JSC Silk Road Bank

Financial statements

Year ended 31 December 2017
Together with independent auditor's report

Contents

Independent auditor's report

Financial statements

Statement of financial position ... 3
Statement of profit or loss ... 4
Statement of comprehensive income ... 5
Statement of changes in equity ... 6
Statement of cash flows ... 7

Notes to the financial statements

1. Principal activities ... 8
2. Basis of preparation ... 8
3. Summary of significant accounting policies ... 8
4. Significant accounting judgments and estimates ... 18
5. Cash and cash equivalents ... 19
6. Amounts due from credit institutions ... 19
7. Loans to customers ... 19
8. Investment securities ... 22
9. Investment property ... 22
10. Property and equipment ... 22
11. Taxation ... 23
12. Other assets and liabilities ... 24
13. Subordinated debt ... 25
14. Amounts due to customers ... 25
15. Equity ... 26
16. Provisions, commitments and contingencies ... 27
17. Net fee and commission income ... 27
18. Other income ... 27
19. Other operating expenses ... 28
20. Risk management ... 28
21. Fair value measurement ... 33
22. Related party disclosures ... 38
24. Capital adequacy ... 39
25. Events after the reporting period ... 41

EY
Building a better working world

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

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

Independent auditor's report

To the Shareholders and Board of Directors of JSC Silk Road Bank

Opinion

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

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

Basis for opinion

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

Responsibilities of management and the supervisory board for the financial statements

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

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

The supervisory board is responsible for overseeing the Bank's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

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

A member firm of Ernst & Young Global Limited

EY
Building a better working world

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

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

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

Ruslan Khoroshvili

On behalf of EY Georgia LLC

14 May 2018

Tbilisi, Georgia

Statement of financial position

As of 31 December 2017

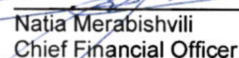
(Thousands of Georgian Lari)

	Notes	2017	2016
Assets			
Cash and cash equivalents	5	15,973	20,120
Amounts due from credit institutions	6	2,273	12,179
Loans to customers	7	6,433	8,178
Investments securities:	8		
- available-for-sale		20	20
- held-to-maturity		1,809	1,805
- loans and receivables		8,426	10,359
Investment property	9	638	10,051
Property and equipment	10	16,274	16,719
Other assets	12	578	470
Intangible assets		57	40
Income tax asset		280	–
Assets held for sale	9	5,806	–
Total assets		**58,567**	**79,941**
Liabilities			
Amounts due to credit institutions		–	9,000
Subordinated debt	13	9,076	–
Amounts due to customers	14	15,462	32,799
Deferred income tax liabilities	11	279	271
Provisions		–	107
Other liabilities	12	692	754
Total liabilities		**25,509**	**42,931**
Equity			
Share capital	15	30,000	30,000
Land and buildings revaluation reserve		5,321	5,153
(Accumulated losses)/retained earnings		(2,263)	1,857
Total equity		**33,058**	**37,010**
Total liabilities and equity		**58,567**	**79,941**

Signed and authorised for release on behalf of the Management Board of the Bank

Alexander Dzneladze
Chief Executive Officer

14 May 2018



Natia Merabishvili
Chief Financial Officer

The accompanying notes on pages 8 to 41 are an integral part of these financial statements.

Statement of profit or loss

For the year ended 31 December 2017

(Thousands of Georgian Lari)

	Notes	2017	2016
Interest income			
Loans to customers		1,008	1,822
Investment securities		1,346	1,497
Amounts due from credit institutions		456	127
		2,810	**3,446**
Interest expense			
Amounts due to customers		(354)	(659)
Amounts due to credit institutions		(277)	(270)
		(631)	**(929)**
Net interest income		**2,179**	**2,517**
Loan impairment (charge)/reversal	7	(273)	592
Net interest income after loan impairment reversal		**1,906**	**3,109**
Net fee and commission income	17	405	212
Net gains/(losses) from foreign currencies:			
- dealing		294	1,455
- translation differences		96	(1,053)
Net (losses)/gains on investment property revaluation	9	(51)	1,219
Net losses from disposal of investment property		(873)	(2,128)
Net losses on reclassification into assets held for sale	9	(1,683)	–
Other income	18	598	365
Non-interest (loss)/income		**(1,214)**	**70**
Personnel expenses		(2,034)	(2,066)
Other operating expenses	19	(2,164)	(2,412)
Depreciation and amortisation		(601)	(666)
Other impairment and provisions charge		(152)	(62)
Non-interest expenses		**(4,951)**	**(5,206)**
Loss before income tax		**(4,259)**	**(2,027)**
Income tax benefit	11	39	2,756
Net (loss)/profit for the year		**(4,220)**	**729**

The accompanying notes on pages 8 to 41 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December 2017

(Thousands of Georgia Laris)

	Notes	2017	2016
(Loss)/profit for the year		(4,220)	729
Other comprehensive income/(loss) not to be reclassified to profit or loss in subsequent periods:			
Revaluation gain/(loss) on land and buildings	10	315	(586)
Income tax relating to components of other comprehensive income	11	(47)	87
Net other comprehensive income/(loss) not to be reclassified to profit or loss in subsequent periods, net of tax		**268**	**(499)**
Total comprehensive (loss)/income for the year		**(3,952)**	**230**

The accompanying notes on pages 8 to 41 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December 2017

(Thousands of Georgian Laris)

	Share capital	*Revaluation reserve for land and buildings*	*Retained earnings / (Accumulated losses)*	*Total equity*
31 December 2015	**30,000**	**5,861**	**919**	**36,780**
Profit for the year	–	–	729	729
Other comprehensive loss for the year	–	(499)	–	(499)
Total comprehensive income for the year	**–**	**(499)**	**729**	**230**
Depreciation of revaluation reserve, net of tax	–	(209)	209	–
31 December 2016	**30,000**	**5,153**	**1,857**	**37,010**
Loss for the year	–	–	(4,220)	(4,220)
Other comprehensive income for the year	–	268	–	268
Total comprehensive income/(loss) for the year	**–**	**268**	**(4,220)**	**(3,952)**
Depreciation of revaluation reserve, net of tax	–	(100)	100	–
31 December 2017	**30,000**	**5,321**	**(2,263)**	**33,058**

The accompanying notes on pages 8 to 41 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2017

(Thousands of Georgian Laris)

	Notes	*2017*	*2016*
Cash flows from operating activities			
Interest received		3,069	2,958
Interest paid		(649)	(549)
Fees and commissions received		540	418
Fees and commissions paid		(120)	(206)
Net realised gains from dealing in foreign currencies		294	1,455
Other income received		344	398
Personnel expenses paid		(2,003)	(2,079)
Other operating expenses paid		(2,652)	(2,139)
Cash flows (used in)/from operating activities before changes in operating assets and liabilities		**(1,177)**	**256**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		9,951	(10,350)
Loans to customers		1,188	6,093
Other assets		17	19
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		(9,000)	6,811
Amounts due to customers		(17,468)	11,965
Other liabilities		(112)	165
Net cash (used in)/from operating activities		**(16,601)**	**14,959**
Cash flows from investing activities			
Purchase of investment securities		–	(7,082)
Proceeds from the redemption of investment securities		1,831	2,501
Proceeds from sales of investment property		1,244	1,987
Purchase of intangible assets		(36)	(13)
Purchase of property and equipment		(11)	(28)
Proceeds from sale of property and equipment		174	15
Net cash from investing activities		**3,202**	**(2,620)**
Cash flows from financing activities			
Proceeds from subordinated debt		9,060	–
Net cash from financing activities		**9,060**	**–**
Effect of exchange rates changes on cash and cash equivalents		192	(2,392)
Net (decrease)/increase in cash and cash equivalents		**(4,147)**	**9,947**
Cash and cash equivalents, beginning	5	**20,120**	**10,173**
Cash and cash equivalents, ending	5	**15,973**	**20,120**

The accompanying notes on pages 8 to 41 are an integral part of these financial statements.

