JSC Silk Road Bank

Financial Statements
for 2019

Contents

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Independent Auditors' Report

To the 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 2019, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2019, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

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 *Auditors' Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the International Code of Ethics for Professional Accountants (including International Independence Standards) together with the ethical requirements that are relevant to our audit of the financial statements in Georgia, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the International Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Statement of Management Report

Management is responsible for the Management Report. The Management Report is expected to be made available to us after the date of this auditors' report.

Our opinion on the financial statements does not cover the Management Report and we will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the Management Report when it becomes available and, in doing so, consider whether the Management Report is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

When we read the Management Report, we conclude whether the other information:

- is consistent with the financial statements and does not contain material misstatement;
- contains all information that is required by and is compliant with the Law of Georgia on Accounting, Reporting and Auditing.

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

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, 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.

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

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 auditors' 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 auditors' 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 those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

The engagement partner on the audit resulting in this independent auditors' report is:

Karen Safaryan

KPMG Georgia LLC
Tbilisi, Georgia
8 May 2020

GEL'000	Notes	2019	2018
Interest income using effective interest method	5	5,006	4,237
Interest expense	5	(291)	(587)
Net interest income		**4,715**	**3,650**
Fee and commission income		463	745
Fee and commission expense		(129)	(221)
Net fee and commission income		**334**	**524**
Net gain from foreign currency dealings		119	706
Fair value changes on forward exchange contracts		720	245
Net foreign currency revaluation gain/(loss)		323	(444)
Impairment loss on the assets held for sale		(74)	(1,452)
Net loss from disposal of assets held for sale		(122)	(397)
Impairment loss on debt financial assets and loan commitments, net	4	(1,208)	(2,933)
Salaries and employment benefits expenses		(2,368)	(1,848)
General administrative expenses	6	(3,149)	(3,637)
Other income		62	371
Loss before income tax		**(648)**	**(5,215)**
Income tax benefit	8	184	528
Loss for the year		**(464)**	**(4,687)**
Other comprehensive income			
Items that will never be reclassified to profit or loss			
Revaluation of land and buildings	13	1,402	2,490
Income tax relating to components of other comprehensive income	8	(210)	(383)
Total other comprehensive income		**1,192**	**2,107**
Total comprehensive income/(loss) for the year		**728**	**(2,580)**

The financial statements as set out on pages 5 to 48 were approved by management on 8 May 2020 and were signed on its behalf by:

Eli Enoch
Chief Executive Officer

Beka Kvezereli
Deputy Chief Executive Officer

The statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to, and forming part of, the financial statements.

GEL'000	Notes	31 December 2019	31 December 2018
ASSETS			
Cash and cash equivalents	9	21,064	20,073
Amounts due from credit institutions	10	2,991	2,183
Investment securities	11	19,967	13,637
Loans to customers	12	13,147	15,987
Property and equipment	13	19,128	18,189
Intangible assets		36	56
Assets held for sale	12	3,687	4,918
Current tax asset	8	55	55
Other assets		1,818	823
Total assets		**81,893**	**75,921**
LIABILITIES			
Current accounts and deposits from customers	14	17,919	12,892
Deferred tax liabilities	8	160	134
Other liabilities		1,064	873
Total liabilities		**19,143**	**13,899**
EQUITY	15		
Share capital		61,146	61,146
Reserves		8,368	7,322
Accumulated loss		(6,764)	(6,446)
Total equity		**62,750**	**62,022**
Total liabilities and equity		**81,893**	**75,921**

The statement of financial position is to be read in conjunction with the notes to, and forming part of, the financial statements.

GEL'000	Notes	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest receipts		4,276	4,115
Interest payments		(282)	(587)
Fee and commission receipts		463	745
Fee and commission payments		(129)	(221)
Net receipts from foreign currencies dealings		119	951
Other income receipts		61	372
Personnel expenses paid		(2,368)	(1,848)
Other general administrative expenses paid		(2,597)	(3,050)
(Increase) decrease in operating assets			
Amounts due from credit institutions		(673)	14
Loans to customers		1,975	(12,447)
Other assets		(45)	154
Increase (decrease) in operating liabilities			
Current accounts and deposits from customers		4,424	(2,547)
Other liabilities		438	194
Net cash flows from/ (used in) operations		**5,662**	**(14,155)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of investment securities		(7,248)	(10,683)
Proceeds from repayment of investment securities		1,000	7,262
Purchase of property plant and equipment and intangible assets		(84)	(21)
Proceeds from sale of assets held for sale		1,116	-
Net cash used in investing activities		**(5,216)**	**(3,442)**
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayment of subordinated borrowings		-	(8,990)
Proceeds from issue of share capital		-	31,146
Net cash flows from financing activities		**-**	**22,156**
Net increase in cash and cash equivalents		**446**	**4,559**
Effect of changes in exchange rates on cash and cash equivalents		545	(459)
Cash and cash equivalents as at the beginning of the year		20,073	15,973
Cash and cash equivalents as at the end of the year	**9**	**21,064**	**20,073**

The statement of cash flows is to be read in conjunction with the notes to, and forming part of, the financial statements.

GEL'000	Share capital	Revaluation reserve of property and equipment	Accumulated loss	Total equity
Balance as at 1 January 2018	30,000	5,321	(1,865)	33,456
Total comprehensive income/ (loss)				
Loss for the year	-	-	(4,687)	(4,687)
Other comprehensive income/(loss)				
Revaluation of property and equipment	-	2,490	-	2,490
Deferred tax effect	-	(383)	-	(383)
Depreciation of revaluation reserve, net of tax	-	(106)	106	-
Total other comprehensive income	**-**	**2,001**	**106**	**2,107**
Total comprehensive income/(loss)	**-**	**2,001**	**(4,581)**	**(2,580)**
Transactions with owners, recorded directly in equity				
Shares issued	31,146	-	-	31,146
Total transactions with owners	**31,146**	**-**	**-**	**31,146**
Balance as at 31 December 2018	**61,146**	**7,322**	**(6,446)**	**62,022**
Balance as at 1 January 2019	**61,146**	**7,322**	**(6,446)**	**62,022**
Total comprehensive income/ (loss)				
Loss for the year	-	-	(464)	(464)
Other comprehensive income				
Revaluation of property and equipment	-	1,402	-	1,402
Deferred tax effect	-	(210)	-	(210)
Depreciation of revaluation reserve, net of tax	-	(146)	146	-
Total other comprehensive income	**-**	**1,046**	**146**	**1,192**
Total comprehensive income	-	**1,046**	**(318)**	**728**
Balance as at 31 December 2019	**61,146**	**8,368**	**(6,764)**	**62,750**

The statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the financial statements.

1. Background

(a) Organisation and operations

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.

Tax identification number of the Bank is 201955027 and the registering authority is Didube-Chugureti district court.

As at 31 December 2019 and 2018, the shareholders of the Bank are as follows:

	Ownership %	
Name	**2019**	**2018**
Silk Road Finance JSC	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 businessman, who has a number of business interests outside the Bank. Related party transactions are disclosed in Note 17.

(b) Business environment

The Bank's operations are primarily located in Georgia. Consequently, the Bank is exposed to the economic and financial markets of Georgia, which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in Georgia.

The financial statements reflect management's assessment of the impact of the Georgian business environment on the operations and financial position of the Bank. The future business environment may differ from management's assessment.

2. Basis of preparation

(a) Statement of compliance

The accompanying financial statements are prepared in accordance with International Financial Reporting Standards (IFRS).

This is the first set of the Bank's annual financial statements in which IFRS 16 *Leases* has been applied. Changes to significant accounting policies are described in note 2 (e).

(b) Basis of measurement

The financial statements are prepared on the historical cost basis except that derivative financial instruments and land and buildings, which are carried at fair value and assets held for sale, which are stated at lower of cost and fair value.

(c) Functional and presentation currency

These financial statements are presented in Georgian Lari (GEL), which is also the Bank's functional currency, as, being the national currency of Georgia, it reflects the economic substance of the majority of underlying events and circumstances relevant to them. All amounts has been rounded to the nearest thousands, except when otherwise indicated.

(d) Use of estimates and judgments

In preparing these financial statements, management has made judgement, estimates and assumptions that affect the application of the Bank's accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about critical judgements made in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is included in the following note:

- Note 3(e)(vi) and Note 4 - establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of ECL and selection and approval of models used to measure ECL.

Information about areas of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities in the year ended 31 December 2019 is included in the following notes:

- Note 4 - impairment of financial instruments: determining inputs into the ECL measurement model, including key assumptions used in estimating recoverable cash flows and incorporation of forward-looking information;
- Note 12 - valuation of assets held for sale;
- Note 13 - valuation of land and buildings.

