JSC MFO Micro Business Capital

Financial Statements
for the year ended 31 December 2018

Contents

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Independent Auditors' Report

To the Shareholders of JSC MFO Micro Business Capital

Opinion

We have audited the financial statements of JSC MFO Micro Business Capital (the "Company"), which comprise the statement of financial position as at 31 December 2018, 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 Company as at 31 December 2018, 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 Company in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code) 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 IESBA Code. 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. Our opinion on the financial statements does not cover the Management Report.

In connection with our audit of the financial statements, our responsibility is to read the Management Report 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.

We do not express any form of assurance conclusion on the Management Report. We have read the Management Report and based on the work we have performed, we conclude that the Management Report:

- is consistent with the financial statements and does not contain material misstatement;
- contains the 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 Company'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 Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company'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 Company'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 Company'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 Company 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
27 June 2019

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Karen Safaryan

KPMG Georgia LLC
Tbilisi, Georgia
27 June 2019

	Notes	2018 GEL'000	2017* GEL'000
ASSETS			
Cash and cash equivalents	9	1,771	1,134
Loans to customers	10	48,348	33,464
Property and equipment	11	1,933	1,363
Intangible assets		236	228
Deferred tax assets	8	346	167
Current tax asset		-	151
Other assets	12	1,020	1,554
Total assets		**53,654**	**38,061**
LIABILITIES			
Subordinated borrowings and other borrowed funds	13	38,429	31,946
Current tax liability		186	-
Other liabilities		370	411
Total liabilities		**38,985**	**32,357**
EQUITY	14		
Share capital		2,185	2,155
Share premium		852	795
Preference shares		7,347	-
Retained earnings		4,285	2,754
Total equity		**14,669**	**5,704**
Total liabilities and equity		**53,654**	**38,061**

*The Company has initially applied IFRS 9 at 1 January 2018. Under the transition methods chosen, comparative information is not restated (see Note 3(e)).

The financial statements as set out on pages 5 to 49 were approved by management on 27 June 2019 and were signed on its behalf by:

Gia Petriashvili
General Director

Tatia Jajanashvili
Financial Director

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

	Notes	2018 GEL'000	2017* GEL'000
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General Director

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Tatia Jajanashvili
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	Notes	2018 GEL'000	2017* GEL'000
Interest income calculated using the effective interest method	6	11,284	8,243
Interest expense	6	(4,172)	(3,439)
Net interest income		**7,112**	**4,804**
Fee and commission income		1,293	830
Net foreign exchange loss		(458)	(797)
Net (loss)/income from trading in foreign currency		(213)	239
Operating income		**7,734**	**5,076**
Impairment losses on debt financial assets	10	(1,523)	(601)
Personnel expenses		(2,988)	(2,034)
General administrative expenses	7	(2,095)	(1,545)
Profit before income tax		**1,128**	**896**
Income tax expense	8	(182)	(151)
Profit for the year		**946**	**745**
Total comprehensive income for the year		**946**	**745**

*The Company has initially applied IFRS 9 at 1 January 2018. Under the transition methods chosen, comparative information is not restated (see Note 3(e)). As a result of adoption of IFRS 9 the Company changed presentation of certain captions, comparative information is re-presented accordingly.

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.

	Notes	2018 GEL'000	2017* GEL'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before income tax		**1,128**	**896**
Adjustments for:			
Impairment losses on debt financial assets	10	1,523	601
Net interest income		(7,112)	(4,804)
Depreciation and amortization		251	189
Bonus and audit fee accrual		318	295
Net foreign exchange loss		458	797
Write-off of property and equipment		29	-
(Increase)/ decrease in operating assets			
Loans to customers		(15,364)	(7,002)
Other assets		537	626
Increase /(decrease) in operating liabilities			
Other liabilities		(301)	(223)
Net cash used in operating activities before income tax paid, interest received and interest paid		**(18,533)**	**(8,625)**
Income tax paid		(22)	(429)
Interest received		11,064	8,004
Interest paid		(4,066)	(3,439)
Cash flows used in operations		**(11,557)**	**(4,489)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of property and equipment		(784)	(1,045)
Purchases of intangible assets		(149)	(152)
Cash flows used in investing activities		**(933)**	**(1,197)**
CASH FLOWS FROM FINANCING ACTIVITIES			
Receipts of subordinated borrowings		3,698	2,676
Receipts of other borrowed funds		69,246	47,608
Repayment of other borrowed funds		(61,067)	(45,290)
Proceeds from issuance of ordinary shares		87	131
Proceeds from issuance of preference shares		1,111	-
Cash flows from financing activities		**13,075**	**5,125**
Net increase/(decrease) in cash and cash equivalents		**585**	**(561)**
Effect of changes in exchange rates on cash and cash equivalents		52	(125)
Cash and cash equivalents as at the beginning of the year		1,134	1,820
Cash and cash equivalents as at the end of the year	9	**1,771**	**1,134**

*The Company has initially applied IFRS 9 at 1 January 2018. Under the transition methods chosen, comparative information is not restated (see Note 3(e)).

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	Share premium	Preference shares	Retained earnings	Total
Balance as at 1 January 2017	2,100	719	-	2,009	4,828
Transactions with owners, recorded directly in equity					
Shares issued	55	76	-	-	131
Total transactions with owners	**55**	**76**	**-**	**-**	**131**
Total comprehensive income					
Profit for the year	-	-	-	745	745
Total comprehensive income for the year	**-**	**-**	**-**	**745**	**745**
Balance as at 31 December 2017*	**2,155**	**795**	**-**	**2,754**	**5,704**
Adjustment on initial application of IFRS 9, net of tax	-	-	-	585	585
Balance as at 1 January 2018	**2,155**	**795**	**-**	**3,339**	**6,289**
Transactions with owners, recorded directly in equity					
Issue of ordinary shares (note 14(a))	30	57	-	-	87
Issue of non-redeemable preference shares (note 14 (b))	-	-	7,347	-	7,347
Total transactions with owners	**30**	**57**	**7,347**	**-**	**7,434**
Total comprehensive income					
Profit for the year	-	-	-	946	946
Total comprehensive income for the year	**-**	**-**	**-**	**946**	**946**
Balance as at 31 December 2018	**2,185**	**852**	**7,347**	**4,285**	**14,669**

*The Company has initially applied IFRS 9 at 1 January 2018. Under the transition methods chosen, comparative information is not restated (see Note 3(e)).

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

MFO Micro Business Capital (the "Company) was established in Georgia as Joint Stock Company on 6 December 2012. Its principal activities are credit operations, cash operations, and foreign exchange transactions. The Company's activities are regulated by the National Bank of Georgia (the NBG). The Company's registration number is 404967078.

The Company aims to provide customer-tailored and accessible financial services to micro and small businesses and farmers, increase availability of funds and loan products, maintain long-term and transparent relations with customers. JSC Microfinance Organisation - Micro Business Capital (MBC), as a socially responsible financial institution, aims to contribute to the sustainable economic growth of Georgia.

The Company's highest management body is the General Shareholders' Meeting. Company's activities are supervised by Supervisory Board, whose members are elected by General Shareholders' Meeting. Company's daily activities are carried out by company's Board of Directors, who are elected by the Supervisory Board.

The Company's registered office is 41 Tsintsadze Street, Tbilisi, Georgia.

The Company has 11 branches. All of its assets and liabilities are located in Georgia.

The Company is wholly owned by members of the Shareholder Group. There is no ultimate controlling party of the Company. As at 31 December the following shareholders owned shares of the Company and comprise the Shareholder Group:

	31 December 2018			**31 December 2017**	
	Percentage of total ordinary shares	**Number of ordinary shares**	**Number of preference shares**	**Percentage of total shares**	**Number of shares**
Gia Petriashvili	32.8%	716,000	200	33.2%	716,000
Otari Rukhadze	14.9%	325,000	800	15.1%	325,000
Murmani Ambroladze	8.2%	180,000	100	8.4%	180,000
Tengizi Maziashvili	9.6%	209,500	250	9.7%	209,500
Tarasi Nizharadze	8.5%	186,000	740	8.6%	186,000
Goderdzi Meladze	6.9%	150,000	300	7.0%	150,000
Giorgi Gotoshia	6.9%	150,000	100	7.0%	150,000
Giorgi Vachnadze	5.7%	123,500	110	5.7%	123,500
JB LLC	2.8%	60,000	200	2.7%	60,000
Giorgi Ghvaladze	1.2%	27,600	-	0.9%	19,000
Eteri Chachibaia	1.5%	33,000	-	1.0%	21,000
Tatia Jajanashvili	0.6%	15,000	-	0.7%	15,000
Nino Devdariani	0.4%	9,000	-	-	-
	100%	**2,184,600**	**2,800**	**100%**	**2,155,000**

Related party transactions are described in detail in note 18.

(b) Business environment

Georgian business environment

The Company's operations are located in Georgia. Consequently, the Company 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 Company. 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 Company's annual financial statements to which IFRS 9 *Financial Instruments and* IFRS 15 *Revenue from Contracts with Customers* 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 financial instruments at fair value through profit or loss are stated at fair value.

