JSC Liberty Bank and Subsidiaries

Consolidated financial statements

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

Contents

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Independent auditor's report

To the Shareholders and Supervisory Board of JSC Liberty Bank

Opinion

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

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

Basis for opinion

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

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For the matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to this matter. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matter below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Key audit matter	How our audit addressed the key audit matter
Allowance for impairment of loans to customers	
The significance of loans to customers and the inherent uncertainty of their collectability makes allowance for impairment a key audit matter. The calculation of the impairment allowance for collectively assessed loans involves credit modelling techniques that utilize significant unobservable inputs and factors, such as probability of default and loss-given-default assumptions. The calculation of the impairment allowance assessed on an individual basis requires recoverability assessments based on significant unobservable inputs, such as the financial performance of the counterparty, expected future cash flows, collateral value, and other factors. The use of different modelling techniques and assumptions could produce significantly different estimates of the allowance for impairment.	We focused on analysis of the following areas during our audit: ▸ Models and assumptions used to determine credit impairments on a collective basis. ▸ Projected future cash flows, including collateral-sourced cash flows, in relation to credit exposures, with signs of deterioration of credit performance. Our audit procedures included evaluation of the methodologies used by the Group in identifying impairment events and calculating impairment allowance. For a sample of significant credit exposures subject to individual impairment assessment, we inspected assumptions on the expected future cash flows, including the value of collateral. For collectively assessed impairment, we tested the underlying credit models, key inputs and assumptions used. We also assessed the disclosures in the consolidated financial statements of the Group in relation to the impairment allowance. Information on the impairment of loans to customers is included in Note 8. Loans to customers and Note 22. Risk Management to the consolidated financial statements.

Other information included in the Group's 2017 Annual report

Other information consists of the information included in the Annual Report other than the consolidated financial statements and our auditor's report thereon. Management is responsible for the other information. The Annual Report is expected to be made available to us after the date of this auditor's report.

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

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

Responsibilities of management and the Supervisory Board for the consolidated financial statements

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

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

The Supervisory Board is responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

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

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

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

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financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

We also provide the Supervisory Board with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Supervisory Board, we determine the matter that was of most significance in the audit of the consolidated financial statements of the current period and is therefore the key audit matter. We describe this matter in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The partner in charge of the audit resulting in this independent auditor's report is Oleg Youshenkov.

Ruslan Khoroshvili
On behalf of EY Georgia LLC

Tbilisi, Georgia

6 April 2018

Consolidated statement of financial position

As of 31 December 2017

(thousands of Georgian Lari)

	Notes	*2017*	*2016*
Assets			
Cash and cash equivalents	6	464,402	462,887
Amounts due from credit institutions	7	73,430	96,255
Loans to customers	8	757,065	631,481
Investment securities:	9		
- Loans and receivables		152,425	164,139
- Held to maturity		70,375	82,451
Property and equipment	10	132,582	133,337
Intangible assets	11	26,349	21,498
Prepayments	13	6,814	4,026
Deferred income tax assets	12	66	–
Other assets	13	19,969	17,011
Total assets		**1,703,477**	**1,613,085**
Liabilities			
Amounts due to credit institutions	14	6,497	21,800
Amounts due to customers	15	1,346,288	1,292,053
Current income tax liabilities		2,375	1,688
Deferred income tax liabilities	12	–	581
Other liabilities	13	25,231	16,812
Subordinated debt	16	105,753	94,920
Total liabilities		**1,486,144**	**1,427,854**
Equity	17		
Share capital		54,405	54,233
Additional paid-in capital		34,300	34,300
Treasury shares		(10,454)	(10,454)
Convertible preferred shares		6,139	6,139
Retained earnings		116,529	84,224
Other reserves		16,414	16,789
Total equity		**217,333**	**185,231**
Total liabilities and equity		**1,703,477**	**1,613,085**

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

Giorgi Kalandarishvili Chief Executive Officer

David Melikidze Chief Financial Officer

6 April 2018

The accompanying notes on pages 6 to 57 are an integral part of these consolidated financial statements.

Consolidated statement of profit or loss

For the year ended 31 December 2017

(thousands of Georgian Lari)

	Notes	*2017*	*2016*
Interest income			
Loans to customers		270,897	247,278
Investment securities		18,760	17,493
Amounts due from credit institutions		5,652	5,375
		295,309	**270,146**
Interest expense			
Amounts due to customers		(100,030)	(107,604)
Amounts due to credit institutions		(326)	(1,155)
Subordinated debt		(13,408)	(10,605)
		(113,764)	**(119,364)**
Net interest income		**181,545**	**150,782**
Loan impairment charge	8	(37,897)	(21,025)
Net interest income after loan impairment charge		**143,648**	**129,757**
Net fee and commission income	19	26,885	27,600
Net gains/(losses) from foreign currencies:			
- Dealing		(34)	6,294
- Translation differences		1,536	(7,900)
Other income	20	21,461	17,120
Non-interest income		**49,848**	**43,114**
Personnel expenses	21	(72,036)	(67,604)
General and administrative expenses	21	(35,050)	(36,236)
Depreciation and amortisation	10, 11	(20,894)	(19,458)
Other operating expenses		(6,795)	(4,179)
Other impairment and provisions reversal/(charge)	13	79	(971)
Non-interest expense		**(134,696)**	**(128,448)**
Profit before income tax expense		**58,800**	**44,423**
Income tax (expense)/benefit	12	(5,786)	3,291
Profit for the year		**53,014**	**47,714**
Earnings per share:	17		
- Basic and diluted earnings per share (in ₾ full amount)		0.01166	0.01045

The accompanying notes on pages 6 to 57 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December 2017

(thousands of Georgian Lari)

	Notes	*2017*	*2016*
Profit for the year		**53,014**	**47,714**
Other comprehensive income			
Other comprehensive income not to be reclassified subsequently to profit or loss			
Revaluation of buildings	10	–	7,508
Income tax effect	12, 17	–	1,343
Net other comprehensive income not to be reclassified subsequently to profit or loss		**–**	**8,851**
Other comprehensive income for the year, net of tax		**–**	**8,851**
Total comprehensive income for the year		**53,014**	**56,565**

The accompanying notes on pages 6 to 57 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2017

(thousands of Georgian Lari)

	Attributable to shareholders of the Bank						
	Share capital	*Additional paid-in capital*	*Treasury shares*	*Convertible preferred shares*	*Retained earnings*	*Other reserves*	*Total*
31 December 2015	**53,863**	**34,886**	**(9,712)**	**6,139**	**37,392**	**8,282**	**130,850**
Total comprehensive income for the year	–	–	–	–	47,714	8,851	**56,565**
Depreciation of revaluation reserve *(Note 17)*	–	–	–	–	162	(162)	**–**
Revaluation reserve of fixed assets sold *(Note 17)*	–	–	–	–	–	(182)	**(182)**
Dividends paid on the convertible preferred shares *(Note 17)*	–	–	–	–	(1,044)	–	**(1,044)**
Purchase of treasury shares *(Note 17)*	–	(586)	(742)	–	–	–	**(1,328)**
Issue of share capital *(Note 17)*	370	–	–	–	–	–	**370**
31 December 2016	**54,233**	**34,300**	**(10,454)**	**6,139**	**84,224**	**16,789**	**185,231**
Total comprehensive income for the year	–	–	–	–	53,014	–	**53,014**
Depreciation of revaluation reserve *(Note 17)*	–	–	–	–	335	(335)	**–**
Revaluation reserve of fixed assets sold *(Note 17)*	–	–	–	–	–	(40)	**(40)**
Dividends paid on the ordinary shares *(Note 17)*	–	–	–	–	(20,000)	–	**(20,000)**
Dividends paid on the convertible preferred shares *(Note 17)*	–	–	–	–	(1,044)	–	**(1,044)**
Issue of share capital *(Note 17)*	172	–	–	–	–	–	**172**
31 December 2017	**54,405**	**34,300**	**(10,454)**	**6,139**	**116,529**	**16,414**	**217,333**

The accompanying notes on pages 6 to 57 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2017

(thousands of Georgian Lari)

	Notes	*2017*	*2016*
Cash flows from operating activities			
Interest received		353,985	287,623
Interest paid		(113,333)	(116,318)
Fees and commissions received		34,646	34,692
Fees and commissions paid		(7,459)	(7,015)
Net realised gains from dealing in foreign currencies		5,313	6,541
Recoveries of assets previously written off	8, 13	2,079	1,593
Other income received		20,097	16,971
Personnel expenses paid		(70,195)	(65,685)
General, administrative and other operating expenses paid		(40,519)	(40,750)
Cash flows from operating activities before changes in operating assets and liabilities		**184,614**	**117,652**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		17,592	(37,990)
Loans to customers		(224,387)	(30,857)
Prepayments and other assets		(6,285)	(2,012)
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		(15,488)	(97,387)
Amounts due to customers		61,744	7,814
Other liabilities		3,986	1,511
Net cash flows from/(used in) operating activities before income tax		**21,776**	**(41,269)**
Income tax paid		(5,746)	(1,500)
Net cash from/(used in) operating activities		**16,030**	**(42,769)**
Cash flows from investing activities			
Proceeds from redemption of investments available for sale		1,060	231
Purchase of investment securities		(144,130)	(179,767)
Proceeds from redemption of investment securities		167,768	139,947
Purchase of intangibles, property and equipment		(23,323)	(19,422)
Proceeds from sale of property and equipment		115	695
Proceeds from sale of investment property		–	2,404
Proceeds from sale of repossessed property		400	163
Net cash from/(used in) investing activities		**1,890**	**(55,749)**
Cash flows from financing activities			
Proceeds from issue of share capital	17	172	370
Purchase of treasury shares	17	–	(1,328)
Proceeds from subordinated debt	25	11,331	27,975
Dividends paid to holders of the ordinary shares	17	(20,000)	–
Dividends paid to holders of the convertible preferred shares	17	(1,044)	(1,044)
Net cash (used in)/from financing activities		**(9,541)**	**25,973**
Effect of exchange rates changes on cash and cash equivalents		(6,864)	33,092
Net increase/(decrease) in cash and cash equivalents		**1,515**	**(39,453)**
Cash and cash equivalents, beginning	6	462,887	502,340
Cash and cash equivalents, ending	6	**464,402**	**462,887**

The accompanying notes on pages 6 to 57 are an integral part of these consolidated financial statements.

(thousands of Georgian Lari)

1. Principal activities

JSC Liberty Bank (the "Bank") is a joint stock company, formed in accordance with legislation of Georgia in 1993. The Bank operates under a general banking license No. 3500/10 issued by the National Bank of Georgia (the "NBG"), the central bank of Georgia, on 10 February 1993.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its retail and corporate customers. Its main office is in Tbilisi, Georgia and it had as of 31 December 2017, 645 branches, service centers, distribution outlets and mobile banking units operating in Georgia (31 December 2016: 697). The Bank's registered legal address is Liberty Tower, 74, I. Chavchavadze Avenue, 0162 Tbilisi, Georgia.

As of 31 December 2017 and 2016, the following shareholders owned more than 5% of the outstanding ordinary shares. Other shareholders individually owned less than 5% of the outstanding ordinary shares.

	2017		*2016*	
Shareholder	***Ownership interest, %***	***Voting rights, %***	***Ownership interest, %***	***Voting rights, %***
European Financial Group B.V.	60.46%	74.64%	–	–
Liberty Bank (Treasury Shares)	19.00%	–	19.00%	–
BNY Limited (Nominees)	6.96%	8.59%	10.19%	12.59%
Liberty Holding Georgia LLC (former Liberty Capital LLC)	–	–	58.18%	71.83%
Other shareholders (individually holding less than 5%)	13.58%	16.77%	12.63%	15.58%
Total	**100.00%**	**100.00%**	**100.00%**	**100.00%**

The Bank is a publicly traded company and its ordinary shares are traded on the Georgian Stock Exchange. The free float amounted to 24.0% as of 31 December 2017 (31 December 2016: 23.6%).

On October 13, 2017, European Financial Group B.V. ("EFG"), a company established and organised under the laws of the Kingdom of Netherlands, purchased 74.64% of equity interest in the Group. The ultimate beneficial owners of the Bank are Irakli Rukhadze, Ben Marson and Igor Alexeev.

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

		The Group ownership interest			
Name	***Country of incorporation***	***31 December 2017***	***31 December 20156***	***Date of incorporation***	***Activities***
Bus Stop LLC*	Georgia	100.00%	100.00%	27 August 2009	–
LBF Luxembourg S.A.**	Luxembourg	100.00%	100.00%	20 July 2015	Financial intermediary services
JSC Smartex***	Georgia	21.47%	21.47%	5 January 2009	Early-stage VC investments

* *Currently dormant.*

** *Currently dormant.*

*** *21.47% is held by the Bank and 78.53% is beneficially held by Mr. Lado Gurgenidze. It is accounted for in the Group's financial statements under the equity method.*

(thousands of Georgian Lari)

2. Basis of preparation

General

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

The Bank and its subsidiaries maintain their accounting records in accordance with IFRS.

The consolidated financial statements have been prepared under the historical cost convention except for derivative financial instruments, investment properties, buildings and available for sale securities as disclosed in the accounting policies below.

These consolidated financial statements are presented in thousands of Georgian Lari ("₾"), except per share amounts and unless otherwise indicated.

3. Summary of accounting policies

Changes in accounting policies

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

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

The amendments require entities to provide disclosure of changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). The Group has provided the information for both the current and the comparative period in *Note 25*.

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

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

Amendments to IFRS 12 Disclosure of Interests in Other Entities: Clarification of the Scope of Disclosure Requirements

The amendments clarify that certain disclosure requirements in IFRS 12 apply to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified as held for sale or included in a disposal group. These amendments did not affect the Group's financial statements.

