

JSC Ziraat Bank Georgia

Financial Statements

Together with the Independent Auditor's Report

Year ended 31 December 2020

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INDEPENDENT AUDITOR'S REPORT

To shareholders and supervisory board of **JSC ZIRAAT BANK GEORGIA**

Opinion

We have audited the accompanying financial statements of **JSC ZIRAAT BANK GEORGIA** (hereinafter the “Bank”), which comprise the statements of financial position as at 31 December 2020 and the statement of comprehensive income, statement of cash flows and changes in equity for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2020, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

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

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

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

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

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

Auditor’s Responsibilities for the Audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

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

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

The engagement partner responsible for the audit resulting in this independent auditor's report is

Ivane Zhuzhunashvili (Saras-A-720718)



For and on behalf of BDO LLC

Tbilisi, Georgia

14 April 2021

JSC ZIRAAT BANK GEORGIA
 STATEMENT OF FINANCIAL POSITION
 As at 31 December 2020
 (Georgian Lari)

Assets	Notes	31.12.2020	31.12.2019
Cash and cash equivalents	6	37,168,398	39,577,357
Mandatory reserve with the NBG	7	12,287,908	13,512,500
Loans to customers	8	56,908,893	49,430,979
Investment securities	9	17,766,115	23,280,588
Other assets		605,669	410,488
Intangible assets	10	702,502	624,502
Right-of-use assets	11	975,835	497,954
Property and equipment	12	5,219,293	4,269,558
Total assets		131,634,613	131,603,926
Liabilities and equity			
Liabilities			
Amounts due to credit institutions	13	2,551,866	2,200,857
Customer accounts	14	67,138,140	70,828,559
Lease liabilities	11	987,652	449,909
Deferred tax liability	19	542,439	318,276
Provision for guarantees issued		48,106	29,168
Other liabilities		453,050	639,127
Total liabilities		71,721,253	74,465,896
Equity			
Share capital	15	50,000,000	50,000,000
Retained earnings		9,913,360	7,138,030
Total equity		59,913,360	57,138,030
Total liabilities and equity		131,634,613	131,603,926

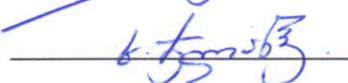
The financial statements for the year ended 31 December 2020 were approved on behalf of the management on 14 April 2021 by:

General director



Omer Aydin

Chief accountant



Sophio Jlantashvili



Notes on pages 9-48 are the integral part of these financial statements.

JSC ZIRAAT BANK GEORGIA

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2020

(Georgian Lari)

		2020	2019
Interest income	16	7,275,394	6,903,347
Interest expense	16	(461,461)	(462,111)
Net interest income		6,813,933	6,441,236
Change in provision for loan impairment	8	(515,915)	1,627
Net interest income after provision for loan impairment		6,298,018	6,442,863
Fee and commission income	17	1,354,967	1,455,220
Fee and commission expense	17	(678,926)	(475,105)
Income from foreign currency trading		1,331,711	1,466,956
Other income		168,849	171,367
Non-interest income		2,176,601	2,618,438
General and administrative expenses	18	(5,511,814)	(4,491,702)
Change in provision for guarantees issued		(18,440)	703
Change in provision for other assets		54,565	(34,273)
Foreign exchange gain/(loss), net		563	54,012
Profit before tax		2,999,493	4,590,041
Income tax expense	19	(224,163)	(374,812)
Total comprehensive income for the year		2,775,330	4,215,229

Notes on pages 9-48 are the integral part of these financial statements.

JSC ZIRAAT BANK GEORGIA

STATEMENT OF CASH FLOWS

For the year ended 31 December 2020

(Georgian Lari)