(c) Functional and presentation currency

The functional currency of the Company is the Georgian Lari (GEL) as, being the national currency of Georgia, it reflects the economic substance of the majority of underlying events and circumstances relevant to them.

The GEL is also the presentation currency for the purposes of these financial statements.

Financial information presented in GEL is rounded to the nearest thousand.

(d) Use of estimates and judgments

In preparing these financial statements, management has made judgement, estimates and assumptions that affect the application of the Company'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.

Judgements

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

- Applicable to 2018 only
  - classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding –Note 3(e)(i).
  - 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 – Note 4.

Assumptions and estimations uncertainty

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2018 is included in the following notes:

- Applicable to 2018 only
  - Impairment of financial instruments: determining inputs into the ECL measurement model, including incorporation of forward-looking information – Note 4.
- Applicable to 2018 and 2017
  - impairment of loans to customers – Note 3(e)(iv)

(e) Changes in accounting policies and presentation

The Company has initialy adopted IFRS 9 and IFRS 15 from 1 January 2018.

A number of other new standards are also effective from 1 January 2018 but they do not have a material effect on the Company's financial statements.

Due to the transition methods chosen by the Company in applying IFRS 9, comparative information throughout these financial statements has not been restated to reflect its requirements.

The effect of initially applying these standards is mainly attributed to the following:

- an decrease in impairment losses recognised on financial assets (see Note 5);
- additional disclosures related to IFRS 9 (see Notes 4 and 5);

A. IFRS 9 Financial instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 *Financial Instruments: Recognition and Measurement*. The requirements of IFRS 9 represent a significant change from IAS 39. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

As a result of the adoption of IFRS 9, the Company has applied consequential amendments to IAS 1 '*Presentation of Financial Statements*', which require separate presentation in the statement of profit or loss and other comprehensive income of interest revenue calculated using the effective interest method. Previously, the company disclosed this amount in notes to the financial statements.

Additionally, the Company has adopted consequential amendments to IFRS 7 '*Financial Instruments: Disclosures*' that are applied to disclosures about 2018 but have not been applied to the comparative information.

The key changes to the Company's accounting policies resulting from its adoption of IFRS 9 are summarised below.

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification. For an explanation of how the Company classifies financial assets under IFRS 9, see Note 3(e)(i).

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognised in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in other comprehensive income; and
- the remaining amount of change in the fair value is presented in profit or loss.

For an explanation of how the company classifies financial liabilities under IFRS 9, see Note 3(e)(i).

Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments.

Under IFRS 9, credit losses are recognised earlier than under IAS 39. For an explanation of how the company applies the impairment requirements of IFRS 9, see Note 3(e)(iv).

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below.

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings as at 1 January 2018. Accordingly, the information presented as at and for the year ended 31 December 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented as at and for the year ended 31 December 2018 under IFRS 9.

  The Company uses the exemption not to restate comparative periods but considering that the amendments made by IFRS 9 to IAS 1 introduced the requirement to present 'interest income calculated using the effective interest method' as a separate line in the statement of profit or loss and other comprehensive income, the company changed the description of the line item 'interest income' reported in 2017 to 'interest income calculated using the effective interest method'.

- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.

  – The determination of the business model within which a financial asset is held.

For more information and details on the changes and implications resulting from the adoption of IFRS 9, see Note 5.

B. IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaced IAS 18 '*Revenue*', IAS 11 '*Construction Contracts and related interpretations*'.

The Company has adopted IFRS 15 using the cumulative effect method (without practical expedients), with the effect of initially applying this standard recognised at the date of initial application (i.e. 1 January 2018). The timing or amount of the Company's fee and commission income from contracts with customers was not impacted by the adoption of IFRS 15 and the transition did not have the effect on the equity of the Company at 1 January 2018.

3 Significant accounting policies

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

(a) Foreign currency

(i) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currency 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 recognised in profit or loss.

(b) Interest

Policy applicable from 1 January 2018

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 Company 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 (or impairment allowance before 1 January 2018).

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. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest.

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)(iv).

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.

Policy applicable before 1 January 2018

Effective interest rate

Interest income and expense were recognised in profit or loss using the effective interest method. The effective interest rate was the rate that exactly discounted the estimated future cash payments and receipts through the expected life of the financial asset or financial liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Company estimated future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

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

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 amortized cost.

Interest expense presented in the statement of profit or loss and other comprehensive income includes 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)).

A contract with a customer that results in a recognised financial instrument in the Company'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 Company 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.

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

Fee and commission income in the Statement of Profit or Loss and Other Comprehensive income comprise fees from late payments of GEL 1,260 thousand for 2018 year (GEL 795 thousand for 2017) and other fees of GEL34 thousand for 2018 year (GEL 35 thousand for 2017).

(d) Taxation

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

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 is recognised 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 assets are recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Future taxable profits are determined based on the reversal of relevant taxable temporary differences. If the amount of taxable temporary differences is insufficient to recognise a deferred tax asset in full, then future taxable profits, adjusted for reversals of existing temporary differences, are considered, based on the business plan of the Company. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised; such reductions are reversed when the probability of future taxable profits improves.

Unrecognised deferred tax assets are reassessed at each reporting date and recognised to the extent that it has become probable that future taxable profits will be available against which they can be used.

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

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets and liabilities, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

In determining the amount of current and deferred tax the Company takes into account the impact of uncertain tax positions and whether additional taxes, penalties and late-payment interest may be due. The Company believes that its accruals for tax liabilities are adequate for all open tax years based on its assessment of many factors, including interpretations of tax law and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Company to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact the tax expense in the period that such a determination is made.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities until 1 January 2023, using tax rates enacted or substantially enacted at the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available until 1 January 2023 against which the temporary differences, unused tax losses and credits can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Due to the nature of the new taxation system described above, the financial institutions registered in Georgia will not have any differences between the tax bases of assets and their carrying amounts from 1 January 2023 and hence, no deferred income tax assets and liabilities will arise, there on.

(e) Financial assets and liabilities

(i) Classification

Financial assets – Policy applicable from 1 January 2018

On initial recognition, a financial asset is classified as measured at: amortised cost, fair value through other comprehensive income (“FVOCI”) or fair value through profit or loss (“FVTPL”).

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

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

For debt financial assets measured at FVOCI, gains and losses are recognised in other comprehensive income, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- interest income using the effective interest method;
- ECL and reversals; and
- foreign exchange gains and losses.

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 Company 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.

Business model assessment

The Company 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 Company'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 Company's stated objective for managing the financial assets is achieved and how cash flows are realised.

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 solely payments of principal and interest, the Company 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 Company considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Company'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.

Reclassification

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

Financial assets – Policy applicable before 1 January 2018

The Company classified its financial assets into one of the following categories:

- loans and receivables;
- held-to-maturity;
- available-for-sale; and
- at FVTPL, and within this category as:

– held for trading; or
– designated as at FVTPL.

As at 31 December 2017 all the financial assets of the Company were classified into loans and receivables category.

See note 5.

Financial liabilities

The Company classifies its financial liabilities, other than financial guarantees, as measured at amortised cost. See note 5.

Reclassification

Financial liabilities are not reclassified subsequent to their initial recognition.

(ii) Derecognition

Financial assets

The Company 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 Company 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.

Financial liabilities

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

(iii) Modification of financial assets and financial liabilities

Policy applicable from 1 January 2018

Financial assets

If the terms of a financial asset are modified, the Company 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.

Changes in cash flows on existing financial assets are not considered as modification, if they result from existing contractual terms, e.g. changes in interest rates initiated by the Company due to changes in the National Bank of Georgia ("NBG") key rate, if the loan agreement entitles the Company to do so.

The Company performs a quantitative and qualitative evaluation of whether the modification is substantial, i.e. whether the cash flows of the original financial asset and the modified or replaced financial asset are substantially different. The Company assesses whether the modification is substantial based on quantitative and qualitative factors in the following order: qualitative factors, quantitative factors, combined effect of qualitative and quantitative factors. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset deemed to have expired. In making this evaluation the Company analogizes to the guidance on the derecognition of financial liabilities.

The Company 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 Company 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 Company further performs qualitative evaluation of whether the modification is substantial.

If the modification of a financial asset measured at amortised cost does not result in derecognition of the financial asset, then the Company 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)(iv)), 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 Company 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.

Company performs a quantitative and qualitative evaluation of whether the modification is substantial considering qualitative factors, quantitative factors and combined effect of qualitative and quantitative factors. The Company 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.

Policy applicable before 1 January 2018

Financial assets

If the terms of a financial asset were modified, then the Company evaluated whether the cash flows of the modified asset were substantially different. If the cash flows were substantially different, then the contractual rights to cash flows from the original financial asset were deemed to have expired. In this case, the original financial asset was derecognised (see Note 3(e)(ii)) and a new financial asset was recognised at fair value.