(Thousands of Georgian Lari)

1. Principal activities

JSC Silk Road Bank (the "Bank") is a Georgian joint stock company.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its corporate and retail customers. The Bank's registered legal address is 2, Zaarbrukeni Square, Tbilisi, Georgia. The Bank is regulated by the National Bank of Georgia (the "NBG"; the central bank of Georgia) and conducts the business under license number 238.

As at 31 December 2017 and 2016, the shareholders of the Bank are as follows:

Shareholder	***2017,%***	***2016,%***
Silk Road Finance Group (Georgia)	99.99	99.99
Other	0.01	0.01
Total	**100.00**	**100.00**

The Bank is ultimately controlled by Mr Giorgi Ramishvili, a Georgian national.

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

2. Basis of preparation

General

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

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

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

3. Summary of significant accounting policies

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

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

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative
The amendments require entities to provide disclosure of changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). The Bank has provided the information for both the current and the comparative period in Note 13.

Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealised Losses
The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of deductible temporary difference related to unrealised losses. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount. Application of the amendments has no effect on the Bank's financial position and performance as the Bank has no deductible temporary differences or assets that are in the scope of the amendments.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Fair value measurement

The Bank measures financial instruments, such as trading and available-for-sale securities, derivatives and non-financial assets such as investment property, at fair value at each balance sheet date. Fair values of financial instruments measured at amortized cost are disclosed in Note 21.

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

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

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

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

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

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

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. The Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

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

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Bank has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held-to-maturity investments are subsequently measured at amortized cost. Gains and losses are recognized in profit or loss when the investments are impaired, as well as through the amortization process.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Financial assets (continued)

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets

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

Cash and cash equivalents

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

Mandatory reserve deposit with the NBG

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

Derivative financial instruments

In the normal course of business, the Bank enters into derivative financial instruments such as currency swaps. These financial instruments are recorded at fair value and the fair values are estimated based on sport market prices, due to short term maturities of the financial instruments. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of profit and loss as net gains/(losses) from foreign currencies dealing.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to the Central bank, amounts due to credit institutions and amounts due to customers. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the borrowings are derecognised as well as through the amortisation process.

Leases

i. Operating – Bank as lessee

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

ii. Operating – Bank as lessor

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

3. Summary of significant accounting policies (continued)

Measurement of financial instruments at initial recognition

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

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

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

Offsetting of financial instruments

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

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

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

Impairment of financial assets

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

Amounts due from credit institutions and loans to customers

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

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of profit or loss. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the statement of profit or loss.

3. Summary of significant accounting policies (continued)

Impairment of financial assets (continued)

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

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

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group.

Held-to-maturity financial investments

For held-to-maturity investments the Bank assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognised in the statement of profit or loss.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, any amounts formerly charged are credited to the statement of profit or loss.

Available-for-sale financial investments

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

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

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.
The accounting treatment of such restructuring is as follows:

- if the currency of the loan has been changed the old loan is derecognised and the new loan is recognised;
- if the loan restructuring is not caused by the financial difficulties of the borrower the Bank uses the same approach as for financial liabilities described below;
- if the loan restructuring is due to the financial difficulties of the borrower and the loan is impaired after restructuring, the Bank recognizes the difference between the present value of the new cash flows discounted using the original effective interest rate and the carrying amount before restructuring in the provision charges for the period. In case loan is not impaired after restructuring the Bank recalculates the effective interest rate.

Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously 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 or current effective interest rate.

3. Summary of significant accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Financial liabilities

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

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

Credit related commitments

In the ordinary course of business, the Bank gives credit related commitments, consisting of letters of credit, and financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties and carry the same credit risk as loans. Financial guarantees are initially recognised in the financial statements at fair value, in 'Other liabilities', being the amount of fees received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised fee and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the statement of profit or loss. The amount of fee received is recognised in the statement of profit or loss on a straight-line basis over the life of the guarantee.

Taxation

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

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

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

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

3. Summary of significant accounting policies (continued)

Property and equipment

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

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

Following initial recognition at cost, land and buildings are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Any revaluation surplus is credited to the revaluation reserve for property and equipment included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in the statement of profit or loss, in which case the increase is recognised in the statement of profit or loss. A revaluation deficit is recognised in the statement of profit or loss, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

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

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

	Years
Buildings	50
Furniture and fixtures	4-10
Computers and office equipment	4-10
Motor vehicles	5
Other	4-10

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

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

Investment property

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

Investment properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the reporting date. Gains or losses arising from changes in the fair values of investment properties are included in the statement of profit or loss in the period in which they arise. Fair value of the Bank's investment property is determined on the base of various sources including reports of independent appraisers, who hold a recognized and relevant professional qualification and who have recent experience in valuation of property of similar location and category.

Investment properties are derecognised either when they have been disposed of or when they are permanently withdrawn from use and no future economic benefit is expected from their disposal. The difference between the net disposal proceeds and the carrying amount of the asset is recognised in the statement of profit or loss in the period of derecognition.

Earned rental income is recorded in statement of profit or loss within other operating income.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Assets classified as held for sale

The Bank classifies a non-current asset (or a disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the non-current asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable.

The sale qualifies as highly probable if the Bank's management is committed to a plan to sell the non-current asset (or disposal group) and an active program to locate a buyer and complete the plan must have been initiated. Further, the non-current asset (or disposal group) must have been actively marketed for a sale at price that is reasonable in relation to its current fair value and in addition the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification of the non-current asset (or disposal group) as held for sale.

The Bank measures an asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell. The Bank recognises an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell if events or changes in circumstance indicate that their carrying amount may be impaired.

Provisions

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

Share capital

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

Contingencies

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

Recognition of income and expenses

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

Interest and similar income and expense

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

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

Fee and commission income

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income agency fees and other fees. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Foreign currency translation

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

Differences between the contractual exchange rate of a transaction in a foreign currency and the NBG exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies.