(e) Changes in accounting policies

The Bank has adopted IFRS 16 Leases from 1 January 2019. IFRS 16 has introduced a single, on-balance sheet lease accounting model for lessees, which means that a lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There was no change to the lessor accounting as a result of adoption of IFRS 16. IFRS 16 has replaced existing leases guidance, including 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.

As at 1 January 2019 and 31 December 2019 the Bank is not a party to any contract as a lessee, hence there was no effect on the Bank's financial statements as a result of adoption of IFRS 16.

A number of other new interpretations and amendments to the existing standards are effective from 1 January 2019 but they do not have a material effect on the Bank's financial statements, except those described above.

3. Significant accounting policies

Except for the changes disclosed in Note 2(e), the Bank has consistently applied the following accounting policies to all periods presented in these financial statements.

(a) Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency of the Bank at exchange rates at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value is determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on retranslation are recognized in profit or loss.

(b) Interest

Effective interest rate

Interest income and expense are recognised in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not expected credit losses. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including expected credit losses.

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Amortised cost and gross carrying amount

The 'amortised cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance.

The 'gross carrying amount of a financial asset' measured at amortised cost is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

Calculation of interest income and expense

The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortised cost of the liability.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

For information on when financial assets are credit-impaired, see Note 3(e)(vi).

Presentation

Interest income calculated using the effective interest method presented in the statement of profit or loss and other comprehensive income includes interest on financial assets measured at amortised cost.

Interest expense presented in the statement of profit or loss and other comprehensive income includes interest on financial liabilities measured at amortised cost.

(c) Fees and commission

Fee and commission income and expense that are integral to the effective interest rate on a financial asset or financial liability are included in the effective interest rate (see Note 3(b)).

If a loan commitment is not expected to result in the draw-down of a loan, then the related loan commitment fee is recognised on a straight-line basis over the commitment period.

A contract with a customer that results in a recognised financial instrument in the Bank's financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Bank first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual.

Fees and commission income for ongoing account management are charged to the customer's account on a monthly basis. Transaction-based fees for interchange, foreign currency transactions and overdrafts are charged to the customer's account when the transaction takes place. Servicing fees are charged on a monthly basis and are based on fixed rates reviewed annually by the Bank. Income from account service and servicing fees is recognised over time as the services are provided. Income related to transactions is recognised at the point in time when the transaction takes place.

Other fee and commission expenses relate mainly to transaction and service fees, which are expensed as the services are received.

(d) Taxation

Income tax comprises current and deferred tax. Income tax is recognized in profit or loss except to the extent that it relates to items of other comprehensive income or transactions with shareholders recognized directly in equity, in which case it is recognized within other comprehensive income or directly within equity.

i. Current tax

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Current tax payable also includes any tax liability arising from dividends.

On 13 May 2016 the Parliament of Georgia passed the bill on corporate income tax reform (also known as the Estonian model of corporate taxation), which mainly moves the moment of taxation from when taxable profits are earned to when they are distributed. The law has entered into force in 2016 and is effective for tax periods starting after 1 January 2017 for all entities except for financial institutions (such as banks, insurance companies, microfinance organizations, pawnshops), for which the law will become effective from 1 January 2023.

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

Tax reimbursement is available for the current tax paid on the undistributed earnings in the years 2008-2017, if those earnings are distributed in 2019 or further years.

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

ii. Deferred tax

Deferred tax assets and liabilities are recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

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

Deferred tax assets are recognized only to the extent that it is probable that future taxable profits will be available against which the temporary differences, unused tax losses and credits can be utilized. Deferred tax assets are reduced to the extent that taxable profit will be available against when the deductible temporary differences can be utilized.

(e) Financial assets and financial liabilities

i. Recognition and initial measurement

The Bank initially recognises loans to customers and deposits on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date when the Bank becomes party of contractual provisions of the instrument.
A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to the acquisition or issue. The fair value of financial instrument at initial recognition is generally its transaction price.

ii. Classification

Financial asset

On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or FVTPL.

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

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

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

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

When a debt financial asset measured at FVOCI is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise (see Note 3(e)(v)).

Business model assessment

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

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the

duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Bank’s management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank’s stated objective for managing the financial assets is achieved and how cash flows are realised.

The Bank’s retail and corporate banking business comprises loans to customers that are held for collecting contractual cash flows. In the retail business the loans comprise mortgages, overdrafts, unsecured and secured lending. Sales of loans from these portfolios are very rare.

Certain debt securities are held by the Bank in a separate portfolio for long term yield. These securities may be sold, but such sales are not expected to be more than infrequent. The Bank considers that these securities are held within a business model whose objective is to hold assets to collect the contractual cash flows.

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

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

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

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

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank’s claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

In some cases loans made by the Bank that are secured by collateral of the borrower limit the Bank’s claim to cash flows of the underlying collateral (non-recourse loans). The Bank applies judgment in assessing whether the non-recourse loans meet SPPI criterion. The Bank typically considers the following information when making the judgement:

- whether the contractual arrangement specifically defines the amounts and dates of cash payments of the loan;
- the fair value of collateral relative to the amount of the secured financial asset;

- the ability and willingness of the borrower to make contractual payments, notwithstanding the decline in the value of collateral;
- the extent to which the collateral represents all or substantial portion of borrower's assets; and
- whether the Bank will benefit from any upside from the underlying asset.

Reclassification

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets.

Financial liabilities

The Bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost.

Reclassification

Financial liabilities are not reclassified subsequent to their initial recognition.

iii. Derecognition

Financial assets

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

If the Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains all or substantially all of the risks and rewards of transferred assets or a portion of them, in such cases, the transferred assets are not derecognised. Examples of such transactions are security lending and sale-and-repurchase transactions.

Financial liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

iv. Modification of financial assets and financial liabilities

Financial assets

If the terms of a financial asset are modified, the Bank evaluates whether the cash flows of the modified asset are substantially different.

If the cash flows are substantially different (referred to as 'substantial modification'), then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows:

- fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- other fees are included in profit or loss as part of the gain or loss on derecognition.

The Bank concludes that the modification is substantial as a result of the following qualitative factors:

- change the currency of the financial asset;
- change in collateral or other credit enhancement.

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place (see below for write-off policy). This approach impacts the result of the quantitative evaluation and means that derecognition criteria are not usually met in such cases. The Bank further performs qualitative evaluation of whether the modification is substantial.

If the modification of a financial asset measured at amortised cost or FVOCI does not result in derecognition of the financial asset, then the Bank first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss. Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

If such a modification is carried out because of financial difficulties of the borrower (see Note 3(e)(vi)), then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest method (see Note 3(b)).

Financial liabilities

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

The Bank concludes that the modification is substantial as a result of the following qualitative factors:

- change the currency of the financial liability;
- change in collateral or other credit enhancement.

For the quantitative assessment the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability.

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

v. Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank has a legally enforceable right to set off amounts and intends either to settle them on a net basis or to realise asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRS standards, or for gains and losses from a group of similar transactions.

vi. Impairment

The Bank recognises loss allowances for expected credit losses (ECL) on the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments;
- loan commitments issued.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- Debt investment securities assets are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition (see Note 4).

The Bank considers a debt investment security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Bank does not apply the low credit risk exemption to any other financial instruments.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognised are referred to as 'Stage 1' financial instruments. Financial instruments allocated to Stage 1 have not undergone a significant increase in credit risk since initial recognition and are not credit-impaired.

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of the financial instrument or the maximum contractual period of exposure. Financial instruments for which a lifetime ECL is recognised but are not credit-impaired are referred to as 'Stage 2' financial instruments. Financial instruments allocated in Stage 2 are those that have experienced a significant increase in credit risk since initial recognition but are not credit-impaired.
Financial instruments for which lifetime ECL are recognised and that are credit-impaired are referred to as "Stage 3 financial instruments".

Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows; and
- undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive.

When discounting future cash flows, the following discount rates are used:

- financial assets other than purchased or originated credit-impaired financial assets: the original effective rate or an approximation thereof; and
- undrawn loan commitments: the effective interest rate or an approximation thereof, that will be applied to the financial asset resulting from the loan commitment.

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised (see Note 3(e)(iii)) and ECL are measured as follows.

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset (see Note 4).
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortised cost are credit-impaired (referred to as ‘Stage 3 financial assets’). A financial asset is ‘credit-impaired’ when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

For retail loans:

- Death of borrower;
- Loans past due more than 90 days (more than 60 days for Silkloan);
- Restructuring of the loan, linked with the economic loss;
- Court’s decision, which causes the borrower’s inability to service its debt obligations.

For business loans:

- Bankruptcy proceedings of the borrower;
- Loans past due more than 90 days;
- Restructuring of the loan, linked with the economic loss;
- Fraud event or misleading information from the borrowers side, that may affect the company’s solvency;
- Transferring any of the borrower’s loan to Stage 3.