If the terms of a financial asset were modified because of financial difficulties of the borrower and the asset was not derecognised, then impairment of the asset was measured using the pre-modification interest rate (see Note 3(e)(iv)).

Financial liabilities

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

If the modification of a financial liability was not accounted for as derecognition, then any costs and fees incurred were recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

(iv) Impairment

See also Note 4.

Policy applicable from 1 January 2018

The Company 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;
- financial guarantees contracts issued

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

- other financial instruments on which credit risk has not increased significantly since their initial recognition (see Note 4).

12-month ECLs are the portion of ECLs 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.

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised are referred to as 'Stage 2' financial instruments (if the credit risk has increased significantly since initial recognition, but the financial instruments are not credit-impaired) and 'Stage 3' financial instruments (if the financial instruments are credit-impaired).

Measurement of ECL

ECLs are a probability-weighted estimate of credit losses and 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 Company 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.
- *financial guarantee contracts:* the present value of the expected payments to reimburse the holder less any amounts that the Company expects to recover.

See also Note 4.

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 Company 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:

- Death of borrower;
- Loans past due more than 90 days;
- A default, initiation of bankruptcy proceedings (for business borrowers);
- Fraud from borrower side towards communication with the Company such as:
  - Provision of misleading information on financial results;
- Restructuring of the loan, linked with the economic or financial losses

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*: as a deduction from the gross carrying amount of the assets

Write-offs

Loans 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 Company 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 financial instruments' 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 Company's procedures for recovery of amounts due.

Policy applicable before 1 January 2018

The Company assesses at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the Company determines the amount of any impairment loss.

A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a loss event) and that event (or events) has had an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, breach of loan covenants or conditions, restructuring of financial asset or group of financial assets that the Company would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, deterioration in the value of collateral, or other observable data related to a group of assets such as adverse changes in the payment status of borrowers in the group, or economic conditions that correlate with defaults in the group.

(i) Financial assets carried at amortised cost

Financial assets carried at amortised cost consist principally of loans and other receivables (loans and receivables). The Company reviews its loans and receivables to assess impairment on a regular basis.

The Company first assesses whether objective evidence of impairment exists individually for loans and receivables that are individually significant, and individually or collectively for loans and receivables that are not individually significant. If the Company determines that no objective evidence of impairment exists for an individually assessed loan or receivable, whether significant or not, it includes the loan or receivable in a group of loans and receivables with similar credit risk characteristics and collectively assesses them for impairment. Loans and receivables that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on a loan or receivable has been incurred, the amount of the loss is measured as the difference between the carrying amount of the loan or receivable and the present value of estimated future cash flows including amounts recoverable from guarantees and collateral discounted at the loan or receivable's original effective interest rate. Contractual cash flows and historical loss experience adjusted on the basis of relevant observable data that reflect current economic conditions provide the basis for estimating expected cash flows.

In some cases the observable data required to estimate the amount of an impairment loss on a loan or receivable may be limited or no longer fully relevant to current circumstances. This may be the case when a borrower is in financial difficulties and there is little available historical data related to similar borrowers. In such cases, the Company uses its experience and judgment to estimate the amount of any impairment loss.

All impairment losses in respect of loans and receivables are recognised in profit or loss and are only reversed if a subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

When a loan is uncollectable, it is written off against the related allowance for loan impairment.
The Company writes off a loan balance (and any related allowances for loan losses) when management determines that the loans are uncollectible and when all necessary steps to collect the loan are completed.

(ii) Non-financial assets

Other non financial assets, other than deferred taxes, are assessed at each reporting date for any indications of impairment. The recoverable amount of non financial assets is the greater of their fair value less costs to sell and value in use.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. An impairment loss is recognised when the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

All impairment losses in respect of non financial assets are recognised in profit or loss and reversed only if there has been a change in the estimates used to determine the recoverable amount. Any impairment loss reversed is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(f) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand and unrestricted balances held with the banks, with original maturity less than 3 months. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(g) Loans to customers

Policy applicable from 1 January 2018

'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.

Policy applicable before 1 January 2018

Loans to customers were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market and that the Company did not intend to sell immediately or in the near term.

Loans to customers included those classified as loans and receivables.

Loans to customers were initially measured at fair value and subsequently measured at their amortised cost using the effective interest method.

(h) Financial guarantees

Financial guarantees are contracts that require the Company to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument.

Financial guarantees issued are initially measured at fair value. Subsequently, they are measured as follows:

- *from 1 January 2018:* at the higher of the loss allowance determined in accordance with IFRS 9 (see Note 3(f)(iv)) and the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15; and
- *before 1 January 2018:* at the higher the amount representing the initial fair value amortised over the life of the guarantee or the commitment and the present value of any expected payment to settle the liability when a payment under the contract has become probable.

Liabilities arising from financial guarantees are included within other liabilities.

(i) Property and equipment

(i) Owned assets

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

(ii) Depreciation

Depreciation is charged to profit or loss on a straight-line basis over the estimated useful lives of the individual assets. Depreciation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Land is not depreciated.

The estimated useful lives are as follows:

- Buildings 40 years;
- Furniture and equipment 5 years; and
- Leasehold improvements 7 years;

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

(j) Intangible assets

Acquired intangible assets are stated at cost less accumulated amortization and impairment losses.

Amortisation is charged to profit or loss on a straight-line basis over the estimated useful lives of intangible assets. The estimated useful lives are 5 years.

(k) Share capital

(i) Ordinary shares

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

(ii) Preference share capital

Preference share capital that is non-redeemable with discretionary dividends is classified as equity.

(iii) Dividends

The ability of the Company to declare and pay dividends is subject to the rules and regulations of Georgian legislation.

Dividends in relation to ordinary shares are reflected as an appropriation of retained earnings in the period when they are declared.

Dividends in relation to preference shares are reflected as an appropriation of retained earnings in the period when they are approved by Annual General Meeting in each given year.

(l) Fair value measurement principles

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Company has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Company measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

When there is no quoted price in an active market, the Company uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all the factors that market participants would take into account in these circumstances.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price, i.e., the fair value of the consideration given or received. If the Company determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument, but no later than when the valuation is supported wholly by observable market data or the transaction is closed out.

(m) Comparative information

As a result of adoption of IFRS 9 the Company changed presentation of certain captions in the primary forms of financial statements. Comparative information is reclassified to conform to changes in presentation in the current period.

The effect of main changes in presentation of the statement of financial position is disclosed in Note 5.

The effect of main changes in presentation of the statement of profit or loss and other comprehensive income for the year ended 31 December 2017 is as follows:

- "Interest income" line item was renamed by "Interest income calculated using the effective interest method" line item;
- "Impairment losses" line item was renamed by "Impairment losses on debt financial assets" line item.

(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 2019 with earlier application permitted;

IFRS 16 Leases

IFRS 16 replaces 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*.

The standard is effective for annual periods beginning on or after 1 January 2019. Early adoption is permitted for entities that apply IFRS 15 at or before the date of initial application of IFRS 16.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. 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 are recognition exemptions for short-term leases and leases of low value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases.

The Company has completed an initial assessment of the potential impact on its financial statements but has not yet completed its detailed assessment. The actual impact of applying IFRS 16 on the financial statements in the period of initial application will depend on future economic conditions, including the Company's borrowing rate at 1 January 2019, the composition of the Company's lease portfolio at that date, the Company's latest assessment of whether it will exercise any lease renewal options and the extent to which the Company chooses to use practical expedients and recognition exemptions.

So far, the most significant impact identified is that the Company will recognise new assets and liabilities for its operating leases of office buildings. The Company is assessing the potential impact on its financial statements resulting from the application of IFRS 16. Based on the preliminary assessment application of IFRS 16 will have significant effect on the Company's financial statements.

In addition, the nature of expenses related to those leases will now change as IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and interest expense on lease liabilities.

i. Transition

As a lessee, the Company can either apply the standard using a:

- retrospective approach; or
- modified retrospective approach with optional practical expedients.

The lessee applies the election consistently to all of its leases.

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

When applying the modified retrospective approach to leases previously classified as operating leases under IAS 17, the lessee can elect, on a lease-by-lease basis, whether to apply a number of practical expedients on transition. The Company is assessing the potential impact of using these practical expedients.

The Company is not required to make any adjustments for leases in which it is a lessor except where it is an intermediate lessor in a sub-lease.

Other standards

The following amended standards and interpretations are not expected to have a significant impact on the Company's financial statements:

– IFRIC 23 *Uncertainty over Tax Treatments*;
– *Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28);*
– *Plan Amendment, Curtailment or Settlement (Amendments to IAS 19);*
– *Annual Improvements to IFRS Standards 2015-2017 Cycle – various standards;*
– *Amendments to References to Conceptual Framework in IFRS Standards.*

4 Financial risk review

This note presents information about the Company's exposure to financial risks. For information on the Company's financial risk management framework, see Note 15.