Basis of consolidation

Subsidiaries, which are those entities which are controlled by the Group, are consolidated. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if, and only if, the Group has:

- Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee).
- Exposure, or rights, to variable returns from its involvement with the investee.
- The ability to use its power over the investee to affect its returns.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Basis of consolidation (continued)

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement(s) with the other vote holders of the investee.
- Rights arising from other contractual arrangements.
- The Group's voting rights and potential voting rights.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All intra-group transactions, balances and unrealised gains on transactions between group companies are eliminated in full; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses are attributed to the non-controlling interests even if that results in a deficit balance.

If the Group loses control over a subsidiary, it derecognises the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests, the cumulative translation differences, recorded in equity; recognises the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in profit or loss and reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss.

Investments in associates

Associates are entities in which the Group generally has between 20% and 50% of the voting rights, or is otherwise able to exercise significant influence, but which it does not control or jointly control. Investments in associates are accounted for under the equity method and are initially recognised at cost, including goodwill. Subsequent changes in the carrying value reflect the post-acquisition changes in the Group's share of net assets of the associate. The Group's share of its associates' profits or losses is recognised in profit or loss, and its share of movements in reserves is recognised in other comprehensive income. However, when the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses, unless the Group is obliged to make further payments to, or on behalf of, the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Fair value measurement

The Group measures financial instruments, such as trading and available for sale securities, derivatives and non-financial assets such as investment properties, at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortised cost are disclosed in *Note 23*.

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

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

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

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Fair value measurement (continued)

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

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

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

Financial assets

Initial recognition

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

Date of recognition

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

Held to maturity investments

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

Loans and receivables

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

Cash and cash equivalents

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

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Amounts due from credit institutions

In the normal course of business, the Group maintains advances or deposits for various periods of time with other banks. Amounts due from credit institutions are initially recognised at fair value and are subsequently measured at amortised cost using the effective interest method. Amounts due from credit institutions are carried net of any allowance for impairment losses.

Derivative financial instruments

In the normal course of business, the Group enters into various derivative financial instruments including forwards and swaps in the foreign exchange and capital markets. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the consolidated statement of profit or loss as net gains/(losses) from trading securities or net gains/(losses) from foreign currencies dealing, depending on the nature of the instrument.

Borrowings

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

If the Group purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is recognised in the consolidated statement of profit or loss.

Leases

i. Operating – Group as lessee

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

ii. Operating – Group as lessor

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

Measurement of financial instruments at initial recognition

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

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

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

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the consolidated statement of financial position.

Impairment of financial assets

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

Amounts due from credit institutions and loans to customers

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

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

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

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

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

Held to maturity financial investments

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

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

Available for sale financial investments

For available for sale financial investments, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

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

In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in the consolidated statement of profit or loss. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the consolidated statement of profit or loss.

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements, agreement of new loan conditions and improvement of collateral. Once the terms have been renegotiated, the loan is no longer considered past due.

The accounting treatment of such restructuring is conducted in 2 basic scenarios. If the loan restructuring is not caused by the financial difficulties of the borrower but the cash flows were renegotiated, the loan is not recognised as impaired. The new effective interest rate is determined based on the remaining cash flows under the loan agreement till maturity. If the new effective interest rate is below the market rate at the date of restructuring, the new carrying amount is calculated as the fair value of the loan after restructuring, being the present value of the future cash flows discounted using the market rate at the date of restructuring. In this case, the difference between the carrying amount before restructuring and the fair value of the loan after restructuring is recognised as a loss on loans restructuring:

- If the loan is impaired after the restructuring, the Group uses the original effective interest rate in respect of new cash flows to estimate the recoverable amount of the loan. The difference between the recalculated present value of the new cash flows taking into account collateral and the carrying amount before restructuring is included in loan impairment charge for the period.

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

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

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

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

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

Financial liabilities

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

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

Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the consolidated financial statements at fair value, in "Other liabilities", being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of the expenditure that is required to settle any financial obligation arising as a result of the guarantee.

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

Taxation

The current income tax expense is calculated in accordance with the regulations of Georgia. It represents the sum of the current and deferred tax expenses.

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

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

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

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

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Property and equipment

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

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

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

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

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

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis at the following annual prescribed rates:

Land and buildings	2%-5%
Furniture and fixtures	10%-20%
Computer and office equipment	15%-25%
Motor vehicles	20%-25%
Leasehold improvements	10%-25%

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

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

Land is not amortised and carried at fair value. Leasehold improvements are amortised over the life of the related leased assets.

Assets under construction comprise costs directly related to construction of property and equipment including an appropriate allocation of directly attributable variable and fixed overheads that are incurred in construction. Depreciation of these assets, on the same basis as similar property assets, commences when the assets are put into operation.

Compensation from third parties for items of property and equipment that were impaired, lost or given up is included in other income when the compensation becomes receivable.

Investment properties

The Group holds certain properties as investments to earn rental income, generate capital appreciation or both and which are not used or held for the sale in the ordinary course of business. Investment properties are initially recognised at cost, including transaction costs, and subsequently remeasured at fair value reflecting market conditions at the end of the reporting period. Fair value of the Group's investment properties is determined on the base of various sources including reports of independent appraisers, who hold a recognised and relevant professional qualification and who have recent experience in valuation of property of similar location and category. Earned rental income is recorded in the profit or loss within income arising from non-banking activities. Gains and losses resulting from changes in the fair value of investment properties are recorded in consolidated statement of profit or loss and presented within other income or other operating expenses lines.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be finite. Intangible assets with finite lives are amortised over the useful economic lives of 1 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Provisions

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

Retirement and other benefit obligations

The Group does not have any pension arrangements separate from the state pension system of Georgia. In addition, the Group has no post-retirement benefits.

Share capital

Share capital and additional paid in capital

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

Treasury shares

Where the Bank purchases the Bank's shares, the consideration paid, including any attributable transaction costs, net of income taxes, is deducted from total equity as treasury shares until they are cancelled or reissued. Where such shares are subsequently sold or reissued, any consideration received is included in equity. Treasury shares are stated at the weighted average cost.

Dividends

Dividends are recognised as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the financial statements are authorised for issue.

Segment reporting

The Group's segment reporting is based on the following operating segments: Retail Banking, Corporate and SME (Small & Medium Enterprise) Banking, Private Banking and Corporate Centre functions.

Contingencies

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

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Recognition of income and expenses

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

Interest and similar income and expense

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

Fee and commission income

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

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

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

- *Fee income from providing transaction services*

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

Dividend income

Dividend income is recognised when the Group's right to receive the payment is established.

Foreign currency translation

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

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

The exchange rates used by the Group in the preparation of the consolidated financial statements as of 31 December 2017 and 31 December 2016 are as follows:

	2017	*2016*
₾ / 1 US Dollar	2.5922	2.6468
₾ / 1 Euro	3.1044	2.7940

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Standards issued but not yet effective

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

IFRS 9 Financial Instruments

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

The Group plans to adopt the new standard by recognizing the cumulative transition effect in opening retained earnings on 1 January 2018 and will not restate comparative information. Based on the data as at 31 December 2017 and current implementation status, the Group is in the process of quantifying the effect of adoption of IFRS 9.

(a) Classification and measurement

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

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

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

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

All investment securities currently classified as loans and receivables and held to maturity are expected to satisfy the SPPI criterion and will continue to be measured at amortised cost. All loans are expected to satisfy the SPPI criterion and will continue to be measured at amortised cost.

(b) Impairment

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

According to the new model for the recognition of impairment losses, introduced by IFRS 9, there is "three stage" approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired. Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

IFRS 15 Revenue from Contracts with Customers

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

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

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

Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely, but an entity that early adopts the amendments must apply them prospectively. The amendment does not have any impact on the consolidated financial statements of the Group.

IFRS 2 Classification and Measurement of Share-based Payment Transactions – Amendments to IFRS 2

The IASB issued amendments to IFRS 2 *Share-based Payment* that address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled. On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and other criteria are met. The amendments are effective for annual periods beginning on or after 1 January 2018, with early application permitted. The Group does not expect a material effect from application of these amendments.

IFRS 16 Leases

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

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

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

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

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

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

IFRS 17 Insurance Contracts

In May 2017, the IASB issued IFRS 17 *Insurance Contracts* (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 *Insurance Contracts* (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features.

A few scope exceptions will apply. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in IFRS 4, which are largely based on grandfathering previous local accounting policies, IFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects.

IFRS 17 is effective for reporting periods beginning on or after 1 January 2021, with comparative figures required. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17. The Group will assess the potential effect of IFRS 17 on its consolidated financial statements, including treatment of non-financial guarantees issued by the Group.

Transfers of Investment Property – Amendments to IAS 40

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

Annual improvements 2014-2016 cycle (issued in December 2016)

These improvements include:

IFRS 1 First-time Adoption of International Financial Reporting Standards – deletion of short-term exemptions for first-time adopters

Short-term exemptions in paragraphs E3-E7 of IFRS 1 were deleted because they have now served their intended purpose. The amendment is effective from 1 January 2018. This amendment is not applicable to the Group.

(thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

IAS 28 Investments in Associates and Joint Ventures – clarification that measuring investees at fair value through profit or loss is an investment-by-investment choice

The amendments clarify that:

- An entity that is a venture capital organisation, or other qualifying entity, may elect, at initial recognition on an investment-by-investment basis, to measure its investments in associates and joint ventures at fair value through profit or loss.
- If an entity, that is not itself an investment entity, has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which: (a) the investment entity associate or joint venture is initially recognised; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent.

The amendments should be applied retrospectively and are effective from 1 January 2018. Group does not expect a material effect from application of these amendments.

Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts – Amendments to IFRS 4

The amendments address concerns arising from implementing the new financial instruments standard, IFRS 9, before implementing IFRS 17 *Insurance Contracts*, which replaces IFRS 4. The amendments introduce two options for entities issuing insurance contracts: a temporary exemption from applying IFRS 9 and an overlay approach. The temporary exemption is first applied for reporting periods beginning on or after 1 January 2018. An entity may elect the overlay approach when it first applies IFRS 9 and apply that approach retrospectively to financial assets designated on transition to IFRS 9. The entity restates comparative information reflecting the overlay approach if, and only if, the entity restates comparative information when applying IFRS 9. There is no effect on the Group from these amendments.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

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

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 and does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments.

An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The Interpretation also addresses the assumptions an entity makes about the examination of tax treatments by taxation authorities, as well as how it considers changes in facts and circumstances.

The interpretation is effective for annual reporting periods beginning on or after 1 January 2019, but certain transition reliefs are available. The Group will apply interpretation from its effective date. Since the Group operates in a complex tax environment, applying the Interpretation may affect its consolidated financial statements and the required disclosures. In addition, the Group may need to establish processes and procedures to obtain information that is necessary to apply the Interpretation on a timely basis.

(thousands of Georgian Lari)

4. Significant accounting judgments and estimates

The preparation of the Group's consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the balance sheet date and the reported amount of income and expenses during the year ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The following estimates and judgments are considered important to the Group's financial condition.

Allowance for impairment of loans

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

The Group regularly reviews its loans to assess for impairment and uses its experienced judgment to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers. Management uses probability estimates based on historical borrower experience including default familiarities and loss given defaults. The Group uses its experienced judgment to adjust observable data for a group of homogenous loans to reflect current circumstances.

The Group considers the fair value of collateral when estimating the amount of impairment loss for collateralised loans and receivables. Management monitors market value of collateral on a regular basis. Management uses its experienced judgment or independent opinion to adjust the fair value to reflect current circumstances. The amount and type of collateral required depends on the assessment of credit risk of the counterparty.

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

Measurement of fair value of investment properties and buildings

Investment properties and buildings are stated at fair value. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards Committee standards.

Buildings of the Group are subject to revaluation on a regular basis. The date of latest revaluation was 31 December 2016. Refer to *Note 10*.

As of 31 December 2017, fair value of investment properties was determined by independent professionally qualified appraisers. Fair value was determined by applying income approach based on discounted cash flow method, supported by the terms of any existing lease and other contracts and, when available, by external evidence such as current market rents for similar properties in a comparable location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows. The estimates of future cash flows include projections of cash outflows for rent or purchase of the land.

The estimates described above are subject to change as new transaction data and market evidence become available.

Taxation

Tax legislation in Georgia is subject to varying interpretations, and changes can occur frequently. Management interpretation of such legislation and changes as applied to the transactions and activity of the Group may be challenged by the relevant authorities. As such, additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three years including the year of review. Management believes that as of 31 December 2017 its interpretation of the relevant legislation is appropriate and that the Group's tax position will be sustained.

(thousands of Georgian Lari)

5. Segment information

For management purposes, the Group is organised into the following operating segments based on products and service:

Retail Banking	Principally handling individual customers' deposits, and providing consumer loans, overdrafts, credit card facilities, funds transfer payments and electronic banking services.
Corporate and SME Banking	Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers.
Private Banking	Principally providing private banking and wealth management services to high net worth individuals.
Corporate Centre	Principally providing treasury and back office services to all operating segments of the Bank.
Other	Segments not classified above, comprising non-banking operations.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance, as explained in the table below, is measured differently from profit or loss in the consolidated financial statements. Income taxes are managed on a group basis and are not allocated to operating segments.

The Group operates in one geographical market – Georgia. Since the Group's assets are located in single geographical area, the Group's external income, total assets and capital expenditure are allocated to a single location.

