charge	244	459	993	104	-	1,800
Eliminated on disposals	-	(2)	(294)	(144)	-	(440)
December 31, 2017	**1,900**	**5,103**	**4,269**	**1,488**	**-**	**12,760**
Depreciation charge	249	403	815	87	-	1,554
Eliminated on disposals	-	(134)	-	-	-	(134)
December 31, 2018	**2,149**	**5,372**	**5,084**	**1,575**	**-**	**14,180**
Net book value						
As at December 31, 2018	**8,211**	**1,404**	**2,281**	**645**	**42**	**12,583**
As at December 31, 2017	**8,460**	**1,766**	**2,902**	**732**	**202**	**14,062**

As at December 31, 2018 and December 31, 2017 included in property and equipment were fully depreciated assets totaling GEL 7,219 and GEL 5,771, respectively.

14. Other assets

Other assets comprise:

	December 31, 2018	December 31, 2017
Other financial assets:		
Accounts receivable	1,463	905
Insurance premium receivable	2,863	3,825
Claims for guarantees paid	159	159
Less: expected credit losses/impairment losses	(419)	-
Total other financial assets	**4,066**	**4,889**
Other non-financial assets:		
Repossessed assets	63,613	66,977
Intangible assets	5,222	6,164
Reinsurance receivable	2,108	1,735
Tax settlements, other than income tax	1,321	728
Advances paid	111	688
Other inventory	786	106
Other	142	158
Total other non-financial assets	**73,303**	**76,556**
Total other assets	**77,369**	**81,445**

Repossessed assets as at December 31, 2018 and December 31, 2017 include land and buildings in the amount of GEL 58,614 and GEL 60,906, respectively, which are measured at the lower of its carrying amount and fair value less cost to sell.

Intangible assets comprise:

	Intangible assets
At cost	
January 1, 2017	**6,683**
Additions	4,051
Disposals	(1,134)
December 31, 2017	**9,600**
Additions	144
Disposals	(330)
December 31, 2018	**9,414**
Accumulated amortization	
January 1, 2017	**2,933**
Charge for the year	1,018
Eliminated on disposals	(515)
December 31, 2017	**3,436**
Charge for the year	1,086
Eliminated on disposals	(330)
December 31, 2018	**4,192**
Net book value	
December 31, 2018	**5,222**
December 31, 2017	**6,164**

Intangible assets include computer software and licenses.

15. Deposits by banks

Deposits by banks comprise:

	December 31, 2018	**December 31, 2017**
Correspondent accounts of other banks	25	3,796
Short-term deposits from banks	15,081	14,602
Total deposits by banks	**15,106**	**18,398**

As at December 31, 2018 and December 31, 2017 accrued interest included in deposits by banks amounted to GEL 360 and GEL 345, respectively.

16. Deposits by customers

Deposits by customers comprise:

	December 31, 2018	December 31, 2017
Time deposits	301,051	259,892
Repayable on demand	340,811	430,765
Total deposits by customers	**641,862**	**690,657**

As at December 31, 2018 and December 31, 2017 accrued interest included in deposits by customers amounted to GEL 9,250 and GEL 4,117 respectively.

As at December 31, 2018 and December 31, 2017 deposits by customers totalling GEL 2,433 and GEL 5,648 respectively, were held as security against guarantees issued by the Bank.

As at December 31, 2018 and December 31, 2017 deposits by customers totalling GEL 317,057 and GEL 304,351 (49% and 44% of total deposits by customers), respectively, were for ten and sixteen customers, respectively, which represents a significant concentration.

	December 31, 2018	December 31, 2017
Analysis by economic sector/customer type:		
Individuals	185,632	197,929
Trade and Services	286,329	273,578
Transport and Communication	71,384	55,608
Energy	33,874	31,644
Construction	5,776	24,545
Manufacturing	4,396	20,116
Agriculture	2,400	2,460
Other	52,071	84,777
Total deposits by customers	**641,862**	**690,657**

As at December 31, 2018 and December 31, 2017 deposits by customers included balances amounting to GEL 184,390 thousand and GEL 170,275 thousand, respectively, that were sequestrated by Prosecutor’s Office of Georgia. Most of them, GEL 183,991 and GEL 169,005, respectively, were sequestrated on the basis of a court decision dated as of September 11, 2015.

17. Other borrowed funds

	Currency	Maturity date	Interest rate %	December 31, 2018	December 31, 2017
GCF LP	USD	28/09/2022	5.50%	-	26,289
Total other borrowed funds				**-**	**26,289**

In 2018, the Bank has totally repaid the borrowings before maturity date; The table below details changes in the Bank's other borrowed funds arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the Bank's statement of cash flows as cash flows from financing activities.

	January 1, 2018	Financing cash flows	Interest accrual during the year 2018	Interest paid during the year 2018	Foreign exchange gain during the year 2018	December 31, 2018
Other borrowed funds	26,289	(24,953)	612	(985)	(963)	-

	January 1, 2017	Financing cash flows	Interest accrual during the year 2017	Interest paid during the year 2017	Foreign exchange loss during the year 2017	December 31, 2017
Other borrowed funds	124,400	(101,201)	682	(315)	2,723	26,289

18. Other liabilities

Other liabilities comprise:

	December 31, 2018	December 31, 2017
Other financial liabilities:		
Accounts payable	769	931
Payables for reinsurance liabilities	2,538	2,396
Total other financial liabilities	**3,307**	**3,327**
Other non-financial liabilities:		
Unearned premium	3,006	3,119
Provision for insurance reserves	710	796
Taxes payable, other than income tax	14	-
Other	343	711
Total other non-financial liabilities:	**4,073**	**4,626**
Total other liabilities	**7,380**	**7,953**

19. Subordinated debt

Subordinated debt comprises:

	Currency	Maturity date	Nominal interest rate %	December 31, 2018
Fin Service XXI	USD	31-Mar-26	4.5%	76,030
Fin Service XXI	USD	31-Mar-26	4.5%	25,354
Fin Service XXI	USD	31-May-28	4.5%	25,068
Cartu Group	USD	31-Oct-26	4.5%	17,683
Inter Consulting Plus	USD	22-May-43	4.5%	3,783
Inter Consulting Plus	USD	17-Oct-29	4.5%	17,799
Georgian Holding	USD	21-Jun-29	4.5%	24,878
Total convertible subordinated debt				**190,595**

	Currency	Maturity date	Nominal interest rate %	December 31, 2017
Fin Service XXI	USD	31-Mar-26	4.5%	73,180
Fin Service XXI	USD	15-Feb-23	4.5%	24,945
Fin Service XXI	USD	31-Mar-26	4.5%	24,403
Cartu Group	USD	01-Jun-25	4.5%	27,594
Cartu Group	USD	31-Oct-26	4.5%	17,151
Inter Consulting Plus	USD	17-Oct-29	4.5%	17,129
Georgian Holding	USD	21-Jun-29	4.5%	23,966
Total convertible subordinated debt				**208,368**

As at December 31, 2018 and December 31, 2017 subordinated debt included accrued interest in amounted of GEL 107 and GEL 794, respectively.

In the event of bankruptcy or liquidation of the Bank, repayment of these debts is subordinate to the repayments of the Bank's liabilities to all other creditors.

On May 31, 2018, the Bank has agreed with LTD Fin service – XXI to make changes in the contractual maturity of lending agreement of USD 10,000. According to the amended agreements, the maturity date was extended till May 31, 2028. The Bank considered the effect of change by applying 10% threshold test and concluded that modification of subordinated debt is not substantial. Consequently, the effect of the changes has been accounted for as a GEL 848 modification gain in the current year profit and loss.

On May 22, 2018 the Bank has taken a new subordinated loans from Inter Consulting Plus in the amount of USD 1,600 with below market interest rate. At the disbursement date the Bank has calculated the effect of conversion right and recorded it accordingly in paid in capital in amount of GEL 444 net of tax.

The table below details changes in the Bank's subordinated debts arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the Bank's statement of cash flows as cash flows from financing activities.

	January 1, 2018	Financing cash inflows	Repay ment	Interest accrual during the year 2018	Interest paid during the year 2018	Foreign exchange loss during the year 2018	Recogniti on of additiona l paid in capital	December 31, 2018
Subordinated debt	**208,368**	4,303	(29,987)	11,162	(9,799)	7,070	(522)	**190,595**

On January 11, 2017, the Bank agreed with all lenders to make changes in the contractual interest rates of lending arrangements. According to the amended agreements, the interest rates were decreased to 4.5% from 6% for all lending agreements listed in the above table.

On June 21, 2017, the Bank agreed with Inter Consulting Plus, Georgian Holding and Cartu Group to make further changes in the terms of lending arrangements. According to the amended agreements, the conversion right of the Bank has been introduced to non-convertible subordinated debts. Respectively, agreements contain an option that allows the Bank to settle ("settlement option") the principal plus any outstanding accrued interest during the contractual lifetime of the debts by delivering Bank's own equity shares. The Bank believes that settlement option is out of the money and is only introduced for Regulatory Capital management purposes.

The Bank considered that modifications of an existing subordinated debts are substantial and accounted for as an extinguishment of the original financial liability and recognition of a new financial liability. The Bank considered modifications of the terms as substantially different as the discounted present value of the cash flows under the new terms and discounted using the original effective interest rate, is more than 10 per cent different from the discounted present value of the remaining cash flows of the original subordinated debts.

In 2017, the Bank transferred additional paid in capital portion of existed subordinated debts in the amount of GEL 9,424 thousand to retained earnings at the date of extinguishment and determined fair value of extinguished subordinated debts at the date of initial recognition.

The Bank considered that the subordinated debts were obtained from related parties and made an assessment of market interest rates of comparable instruments in the market. Following the analysis of borrowing rates in Georgia for the similar terms of the borrowed funds the Bank concluded that at the date of changes in terms a market interest rate represents 5.5%. The Bank estimated fair value of subordinated debt at the date of initial recognition following the extinguishment and recorded gain on extinguishment in the amount of GEL 16,230 thousand, the difference between original amortised cost and the fair value, directly in equity as additional paid in capital.