For investment securities:

- The market's assessment of creditworthiness as reflected in bond yields;
- The rating agencies assessment of creditworthiness;
- The counterparty's ability to access the capital markets for new debt issuance;
- The probability of debt being restructured, resulting in holder's suffering losses through voluntary or mandatory debt forgiveness.

Presentation of allowance for ECL in the statement of financial position

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

- financial assets measured at amortised cost including undrawn loan commitment on credit cards: as a deduction from the gross carrying amount of the assets.

Write-offs

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in 'impairment losses on debt financial assets and loan commitments, net" in the statement of profit or loss and other comprehensive income.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

(f) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the National Bank of Georgia, excluding obligatory reserves, and amounts due from financial institutions that mature within ninety days or less of the date of acquisition that are subject to an insignificant risk of changes in their fair value.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(g) Loans to customers

'Loans to customers' caption in the statement of financial position include loans to customers measured at amortized cost (see Note 3(e)(i)); they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortized cost using the effective interest method.

(h) Investment securities

The 'investment securities' caption in the statement of financial position includes debt investment securities measured at amortised cost (see Note 3(e)(i)); these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

(i) Property and equipment

(i) Recognition and measurement

Items of property and equipment, except for land and buildings, are measured at cost less accumulated depreciation and any accumulated impairment losses.

Cost includes expenditure that is directly attributable to the acquisition of the asset and bringing the asset to a working condition for their intended use. Purchased software that is integral to the functionality of the related equipment is capitalised as part of equipment.

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.

(ii) Subsequent costs

Subsequent expenditure is capitalised only if it is probable that future economic benefits associated with the expenditure will flow to the Bank. Ongoing repairs and maintenance are expensed as incurred.

(iii) Depreciation

Depreciation of an asset begins when it is available for use. Land is not depreciated. 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.

(j) Impairment of non-financial assets

At each reporting date, the Bank reviews the carrying amount of its non-financial assets (other than deferred tax assets) to determine whether there is any indication of impairment. If any such indication exists, than the asset’s recoverable amount is estimated.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGU.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

An impairment loss is recognized if the carrying amount of an asset and its related cash-generating unit (CGU) exceeds its estimated recoverable amount.

The bank's assets do not generate separate cash inflows and are used as one CGU.

Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the other assets in the CGU on a pro rata basis. An impairment loss in respect of goodwill is not reversed. For other assets, an impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(k) Current accounts and deposits from customers

Current accounts and deposits from customers are initially measured at fair value minus incremental direct transaction costs. Subsequently, they are measured at their amortised costs using effective interest method (see Note 3(e)(ii))

(l) Assets held for sale

Bank classify a non-current asset (or disposal group) of repossessed property as "assets held for sale" whose carrying amount will be recovered principally through a sale transaction rather than through continuing use. Fixed assets held for sale are measured at lower of its carrying amount and fair value less cost to sell. Subsequent write downs (which does not include gain or loss from disposals) of carrying amount of fixed assets held for sale are recognized as an impairment loss. Gain on the subsequent increase in fair value less cost to sell of asset held for sale is recognized not in excess of previously recognized impairment loss.

(m) Share capital

i. Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognized as a deduction from equity, net of any tax effects.

ii. Dividends

The ability of the Bank to declare and pay dividends is subject to the rules and regulations of Georgia. Dividends in relation to ordinary shares are reflected as an appropriation of retained earnings in the period when they are declared.

(n) Standards issued but not yet effective

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2020 with earlier application permitted; however, the Bank has not early adopted them in preparing these financial statements. The following new and amended standards are not expected to have a significant effect on the Bank's financial statements:

– *Amendments to References to Conceptual Framework in IFRS Standards;*
– *Definition of Business (Amendments to IFRS 3);*
– *Definition of Material (Amendments to IAS 1 and IAS 8);*
– *IFRS 17 Insurance Contracts.*

4. Financial risk review

This note presents information about the Bank's exposure to financial risks. For information on the Bank's financial risk management framework, see Note 18.

Credit quality analysis

The following table sets out information about the credit quality of financial assets measured at amortised cost without taking into account collateral or other credit enhancement. Unless specially indicated, for financial assets, the amounts in the table represent gross carrying amounts. Explanation of the terms: Stage 1, Stage 2, Stage 3, are included in Note 3(e)(vi).

	31 December 2019			
GEL'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost – corporate customers				
Rated B1	3,544	-	-	3,544
Rated B2	1,856	-	-	1,856
Rated B3	980	-	-	980
Rated Caa1	182	-	-	182
Unrated	-	-	1,048	1,048
Total	**6,562**	**-**	**1,048**	**7,610**
Loss allowance	**(123)**	**-**	**(179)**	**(302)**
Carrying amount	**6,439**	**-**	**869**	**7,308**
Loans to customers at amortised cost – retail customers				
Online Loans				
Not overdue	738	-	-	738
Online loans - Overdue less than 30 days	86	-	-	86
Online loans - Overdue 30-60 days	-	17	-	17
Online loans - Overdue more than 60-90 days	-	15	-	15
Overdue more than 90 days	-	-	1,347	1,347
Overdue less than 90 (with restructure status)	-	432	-	432
Other retail loans*				
Not overdue	4,218	-	-	4,218
Overdue less than 30 days	16	-	-	16
Overdue 30-60 days	-	5	-	5
Overdue 60-90 days	-	140	-	140
Overdue more than 90 days	-	-	462	462
Overdue less than 90 (with restructure status)	-	-	241	241
Overdue more than 90 (with restructure status)	-	-	-	-
Total retail	**5,058**	**609**	**2,050**	**7,717**
Loss allowance	**(288)**	**(247)**	**(1,343)**	**(1,878)**
Carrying amount	**4,770**	**362**	**707**	**5,839**
Grand total of carrying amount of loans to customers	**11,209**	**362**	**1,576**	**13,147**

The probability of default for the business loan is evaluated by an individual approach by an expert on a rating system based on a scoring questionnaire and represents the country's rating (based on Moody's rating agency) adjusted by the individual risk characteristics of each individual borrower and level of their access to the government support.

	31 December 2018			
GEL'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost – corporate customers				
Rated B2	4,907	-	-	4,907
Rated Caa2	2,460	-	-	2,460
Rated Caa3	187	-	-	187
Unrated	-	-	956	956
Total	**7,554**	**-**	**956**	**8,510**
Loss allowance	**(81)**	**-**	**(114)**	**(195)**
Carrying amount	**7,473**	**-**	**842**	**8,315**
Loans to customers at amortised cost – retail customers				
Online Loans				
Not overdue	4,935	-	-	4,935
Online loans - Overdue less than 30 days	371	-	-	371
Online loans - Overdue 30-60 days	-	320	-	320
Online loans - Overdue more than 60-90 days	-	88	1,406	1,494
Overdue more than 90 days	-	-	707	707
Overdue less than 90 (with restructure status)	-	201	-	201
Other retail loans*				
Not overdue	1,413	-	-	1,413
Overdue less than 30 days	97	-	-	97
Overdue 30-60 days	-	133	-	133
Overdue 60-90 days	-	52	-	52
Overdue more than 90 days	-	-	758	758
Overdue less than 90 (with restructure status)	-	323	-	323
Overdue more than 90 (with restructure status)	-	-	292	292
Total retail	**6,816**	**1,117**	**3,163**	**11,096**
Loss allowance	**(961)**	**(424)**	**(2,039)**	**(3,424)**
Carrying amount	**5,855**	**693**	**1,124**	**7,672**
Grand total of carrying amount of loans to customers	**13,328**	**693**	**1,966**	**15,987**

* Expected credit losses under IFRS 9 for loans to retail customers include ECL for undrawn loan commitments on credit cards.

At 31 December 2019, the Bank did not hold any financial instruments for which no loss allowance is recognised because of collateral.

During the period, there was no change in the Bank's collateral policies.

Credit risk - Amounts arising from ECL

Inputs, assumptions and techniques used for estimating impairment

See accounting policy in Note 3(e)(vi).

Significant increase in credit risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and

analysis, based on the Bank's historical experience and expert credit assessment and including forward-looking information.
The objective of assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- the remaining lifetime probability of default (PD) as at reporting date; with
- the remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where appropriate for changes in prepayment expectations).

The Bank uses three criteria for determining whether there has been a significant increase in credit risk:

- a quantitative test based on movement in PD;
- qualitative indicators; and
- backstop indicator of more than 30 days past due.

Generating the term structure of PD

Consumer loans

Modelling of probability of default of consumer loans is based on the collective analysis method for each segment of loan separately. According to definition of default, probability of default is based on historic monthly migration analysis in accordance with defaults in segments for previous 5 years period. For the segments lacking historical data, the period differs depending on what period there are factual data.