2017	*Retail banking*	*Corporate & SME banking*	*Private banking*	*Corporate centre*	*Other*	*Adjustments and eliminations*	*Total*
Net interest income	**153,236**	**10,837**	**3,246**	**14,209**	**5**	**12**	**181,545**
Net fee and commission income	21,373	3,764	538	1,210	–	–	**26,885**
Net gains from foreign currencies	901	376	75	150	–	–	**1,502**
Other income	13,291	6,329	1,055	422	60	304	**21,461**
Total revenue	**188,801**	**21,306**	**4,914**	**15,991**	**65**	**316**	**231,393**
Loan impairment (charge)/reversal	(38,625)	807	(79)	–	–	–	**(37,897)**
Personnel expenses	(53,282)	(10,799)	(712)	(7,199)	(44)	–	**(72,036)**
Depreciation and amortisation	(14,419)	(3,132)	(209)	(3,134)	–	–	**(20,894)**
Other impairment and provisions reversal	46	27	2	4	–	–	**79**
General and administrative and other operating expenses	(28,900)	(8,117)	(635)	(4,184)	(10)	1	**(41,845)**
Segment results	**53,621**	**92**	**3,281**	**1,478**	**11**	**317**	**58,800**
Income tax expense	–	–	–	–	–	–	**(5,786)**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**53,014**
Segment assets	1,373,869	6,664	5,730	316,733	84	397	**1,703,477**
Segment liabilities	975,002	298,530	212,675	–	15	(78)	**1,486,144**
Other segment information							
Investments in associates	–	–	–	813	–	–	**813**
Share of profit of associates	–	–	–	304	–	–	**304**

(thousands of Georgian Lari)

5. Segment information (continued)

2016	*Retail banking*	*Corporate & SME banking*	*Private banking*	*Corporate centre*	*Other*	*Adjustments and eliminations*	*Total*
Net interest income	**119,744**	**15,721**	**2,587**	**12,718**	**4**	**8**	**150,782**
Net fee and commission income	21,951	3,866	552	1,242	(11)	–	**27,600**
Net losses from foreign currencies	(964)	(401)	(80)	(161)	–	–	**(1,606)**
Other income	10,630	5,062	844	337	159	88	**17,120**
Total revenue	**151,361**	**24,248**	**3,903**	**14,136**	**152**	**96**	**193,896**
Loan impairment charge	(20,467)	(481)	(77)	–	–	–	**(21,025)**
Personnel expenses	(49,997)	(10,133)	(668)	(6,755)	(51)	–	**(67,604)**
Depreciation and amortisation	(13,403)	(2,911)	(194)	(2,913)	(37)	–	**(19,458)**
Other impairment and provisions charge	(569)	(328)	(23)	(50)	(1)	–	**(971)**
General and administrative and other operating expenses	(27,711)	(7,783)	(609)	(4,011)	(361)	60	**(40,415)**
Segment results	**39,214**	**2,612**	**2,332**	**407**	**(298)**	**156**	**44,423**
Income tax benefit	–	–	–	–	–	–	**3,291**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**47,714**
Segment assets	1,189,712	16,298	6,376	400,528	191	(20)	**1,613,085**
Segment liabilities	914,207	290,644	205,549	17,501	19	(66)	**1,427,854**
Other segment information							
Investments in associates	–	–	–	530	–	–	**530**
Share of profit of associates	–	–	–	149	–	–	**149**

6. Cash and cash equivalents

Cash and cash equivalents comprise:

	2017	*2016*
Cash on hand	156,963	133,741
Current accounts with the NBG	60,533	174,852
Current accounts with other credit institutions	231,906	154,294
Time deposits with credit institutions up to 90 days	15,000	–
Cash and cash equivalents	**464,402**	**462,887**

As of 31 December 2017, ₾ 209,128 (31 December 2016: ₾ 136,437) was placed on current accounts with internationally recognised OECD banks that are the counterparties of the Group in performing international settlements.

Credit rating of current accounts with other credit institutions is as follows:

	2017	*2016*
A-	–	136,322
BBB+	209,111	95
BBB-	838	673
BB+	18	–
BB	–	4
BB-	19,465	15,993
B+	27	38
B-	5	–
CCC	–	23
Not rated	2,442	1,146
Total	**231,906**	**154,294**

(thousands of Georgian Lari)

6. Cash and cash equivalents (continued)

Credit rating of time deposits with credit institutions up to 90 days is as follows:

	2017	*2016*
BB-	15,000	–
Total	**15,000**	**–**

The tables contain ratings of Fitch Ratings international agency.

7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2017	*2016*
Obligatory reserve with the NBG	61,098	82,558
Time deposits for more than 90 days	12,332	13,697
Amounts due from credit institutions	**73,430**	**96,255**

Credit institutions are required to maintain an interest-earning cash deposit (obligatory reserve) with the NBG, the amount of which depends on the level of funds attracted by the credit institution. The Group's ability to withdraw these deposits is restricted by the statutory legislature. In November and September 2017, the Standard&Poor's and Fitch Ratings reconfirmed their respective sovereign ratings of Georgia at "BB-"with outlook "Stable", while in September 2017, Moody's upgraded by one-notch to "Ba2".

As of 31 December 2017, ₾ 11,413 (31 December 2016: ₾ 12,625) was placed as the guarantee deposit placed for variation and safety margins defined in the Credit Support Annex (the "CSA") to the Schedule to the ISDA Master Agreement for funding swaps. Variation margin is modified from time to time based on the mark-to-market revaluation of the forward contracts. More details are provided in *Note 13*.

8. Loans to customers

Loans to customers comprise:

	2017	*2016*
Loans to retail clients with regular inflows	403,368	331,120
Consumer loans	261,063	184,801
Micro loans	117,203	108,673
Gold pawn loans	60,583	54,726
Residential mortgage loans	19,998	16,595
Corporate and SME loans	4,336	8,649
Gross loans to customers	**866,551**	**704,564**
Less – allowance for loan impairment	(109,486)	(73,083)
Loans to customers	**757,065**	**631,481**

Loans to retail clients with regular inflows are provided to individuals who have a stream of regular (typically monthly) inflows into their accounts at the Bank either in form of a salary, state pension or welfare payment.

(thousands of Georgian Lari)

8. Loans to customers (continued)

Allowance for impairment of loans to customers

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

	Loans to retail clients with regular inflows	*Consumer loans*	*Micro loans*	*Gold pawn loans*	*Residential mortgage loans*	*Corporate & SME loans*	*Total*
At 1 January 2017	**28,030**	**34,870**	**4,663**	**2,528**	**292**	**2,700**	**73,083**
Charge/(recovery) for the year	10,326	26,149	2,497	(396)	128	(807)	**37,897**
Recoveries	726	777	39	–	56	266	**1,864**
Amounts written off	(1,171)	(450)	(36)	(850)	–	(851)	**(3,358)**
At 31 December 2017	**37,911**	**61,346**	**7,163**	**1,282**	**476**	**1,308**	**109,486**
Individual impairment	–	–	–	1,244	–	740	**1,984**
Collective impairment	37,911	61,346	7,163	38	476	568	**107,502**
	37,911	**61,346**	**7,163**	**1,282**	**476**	**1,308**	**109,486**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**–**	**–**	**–**	**1,926**	**–**	**2,560**	**4,486**

	Loans to retail clients with regular inflows	*Consumer loans*	*Micro loans*	*Gold pawn loans*	*Residential mortgage loans*	*Corporate & SME loans*	*Total*
At 1 January 2016	**19,974**	**27,717**	**3,548**	**3,464**	**422**	**2,219**	**57,344**
Charge/(recovery) for the year	8,739	11,357	1,222	(670)	(104)	481	**21,025**
Recoveries	1,051	534	8	–	–	–	**1,593**
Amounts written off	(1,734)	(4,738)	(115)	(266)	(26)	–	**(6,879)**
At 31 December 2016	**28,030**	**34,870**	**4,663**	**2,528**	**292**	**2,700**	**73,083**
Individual impairment	–	–	–	2,345	–	1,462	**3,807**
Collective impairment	28,030	34,870	4,663	183	292	1,238	**69,276**
	28,030	**34,870**	**4,663**	**2,528**	**292**	**2,700**	**73,083**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**–**	**–**	**–**	**3,257**	**–**	**3,957**	**7,214**

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognised as of 31 December 2017 comprised ₾ 876 (2016: ₾ 1,083). Related allowance charges were recognised both in 2017 and 2016 and are recorded in consolidated statement of profit or loss under net impairment charge on interest-bearing assets.

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

(thousands of Georgian Lari)

8. Loans to customers (continued)

Collateral and other credit enhancements (continued)

The main types of collateral obtained are as follows:

- For lending to legal entities, mortgages over real estate properties, inventory and trade receivables;
- For retail lending, mortgages over residential properties and gold over gold pawns.

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

Without taking into account discounted value of collateral, allowance for loan impairment would be ₾2,502 higher as at 31 December 2017 (2016: ₾ 3,407 higher).

Concentration of loans to customers

As of 31 December 2017, the concentration of loans granted by the Group to ten largest third party borrowers comprised ₾ 4,632 accounting for 0.5% of the gross loan portfolio of the Group (2016: ₾ 6,666 and 0.9%, respectively). An allowance of ₾ 999 (2016: ₾ 2,523) was established against these loans.

Loans have been extended to the following types of customers:

	2017	*2016*
Individuals	862,722	695,804
Private companies	3,829	8,760
Loans to customers, gross	**866,551**	**704,564**
Less – allowance for loan impairment	(109,486)	(73,083)
Loans to customers, net	**757,065**	**631,481**

Loans are made principally within Georgia in the following industry sectors:

	2017	*2016*
Individuals	862,722	695,804
Trade and service	2,470	4,914
Construction	2	686
Other	1,357	3,160
Loans to customers, gross	**866,551**	**704,564**
Less – allowance for loan impairment	(109,486)	(73,083)
Loans to customers, net	**757,065**	**631,481**

9. Investment securities

Loans and receivables comprise:

	2017	*2016*
Treasury bills of the Ministry of Finance of Georgia	83,207	132,898
Treasury bonds of the Ministry of Finance of Georgia	69,218	21,638
Certificates of deposit of the NBG	–	9,603
Loans and receivables	**152,425**	**164,139**

Due to lack of active market for treasury securities and certificates of deposits of NBG since 2014, the Group classifies securities purchased in 2015 and afterwards as loans and receivables at amortised cost with no impact on the consolidated statement of profit and loss. Securities purchased before 2015 are classified as investment securities held to maturity.

(thousands of Georgian Lari)

9. Investment securities (continued)

Held to maturity securities comprise:

	2017	*2016*
Treasury bonds of the Ministry of Finance of Georgia	70,375	82,451
Held to maturity securities	**70,375**	**82,451**

As of 31 December 2017, no investment securities were pledged as a collateral (as of 31 December 2016, investment securities with book value of ₾ 17,863 were pledged as a collateral for short-term loan received from the NBG). Please refer to *Note 14*.

10. Property and equipment

The movements in property and equipment were as follows:

	Land and buildings	*Furniture and fixtures*	*Computers and office equipment*	*Motor vehicles*	*Leasehold improve-ments*	*Assets under construction*	*Total*
Cost or revalued amount							
31 December 2016	**81,349**	**70,351**	**27,442**	**13,839**	**9,305**	**132**	**202,418**
Additions	1,105	8,554	2,402	1,482	298	–	**13,841**
Disposals	(82)	(1)	–	(198)	(875)	(132)	**(1,288)**
31 December 2017	**82,372**	**78,904**	**29,844**	**15,123**	**8,728**	**–**	**214,971**
Accumulated depreciation and impairment							
31 December 2016	**–**	**33,548**	**19,943**	**11,643**	**3,947**	**–**	**69,081**
Depreciation charge	1,642	7,020	3,325	1,126	804	–	**13,917**
Disposals	–	–	–	(182)	(427)	–	**(609)**
31 December 2017	**1,642**	**40,568**	**23,268**	**12,587**	**4,324**	**–**	**82,389**
Net book value							
31 December 2016	**81,349**	**36,803**	**7,499**	**2,196**	**5,358**	**132**	**133,337**
31 December 2017	**80,730**	**38,336**	**6,576**	**2,536**	**4,404**	**–**	**132,582**

	Land and buildings	*Furniture and fixtures*	*Computers and office equipment*	*Motor vehicles*	*Leasehold improve-ments*	*Assets under construction*	*Total*
Cost or revalued amount							
31 December 2015	**77,788**	**63,675**	**25,788**	**13,783**	**8,696**	**–**	**189,730**
Additions	1,032	6,755	2,830	739	1,301	132	**12,789**
Disposals	(1,793)	(79)	(1,176)	(683)	(692)	–	**(4,423)**
Revaluation	4,322	–	–	–	–	–	**4,322**
31 December 2016	**81,349**	**70,351**	**27,442**	**13,839**	**9,305**	**132**	**202,418**
Accumulated depreciation and impairment							
31 December 2015	**2,201**	**27,003**	**17,567**	**10,702**	**3,640**	**–**	**61,113**
Depreciation charge	1,573	6,623	3,552	1,530	925	–	**14,203**
Disposals	(746)	(78)	(1,176)	(589)	(618)	–	**(3,207)**
Revaluation	(3,028)	–	–	–	–	–	**(3,028)**
31 December 2016	**–**	**33,548**	**19,943**	**11,643**	**3,947**	**–**	**69,081**
Net book value							
31 December 2015	**75,587**	**36,672**	**8,221**	**3,081**	**5,056**	**–**	**128,617**
31 December 2016	**81,349**	**36,803**	**7,499**	**2,196**	**5,358**	**132**	**133,337**

Buildings and land of the Group are subject to revaluation on a regular basis. The date of the latest revaluation was 31 December 2016. As a result of revaluation of land and buildings, their value increased by ₾ 7,350 of which ₾ 7,508 and ₾ 158 were recognized as gain in other comprehensive income and loss in other operating expenses, respectively.

(thousands of Georgian Lari)

10. Property and equipment (continued)

As of 31 December 2017 the Group analysed market prices for its premises and concluded that the market price of the premises does not differ materially from their carrying amount.

The gross carrying amount of fully depreciated property and equipment that is still in use is as follows:

	Furniture and fixtures	*Computers and office equipment*	*Motor vehicles*	*Leasehold improvements*	*Total*
Cost or revalued amount					
31 December 2017	11,786	16,276	10,305	230	**38,597**
31 December 2016	7,516	12,300	8,020	230	**28,066**

The Group's buildings are classified to Level 3 of the fair value hierarchy. There were no transfers among the levels of the fair value hierarchy in 2017.