	January 1, 2017	Financing cash flows	Interest accrual during the year 2017	Interest paid during the year 2017	Gain on extinguis hment during the year 2017	Foreign exchange gain during the year 2017	December 31, 2017
Subordinated debt	**227,179**	-	11,866	(9,897)	(16,229)	(4,550)	**208,368**

Following table summarises the equity and liability components before and after the modifications of the terms of the lending arrangements:

	Liability component	Equity component
As at January 1, 2018	**208,368**	**13,795**
Interest expense recognised	12,010	-
Repayment of accrued interest	(9,799)	-
Recognition of new subordinated debt	4,303	-
Recognition of additional paid in capital at the date of initial recognition	(522)	522
Income tax on additional paid in capital directly recognized in equity	-	(78)
Modification gain	(848)	-
Repayments of subordinated debt	(29,987)	-
Transfer of equity component of repaid loans to the retained earnings	-	(1,850)
Income tax on additional paid in capital directly recognized in equity	-	278
Foreign exchange loss	7,070	-
As at December 31, 2018	**190,595**	**12,667**

20. Share capital

Both December 31, 2018 and 2017 share capital consisted of 114,430 ordinary shares with par value of GEL 1 each. On August 20, 2018 the Bank has declared and disbursed dividends from previous year’s retained earning in amount of GEL 20,000.

21. Net interest income

	2018	**2017**
Interest revenue calculated using the effective interest rate method:		
Loans to customers	72,007	79,844
Due from financial institutions	6,172	6,171
Investments in debt instruments	1,818	1,380
	79,997	**87,395**
Other interest income:		
Penalty income	11,689	12,125
Total interest income:	**91,686**	**99,520**
Interest expense calculated using the effective interest rate method:		
Deposits by customers	(18,254)	(17,897)
Subordinated debt	(11,162)	(11,866)
Deposits by banks	(663)	(1,084)
Other borrowed funds	(612)	(682)
Total interest expense	**(30,691)**	**(31,529)**
Net interest income	**60,995**	**67,991**

22. Provision for impairment losses on interest bearing assets and other provisions

The movements in allowance for expected credit losses on interest bearing assets for the year ended December 31, 2018 were as follows:

	Cash and cash equivalents	Mandatory cash balances with the NBG	Due from financial institutions	Loans to Customers	Investments in debt instruments	Total
January 1, 2017	**-**	-	-	**82,667**	**-**	**82,667**
Recovery of impairment losses	-	-	-	(6,522)	-	(6,522)
Write offs	-	-	-	(3,962)	-	(3,962)
Recoveries of previously written-off	-	-	-	2,654	-	2,654
December 31, 2017	**-**	**-**	**-**	**74,837**	**-**	**74,837**
Adjustment on initial application of IFRS 9	42	32	21	15,273	27	15,395
January 1, 2018 (restated)	**42**	**32**	**21**	**90,110**	**27**	**90,232**
Impairment losses/(recovery of impairment losses)	4	4	(9)	3,040	(13)	**3,026**
Interest revenue correction	-	-	-	2,173	-	**2,173**
Write offs	-	-	-	(2,660)	-	**(2,660)**
Recoveries of previously written-off	-	-	-	178	-	**178**
December 31, 2018	**46**	**36**	**12**	**92,841**	**14**	**92,949**

The movements in allowance for expected credit losses on non-interest bearing assets for the year ended December 31, 2018 were as follows:

	Other financial assets
December 31, 2017	**-**
Adjustment on initial application of IFRS 9	466
January 1, 2018	**466**
Recovery of impairment losses	(47)
December 31, 2018	**419**

The movements in allowance for impairment on other assets and other provisions were as follows:

	Repossessed assets
January 1, 2017	**736**
Recovery of impairment losses	(736)
December 31, 2017	**-**
Adjustment on initial application of IFRS 9	-
January 1, 2018	**-**
Impairment losses	2,128
December 31, 2018	**2,128**

	Guarantees and commitments
January 1, 2017	**1,530**
Impairment losses	878
December 31, 2017	**2,408**
Adjustment on initial application of IFRS 9	(441)
January 1, 2018	**1,967**
Recovery of impairment losses	(298)
December 31, 2018	**1,669**

23. Net gain on financial assets at fair value through profit or loss

Net gain on financial assets at fair value through profit or loss comprises:

	2018	2017
Net gain on operations with financial assets initially recognized at fair value through profit and loss comprise:		
Gain on trading operations, net	-	650
Gain on embedded derivative instrument, net	-	2,067
Total net gain on operations with financial assets at fair value through profit or loss	-	**2,717**

24. Net loss on foreign exchange operations

Net loss on foreign exchange operations comprises:

	2018	2017
Dealing, net	6,360	6,580
Translation differences, net	(10,319)	(3,432)
Total net loss on foreign exchange operations	**(3,959)**	**3,148**

25. Fee and commission income and expense

Fee and commission income and expense comprise:

	2018	2017
Fee and commission income:		
Plastic cards operations	2,847	3,020
Documentary operations	1,761	1,964
Settlements	1,295	1,130
Cash operations	440	381
Letter of credit	344	15
Other	116	42
Total fee and commission income	**6,803**	**6,552**
Fee and commission expense:		
Plastic cards services	(3,715)	(4,161)
Settlements	(1,737)	(706)
Documentary operations	(161)	(76)
Letter of credit	(14)	(44)
Other	(735)	(101)
Total fee and commission expense	**(6,362)**	**(5,088)**

26. Other income, net

Other income / (expense) comprises:

	2018	2017
Net written premiums	9,712	7,850
Gain on disposal of property and repossessed assets	5,700	680
Change in provisions for reported but not settled claims	742	1,643
Income from operating lease	1,122	999
Fines and penalties received	9	21
Claims settled, net of reinsurance	(6,011)	(3,997)
Reinsurers' share of claims settled	(2,804)	(2,946)
Change in provisions for incurred but not reported claims	(600)	(695)
Other	215	567
Total other income, net	**8,085**	**4,122**

27. Operating expenses

Operating expenses comprise:

	2018	2017
Staff costs	11,940	10,622
Communication expenses	2,727	2,248
Depreciation and amortization	2,640	2,818
Charity and sponsorship	2,502	6,052
Operating leases	2,303	2,279
Security expenses	652	618
Representative expenses	615	246
Utilities	477	431
Professional services	300	359
Postal expenses	221	199
Taxes, other than income tax	197	198
Business trip expenses	115	85
Property and equipment maintenance	108	95
Advertising expenses	67	132
Training	51	56
Other expenses	3,320	2,718
Total operating expenses	**28,235**	**29,156**

28. Income taxes

The Bank measures and records its current income tax payable and its tax bases in its assets and liabilities in accordance with the tax regulations of Georgia, which differ from IFRS.

The Bank is subject to certain permanent tax differences due to the non-tax deductibility of certain expenses and certain income being treated as non-taxable for tax purposes.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at December 31, 2018 and 2017 relate mostly to different methods/timing of income and expense recognition as well as to temporary differences generated by tax – book bases' differences for certain assets.

The tax rate used for the reconciliations below is the corporate tax rate of 15% payable by corporate entities in Georgia on taxable profits as defined under tax law of Georgia.

Deferred tax liabilities as at December 31, 2018 and 2017 comprise:

	December 31, 2018	December 31, 2017
Other provisions	768	(133)
Provisions for other assets	57	6
Other liabilities	28	14
Cash and cash equivalents	10	-
Mandatory reserves with NBG	5	-
Investments in debt instruments	2	-
Embedded derivative financial instrument	-	464
Loans to customers	(8,340)	(6,165)
Property and equipment	(569)	(490)
Subordinated debt	(509)	(87)
Intangible assets	(88)	29
Due to financial institutions	(1)	-
Net deferred income tax liability	**(8,637)**	**(6,362)**

The effective tax rate reconciliation is as follows for the years ended December 31, 2018 and 2017:

	2018	**2017**
Profit before income tax	32,518	56,666
Tax at the statutory tax rate (15%)	4,878	8,500
Effect of changes in tax legislation	1,822	(1,193)
Permanent differences	(386)	(359)
Income tax expense	**6,314**	**6,948**
Current income tax expense	3,395	9,320
Deferred income tax expense	2,919	(2,372)
Income tax expense	**6,314**	**6,948**

	2018	**2017**
As at January 1 – deferred income tax liability	**(6,362)**	**(6,299)**
Adjustment on initial application of IFRS 9	**444**	**-**
As at 1 January	**(5,918)**	**(6,299)**
Deferred tax recognised in equity	200	(2,435)
Deferred income tax expense recognized in profit or loss	(2,919)	2,372
As at December 31- deferred income tax liabilities	**(8,637)**	**(6,362)**

29. Commitments and contingencies

In the normal course of business, the Group is a party to financial instruments with off-balance sheet risk in order to meet the needs of its customers. These instruments, involving varying degrees of credit risk, are not reflected in the consolidated statement of financial position.

The Group uses the same credit control and management policies in undertaking off-balance sheet commitments as it does for on-balance operations.

Provision for losses on contingent liabilities totaled GEL 1,669 and GEL 2,408 as at December 31, 2018 and 2017, respectively.

As at December 31, 2018 and 2017 contingent liabilities comprise:

	December 31, 2018	**December 31, 2017**
Contingent liabilities and credit commitments		
Guarantees issued and similar commitments	53,530	64,691
Letters of credit and other transaction related contingent obligations	7,863	8,252
Commitments on loans and unused credit lines	48,811	22,310
Total contingent liabilities and credit commitments	**110,204**	**95,253**

Extension of loans to customers within credit line limits is approved by the Group on a case-by-case basis and depends on borrowers' financial performance, debt service and other conditions.

Capital commitments – The Group had no material commitments for capital expenditures outstanding as at December 31, 2018 and 2017.