For every segment, historical average monthly matrix was calculated and the probability of default for desired period was defined by extrapolation of the matrix (1 year and whole lifecycle).

Corporate loans

The probability of default for the business loan is evaluated by an individual approach by an expert on a rating system based on a scoring questionnaire and represents the country's rating adjusted by the individual risk characteristics of each individual borrower and level of their access to the government support.

Determining whether credit risk has increased significantly

The Bank assesses whether credit risk has increased significantly since initial recognition at each reporting period. Definition of significant varies for different type of lending in particular between corporate and retail.

As a general indicator, credit risk of a particular exposure is deemed to have increased significantly since initial recognition based on the Bank's quantitative and qualitative modelling. Below are the description of qualitative indicators of significant increase in credit risk.

Corporate customers

- Violation of financial or non-financial covenants;
- Legal action to borrower, which may cause significant cash outflow;
- Restructuring of the loan, which is not linked with the economic loss;
- Placing lien or restriction on the bank account of the borrower;
- Delay in providing financial information for 1 year;
- EBITDA < 0 or EBITDA/Debt Payment < 1, compared to previous period;
- Significant deterioration of borrower's financial position, including: loss of contract with main supplier; loss of main customer; forecast of negative cash flow; significant deterioration of profitability.

Retail customer

- Restructuring of the loan, which is not linked with the economic loss;
- Increase of Loan-to-Value ratio up to 100%;
- If borrower falls in the debtor registry list;
- Placing lien or restriction on the bank account of the borrower;
- If borrower losses job.

As a backstop, the Bank considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. Days past due are determined by counting the number of days since the earliest missed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower.

If there is evidence that there is no longer a significant increase in credit risk relative to initial recognition, then the loss allowance on an instrument returns from lifetime ECL to being measured as 12-month ECL.

The Bank monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that:

- the criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- the criteria do not align with the point in time when an asset becomes more than 30 days past due;
- the average time between the identification of a significant increase in credit risk and default appears reasonable;
- exposures are not generally transferred directly from 12-month ECL measurement to credit-impaired; and
- there is no unwarranted volatility in loss allowance from transfers between 12-month PD (stage 1) and lifetime PD measurements (stage 2).

Definition of default

The Bank considers a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising security (if any is held);
- the borrower is either more than 90 days past due (more than 60 days for silkloan) or has restructured loan more than once due on any material obligations to the Bank.

In assessing whether a borrower is in default, the Bank considers indicators that are:

- qualitative: e.g. breaches of covenant;
- based on data developed internally or obtained from external sources.

Incorporation of forward-looking

In order to evaluate the effect of forward-looking macroeconomic information on loan portfolio, PD of the whole loan portfolio was analysed and correlation coefficient between annual average PD of every quarter of last four years and 2 quarters lagged GDP growth rate was calculated. PD-s for every segment were adjusted by GDP forecasts considering the different weights of possible scenarios (optimistic scenario - 25%, base scenario - 50%, pessimistic scenario – 25%) and results were incorporated in the calculation of annual PD by Vasicek’s formula.

Modified financial assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognised and the renegotiated loan recognised as a new loan at fair value in accordance with the accounting policy set out in Note 3(e)(iv).

When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- its remaining lifetime PD at the reporting date based on the modified terms; with
- the remaining lifetime PD estimated based on data at initial recognition and the original contractual terms.

When modification results in derecognition, a new loan is recognised and allocated to Stage 1 (assuming it is not credit-impaired at that time).

Measurement of ECL

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

- probability of default (PD);
- loss given default (LGD);
- exposure at default (EAD).

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD. Lifetime ECL is calculated by multiplying the lifetime PD by LGD and EAD.

The methodology of estimating PDs is discussed above under the heading "Generating the term structure of PD".

For the credit loss calculating purposes, the loss of the financial asset defaults is measured. The loss on consumer loans is assessed collectively according to segments and business loans according to individual scenarios.

LGD is the magnitude of the likely loss if there is a default. The Bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. Loans are grouped by the default years and repaid exposure is linked to each group. LGD is calculated on a discounted cash flow basis using effective interest rate as the discounting factor.

Exposure at Default (EAD) represents the expected exposure in the event of a default. The EAD for financial assets is its gross carrying amount at the time of default. The Bank differentiates EAD on a product basis. For Collateralized and Uncolateralized loans EAD is calculated based on average remaining maturity of these products, for every year separately. Bank assumes, that mid-year is the point of default (month 6), meaning that payments were made during first three months (month 3) and exposure becomes overdue starting from fourth month EAD for Credit cards is stated to be 100% of the disbursed amounts. EAD for Silkloan and Silkloan plus – is 100% of the whole portfolio for the reporting date as these products are short-term by its nature.

Loss allowance

The following tables show reconciliations from the opening to the closing balances of the loss allowance by class of financial instruments. The basis for determining transfers due to changes in credit risk is set out in our accounting policy; see Note 3 (e).

	2019				2018			
GEL'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost								
Balance at 1 January	1,042	424	2,153	3,619	213	168	724	1,105
Transfer to Stage 2	(10)	10	-	-	(15)	40	(25)	-
Transfer to Stage 3	(183)	(84)	267	-	(31)	(27)	58	-
Net remeasurement of loss allowance	(581)	(310)	1,394	503	(88)	(110)	463	265
New financial assets originated or purchased	762	-	-	762	3,039	-	-	3,039
Transfer to Stage 2	(207)	207	-	-	(353)	353	-	-
Transfer to Stage 3	(412)	-	412	-	(1,723)	-	1,723	-
Write-offs	-	-	(2,704)	(2,704)	-	-	(790)	(790)
Balance at 31 December	**411**	**247**	**1,522**	**2,180**	**1,042**	**424**	**2,153**	**3,619**

	2019				2018			
GEL'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost – corporate customers								
Balance at 1 January	81	-	114	195	62	-	154	216
Transfer to Stage 3	-	-	-	-	(14)	-	14	-
Net remeasurement of loss allowance	42		(114)	(72)	(5)	-	159	154
New financial assets originated or purchased	179	-	-	179	38	-	-	38
Transfer to Stage 3	(179)		179		-	-	-	-
Write-offs	-	-	-	-	-	-	(213)	(213)
Balance at 31 December	**123**	**-**	**179**	**302**	**81**	**-**	**114**	**195**

	2019				2018			
GEL'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost – retail customers								
Balance at 1 January	961	424	2,039	3,424	151	168	570	889
Transfer to Stage 2	(10)	10	-	-	(15)	40	(25)	-
Transfer to Stage 3	(183)	(84)	267	-	(17)	(27)	44	-
Net remeasurement of loss allowance	(623)	(310)	1,508	575	(83)	(110)	304	111
New financial assets originated or purchased	583	-	-	583	3,001	-	-	3,001
Transfer to Stage 2	(207)	207	-	-	(353)	353	-	-
Transfer to Stage 3	(233)	-	233	-	(1,723)	-	1,723	-
Write-offs	-	-	(2,704)	(2,704)	-	-	(577)	(577)
Balance at 31 December	**288**	**247**	**1,343**	**1,878**	**961**	**424**	**2,039**	**3,424**

GEL'000	**2019**	**2018**
Investment securities at amortised cost		
Balance at 1 January	-	-
Net remeasurement of loss allowance	36	-
New financial assets originated or purchased	50	-
Foreign exchange and other movements	-	-
Balance at 31 December	**86**	**-**

The following table provides a reconciliation between amounts shown in the above tables reconciling opening and closing balances of loss allowance per class of financial instrument.

	2019			
GEL'000	**Loans to customers at amortised cost - retail customers**	**Loans to customers at amortised cost - corporate customers**	**Investment securities at amortised cost**	**Total**
Net remeasurement of loss allowance	575	(72)	36	539
New financial assets originated or purchased	583	179	50	812
Total	**1,158**	**107**	**86**	**1,351**
Recoveries of amounts previously written off	(143)	-	-	(143)
Total	**1,015**	**107**	**86**	**1,208**

	2018			
GEL'000	**Loans to customers at amortised cost - retail customers**	**Loans to customers at amortised cost - corporate customers**	**Investment securities at amortised cost**	**Total**
Net remeasurement of loss allowance	111	154	-	265
New financial assets originated or purchased	3,001	38	-	3,039
Total	**3,112**	**192**	**-**	**3,304**
Recoveries of amounts previously written off	(363)	(8)	-	(371)
Total	**2,749**	**184**	**-**	**2,933**

The significant changes in the gross carrying amount of loans measured at amortized cost disbursed to corporate and retail customers are further explained below.