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

	2017	*2016*
Cost	51,901	50,878
Accumulated depreciation and impairment	(9,411)	(8,373)
Net carrying amount	**42,490**	**42,505**

11. Intangible assets

The movements in intangible assets, which comprised computer software and licenses, were as follows:

	Computer software and licenses
Cost	
31 December 2016	**36,331**
Additions	11,828
31 December 2017	**48,159**
Accumulated amortisation	
31 December 2016	**14,833**
Amortisation charge	6,977
31 December 2017	**21,810**
Net book value	
31 December 2016	**21,498**
31 December 2017	**26,349**

	Computer software and licenses
Cost	
31 December 2015	**29,835**
Additions	6,496
31 December 2016	**36,331**
Accumulated amortisation	
31 December 2015	**9,578**
Amortisation charge	5,255
31 December 2016	**14,833**
Net book value	
31 December 2015	**20,257**
31 December 2016	**21,498**

(thousands of Georgian Lari)

12. Taxation

The corporate income tax expense comprised:

	2017	*2016*
Current year tax charge	6,433	2,650
Deferred tax benefit – origination and reversal of temporary differences	(647)	(5,941)
Income tax expense/(benefit)	**5,786**	**(3,291)**

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

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

The amendments to the Georgian tax law described above also provide for charging corporate income tax on certain transactions that are considered deemed profit distributions, e.g. transactions carried at non-market prices, non-business related expenses or supply of goods and services free of charge. Taxation of such transactions is the outside scope of IAS 12 *Income Taxes* and will be accounted for similarly to operating taxes starting from 1 January 2019. Tax law amendments related to such deemed profit distribution did not have any effect on the Group's financial statements for the year ended 31 December 2017.

The tax rate for banks for profits other than on state securities was 15% for 2017 and 2016. The tax rate for interest income on state securities and the NBG deposits is 0%.

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

	2017	*2016*
Profit before income tax expense	**58,800**	**44,423**
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	**8,820**	**6,663**
Tax effect from income from state securities and deposits placed with the NBG at 0%	(3,125)	(2,792)
Effect of changes in cncome tax legislation	(251)	(7,436)
Non-tax deductible expenses	342	274
Income tax expense/(benefit)	**5,786**	**(3,291)**

(thousands of Georgian Lari)

12. Taxation (continued)

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

		Origination and reversal of temporary differences			*Origination and reversal of temporary differences*	
	2015	*In the statement of profit or loss*	*Effect of change in statement of comprehensive income*	*2016*	*In the statement of profit or loss*	*2017*
Tax effect of deductible temporary differences						
Loans to customers	2,482	(2,007)	–	475	(475)	–
Equity investments	275	(275)	–	–	–	–
Other assets	1,010	(978)	–	32	(24)	8
Other liabilities	772	490	–	1,262	832	2,094
Gross deferred tax assets	**4,539**	**(2,770)**	**–**	**1,769**	**333**	**2,102**
Deferred tax asset	**4,539**	**(2,770)**	**–**	**1,769**	**333**	**2,102**
Tax effect of taxable temporary differences						
Loans to customers	–	–	–	–	(747)	(747)
Property and equipment and intangible assets	(12,404)	8,711	1,343	(2,350)	1,061	(1,289)
Deferred tax liabilities	**(12,404)**	**8,711**	**1,343**	**(2,350)**	**314**	**(2,036)**
Net deferred tax assets/ (liabilities)	**(7,865)**	**5,941**	**1,343**	**(581)**	**647**	**66**

13. Other assets, prepayments and other liabilities

Other assets comprise:

	2017	*2016*
Receivables from remittances systems operators	7,116	4,523
Investment properties	2,597	2,729
Guarantee deposits placed	2,310	2,345
Inventories	2,061	2,001
Prepaid taxes other than income tax	910	856
Repossessed property	906	1,306
Receivable from guarantees paid	899	899
Investment in associate	813	530
Derivative asset	104	1,195
Other	5,045	3,041
Total	**22,761**	**19,425**
Less – allowance for impairment of other assets	(2,792)	(2,414)
Other assets	**19,969**	**17,011**

Investment properties primarily comprise of class B office space located in downtown Zugdidi with total rental space of 1,582 square meters and several other properties located outside of Tbilisi.

Investment properties are stated at fair value. The fair value represents the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The date of latest revaluation was 31 December 2017. The valuation was performed by an accredited independent valuator with a recognised and relevant professional qualification and with recent experience in the locations and categories of the investment properties being valued. The valuation models in accordance with those recommended by the International Valuation Standards Committee have been applied and are consistent with the principles in IFRS 13. Refer to *Note 23* for details.

(thousands of Georgian Lari)

13. Other assets, prepayments and other liabilities (continued)

There were no significant movements in investment properties except for the fair value revaluation.

The Group's investment properties items are classified to Level 3 of the fair value hierarchy. There were no transfers among the levels of the fair value hierarchy in 2017.

Receivables from remittances in the amount of ₾ 7,116 (2016: ₾ 4,523) represent money transfers made in advance toward the retail clients at the period end that were subsequently settled by the systems operators within several days in accordance with respective service contracts.

As of 31 December 2017 guarantee deposits placed primarily represent pledged funds at VISA Inc. and MasterCard Inc. in the amount of ₾924 and ₾ 1,386, respectively (31 December 2016: VISA Inc. for ₾ 937, MasterCard Inc. for ₾ 1,408).

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

	2017				*2016*			
	Notional amount		*Fair values*		*Notional amount*		*Fair value*	
	Asset	*Liability*	*Asset*	*Liability*	*Asset*	*Liability*	*Asset*	*Liability*
Foreign exchange contracts								
Forwards and swaps – domestic	–	(2,651)	–	(34)	1,505	(1,290)	15	(107)
Forwards and swaps – foreign	17,741	(51,922)	104	(5,608)	19,859	(45,697)	1,180	(1,279)
Total derivative assets/liabilities	**17,741**	**(54,573)**	**104**	**(5,642)**	**21,364**	**(46,987)**	**1,195**	**(1,386)**

As of 31 December 2017, the Group has positions in the following types of derivatives:

Forwards

Forward contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market.

The Group's forward is classified to Level 2 of the fair value hierarchy. There were no transfers among the levels of the fair value hierarchy in 2017.

Prepayments comprise:

	2017	*2016*
Prepayments for fixed and intangible assets	4,987	1,103
Prepayments for professional services	608	944
Prepaid insurance	362	415
Other	857	1,564
Total prepayments	**6,814**	**4,026**

Other liabilities comprise:

	2017	*2015*
Bonus accrual	10,021	8,180
Derivative liability	5,642	1,386
Funds pending settlements	2,320	1,564
Sundry creditors	743	963
Taxes payable other than income tax	386	365
Provision for various contingencies including guarantees and commitments	215	461
Other	5,904	3,893
Other liabilities	**25,231**	**16,812**

(thousands of Georgian Lari)

13. Other assets, prepayments and other liabilities (continued)

The movements in other impairment allowances and provisions were as follows:

	Other assets	*Provision for various contingencies including guarantees and commitments*	*Total*
31 December 2016	**2,414**	**461**	**2,875**
Charge/(reversal)	382	(461)	**(79)**
Write-offs	(4)	–	**(4)**
Recoveries	–	215	**215**
31 December 2017	**2,792**	**215**	**3,007**

	Other assets	*Provision for various contingencies including guarantees and commitments*	*Total*
31 December 2015	**5,130**	**482**	**5,612**
Charge/(reversal)	992	(21)	**971**
Write-offs	(3,708)	–	**(3,708)**
31 December 2016	**2,414**	**461**	**2,875**

Provisions for claims, guarantees and commitments are recorded in other liabilities.

14. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2017	*2016*
Current accounts	5,703	3,859
Time deposits and loans	794	17,941
Amounts due to credit institutions	**6,497**	**21,800**

As of 31 December 2017, the Bank does not have any loans received from NBG (as of 31 December 2016, time deposits and loans included ₾ 17,000 of short-term loan received from the NBG. Certain investment securities with book value of ₾ 17,863 were pledged as a collateral for this loan).

15. Amounts due to customers

Amounts due to customers comprise:

	2017	*2016*
Current accounts	669,253	615,151
Time deposits (including certificates of deposits)	677,035	676,902
Amounts due to customers	**1,346,288**	**1,292,053**
Held as security against guarantees issued (Note 18)	814	1,319

At 31 December 2017, amounts due to customers of ₾ 140,272 (10.4%) were due to the ten largest customers (31 December 2016: ₾ 130,592 (10.1%)).

(thousands of Georgian Lari)

15. Amounts due to customers (continued)

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

	2017	*2016*
Individuals	1,035,010	980,090
State and public sector	187,204	206,828
Private enterprises	124,074	105,135
Amounts due to customers	**1,346,288**	**1,292,053**

Amounts due to customers by economic sector are as follows:

	2017	*2016*
Individuals	1,035,010	980,090
State and public sector	187,204	206,828
Trade	28,471	30,511
Real estate constructions	2,584	2,458
Transport and communication	919	1,998
Energy	876	4,016
Agriculture	332	275
Other	90,892	65,877
Amounts due to customers	**1,346,288**	**1,292,053**

16. Subordinated debt

In November 2014, the Bank commenced the sale of unsecured Subordinated Loan Contracts (the "SLCs") to high net worth individuals and corporate clients. The primary reason for the issuance of the SLCs was to attract Tier 2 qualified capital to support the Bank's capitalisation.

As of 31 December 2017, the Bank had ₾ 105,753 (31 December 2016: ₾ 94,920) of Subordinated Debt outstanding, of which the amortised value of qualified for the inclusion in the Tier 2 capital under the Current NBG and the NBG Basel II/III requirements, were ₾ 51,415 and ₾ 51,415 (31 December 2016: ₾ 54,611and ₾ 60,818), respectively.

17. Equity

Share capital

As of 31 December 2017, the authorised share capital of the Bank comprised 7,500,000,000 ordinary shares, of which 5,502,254,354 were issued, 5,440,480,024 ordinary shares were fully paid of which 1,045,428,327 shares represented treasury shares (31 December 2016: the authorised share capital was 7,500,000,000 ordinary shares, of which 5,502,254,354 were issued and 5,423,313,907 were fully paid including 1,045,428,327 treasury shares). Each share has nominal value of ₾ 0.01. From the total number of ordinary shares issued, 59,926,012 shares have been sold on a deferred payment basis to Stichting Liberty ESOP (2016: 78,940,447) and are attributable to the share based compensation programme.

Movements in the fully paid and repurchased ordinary and the convertible preferred shares are described below:

	Number of shares		*Nominal amount*		
	Convertible preferred	*Ordinary*	*Convertible preferred*	*Ordinary*	*Total*
31 December 2015	**6,139,064**	**4,415,081,485**	**6,139**	**44,151**	**50,290**
Increase in share capital	–	36,998,040	–	370	**370**
Purchase of treasury shares	–	(74,193,945)	–	(742)	**(742)**
31 December 2016	**6,139,064**	**4,377,885,580**	**6,139**	**43,779**	**49,918**
Increase in share capital	–	17,166,117	–	172	**172**
31 December 2017	**6,139,064**	**4,395,051,697**	**6,139**	**43,951**	**50,090**

(thousands of Georgian Lari)

17. Equity (continued)

Share capital (continued)

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

The increase of share capital represents the exercise of ESOP shares. The total number of ESOP shares exercised in 2017 comprised of 19,014,435 shares, of which cash contribution happened on 17,166,117 shares; the remaining 1,848,318 shares were settled in January 2018 (The total number of ESOP shares exercised in 2016 comprised of 36,998,040 shares, which were fully settled during 2016). No new ordinary shares were issued or sold during 2017 and 2016.

As of 31 December 2017 and 2016, the book value per ordinary share comprised ₾ 0.0474 and ₾ 0.0402, respectively.

Treasury shares

On 12 November 2015, the Group commenced the buyback of ordinary shares (the "Buyback") at ₾ 0.0179 per ordinary share, with the maximum number of 1,045,428,327 ordinary shares or 19.00% of the total number of issued and outstanding ordinary shares.

The Buyback period was set as 90 calendar days from announcement date, up until 10 February 2016. As of 31 December 2016, the Group bought back and fully settled 1,045,428,327 ordinary shares (19.00% of the total number of shares issued and outstanding).

The consideration paid, including any attributable transaction costs is deducted from total equity as treasury shares until they are cancelled or reissued. Treasury shares are stated at the weighted average cost.

Any share repurchased during the Buyback that have not been sold until 27 July 2018 shall be considered to be cancelled and the management shall register the cancellation of such unsold treasury shares in the share registry of the Bank maintained by the independent share registrar.

Convertible preferred shares

In August 2012, the Bank issued and made available for sale to the general public in a public offer in Georgia 10,000,000 non-redeemable convertible preferred shares at the gross placement price of ₾ 1 per convertible preferred share (with the permissible size of the public offer subsequently increased to 30,000,000 convertible preferred shares), of which 6,139,064 convertible preferred shares were outstanding and fully paid-up as of 31 December 2017 (2016: 6,139,064). The public offer period expired on 31 December 2015. The convertible preferred shares are perpetual and can be converted, at the holder's discretion, into ordinary shares of the Bank at the conversion price based on 1.05 times the IFRS audited ordinary equity book value of the Bank per ordinary share outstanding (net of any treasury shares) as of the end of the preceding calendar year.

The dividend rate on the convertible preferred shares is 17% per annum, payable annually, subject to the AGM approval in each given year. The dividends are non-cumulative. The conversion option was classified as equity component as of the initial recognition date.

The ability to pay dividends is subject to the Bank's financial condition and results of operations and compliance with the prudential capital adequacy requirements and may be restricted by, among other things, applicable laws and regulations, and by the NBG.

Basic/diluted earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period (net of any treasury shares). Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding of the effect of all dilutive potential ordinary shares (but ignoring any treasury shares), which comprise share options granted to employees and the convertible preferred shares.

In 2017, net profit attributable to ordinary shareholders of the Bank comprised ₾ 53,014 (2016: ₾ 47,714) and the weighted average number of ordinary shares outstanding during the year was 4,456,826,027 (2016: 4,465,137,370), resulting in earnings per share of ₾ 0.01166 for 2017 (2016: ₾ 0.01045).