Operating lease commitments – Lease agreements are generally cancellable upon the Bank giving notice to the landlord. Notice periods generally vary from one to three months and subject to significant penalties. Non-cancellable minimum lease rentals are payable as follows:

	December 31, 2018	**December 31, 2017**
Less than 1 year	1,832	2,111
Between 1 and 5 year	7,149	7,208
More than 5 years	-	1,773
Total	**8,981**	**11,092**

The Bank leases a number of premises under operating leases. The leases typically run for an initial period of three to five years, with an option to renew the lease after that date. Lease payments are usually increased every two or three years to reflect market rentals.

Legal proceedings – From time to time and in the normal course of business, claims against the Group are received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these consolidated financial statements.

Taxation – Commercial legislation of Georgia, including tax legislation, may allow more than one interpretation. In addition, there is a risk of tax authorities making arbitrary judgments of business activities. If a particular treatment, based on management's judgment of the Group's business activities, was to be challenged by the tax authorities, the Group may be assessed additional taxes, penalties and interest.

Georgian transfer pricing legislation was amended starting from January 1, 2015 to introduce additional reporting and documentation requirements. The new legislation allows the tax authorities to impose additional tax liabilities in respect of certain transactions, including but not limited to transactions with related parties, if they consider transaction to be priced not at arm's length. The impact of challenge of the Group's transfer pricing positions by the tax authorities cannot be reliably estimated.

Such uncertainty may relate to the valuation of financial instruments, valuation of provision for impairment losses and the market pricing of deals. Additionally such uncertainty may relate to the valuation of temporary differences on the provision and recovery of the provision for impairment losses on loans to customers and receivables, as an underestimation of the taxable profit. The management of the Group believes that it has accrued all tax amounts due and therefore no allowance has been made in the consolidated financial statements.

Operating environment – Emerging markets such as Georgia are subject to different risks than more developed markets; these include economic, political and social, and legal and legislative risks. Laws and regulations affecting businesses in Georgia continue to evolve rapidly with tax and regulatory frameworks subject to varying interpretations. The future direction of Georgia's economy is heavily influenced by the fiscal and monetary policies adopted by the government, together with developments in the legal, regulatory, and political environment.

For the last two years Georgia has experienced a number of legislative changes, which have been largely related to Georgia's accession plan to the European Union. Whilst the legislative changes implemented during 2017 and 2018 paved the way, more can be expected as Georgia's action plan for achieving accession to the European Union continues to develop.

30. Transactions with related parties

Transactions between the Bank and its subsidiaries, which are related parties of the Bank, have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Group and other related parties are disclosed below:

	December 31, 2018		December 31, 2017	
	Related party balances	**Total category as per the consolidated financial statements caption**	**Related party balances**	**Total category as per the consolidated financial statements caption**
Loans to customers	68,703	914,736	41,568	869,723
– other related parties	67,950		41,146	
- key management personnel	753		422	
Allowance for expected credit losses on loans to customers	(33)	(92,841)	(20)	(74,837)
– other related parties	(30)		(18)	
– key management personnel	(3)		(2)	
Deposits by customers	(30,611)	(641,862)	(34,400)	(690,657)
– parent	(337)		(1,812)	
- shareholder	(286)		-	
– other related parties	(29,953)		(32,527)	
– key management personnel	(35)		(61)	
Subordinated debt	(190,595)	(190,595)	(208,368)	(208,368)
- other related parties	(172,912)		(163,623)	
- shareholders	(17,683)		(44,745)	
Other borrowed funds	-	-	(26,289)	(26,289)
- other related parties	-		(26,289)	
Other liabilities	(176)	(7,380)	-	-
- other related parties	(176)		-	
Guarantees issued and similar commitments	(25,299)	(110,204)	(11,452)	(95,253)
– key management personnel	-		(38)	
– other related parties	(25,299)		(11,414)	

The remuneration of directors and other members of key management were as follows:

	2018		2017	
	Related party transactions	**Total category as per the consolidated financial statements caption**	**Related party transactions**	**Total category as per the consolidated financial statements caption**
Key management personnel compensation:				
- short-term employee benefits	1,043	11,940	645	9,726

Included in the consolidated statement of profit or loss for the years ended December 31, 2018 and 2017 are the following amounts which were recognized in transactions with related parties:

	2018		2017	
	Related party transactions	**Total category as per the consolidated financial statements caption**	**Related party transactions**	**Total category as per the consolidated financial statements caption**
Interest income	6,005	91,686	1,967	99,520
- *parent*	710		-	
- *other related parties*	5,201		1,954	
- *key management personnel*	94		13	
Interest expense	(12,496)	(30,691)	(12,548)	(31,529)
– *key management personnel*	(11)		-	
- *parent*	(2,068)		(2,331)	
- *other related parties*	(10,417)		(10,217)	
Charity and sponsorship	(2,502)	(2,502)	(6,052)	(6,052)
- *other related parties*	(2,502)		(6,052)	

31. Fair value of financial instruments

IFRS defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Recurring fair value measurements

Recurring fair value measurements are those that the accounting standards require or permit in the statement of financial position at the end of each reporting period. Investments in equity instruments are measured at fair value and categorized into Level 3.

Fair value of financial assets and financial liabilities that are not measured at fair value on a recurring basis (but fair value disclosures are required).

For financial assets and liabilities that have a short term maturity (less than 3 months), it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and current accounts without a maturity.

Cash and cash equivalents, mandatory reserves with the NBG, due from financial institutions, due to financial institutions and deposits by customers

For cash and cash equivalents, mandatory reserves with the NBG, due from financial institutions, due to financial institutions and deposits by customers fair value has been estimated by reference to the market rates available at the balance sheet date for similar instruments of maturity equal to the remaining fixed period.

Loans to customers – The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates of new instruments with similar credit risk and remaining maturity. Discount rates depend on currency, maturity of the instrument and credit risk of the counterparty.

Deposits by banks – Deposit by banks include deposits placed by banks at the end of the year with original maturity less than 1 year and loro accounts. Therefore, management of the Bank has concluded that carrying amount of deposits by banks which are carried at amortized cost approximates their fair value.

Investments in debt instruments - The fair values of investments in debt instruments is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions for similar instruments. All investments in debt instruments have original maturity less than 1 year. Therefore, the management concluded that fair value approximates to carrying amount.

Subordinated debt – The fair values of subordinated debt is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions for similar instruments.

Other non-derivative financial assets and non-derivative financial liabilities – Other financial assets and liabilities are mainly represented by short-term receivables and payables, therefore the carrying amount is assumed to be reasonable estimate of their fair value.

The fair value of financial assets and liabilities compared with the corresponding carrying amount in the statement of financial position of the Bank is presented below:

		31-Dec-18		31-Dec-17	
	Fair value hierarchy	**Carrying amount**	**Fair value**	**Carrying amount**	**Fair value**
Cash and cash equivalents	Level 1	124,535	124,535	224,644	224,644
Mandatory cash balance with the NBG	Level 2	138,155	138,155	120,479	120,479
Due from financial institutions	Level 2	12,380	12,380	18,800	18,800
Loans to customers	Level 3	821,895	861,862	794,886	812,530
Investments in debt securities	Level 2	19,295	19,295	27,978	27,978
Investments in equity instruments	Level 3	57	57	57	57
Other financial assets	Level 3	4,066	4,066	4,889	4,889
Deposits by banks	Level 2	15,106	15,106	18,398	18,398
Deposits by customers	Level 3	641,862	646,966	694,292	714,850
Other financial liabilities	Level 3	3,307	3,307	3,327	3,327
Subordinated debt	Level 3	190,595	190,595	208,368	208,368

Fair value of the Bank's financial assets and financial liabilities measured at fair value on a recurring basis. As at 31 December, 2017 embedded derivative was measured at fair value at the end of each reporting period. The following table gives information about how the fair values of these financial assets were determined (in particular, the valuation technique(s) and inputs used).

	December 31, 2018	**December 31, 2017**	**Fair value hierarchy**	**Valuation technique(s) and key input(s)**	**Significant unobservable input(s)**	**Relationship of unobservable inputs to fair value**
Embedded derivatives (See Note 8)	-	18,253	Level 3	Discounted cash flows	Forward exchange rate	10% increase /(decrease) in forward exchange rate leads fair value increase/(decrease) by GEL 12,780 /(12,780)

32. Capital risk management

The Group manages its capital to ensure that it will be able to continue as a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance. The management and shareholder have the intention to further develop the Bank and the Bank's management believes that the going concern assumption is appropriate for the Bank due to its sufficient capital adequacy and based on historical experience that short-term obligations will be refinanced in the normal course of business.

The adequacy of the Bank's capital is monitored using the ratios established by the NBG in supervising the Bank. The compliance with capital adequacy ratios set by the NBG is monitored monthly with the Bank's standalone reports prepared in accordance with the NBG accounting rules.

According to the NBG regulations commercial banks have to:

a) hold the minimum level of Regulatory Capital according to the following schedule:

- 30,000 thousand GEL as at December 31, 2017
- 40,000 thousand GEL as at June 30, 2018
- 50,000 thousand GEL as at December 31, 2018

b) maintain ratios of Common Equity Tier 1 Capital, Tier 1 Capital and Regulatory Capital to the risk-weighted assets at or above the prescribed minimum of levels throughout the reporting period.

On December 18, 2017 the NBG has introduced amendments to the "Regulation on Capital Adequacy Requirements for Commercial Banks" (Decree N100/04). Under the updated capital adequacy framework capital requirements are divided into Pillar 1 Requirements for Common Equity Tier 1, Tier 1 and Regulatory Capital and additional buffers for Common Equity Tier 1, Tier 1 and Regulatory Capital under Pillar 1 and Pillar 2.

As at December 31, 2018, the details of the all Pillar 1 and Pillar 2 buffers introduced by the NBG are as follows:

1. Pillar 1 buffers include:
   - The Capital Conservation ("CC") buffer that is effective as at December 31, 2018;
   - The Systemic Risk ("SR") buffer will be introduced for systematically important banks over the 4 years period.
   - The Countercyclical Capital ("CCC") buffer is set at 0%.