	2020	2019
Cash flows from operating activities		
Profit before tax	2,999,493	4,590,041
Adjustments for:		
Interest income	(2,591,682)	(1,056,173)
Interest expense	-	61,170
Depreciation and amortization	767,082	517,037
Amortization of right of use of assets	276,599	137,559
PPE write off	-	436
Net change in Provision for impairment	479,790	31,943
Net loss/(gain) from exchange rate difference	(563)	(54,012)
Discount on investment securities	(1,779,974)	(1,799,702)
Gain from sale of repossessed property	-	(13,033)
Cash inflows from operating activities before changes in working capital	150,745	2,415,266
(Increase)/Decrease in mandatory reserve with the NBG	1,224,592	(3,139,616)
Increase in loans to customers	(5,402,147)	(14,183,004)
(Increase)/Decrease in other assets	(140,616)	1,639,252
Increase/(Decrease) in customer accounts	(3,565,175)	11,203,640
Increase/(Decrease) in other liabilities	(29,748)	345,981
Increase in amounts due to credit institutions	351,009	177,648
Cash used in operations	(7,411,340)	(1,540,833)
Income taxes paid	(155,831)	(162,537)
Net cash used in operating activities	(7,567,171)	(1,703,370)
Investing activities		
Purchase of property and equipment and intangible assets	(1,794,817)	(1,061,085)
Purchase of investment securities	(48,802,553)	(35,457,813)
Redemption of investment securities	56,097,000	42,682,000
Net cash from investing activities	5,499,630	6,163,102
Financing activities		
Principal paid on lease liabilities	(270,454)	(207,345)
Interest paid on lease liabilities	(71,527)	(20,602)
Net cash used in financing activities	(341,981)	(227,947)
Net (Decrease)/Increase in cash and cash equivalents	(2,409,522)	4,231,785
Cash and cash equivalents at beginning of year	39,577,357	35,291,560
Effect of changes in foreign exchange rate on cash and cash equivalents	563	54,012
Cash and cash equivalents at end of year	37,168,398	39,577,357

Notes on pages 9-48 are the integral part of these financial statements.

JSC ZIRAAT BANK GEORGIA

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2020

(Georgian Lari)

	Share capital	Retained earnings	Total equity
31.12.2018	50,000,000	2,922,801	52,922,801
Total comprehensive income of the year	-	4,215,229	4,215,229
31.12.2019	50,000,000	7,138,030	57,138,030
Total comprehensive income of the year	-	2,775,330	2,775,330
31.12.2020	50,000,000	9,913,360	59,913,360

Notes on pages 9-48 are the integral part of these financial statements.

1. General information

Ziraat Bank Tbilisi Branch was incorporated in 1998. According to the Order No.386. received in 27th April of 2017, the Company has received a banking license and therefore changed the identification code, but the scope of activity remained unchanged and the Company continued operating as “Ziraat Bank Georgia”.

JSC “Ziraat Bank Georgia” (hereinafter the “Bank”) was incorporated on 27th April of 2017 and is domiciled in Georgia. The Bank is a joint stock company and was set up in accordance with Georgian regulations.

The Bank accepts deposits from the individuals and corporate clients and extends credit and guarantees, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its customers.

The Bank is registered at the following address: Georgia. Tbilisi, Old Tbilisi District, Sanapiro Street N-6. The Bank with its service centres in Tbilisi, Batumi, Marneuli and Kutaisi operates under a general banking license issued by National Bank of Georgia. (The NBG).

As of 31 December 2020 and 2019, JSC Ziraat Bank Turkey represents shareholder owning 100% of the shares of the Bank.

Average annual number of employees of the Bank (Fixed contracts) by category is presented as follows:

	<u>2020</u>	<u>2019</u>
Top management	3	3
Middle managers	32	28
Other employees	18	12

The Bank had no temporary employment contracts during 2020 and 2019 years.

2. Basis of preparation**Statement of compliance**

These financial statements have been prepared in accordance with International Financial Reporting Standards, International Accounting Standards and Interpretations (collectively IFRS) issued by the International Accounting Standards Board (IASB).

The Bank prepares financial statements in Georgian Lari. The financial statements have been prepared on the historical cost basis. The reporting period for the Bank is the calendar year from January 1 to December 31.

The preparation of financial statements in compliance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying The Bank's accounting policies, which has significant influence on the book values of assets and liabilities, income and expense recognized in profit and loss of the year. Factual results may be different from the current estimates. Adjustments, resulting from the changes in accounting estimates belong to the period when they are recognized. The areas where significant judgments and estimates have been made in preparing the financial statements and their effect are disclosed in Note 3.

Summary of significant accounting policies used for preparing these financial statements are explained in Note 23.

Going concern

These financial statements have been prepared on the assumption that the Bank is a going concern and will continue its operations for the foreseeable future. The management and shareholders have the intention to further develop the business of the Bank in Georgia. The management believes that the going concern assumption is appropriate for the Bank.