Credit risk – Amounts arising from ECL

Inputs, assumptions and techniques used for estimating impairment

See accounting policy in Note 3(f)(iv).

Significant increase in credit risk

When determining whether the credit risk (i.e. risk of default) on a financial instrument has increased significantly since initial recognition, the Company considers reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information and analysis based on the Company's historical experience, expert credit assessment and forward-looking information.

The Company uses the following criteria for determining whether there has been a significant increase in credit risk:

- The exposure is overdue for more than 30 days; and
- Its financial standing deteriorated and the exposure has been restructured;

Generating the term structure of PD

Loans to customers

Modelling of probability of default of loans to customers 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.

Determining whether credit risk has increased significantly

The Company assesses whether credit risk has increased significantly since initial recognition at each reporting period. Definition of what is significant varies for different type of lending.

The Company has established a framework that incorporates backstop indicators based on delinquency and qualitative information to determine whether the credit risk on a particular financial instrument has increased significantly since initial recognition. The framework aligns with the Company's internal credit risk management process. The criteria for determining whether credit risk has increased significantly will vary by portfolio and will include a backstop based on delinquency. In certain instances, using its expert credit judgement and, where possible, relevant historical experience, the Company may determine that an exposure has undergone a significant increase in credit risk if particular qualitative factors indicate so and those indicators may not be fully captured by its backstop indicators on a timely basis.

Below are the description of indicators of significant increase in credit risk

- Loan being past due more than 30 days;
- Restructuring of exposures not linked with the economic or financial losses;
- Loss of job by the borrower;
- Borrower is unfit for work due to health issue;
- Fraud in the borrowers business;

As a backstop, the Company presumptively considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. The Company determines days past due by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received.

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 to being measured as 12-month ECL.

The Company 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 ECL (stage 1) and lifetime ECL measurements (stage 2).

Definition of default

The Company considers loan to be in default if any of the following criteria are met:

- Loans past due more than 90 days,
- Death of the borrower;

- Initiation of bankruptcy proceedings (if legal entities); or
- Fraud from borrower side or other force-majeure that may affect borrower's ability to repay the loan.

Incorporation of forward-looking

The Company incorporates forward-looking information into its measurement of ECLs. This assessment is based also on external information. External information may include economic data and forecasts published by governmental bodies and monetary authorities in the countries where the Company operates, such as the National Bank of Georgia.

The Company has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro-economic variable and probabilities of default. This key driver is GDP forecasts. Predicted relationships between the key indicator and default and loss rates of loan portfolios have been developed based on analysing historical data over the past 5 years.

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)(iii).

The Company renegotiates loans to customers in financial difficulties (referred to as 'forbearance activities') to maximise collection opportunities and minimise the risk of default. Under the Company's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms. Restructured loans are transferred to stage 2 and lifetime ECL is applied.

The revised terms usually include extending the maturity and changing the timing of interest payments.

Measurement of ECLs

The key inputs into the measurement of ECLs are the term structures of the following variables:

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

These parameters are derived from internally developed statistical models and other historical data that leverage regulatory models. They are adjusted to reflect forward-looking information as described below.

PD estimates are estimates at a certain date, which are calculated based on monthly historical migration of the loan segments through delinquency buckets. Migration matrices are further extrapolated to derive 1 year and lifetime PDs.

LGD is the magnitude of the likely loss if there is a default. The Company estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. Recovery rates are calculated on a discounted cash flow basis using the effective interest rate as the discounting factor.

EAD represents the expected exposure in the event of a default. The Company derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract, including amortisation, and prepayments. The EAD of a financial asset is the gross carrying amount at default.

Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics that include:

- product type;
- collateral type;

The groupings are subject to regular reviews to ensure that exposures within a particular group remain appropriately homogeneous.

Loss allowance

The following tables show reconciliations from the opening to the closing balances of the loss allowance by class of loans to customers. Comparative amounts for 2017 represent allowance account for credit losses and reflect measurement basis under IAS 39.

	2018				2017
GEL'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Total**
Loans to customers at amortised cost					
Balance at 1 January	176	65	124	365	639
Transfer to Stage 1	2	(2)	-	-	-
Transfer to Stage 2	(1)	1	-	-	-
Transfer to Stage 3	(2)	-	2	-	-
Net remeasurement of loss allowance	450	79	31	560	743
New financial assets originated	1,313	-	-	1,313	-
Transfer to stage 2	(149)	149	-	-	-
Transfer to stage 3	(835)	-	835	-	-
Write-offs	(553)	(114)	(747)	(1,414)	(432)
Balance at 31 December	**401**	**178**	**245**	**824**	**950**

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

GEL'000	**Loans to customers at amortised cost**
Net remeasurement of loss allowance	560
New financial assets originated	1,313
Subtotal	**1,873**
Recoveries of amounts previously written off	(350)
Total	**1,523**

The significant changes in the gross carrying amount of the loans measured at amortized cost contributed to changes in loss allowance are further explained below.

The high volume of loans originated during the period increased the gross carrying amount of the loans portfolio by GEL 38,776 thousand with a corresponding increase in loss allowance measured on a 12-month basis by GEL 1,313 thousand. The loans originated and repaid during the period amount GEL 25,448 thousand with a corresponding decrease in loss allowance measured on a 12-month basis by GEL 161 thousand.

Credit quality analysis

Information on the analysis of credit quality of Loans to customers is given in the note 10 (a). Explanation of the terms: Stage 1, Stage 2, Stage 3, are included in Note 3(f)(iv).

The following table sets out information on loans to customers that are credit-impaired and related collateral held in order to mitigate potential losses as at 31 December 2018:

GEL	Gross carrying amount	Loss allowance	Carrying amount	Fair value of collateral held: Real estate	Vehicles	Precious metals	Total
Consumption	274	(121)	153	89	62	2	153
Services	157	(67)	90	61	29	-	90
Trade	127	(57)	70	47	23	-	70
Total credit-impaired loans to customers	**558**	**(245)**	**313**	**197**	**114**	**2**	**313**

During the period, there was no change in the Company's collateral policies. For details, refer to Note 10(c).

5 Transition to IFRS 9

Classification of financial assets and financial liabilities on the date of initial application of IFRS 9

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

GEL'000	Note	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Financial assets					
Cash and cash equivalents	9	Loans and receivables	Amortised cost	1,134	1,134
Loans to customers	10	Loans and receivables	Amortised cost	33,464	34,049
Other financial asset (included in other assets)		Loans and receivables	Amortised cost	1,429	1,429
Total financial assets				**36,027**	**36,612**
Financial liabilities					
Subordinated borrowings and other borrowed funds	13	Amortised cost	Amortised cost	31,946	31,946
Other financial liabilities		Amortised cost	Amortised cost	411	411
Total financial liabilities				**32,357**	**32,357**

The following table reconciles the carrying amounts under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 on 1 January 2018.

GEL'000	IAS 39 carrying amount 31 December 2017	Remeasurement	IFRS 9 carrying amount 1 January 2018
Financial assets			
Amortised cost			
Cash and cash equivalents	1,134	-	1,134
Loans to customers:			
Opening balance	33,464	-	-
Remeasurement	-	585	-
Closing balance	-	-	34,049
Other financial asset (included in other assets)	1,429	-	1,429
Total amortised cost	**36,027**	**585**	**36,612**

As a result of adoption of IFRS 9 there were no reclassification or remeasurement of financial liabilities.

The following table summarises the impact, of transition to IFRS 9 on the opening balance of retained earnings. There is no impact on other components of equity.

GEL'000	Impact of adopting IFRS 9 at 1 January 2018
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	2,754
Recognition of expected credit losses under IFRS 9 for loans to customers	585
Opening balance under IFRS 9 (1 January 2018)	**3,339**

The following table reconciles:

- the closing impairment allowance for financial assets in accordance with IAS 39 as at 31 December 2017; to
- the opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2018.

	Impairment allowance and provisions			
GEL'000	31 December 2017 (IAS 39)	Reclassification	Remeasurement	1 January 2018 (IFRS 9)
Loans to customers	950	-	(585)	365
Total measured at amortised cost	**950**	**-**	**(585)**	**365**

6 Net interest income

	2018 GEL'000	2017 GEL'000
Interest income calculated using the effective interest method		
Loans to customers	11,283	8,241
Placements with banks	1	2
	11,284	**8,243**
Interest expense		
Borrowings from legal entities	(2,043)	(678)
Borrowings from individuals	(1,848)	(2,239)
Other borrowings	(281)	(522)
	(4,172)	**(3,439)**

7 General administrative expenses

	2018 GEL'000	2017 GEL'000
Advertising and marketing	529	438
Rent	485	414
Depreciation and amortisation	251	189
Consulting	142	115
Mortgage insurance	117	-
Bank charges	111	48
Application inspection	70	35
Office supplies	63	74
Utilities	60	50
Communication	50	35
Security	38	32
Tax expense other than income tax	13	7
Other	166	108
	2,095	**1,545**

For 2018, professional fees paid to the audit firm for the provision of audit and other professional services comprised GEL 97 thousand (2017: GEL 66 thousand).