Adjustments to the Pillar 1 buffers are at NBG's discretion.

2. Pillar 2 buffers include:
   - The Currency Induced Credit Risk ("CICR") buffer that is effective as at December 31, 2018 for un-hedged FX loans denominated in foreign currencies;
   - The Concentration Risk ("CR") buffer that was introduced for sectoral and single borrower exposure;
   - The Net Stress ("NS") buffer that will be introduced based on stress testing results provided by the Group;
   - Net General Risk-assessment Programme ("GRAPE") buffer that will be defined by the NBG and will be applied based on the bank's specific risks.

The summary of the Capital Adequacy ratio requirements set under the Capital Adequacy Framework effective as at December 31, 2017 and 2018 are as follows:

Capital to the Risk-Weighted Assets	**Pillar 1**				**Pillar 2**	**December 31, 2018**
	Require-ments	**Pillar 1 buffers**			**Pillar 2 buffers**	**Total minimum requirements**
		CC	**SR**	**CCC**		
Common Equity Tier 1 Capital ratio	4.5%	2.5%	0%	0%	2.27%	9.27%
Tier 1 Capital ratio	6.0%	2.5%	n/a	n/a	3.04%	11.54%
Total Regulatory Capital ratio	8.0%	2.5%	n/a	n/a	9.68%	20.18%

Capital to the Risk-Weighted Assets	Pillar 1				Pillar 2	December 31, 2017
	Require-ments	Pillar 1 buffers			Pillar 2 buffers	Total minimum requirements
		CC	SR	CCC		
Common Equity Tier 1 Capital ratio	4.5%	2.5%	0%	0%	1.49%	8.49%
Tier 1 Capital ratio	6.0%	2.5%	n/a	n/a	2.00%	10.50%
Total Regulatory Capital ratio	8.0%	2.5%	n/a	n/a	2.66%	13.16%

Additionally, based on the updated methodology, specific PTI (payment to income) and LTV (loan to value) thresholds were introduced. For the exposures which do not fall into pre-defined limits for PTI and LTV ratios, higher risk weights were applied.

As at December 31, 2017 and 2018 Capital Adequacy Ratios based on the Bank's reports prepared in accordance with the NBG accounting rules and Capital Adequacy Framework effective as at December 31, 2017 and 2018 are as follows:

	December 31, 2018	December 31, 2017
Common Equity Tier 1 Capital	**220,764**	**222,346**
Additional Tier 1 Capital	-	-
Tier 1 Capital	**220,764**	**222,346**
Convertible subordinated debts	202,351	221,585
Non-convertible subordinated debts	-	-
General loan loss provisions (up to 1.25 % of risk–weighted assets)	9,542	9,735
Total regulatory capital	**432,657**	**453,666**
Risk weighted assets	**1,381,509**	**1,384,981**
Common Equity Tier 1 Capital Adequacy Ratio	15.98%	16.05%
Tier 1 Capital Adequacy Ratio	15.98%	16.05%
Total regulatory capital adequacy Ratio	31.32%	32.76%

In the event of bankruptcy or liquidation of the Bank, repayment of these debts is subordinated to the repayments of the Bank's liabilities to all other creditors.

As at December 31, 2018 and December 31, 2017, the Bank included in the computation of total regulatory capital for capital adequacy purposes the general provisions, limited to 1.25% of risk weighted assets.

During the years ended December 31, 2018 and December, 31, 2018 the Bank had complied in full with all its externally imposed capital requirements.

33. Risk management policies

Management of risk is fundamental to the Group's banking business and is an essential element of the Bank's operations. The main risks inherent to the Bank's operations are those related to the following:

- Credit risk;
- Liquidity risk;
- Market risk;
- Operational risk;

To enable and apply high-performance risk policies, the Bank has established a risk management framework, whose main purpose is to protect the Bank from unacceptable level of risk and allow it to achieve its performance objectives. Through the risk management framework, the Bank manages the following risks:

Credit risk. The Bank is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

Risk management and monitoring is performed within set limits of authority. These processes are performed by the Credit Committees and the Bank's Management Board. Before any application is made by the Credit Committee, all recommendations on credit processes (borrower's limits approved, or amendments made to loan agreements, etc.) are reviewed and approved by the Risk Management Department of Head Office. Daily risk management is performed by the Heads of Credit Departments and Service Centre's Credit Divisions.

The Bank structures the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Limits on the level of credit risk by a borrower, industry sector are approved by the Management Board. The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures which are set by the Credit Committee. Actual exposures against limits are monitored on a regular basis.

Where appropriate, and in the case of most loans, the Bank obtains collateral and corporate and personal guarantees. However, some portion of loans is personal lending, where no such facilities can be obtained. Such risks are monitored on a continuous basis and subject to annual or more frequent reviews.

Commitments to extend credit represent unused portions of credit in the form of loans, guarantees or letters of credit. The credit risk on off-balance sheet financial instruments is defined as a probability of losses due to the inability of counterparty to comply with the contractual terms and conditions.

With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of the loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank applies the same credit policy to the contingent liabilities as it does to the balance sheet financial instruments, i.e. the one based on the procedures for approving the grant of loans, using limits to mitigate the risk, and current monitoring. The Bank monitors the term to maturity of off balance sheet contingencies because longer term commitments generally have a greater degree of credit risk than short-term commitments.

Credit risk measurement methodology applicable after 1 January 2018

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Bank measures credit risk using Probability of Default ("PD"),

Exposure at Default ("EAD") and Loss Given Default ("LGD"). This is similar to the approach used for the purposes of measuring ECL under IFRS 9.
In accordance with the IFRS 9 the Bank uses a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarised below:

- A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Bank.
- If a significant increase in credit risk (SICR) since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired.
- If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'.
- Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis.
- A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information.
- Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition. Their ECL is always measured on a lifetime basis (Stage 3).

The Bank recognizes loss allowances for ECLs on the following financial instruments that are not measured at FVTPL:

- Due from financial institutions;
- Loans and advances to customers;
- Investment in debt securities;
- Other receivables;
- Loan commitments issued; and
- Financial guarantee contracts issued.
- Interbank deposits and corresponding accounts.

ECLs are required to be measured through a loss allowance at an amount equal to:
- 12-month ECL, i.e. lifetime ECL that result from those default events on the financial instrument that are possible within 12 months after the reporting date, (referred to as Stage 1); or
- Full lifetime ECL, i.e. lifetime ECL that result from all possible default events over the life of the financial instrument, (referred to as Stage 2 and Stage 3).

A loss allowance for full lifetime ECL is required for a financial instrument if the credit risk on that financial instrument has increased significantly since initial recognition. For all other financial instruments, ECLs are measured at an amount equal to the 12-month ECL.

For undrawn loan commitments and financial guarantee contracts, ECL is measured based on Credit Conversion Factor of 100% of 4.01%, respectively.

Due from financial institutions, interbank deposits and corresponding accounts, investment in debt securities are subject to impairment based on 12-months ECL. The estimates of probability default and loss given default for clients are derived from credit rating information supplied by international rating agencies.

Allowance for expected credit losses on other receivables is estimated individually using the loan loss allowance rate of the client. If the client does not have loan exposure in the bank, than the credit rating of the client and the corresponding probability of default and loss given default are used. In addition, expected period of exposure for receivable is estimated. Finally, PDs, LGDs and expected period of exposure are multiplied to calculate expected credit allowance for receivables.

Loans to customers

To assess credit risk of exposures to the borrowers the Bank has developed methodology in accordance with IFRS 9.

The Bank divides loan portfolio into individually significant and non-significant group of borrowers. Individually significant are group of borrowers which exposure exceeds 1% of Bank's Regulatory Capital.

Significant increase in credit risk

The Bank monitors financial assets that are subject to the impairment requirements to assess whether there has been a significant increase in credit risk since initial recognition. If there has been a significant increase in credit risk the Bank will measure the loss allowance based on lifetime rather than 12-month ECL.

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, Bank considers both quantitative and qualitative information that is reasonable and supportable.

The Bank considers that if the borrower becomes "adversely classified" (an asset classified as watch, substandard, doubtful or loss) according to NBG regulations significant increase in credit risk has occurred. Borrower classification itself according to NBG regulations are derived from borrower's solvency ratios and other available information in the market.

As a backstop criteria, when an asset becomes more than 30 days past due, the Bank assumes that a significant increase in credit risk has occurred and the asset is transferred to stage 2 of the impairment model, i.e. the loss allowance is measured as the lifetime ECL.

Measurement of ECL on an individual basis

For individually assessed loans, ECLs are measured as the present value of the difference between the cash flows due to the Bank under the contract and the cash flows that the bank expects to receive arising from the weighting of multiple future economic scenarios, discounted using effective interest rate. Besides, the repayments and realization of any assets held as collateral against the loan are taking into account.

For the purpose of estimation of expected cash flows from the group of borrowers business, the management considers available information about the borrowers' liquidity, solvency, business and financial risks, delinquency levels and available cash flows from operations. The Bank uses forward-looking information in determining of free cash flows of the borrower. The information used includes
economic data and economic indicators prognoses published by National Bank of Georgia. The following macroeconomic variables are applied in the model:

1. Nominal GDP growth rate – used to adjust the revenue and COGS of the borrower;
2. Inflation Rate – used to adjust indirect costs of the borrower;
3. Foreign exchange rate GEL/USD – used to adjust Free Cash Flow of the borrower;

Estimated future cash flows of collateralised loans also reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

Cash flows that may result from foreclosure of the collateral is dependent on the fair value of the collateral and applied valuation and liquidity haircuts per each type of collateral. There are four key types of collateral used in the cash flows estimation:

- Real estate;
- Movable property including fixed assets;
- Inventory;
- Deposits.

The Bank generally assesses liquidation value of the collaterals considering 2 years as a time to collect period and application of valuation haircut of 15% for real estate, 30% for movable property including fixed assets and 45% for inventory. The general approach is overriden individually if other circumstances demonstrate that generic time to collect period and valuation haricut is not reasonable.