Standards issued but not effective

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

IFRS 9 Financial Instruments

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

The Bank plans to adopt the new standard by recognizing the cumulative transition effect in opening retained earnings on 1 January 2018 and will not restate comparative information.

The Bank is in the process of quantifying the effect of adoption of IFRS 9, however no reasonable estimate of this effect is yet available.

(a) Classification and measurement

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

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

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

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

The Bank expects to continue measuring financial assets currently classified as loans and receivables and held to maturity at amortized cost, however as of the date of these financial statements the Bank has not finalized the assessment of the classification and measurement of its financial assets in accordance with IFRS 9 requirements.

3. Summary of significant accounting policies (continued)

Standards issued but not effective (continued)

(b) Impairment

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

The Bank is in the process of analyzing the requirements of IFRS 9 in relation to impairment and does not have an impairment methodology in accordance with IFRS 9 as of the date of these financial statements.

IFRS 15 Revenue from Contracts with Customers

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

IFRS 15 Revenue from Contracts with Customers (continued)

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

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

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

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

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

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

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

3. Summary of significant accounting policies (continued)

Standards issued but not effective (continued)

Transfers of Investment Property — Amendments to IAS 40

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

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

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

4. Significant accounting judgments and estimates

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

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its judgement to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. In addition, the management monitors market value of collateral on a regular basis. Management uses its experienced judgment or independent opinion to adjust the fair value to reflect current circumstances.

The amount and type of collateral required depends on the assessment of credit risk of the counterparty. The Bank uses its judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

The amount of allowance for loan impairment recognized by the Bank as at 31 December 2017 is GEL 1,503 (2016: GEL 1,878) (Note 7).

Determination of fair value of property and equipment and investment property

The Bank carries its investment properties at fair value, with changes in fair value being recognized in the statement of profit or loss. In addition, it measures land and buildings at revalued amounts with changes in fair value being recognised in other comprehensive loss.

The Bank's investment properties and land and buildings are located in Georgia. The Georgian real estate market has not been active historically. Thus, in absence of active real estate market, determination of fair values of the Bank's investment properties and land and buildings is highly subjective and involves significant judgment.

The Bank engages independent valuator to assess the fair value of investment property owned and the land and buildings. For land and building and investment property market approach method was used. Under market approach the market value of the subject property is estimated by comparing it to other similar properties that have recently been sold, been listed for the sale, or for which offers have been made. The valuator obtains an indication of the subject property's value by adjusting the prices of the comparable properties to account for their differences from the subject property. Real estate valuators compare the legal, economic, locational and physical characteristics of the property they are appraising to those corresponding characteristics of similar sales, listings, or pending sales (Notes 9, 10).

(Thousands of Georgian Lari)

4. Significant accounting judgments and estimates (continued)

Classification of assets held for sale

The Bank classifies buildings as held for sale if its carrying amount will be recovered principally through a sale transaction. The criteria for classification as held for sale are as follows:

- There is an internal decision of the Bank's General Director to initiate an active plan of sale of these properties;
- The Bank has hired a real estate broker to assist with the sales of the properties;
- The properties are announced for sale on the web.

The classification as an asset held for sale has a significant impact on the valuation of the properties (Note 9).

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2017	*2016*
Cash on hand	3,079	3,857
Current accounts with the NBG, excluding obligatory reserves	500	2,972
Time deposits with credit institutions up to 90 days	2,201	5,171
Current accounts with other credit institutions	10,193	8,120
Cash and cash equivalents	**15,973**	**20,120**

6. Amounts due from credit institutions

	2017	*2016*
Obligatory reserves with the NBG	2,273	5,179
Time deposits for more than 90 days	–	7,000
Amounts due from credit institutions	**2,273**	**12,179**

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

7. Loans to customers

Loans to customers comprise:

	2017	*2016*
Corporate lending	3,534	4,833
Consumer lending	1,781	566
Residential mortgages	1,709	2,885
Small business lending	273	433
Credit cards	133	491
Auto loans	15	42
Other	491	806
Gross loans to customers	**7,936**	**10,056**
Less: allowance for impairment	(1,503)	(1,878)
Loans to customers, net	**6,433**	**8,178**

(Thousands of Georgian Lari)

7. Loans to customers (continued)

Allowance for impairment of loans to customers

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

	Corporate lending	*Residential mortgages*	*Small business lending*	*Consumer lending*	*Credit cards*	*Auto loans*	*Other*	*Total*
At 1 January 2017	**145**	**632**	**310**	**261**	**353**	**37**	**140**	**1,878**
Net charge/(reversal) for the year	177	64	(43)	55	(58)	(39)	117	273
Recoveries	–	20	32	70	48	11	3	184
Amounts written off	(215)	(69)	(30)	(170)	(335)	(9)	(4)	(832)
At 31 December 2017	**107**	**647**	**269**	**216**	**8**	–	**256**	**1,503**
Individual impairment	20	647	269	79	6	–	256	1,277
Collective impairment	87	–	–	137	2	–	–	226
	107	**647**	**269**	**216**	**8**	–	**256**	**1,503**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**54**	**1,255**	**273**	**79**	**6**	–	**382**	**2,049**

	Corporate lending	*Residential mortgages*	*Small business lending*	*Consumer lending*	*Credit cards*	*Auto loans*	*Other*	*Total*
At 1 January 2016	**82**	**1,002**	**284**	**289**	**306**	**41**	**502**	**2,506**
Net charge/(reversal) for the year	63	(114)	26	(117)	(2)	(12)	(436)	(592)
Recoveries	–	55	–	90	50	8	74	277
Amounts written off	–	(311)	–	(1)	(1)	–	–	(313)
At 31 December 2016	**145**	**632**	**310**	**261**	**353**	**37**	**140**	**1,878**
Individual impairment	145	632	309	260	352	37	139	1,874
Collective impairment	–	–	1	1	1	–	1	4
	145	**632**	**310**	**261**	**353**	**37**	**140**	**1,878**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**1,292**	**1,826**	**260**	**353**	**433**	**42**	**657**	**4,863**

Interest income accrued on loans and advances, for which individual impairment allowances have been recognized, as at 31 December 2017, comprised GEL 155 (2016: GEL 851).

In accordance with the Georgian legislation, loans may only be written off with the approval of the Board of Directors and, in certain cases, with the respective decision of the Court.

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, inventory, and cash held in bank;
- for retail lending, mortgages over residential properties.

(Thousands of Georgian Lari)

7. Loans to customers (continued)

Collateral and other credit enhancements (continued)

The Bank also obtains guarantees from parent companies for loans to their subsidiaries.

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

Without taking into account discounted value of collateral, allowance for loan impairment would be GEL 773 higher as at 31 December 2017 (2016: GEL 2,989 higher).

It is the Bank's policy to dispose repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Bank does not occupy repossessed properties for business use. The repossessed properties are recorded separately on the face of statement of financial position.