8 Income tax expense

	2018 GEL'000	2017 GEL'000
Current year tax expense	361	170
Movement in deferred tax assets and liabilities due to origination and reversal of temporary differences	(179)	(19)
Total income tax expense	**182**	**151**

In 2018, the applicable tax rate for current and deferred tax is 15% (2017: 15%).

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

	2018 GEL'000	%	2017 GEL'000	%
Profit before income tax	1,128		896	
Income tax at the applicable tax rate	169	15	134	15
Non-deductible costs	13	1	17	2
	182	**16**	**151**	**17**

(a) 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 assets as at 31 December 2018 and 2017. Future tax benefits will only be realised if profits will be available against which unused tax losses can be utilised and there are no changes to the law and regulations that adversely affect the Company's ability to claim deductions in future periods.

Movements in temporary differences during the years ended 31 December 2018 and 2017 are presented as follows.

2018 GEL'000	**Balance 1 January 2018**	**Recognized in profit or loss**	**Balance 31 December 2018**
Loans to customers	214	143	357
Property and equipment	(127)	17	(110)
Intangible assets	1	18	19
Other assets	15	(15)	-
Subordinated borrowings and other borrowed funds	20	10	30
Other liabilities	44	6	50
	167	**179**	**346**

2017 GEL'000	**Balance 1 January 2017**	**Recognized in profit or loss**	**Balance 31 December 2017**
Loans to customers	133	81	214
Property and equipment	(40)	(87)	(127)
Intangible assets	(1)	2	1
Other assets	10	5	15
Subordinated debt and other borrowings	12	8	20
Other liabilities	34	10	44
	148	**19**	**167**

9 Cash and cash equivalents

	2018 GEL'000	2017 GEL'000
Cash on hand	1,173	818
Accounts with banks		
- rated BB-	598	316
Total cash and cash equivalents	**1,771**	**1,134**

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

10 Loans to customers

Comparative Information

Comparative information is reclassified to conform to the presentation of 2018. The Company has changed presentation in 2018 of loans to customers and presented them on the basis of loan purposes, whereas in 2017 loans were presented by type of underlying collateral and separately shown business loan. The Company believes that such classification reflect more accurate disclosure of loans to customers. Movements in the gross amounts of loans to customers measured at amortized as at 31 December 2017 from previous year presentation to current year presentation are as follows:

	Gross amount as at 31 December 2017 per previous year Financial Statement					
Loans to customers	**Collateralized by real estate**	**Business loans**	**Collateralized by vehicles**	**Collateralized by precious metals**	**Loans without collateral**	**Total**
Loan Purpose						
Farming/agro-activities	249	358	20	-	3	**630**
Production/construction	379	199	36	-	-	**614**
Services	3,392	1,519	841	50	3	**5,805**
Trade	3,174	6,817	400	4	8	**10,403**
Consumption	9,338	-	3,144	589	333	**13,404**
Housing	3,377	-	181	-	-	**3,558**
Total loans to customers	**19,909**	**8,893**	**4,622**	**643**	**347**	**34,414**

	2018 GEL'000	2017 GEL'000
Loans to customers		
Consumption	18,977	13,404
Trade	14,456	10,403
Services	9,507	5,805
Housing	4,720	3,558
Farming/agro-activities	939	630
Production/construction	573	614
Total gross loans to customers	**49,172**	**34,414**
Credit loss allowance	(824)	(950)
Net loans to customers	**48,348**	**33,464**

Movements in the credit loss allowance of loans to customers measured at amortized are as follows:

Loan loss allowance	2018 GEL'000	2017 GEL'000
Balance at the beginning of the year	950	639
Adjustment on initial application of IFRS 9	(585)	-
Balance as at 1 January after application of IFRS 9	365	639
Net charge	1,523	601
Write-offs	(1,414)	(432)
Recoveries	350	142
Balance at the end of the year	**824**	**950**

(a) Credit quality of loans to customers

The following table provides information on the credit quality of loans to customers as at 31 December 2018:

	31 December 2018				31 December 2017
	Stage 1 GEL'000	Stage 2 GEL'000	Stage 3 GEL'000	Total GEL'000	Total GEL'000
Loans to customers					
Farming/agro-activities					
- not overdue	875	15	-	890	557
- overdue less than 30 days	49	-	-	49	73
Total loans Farming/agro-activities	**924**	**15**	**-**	**939**	**630**
Loss allowance	**(8)**	**-**	**-**	**(8)**	**(20)**
Carrying amount	**916**	**15**	**-**	**931**	**610**
Production/construction					
- not overdue	573	-	-	573	611
- overdue 30-89 days	-	-	-	-	3
Total Production/construction	**573**	**-**	**-**	**573**	**614**
Loss allowance	**(3)**	**-**	**-**	**(3)**	**(12)**
Carrying amount	**570**	**-**	**-**	**570**	**602**
Services					
- not overdue	8,607	60	-	8,667	5,571
- overdue less than 30 days	497	-	-	497	124
- overdue 30-90 days	-	186	-	186	10
- overdue 91-179 days	-	-	157	157	100
Total Services	**9,104**	**246**	**157**	**9,507**	**5,805**
Loss allowance	**(77)**	**(43)**	**(67)**	**(187)**	**(173)**
Carrying amount	**9,027**	**203**	**90**	**9,320**	**5,632**
Trade					
- not overdue	13,699	47	-	13,746	9,758
- overdue less than 30 days	457	12	-	469	383
- overdue 30-90 days	-	114	-	114	222
- overdue 91-179 days	-	-	112	112	40
- overdue more than 180 days	-	-	15	15	-
Total Trade	**14,156**	**173**	**127**	**14,456**	**10,403**
Loss allowance	**(116)**	**(26)**	**(57)**	**(199)**	**(278)**
Carrying amount	**14,040**	**147**	**70**	**14,257**	**10,125**
Consumption					
- not overdue	17,447	277	-	17,724	12,977
- overdue less than 30 days	519	52	-	571	189
- overdue 30-90 days	-	408	-	408	129
- overdue 91-179 days	-	-	274	274	109
Total Consumption	**17,966**	**737**	**274**	**18,977**	**13,404**
Loss allowance	**(177)**	**(99)**	**(121)**	**(397)**	**(375)**
Carrying amount	**17,789**	**638**	**153**	**18,580**	**13,029**
Housing					
- not overdue	4,511	78	-	4,589	3,517
- overdue less than 30 days	82	-	-	82	27
- overdue 30-90 days	-	49	-	49	14
Total Housing	**4,593**	**127**	**-**	**4,720**	**3,558**
Loss allowance	**(20)**	**(10)**	**-**	**(30)**	**(92)**
Carrying amount	**4,573**	**117**	**-**	**4,690**	**3,466**

(b) Key assumptions and judgments for estimating loan impairment

Key assumptions used by the Company 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).

Change in these estimate by 10% increase/decrease could affect the expected credit loss on loans to customers for 2018 as follows:

- probability of default (PD) – GEL 58 thousand;
- loss given default (LGD) – GEL 80 thousand;
- exposure at default (EAD) – GEL 58 thousand.

(c) Analysis of collateral and other credit enhancements

The general creditworthiness of a customer tends to be the most relevant indicator of credit quality of the loan extended to it. However, collateral provides additional security and the Company generally requests borrowers to provide it.

As at 31 December 2018 loans to customers of GEL 35,773 thousand (31 December 2017: GEL 26,588 thousand) were collateralized by real estate. The Company's policy is to issue loans collateralized with real estate with a loan-to-value ratio at the date of loan issuance of a maximum of 60%.

For certain loans collateralized by real estate the Company updates the appraised values of collateral obtained at inception of the loan to the current values, taking into account the approximate changes in property values. The Company may also obtain a specific individual valuation of collateral at each reporting date where there are indications of impairment. For the remaining loans collateralized by real estate the fair value of collateral was estimated at inception of the loans and was not adjusted for subsequent changes to the reporting date.

Loans collateralized by vehicles are secured by the underlying cars. The Company's policy is to issue loans collateralized by vehicles with a loan-to-value ratio at the date of loan issuance of a maximum of 80%.

Loans collateralized by precious metals are collateralized by underlying precious metals. The Company's policy is to issue loans collateralized by precious metals with a loan-to-value ratio at the date of loan issuance of a maximum of 90%.

Following table provides information on the collateral, securing the loan portfolio, net of impairment:

GEL'000 At 31 December 2018	Real estate	Vehicles	Precious metals	No collateral	Total
Farming/agro-activities	864	67	-	-	931
Production/construction	525	45	-	-	570
Services	6,164	3,112	44	-	9,320
Trade	11,309	2,914	2	32	14,257
Consumption	12,361	5,538	240	441	18,580
Housing	4,550	140	-	-	4,690
Total	**35,773**	**11,816**	**286**	**473**	**48,348**

GEL'000 At 31 December 2017	Real estate	Vehicles	Precious metals	No collateral	Total
Farming/agro-activities	542	65	-	3	610
Production/construction	539	63	-	-	602
Services	4,387	1,193	49	3	5,632
Trade	8,728	1,385	4	8	10,125
Consumption	9,104	3,059	546	320	13,029
Housing	3,288	178	-	-	3,466
Total	**26,588**	**5,943**	**599**	**334**	**33,464**

(d) Geographical analysis of the loan portfolio

Loans to customers were issued to customers located within Georgia.