Where the individually significant exposures are determined not to be impaired individually, collective assessment methodology applied to reflect ECLs that were incurred but have not been specifically identified;

Measurement of ECL on a collective basis

The key inputs into the measurement of ECL are the term structure of the following variables:

- Probability of default (PD);
- Loss given default (LGD);
- Exposure at default (EAD).

These parameters are generally derived from internally developed statistical models and other historical data.

Definition of default

Critical to the determination is the definition of default. The definition of default is incorporated in measuring the amount of ECL. The Bank considers the following as constituting an event of default:

- The borrower is past due more than 90 days on any material credit obligation to the Bank for collective assessed loans
- The Borrower is transferred to the problem asset management division;
- The borrower has Loan Loss Provision Rate category 30% or above according to the Regulation of National Bank of Georgia;
- Other criteria indicating the borrower’s unlikeness to repay the liabilities including bad restructuring.

PD model

To determine the PD rates for each group, the Bank utilizes migration matrices based on “Markov chain” model. At the beginning of analysing 12-month period borrowers in each pool are grouped in 11 buckets by overdue days and NBG LLP. The analysis is conducted on every 12-month period from December 1, 2014 to the reporting date; The final PD used in the model represents the weighted average of the historical 12-month period PDs.

The Bank has assessed the impact of the forward-looking information into collective assessment model as not material, thus, the results were not incorporated in ECLs.

As at December 31, 2018, 10% increase in average PD per each pool results in total ECL increase by 0.39% that represents GEL 359 thousand and 10% decrease in average PD per each pool results in total ECL decrease by 3.15% that represents GEL 2,928 thousand.

LGD model

Another component of impairment model is LGD (loss given default), that’s is an estimate of the loss arising on default. To measure it, defaulted exposures by segments is reduced by deposits pledged and the discounted liquidation value of properties pledged using 2 years of time to collect period and valuation haircut.

As at December 31 2018, 10% increase in valuation haircut results in ECL increase by 5.31% that represents GEL 4,930 thousand and 10% decrease in valuation haircut results in ECL decrease by 5.25% that represents GEL 4,876 thousand.

As at December 31, 2018, 10% increase in time to collect period results in ECL increase by 6.51% that represents GEL 6,040 thousand and 10% decrease in time to collect period results in ECL decrease by 4.42% that represents GEL 4,106 thousand.

EAD model

EAD represents the expected exposure in the event of default. The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract including amortisation.

Incorporation of forward-looking information

The Bank considers forward-looking information in its measurement of ECL. The information used includes economic data and economic indicators prognoses published by monetary authorities. Three economic scenarios (baseline, pessimistic, optimistic) form the basis of determining the probability of default. They will lead to a different probability of default. Weighting of these different scenarios forms the basis of a weighted average probability of default that is used in calculations of ECL. 12-month ECL (stage 1 loans) is measured only with twelve month PDs. Lifetime ECL (stages 2 and 3 loans) are measured with all annual marginal PDs until the maturity of loan expires.

Macroeconomic indicators prognoses with different scenarios and their weights are published by National Bank of Georgia for IFRS 9 purposes. The base case scenario is the single most-likely outcome and its weighting in calculations is 50%. The weighting of pessimistic and optimistic scenarios are 25% for each.

Using a statistical analysis of historical data, has estimated relationships between macro-economic variables and credit risk and probability of default. Three macroeconomic indicators (GDP growth, GEL/USD exchange rates, and real estate prices) are included in future economic scenarios for individual assessed loans. For collectively assessed portfolio Bank is able to estimate the impact on ECL only GDP growth rate, despite best efforts, due to lack of reasonable and supportable information.

The table below summarizes the principal macroeconomic indicators included in the economic scenarios used at 31 December 2018 for the years 2019 to 2023, for Georgia and therefore have a significant impact on ECLs.

	2019	**2020**	**2021**	**2022**	**2023**
GDP growth rate					
Base scenario	5.00%	5.00%	5.00%	5.00%	5.00%
Upside scenario	6.50%	5.50%	5.00%	5.00%	5.00%
Downside scenario	2.00%	3.00%	4.00%	4.00%	4.00%
GEL/USD foreign exchange rate change (YoY)					
Base scenario	0%	0%	0%	0%	0%
Upside scenario	3%	2%	2%	0%	0%
Downside scenario	-15%	-10%	5%	0%	0%
Real Estate Price change (YoY)					
Base scenario	2.90%	3.00%	3.00%	0.00%	0.00%
Upside scenario	3.60%	3.30%	3.00%	0.00%	0.00%
Downside scenario	0.00%	0.00%	0.00%	0.00%	0.00%

Predicted relationship between the economic indicators and default and loss rates on loan portfolios have been developed based on analysing historical data over the past 5 years.

Based on the Bank’s macro-economic model, there is no significant dependency between macro-economic variables and loan portfolio quality.

Calculation of ECL

When the marginal PDs and LGD are determined for each group/segment, final calculations of loan loss allowance is made depending on risk characteristics of the particular loan in the portfolio. 12 months ECL is calculated for Stage 1 and lifetime ECLs for stage 2 or 3 loans as a discounted expected cash shortfalls as at reporting date.

Renegotiated loans to customers. Loans to customers are generally renegotiated either as part of an ongoing customer relationship or in response to an adverse change in the circumstances of the borrower. In the latter case, renegotiation can result in an extension of the due date of payment or repayment plans under which the Bank offers a concessionary rate of interest to genuinely distressed borrowers. This will result in the asset continuing to be overdue and will be individually impaired where the renegotiated payments of interest and principal will not recover the original carrying amount of the asset. In other cases, renegotiation will lead to a new agreement, which is treated as a new loan.

Carrying amount by class of financial assets whose terms have been renegotiated:

The table below shows the carrying amount of renegotiated financial assets, by class:

Financial asset class	**December 31, 2018**	**December 31, 2017**
Loans to customers	138,552	44,027

The gross carrying value of loans that have previously been modified when they were in Stage 2/3 which are now categorized as Stage 1, with loss allowance measured at an amount equal to 12 months expected losses amounts to zero as at December 31, 2018.

Stage movements in loans to customers

Movements in the gross carrying value of the loans to customers for the year ended December 31, 2018 was as following:

	2018			
	Stage 1 12 month ECL	**Stage 2** Lifetime ECL - not credit-impaired	**Stage 3** Lifetime ECL – credit-impaired	**Total**
	1	**2**	**3**	
Gross carrying amount as at 31 December 2017	**480,070**	**81,680**	**307,973**	**869,723**
Adjustment on initial application of IFRS 9	8,359	5,756	16,599	30,714
Gross carrying amount as at January 1, 2018	488,429	87,436	324,572	900,437
New loans originated (Interest income accrued)	285,827	9,279	52,373	347,479
Changes in the gross carrying amount:				
- Transfer to 12-month ECL	6,533	(6,533)	-	-
- Transfer to lifetime ECL not credit-impaired	(98,220)	102,381	(4,161)	-
- Transfer to lifetime ECL credit-impaired	-	(58,188)	58,188	-
Repaid loans	(237,501)	(27,687)	(77,490)	(342,678)
Written off for the year	-	-	(2,660)	(2,660)
Recoveries of previously written off	-	-	178	178
Foreign exchange loss	3,303	2,283	6,394	11,980
Gross carrying amount as at December 31, 2018	**448,371**	**108,971**	**357,394**	**914,736**

Movements in the allowance for expected credit losses for the year ended December 31, 2018 was as following:

	2018			
	Stage 1 12 month ECL	**Stage 2** Lifetime ECL - not credit-impaired	**Stage 3** Lifetime ECL – credit-impaired	**Total**
	1	**2**	**3**	
Loss allowance as at 31 December 2017	**3,444**	**2,431**	**68,962**	**74,837**
Adjustment on initial application of IFRS 9	1,717	545	13,011	15,273
Loss allowance as at 1 January 2018	5,161	2,976	81,973	90,110
New loans originated	3,619	150	16,970	20,739
Changes in the loss allowance:				
- Transfer to 12-month ECL	866	(866)	-	-
- Transfer to lifetime ECL not credit-impaired	(1,195)	2,056	(861)	-
- Transfer to lifetime ECL credit-impaired	-	(1,579)	1,579	-
Repaid loans	(2,401)	(560)	(20,979)	(23,940)
Written off for the year	-	-	(2,660)	(2,660)
Recoveries of previously written off	-	-	178	178
Changes due to change in credit-risk	(1,137)	4,858	1,126	4,847
Interest income correction	-	-	2,173	2,173
Foreign exchange gain	42	223	1,129	1,394
Balance at the end of the year	**4,955**	**7,258**	**80,628**	**92,841**

Credit risk assessment methodology applicable before 1 January 2018

Before January 1, 2018 the Bank used credit risk assessment methodology in accordance with IAS 39.

The Bank divides loan portfolio into individually significant and non-significant group of borrowers. Individually significant are group of borrowers which exposure exceeds 1% of Bank's Regulatory Capital.

Individual assessment of impairment for individually significant exposures

Impairment for individually significant exposures to the group of borrowers are assessed individually using the individual assessment methodology by determining future cash flows discounted at original effective interest rate.

For the purpose of estimation of expected cash flows from the group of borrowers business, the management considers available information about the borrowers' liquidity, solvency, business and financial risks, delinquency levels and available cash flows from operations.

Estimated future cash flows of collateralised loans also reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

Cash flows that may result from foreclosure of the collateral is dependent on the fair value of the collateral and applied valuation and liquidity haircuts per each type of collateral. There are three key types of collateral used in the cash flows estimation:

- Real estate;
- Movable property including fixed assets and inventory;
- Financial assets including deposits.

Estimated future cash flows that may result from foreclosure of collateral less costs for obtaining and selling the collateral is discounted using the original effective interest rate of the loan over the expected time to sell period.

Time to sell period is dependent on the type of collaterals and represents management's best estimate of expected period to sell the collateral since the default date.