The Bank has been violating one of the NBG's prudential ratios - Unsecured loans ratio (SK-6) - since October 2017, but had an official waiver from the NBG until March 2018. In April 2018, the NBG requested the Bank to cease issuing uncollateralized loans to meet the prudential requirements. After the negotiations with the NBG, parties have agreed on specific calculation of the ratio (uncollateralized loans should not be more than 25% of the Regulatory Capital instead of 25% of loan portfolio) for the Bank and the latter was allowed to continue issuing uncollateralized loans to customers.

On 17 April 2018 the NBG approved amendments to the decree N49/04 of 17 June 2014, which became effective from 7 May 2018. These amendments introduce additional limitations for the commercial banks on issuing loans to customers without high quality analysis of their solvency (except where precious metals, jewellery or real estate is pledged as collateral). Such loans to customers should not exceed 25% of the Regulatory Capital. The loans to customers with real estate pledged under collateral and without high quality analysis of borrower solvency are limited to 15% of the Regulatory Capital and the "Loan to Value" ratio ("LTV") was limited to 50%.
The Bank is currently assessing the impact of these new regulations on its financial statements.

Concentration of loans to customers

As at 31 December 2017, the Bank had a concentration of loans represented by GEL 4,771 due from the ten largest borrowers that represents 60% of gross loan portfolio (2016: GEL 5,631 or 57%). An allowance of GEL 960 (2016: GEL 862) was recognized against these loans. Included in total loans to customers is an exposure to a single greatest borrower of GEL 1,305 (2016: GEL 1,638).

Loans have been extended to the following types of customers:

	2017	*2016*
Individuals	4,130	4,800
Commercial legal entities	3,806	5,256
	7,936	**10,056**

Loans are issued in Georgia to the following industry sectors:

	2017	*2016*
Individuals	4,130	4,800
Communication	1,305	1,674
Construction	1,055	2,175
Agricultural	925	173
Retail	516	809
Food industry	5	23
Energy	–	383
Other	–	19
Gross loans and advances to customers	**7,936**	**10,056**

(Thousands of Georgian Lari)

8. Investment securities

Available for sale securities comprise investments in unquoted shares of Georgian companies with carrying value of GEL 20 (2016: GEL 20).

Held-to-maturity securities comprise:

	2017	*2016*
Government Treasury bonds of the Ministry of Finance of Georgia	1,809	1,805
Held-to-maturity securities	**1,809**	**1,805**

Investment securities classified as loans and receivables comprise:

	2017	*2016*
Government Treasury bonds of the Ministry of Finance of Georgia	8,426	10,359
Investment securities classified as loans and receivables	**8,426**	**10,359**

9. Investment property

	2017	*2016*
Opening balance at 1 January	**10,051**	**12,305**
Additions	244	642
Disposals	(2,117)	(4,115)
Reclassified to assets held for sale	(7,489)	–
Net (losses)/gains from revaluation	(51)	1,219
31 December	**638**	**10,051**

Investment property is represented by several properties which the Bank took possession in satisfaction of non-performing loans, and holds for long-term appreciation in value or to generate rental income.

In line with the Bank's shifting of strategy towards uncollateralized individual lending and reduction of corporate and mortgage portfolio, management has initiated a process of active sale of its investment property portfolio. As a result it has reclassified investment property with a balance of GEL 7,489 as assets held for sale. The Bank recognized losses of GEL 1,683 from this reclassification.

As of 31 December 2017 the Bank engaged an accredited independent appraiser to determine the fair value of these properties. The appraiser is an industry specialist in valuing these types of investment properties.

The fair value of the property was determined based on the market data. The market approach was used to determine the fair value and the income approach was used to validate the obtained value estimates. More details about the fair value of investment property are disclosed in Note 21.

Rental income arising from investment properties comprised GEL 216 (2016: GEL 64).

10. Property and equipment

	Land and buildings	*Computers and commu-nication equipment*	*Furniture, fixtures and office equipment*	*Motor vehicles*	*Leasehold improve-ments*	*Other*	*Total*
Cost or revalued amount							
31 December 2016	**15,961**	**1,525**	**1,105**	**208**	**390**	**933**	**20,122**
Additions	–	11	1	–	–	–	**12**
Disposals	(38)	(90)	(122)	(46)	(390)	(113)	**(799)**
Write-offs	–	–	(13)	–	–	–	**(13)**
Effect of revaluation*	(30)	–	–	–	–	–	**(30)**
31 December 2017	**15,893**	**1,446**	**971**	**162**	**–**	**820**	**19,292**
Accumulated depreciation							
31 December 2016	–	**1,197**	**949**	**198**	**214**	**845**	**3,403**
Depreciation charge	345	104	51	9	–	70	**579**
Disposals	–	(90)	(112)	(46)	(238)	(133)	**(619)**
Effect of revaluation*	**(345)**	–	–	–	–	–	**(345)**
31 December 2017	–	**1,211**	**888**	**161**	**(24)**	**782**	**3,018**
Net book value							
31 December 2016	**15,961**	**328**	**156**	**10**	**176**	**88**	**16,719**
31 December 2017	**15,893**	**235**	**83**	**1**	**24**	**38**	**16,274**

10. Property and equipment and intangible assets (continued)

	Land and buildings	*Computers and commu-nication equipment*	*Furniture, fixtures and office equipment*	*Motor vehicles*	*Leasehold improve-ments*	*Other*	*Total*
Cost or revalued amount							
31 December 2015	**16,852**	**1,667**	**1,371**	**208**	**727**	**996**	**21,821**
Additions	18	–	–	–	–	–	**18**
Disposals	–	(39)	(127)	–	(337)	(26)	**(529)**
Write-offs	–	(103)	(139)	–	–	(37)	**(279)**
Effect of revaluation*	(909)	–	–	–	–	–	**(909)**
31 December 2016	**15,961**	**1,525**	**1,105**	**208**	**390**	**933**	**20,122**
Accumulated depreciation							
31 December 2015	–	**1,224**	**1,118**	**180**	**501**	**826**	**3,849**
Depreciation charge	324	25	62	18	23	173	**625**
Disposals	(40)	(37)	(106)	–	(310)	(20)	**(513)**
Write-offs	–	(15)	(125)	–	-	(134)	**(274)**
Effect of revaluation*	(284)	–	–	–	–	–	**(284)**
31 December 2016	–	**1,197**	**949**	**198**	**214**	**845**	**3,403**
Net book value							
31 December 2015	**16,852**	**443**	**253**	**28**	**226**	**170**	**17,972**
31 December 2016	**15,961**	**328**	**156**	**10**	**176**	**88**	**16,719**

* In 2017 the total revaluation effect of GEL 315 (2016: GEL 625) comprises totally of revaluation gain recognized in other comprehensive income (2016: revaluation loss of GEL 586 recognized in other comprehensive income and revaluation loss of GEL 39 recognized within other operating expenses).

The Bank engaged an independent appraiser to determine the fair value of its buildings. Fair value is determined by reference to market-based evidence. The date of the revaluation was 31 December 2017. More details about the fair value of buildings are disclosed in Note 22.