In adopting the going concern basis for preparing the financial statements, the Management have considered the bank's business activities, objectives and strategy, principal risks and uncertainties in achieving its objectives, and performance.

JSC Ziraat Bank (Turkey), a state-owned bank, represents 100% owning shareholder of the Bank. Ziraat Bank is interested in further developing economic activity of Ziraat Bank Georgia, guaranteeing unlimited service for its clients. As at 31 December 2020 the Bank has Significant transactions with its shareholder including deposits placed in Bank. As of the management's estimate shareholder is ready to make further financial resources available for the Bank if needed. Financial resources may be the following: contribution in capital, deposits placed, etc.

Based on this, the Management confirm that they have a reasonable expectation that the Bank, as a whole, have adequate resources to continue in operational existence for the 12 months from the date the financial statements are authorised for issue. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern for the foreseeable future. Therefore, the financial statements continue to be prepared on the going concern basis.

2. Basis of preparation (Continued)

Changes in accounting policies

a) *New standards, interpretations and amendments adopted from 1 January 2020*

New standards that have been adopted in the annual financial statements for the year ended 31 December 2020, but have not had a significant effect on the Bank are:

- IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors (Amendment - Disclosure Initiative - Definition of Material); and
- Revisions to the Conceptual Framework for Financial Reporting.
- Definition of a Business (Amendments to IFRS 3);
- Interest Rate Benchmark Reform - IBOR 'phase 2' (Amendments to IFRS 9, IAS 39 and IFRS 7); and
- COVID-19-Related Rent Concessions (Amendments to IFRS 16).

b) *New standards, interpretations and amendments not yet effective*

There are a number of standards, amendments to standards, and interpretations which have been issued by the IASB that are effective in future accounting periods that the Bank has decided not to adopt early.

The following amendments are effective for the period beginning 1 January 2022:

- Onerous Contracts - Cost of Fulfilling a Contract (Amendments to IAS 37);
- Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16);
- Annual Improvements to IFRS Standards 2018-2020 (Amendments to IFRS 1, IFRS 9, IFRS 16 and IAS 41); and
- References to Conceptual Framework (Amendments to IFRS 3).

The Bank is currently assessing the impact of these new accounting standards and amendments.

Other

The Bank does not expect any other standards issued by the IASB, but not yet effective, to have a material impact on the bank.

3. Critical accounting estimates and judgments

The Bank makes certain estimates and assumptions regarding the future. Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may deviate from these estimates and assumptions. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Expected credit loss allowance (ECL)

Measurement of ECL is a significant estimate that involves forecasting future economic conditions, longer the term of forecasts more management judgment is applied, and those judgements may be the source of uncertainty. Details of ECL measurement methodology are disclosed in Note 23.

The measurement of impairment losses under IFRS 9 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies.

3. Critical accounting estimates and judgments (Continued)

The following components have a major impact on credit loss allowance: definition of default, definition of significant increase in credit risk (SICR), probability of default (“PD”), exposure at default (“EAD”), and loss given default (“LGD”), as well as models of macro-economic scenarios.

Elements of the ECL models that are considered accounting judgements and estimates include:

- The Bank’s internal credit grading model, which assigns PDs to the individual grades;
- The Bank’s criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment;
- The segmentation of financial assets when their ECL is assessed on a collective basis;
- Development of ECL models, including the various formulae and the choice of inputs;
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs;
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

The Bank 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 Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers. Management uses probability estimates based on historical borrower experience including default familiarities and loss given defaults. The Bank uses its experienced judgment to adjust observable data for a bank of homogenous loans to reflect current circumstances and forward-looking macroeconomic variables.

Impact of COVID-19 on ECL

The impact of COVID-19 resulted in the application of further judgement within number of judgements, assumptions and estimates that affect the allowance for ECL due to the limited recent experience of the economic and financial impacts of such an event. Given the unprecedented nature of the COVID-19 pandemic and the uncertainties associated with it, the Bank reconsidered the existing accounting judgements and estimates and applied management overlays to the methodology.

The economic environment remains uncertain and future impairment charges may be subject to further volatility depending on the longevity of the COVID-19 pandemic and related containment and other measures.

In response to COVID-19 outbreak the Bank came out with an initiative to grant three-month payment holidays to its borrowers in March and May 2020 in order to significantly reduce the requirement for customers to physically visit Bank branches. Such event was not automatically considered as SICR event (i.e. trigger to transfer the exposure from Stage 1 to Stage 2) and the exposure was only transferred to Stage 2 where there was an observable evidence of financial difficulties of the borrower indicating that the level of risk has increased significantly since loan origination.