Where the individually significant exposures are determined not to be impaired individually, collective assessment methodology applied to reflect impairment losses that were incurred but have not been specifically identified.

Collective assessment of impairment

For the purpose of collective assessment of impairment, the loan portfolio is divided into groups of loans with impairment trigger events and without impairment trigger events.

Methodology for loans with impairment trigger events assumes that default occurred and Loss Given Default ("LGD") is estimated that reflects discounted cash flows that may result from foreclosure less costs for obtaining and selling the collateral. Estimation approach for cash flows that may result from foreclosure of the collaterals is described above.

Loans without impairment trigger events are grouped on the basis of similar credit risk characteristics.

In order to calculate impairment allowance for collectively assessed loans without impairment triggers, the Bank estimates the following risk parameters: Probability of Default ("PD") and Loss Given Default ("LGD).

In case of a change in either the internal or external environment and historical data no longer reflect the current situation, the Bank adjusts risk parameters on the basis of current observable data to reflect the effects of present conditions that did not affect past periods, and to remove the effects of past conditions that do no longer exist.

Default definition includes criteria as:

- 180 past due
- Other criteria indicating the borrower's unlikeness to repay the liabilities including bad restructuring.

To reflect incurred but not specifically identified impaired losses the Bank developed Probability of Default ("PD") model using the transitional matrices approach.

The observation period for each segment was considered as last 3 years. During the observation period by the state of end of months in the overdue buckets and with account of exposure of each loan, the average one month matrix is constructed and then 12 months migration period allowed to estimate PD parameter.

Analysis of 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 as follows:

- For commercial lending, charges over real estate properties, guarantees, vehicles and equipment;
- For retail lending, mortgages over residential properties, guarantees, vehicles and equipment.

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 impairment losses.

The following table provides the analysis of the loan portfolio by collateral types:

Type of collateral	December 31, 2018 Gross carrying amount	December 31, 2018 Allowance for ECL	December 31, 2018 Carrying amount	December 31, 2018 Collateral Fair Value
Loans collateralized by pledge of real estate	764,348	(48,369)	715,978	1,608,899
Loans collateralized by pledge of cash	11,363	(551)	10,811	22,610
Loans collateralized by pledge of equipment	64,107	(16,340)	47,768	267,314
Loans collateralized by pledge of Inventory	20,323	(1,030)	19,293	102,278
Other collateral	14,074	(1,628)	12,447	16,747
Unsecured loans	40,521	(24,923)	15,598	-
Total	**914,736**	**(92,841)**	**821,895**	**2,017,848**

Type of collateral	December 31, 2017 Gross carrying amount	December 31, 2017 Allowance for ECL	December 31, 2017 Carrying amount	December 31, 2017 Collateral Fair Value
Loans collateralized by pledge of real estate	800,420	(61,932)	738,488	1,960,254
Loans collateralized by pledge of cash	7,290	-	7,290	23,258
Loans collateralized by pledge of equipment	18,730	(4,231)	14,499	360,075
Loans collateralized by pledge of Inventory	13,512	(98)	13,414	137,779
Other collateral	9,191	(3,965)	5,226	20,533
Unsecured loans	20,580	(4,611)	15,969	-
Total	**869,723**	**(74,837)**	**794,886**	**2,501,899**

The Bank’s policy is to issue such loans with a loan-to-value (LTV) ratio at the date of loan issuance of on average of 70%, when referring to the collateral’s discounted value, i.e. the least value at which it is expected to be realized and used in ECL calculations.

LTV Ratio based on collateral discounted value	December 31, 2018 Gross Carrying Amount	December 31, 2018 Allowance for ECL	December 31, 2018 Carrying Amount
Less than 50%	136,471	(303)	136,168
51-70%	125,038	(314)	124,724
71-90%	141,899	(651)	141,248
91-100%	48,539	(2,057)	46,482
More than 100%	462,789	(89,516)	373,273
Total	**914,736**	**(92,841)**	**821,895**

LTV Ratio based on collateral discounted value	December 31, 2017 Gross Carrying Amount	December 31, 2017 Allowance for impairment	December 31, 2017 Carrying Amount
Less than 50%	139,008	-	139,008
51-70%	195,008	(482)	194,526
71-90%	192,917	(4,293)	188,624
91-100%	64,053	(2,134)	61,919
More than 100%	278,737	(67,928)	210,809
Total	**869,723**	**(74,837)**	**794,886**

Management estimates that the fair value of collateral at the inception of the loans is at least equal to the carrying amounts of corresponding secured loans. The fair value of collaterals are re-estimated as at December 31, 2018 and 2017.

The analysis of loan portfolio by LTV ratio based on collateral fair values is as following:

LTV Ratio based fair values	December 31, 2018 Gross Carrying Amount	December 31, 2018 Allowance for ECL	December 31, 2018 Carrying Amount
Less than 50%	289,016	(708)	288,308
51-70%	217,900	(2,989)	214,911
71-90%	192,042	(23,661)	168,381
91-100%	70,069	(15,871)	54,198
More than 100%	145,709	(49,612)	96,097
Total	**914,736**	**(92,841)**	**821,895**

LTV Ratio based on fair values	December 31, 2017 Gross Carrying Amount	December 31, 2017 Allowance for impairment	December 31, 2017 Carrying Amount
Less than 50%	342,675	(506)	342,169
51-70%	243,367	(4,609)	238,758
71-90%	84,601	(9,870)	74,731
91-100%	67,671	(18,176)	49,495
More than 100%	131,409	(41,676)	89,733
Total	**869,723**	**(74,837)**	**794,886**

Maximum exposure of credit risk. The Group exposure to credit risk has increased significantly over the past year, following the general market development. Nonetheless this growth of the exposure was not accompanied by deterioration of the performance indicators of the banks portfolio.

The following table presents the maximum exposure to credit risk of balance sheet and off balance sheet financial assets. For financial assets in the balance sheet, the maximum exposure is equal to the carrying amount of those assets prior to any offset or collateral. The Group's maximum exposure to credit risk under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove value less, is represented by the contractual amounts of those instruments.

December 31, 2018	Maximum Exposure	Net Exposure
Cash and cash equivalents	124,581	124,535
Mandatory balances with NBG	138,191	138,155
Due from financial institutions	12,392	12,380
Loans to customers	914,736	821,895
Investments in debt instruments	19,309	19,295
Investments in equity instruments	57	57
Other financial assets	4,485	4,066
Guarantees issued and similar commitments	53,530	52,246
Letters of credit and other transaction related contingent obligations	7,863	7,863
Commitments on loans and unused credit lines	48,811	48,426

December 31, 2017	Maximum Exposure	Net Exposure
Cash and cash equivalents	224,375	224,375
Mandatory balances with NBG	120,479	120,479
Financial Assets through profit and loss	18,253	18,253
Due from financial institutions	18,800	18,800
Loans to customers	869,723	794,886
Investments in debt instruments	27,978	27,978
Investments in equity instruments	57	57
Other financial assets	4,889	4,889
Guarantees issued and similar commitments	64,691	62,590
Letters of credit and other transaction related contingent obligations	8,252	8,252
Commitments on loans and unused credit lines	22,310	22,227

Off-balance sheet risk. The Group applies fundamentally the same risk management policies for off-balance sheet risks as it does for its on-balance sheet risks. In the case of commitments to lend, customers and counterparties will be subject to the same credit management policies as for loans and advances. Collateral may be sought depending on the strength of the counterparty and the nature of the transaction.

Geographical concentration. The Assets and Liabilities Committee ("ALCO") exercises control over the risk in the legislation and regulatory area and assesses its influence on the Group's activity. This approach allows the Group to minimize potential losses from the investment climate fluctuations in Georgia.
The geographical concentration of assets and liabilities is set out below:

	Georgia	Other non-OECD countries	OECD countries	December 31, 2018 Total
FINANCIAL ASSETS				
Cash and cash equivalent	115,539	3,200	5,796	124,535
Mandatory cash balance with the NBG	138,155	-	-	138,155
Due from financial institutions	6,212	-	6,168	12,380
Loans to customers	817,917	3,083	895	821,895
Investments in equity instruments	57	-	-	57
Investments in debt instruments	19,295	-	-	19,295
Other financial assets	4,066	-	-	4,066
TOTAL FINANCIAL ASSETS	**1,101,241**	**6,283**	**12,859**	**1,120,383**
FINANCIAL LIABILITIES				
Deposits by banks	15,095	11	-	15,106
Deposits by customers	619,013	19,641	3,208	641,862
Other financial liabilities	3,307	-	-	3,307
Subordinated debt	190,595	-	-	190,595
TOTAL FINANCIAL LIABILITIES	**828,010**	**19,652**	**3,208**	**850,870**
NET POSITION	**273,231**	**(13,369)**	**9,651**	

	Georgia	Other non-OECD countries	OECD countries	December 31, 2017 Total
FINANCIAL ASSETS				
Cash and cash equivalent	212,482	3,914	8,248	224,644
Mandatory cash balance with the NBG	120,479	-	-	120,479
Financial assets at fair value through profit or loss	18,253	-	-	18,253
Due from financial institutions	6,507	-	12,293	18,800
Loans to customers	776,046	17,714	1,126	794,886
Investments in equity instruments	57	-	-	57
Investments in debt instruments	27,978	-	-	27,978
Other financial assets	4,889	-	-	4,889
TOTAL FINANCIAL ASSETS	**1,166,691**	**21,628**	**21,667**	**1,209,986**
FINANCIAL LIABILITIES				
Deposits by banks	18,398	-	-	18,398
Deposits by customers	655,741	21,026	13,890	690,657
Other borrowed funds	-	-	26,289	26,289
Other financial liabilities	3,327	-	-	3,327
Subordinated debt	208,368	-	-	208,368
TOTAL FINANCIAL LIABILITIES	**885,834**	**21,026**	**40,179**	**947,039**
NET POSITION	**280,857**	**602**	**(18,512)**	