If the land and buildings were measured using the cost model, the carrying amounts would be as follows:

	2017	*2016*
Cost	20,131	20,131
Accumulated depreciation and impairment	(5,458)	(5,018)
Net carrying amount	**14,673**	**15,113**

11. Taxation

Both in 2017 and 2016 income taxes fully comprised of deferred tax charges and benefits. As at 31 December 2017 and 2016 and for the years then ended, the Bank did not recognize any current tax expense and respective liability as it had sufficient amount of tax losses carried forward to utilize against its taxable profits for the respective periods.

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

	2017	*2016*
Loss before tax	**(4,259)**	**(2,027)**
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	**639**	**304**
Effect of change in Income tax legislation	(256)	2,739
Change in unrecognized deferred tax assets	(304)	(287)
Non-taxable expenses	(40)	–
Income tax benefit	**39**	**2,756**

11. Taxation (continued)

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

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

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

		Origination and reversal of temporary differences			*Origination and reversal of temporary differences*		
	2015	*In the income statement*	*In other compre-hensive income*	*2016*	*In the income statement*	*In other compre-hensive income*	*2017*
Tax effect of deductible temporary differences							
Tax losses carried forward	881	287	–	1,168	304	–	1,472
Other assets	8	(8)	–	–	–	–	–
Other liabilities	6	(6)	–	–	48	–	48
Gross deferred tax assets	**895**	**273**	–	**1,168**	**352**		**1,520**
Unrecognized deferred tax asset	(881)	(287)	–	(1,168)	(304)	–	(1,472)
Net deferred tax assets	**14**	**(14)**	–	–	**48**	–	**48**
Tax effect of taxable temporary differences							
Investment property	(2,082)	2,082	–	–	–	–	–
Property and equipment	(983)	709	87	(187)	(2)	(47)	(236)
Allowance for loan impairment	(63)	(24)	–	(87)	(4)	–	(91)
Other liabilities	–	3	–	3	(3)	–	–
Deferred tax liabilities	**(3,128)**	**2,770**	**87**	**(271)**	**(9)**	**(47)**	**(327)**
Net deferred tax liabilities	**(3,114)**	**2,756**	**87**	**(271)**	**39**	**(47)**	**(279)**

As at 31 December 2017 the Bank has tax losses carried forward amounting to GEL 6,814 that will expire on 31 December 2018. Deferred tax assets have not been recognized in respect of those losses as there is uncertainty whether the Bank will be able to generate taxable profit in the future.

12. Other assets and liabilities

Other assets comprise:

	2017	*2016*
Financial assets		
Receivable from operating lease	–	30
Other	348	92
Total financial assets	**348**	**122**
Non-financial assets		
Prepaid operational taxes	202	202
Prepaid expenses	28	146
Total non-financial assets	**230**	**348**
Other assets	**578**	**470**

12. Other assets and liabilities (continued)

Other liabilities comprise:

	2017	*2016*
Financial liabilities		
Creditors	367	468
Unsettled transactions on money transfers	4	51
Total financial liabilities	**371**	**519**
Non-financial liabilities		
Operating taxes payable	215	177
Unused vacations	106	58
Total non-financial liabilities	**321**	**235**
Total other liabilities	**692**	**754**

13. Subordinated debt

On 28 December 2017 the Bank obtained a subordinated debt from its Parent in amount of USD 3,500 thousand maturing on 28 December 2023, bearing an interest rate of 5%. As at 31 December 2017 the carrying value of the subordinated debt was GEL 9,076 (2016: nil).

Changes in liabilities arising from financing activities

	Subordinated loans	*Total liabilities from financing activities*
Carrying amount at 31 December 2016	–	–
Proceeds from issue	9,060	**9,060**
Foreign currency translation	13	**13**
Other	3	**3**
Carrying amount at 31 December 2017	**9,076**	**9,076**

The "Other" line includes the effect of accrued but not yet paid interest on subordinated loan. The Bank classifies interest paid as cash flows from operating activities.

14. Amounts due to customers

The amounts due to customers include the following:

	2017	*2016*
Current accounts	8,903	26,336
Time deposits	6,559	6,463
Amounts due to customers	**15,462**	**32,799**

As at 31 December 2017 amounts due to customers of GEL 8,286 (54%) were due to ten largest customers (2016: GEL 24,904 (76%)).

(Thousands of Georgian Lari)

14. Amounts due to customers (continued)

Amounts due to customers include accounts with the following types of customers:

	2017	*2016*
Individuals:		
- Term deposits	5,593	5,715
- Current accounts	2,445	1,584
Total due to individuals	**8,038**	**7,299**
Commercial legal entities:		
- Current/settlement accounts	6,458	24,752
- Term deposits	966	748
Total due to commercial legal entities	**7,424**	**25,500**
Total amounts due to customers	**15,462**	**32,799**
Held as security against guarantees issued	49	25

An analysis of customer accounts by economic sector follows:

	2017	*2016*
Individuals	8,038	7,299
Trade and service	3,749	6,437
Finance sector	1,308	16,433
Transportation and communication	600	43
Construction	191	655
Agriculture	51	13
Energy	–	185
Other	1,525	1,734
Amounts due to customers	**15,462**	**32,799**

15. Equity

Share capital

As at 31 December 2017 and 2016, share capital of the Bank comprised 300,000 of authorized fully paid shares with nominal value GEL 0.1 each.

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

Dividends

In accordance with the Georgian legislation, dividends may only be declared to the shareholders of the Bank from the net income of the Bank determined in accordance with the NBG requirements. National Bank shall be informed regarding declaration of dividends and also shall be authorized to suspend or restrict payment of dividends, if a commercial bank has violated regulatory requirements of the National Bank. No dividends were declared nor paid in 2017 and 2016.

Revaluation reserve

The revaluation reserve for land and buildings is used to record increases in the fair value of the land and buildings and decreases to the extent that such decrease relates to an increase on the same asset previously recognised in equity.

16. Provisions, commitments and contingencies

As of 31 December the Bank's commitments and contingencies comprised the following:

	2017	*2016*
Credit related commitments		
Undrawn loan commitments	117	202
Guarantees	43	23
	160	**225**
Operating lease commitments		
Not later than 1 year	5	26
Capital expenditure commitments	–	47
	5	**73**
Commitments and contingencies (before deducting collateral)	**165**	**298**
Less – cash held as security guarantees issued (Note 14)	(49)	(25)
Commitments and contingencies	**116**	**273**

17. Net fee and commission income

Net fee and commission income comprises:

	2017	*2016*
Settlements operations	378	379
Cash operations	141	20
Currency conversion operations	20	17
Other	1	2
Fee and commission income	**540**	**418**
Cash operations	(36)	(70)
Plastic card operations	(34)	(53)
Settlements operations	(57)	(45)
Other	(8)	(38)
Fee and commission expense	**(135)**	**(206)**
Net fee and commission income	**405**	**212**

18. Other income

	2017	*2016*
Refunded court fees	265	138
Rental income from investment property (Note 9)	216	64
Income from fines and penalties	87	114
Other	30	49
Total other income	**598**	**365**

19. Other operating expenses

Other operating expenses comprise:

	2017	*2016*
Legal and consultancy	729	768
Office supplies	349	377
Occupancy and rent	297	495
Operating taxes	221	209
Insurance	126	25
Security	85	170
Repair and maintenance of property and equipment	29	29
Loss on disposal of property and equipment	13	54
Loss on revaluation of property and equipment	–	39
Other	315	246
Other operating expenses	**2,164**	**2,412**

Auditor's remuneration

Remuneration of Bank's auditor for the years ended 31 December 2017 and 2016 comprises (net of VAT):

	2017	*2016*
Fees for the audit of the Bank's annual financial statements for the year ended 31 December	62	69
Total fees and expenditures	**62**	**69**

Fees and expenditures payable to other auditors and audit firms in respect of the audit of the Bank's annual financial statements comprised nil GEL (2016: nil) and in respect of other professional services GEL 8 (2016: GEL 23), net of VAT.