(e) Collateral

In 2018 loan portfolio in the amount of GEL 31,607 thousands (2017: GEL 15,303 thousands) is pledged against secured bank loans.

11 Property and equipment

GEL'000	Land and buildings	Furniture and equipment	Leasehold improvements	Total
Cost				
Balance at 1 January 2018	755	649	280	1,684
Additions	428	268	88	784
Write off	-	(6)	(43)	(49)
Balance at 31 December 2018	**1,183**	**911**	**325**	**2,419**
Depreciation				
Balance at 1 January 2018	(2)	(226)	(93)	(321)
Depreciation for the year	(14)	(127)	(44)	(185)
Write off	-	-	20	20
Balance at 31 December 2018	**(16)**	**(353)**	**(117)**	**(486)**
Carrying amount				
At 31 December 2018	**1,167**	**558**	**208**	**1,933**

GEL'000	Land and buildings	Furniture and equipment	Leasehold improvements	Total
Cost				
Balance at 1 January 2017	-	382	257	639
Additions	755	267	23	1,045
Balance at 31 December 2017	**755**	**649**	**280**	**1,684**
Depreciation				
Balance at 1 January 2017	-	(128)	(52)	(180)
Depreciation for the year	(2)	(98)	(41)	(141)
Balance at 31 December 2017	**(2)**	**(226)**	**(93)**	**(321)**
Carrying amount				
At 31 December 2017	**753**	**423**	**187**	**1,363**

12 Other assets

	2018 GEL'000	2017 GEL'000
Repossessed assets	318	124
Cash collateral pledged under the credit line agreement	470	1,282
Other receivables	80	147
Prepayments	152	1
Total other assets	**1,020**	**1,554**

Analysis of movements in repossessed assets

Movements in the repossessed assets for the year ended 31 December 2018 and 2017 are as follows:

	2018 GEL'000	2017 GEL'000
Repossessed assets at the beginning of the year	**124**	**91**
Additions	194	66
Impairment charge	-	(33)
Repossessed assets at the end of the year	**318**	**124**

13 Subordinated borrowings and other borrowed funds

	2018 GEL'000	2017 GEL'000
Principal	38,121	31,755
Accrued interest	308	191
	38,429	**31,946**

GEL'000	Currency	Nominal interest rate	Year of maturity	31 December 2018 Face value	Carrying amount
Secured loans from financial institutions	USD	7%-8%	2020-2027	6,209	6,209
Secured loans from financial institutions	GEL	13%-16%	2019-2020	16,555	16,555
Secured loans from financial institution	GEL	Monetary Policy Rate +1%	2020	466	466
Unsecured subordinated loans from related parties	USD	10.5%-12.5%	2021-2024	3,913	3,913
Unsecured loans from related parties	USD	5%-12%	2019-2024	3,853	3,853
Unsecured loan from related party	USD	3.5%	2019	455	455
Unsecured loans from related parties	GEL	9.5%-16%	2019-2020	188	188
Unsecured loans from related parties	EUR	3%-7.5%	2019	150	150
Unsecured loans from individuals	USD	6%-12.5%	2019-2021	5,179	5,179
Unsecured loans from individuals	GEL	16.5%-17.5%	2019	112	112
Unsecured loans from individuals	EUR	7.5%	2019	16	16
Unsecured loans from other legal entities	USD	8.75%	2020	817	817
Unsecured loans from other legal entities	GEL	15.25%	2020	516	516
				38,429	**38,429**

GEL'000	Currency	Nominal interest rate	Year of maturity	31 December 2017 Face value	Carrying amount
Secured loans from financial institutions	USD	7.50%	2027	519	519
Secured loans from financial institutions	GEL	14%-16%	2018-2020	7,608	7,608
Secured loans from financial institution	GEL	Monetary Policy Rate +1%	2018	1,176	1,176
Unsecured subordinated loans from related parties	USD	12.5%	2021-2023	4,991	4,991
Unsecured loans from related parties	USD	6.25%-13%	2018-2019	9,770	9,770
Unsecured loans from related parties	USD	3.25%	2018	519	519
Unsecured loans from related parties	GEL	16%	2018	36	36
Unsecured loans from individuals	EUR	7.5%-11%	2018-2019	94	94
Unsecured loans from individuals	USD	6.25%-13%	2018-2019	5,953	5,953
Unsecured loans from individuals	GEL	15%-20%	2018-2019	202	202
Unsecured loans from other legal entities	EUR	6%-7.5%	2018	113	113
Unsecured loans from other legal entities	USD	11%-12%	2018	965	965
				31,946	**31,946**

During 2018 other borrowed funds of GEL 1,208 thousand were converted into preference shares (see note 14(b)).

(a) Subordinated borrowings

As at 31 December 2018, subordinated borrowings in the amount of GEL 3,913 thousand (2017: GEL 4,991 thousand) comprise loans received from shareholders maturing in 2021-2024 (2017: 2021-2023) and carry an annual interest rate of 10.5% and 12.5 % (2017: 12.5%). In case of bankruptcy, the repayment of the subordinated borrowings will be made after repayment in full of all other liabilities of the Company.

During 2018, subordinated borrowings of GEL 5,028 thousand were converted into preference shares (see note 14(b)).

(b) Covenants

The Company has complied with all the financial covenants stipulated by lending agreements as of 31 December 2018 and 31 December 2017.

(c) Collateral

In 2018 immovable properties with carrying amount of GEL 816 thousand (2017: GEL 420 thousands) are pledged against secured bank loans. Loan portfolio in the amount of GEL 31,607 thousands (2017: GEL 15,303 thousand) is pledged against secured bank loans. GEL 470 thousands (207: GEL 1,282 thousands) represents cash collateral of loans from financial institution.

(d) Reconciliation of movements of liabilities and equity items to cash flows arising from financing activities

GEL'000	**Subordinated borrowings**	**Other borrowed funds**	**Share Capital**	**Share premium**	**Preference shares**	**Total**
Balance at 1 January 2018	4,991	26,955	2,155	795	-	34,896
Changes from financing cash flows						
Proceeds	3,698	69,246	30	57	1,111	74,142
Repayment	-	(61,067)	-	-	-	(61,067)
Total changes from financing cash flows	**3,698**	**8,179**	**30**	**57**	**1,111**	**13,075**
The effect of changes in foreign exchange rates	**170**	**566**	**-**	**-**	**-**	**736**
Other changes						
Interest expense	555	3,617	-	-	-	4,172
Interest paid	(473)	(3,593)	-	-	-	(4,066)
Conversion of borrowing funds	(5,028)	(1,208)	-	-	6,236	-
Balance at 31 December 2018	**3,913**	**34,516**	**2,185**	**852**	**7,347**	**48,813**

GEL'000	**Subordinated borrowings**	**Other borrowed funds**	**Share Capital**	**Share premium**	**Total**
Balance at 1 January 2017	2,338	24,862	2,100	719	30,019
Changes from financing cash flows					
Proceeds	2,676	47,608	55	76	50,415
Repayment	-	(45,290)	-	-	(45,290)
Total changes from financing cash flows	**2,676**	**2,318**	**55**	**76**	**5,125**
The effect of changes in foreign exchange rates	**(32)**	**(216)**	**-**	**-**	**(248)**
Other changes					
Interest expense	371	3,068	-	-	3,439
Interest paid	(362)	(3,077)	-	-	(3,439)
Balance at 31 December 2017	**4,991**	**26,955**	**2,155**	**795**	**34,896**

14 Share capital and reserves

(a) Issued capital

The authorised, issued and outstanding share capital comprises 2,184,600 ordinary shares (2017: 2,155,000). All shares have a nominal value of GEL 1. During 2018, 29,600 ordinary shares (2017: 55,000) were issued.

Difference between nominal value and market price is recognized in share premium. Share premium comprises GEL 852 thousand as at 31 December 2018 (31 December 2017: GEL 795 thousand).

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at annual and general meetings of the Company.

(b) Preference shares

During 2018, the Company issued 2,800 non-redeemable preference shares with nominal value USD 1,000 (2017: nil). The Dividend rate on the preference shares is 12.5% per annum, payable semi-annually, subject to the Annual General Meeting (AGM) approval in each given year. The ability to pay dividends is subject to the Company’s financial condition and results of operations and other factors considered by Annual General Meeting.

According the Charter of the Company, if based on the decision of AGM dividends on preference shares will not be paid two times in a row or dividend rate will be decreased, the holder of the preference shares has right to convert its preference shares into ordinary shares.