Credit quality by class of financial assets. Financial assets are graded according to the current credit rating they have been issued by an internationally regarded agency such as Fitch. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

The following table details credit ratings of financial assets held by the Group as at December 31, 2018:

	AAA	AA	A	BBB	<BBB	Not rated	Total at December 31, 2018
Cash and cash equivalents	-	-	1	62,090	55,403	7,041	124,535
Mandatory cash balance with the NBG	-	-	-	-	138,155	-	138,155
Due from financial institutions	-	-	6,168	-	556	5,656	12,380
Loans to customers	-	-	-	-	25,794	796,101	821,895
Investments in equity instruments	-	-	-	-	-	57	57
Investments in debt instruments	-	-	-	-	19,295	-	19,295
Other financial assets	-	-	-	-	-	4,066	4,066

As at December 31, 2017:

	AAA	AA	A	BBB	<BBB	Not rated	Total at December 31, 2017
Cash and cash equivalents	-	-	7,658	124,623	79,359	13,004	224,644
Mandatory cash balance with the NBG	-	-	-	-	120,479	-	120,479
Financial assets at fair value through profit or loss	-	-	-	-	-	18,253	18,253
Due from financial institutions	-	-	11,904	389	-	6,507	18,800
Loans to customers	-	-	-	-	-	794,886	794,886
Investments in equity instruments	-	-	-	-	-	57	57
Investments in debt instruments	-	-	-	-	27,978	-	27,978
Other financial assets	-	-	-	-	-	4,889	4,889

Financial assets other than loans to customers are graded according to the current credit rating they have been issued by an internationally regarded agency such as Fitch, Standard & Poor's and Moody's.

The Group enters into numerous transactions where the counterparties are not rated by international rating agencies. The Group has developed internal models, which allow it to determine the rating of counterparties. A methodology to determine credit ratings of borrowers has been developed in the Group to assess borrowers based on financial strength, purposeful use of funds and collateralization which in turn are weighted against different risk measures. Based on these three indicators the Bank calculates overall loan stability and customer ratings.

Liquidity risk

Liquidity risk management. Liquidity risk refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due.

The Assets and Liabilities Committee ("ALCO") controls these types of risks by means of maturity analysis, determining the Group's strategy for the next financial period. Current liquidity is managed by the Treasury Department, which deals in the money markets for current liquidity support and cash flow optimization.

In order to manage liquidity risk, the Group performs daily monitoring of future expected cash flows on clients' and banking operations, which is a part of assets/liabilities management process. The Management Board sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level on interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

Further is analysis of liquidity and interest rate risks:

(a) Term to maturity of financial liabilities, that are not derivatives, calculated for non-discounted cash flows on financial liabilities (main debt and interests) on the earliest date, when the Group will be liable to redeem the liability;
(b) Term to maturity of financial liabilities, that are derivatives, calculated for non-discounted cash flows on financial liabilities on the earliest date, when the Group will be liable to redeem the liability; and
(c) Estimated term till maturity of financial assets, that are not derivatives, calculated for non-discounted cash flows on financial assets (including interests), which will be received on these assets based on contractual terms of maturity, except the cases when the Group expects that cash flows will be received in the different time.

An analysis of the liquidity by classes of financial assets and financial liabilities, and interest rate risks is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the Group.

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	December 31, 2018 Total
FINANCIAL ASSETS						
Cash and cash equivalents	96,497	-	-	-	-	96,497
Mandatory cash balance with the NBG	138,155	-	-	-	-	138,155
Due from financial institutions	-	5,656	556	-	3,843	10,055
Loans to customers	128,815	37,117	187,126	349,450	119,387	821,895
Investments in debt instruments	3,470	7,075	8,750	-		19,295
Total interest bearing financial assets	**366,937**	**49,848**	**196,432**	**349,450**	**123,230**	**1,085,897**
Cash and cash equivalents	28,038	-	-	-	-	28,038
Due from financial institutions	-	-	2,325	-	-	2,325
Investments in equity instruments	57	-	-	-	-	57
Other financial assets	3,083	624	3	356	-	4,066
Total non-interest bearing financial assets	**31,178**	**624**	**2,328**	**356**	**-**	**34,486**
Total financial assets	**398,115**	**50,472**	**198,760**	**349,806**	**123,230**	**1,120,383**
FINANCIAL LIABILITIES						
Deposits by customers	98,733	12,673	232,384	26,127	22	369,939
Due to banks	-	360	14,721			15,081
Subordinated debt	-	107	-	-	190,488	190,595
Total interest bearing financial liabilities	**98,733**	**13,140**	**247,105**	**26,127**	**190,510**	**575,615**
Due to banks	25	-	-	-	-	25
Deposits by customers	271,923	-	-	-	-	271,923
Other financial liabilities	655	-	2,652	-	-	3,307
Total non-interest bearing financial liabilities	**272,603**	**-**	**2,652**	**-**	**-**	**275,255**
Total financial liabilities	**371,336**	**13,140**	**249,757**	**26,127**	**190,510**	**850,870**
Interest sensitivity gap	268,204	36,708	(50,673)	323,323	(67,280)	
Cumulative interest sensitivity gap	**268,204**	**304,912**	**254,239**	**577,562**	**510,282**	
Liquidity gap	26,779	37,332	(50,997)	323,679	(67,280)	
Cumulative liquidity gap	**26,779**	**64,111**	**13,114**	**336,793**	**269,513**	

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	December 31, 2017 Total
FINANCIAL ASSETS						
Cash and cash equivalents	45,000	-	-	-	-	45,000
Mandatory cash balance with the NBG	120,479	-	-	-	-	120,479
Due from financial institutions	-	6,000	507	-	-	6,507
Loans to customers	119,685	43,273	149,435	286,992	195,501	794,886
Investments in debt instruments	4,491	9,283	14,204	-	-	27,978
Total interest bearing financial assets	**289,655**	**58,556**	**164,146**	**286,992**	**195,501**	**994,850**
Cash and cash equivalents	179,644	-	-	-	-	179,644
Financial assets at fair value through profit or loss	6,109	264	1,379	6,945	3,556	18,253
Due from financial institutions	-	-	8,245	-	4,048	12,293
Investments in equity instruments	57	-	-	-	-	57
Other financial assets	4,889	-	-	-	-	4,889
Total non-interest bearing financial assets	**190,699**	**264**	**9,624**	**6,945**	**7,604**	**215,136**
Total financial assets	**480,354**	**58,820**	**173,770**	**293,937**	**203,105**	**1,209,986**
FINANCIAL LIABILITIES						
Deposits by customers	147,125	9,087	167,635	67,864	4,687	396,398
Deposits by banks	-	-	14,602	-	-	14,602
Subordinated debt	-	95	-	-	208,273	208,368
Other borrowed funds	-	-	-	26,289	-	26,289
Total interest bearing financial liabilities	**147,125**	**9,182**	**182,237**	**94,153**	**212,960**	**645,657**
Deposits by customers	294,259	-	-	-	-	294,259
Deposits by banks	3,796	-	-	-	-	3,796
Other financial liabilities	3,327	-	-	-	-	3,327
Total non-interest bearing financial liabilities	**301,382**	**-**	**-**	**-**	**-**	**301,382**
Total financial liabilities	**448,507**	**9,182**	**182,237**	**94,153**	**212,960**	**947,039**
Interest sensitivity gap	142,530	49,374	(18,091)	192,839	(17,459)	
Cumulative interest sensitivity gap	**142,530**	**191,904**	**173,813**	**366,652**	**349,193**	
Liquidity gap	31,847	49,638	(8,467)	199,784	(9,855)	
Cumulative liquidity gap	**31,847**	**81,485**	**73,018**	**272,802**	**262,947**	

An analysis of liquidity and interest rate risk is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the Group. The amounts disclosed in these tables do not correspond to the amounts recorded in the consolidated statement of financial position as the presentation below includes a maturity analysis for financial assets and liabilities that indicates the total remaining contractual payments (including interest payments), which are not recognized in the consolidated statement of financial position under the effective interest rate method.

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	December 31, 2018 Total
FINANCIAL ASSETS							
Cash and cash equivalents	4.17%	96,497	-	-	-	-	96,497
Mandatory cash balance with the NBG	0.86%	138,155	-	-	-	-	138,155
Due from financial institutions	5.25%	-	6,044	556	-	4,108	10,708
Loans to customers	10.72%	135,894	46,851	234,294	479,994	121,670	1,018,703
Investments in debt instruments	7.21%	3,473	7,148	9,063	-	-	19,684
Total interest bearing financial assets		**374,019**	**60,043**	**243,913**	**479,994**	**125,778**	**1,283,747**
Cash and cash equivalents		28,038	-	-	-	-	28,038
Financial assets at fair value through profit or loss		-	-	-	-	-	-
Due from financial institutions		-	-	2,325	-	-	2,325
Investments in equity instruments		57	-	-	-	-	57
Other financial assets		3,083	624	3	356	-	4,066
Total non-interest bearing financial assets		**31,178**	**624**	**2,328**	**356**	**-**	**34,486**
TOTAL FINANCIAL ASSETS		**405,197**	**60,667**	**246,241**	**480,350**	**125,778**	**1,318,233**
FINANCIAL LIABILITIES							
Deposits by customers	4.95%	101,342	12,862	239,754	27,849	892	382,699
Deposits by banks	4.80%	-	636	14,798	-	-	15,434
Subordinated debt	5.50%	-	2,245	6,861	36,448	232,860	278,414
Total interest bearing financial liabilities		**101,342**	**15,743**	**261,413**	**64,297**	**233,752**	**676,547**
Deposits by banks		25	-	-	-	-	25
Deposits by customers		271,923	-	-	-	-	271,923
Other financial liabilities		655	-	2,652	-	-	3,307
Total non-interest bearing financial liabilities		**272,603**	**-**	**2,652**	**-**	**-**	**275,255**
TOTAL FINANCIAL LIABILITIES		**373,945**	**15,743**	**264,065**	**64,297**	**233,752**	**951,802**
Guarantees issued		1,710	9,703	24,916	17,116	85	**53,530**
Letter of Credit and other transactions		2,765	784	4,314	-	-	**7,863**
Unused credit line		10,285	946	13,131	15,311	9,138	**48,811**
TOTAL FINANCIAL LIABILITIES AND COMMITMENTS		**388,705**	**27,176**	**306,426**	**96,724**	**242,975**	**1,062,006**