20. Risk management

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

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

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

Risk management structure

The Supervisory Board is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks. Currently risk is monitored by the following units with the Management Board –

- credit risk is managed by the Credit Risk Committees;
- liquidity risk is managed by ALCO;
- market risk is managed by ALCO;
- Operational risk is managed by the Operational Risk Management Department.

Internal Audit

Risk management processes throughout the Bank are audited by the internal audit function that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the supervisory board.

(Thousands of Georgian Lari)

20. Risk management (continued)

Risk mitigation

The Bank actively uses collateral to reduce its credit risks.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. Exposure to credit risk arises as a result of the Bank's lending and other transactions with counterparties giving rise to financial assets.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers.

The Bank established 1 level of credit committee which is responsible for approving credit limits for individual borrowers.

Loan applications originated by the relevant client relationship managers are passed on to the relevant credit committee for approval of credit limit. Exposure to credit risk is also managed, in part, by obtaining collateral and corporate and personal guarantees.

Due to relatively small size of the Bank's operations during the year credit risk exposure is monitored by the Management Board.

Credit-related commitments risks

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

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank internal credit review process.
All neither past due nor impaired loans to customers are classified in three quality groups presented in the tables below:

- a financial asset that is neither past due nor impaired at the reporting date, also historically has never been either past due or impaired and is secured by deposit, real estate or by other collaterals is assessed as a financial asset of high grade;
- a financial asset that is neither past due nor impaired at the reporting date, also historically has never been either past due or impaired is assessed as a financial asset of standard grade;
- a financial asset that is neither past due nor impaired at the reporting date, but historically used to be past due is assessed as a financial asset with sub-standard grade.

Obligatory reserve with the NBG and government securities are assessed as high grade.

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

20. Risk management (continued)

Credit risk (continued)

	Notes	*Neither past due nor impaired*					
		High grade 2017	*Standard grade 2017*	*Sub-standard grade 2017*	*Past due but not impaired 2017*	*Individually impaired 2017*	*Total 2017*
Cash and cash equivalents, except for cash on hand	5	10,193	2,701	–	–	–	12,894
Amounts due from credit institutions	6	2,273	–	–	–	–	2,273
Loans to customers	7						
Corporate lending		1,120	–	2,360	–	54	3,534
Residential mortgages		38	–	140	276	1,255	1,709
Small business lending		–	–	–		273	273
Consumer lending		4	1,182	292	224	79	1,781
Credit cards		–	93	19	15	6	133
Auto loans		–	–	15	–	–	15
Other		–	5	65	39	382	491
		1,162	1,280	2,891	554	2,049	7,936
Other financial assets							
Debt investment securities	8						
Held to maturity		1,809	–	–	–	–	1,809
Loans and receivables		8,426	–	–	–	–	8,426
Total		23,863	3,981	2,891	554	2,049	33,338

	Notes	*Neither past due nor impaired*					
		High grade 2016	*Standard grade 2016*	*Sub-standard grade 2016*	*Past due but not impaired 2016*	*Individually impaired 2016*	*Total 2016*
Cash and cash equivalents, except for cash on hand	5	8,120	8,143	–	–	–	16,263
Amounts due from credit institutions	6	5,179	7,000	–	–	–	12,179
Loans to customers	7						
Corporate lending		3,541	–	–	–	1,292	4,833
Residential mortgages		185	–	654	220	1,826	2,885
Small business lending		17	244	37	8	260	566
Consumer lending		–	98	32	8	353	491
Credit cards		–	–	–	–	433	433
Auto loans		–	–	–	–	42	42
Other		–	45	104	–	657	806
		3,743	387	827	236	4,863	10,056
Other financial assets		–	122	–	–	–	122
Debt investment securities	8						
Held to maturity		1,805	–	–	–	–	1,805
Loans and receivables		10,359	–	–	–	–	10,359
Total		29,206	15,652	827	236	4,863	50,784

(Thousands of Georgian Lari)

20. Risk management (continued)

Credit risk (continued)

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

	Less than 30 days 2017	*31 to 60 days 2017*	*61 to 90 days 2017*	*More than 30 days 2017*	*Total 2017*
Loans to customers					
Residential mortgages	–	–	214	62	276
Credit cards	–	1	14	–	15
Consumer lending	–	106	79	39	224
Other	–	39	–	–	39
Total	–	**146**	**307**	**101**	**554**

	Less than 30 days 2016	*31 to 60 days 2016*	*61 to 90 days 2016*	*More than 30 days 2016*	*Total 2016*
Loans to customers					
Residential mortgages	149	46	25	–	220
Credit cards	4	4	–	–	8
Consumer lending	3	5	–	–	8
Other	–	–	–	–	–
Total	**156**	**55**	**25**	–	**236**

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

Loans and advances to customers have been assessed for impairment on the collective basis. Details of loan loss allowance of loan portfolio are disclosed in Note 7.

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas - individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

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

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to customers that are not past due of more than 90 days and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date for each portfolio based on overdue day's buckets.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration historical losses on the portfolio and expected losses on the collectively assessed loans based on realisable collateral value. The impairment allowance is then reviewed by the management to ensure alignment with the Bank's overall policy.

Financial guarantees and letters of credit are assessed and provisions are made in a similar manner as for loans.

Almost all of Bank's financial assets and liabilities are concentrated in Georgia.

20. Risk management (continued)

Liquidity risk and funding management

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

The Bank maintains a portfolio of state securities that can be pledged to the NBG to obtain financing in the event of demand.

The liquidity position is assessed and managed by the Bank based on certain liquidity ratio established by National Bank of Georgia. The NBG requires banks to maintain liquidity ratio of more than 30%. As at 31 December 2017 and 2016 the ratio was as follows:

	2017	*2016*
LK "Average Liquidity Ratio" (average monthly volume of liquid assets / average monthly volume of liabilities)	108.21%	91.08%

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately.