During 2018 subordinated borrowings of GEL 5,028 thousand and other borrowed funds of GEL 1,208 thousand were converted into preference shares, rest of the funds were received by the Company in cash (note 13).

(c) Externally imposed capital requirements

In accordance with the existing legislation of Georgia, the Company has to maintain issued capital of not less than GEL 1,000 thousand. The Company was in compliance with this requirement at 31 December 2018 and 2017.

(d) Dividends

Dividends payable are restricted to the maximum retained earnings of the Company, which are determined according to Georgian legislation. No ordinary or preference dividends were declared by the Company during 2018 and up to date of preparation of these financial statements.

15 Risk management, corporate governance and internal control

(a) Corporate governance framework

The Company is established as a joint stock company in accordance with Georgian law. The supreme governing body of the Company is the general shareholders’ meeting that is called for annual or extraordinary meetings. The general shareholders’ meeting makes strategic decisions on the Company’s operations.

The general shareholders’ meeting elects the Supervisory Board. Supervisory Board is responsible for Companys’ supervision and elects the Board of Directors. The Board of Directors is responsible for overall governance of the Company's activities.

Georgian legislation and the charter of the Company establish lists of decisions that are exclusively approved by the general shareholders’ meeting and that are approved by the Management Board.

As at 31 December 2018 the Management Board includes:

Gia Petriashvili – Chairman of the Management Board and General Director
Giorgi Ghvaladze – Director of Credit Department
Eter Chachibaia – Director of Operations
Tatia Jajanashvili – Director of Finance Department
Nino Devdariani – Director of Risk Management Department

General activities of the Company are managed by the sole executive body of the Company (the Management Board). The Supervisory Board elects the General Director and the Management Board. The Management Board of the Company is responsible for implementation of decisions of the general shareholders' meeting. The Management Board of the Company report to the supervisory board and general shareholders' meeting.

(b) Risk management policies and procedures

Management of risk is fundamental to the business of the Company and forms an essential element of the Company's operations. The major (significant) risks faced by the Company are those related to market risk, credit risk, liquidity risk, operational risk, legal and reputational risks.

The risk management policies aim to identify, analyse and manage the risks faced by the Company, to set appropriate risk limits and controls, and to continuously monitor risk levels and adherence to limits. Risk management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and emerging best practice.

The Board of Directors has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing its risk management policies and procedures as well as approving significantly large exposures.

The Management Board is responsible for monitoring and implementing risk mitigation measures, and ensuring that the Company operates within established risk parameters.

The management bodies of the Company have responsibility for controlling the Company's compliance with risk limits and capital adequacy ratios as established by the Company's internal documentation and regulatory bodies.

Both external and internal risk factors are identified and managed throughout the organisation. Particular attention is given to identifying the full range of risk factors and determining the level of assurance over current risk mitigation procedures. Apart from the standard credit and market risk analysis, the Management Board monitors financial and non-financial risks by holding regular meetings with operational units in order to obtain expert judgments in their respective areas of expertise.

(c) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises currency risk, interest rate risk and other price risks. Market risk arises from open positions in interest rate, which are exposed to general and specific market movements and changes in the level of volatility of market prices and foreign currency rates. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

The Company manages its market risk by setting open position limits in relation to financial instruments, interest rate maturity and currency positions. These are monitored on a regular basis and reviewed and approved by the Management Board.

(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. The Company is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes, but may also reduce or create losses in the event that unexpected movements occur.

Interest rate gap analysis

Interest rate risk is managed principally through monitoring interest rate gaps. A summary of the interest gap position for major financial instruments is as follows:

GEL'000	Less than 3 months	3-12 months	1-5 years	More than 5 years	Carrying amount
31 December 2018					
ASSETS					
Cash and cash equivalents	1,771	-	-	-	1,771
Loans to customers	4,234	9,218	34,228	668	48,348
Other financial assets	80	-	470	-	550
	6,085	**9,218**	**34,698**	**668**	**50,669**
LIABILITIES					
Subordinated borrowings	97	-	3,816	-	3,913
Other borrowed funds	5,288	6,499	18,429	4,300	34,516
Other financial liabilities	84	286	-	-	370
	5,469	**6,785**	**22,245**	**4,300**	**38,799**
	616	**2,433**	**12,453**	**(3,632)**	**11,870**
31 December 2017					
ASSETS					
Cash and cash equivalents	1,134	-	-	-	1,134
Loans to customers	3,227	6,408	18,737	5,092	33,464
Other financial assets	-	1,429	-	-	1,429
	4,361	**7,837**	**18,737**	**5,092**	**36,027**
LIABILITIES					
Subordinated borrowings	2	9	1,961	3,020	4,992
Other borrowed funds	5,299	16,616	4,729	310	26,954
Other financial liabilities	148	263	0	0	411
	5,449	**16,888**	**6,690**	**3,330**	**32,357**
	(1,088)	**(9,051)**	**12,047**	**1,762**	**3,670**

Average effective interest rates

The table below displays average effective interest rates for interest-bearing assets and liabilities as at 31 December 2018 and 2017. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

	2018 Average effective interest rate, %			**2017 Average effective interest rate, %**		
	GEL	**USD**	**Other currencies**	**GEL**	**USD**	**Other currencies**
Interest bearing assets						
Loans to customers	29%	19%	0%	31%	22%	0%
Interest bearing liabilities						
Subordinated borrowings	-	12.2%	-	-	12.4%	-
Other borrowed funds	14%	10%	6%	12%	13%	8%

Interest rate sensitivity analysis

The management of interest rate risk, based on an interest rate gap analysis, is supplemented by monitoring the sensitivity of financial assets and liabilities. An analysis of the sensitivity of net profit or loss (net of taxes) to changes in interest rates (repricing risk), based on a simplified scenario of a 100 basis point (bp) symmetrical fall or rise in all yield curves and positions of interest-bearing assets and liabilities existing as at 31 December 2018 and 2017, is as follows:

	2018 GEL'000	2017 GEL'000
100 bp parallel fall	35	14
100 bp parallel rise	(35)	(14)

(ii) Currency risk

The Company 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 Company hedges its exposure to currency risk, such activities do not qualify as hedging relationships in accordance with IFRS.

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

	GEL GEL'000	USD GEL'000	Other currencies GEL'000	Total GEL'000
ASSETS				
Cash and cash equivalents	647	692	432	1,771
Loans to customers	38,549	9,799	-	48,348
Other financial asset	80	470	-	550
Total assets	**39,276**	**10,961**	**432**	**50,669**
LIABILITIES				
Subordinated borrowings and other borrowed funds	17,838	20,424	167	38,429
Total liabilities	**17,838**	**20,424**	**167**	**38,429**
Net position	**21,438**	**(9,463)**	**265**	**12,240**
The effect of derivatives held for risk management	**(25,197)**	**25,170**	**-**	**(27)**
Net position after derivatives held for risk management purposes	**(3,759)**	**15,707**	**265**	**12,213**

The following table shows the currency structure of financial assets and liabilities as at 31 December 2017:

	GEL GEL'000	USD GEL'000	Other Currencies GEL'000	Total GEL'000
ASSETS				
Cash and cash equivalents	266	632	236	1,134
Loans to customers	21,834	11,630	-	33,464
Cash collateral pledged under the credit line agreement	-	1,282	-	1,282
Total assets	**22,100**	**13,544**	**236**	**35,880**
LIABILITIES				
Subordinated borrowings and other borrowed funds	9,022	22,717	207	31,946
Total liabilities	**9,022**	**22,717**	**207**	**31,946**
Net position	**13,078**	**(9,173)**	**29**	**3,934**
The effect of derivatives held for risk management	**(15,383)**	**15,362**	**-**	**(21)**
Net position after derivatives held for risk management purposes	**(2,305)**	**6,189**	**29**	**3,913**

A weakening of the GEL, as indicated below, against the following curreny at 31 December 2018 and 2017, 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 Company 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.

	2018 GEL'000	2017 GEL'000
10% appreciation of USD against GEL	1,335	526

A strengthening of the GEL against the above currencies at 31 December 2018 and 2017 would have had the equal but opposite effect on the above currency to the amounts shown above, on the basis that all other variables remained constant.

(d) Foreign currency contracts

The table below summarises, by major currencies, the contractual amounts of forward foreign exchange contracts outstanding at 31 December 2018 and 31 December 2017, with details of the weighted average contractual exchange rates and remaining periods to maturity. Foreign currency amounts presented below are translated at rates in effect at the reporting date. The resultant unrealised gains and losses on these unmatured contracts, together with the amounts payable and receivable on the matured but unsettled contracts, are recognised in profit or loss and in other financial liabilities in the statement of financial position as at 31 December 2018 and 2017.