(thousands of Georgian Lari)

17. Equity (continued)

Basic/diluted earnings per share (continued)

At 31 December 2017, the convertible preferred shares did not have a dilutive effect as the conversion price of ₾ 0.050 exceeded the quoted weighted average market price for the period of ₾ 0.033. Thus, the potential dilution did not include the potential effect from the conversion of 6,139,064 convertible preferred shares into ordinary shares as of 31 December 2017 (at 31 December 2016, the convertible preferred shares did not have a dilutive effect as the conversion price of ₾ 0.042 exceeded the quoted weighted average market price for the period of ₾ 0.017).

Dividends

The Bank paid dividends on its ordinary shares in the amount of ₾ 20,000 in 2017 (2016: ₾ nil). The Bank paid dividends on the convertible preferred shares in the amount of ₾ 1,044 in 2017 (2016: ₾ 1,044).

Other reserves

Movements in other reserves were as follows:

	Revaluation reserve for property and equipment	*Total*
At 31 December 2015	**8,282**	**8,282**
Revaluation of buildings, net of tax	8,851	**8,851**
Revaluation reserve of sold assets, net of tax	(182)	**(182)**
Depreciation of revaluation reserve, net of tax	(162)	**(162)**
At 31 December 2016	**16,789**	**16,789**
Revaluation reserve of sold assets, net of tax	(40)	**(40)**
Depreciation of revaluation reserve, net of tax	(335)	**(335)**
At 31 December 2017	**16,414**	**16,414**

Nature and purpose of other reserves

Revaluation reserve for property and equipment

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

18. Commitments and contingencies

Operating environment

In November and September 2017, the Standard & Poor's and Fitch Ratings reconfirmed their respective sovereign ratings of Georgia at "BB-"with outlook "Stable", while in September 2017, Moody's upgraded by one-notch to "Ba2". In the recent years, country has implemented and largely maintained far-reaching structural reforms. In 2017, Georgia became No. 9 country in the World Bank Ease of Doing Business global rankings (upgraded from 16th in 2016) and No. 13 in the Index of Economic Freedom. However, it still remains a small open economy, which is exposed to exogenous trends and pressures. In 2017, the trade deficit widened by just 1.5% year-on-year, notably, excluding a one-off import of aircraft in November, the trade deficit was flat in the reporting period (from US Dollar 5.12 bln in 2016 to US Dollar 5.20 bln in 2017); the net inflows from remittances increased by 22.3% (from US Dollar 957 mln in 2016 to US Dollar 1,171 mln in 2017), number of international arrivals from tourism increased by 19.0% (from 6.4 mln in 2016 to 7.6 mln in 2017) and net FDI raised by 16.2% (from US Dollar 1.6 bln in 2016 to US Dollar 1.9 bln in 2017). As a result, the local currency appreciated (against the US Dollar, in nominal terms) by 2.1% as compared to prior year depreciation of 10.5%; the real exchange rate (nominal exchange rate adjusted by trading countries inflation) appreciated by 0.1%, as compared to the prior year depreciation of 3.6%. Real GDP growth reached 4.8% in 2017, as compared to 2.7% in 2016, 2.8% and 4.6% in 2015 and 2014, respectively.

(thousands of Georgian Lari)

18. Commitments and contingencies (continued)

Operating environment (continued)

Budget deficit reduced to 3.9% of GDP in 2017 from 4.1% in 2016. Proper fiscal-monetary interaction and prudent banking sector supervision allowed to sustain positive development dynamics in the financial sector and credit risks, providing for 17.9% banking sector loan book growth while keeping the banking sector NPLs (defined as loans overdue by 90 days) at a relatively low level (below 3%). As of 31 December 2017, the loan and deposit dollarization ratios were also down to 56.9% and 65.6% as compared to 65.4% and 72.4% as of 31 December 2016, respectively.

The period average inflation rate increased from 2.1% as of 31 December 2016 to 6.7% as of 31 December 2017. Nearly 40% of the price growth was due to excise tax-related increases and core inflation remained close to the NBG's target of 4.0% throughout 2017. Public debt remained flat at 44.7% as a share of GDP in 2017. The government and the NBG sustain sufficient liquidity – in the form of the government cash deposit at the NBG and in the form of the NBG's international reserves (NBG International Reserves increased by 10.2% year-on-year to US Dollar 3,039 mln in 2017 from US Dollar 2,757 mln in 2016). Economic fundamentals in the region appear to be improving in 2018, alongside with better-than-expected growth momentum among Georgia's main trading partners (29.1% year-on-year growth in export in 2017); fast growing tourism sector (27.0% year-on-year growth in revenue from tourism in 2017, US Dollar 2.8 bln, 18.2% of GDP); commencement of large investment projects and acceleration of the positive impact from growth-enhancing reforms by the government.

The management believes that the Bank is well-equipped to follow the upcoming trend, due to well diversified retail loan book, low concentrations in overall credit portfolio and funding base; high capitalization and fairly stable liquidity buffer. Furthermore, the Bank's refinancing risk is materially restricted due to significant reliance on retail fixed term deposits and CDs.

Legal

In the ordinary course of business, the Group 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 of the Group.

The Group's commitments and contingencies comprised the following:

	2017	*2016*
Credit related commitments		
Guarantees	840	849
Undrawn loan commitments	32,312	31,101
	33,152	**31,950**
Operating lease commitments		
Not later than 1 year	7,445	8,438
Later than 1 year but not later than 5 years	20,959	26,440
Later than 5 years	8,104	12,093
	36,508	**46,971**
Capital expenditure commitments	**2,330**	**259**
Less – provisions	–	(1)
Commitments and contingencies (before deducting collateral)	**71,990**	**79,179**
Less – cash held as security against guarantees issued *(Note 15)*	(814)	(1,319)
Commitments and contingencies	**71,176**	**77,860**

As of 31 December 2017 and 31 December 2016, the Bank had Bankers Blanket Bond insurance, Directors and Officers liability insurance, and Property and Vehicle insurance coverage.

(thousands of Georgian Lari)

18. Commitments and contingencies (continued)

Legal (continued)

Litigation

In October-November 2013, several of the former shareholders of JSC Liberty Bank – Irina Jincharadze, Elena Kovalenko, Tamar Marshania and Ana Gerbyak (hereinafter the "Claimants") – filed a claim at the Tbilisi City Court against the respondents Eurooil LLP, the Bank, Liberty Holding Georgia LLC, JSC Liberty Capital and Liberty Investments Holding BV (hereinafter the "Respondents"). In their claims the Claimants alleged that they were coerced to sell their respective shares of the Bank to Eurooil LLP and that Eurooil LLP and the Respondents were related and/or acted in concert, and thus seek partial annulment of the share purchase agreement (hereinafter the "SPA"). The Claimants sold in total 914,827,300 ordinary shares of the Bank. In conjunction with the claim, the Claimants requested injunctive relief in the form of an encumbrance over 58.18% of the Bank's ordinary shares held by Liberty Holding Georgia LLC and nine units of real estate property owned by JSC Liberty Bank. Tbilisi City Court partially satisfied the Claimants' application for an injunction and encumbered 58.18% of the ordinary shares of the Bank held by Liberty Holding Georgia LLC.

In addition, on 8 June 2016 Tbilisi Court of Appeals issued a resolution satisfying the application of European Financial Group B.V. against Liberty Holding Georgia LLC, Elvin Solutions Limited and Olive Capital Management (minority shareholders of the Bank) regarding the arbitral proceedings between the abovementioned parties at London Court of International Arbitration and as an injunctive relief restrained Liberty Holding Georgia LLC, Elvin Solutions Limited and Olive Capital Management to dispose of or to collateralise their respective ordinary shares of the Bank in the amount of 3,326,488,049 (Liberty Holding Georgia LLC – 3,201,321,628 ordinary shares; Elvin Solutions Limited – 72,584,672 ordinary shares and Olive Capital Management – 52,581,749 ordinary shares). Abovementioned case at London Court of International Arbitration was settled among the parties.

Consequently, Tbilisi City Court approved the settlement between the Claimants and Liberty Holding Georgia LLC on 20 September 2017 regarding the litigation for the annulment of the SPA, the case was closed and all respective encumbered shares were fully released.

19. Net fee and commission income

Net fee and commission income comprise:

	2017	*2016*
Plastic card operations	10,157	10,567
Settlements operations	6,020	6,222
Remittances	4,750	5,073
Fee income received from bill payments	3,517	2,905
Cash operations	3,370	4,220
Guarantees and letters of credit	26	31
Other	6,769	5,655
Fee and commission income	**34,609**	**34,673**
Plastic card operations	(6,160)	(5,400)
Fee expense paid for bill payments	(755)	(806)
Settlements operations	(798)	(854)
Cash operations	(11)	(10)
Guarantees and letters of credit	–	(3)
Fee and commission expense	**(7,724)**	**(7,073)**
Net fee and commission income	**26,885**	**27,600**

(thousands of Georgian Lari)

20. Other income

Other income comprise:

	2017	*2016*
Income from penalty on late payments on customer loans and advances	18,371	14,581
Income from sale of shares in investment available for sale	1,026	231
Gain from sale of assets	379	375
Income from rent	344	499
Gain from revaluation of assets	46	47
Other	1,295	1,387
Total other income	**21,461**	**17,120**

21. Personnel and general and administrative expenses

Personnel and general and administrative expenses comprise:

	2017	*2016*
Salaries	53,434	50,960
Variable monthly bonuses	7,785	7,285
Performance based discretionary bonus pool	9,057	7,766
Employee retention of subordinated debt contracts	1,760	1,593
Personnel expenses	**72,036**	**67,604**

	2017	*2016*
Occupancy and rent	8,865	8,748
Legal and other professional services	3,861	4,715
Marketing and advertising	3,937	3,829
Communications	3,707	3,896
Office supplies	2,648	3,181
Utility expense	2,286	2,283
Repair and maintenance	1,347	1,346
Operating taxes	1,326	1,377
Security	1,095	1,231
Audit, audit related and other service expenses	380	429
Travel expenses	865	986
Insurance	836	913
Corporate hospitality and entertainment	405	645
Other	3,492	2,657
General and administrative expenses	**35,050**	**36,236**

22. Risk management

Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. The Group is exposed to credit risk, liquidity risk, market risk, operational risk and other non-financial risks. The risk management framework adopted by the Group sets the boundaries of risk bearing capacity for each risk and business line and ensures its compliance.

(thousands of Georgian Lari)

22. Risk management (continued)

Introduction (continued)

The responsibility of the individuals responsible for risk management is to ensure the compliance of the Group to the Risk Appetite Statement ("RAS") set by the Supervisory Board of the Bank. The compliance is ensured by continuous monitoring of the RAS parameters and proposing any changes to these parameters when circumstances change. The Enterprise Risk Management ("ERM") Department has the overall responsibility for monitoring of the RAS set by the Supervisory Board. RAS establishes escalation routes for trigger events and limits breaches in order to timely and effectively initiate and implement pre-defined mitigation actions. For the purposes of effective inclusion into daily activities of the Group, RAS parameters are detailed into more granular business unit and transactional levels. With the active involvement of Management Board risk management functions ensure proper communication and clarity at all levels regarding risk objectives, constant monitoring of risk profile against risk appetite, timely escalation of risk-related alerts and design of mitigating actions.

Risk management framework and structure

The Supervisory Board of the Bank has overall responsibility for the establishment and oversight of the Group's risk management framework. The Supervisory Board has established committees, which are responsible for developing and monitoring Group risk management policies in relevant specified areas, which are communicated through RAS.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Group, through its management standards, procedures and trainings aims, has a disciplined and constructive control environment, in which all employees understand their roles and obligations.

Audit Committee

The Audit Committee is responsible for monitoring compliance with the Group's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Group. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions. The Audit Committee is assisted in these functions by Internal Audit.

Internal Audit

Risk management processes throughout the Group are audited by the internal audit function, which examines, by undertaking regular and ad-hoc reviews, both the adequacy of the procedures and the Group's compliance with the procedures. Internal Audit discusses the results of all assessments with the Management Board, and reports its findings and recommendations to the Audit Committee.

Other structural units

The Supervisory Board is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks. Risk Appetite metrics are set by the Supervisory Board and monitored by the following committees and units with the active involvement of Management Board:

- Credit risk is managed by the Credit Risk Committees;
- Liquidity risk is managed by Asset-Liability Committee ("ALCO");
- Market risk is managed by ALCO;
- Operational risk is managed by the Operational Risk Management Department with close cooperation of Management Board;
- Information security and technology risks are managed by Information Security Department.

All committees have representatives of all relevant business units and report regularly to the Management Board.

(thousands of Georgian Lari)

22. Risk management (continued)

Risk management framework and structure (continued)

Business lines represent the primary owners of risks affecting daily activities and operations within the Group. Business processes incorporate controlling activities performed by the relevant risk unit representatives. Units with risk management functions represent the second line of defense. The following departments are responsible for day-to-management of credit, liquidity, market, operational and other financial risks:

- Enterprise Risk Management;
- Credit Underwriting;
- Credit Administration;
- Credit Controlling;
- Collections;
- Operational Risk Management;
- Information Security.

Anti-Money Laundering ("AML") and Compliance Risks are managed by Operational Risk Management Department. Collections function is divided into two broad sub-functions, each responsible for leading and monitoring collection process per types of outstanding receivables.

Business lines represent the primary owners of risks affecting daily activities and operations within the Group. Business processes incorporate day-to-day involvement of risk management representatives, with focus on risk identification, analysis, evaluation and treatment.

Risk measurement and reporting systems

The Group's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience.

Monitoring and controlling risks is primarily performed based on limits established by the RAS. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Management Board, and the head of each business division. Senior management assesses the appropriateness of the allowance for credit losses on a monthly basis.

For all levels throughout the Group, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

Risk mitigation

The Group uses collateral and diversification to mitigate its credit risks.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location. The Group risk management functions ensure that potential negative impact from concentration is identified in a timely manner, respective risks properly measured and evaluated, and, ultimately, responsive actions planned and realised. RAS sets overall limits on excessive credit risk, liquidity and market risk concentrations.