Financial liabilities as at 31 December 2017	*On demand and less than 1 month*	*1 to 3 months*	*3 to 12 months*	*1 to 5 years*	*More than 5 years*	*Total*
Subordinated debt	–	–	–	–	11,770	11,770
Amounts due to customers	10,924	–	–	5,048	–	15,972
Other financial liabilities	194	159	18	–	–	371
Total undiscounted financial liabilities	**11,118**	**159**	**18**	**5,048**	**11,770**	**28,113**

Financial liabilities as at 31 December 2016	*On demand and less than 1 month*	*1 to 3 months*	*3 to 12 months*	*1 to 5 years*	*More than 5 years*	*Total*
Amounts due to credit institutions	9,008	–	–	–	–	9,008
Amounts due to customers	27,880	2,740	1,791	434	–	32,845
Other financial liabilities	519	–	–	–	–	519
Total undiscounted financial liabilities	**37,407**	**2,740**	**1,791**	**434**	**–**	**42,372**

Undrawn loan facilities and guarantees issued of GEL 160 (2016: GEL 225) are due on demand.

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

The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due on demand and less than one month in the tables above.

Market risk

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

(Thousands of Georgian Lari)

20. Risk management (continued)

Market risk (continued)

Currency risk

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

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

Currency	*Change in currency rate in % 2017*	*Effect on profit before tax 2017*	*Change in currency rate in % 2016*	*Effect on profit before tax 2016*
USD	15 %/(20%)	(8)/10	15%/(20%)	(20)/27

Interest rate risk

All of the interest-bearing loans and borrowings have fixed rates and do not expose the Bank to interest rate risk.

Prepayment risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected. The effect on loss before tax for one year and on equity, assuming 10% of repayable financial instruments were to prepay at the beginning of the year excluding the effect of any prepayment penalty income, with all other variables held constant would be GEL 104 (2016: GEL 179).

Operational risk

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

21. Fair value measurement

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

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

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

(Thousands of Georgian Lari)

21. Fair value measurement (continued)

Fair value hierarchy

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

	Fair value measurement using			
At 31 December 2017	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value				
Investment securities available-for-sale	–	–	20	**20**
Investment property	–	–	638	**638**
Property and equipment – land and buildings	–	–	15,893	**15,893**
Assets for which fair values are disclosed				
Cash and cash equivalents	15,973	–	–	**15,973**
Amounts due from credit institutions	–	2,273	–	**2,273**
Loans to customers	–	–	7,698	**7,698**
Investment securities: held-to-maturity	–	1,920	–	**1,920**
Investment securities: loans and receivables	–	8,545	–	**8,545**
Assets held for sale	–	–	5,806	**5,806**
Liabilities for which fair values are disclosed				
Subordinated debt	–	9,076	–	**9,076**
Amounts due to customers	–	15,586	–	**15,586**

	Fair value measurement using			
At 31 December 2016	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value				
Investment securities available-for-sale	–	–	20	**20**
Investment property	–	–	10,051	**10,051**
Property and equipment – land and buildings	–	–	15,961	**15,961**
Assets for which fair values are disclosed				
Cash and cash equivalents	20,120	–	–	**20,120**
Amounts due from credit institutions	–	12,179	–	**12,179**
Loans to customers	–	–	10,243	**10,243**
Investment securities: held-to-maturity	–	1,835	–	**1,835**
Investment securities: loans and receivables	–	10,417	–	**10,417**
Liabilities for which fair values are disclosed				
Amounts due to credit institutions	–	9,000	–	**9,000**
Amounts due to customers	–	32,866	–	**32,866**

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

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

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

21. Fair value measurement (continued)

Fair value hierarchy (continued)

	Carrying value 2017	*Fair value 2017*	*Unrecognised gain 2017*	*Carrying value 2016*	*Fair value 2016*	*Unrecognised gain 2016*
Financial assets						
Loans to customers	6,433	7,698	1,265	8,178	10,243	2,065
Investment securities: held-to-maturity	1,809	1,920	111	1,805	1,835	30
Investment securities: loans and receivables	8,426	8,545	119	10,359	10,417	58
Financial liabilities						
Amounts due to customers	15,462	15,586	124	32,799	32,866	67
Total unrecognised change in unrealised fair value			**1,619**			**2,220**

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

Assets for which fair value approximates carrying value

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

Financial assets and financial liabilities carried at amortized cost

The fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to credit institutions and other financial assets and liabilities, is estimated by discounting future cash flows using rates currently available for similar financial instruments on similar terms, credit risk and remaining maturities.

Movement in level 3 assets and liabilities at fair value

Reconciliation of the opening and closing amounts of investment properties and land and buildings are disclosed in Note 9 and Note 10 respectively.

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

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

21. Fair value measurement (continued)

Fair value hierarchy (continued)

	Fair value, GEL	*Valuation technique*	*Significant unobservable inputs*	*Range (weighted average)*	*Sensitivity of the input to fair value*
Investment property	**638**				
Land	90	Market approach	Price per square metre	0.3-95(3) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value
Residential properties	404	Market approach	Price per square metre	14-763(88) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value
Non-residential properties	144	Market approach	Price per square metre	44-286(45) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value

	Fair value, GEL	*Valuation technique*	*Significant unobservable inputs*	*Range (weighted average)*	*Sensitivity of the input to fair value*
Revaluated land and premises	**15,893**				
Office buildings	13,860	Market approach	Price per square metre	6,619(6,619) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value
Service centres	1,783	Market approach	Price per square metre	800-3,290 (3,129) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value
Non-residential properties	250	Market approach	Price per square metre	1,359(1,359) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value

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

21. Fair value measurement (continued)

Fair value hierarchy (continued)

	Fair value, GEL	*Valuation technique*	*Significant unobservable inputs*	*Range (weighted average)*	*Sensitivity of the input to fair value*
Investment property	**10,051**				
Land	114	Market approach	Price per square metre	3-58(26) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value
Residential properties	9,468	Market approach	Price per square metre	64-3,346(1,302) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value
Non-residential properties	458	Market approach	Price per square metre	16-9,264(1,890) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value
Service centres	11	Market approach	Price per square metre	802-855(823) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value

	Fair value, GEL	*Valuation technique*	*Significant unobservable inputs*	*Range (weighted average)*	*Sensitivity of the input to fair value*
Revaluated land and premises	**15,961**				
Office buildings	13,988	Market approach	Price per square metre	4,790-7,443 (6,473) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value
Service centres	1,761	Market approach	Price per square metre	13-3,250 (2,487) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value
Non-residential properties	212	Market approach	Price per square metre	613-948(749) Georgian Lari	Increase (decrease) in the price per square metre would result in increase (decrease) in fair value

22. Maturity analysis of financial assets and liabilities

The table below shows an analysis of financial assets and liabilities according to when they are expected to be recovered or settled. See Note 21 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2017			*2016*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Financial assets						
Cash and cash equivalents	15,973	–	15,973	20,120	–	20,120
Amounts due from credit institutions	2,273	–	2,273	12,179	–	12,179
Loans to customers	2,669	3,764	6,433	1,490	6,688	8,178
Investment securities:						
available-for-sale	–	20	20	–	20	20
held-to-maturity	261	1,548	1,809	–	1,805	1,805
loans and receivables	7,446	980	8,426	1,922	8,437	10,359
Other financial assets	347	1	348	122	–	122
Total	**28,969**	**6,313**	**35,282**	**35,833**	**16,950**	**52,783**
Financial liabilities						
Subordinated debt	–	9,076	9,076	–	–	–
Amounts due to credit financial institutions	–	–	–	9,000	–	9,000
Amounts due to customers	10,802	4,660	15,462	32,392	407	32,799
Other financial liabilities	371	–	371	519	–	519
Total	**11,173**	**13,736**	**24,909**	**41,911**	**407**	**42,318**
Net	**17,796**	**(7,423)**	**10,373**	**(6,078)**	**16,543**	**10,465**

The Bank's capability to discharge its liabilities relies on its ability to realize an equivalent amount of assets within the same period of time. The gap between assets and liabilities within one year in the table above does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the table above.