	2019				2018			
GEL'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost								
Balance at 1 January	14,370	1,117	4,119	19,606	5,616	542	1,772	7,930
Transfer to Stage 2	(121)	121	-	-	(177)	244	(67)	-
Transfer to Stage 3	(987)	(381)	1,368	-	(1,173)	(126)	1,299	-
New financial assets originated or purchased	5,640	-	-	5,640	15,222			15,222
Transfer to Stage 2	(430)	430	-	-	(713)	713	-	-
Transfer to Stage 3	(1,334)	-	1,334	-	(2,112)	-	2,112	-
Repayments and other movements (including foreign currency revaluations	(5,518)	(678)	(1,014)	(7,210)	(2,293)	(256)	(784)	(3,333)
Write-offs	-	-	(2,704)	(2,704)	-	-	(213)	(213)
Balance at 31 December	**11,620**	**609**	**3,103**	**15,332**	**14,370**	**1,117**	**4,119**	**19,606**

	2019				2018			
GEL'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost – corporate customers								
Balance at 1 January	7,554	-	956	8,510	3,480	-	327	3,807
Transfer to Stage 2	-	-	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	(925)	-	925	-
New financial assets originated or purchased	1,048	-	-	1,048	5,548	-	-	5,548
Transfer to Stage 2	-	-	-	-	-	-	-	-
Transfer to Stage 3	(1,048)	-	1,048	-	-	-	-	-
Repayments and other movements (including foreign currency revaluations	(992)	-	(956)	(1,948)	(549)	-	(83)	(632)
Write-offs	-	-	-	-	-	-	(213)	(213)
Balance at 31 December	**6,562**	**-**	**1,048**	**7,610**	**7,554**	**-**	**956**	**8,510**

	2019				2018			
GEL'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost – retail customers								
Balance at 1 January	6,816	1,117	3,163	11,096	2,136	542	1,445	4,123
Transfer to Stage 2	(121)	121	-	-	(177)	244	(67)	-
Transfer to Stage 3	(987)	(381)	1,368	-	(248)	(126)	374	-
New financial assets originated or purchased	4,592	-	-	4,592	9,674	-	-	9,674
Transfer to Stage 2	(430)	430	-	-	(713)	713	-	-
Transfer to Stage 3	(286)	-	286	-	(2,112)	-	2,112	-
Repayments and other movements (including foreign currency revaluations	(4,526)	(678)	(58)	(5,262)	(1,744)	(256)	(701)	(2,701)
Write-offs	-	-	(2,704)	(2,704)	-	-	-	-
Balance at 31 December	**5,058**	**609**	**2,055**	**7,722**	**6,816**	**1,117**	**3,163**	**11,096**

5. Net interest income

	2019 GEL'000	2018 GEL'000
Interest income using effective interest method		
Loans to customers	2,740	2,915
Investment securities	1,555	863
Other	711	459
	5,006	**4,237**
Interest expense		
Current accounts and deposits from customers	291	228
Subordinated borrowing	-	359
	291	**587**

6. General administrative expenses

	2019 GEL'000	2018 GEL'000
Communications and information services	761	372
Legal and consultancy*	700	1,115
Depreciation and amortization expense	553	560
Taxes other than on income	316	238
Utilities and office supplies	212	503
Security	84	84
Advertising and marketing expenses	45	411
Other	478	354
	3,149	**3,637**

* Legal and consultancy expenses include audit fees of GEL 68 thousand (2018: GEL 71 thousand).

7. Salaries and employment benefit expenses

	2019 GEL'000	2018 GEL'000
Wages and salaries	2,320	1,800
Other benefits	48	48
Total income tax benefit	**2,368**	**1,848**

The average number of Bank employees (excluding supervisory board members) for the year ended 31 December 2019 amounted 82 persons, of which: top management: 4 employees, mid-level managers: 14 employees and other staff: 64 employees. All employees were full time employees.

8. Income tax benefit

	2019 GEL'000	2018 GEL'000
Movement in deferred tax assets and liabilities due to origination and reversal of temporary differences	184	528
Total income tax benefit	**184**	**528**

In 2019, the applicable tax rate for current and deferred tax is 15% (2018: 15%).

Reconciliation of effective tax rate for the year ended 31 December:

	2019 GEL'000	%	2018 GEL'000	%
Loss before income tax	(648)		(5,215)	
Income tax at the applicable tax rate	(97)	15	(782)	15
Effect of change in income tax legislation	-	-	21	0
Change in unrecognised deferred tax assets	88	(14)	377	(7)
Non-deductible differences	(175)	27	(144)	3
	(184)	**28**	**(528)**	**11**

Deferred tax assets and liabilities

Temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes give rise to net deferred tax liability as at 31 December 2019 and 31 December 2018. Movements in temporary differences during the years ended 31 December 2019 and 2018 are presented as follows:

2019 GEL'000	**1 January 2019**	**Recognised in equity**	**Recognized in profit or loss**	**31 December 2019**
Property and equipment	(308)	(210)	208	(310)
Loans to customers	100	-	(27)	73
Assets held for sale	45	-	7	52
Other liability	29	-	(4)	25
	(134)	**(210)**	**184**	**(160)**

2018 GEL'000	**1 January 2018**	**Recognised in equity**	**Recognized in profit or loss**	**31 December 2018**
Property and equipment	(236)	(383)	311	(308)
Loans to customers	(91)	-	191	100
Assets held for sale	-	-	45	45
Other liability	48	-	(19)	29
	(279)	**(383)**	**528**	**(134)**

Unrecognised deferred tax assets

Deferred tax asset of GEL 1,021 thousand (2018: GEL 933 thousand) have not been recognised in respect of tax losses. According to the Estonian Tax Model (note 3 (d) (i)), utilization of tax losses will not be applicable starting from 2023. Deferred tax assets have not been recognised in respect of these items because it is not probable that future taxable profit will be available against which the Bank can utilise the benefits there from.

9. Cash and cash equivalents

	2019 GEL'000	2018 GEL'000
Cash on hand	**3,821**	**5,052**
Nostro accounts with National Bank of Georgia excluding obligatory reserves	**223**	**1,580**
Nostro accounts with other Banks		
Rated BB- to BB+	13,552	6,183
Rated below B+	468	258
Total nostro accounts with other banks	**14,020**	**6,441**
Cash equivalents		
Term deposit	3,000	7,000
Total cash and cash equivalents	**21,064**	**20,073**

No cash and cash equivalents are past due. As at 31 December 2019 the Bank allocates cash equivalents under Stage 1 for the purposes of identifying expected credit loss under IFRS 9 (31 December 2018: Stage 1). Management estimates that ECL is immaterial at reporting dates.

The cash and cash equivalents are mainly held with banks in Georgia with short term issuer default rating of BB issued by Fitch Ratings.

10. Amounts due from credit institution

	2019 GEL'000	2018 GEL'000
Obligatory reserve with National Bank of Georgia (NBG)	2,991	2,183
Total amounts due from credit institution	**2,991**	**2,183**

In 2019 the credit institutions are required to maintain an interest earning cash deposit (obligatory reserve) with the NBG at 5% and at 25% 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.

As at 31 December 2019 the Bank allocates amounts due from credit institution under Stage 1 for the purposes of identifying expected credit loss under IFRS 9 (31 December 2018: Stage 1). Management estimates that ECL is immaterial at reporting dates.

11. Investment securities

	2019 GEL'000	2018 GEL'000
Government treasury bonds	16,945	13,637
Corporate bonds	3,022	-
Total investment securities measured at amortized cost	**19,967**	**13,637**

	31 December 2019			31 December 2018		
	Nominal interest rate, %	Maturity	Amount	Nominal interest rate, %	Maturity	Amount
Debt securities with the Ministry of Finance of Georgia	7.7-12.9	2020-2028	16,945	8.1 – 11.25	2019 - 2028	13,637
Corporate bonds (JSC Nikora)	4% + 3M TIBR	2022	2,000	-	-	-
Corporate bonds (JSC MFO Crystal)	4% + NBG refinancing rate	2021	1,022	-	-	-

No investment securities are past due. During the year the Bank has obtained new investment securities of GEL 7,248 thousand and sold of GEL 1,000 thousand. As at 31 December 2019 the Bank allocates investment securities under Stage 1 for the purposes of identifying expected credit loss under IFRS 9 (31 December 2018: Stage 1). ECL estimation is presented in Note 4.