(thousands of Georgian Lari)

22. Risk management (continued)

Credit risk

Credit risk is the risk that the Group will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Group manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

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

Actual exposure per borrower against limits is monitored on loans granted. The Credit Committee may initiate a change in the limits.

Where appropriate, the Group obtains collateral and corporate guarantees. The credit risks are monitored on a continuous basis and are subject to annual or more frequent reviews.

Credit-related commitments risks

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

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group's internal credit policies. The table below shows the credit quality by class of asset for loan-related lines in the statement of financial position, based on the categories specified in the tables.

		Neither past due nor impaired					
As of 31 December 2017	***Notes***	***High grade***	***Standard grade***	***Sub-standard grade***	***Past due but not individually impaired***	***Individually impaired***	***Total***
Cash and cash equivalents, except for cash on hand	6	**307,439**	**–**	**–**	**–**	**–**	**307,439**
Amounts due from credit institutions	7	**73,430**	**–**	**–**	**–**	**–**	**73,430**
Loans to customers	8						
Loans to retail clients with regular inflows		360,795	4,744	1,760	36,069	–	**403,368**
Consumer loans		187,036	3,949	3,298	66,780	–	**261,063**
Micro loans		106,337	814	190	9,862	–	**117,203**
Gold pawn loans		57,238	–	4	1,415	1,926	**60,583**
Residential mortgage loans		18,672	262	210	854	–	**19,998**
Corporate & SME loans		968	115	68	625	2,560	**4,336**
		731,046	**9,884**	**5,530**	**115,605**	**4,486**	**866,551**
Investment securities	9						
- Loans and receivables		152,425	–	–	–	–	**152,425**
- Held to maturity		70,375	–	–	–	–	**70,375**
		222,800	**–**	**–**	**–**	**–**	**222,800**
Total		**1,334,715**	**9,884**	**5,530**	**115,605**	**4,486**	**1,470,220**

(thousands of Georgian Lari)

22. Risk management (continued)

Credit risk (continued)

		Neither past due nor impaired			Past due but not individually impaired	Individually impaired	Total
As of 31 December 2016	*Notes*	*High grade*	*Standard grade*	*Sub-standard grade*			
Cash and cash equivalents, except for cash on hand	6	**329,146**	**–**	**–**	**–**	**–**	**329,146**
Amounts due from credit institutions	7	**96,255**	**–**	**–**	**–**	**–**	**96,255**
Loans to customers	8						
Loans to retail clients with regular inflows		293,149	6,699	1,575	29,697	–	**331,120**
Consumer loans		130,705	5,467	3,803	44,826	–	**184,801**
Micro loans		100,168	846	188	7,471	–	**108,673**
Gold pawn loans		50,160	–	–	1,309	3,257	**54,726**
Residential mortgage loans		15,958	–	181	456	–	**16,595**
Corporate & SME loans		2,677	431	118	1,466	3,957	**8,649**
		592,817	**13,443**	**5,865**	**85,225**	**7,214**	**704,564**
Investment securities	9						
- Loans and receivables		164,139	–	–	–	–	**164,139**
- Held to maturity		82,451	–	–	–	–	**82,451**
		246,590	**–**	**–**	**–**	**–**	**246,590**
Total		**1,264,808**	**13,443**	**5,865**	**85,225**	**7,214**	**1,376,555**

The credit risk assessment policy for neither past due not impaired financial assets has been determined by the Group as follows:

- A financial asset that is neither past due nor impaired at the reporting date, but historically used to be past due no more than 30 days is assessed as a financial asset with high grade;
- A financial asset that is neither past due nor impaired at the reporting date, but historically used to be past due more than 30 but less than 90 days is assessed as a financial asset with standard grade;
- A financial asset that is neither past due nor impaired at the reporting date, but historically used to be past due more than 90 days is assessed as a financial asset with sub-standard grade.

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories. The attributable risk ratings are assessed and updated regularly.

An analysis of past due but not individually impaired loans, by age, is provided below.

(thousands of Georgian Lari)

22. Risk management (continued)

Credit risk (continued)

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

As of 31 December 2017	*Notes*	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Loans to customers	8					
Loans to retail clients with regular inflows		3,675	1,683	1,165	29,546	**36,069**
Consumer loans		8,799	2,888	2,757	52,336	**66,780**
Micro loans		1,635	509	395	7,323	**9,862**
Gold pawn loans		780	375	260	–	**1,415**
Residential mortgage loans		216	58	5	575	**854**
Corporate & SME loans		9	–	25	591	**625**
Total		**15,114**	**5,513**	**4,607**	**90,371**	**115,605**

As of 31 December 2016	*Notes*	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Loans to customers	8					
Loans to retail clients with regular inflows		3,983	1,673	1,153	22,888	**29,697**
Consumer loans		7,492	2,853	2,418	32,063	**44,826**
Micro loans		1,257	465	483	5,266	**7,471**
Gold pawn loans		771	375	159	4	**1,309**
Residential mortgage loans		168	35	11	242	**456**
Corporate & SME loans		–	118	90	1,258	**1,466**
Total		**13,671**	**5,519**	**4,314**	**61,721**	**85,225**

See *Note 8* for more detailed information with respect to the allowance for impairment of loans to customers.

Carrying amount per class of financial assets whose terms have been renegotiated

The table below shows the carrying amount for renegotiated financial assets, by class.

	2017	*2016*
Loans to customers		
Loans to retail clients with regular inflows	9,494	9,734
Consumer loans	1,870	3,469
Micro loans	3,346	1,572
Residential mortgage loans	78	–
Total	**14,788**	**14,775**

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue or there are any known difficulties in the cash flows of counterparties or infringement of the original terms of the contract. The Group addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Group determines the allowances appropriate for each individually significant loan on an individual basis. The main consideration for the individual assessment include whether any payment of principal or interest are overdue by more than 90 days for all loans. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

(thousands of Georgian Lari)

22. Risk management (continued)

Credit risk (continued)

Collectively assessed allowances

Allowances are evaluated on each reporting date. The calculations are made by homogenous products, meaning that all the statistical data and parameters are collected and computed for each product individually. To determine the Probability of Default (PD), the Bank applies Marginal Mortality Rate (MMR) in order to define the PD for various loan products by their age (number of the months from loan issuance to the reporting date: maximum history of 36 month to the lowest of 24 months, depending on the loan product). Recovery Rate (RR) of the defaulted loans (defined as Days Past Due >90) includes the cash paid from the default date cumulatively until the reporting date. The paid sums are discounted by the average effective weighted interest rate for the product. The Loss Given Default (LGD), equals 1 − RR. The loans written off during the period being analysed, are treated as defaulted and are involved in definition of both PD and LGD. The credit portfolio on the reporting date is classified into three categories: standard portfolio exposed to the PD in the next 12 months; nonstandard portfolio exposed to the PD during its lifetime and defaulted portfolio.

- For standard portfolio, possible loan loss allowance equals total exposure provisioned at 12 months PD and LGD.
- For nonstandard portfolio, possible loan allowance equals total exposure provisioned at lifetime PD and LGD.
- For defaulted portfolio, possible loan loss allowance equals total exposure provisioned at LGD only.

The geographical concentration of the Group's assets and liabilities is set out below:

	2017				*2016*			
	Georgia	*OECD*	*CIS and other foreign countries*	*Total*	*Georgia*	*OECD*	*CIS and other foreign countries*	*Total*
Assets								
Cash and cash equivalents	253,424	209,128	1,850	**464,402**	324,714	136,437	1,736	**462,887**
Amounts due from credit institutions	73,430	–	–	**73,430**	96,255	–	–	**96,255**
Loans to customers	757,065	–	–	**757,065**	631,481	–	–	**631,481**
Investment securities:								
- Loans and receivables	152,425	–	–	**152,425**	164,139	–	–	**164,139**
- Held to maturity	70,375	–	–	**70,375**	82,451	–	–	**82,451**
All other assets	175,451	5,642	4,687	**185,780**	169,224	3,538	3,110	**175,872**
	1,482,170	**214,770**	**6,537**	**1,703,477**	**1,468,264**	**139,975**	**4,846**	**1,613,085**
Liabilities								
Amounts due to credit institutions	6,479	–	18	**6,497**	21,782	–	18	**21,800**
Amounts due to customers	1,237,354	68,472	40,462	**1,346,288**	1,177,702	65,377	48,974	**1,292,053**
Subordinated debt	53,641	36,720	15,392	**105,753**	53,007	33,657	8,256	**94,920**
All other liabilities	21,219	6,387	–	**27,606**	17,406	1,675	–	**19,081**
	1,318,693	**111,579**	**55,872**	**1,486,144**	**1,269,897**	**100,709**	**57,248**	**1,427,854**
Net assets/(liabilities)	**163,477**	**103,191**	**(49,335)**	**217,333**	**198,367**	**39,266**	**(52,402)**	**185,231**

Liquidity risk and funding management

Liquidity risk management and supervision

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The primary objective of the liquidity risk management is to ensure with a high degree of confidence that the Group is in a position to both address its daily liquidity obligations and withstand a period of liquidity stress, the source of which could be either Group-specific or market-wide. Other objectives include securing a balanced financing mix for the Group's activities, compliance with standards set by the NBG, managing crisis situations and controlling the cost of funding.

(thousands of Georgian Lari)

22. Risk management (continued)

Liquidity risk and funding management (continued)

The main liquidity risk mitigation techniques are building liquidity reserves, diversifying funding sources and extending financing maturities. However, significant liquidity in excess of statutory requirements due to unexpected net cash inflows should be avoided and the Management Board should examine options to reduce liquidity to an appropriate level.

The Treasury Department is responsible for the management of the liquidity and funding risk within targets, boundaries and limits being set out in the RAS. The Treasury Department manages the liquidity risk on a centralised level and reports to the Management Board at least weekly. Key decisions on liquidity risk management and monitoring are taken by the ALCO. Input for analysis for ALCO purposes is presented by Treasury and ERM Departments. ERM performs additional monthly stress-tests on liquidity position of the Bank and reports the results to the ALCO.

The Bank maintains a Recovery Plan which includes pressure on liquidity triggers and recovery plan strategy. Since the precise nature of any stress event cannot be known in advance, the plans are designed to be flexible to the nature and severity of the stress event and provide a menu of options that could be used as appropriate at the time. The liquidity triggers are monitored by Treasury and ERM departments on a daily basis. Any potential trigger event is escalated to the Management Board level and should be discussed at the ALCO meeting. Recovery Plan contains step-by-step actions, to generate additional liquidity in order to facilitate recovery in a severe stress, and is executed by the Head of Treasury Department under the supervision of ALCO and Management Board.

The Group uses stress testing and scenario analysis to evaluate the impact of a sudden and severe stress events on its liquidity position. The scenarios cover the Group-specific and market related risk events.

Statutory requirement

The NBG requires all banks in Georgia to maintain average liquidity ratio, calculated as the ratio of average liquid assets to average liabilities for the respective month, including borrowings from financial institutions and part of off-balance sheet liabilities with residual maturity of up to 6 months, of no less than 30.0%. The Bank's average liquidity ratio for the month was 61.7% as of 31 December 2017 (31 December 2016: 68.2%). The Bank's average liquidity ratio for the year 2017 was 64.9% (2016: 64.6%).

Approved and published on 15 May 2017 by the NBG (Decree N70/04), liquidity coverage ratio (LCR) regulation, became effective on 1 September 2017. The LCR is calculated following Basel III framework, however, higher run-off rates apply. The NBG requires all banks to maintain the LCR of 75.0% in ₾, and LCR of 100.0% in foreign currency and total LCR of 100% on a daily basis. As of 31 December 2017, the Bank's total LCR stood at 287.3%, the LCR in ₾ was 285.9% and the LCR in foreign currency was 289.0% (31 December 2016: total LCR stood at 292.2%, the LCR in ₾ was 262.8% and the LCR in foreign currency was 330.9%).

(thousands of Georgian Lari)

22. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis by remaining contractual maturities

The tables below summarise the maturity profile of the Group's financial liabilities as of 31 December 2017 and as of 31 December 2016 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

As of 31 December 2017	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Non-derivative financial liabilities					
Amounts due to credit institutions	6,303	194	–	–	**6,497**
Amounts due to customers	831,936	399,710	180,491	1,273	**1,413,410**
Subordinated debt	4,016	10,576	111,191	22,306	**148,089**
Total undiscounted financial liabilities	**842,255**	**410,480**	**291,682**	**23,579**	**1,567,996**
Derivative financial instruments – gross settled					
Positive fair value of derivatives					
(Inflow)	–	–	(17,898)	–	**(17,898)**
Outflow	–	–	17,741	–	**17,741**
Derivative financial instruments – gross settled					
Negative fair value of derivatives					
(Inflow)	(1,303)	(1,160)	(44,552)	–	**(47,015)**
Outflow	1,303	1,348	51,922	–	**54,573**

As of 31 December 2016	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Non-derivative financial liabilities					
Amounts due to credit institutions	21,466	350	–	–	**21,816**
Amounts due to customers	782,915	411,249	160,949	1,607	**1,356,720**
Subordinated debt	3,210	9,630	124,530	7,059	**144,429**
Total undiscounted financial liabilities	**807,591**	**421,229**	**285,479**	**8,666**	**1,522,965**
Derivative financial instruments – gross settled					
Positive fair value of derivatives					
(inflow)	(1,520)	–	(21,218)	–	**(22,738)**
Outflow	1,505	–	19,859	–	**21,364**
Derivative financial instruments – gross settled					
Negative fair value of derivatives					
(inflow)	–	(1,045)	(43,778)	–	**(44,823)**
Outflow	–	1,290	45,697	–	**46,987**

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

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
2017	36,380	6,329	21,127	8,154	**71,990**
2016	33,841	6,603	26,593	12,143	**79,180**

(thousands of Georgian Lari)

22. Risk management (continued)

Liquidity risk and funding management (continued)

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

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

Maturity analysis of assets and liabilities

Treasury Department manages the maturity analysis of assets and liabilities. Modeling of assets and liabilities is necessary where contractual maturity does not adequately reflect the liquidity risk position. The most significant example in this context for the Group would be current and savings accounts from retail, corporate and municipal and other state entities. Although, contractually, current accounts are repayable on demand and savings accounts at short notice, the Bank's broad base of customers – numerically and by depositor type – helps protect against unexpected fluctuations in balances. Such accounts form a stable funding base for the Group's operations and liquidity needs. Table below shows the maturity analysis of the Group's monetary assets and liabilities according to when they are expected to be recovered or settled.