	Notional amount		Weighted average contractual exchange rates	
	2018 GEL'000	2017 GEL'000	2018	2017
Buy USD sell GEL'000				
Less than 3 months			2.6874	2.5884
Outflow	(25,197)	(15,383)		
Inflow	25,170	15,362		
Net position	**(27)**	**(21)**		

(e) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company has policies and procedures in place to manage credit exposures (both for recognised financial assets and unrecognised contractual commitments), including guidelines to limit portfolio concentration. The credit policy is reviewed and approved by the Management Board.

The credit policy establishes:

- procedures for reviewing and approving loan credit applications
- methodology for the credit assessment of borrowers
- methodology for the credit assessment of counterparties
- methodology for the evaluation of collateral
- credit documentation requirements
- procedures for the ongoing monitoring of loans and other credit exposures

Loan credit applications are originated by the relevant credit officers and are then passed on to the credit committee members, according to credit policy. Credit Committee is responsible for the loan approval/rejection decision. Committee acts in line with the defined limits and standards, which are defined in credit policy and product specification. Analysis is based on a structured analysis, focusing on the customer's business and financial performance.

Credit officer is responsible for the accuracy, reliability and transparency of loan application, which includes information on client, detailed analysis of clients business and preliminary assessment of credit risks and etc. Based on certain criteria (clients' credit history, creditworthiness, financial position, business sustainability and etc) credit committee members review loan application.

The Company 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 Company. Regular monitoring of loans allows the Company to mitigate credit risks. Collateral is another tool for credit risk control.

Risk Management Department performs clients individual risk assessment as well as analysis of overall portfolio quality, credit concentration and market risks.

The maximum exposure to credit risk is generally reflected in the carrying amounts of financial assets in the statement of financial position and unrecognised contractual commitment amounts. The impact of the possible netting of assets and liabilities to reduce potential credit exposure is not significant.

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

	2018 GEL'000	**2017 GEL'000**
ASSETS		
Cash and cash equivalents	598	315
Loans to customers	48,348	33,464
Other financial assets	550	1,429
Total maximum exposure	**49,496**	**35,208**

(f) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/-or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to liquidity management. It is unusual for financial institutions ever to be completely matched, since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

The Company maintains liquidity management with the objective of ensuring that funds will be available at all times to honour all cash flow obligations as they become due. The liquidity policy is reviewed and approved by the Management Board.

The liquidity management policy requires:

- projecting cash flows by major currencies and taking into account the level of liquid assets necessary in relation thereto
- maintaining a diverse range of funding sources
- managing the concentration and profile of debts
- maintaining debt financing plans
- maintaining liquidity and funding contingency plans

The daily liquidity position is monitored. Decisions on liquidity management are made and implemented by the Management Board. The Company has unused credit line facility of GEL 1,034 thousand from local financial institution.

The following tables show the undiscounted cash flows on financial assets, liabilities and credit-related commitments 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 maturity analysis for financial assets and liabilities as at 31 December 2018 is as follows:

GEL'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 6 months	From 6 to 12 months	More than 1 year	Total gross amount inflow	Carrying amount
Non-derivative assets							
Loans to customers	2,024	4,604	6,304	11,420	48,026	72,378	48,348
Other financial assets	80	-	-	-	470	550	550
Total financial assets	**2,104**	**4,604**	**6,304**	**11,420**	**48,496**	**72,928**	**48,898**
Non-derivative liabilities							
Subordinated borrowings	-	189	-	202	5,922	6,313	3,913
Other borrowed funds	1,060	4,914	3,675	5,095	24,315	39,059	34,516
Other financial liabilities	13	44	58	228	-	343	343
Derivative liability							
Gross settled derivatives							
- Inflow	(25,170)	-	-	-	-	(25,170)	(25,170)
- Outflow	25,197	-	-	-	-	25,197	25,197
Total financial liabilities	**1,100**	**5,147**	**3,733**	**5,525**	**30,237**	**45,742**	**38,799**
Net liquidity gap on recognised financial assets and liabilities	**1,004**	**(543)**	**2,571**	**5,895**	**18,259**	**27,186**	**10,099**

The maturity analysis for financial assets and liabilities as at 31 December 2017 is as follows:

GEL'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 6 months	From 6 to 12 months	More than 1 year	Total gross amount inflow (outflow)	Carrying amount
Non-derivative assets							
Loans to customers	1,439	4,001	4,879	5,713	34,546	50,578	33,464
Other financial assets	-	-	1,429	-	-	1,429	1,429
Total financial assets	**1,439**	**4,001**	**6,308**	**5,713**	**34,546**	**52,007**	**34,893**
Non-derivative liabilities							
Subordinated borrowings	2	-	299	312	7,583	8,196	4,991
Other borrowed funds	761	5,146	9,559	6,921	5,591	27,978	26,955
Other financial liabilities	65	62	246	17	-	390	390
Derivative liability							
Gross settled derivatives							
- Inflow	(15,362)	-	-	-	-	(15,362)	(15,362)
- Outflow	15,383	-	-	-	-	15,383	15,383
Total financial liabilities	**849**	**5,208**	**10,104**	**7,250**	**13,174**	**36,585**	**32,357**
Net liquidity gap on recognised financial assets and liabilities	**590**	**(1,207)**	**(3,796)**	**(1,537)**	**21,372**	**15,422**	**2,536**

Management expects that based on past experience cash flows from loans to customers will mature on average in one year (2017: one year). Management has the discretionary ability to manage the cash flows from subordinated borrowings and other borrowed funds either because it reaches agreement with the lenders over prolongation of existing facilities or has the ability to substitute existing facilities with alternative funding sources.

(g) Operational risk

Definition of operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Company's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks, such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior. Operational risks arise from all of the Company's operations.

The Company's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Company's reputation with overall cost effectiveness and innovation. In all cases, the Company policy requires compliance with all applicable legal and regulatory requirements.

The Company manages operational risk by establishing internal controls that management determines to be necessary in each area of its operations.

The Company defines as capital those items defined by statutory regulation as capital for microfinance groups. The Company monitors its capital adequacy levels calculated in accordance with the requirements of the National Bank of Georgia. The company is in compliance with those requirements as at 31 December 2018 and 31 December 2017.

16 Operating leases

(a) Leases as lessee

Non-cancellable operating lease rentals as at 31 December are payable as follows:

	2018 GEL'000	2017 GEL'000
Less than 1 year	515	451
Between 1 and 5 years	863	947
	1,378	**1,398**

The Company leases a number of premises and equipment under operating leases. The leases typically run for an initial period of five-to-ten years, with an option to then renew the lease. Lease payments are usually increased annually to reflect market rentals. None of the leases includes contingent rentals.

17 Contingencies

(a) Insurance

The insurance industry in Georgia is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Company does not have full coverage for its premises and equipment, business interruption, or third-party liability in respect of property or environmental damage arising from accidents on its property or related to operations. Until the Company obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on operations and financial position.

(b) Litigation

In the ordinary course of business, the Company 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.

Management is unaware of any significant actual, pending or threatened claims against the Company.

(c) Taxation contingencies

Taxation contingencies in Georgia

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.

(d) Financial guarantees

As at 31 December 2018, the Company has issued financial guarantee of USD 850 thousand to a Georgian bank to secure loan of a related party with premium rate of 2%. The period of the guarantee is 10 years. The loan is secured by the property, for which the related party obtained the loan. The property (residential –commercial building (15 floor) in Tbilisi) is pledged under the same loan as a primary security. Based on management's assessment, there is a remote chance of default. As at 31 December 2018 the Company allocated financial guarantee in Stage 1 for the purposes of identifying expected credit loss under IFRS 9. Management estimates that ECL is immaterial at reporting date.

18 Related party transactions

The Company is wholly owned by members of the Shareholder Group. The Company does not have an ultimate controlling party. (see note 1(a)).

(a) Transactions with members of the Shareholder Group and Management

Total remuneration included in personnel expenses for the years ended 31 December 2018 and 2017 is as follows:

	2018 GEL'000	2017 GEL'000
Short-term employee benefits	744	657
	744	**657**

These amounts include cash and non-cash benefits in respect of members of the Board of Directors and the Management Board.

The outstanding balances and average effective interest rates as at 31 December 2018 and 2017 for transactions with all related parties are as follows:

	2018 GEL'000	Average effective interest rate, %	2017 GEL'000	Average effective interest rate, %
Statement of financial position				
Subordinated borrowings	3,913	12.2%	4,991	12.4%
Other borrowed funds	4,646	12%	10,325	10%
Prepayments	133	-	-	-

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

	2018 GEL'000	2017 GEL'000
Statement of profit or loss and other comprehensive income		
Interest expense	(1,427)	(1,585)

19 Fair value hierarchy

The Company 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 2018 and 31 December 2017 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.

20 Events after reporting period

New loans were borrowed from a local financial institutions, of GEL 500 thousand with 12% annual interest rate, maturing in January 2021; GEL 1,000 thousand with 14.5% annual interest rate, maturing in February 2021 and GEL 2,000 thousand with 14 % interest rate maturing in May 2021. Also the Company had borrowed USD 200 thousand subordinated loan from related party, with 10.5% interest rate maturing in June 2025.