23. Related party disclosures

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

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

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

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

(Thousands of Georgian Lari)

23. Related party disclosures (continued)

	2017			2016		
	The Parent	*Entities under common control*	*Key management personnel*	*The Parent*	*Entities under common control*	*Key management personnel*
Loans outstanding at 31 December, gross	**–**	**2,361**	**20**	**–**	**1,149**	**45**
Less: allowance for impairment at 31 December	–	(60)	–	–	(4)	–
Loans outstanding at 31 December, net	**–**	**2,301**	**20**	**–**	**1,145**	**45**
Amounts due to customers at 31 December	195	3,584	104	89	11,819	128
Subordinated debt	9,076	–	–	–	–	–
Other liabilities	–	–	1	–	–	31
Commitments and guarantees issued	–	26	3	–	–	30

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

	For the year ended 31 December					
	2017			2016		
	The Parent	*Entities under common control*	*Key management personnel*	*The Parent*	*Entities under common control*	*Key management personnel*
Interest income on loans to customers	–	325	6	–	308	15
Loan impairment charge	–	33	1	–	162	1
Interest expense on amounts due to customers	–	45	–	–	3	1
Other operating expenses	–	–		–	–	96

Compensation of key management personnel was comprised of the following:

	2017	*2016*
Salaries and other short-term benefits	246	379
Total key management compensation	**246**	**379**

As at 31 December 2017 other liabilities to key management personnel comprised of unpaid vacation of GEL 30 (2016: GEL 31).

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

24. Capital adequacy

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

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

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

(Thousands of Georgian Lari)

24. Capital adequacy (continued)

The NBG capital adequacy ratio

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

	2017	*2016*
Core capital	22,732	24,891
Supplementary capital	8,636	(2,138)
Total regulatory capital	**31,368**	**22,753**
Risk-weighted assets	**33,293**	**44,754**
Capital adequacy ratio	94.22%	50.84%
Tier 1 capital adequacy ratio	68.28%	55.62%

Regulatory capital consists of core capital, which comprises share capital and retained earnings excluding current year profit. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the NBG. The other component of regulatory capital is Supplementary capital, which includes current year profit/(loss), subordinated debt and general reserves created for loans to customers per the NBG regulation.

NBG Basel II/III Capital adequacy ratio

On 18 December 2017, the NBG published and approved amendments in capital adequacy regulation (Decree N100/04), according to which the minimum capital requirement ratios have been revised whereas incorporated Pillar I model and set Capital Conservation, Systemic Risk and Countercyclical buffers (Pillar I Buffers).

As at 31 December 2017 Common Equity Tier 1 Capital (CET I), Tier I Capital (Tier I) and Total Capital ratios were set at 4.50%, 6.00% and 8.00% respectively, in addition to which the Bank had to maintain Pillar I Buffers and Pillar II requirements.

Capital Conservation and Countercyclical buffers are set at 2.50% and 0.00%, respectively. Any adjustment of Pillar I Buffers is at the NBG's discretion.

As at 31 December 2017, the Bank had to maintain the currency induced credit risk (CICR) buffer of 0.27%, primary due to percentage share of foreign currency denominated loans to customers. All the rest Pillar II buffers were to preserve at zero.

As at 31 December 2017, under total Basel III requirements the Bank was required to maintain a minimum regulatory capital ratio, Common Equity Tier 1 capital adequacy ratio and Tier 1 capital adequacy ratio of 10.77%, 7.15% and 8.70%, respectively. The Bank was in compliance with these capital adequacy ratios as at 31 December 2017.

The calculation of the capital adequacy ratios in accordance with the NBG accounting rules and capital adequacy Basel III framework, effective from 31 December 2017 is as follows:

	2017
Tier 1 capital	22,237
Supplementary capital	9,132
Total regulatory capital	**31,369**
Risk weighted assets	**46,023**
Regulatory capital ratio	68.16%
Common Equity Tier 1 capital adequacy ratio / tier 1 capital adequacy ratio	48.32%

No comparative information is available in respect of capital adequacy measured in accordance with the NBG Basel III framework which only became effective from 31 December 2017.

Regulatory capital consists of core Tier 1 capital, which comprises share capital and retained earnings including current year profit. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the NBG. The other component of regulatory capital is Supplementary capital, which includes subordinated debt and general reserves created for loans to customers per the NBG regulation.

(Thousands of Georgian Lari)

24. Capital adequacy (continued)

Based on Basel II regulations which was effective as at 31 December 2016 the Bank was required to maintain minimum ratio of 10.50% for total regulatory capital ratio, minimum 7.00% of the Common Equity Tier 1 capital adequacy ratio and minimum 8.50% for Tier 1 capital adequacy ratio. The Bank's capital adequacy ratios on the Basel II basis were as follows:

	2017	*2016*
Tier 1 capital	22,237	22,753
Supplementary capital	9,132	44
Total regulatory capital	**31,369**	**22,797**
Risk weighted assets	**46,338**	**57,908**
Regulatory capital ratio	67.70%	39.37%
Common Equity Tier 1 capital adequacy ratio / tier 1 capital adequacy ratio	47.99%	39.29%

25. Events after the reporting period

In April 2018, the NBG requested the Bank to cease issuing uncollateralized loans to meet the prudential requirements. After the negotiations with the NBG, parties have agreed on specific calculation of the ratio (uncollateralized loans should not be more than 25% of the Regulatory Capital instead of 25% of loan portfolio) for the Bank and the latter was allowed to continue issuing uncollateralized loans to customers.

On 17 April 2018 the NBG approved amendments to the decree N49/04 of 17 June 2014, which became effective from 7 May 2018. These amendments introduce additional limitations for the commercial banks on issuing loans to customers without high quality analysis of their solvency (except where precious metals, jewellery or real estate is pledged as collateral). Such loans to customers should not exceed 25% of the Regulatory Capital. The loans to customers with real estate pledged under collateral and without high quality analysis of borrower solvency are limited to 15% of the Regulatory Capital and the "Loan to Value" ratio ("LTV") was limited to 50%.
The Bank is currently assessing the impact of these new regulations on its financial statements.