	2017			*2016*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	464,402	–	**464,402**	462,887	–	**462,887**
Amounts due from credit institutions	73,430	–	**73,430**	96,255	–	**96,255**
Loans to customers	500,093	256,972	**757,065**	458,907	172,574	**631,481**
Investment securities:						
- Loans and receivables	95,888	56,537	**152,425**	146,004	18,135	**164,139**
- Held to maturity	6,120	64,255	**70,375**	14,783	67,668	**82,451**
Total	**1,139,933**	**377,764**	**1,517,697**	**1,178,836**	**258,377**	**1,437,213**
Amounts due to credit institutions	6,497	–	**6,497**	21,800	–	**21,800**
Amounts due to customers, of which:	644,960	701,328	**1,346,288**	577,362	714,691	**1,292,053**
- Current accounts	120,053	549,200	**669,253**	24,310	590,841	**615,151**
- Time deposits (including certificates of deposit)	524,907	152,128	**677,035**	553,052	123,850	**676,902**
Subordinated debt	–	105,753	**105,753**	–	94,920	**94,920**
Total	**651,457**	**807,081**	**1,458,538**	**599,162**	**809,611**	**1,408,773**
Net	**488,476**	**(429,317)**	**59,159**	**579,674**	**(551,234)**	**28,440**

The maturity of the assets is based on their carrying amounts and upon earliest legally exercisable maturity as of 31 December of the year concerned. The maturity of liabilities is based on the earliest contractual maturity or first call. The portion of current and savings accounts is presented in more than one year maturity range due to their stability. Customer deposits diversification by number and type of depositors and the past experience of the Group indicate that such accounts and deposits provide a long term and stable source of funding, and as a result they are allocated per expected time of the funds outflow in the gap analysis table on the basis of the statistical data accumulated by the Group during the previous periods and assumptions made regarding the "permanent" part of current account balances.

As of 31 December 2017, total Amounts due to customers amounted to ₾ 1,346,288 (as of 31 December 2016: ₾ 1,292,053), of which current accounts comprised ₾ 669,253 (as of 31 December 2016: ₾ 615,151). The Bank conducts the analysis of the stability of the current account balances for the period of the preceding two years on a daily basis. These balances have not fallen below ₾ 549,200 (2016: ₾ 590,841) for the respective periods of the preceding 24 months. As such, it is reasonable to present these funds in Amounts due to customers in more than one year maturity range in the above schedule. If the contractual maturities of Amounts due to customers were considered, the cumulative liquidity gap within one year as of 31 December 2016 would have been negative ₾ 60,724 (31 December 2016: negative ₾ 11,167).

As of 31 December 2017, the Bank had sufficient liquid collateral to additionally draw down ₾ 209,245 (2016: ₾ 217,941) from the NBG at immediate notice.

On 4 May 2017, Fitch Ratings affirmed the Bank's Long-Term Foreign Currency Issuer Default Rating (IDR) of 'B+' with Stable Outlook, Short-Term Foreign Currency IDR of 'B', Support Rating of '4' and Support Rating Floor of 'B'.

On 30 May 2017, Standard & Poor's affirmed the Bank's long-term counterparty credit rating of 'B' and short-term counterparty credit rating of 'B' and revised its Outlook from Stable to Positive.

(thousands of Georgian Lari)

22. Risk management (continued)

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. The Bank's strategy is not to be involved in trading book activity or investments in commodities. Accordingly, the Bank`s exposure to market risk is limited to interest rate risk and currency risk.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments.

The sensitivity of the statement of profit or loss is the effect of the assumed changes in interest rates on the net interest income for one year, due to re-pricing or maturity period characteristics of financial instruments. The Bank is exposed to interest rate risk in case of material drop in interest rates from competitors on loan products or rise in the cost of funds due to macro and Bank specific events.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The NBG requires the Bank to monitor both balance-sheet and total aggregate (including off-balance sheet) open currency positions and to maintain the later one within 20.0% of the Bank's total regulatory capital. As at 31 December 2017, the Bank maintained an aggregate open currency position of 1.9% of regulatory capital (31 December 2016: 1.3%).

The Bank has approved Foreign Currency Risk Management Policy, which is intended to establish parameters for the Bank for the management of foreign currency exposures.

The process of foreign currency risk management includes, but is not limited to:

- Selection of adequate methodology for foreign currency risk identification and quantitative measurement;
- Daily monitoring of the open foreign currency position;
- Minimising currency risk through compliance with established limits;
- Revealing existing and anticipated negative tendencies of increased currency risk followed by the analysis of its causes and implications;
- Making recommendations on the currency risk management strategy;
- Determining the types and limits on instruments used in the foreign currency risk operations.

ALCO sets limits on the level of exposure by currency as well as on aggregate exposure positions which are more conservative than those set by the NBG. The Bank's compliance with such limits is monitored daily by Treasury and ERM Departments.

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

Currency	*Appreciation/ (depreciation) of the exchange rate of ₾ against the respective currency in % 2017*	*Effect on profit before tax 2017*	*Appreciation/ (depreciation) of the exchange rate of ₾ against the respective currency in % 2016*	*Effect on profit before tax 2016*
US Dollar	2.06%	(76)	-10.52%	200
EUR	-11.11%	(15)	-6.77%	29

22. Risk management (continued)

Operational risk

Operational risk is defined as the risk of a financial loss resulting from the inadequacy or failure of internal processes, systems or people, or from external events, whether deliberate, accidental or natural occurrences. External events include, but are not limited to fraud, floods, fire, earthquakes and terrorist or hacker attacks. Credit or market events such as default or fluctuations in value do not fall in the scope of operational risk. Compliance risk is included under operational risk. Compliance risk is the potential that the Bank may incur regulatory sanctions, financial loss and/or reputational damage arising from its failure to comply with applicable laws, rules and regulations. The operational risk does not cover the reputational risk.

The overall objective of the operational risk management is to identify risks arising from inadequate or failed internal processes, people and systems or from external events and mitigate them where feasible and to the extent economically reasonable.

The Bank has established the Operational Risk Management (ORM) framework and takes all possible steps to understand exposure of the business to the variety of operational risks arising from inadequate or failed internal processes, people and systems or from external events. The aim of the ORM framework is to enable the Bank to collect, assess, manage, and report operational risk efficiently and effectively.

The responsibilities of the Operational Risk Management and ERM Departments, Internal Audit and Business Owners within ORM framework are defined in the Operational Risk Management Policy.

In general, the Bank has low appetite towards the operational risks and aims to reduce the losses resulting from risk events to the point where the Bank is not materially impacted by them. The Bank has no appetite towards operational risks related to fraud, information security (including IT) and compliance breaches, therefore the Bank makes all efforts to eliminate these types of risks.

The Risk Event Database (RED) is developed and maintained to ensure that all incidents, losses and near misses are evidenced and treated appropriately. It provides the Bank with a technical tool to systematically collect realised and potential risk events. This information is used to refine the identification of risks and the appropriate approaches to managing them. The collection of the data and a corresponding analysis is carried out by the Operational Risk Management Department in a centralised manner. Operational risk events from the RED database with material impacts, direct and indirect losses are reported to the Management Board.

Compliance with Group standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of respective business lines, with summaries submitted to the Audit Committee and Supervisory Board.

The key mitigation controls the Bank deploys stem from its Operational Risk Profile (ORP) and the RAS of the Supervisory Board. The Bank actively uses corporate insurance to mitigate its operational risks.

23. Fair value disclosures

Fair value measurement procedures

External Appraisers are involved for valuation of significant assets, such as properties. Involvement of external Appraisers is decided upon annually by the management after discussion with and approval by the Bank's audit committee. The selection criteria include market knowledge, reputation, independence and whether professional standards are maintained. Valuators are normally rotated every three years. The management decides, after discussions with the Group's external Appraisers, which valuation techniques and inputs to use for each case.

At each reporting date, the management analyses the movements in the values of assets and liabilities which are required to be re-measured or re-assessed as per the Group's accounting policies. For this analysis, the management verifies the major inputs applied in the latest valuation by agreeing the information in the valuation computation to contracts and other relevant documents. The management, in conjunction with the Group's external Valuators, also compares each the changes in the fair value of each asset and liability with relevant external sources to determine whether the change is reasonable. On an interim basis, the management and the Group's external Valuators present the valuation results to the audit committee and the Group's independent auditors. This includes a discussion of the major assumptions used in the valuations.

(thousands of Georgian Lari)

23. Fair value disclosures (continued)

Fair value hierarchy

For the purpose of fair value disclosures, the Group has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy.

		Fair value measurement using			
At 31 December 2017	***Date of valuation***	***(Level 1)***	***(Level 2)***	***(Level 3)***	***Total***
Assets measured at fair value					
Foreign exchange forwards and swaps	31 December 2017	–	104	–	**104**
Investment properties	31 December 2017	–	–	2,597	**2,597**
Property and equipment – land and buildings	31 December 2016	–	–	80,730	**80,730**
		–	**104**	**83,327**	**83,431**
Assets for which fair values are disclosed					
Investment securities:	31 December 2017				
- Loans and receivables		–	153,286	–	**153,286**
- Held to maturity		–	75,409	–	**75,409**
		–	**228,695**	**–**	**228,695**
Liabilities measured at fair value					
Foreign exchange forwards and swaps	31 December 2017	–	5,642	–	**5,642**
		–	**5,642**	**–**	**5,642**
Liabilities for which fair values are disclosed					
Subordinated debt	31 December 2017	–	108,874	–	108,874
		–	**108,874**	**–**	**108,874**

		Fair value measurement using			
At 31 December 2016	***Date of valuation***	***(Level 1)***	***(Level 2)***	***(Level 3)***	***Total***
Assets measured at fair value					
Foreign exchange forwards and swaps	31 December 2016	–	1,195	–	**1,195**
Investment properties	31 December 2016	–	–	2,729	**2,729**
Property and equipment – land and buildings	31 December 2016	–	–	81,349	**81,349**
		–	**1,195**	**84,078**	**85,273**
Assets for which fair values are disclosed					
Investment securities:	31 December 2016				
- Loans and receivables		–	164,088	–	**164,088**
- Held to maturity		–	86,058	–	**86,058**
		–	**250,146**	**–**	**250,146**
Liabilities measured at fair value					
Foreign exchange forwards and swaps	31 December 2016	–	1,386	–	**1,386**
		–	**1,386**	**–**	**1,386**
Liabilities for which fair values are disclosed					
Subordinated debt	31 December 2016	–	95,410	–	**95,410**
		–	**95,410**	**–**	**95,410**

There were no transfers among the levels of the fair value hierarchy in 2017 and 2016.

(thousands of Georgian Lari)

23. Fair value disclosures (continued)

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

Set out below is a comparison by class of the carrying amounts and fair values of the Group's financial instruments that are carried in the consolidated statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2017	*Fair value 2017*	*Unrecognised gain/(loss) 2017*	*Carrying value 2016*	*Fair value 2016*	*Unrecognised gain/(loss) 2016*
Financial assets						
Investment securities:						
- Loans and receivables	152,425	153,286	861	164,139	164,088	(51)
- Held to maturity	70,375	75,409	5,034	82,451	86,058	3,607
Financial liabilities						
- Subordinated debt	105,753	108,874	(3,121)	94,920	95,410	(490)
Total unrecognised change in unrealised fair value			**2,774**			**3,066**

Valuation techniques and assumptions

The following describes the methodologies and assumptions used to determine fair values for assets and liabilities recorded at fair value in the consolidated financial statements and those items that are not measured at fair value in the statement of financial position but whose fair value are disclosed.

Assets for which fair value approximates carrying amount

The carrying amounts of cash and cash equivalents, amounts due from credit institutions, loans to customers, amounts due to credit institutions and amounts due to customers (including current and savings accounts), are considered to approximate their respective fair values due to their short-term maturities, liquid nature and as such continues repricing to market terms. Considering the nature and characteristics, the cash and cash equivalents are classified as Level 1 of the fair value hierarchy.

Derivatives

Derivatives valued using a valuation technique with market observable inputs are mainly interest rate swaps, currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves.

Financial assets and financial liabilities carried at amortised cost

Fair value of the quoted notes and bonds is based on price quotations at the reporting date, as such they fall under Level 2 fair value hierarchy. The fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to the NBG and credit institutions and other financial assets and liabilities, is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

Investment properties and buildings

There are three main approaches to valuation of real property:

Market approach

Establishes limits on the market value for the real estate by examining the prices commonly paid for properties that compete with the subject property for buyers. Sales are investigated to ensure that the parties to the transaction were adequately motivated. Sale prices reflecting motivation other than that of a typical market participant, i.e. transactions of special purchasers who are willing to pay a premium for a particular property, should be eliminated. The method involves analysing units of comparison such as a price per square metre of gross building area. Adjustments are made to the sales/listing for differences in location, size, age and condition, financing and various other factors which may have any influence on the value.

(thousands of Georgian Lari)

23. Fair value disclosures (continued)

Valuation techniques and assumptions (continued)

In the analysis of the market value of appraised properties by the sales comparison (market data) approach, it is utilised the sales/listing measured to the best available, most recent and overall similar sales/listing available as of the report date.

Information on the comparable sales and listing is obtained from brokerage companies, agents and brokers, as well as public information, including commercial broker listings on websites and published data. Then such information is further confirmed with owners and/or principles or brokers involved in the listed transactions.