12. Loans to customers

	2019 GEL'000	2018 GEL'000
Loans to corporate customers		
Loans to corporate customers	7,610	8,510
Total loans to corporate customers	**7,610**	**8,510**
Loans to retail customers		
Consumer lending - collateralized	2,736	1,149
Consumer lending - uncollateralized	1,897	524
Silkloan Plus	1,405	3,565
Silkloan	1,230	4,461
Credit cards	449	1,397
Total Loans to retail customers	**7,717**	**11,096**
Total gross loans to customers	**15,327**	**19,606**
Loss allowance	(2,180)	(3,619)
Net loans to customers	**13,147**	**15,987**

Movements in the credit loss allowance of loans to customers measured at amortized cost for the year ended 31 December 2019 are as follows:

	Loans to corporate customers GEL'000	Loans to retail customers GEL'000	Total GEL'000
Balance at the beginning of the year	195	3,424	3,619
Net charge	107	1,015	1,122
Write-offs	-	(2,704)	(2,704)
Recovery	-	143	143
Balance at the end of the year	**302**	**1,878**	**2,180**

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2018 are as follows:

	Loans to corporate customers GEL'000	Loans to retail customers GEL'000	Total GEL'000
Balance at the beginning of the year	216	889	1,105
Net charge	184	2,749	2,933
Write-offs	(213)	(577)	(790)
Recovery	8	363	371
Balance at the end of the year	**195**	**3,424**	**3,619**

Information on the credit quality of loans to customers as at 31 December 2019 and 31 December 2018 is disclosed in Note 4.

(a) Analysis of collateral and other credit enhancements

i. Loans to corporate customers

Loans to corporate customers are subject to individual credit appraisal and impairment testing. The general creditworthiness of a corporate customer tends to be the most relevant indicator of credit quality of the loan extended to it. However, collateral provides additional security and the Bank generally requests corporate borrowers to provide it.

The following tables provides information on collateral and other credit enhancements securing loans to corporate customers, net of impairment, by types of collateral:

31 December 2019 **GEL'000**	**Loans to customers, carrying amount**	**Fair value of collateral: for collateral assessed as of reporting date**	**Fair value of collateral: for collateral assessed as of loan inception date**
Loans without individual signs of impairment			
Real estate	4,914	-	4,914
Inventory	1,525	-	1,525
Total loans without individual signs of impairment	**6,439**	**-**	**6,439**
Overdue or impaired loans			
Real estate	869	869	-
Total overdue or impaired loans	**869**	**869**	**-**
Total loans to corporate customers	**7,308**	**869**	**6,439**

31 December 2018 **GEL'000**	**Loans to customers, carrying amount**	**Fair value of collateral: for collateral assessed as of reporting date**	**Fair value of collateral: for collateral assessed as of loan inception date**
Loans without individual signs of impairment			
Real estate	6,028	-	6,028
Inventory	1,445	-	1,445
Total loans without individual signs of impairment	**7,473**	**-**	**7,473**
Overdue or impaired loans			
Real estate	842	-	842
Total overdue or impaired loans	**842**	**-**	**842**
Total loans to corporate customers	**8,315**	**-**	**8,315**

The tables above exclude overcollateralization.

The Bank has loans, for which the fair value of collateral was assessed at the loan inception date and it was not updated for further changes. For certain loans the fair value of collateral is updated as at the reporting date. Information on the valuation of collateral is based on when this estimate was made, if any.

For loans secured by multiple types of collateral, all collateral that are relevant for impairment assessment are disclosed.

The recoverability of loans which are neither past due nor impaired primarily depends on the creditworthiness of borrowers rather than the value of collateral, and the Bank does not necessarily update the valuation of collateral as at each reporting date.

During the period, there was no change in the Bank's collateral policies.

ii. Loans to retail customers

The major part of the retail collateralized loans are secured by real estate. The major part of the retail collateralized loans are secured by real estate with LTV ratio of approximately 41%. Approximately 23% of credit impaired loans were collateralized as at 31 December 2019.

iii. Assets held for sale

As at 31 December 2019 and 2018, assets held for sale comprise from repossessed collateral:

	2019 GEL'000	**2018 GEL'000**
Real estate	3,687	4,918
Total repossessed collateral	**3,687**	**4,918**

In 2019 assets held for sale balances have been written down to fair value less cost to sale of by GEL 74 thousand recognised in the statement of profit or loss and other comprehensive income as impairment loss on the assets held for sale (2018: GEL 1,452 thousand).

The Bank's policy is to sell these assets as soon as it is practicable.

(b) Key assumptions and judgments for estimating loan impairment

Key assumptions used by the Bank in estimation of the expected credit loss on loans to customers are as follows:

- probability of default (PD);
- loss given default (LGD);
- exposure at default (EAD).

10 % increase (capped to 100%, if applicable) in any of these assumptions, assuming that all other variables remain constant, could affect the expected credit loss on loans to customers for 2019 by amounts in the range of GEL 250 thousand to GEL 300 thousand for retail customers and up to GEL 670 thousand for corporate customers.

(c) Significant credit exposures

As at 31 December 2019 and 2018, the Bank has no borrowers or groups of connected borrowers, whose net loan balances exceed 10% of equity.

(d) Loan maturities

The maturity of the loan portfolio is presented in Note 19(c)(iv), which shows the remaining period from the reporting date to the contractual maturity of the loans.

13. Property and equipment

GEL'000	Land and building	Computer and communication equipment	Fixtures and fittings	Motor vehicles	Other	Total
Cost/revalued amount						
Balance at 1 January 2018	15,893	1,446	971	162	820	19,292
Additions	-	6	14	-	1	21
Disposals	-	(52)	(10)	-	(69)	(131)
Effect of revaluation	2,139	-	-	-	-	2,139
Balance at 31 December 2018	**18,032**	**1,400**	**975**	**162**	**752**	**21,321**
Balance at 1 January 2019	18,032	1,400	975	162	752	21,321
Additions	-	44	-	-	40	84
Disposals	-	(50)	(21)	-	-	(71)
Effect of revaluation	1,051	-	-	-	-	1,051
Balance at 31 December 2019	**19,083**	**1,394**	**954**	**162**	**792**	**22,385**
Depreciation						
Balance at 1 January 2018	-	1,297	888	161	696	3,042
Depreciation for the year	351	84	49	1	46	531
Disposals	-	(52)	(10)	-	(28)	(90)
Effect of revaluation	(351)	-	-	-	-	(351)
Balance at 31 December 2018	**-**	**1,329**	**927**	**162**	**714**	**3,132**
Balance at 1 January 2019	-	1,329	927	162	714	3,132
Depreciation for the year	351	94	45	-	42	532
Disposals	-	(35)	(21)	-	-	(56)
Effect of revaluation	(351)	-		-	-	(351)
Balance at 31 December 2019	**-**	**1,388**	**951**	**162**	**756**	**3,257**
Carrying amount						
At 31 December 2017	15,893	149	83	1	124	16,250
At 31 December 2018	**18,032**	**71**	**48**	**-**	**38**	**18,189**
At 31 December 2019	**19,083**	**4**	**5**	**-**	**36**	**19,128**

(a) Revalued assets

As at 31 December 2019 management estimated fair value of land and buildings which, in accordance with the Bank's accounting policy, is measured at fair value.

The fair value of buildings was determined to be GEL 19,083 thousand. Land and buildings are categorized within level 3 of fair value hierarchy.

The fair value of land and buildings was determined by the management with the assistance of the independent expert and was based on announced asking prices of similar properties in the similar location and physical condition. The significant unobservable inputs related to the differences in the characteristics of the properties, such as size, location, access to the properties and conditions for sale. The adjustments related to each of the significant unobservable input above varied between 5% to 10%. 5% change in the adjusted market prices used in the valuation would have changed the fair value measurement by GEL 939 thousand.

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

	2019 GEL'000	2018 GEL'000
Cost	20,131	20,131
Accumulated depreciation	(6,264)	(5,861)
Net carrying amount	**13,867**	**14,270**

14. Current accounts and deposits from customers

	2019 GEL'000	2018 GEL'000
Current accounts	15,834	10,052
Time deposits	2,085	2,840
	17,919	**12,892**

As at 31 December 2019 amounts due to customers of GEL 12,045 thousand (67% of total current accounts and deposits from customers balance) were due to ten largest customers (2018: GEL 8,728 thousand (68%)).

As at 31 December 2019 and 2018, the Bank has no customers, whose balances exceed 10% of equity.

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

	2019 GEL'000	2018 GEL'000
Individuals:		
- Current accounts	1,538	2,169
- Term deposits	1,340	2,322
Total due to individuals	**2,878**	**4,491**
Commercial legal entities:		
- Current accounts	14,296	7,884
- Term deposits	745	517
Total due to commercial legal entities	**15,041**	**8,401**
Total amounts due to customers	**17,919**	**12,892**

An analysis of customer accounts by economic sector is as follows:

	2019 GEL'000	2018 GEL'000
Trade and service	5,202	5,883
Investing activities	5,026	188
Transportation and communication	3,502	525
Individuals	2,878	4,491
Real estate	592	536
Construction	127	300
Other	592	969
Amounts due to customers	**17,919**	**12,892**

15. Share capital and reserves

(a) Issued capital and share premium

As at 31 December 2019, share capital of the Bank comprised 611,464 of authorized fully paid shares with nominal value GEL 100 each (2018: 611,464 authorized fully paid shares with the nominal value 100 GEL 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.