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	December 31, 2017 Total
FINANCIAL ASSETS							
Cash and cash equivalents	7.25%	45,068	-	-	-	-	45,068
Mandatory cash balance with the NBG	1.25%	120,479	-	-	-	-	120,479
Due from financial institutions	8.00%	-	6,068	-	-	-	6,068
Loans to customers	10.00%	125,653	53,755	194,227	391,094	234,328	999,057
Investments in debt instruments	7.28%	4,500	9,380	14,759	-	-	28,639
Total interest bearing financial assets		**295,700**	**69,203**	**208,986**	**391,094**	**234,328**	**1,199,311**
Cash and cash equivalents		179,643	-	-	-	-	179,643
Financial assets at fair value through profit or loss		6,109	264	1,379	6,945	3,556	18,253
Due from financial institutions		-	-	8,245	-	4,048	12,293
Investments in equity instruments		57	-	-	-	-	57
Other financial assets		1,295	777	2,133	380	304	4,889
Total non-interest bearing financial assets		**187,104**	**1,041**	**11,757**	**7,325**	**7,908**	**215,135**
TOTAL FINANCIAL ASSETS		**482,804**	**70,244**	**220,743**	**398,419**	**242,236**	**1,414,446**
FINANCIAL LIABILITIES							
Deposits by customers	3.25%	147,896	9,497	175,880	99,845	5,044	438,162
Deposits by banks	4.5%	-	-	14,901	-	-	14,901
Subordinated debt	5.5%	-	2,452	9,132	39,805	250,057	301,446
Other borrowed funds	5.5%	-	-	-	33,054	-	33,054
Total interest bearing financial liabilities		**147,896**	**11,949**	**199,913**	**172,704**	**255,101**	**787,563**
Deposits by banks		3,796	-	-	-	-	3,796
Deposits by customers		294,259	-	-	-	-	294,259
Other financial liabilities		931	2,397	-	-	-	3,328
Total non-interest bearing financial liabilities		**298,986**	**2,397**	**-**	**-**	**-**	**301,383**
TOTAL FINANCIAL LIABILITIES		**446,882**	**14,346**	**199,913**	**172,704**	**255,101**	**1,088,946**
Guarantees issued		2,284	10,004	25,057	27,246	100	64,691
Letters of credit		7	-	8,245	-	-	8,252
Unused credit line		9,271	628	4,938	6,264	1,209	22,310
TOTAL FINANCIAL LIABILITIES AND COMMITMENTS		**458,444**	**24,978**	**238,153**	**206,214**	**256,410**	**1,184,199**

Market risk. Market risk is the risk that the Group's earnings or capital or its ability to meet business objectives will be adversely affected by changes in the level or volatility of market rates or prices. Market risk covers interest rate risk, currency risk and other pricing risks that the Group is exposed to. There have been no changes as to the way the Group measures risk or to the risk it is exposed or the manner in which these risks are managed and measured.

The Group is exposed to interest rate risks as the Group borrows funds at both fixed and floating rates. The risk is managed by the Group maintaining an appropriate mix between fixed and floating rate borrowings.

The ALCO also manages interest rate and market risks by matching the Group's interest rate position, which provides the Group with a positive interest margin. The Department of Financial Supervision conducts monitoring of the Group's current financial performance, estimates the Group's sensitivity to changes in interest rates and its influence on the Group's profitability.

The majority of the Group's loan contracts and other financial assets and liabilities that bear interest are either variable or contain clauses enabling the interest rate to be changed at the option of the lender. The Group monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

Interest rate sensitivity. The Group manages fair value interest rate risk through periodic estimation of potential losses that could arise from adverse changes in market conditions. The Department of Financial Supervision conducts monitoring of the Group's current financial performance, estimates the Group's sensitivity to changes in fair value interest rates and its influence on the Group's profitability.

The following table presents a sensitivity analysis of interest rate risk, which has been determined based on "reasonably possible changes in the risk variable". The level of these changes is determined by management and is contained within the risk reports provided to key management personnel.

Impact of interest rate 2 basis points changes on profit before tax and equity based on financial assets and liabilities values as at December 31, 2018 and 2017 were as following:

	December 31, 2018		**December 31, 2017**	
	Interest rate +5%	**Interest rate -5%**	**Interest rate +5%**	**Interest rate -5%**
Net impact on profit before tax	25,514	(25,514)	17,571	(17,571)
Net impact on equity	21,687	(21,687)	14,826	(14,826)

Currency risk. Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The ALCO controls currency risk by management of the open currency position on the estimated basis of Georgian Lari devaluation and other macroeconomic indicators, which gives the Group an opportunity to minimize losses from significant currency rates fluctuations toward its national currency. The Treasury Department performs daily monitoring of the Group's open currency position with the aim to match the requirements of the National Bank of Georgia.

The Group's open positions by the major currencies in which it holds the assets and liabilities are presented below:

	GEL	USD USD 1 = GEL 2.6766	EUR EUR 1 = GEL 3.070	Other currency	December 31, 2018 Total
NON-DERIVATIVE FINANCIAL ASSETS					
Cash and cash equivalents	53,381	62,490	4,775	3,889	**124,535**
Mandatory cash balance with the NBG	-	126,294	11,861	-	**138,155**
Due from financial institutions	6,212	3,844	2,324	-	**12,380**
Loans to customers	253,467	544,525	23,903	-	**821,895**
Investments inequity instruments	57	-	-	-	**57**
Investments in debt instruments	19,295	-	-	-	**19,295**
Other financial assets	1,799	1,859	407	1	**4,066**
TOTAL NON-DERIVATIVE FINANCIAL ASSETS	**334,211**	**739,012**	**43,270**	**3,890**	**1,120,383**
NON-DERIVATIVE FINANCIAL LIABILITIES					
Deposits by banks	2	15,101	3	-	**15,106**
Deposits by customers	101,182	493,633	46,920	127	**641,862**
Other financial liabilities	92	2,390	825	-	**3,307**
Subordinated debt	-	190,595	-	-	**190,595**
TOTAL NON-DERIVATIVE FINANCIAL LIABILITIES	**101,276**	**701,719**	**47,748**	**127**	**850,870**
OPEN BALANCE SHEET POSITION	**232,935**	**37,293**	**(4,478)**	**3,763**	

	GEL	USD USD 1 = GEL 2.5922	EUR EUR 1 = GEL 3.1044	Other currency	December 31, 2017 Total
NON-DERIVATIVE FINANCIAL ASSETS					
Cash and cash equivalents	69,593	143,398	10,751	902	224,644
Mandatory cash balance with the NBG	-	109,873	10,606	-	120,479
Financial assets at fair value through profit or loss	18,253	-	-	-	18,253
Due from financial institutions	6,507	4,048	8,245	-	18,800
Loans to customers	230,496	543,869	20,521	-	794,886
Investments in equity instruments	57	-	-	-	57
Investments in debt instruments	27,978	-	-	-	27,978
Other financial assets	4,295	437	157	-	4,889
TOTAL NON-DERIVATIVE FINANCIAL ASSETS	**357,179**	**801,625**	**50,280**	**902**	**1,209,986**
NON-DERIVATIVE FINANCIAL LIABILITIES					
Deposits by banks	1,413	16,982	3	-	18,398
Deposits by customers	131,942	504,034	54,328	353	690,657
Other borrowed funds	-	26,289	-	-	26,289
Other financial liabilities	2,396	931	-	-	3,327
Subordinated debt	-	208,368	-	-	208,368
TOTAL NON-DERIVATIVE FINANCIAL LIABILITIES	**135,751**	**756,604**	**54,331**	**353**	**947,039**
OPEN BALANCE SHEET POSITION	**221,428**	**45,021**	**(4,051)**	**549**	

Currency risk sensitivity. The following table details the Group's sensitivity to a 30% increase and decrease in the USD against the GEL. 30% is the sensitivity rate used when reporting foreign currency risk internally to the key management personnel and represents the management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 30% change in foreign currency rates.

Impact on net profit and equity based on asset values as at December 31, 2018 and 2017:

	December 31, 2018		**December 31, 2017**	
	GEL/USD +30%	**GEL/USD -30%**	**GEL/USD +30%**	**GEL/USD -30%**
Impact on profit or loss before tax	11,188	(11,188)	13,506	(13,506)
Impact on equity	9,510	(9,510)	11,480	(11,480)

Limitations of sensitivity analysis. The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analyses do not take into consideration that the Group's assets and liabilities are actively managed. Additionally, the financial position of the Group may vary at the time that any actual market movement occurs. For example, the Group's financial risk management strategy aims to manage the exposure to market fluctuations. As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation and taking other protective action. Consequently, the actual impact of a change in the assumptions may not have any impact on the liabilities, whereas assets are held at market value in the consolidated statement of financial position. In these circumstances, the different measurement bases for liabilities and assets may lead to volatility in shareholder equity.

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Group's view of possible near-term market changes that cannot be predicted with any certainty; and the assumption that all interest rates move in an identical fashion.

Price risk. Price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market. The Group is exposed to price risks of its products which are subject to general and specific market fluctuations.

The Group manages price risk through periodic estimation of potential losses that could arise from adverse changes in market conditions and establishing and maintaining appropriate stop-loss limits and margins and collateral requirements. With respect to undrawn loan commitments the Group is potentially exposed to a loss of an amount equal to the total amount of such commitments. However, the likely amount of a loss is less than that, since most commitments are contingent upon certain conditions set out in the loan agreements.

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

34. Subsequent events

On January 29, 2019 and on April 16, 2019 JSC Cartu Bank has declared and disbursed dividends in amount of GEL 20,000 and GEL 25,000, respectively.