Cost approach

Establishes the value of the real estate by estimating the cost of acquiring the land and building a new property or renovating an old property for equivalent utilisation purposes with no undue cost due to delay. An estimate of entrepreneurial incentive or developer's profit/loss is commonly added to the land and construction costs. For mature properties, the cost approach is used to estimate the depreciation cost, including items of physical deterioration and functional obsolescence.

The main approach of the cost replacement method reflects the idea that one will not pay for the given property more than he/she would pay for the construction of that property.

The cost approach involves the following steps:

- Estimate land value;
- Estimate reproduction or replacement cost of the improvements;
- Estimate accrued depreciation from all sources (physical deterioration, functional obsolescence, external and economic obsolescence);
- Deduct accrued depreciation from the reproduction or replacement cost to arrive at the depreciated improvement cost;
- Estimate equipment cost and deduct depreciation;
- Add the depreciated improvement cost to depreciated equipment cost and to the land value to arrive at a total property value indication.

Income capitalisation approach

The income generation methodology is based on the hypothetical incomes generated through the use of the property being valued. The estimation of the real estate market value is based on the capitalisation coefficient which is calculated based on the long-term rate of the alternative investment methodology.

Discount cash flow (DCF)

The fair value of completed investment properties is determined using a discounted cash flow (DCF). Based on the actual and projected market demand, types of goods/services to be produced/provided, pricing policy and expected competitive environment in the market, the strategic financial projections for the business is developed. Using DCF method, a property's fair value is estimated using explicit assumptions regarding the benefits and liabilities of ownership over the asset's life including an exit or terminal value. As an accepted method within the income approach to valuation, the DCF method involves the projection of a series of cash flows on a real property interest. To this projected cash flow series, an appropriate, market-derived discount rate is applied to establish the present value of the cash inflows associated with the real property. The duration of the cash flow and the specific timing of inflows and outflows are determined by events such as rent reviews, lease renewal and related lease up periods, re-letting, redevelopment, or refurbishment. The appropriate duration is typically driven by market behaviour that is a characteristic of the class of real property.

In the case of investment properties, periodic cash flow is typically estimated as gross income less vacancy, non-recoverable expenses, collection losses, lease incentives, maintenance cost, agent and commission costs and other operating and management expenses. The series of periodic net cash inflows, along with an estimate of the terminal value anticipated at the end of the projection period, is then discounted.

(thousands of Georgian Lari)

23. Fair value disclosures (continued)

Valuation techniques and assumptions (continued)

Movements in Level 3 assets and liabilities at fair value

The following tables show a reconciliation of the opening and closing amount of investment properties in Level 3 assets and liabilities which are recorded at fair value. For the reconciliation of property and equipment – buildings refer to *Note 10*:

	At 1 January 2017	*Total gain/(loss) recorded in profit or loss*	*Purchases/ additions*	*Sales*	*At 31 December 2017*
Assets					
Investment properties	2,729	(132)	–	–	2,597
	2,729	**(132)**	**–**	**–**	**2,597**

	At 1 January 2016	*Total gain/(loss) recorded in profit or loss*	*Purchases/ additions*	*Sales*	*At 31 December 2016*
Assets					
Investment properties	4,665	47	55	(2,038)	2,729
	4,665	**47**	**55**	**(2,038)**	**2,729**

The following table shows the quantitative information about significant unobservable inputs used in the fair value measurement categorised within Level 3 of the fair value hierarchy:

As of 31 December 2017	*Carrying amount*	*Valuation techniques*	*Unobservable input*	*Range (weighted average)*
Land and buildings – head office	45,540	- Income Capitalisation Approach (DCF)	- 10% increase/decrease of rent price - 10% increase/decrease of Occupancy rate	(11.49%) up to 8.05%
Land and buildings	13,050	- Income Capitalisation Approach (DCF)	- 10% increase/decrease of rent price - 10% increase/decrease of Occupancy rate	(13.18%) up to 13.57%
Land and buildings	4,208	- Cost approach	- 10% increase/decrease of land price - 10% increase/decrease of Replacement cost	(6.49%) up to 6.36%
Land and buildings	17,932	- Market approach	- Price volatility adjustment: 10% increase/decrease of market prices	(9.31%) up to 9.63%
Investment properties – commercial building	777	- Cost approach	- 10% increase/decrease of land price - 10% increase/decrease of Replacement cost	(3.33%) up to 10%
Investment properties – commercial building	1,763	- Market approach	- Price volatility/adjustment: 10% increase/decrease of market prices	(10.30%) up to 10.3%
Investment properties – commercial building	57	- Market approach	- Price volatility adjustment: 10% increase/decrease of market prices	(9.1%) up to 9.1%

As of 31 December 2016	*Carrying amount*	*Valuation techniques*	*Unobservable input*	*Range (weighted average)*
Land and buildings – head office	46,054	- Income Capitalisation Approach (DCF)	- 10% increase/decrease of rent price - 10% increase/decrease of Occupancy rate	(11.49%) up to 8.05%
Land and buildings	12,982	- Income Capitalisation Approach (DCF)	- 10% increase/decrease of rent price - 10% increase/decrease of Occupancy rate	(13.18%) up to 13.57%
Land and buildings	4,039	- Cost approach	- 10% increase/decrease of land price - 10% increase/decrease of Replacement cost	(6.49%) up to 6.36%
Land and buildings	18,274	- Market approach	- Price volatility adjustment: 10% increase/decrease of market prices	(9.31%) up to 9.63%
Investment properties – commercial building	882	- Cost approach	- 10% increase/decrease of land price - 10% increase/decrease of Replacement cost	(6.31%) up to 6.31%
Investment properties – commercial building	1,789	- Market approach	- Price volatility/adjustment: 10% increase/decrease of market prices	(9.91%) up to 10.06%
Investment properties – commercial building	58	- Market approach	- Price volatility adjustment: 10% increase/decrease of market prices	(9.09%) up to 9.09%

(thousands of Georgian Lari)

24. Related party disclosures

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

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

The outstanding balances at the period end of and related income and expense arising from related party transactions are as follows:

	2017			*2016*		
	Parent	*Entities under common control*	*Key management personnel*	*Parent*	*Entities under common control*	*Key management personnel*
Loans outstanding at 1 January, gross	**–**	**–**	**233**	**–**	**–**	**227**
Loans issued during the year	–	–	25	–	–	13
Loan repayments during the year	–	–	(40)	–	–	(7)
Loans outstanding at 31 December, gross	**–**	**–**	**218**	**–**	**–**	**233**
Less: allowance for impairment at 31 December	–	–	(4)	–	–	(5)
Loans outstanding at 31 December, net	**–**	**–**	**214**	**–**	**–**	**228**
Interest income on loans	–	–	32	–	–	32
Impairment charge/(reversal) for loans	–	–	(1)	–	–	2
Deposits* at 1 January	**–**	**–**	**101**	**–**	**–**	**101**
Deposits received during the year	–	–	365	–	–	–
Deposits repaid during the year	–	–	(112)	–	–	–
Deposits at 31 December	**–**	**–**	**354**	**–**	**–**	**101**
Subordinated debt at 1 January	**–**	**1,226**	**2,288**	**–**	**996**	**798**
Subordinated debt received during the year	–	111	904	–	230	1,490
Subordinated debt repaid during the year	–	(1,337)	(1,149)	–	–	–
Subordinated debt at 31 December	**–**	**–**	**2,043**	**–**	**1,226**	**2,288**
Current accounts at 31 December	–	1,748	5,382	42	3,099	3,135
Interest expense on deposits and current accounts	20	90	325	14	58	262
Interest expense on subordinated debt	–	111	264	–	142	118
Fee and commission income received	–	1,091	9	–	769	7
Other operating expenses	–	336	1	–	463	25

* *Deposits include Time Deposits and CDs as well as Savings Account.*

Entities under common control comprises of organisations in which shareholders of the Group exercise control which represent related parties to the Group. Since control change of the Group occurred on 13 October 2017 (see Note 1), the year-end outstanding balances encompass the relationship with related parties presented at year-end, while expenses and income covers all transactions with the deliberated related parties throughout 2017.

(thousands of Georgian Lari)

24. Related party disclosures (continued)

The number of key personnel at 31 December 2017 was 8 (2016: 9) and their compensation comprised the following:

	2017	*2016*
Salaries, bonuses and other short term benefits	9,498	8,358
Retention bonus paid in cash for purchase of the subordinated debt contracts	1,760	1,593
Total key personnel compensation	**11,258**	**9,951**

25. Changes in liabilities arising from financing activities

	Note	*Subordinated debt*	*Total liabilities from financing activities*
Carrying amount at 31 December 2015		**58,346**	**58,346**
Proceeds from issue	16	27,975	**27,975**
Foreign currency translation	16	8,453	**8,453**
Other	16	146	**146**
Carrying amount at 31 December 2016		**94,920**	**94,920**
Proceeds from issue	16	11,331	**11,331**
Foreign currency translation	16	(571)	**(571)**
Other	16	73	**73**
Carrying amount at 31 December 2017		**105,753**	**105,753**

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

26. Capital management

The Bank's capital management objectives consist of ensuring its solvency at all times, complying with the supervisory and internal capital requirements, and maintaining a prudent capital cushion in order to protect the Bank from known (and, to some extent, the unknown) risks.

The Bank's management of its total capital is based on the Internal Capital Adequacy Assessment Process (ICAAP), which represents its main capital management tool. Besides, as an additional capital management tool, the Bank maintains Recovery Plan which includes regulatory capital alert thresholds and recovery strategies.

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

NBG Capital adequacy ratio

Under the current capital requirements set by the NBG throughout 2017 banks have to maintain minimum Capital adequacy ratio of 9.6% (2016: 10.8%) of the risk-weighted assets (RWA), as well as the minimum Tier 1 Capital adequacy ratio of 6.4% (2016: 7.2%) of the RWA, computed based on the Bank's stand-alone financial statements prepared in accordance with the NBG requirements.

The current capital adequacy calculation methodology was effective until 31 December 2017 and Decree 100/04 (New Methodology, Basel II/III framework) will remain only (see below: NBG Basel II/III Capital adequacy ratio).

(thousands of Georgian Lari)

26. Capital management (continued)

NBG Capital adequacy ratio (continued)

As of 31 December 2017 and 31 December 2016, the Bank's Capital adequacy ratios were as follows:

	2017	*2016*
Tier 1 capital	118,497	109,222
Tier 2 capital	118,497	102,049
Less: deductions from capital	(110)	(112)
Total capital	**236,884**	**211,159**
Risk-weighted assets	**1,140,371**	**903,312**
Tier 1 capital adequacy ratio	10.4%	12.1%
Capital adequacy ratio	20.8%	23.4%

NBG Basel II/III Capital adequacy ratio

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

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

Systemic Risk buffer is designed as a build-up manner and is allocated over upcoming three years. Effective from 31 December 2018, first year is set at 0.6%, and increases every year by 0.3% throughout 31 December 2021. Capital Conservation and Countercyclical buffers are set at 2.50% and 0.00%, respectively. Any adjustment of Pillar I Buffers is at NBG's discretion.

On 18 December 2017, the NBG also published and approved Pillar II Requirements in additional to Pillar I Buffers. Pillar II Requirements include the following capital buffers: Unhedged Currency Induced Credit Risk (CICR), Net GRAPE, Credit Portfolio Concentration Risk and Net Stress-Test buffers.

As of 31 December 2017, the Bank had to maintain CICR buffer of 0.06%, primary due to percentage share of foreign currency denominated loans to customers. All the rest Pillar II buffers were to preserve at zero.

As of 31 December 2017, under total Basel II/III requirements the Bank was required to maintain a minimum Total Capital adequacy ratio of 10.56% of the risk-weighted exposures (RWE), minimum Tier 1 Capital adequacy ratio of 8.54% of the RWE and Common Equity Tier 1 Capital adequacy ratio of 7.03% of the RWE computed based on the Bank's stand-alone financial statements prepared in accordance with the NBG requirements (as at 31 December 2016 the Bank maintained minimum capital requirements in accordance to capital adequacy regulation approved and published on 28 October by the NBG (Decree N100/04) and adjusted for NBG's discretionary items, became effective on 30 June 2014. As at 31 December 2016 minimum Total Capital adequacy ratio, minimum Tier 1 Capital adequacy ratio and Common Equity Tier 1 Capital adequacy ratio was set as 10.50%, 8.50% and 7.00% respectively).

The Bank's capital adequacy ratios calculated in accordance with NBG Basel II/III requirement were as follows:

	2017	*2016*
Common Equity Tier 1 capital	**162,444**	**136,025**
Additional Tier 1 capital	6,139	6,139
Tier 1 capital	**168,583**	**142,164**
Tier 2 capital	63,911	72,275
Total regulatory capital	**232,494**	**214,439**
Risk-weighted exposures	**1,355,391**	**1,149,962**
Common Equity Tier 1 capital ratio	12.0%	11.8%
Tier 1 capital ratio	12.4%	12.4%
Total regulatory capital ratio	17.2%	18.6%

(thousands of Georgian Lari)

27. Events after the reporting period

Mandatory tender offer

On November 2017, upon acquisition of Groups controls by purchasing more than half of total voting shares, the EFG hereby announced the mandatory tender offer as per Article 532 of the Georgian Law on Entrepreneurs offering to purchase the remaining ordinary and preferred shares of the Group. Mandatory tender offer started on 25 November 2017 and ended on 25 January 2018 inclusive:

- Repurchase price set for the mandatory tender offer was determined by the independent audit company BDO Georgia and was not less than the price EFG paid to acquire 74.64% of the total outstanding voting ordinary shares of the Group;
- Repurchase price per ordinary share and preferred share of Liberty Bank constituted GEL 0.03723611724 and GEL 1.22272172210, respectively.

Within the mandatory tender offer EFG acquired 8,253,442 ordinary and 2,257,840 preferred shares. Accordingly, the EFG's voting ownership interest increased to 74.82% in subsequent period.