(b) Nature and purpose of reserves

Revaluation surplus for property and equipment

The revaluation surplus for property and equipment comprises the cumulative positive revalued value of property and equipment after depreciation transfer to retained earnings, until the assets are derecognised or impaired.

(c) Dividends

Dividends payable are restricted to the maximum retained earnings of the Bank, which are determined according to Georgian legislation.

16. Contingencies

(a) Litigation

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations.

(b) Taxation contingencies

The taxation system in Georgia is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes unclear, contradictory and subject to varying interpretation. In the event of a breach of tax legislation, no liabilities for additional taxes, fines or penalties may be imposed by the tax authorities after three years have passed since the end of the year in which the breach occurred.

These circumstances may create tax risks in Georgia that are more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Georgian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

17. Related party transactions

(a) Control relationships

The Bank's parent Company is Silk Road Finance JSC (Tbilisi, Georgia), which owns 99.99 % of the share capital. No publicly available financial statements are produced by the Bank's parent company.

The Bank's ultimate controlling party is Georgian businessman Giorgi Ramishvili.

(b) Related party transactions

Total remuneration included in personnel expenses for the years ended 31 December 2019 and 2018 is as follows:

	2019 GEL'000	2018 GEL'000
Short-term employee benefits	**656**	**374**

The outstanding balances and average effective interest rates as at 31 December 2019 and 2018 for related party transactions are shown below:

	2019 GEL'000	2018 GEL'000
Statement of financial position		
Loans issued net carrying amount		
Entities under common control	5,754	7,440
Shareholders	324	-
Close family members of management and shareholders	-	39
Key management personnel	19	14
Current accounts and deposits from customers		
Entities under common control	9,880	4,069
Shareholders	412	183
Close family members of management and shareholders	25	154
Key management personnel	21	50
Subsidiaries and investments	146	33
Other	90	109

Loans issued to related parties are mainly long term and bear average interest rate of 10.5% to 14.2% (2018: mainly long-term, average interest rate from 10% to 18%). Current accounts and deposits from related parties mainly mature within 1 year and bear average interest rate up to 8.5% (2018: mainly short-term, average interest rate up to 1%).

Loans issued to related parties are secured with the collateral with the loan to value ratio of less than 75%. Impairment allowance as at 31 December 2019 on loans issued to related parties is GEL 123 thousand (31 December 2018: GEL 81 thousand).

Amounts included in profit or loss in relation to transactions with related parties for the year ended 31 December are as follows:

	2019 GEL'000	2018 GEL'000
Profit or loss		
Interest income	710	446
Interest expense	229	409
Consulting fees	160	157
Fees and commission income	50	71

18. Fair values of financial instruments

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements:

- Level 1: quoted market price (unadjusted) in an active market for an identical instrument.
- Level 2: inputs other than quotes prices included within Level 1 that are observable either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: inputs that are unobservable. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The estimated fair values of all financial instruments as at 31 December 2019 and 31 December 2018 approximate their carrying amounts.

The estimates of fair value are intended to approximate the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realisable in an immediate sale of the assets or transfer of liabilities.

19. Risk management

(a) Corporate governance, internal control policies and procedures

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 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 Risk Management Department.

Risk mitigation

The Bank actively uses collateral to reduce its credit risks.

(b) 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.

(c) 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.

i. Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. As at 31 December 2019 and 2018, the Bank is not materially exposed to the interest rate risk as it does not have material balances of financial assets or liabilities, bearing variable interest rates.

Average effective interest rates

The table below displays average effective interest rates for interest-bearing assets and liabilities as at 31 December 2019 and 2018. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

	2019 Average effective interest rate, %			2018 Average effective interest rate, %		
	GEL	**USD**	**Other currencies**	**GEL**	**USD**	**Other currencies**
Interest bearing assets						
Cash and cash equivalents	8.50%	0.62%	-	7%	1%	1%
Loans to customers	23.16%	12.51%	-	44%	12%	-
Investment securities	9.25%	-	-	9%	-	-
Interest bearing liabilities						
Current accounts and deposits from customers	6.06%	0.77%	-	5.5%	1.5%	2%

ii. Currency risk

The Bank has assets and liabilities denominated in several foreign currencies.

Currency risk is the risk that the fair value or the future cash flows of a financial instrument will fluctuate because of changes in foreign currency exchange rates. Although the Bank hedges its exposure to currency risk, such activities do not qualify as hedging relationships in accordance with IFRS.

The following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2019:

	USD GEL'000	EUR GEL'000	Total GEL'000
ASSETS			
Cash and cash equivalents	13,264	3,076	16,340
Amounts due from credit institutions	2,342	606	2,948
Loans to customers	4,669	-	4,669
Other financial assets	264	-	264
Total assets	**20,539**	**3,682**	**24,221**
LIABILITIES			
Current accounts and deposits from customers	(9,435)	(2,609)	(12,044)
Other financial liabilities	(250)	-	(250)
Total liabilities	**(9,685)**	**(2,609)**	**(12,294)**
Effect of derivatives*	**(12,517)**	**-**	**(12,517)**
Net position	**(1,663)**	**1,073**	**(590)**

The following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2018:

	USD GEL'000	EUR GEL'000	Total GEL'000
ASSETS			
Cash and cash equivalents	9,503	2,090	11,593
Loans to customers	5,427	-	5,427
Amounts due from credit institutions	1,481	702	2,183
Other financial assets	257	-	257
Total assets	**16,668**	**2,792**	**19,460**
LIABILITIES			
Current accounts and deposits from customers	(6,560)	(2,778)	(9,338)
Other financial liabilities	(150)	-	(150)
Total liabilities	**(6,710)**	**(2,778)**	**(9,488)**
Effect of derivatives*	**(9,900)**	**-**	**(9,900)**
Net position	**58**	**14**	**72**

* The table below shows the fair values of foreign currency forward contract recorded in other assets (31 December 2018: other assets) together with their notional amounts. The notional amount, recorded gross, is the amount of a financial instrument's underlying asset or liability, reference rate and is the basis upon which changes in the value of financial instruments are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of the credit risk.

	31 December 2019		31 December 2018	
GEL'000	**Notional amount**	**Fair value**	**Notional amount**	**Fair value**
Foreign currency forward contract				
Sell USD buy GEL	23,228	822	9,900	202
Buy USD sell GEL	(10,711)		-	

The following significant exchange rates have been applied during the year:

in GEL	Average rate		Reporting date spot rate	
	2019	**2018**	**2019**	**2018**
USD 1	2.8192	2.5345	2.8677	2.6766
EUR 1	3.1553	2.9913	3.2095	3.0701

A weakening of the GEL, as indicated below, against the following currencies at 31 December 2019 and 2018, would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis is on a net-of-tax basis, and is based on foreign currency exchange rate variances that the Bank considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

	2019 GEL'000	2018 GEL'000
10% appreciation of USD against GEL	(141)	5
10% appreciation of EUR against GEL	91	1

A strengthening of the GEL against the above currencies at 31 December 2019 and 2018 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remained constant.

iii. 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.

The Bank continuously monitors the performance of individual credit exposures and regularly reassesses the creditworthiness of its customers. The review is based on the customer's most recent financial statements and other information submitted by the borrower, or otherwise obtained by the Bank.

The maximum exposure to credit risk from financial assets at the reporting date is as follows:

	2019 GEL'000	2018 GEL'000
ASSETS		
Cash and cash equivalents	17,243	15,021
Amounts due from credit institutions	2,991	2,183
Loans to customers	13,147	15,987
Investment securities	19,967	13,637
Other financial assets	350	348
Total maximum exposure	**53,698**	**47,176**

For the analysis of collateral held against loans to customers and concentration of credit risk in respect of loans to customers, see Note 12.

iv. Liquidity risk

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 100%. As at 31 December 2019 and 2018 the ratio was as follows:

	2019	2018
LCR "Average Liquidity Ratio" (average monthly volume of liquid assets / average monthly volume of liabilities)*	336.04%	153.24%

* This ratio is unaudited.

The following tables show the undiscounted cash flows on financial assets, liabilities on the basis of their earliest possible contractual maturity. The total gross inflow and outflow disclosed in the tables is the contractual, undiscounted cash flow on the financial assets, liability.

The remaining maturity analysis for financial assets and liabilities as at 31 December 2019 is as follows:

GEL'000	On demand and less than 1 month	1 to 3 months	3 to 12 months	1 to 5 years	More than 5 years	Total gross amount inflow (outflow)	Carrying amount
Cash and cash equivalents	17,243	-	-	-	-	17,243	17,243
Amounts due from credit institutions	2,991	-	-	-	-	2,991	2,991
Investment securities	740	29	1,965	13,131	13,914	29,779	19,967
Loans to customers	381	1,768	2,892	7,663	4,969	17,673	13,147
Other financial asset	235	-	115	-	-	350	350
Total financial assets	**21,590**	**1,797**	**4,972**	**20,794**	**18,883**	**68,036**	**53,698**
Current accounts and deposits from customers	(17,391)	(306)	(39)	(193)	-	(17,929)	(17,919)
Other financial liabilities	(580)	(61)	-	-	-	(641)	(641)
Total financial liabilities	**(17,971)**	**(367)**	**(39)**	**(193)**	**-**	**(18,570)**	**(18,560)**
Net liquidity gap on recognised financial assets and liabilities	**3,619**	**1,430**	**4,933**	**20,601**	**18,883**	**49,466**	**35,138**

The remaining maturity analysis for financial assets and liabilities as at 31 December 2018 is as follows:

GEL'000	On demand and less than 1 month	1 to 3 months	3 to 12 months	1 to 5 years	More than 5 years	Total gross amount inflow (outflow)	Carrying amount
Cash and cash equivalents	15,021	-	-	-	-	15,021	15,021
Amounts due from credit institutions	2,183	-	-	-	-	2,183	2,183
Loans to customers	489	1,049	618	9,357	9,390	20,903	15,987
Investment securities	8,924	906	3,103	6,915	4,961	24,809	13,637
Other financial asset	348	-	-	-	-	348	348
Total financial assets	**26,965**	**1,955**	**3,721**	**16,272**	**14,351**	**63,264**	**47,176**
Amounts due to credit institutions	(11,604)	(486)	(248)	(640)	-	(12,978)	(12,892)
Other financial liabilities	(371)	-	-	-	-	(371)	(371)
Total financial liabilities	**(11,975)**	**(486)**	**(248)**	**(640)**	-	**(13,349)**	**(13,263)**
Net liquidity gap on recognised financial assets and liabilities	**14,990**	**1,469**	**3,473**	**15,632**	**14,351**	**49,915**	**33,913**

(d) Maturity analysis of financial assets and liabilities

The table below shows an analysis of financial assets and liabilities according to when they are contractually due to be recovered or settled.

	2019			2018		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Financial assets						
Cash and cash equivalents	17,243	-	17,243	15,021	-	15,021
Amounts due from credit institutions	2,991	-	2,991	2,183	-	2,183
Loans to customers	2,859	10,288	13,147	8,233	7,754	15,987
Investment securities	1,001	18,966	19,967	1,492	12,145	13,637
Other financial assets	350	-	350	348	-	348
Total	**24,444**	**29,254**	**53,698**	**27,277**	**19,899**	**47,176**
Financial liabilities						
Amounts due to customers	(17,732)	(187)	(17,919)	(10,817)	(2,075)	(12,892)
Other financial liabilities	(641)	-	(641)	(371)	-	(371)
Total	**(18,373)**	**(187)**	**(18,560)**	**(11,188)**	**(2,075)**	**(13,263)**
Net exposure	**6,071**	**29,067**	**35,138**	**16,089**	**17,824**	**33,913**

The Bank's ability to discharge its liabilities relies on its ability to realize an equivalent amount of assets within the same period of time.

20. 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 National Bank of Georgia ("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 is monitored monthly with reports outlining their calculation reviewed and subsequently submitted to the NBG.

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

According to the NBG regulations about capital adequacy (Decree N100/04) on 18 December 2017 the minimum capital requirement ratios have been revised. As at 31 December 2019 and 2018 Common Equity Tier 1 Capital (CET I), Tier I Capital (Tier I) and Total Capital ratios is set at 4.50%, 6.00% and 8.00%, respectively. Capital Conservation and Countercyclical buffers were set at 2.50% and 0%, respectively.

As at 31 December 2019, the Bank had to maintain the currency induced credit risk (CICR) buffer of 0.44% (2018: 0.55%), Risk buffer for credit portfolio concentration of 3.25% (2018: 4.18%) and net GRAPE buffer of 9.7% (2018: 14.4%). All the rest Pillar II buffers were to preserve at nil percent (2018: nil). 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 23.89%, 11.42% and 9.19%, respectively (2018: 29.63%, 10.09% and 12.63%, respectively). The Bank was in compliance with these capital adequacy ratios as at 31 December 2019 and as at 31 December 2018.

The calculation of the capital adequacy ratios in accordance with the NBG accounting rules and capital adequacy Basel III framework for 31 December 2019 and 31 December 2018:

GEL'000	2019	2018
Tier 1 capital*	50,191	50,381
Supplementary capital*	202	244
Total regulatory capital*	**50,393**	**50,625**
Risk weighted assets*	**64,897**	**55,931**
Regulatory capital ratio*	77.65%	90.51%
Common Equity Tier 1 capital adequacy ratio / tier 1 capital adequacy ratio*	77.34%	90.08%

*These amounts are unaudited.

21. Subsequent events

(a) Change in key management

Vitali Taktakishvili has been appointed as Head of Risk Department of the Bank at 5 March, 2020.

(b) COVID-19

i. General overview

On 11 March 2020, the World Health Organisation (WHO) declared the COVID-19 coronavirus pandemic. The first case in Georgia was officially reported on 26 February 2020. As measures against spreading of the virus, Government of Georgia imposed various restrictions over activities within the country. The restrictions imposed at various times include ban on all cross-border travel, restriction over all travel within the country during specific hours, closing of all public transport, stopping all commercial activity except those which can be done distantly from home as well as except specific business (groceries, pharmacies, commercial banks, gas stations, post offices etc.).

The restrictions imposed by Government of Georgia do not apply to any of the Bank's operations. The Bank continues work in under the business continuity plan with personnel assigned to either of the two offices and working remotely from home as much as possible.

ii. Changes in regulatory requirements

As response to the existing crisis, the National Bank of Georgia ("NBG") took several actions aiming at alleviating the negative financial and economic challenges created by the global COVID-19 pandemic in Georgia. The following NBG actions may potentially have effect on the Bank's operations:

- In order to stabilize sudden increase in foreign exchange rates (GEL/USD peak rate of 3.4842 was recorded on 27 March, 2020), NBG sold USD 100 million on local market during March;
- NBG coordinated Georgian banks' initiative to provide voluntary grace period of three months to most of commercial banks' retail and small business borrowers within the country. In parallel to slightly amplified drawdowns of deposits for household cash needs, this initiative has further stressed the GEL liquidity in the financial sector. To address it, NBG started to offer FX swaps to commercial banks and microfinance organizations, up to USD 200 million for each sector;
- NBG softened regulatory requirements for commercial banks, including softening certain requirements for capital adequacy and liquidity ratios. This will allow banks to use existing buffers to support customers in the current financially stressed circumstances, to continue normal business activities to the extent possible. Liquidity coverage ratio (LCR) requirements (for local and foreign currency, as well as total requirement) may as well be revisited and reduced, if necessary;
- NBG imposed general provisions for possible credit losses for each bank individually;
- NBG will not impose any monetary sanctions in case of breach of economic normatives and limits driven by external factors (e.g. reserves, exchange rate deprecation).

iii. Effect of COVID-19 on the Bank

It is expected that the Bank's liquidity position and reserves, consisting of high rated securities and short-term bank deposits, will not be materially affected by deterioration of market conditions. Domestic lending operations will continue against appropriate collateral; hence, credit quality of domestic assets is not expected to decline either. Based on these and other assumptions, the directors have prepared cash flow forecasts for a period of at least 12 months from the date of approval of these financial statements which indicate that, taking account of reasonably possible downsides, the Bank will have sufficient funds to meet its liabilities as they fall due for that period. The directors also analysed the Bank's compliance with the NBG regulations. The Bank is and generally is expected to be in compliance with NBG requirements, including the mandated general provision, with one exception. As at 31 March 2020, according to the new requirement of NBG, the Bank has being required to recalculate additional general provision of GEL 790 thousand (5.25% of gross loan portfolio) that resulted in a breach of Bank's minimum regulatory capital requirement. The Bank has obtained waiver for this breach from NBG till the end of 2020 – the date when the Bank is confident to be in compliance with the minimum regulatory capital requirements. The additional provision may be revised and amended (if necessary) during 2020, subject to the economic situation. The directors intend to perform detailed credit risk assessments in due course and solicit NBG's consent to replace the general provision with specific provisions, as may be necessary, in the course of 2020. Based on the above analysis, directors are confident, that COVID-19 pandemic and resulting reduction of economic activity within the country as well as downturn in global financial markets will not have significant effect on the Bank's financial position and financial results.