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 Bank 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 2020 and 2019 its interpretation of the relevant legislation is appropriate, and that the Bank’s tax position will be sustained.

4. Financial instruments - risk management

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

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

The responsibility of the individuals responsible for risk management is to ensure the compliance of the Bank 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") Division 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 Bank, 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.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, 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 Bank, 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 a significant element of the Bank's corporate governance system. The Audit Committee supervises the activities of the Internal Audit Department, develops appropriate recommendations for this service and protects the interests of shareholders in terms of the reliability of financial statements. The Audit Committee is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank.

Internal Audit

Risk management processes throughout the Bank are audited by the internal audit function, which examines, by undertaking regular and ad-hoc reviews, both the adequacy of the procedures and the Bank'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 Committees;
- Liquidity risk is managed by Asset-Liability Committee ("ALCO");
- Market risk is managed by ALCO;
- Operational risk is managed by the Risk Management Department with close cooperation of Management Board;
- Information security and technology risks are managed by Information Technology Department.

4. Financial instruments - risk management (Continued)

Credit risk

The Bank is exposed to credit risk, which is the risk that a customer or counterparty will be unable to meet its obligation to settle outstanding amounts. The Bank's exposure to credit risk arises as a result of its lending operations and other transactions with counterparties giving rise to financial assets. Maximum exposure to credit risk of on-balance sheet items equals their carrying values.

For maximum exposure on off-balance sheet commitments refer to Note 4 - Liquidity risk.

Credit risks include: risks arising from transactions with counterparties, concentration risk, currency-induced credit risks and residual risks.

- Risks arising from transactions with counterparties are the loss risk related to default or non-fulfillment of contracts due to deterioration in the counterparty's credit quality;
- Concentration risk is the risk related to the quality deterioration due to large exposures provided to single borrowers or a group of connected borrowers, or loan concentration in certain economic industries;
- Currency-induced credit risks relate to risks arising from foreign currency-denominated loans in the Bank's portfolio;
- Residual risks result from applying credit risk-mitigation techniques, which could not satisfy expectation in relation to received collateral.

Credit Approval

The Bank strives to ensure a sound credit-granting process by establishing well-defined credit granting criteria and building up an efficient process for the comprehensive assessment of a borrower's risk profile.

The credit assessment process differs across segments, being further differentiated across various product types reflecting the different natures of these asset classes. Corporate, SME and larger retail and micro loans are assessed on an individual basis with thorough analysis of the borrower's creditworthiness and structure of the loan;

The Credit Committees are established by the decision of supervisory board and the choosing of members occurs by the following persons: General director, deputy managing director, director, risk manager.

The credit committee is responsible for overseeing loan requests and approving credit products. Credit risk managers (respective credit committee members) conduct detailed analysis of debtors and proposed credit risks. If the total liability exceeds equivalent to USD400,000, final decision regarding the issuance of loan is made by the supervisory board, but if the total liability does not exceed USD400,000, the decision is made by the credit committee.

Segmentation

Segmentation criteria is based on risk characteristics and experts' estimation based on the current and past information. Characteristics of the instruments used in analysis may become subject to review.

Segmentation of the loan portfolio consists of the following sub-segments:

- 1) Segment 1 - "Mortgage";
- 2) Segment 2 - „Consumer loan”
- 3) Segment 3,4 - "Corporate" and SME (Small and medium entities);

Credit Risk Monitoring

The Bank's risk management policies and processes are designed to identify and analyse risk in a timely manner, and monitor adherence to predefined limits by means of reliable and timely data. The Bank dedicates considerable resources to gain a clear and accurate understanding of the credit risk faced across various business segments.

Monitoring processes are tailored to the specifics of individual segments, as well as they encompass individual credit exposures, overall portfolio performance and external trends that may impact the portfolios risk profile.

By comparing current data with historical figures and analysing forecasts, the management believes that it is capable identifying risks and responding to them by amending its policies in a timely manner.

4. Financial instruments - risk management (Continued)

Credit Risk Mitigation

Credit decisions are based primarily on the borrower's repayment capacity and creditworthiness; in addition, the Bank uses credit risk mitigation tools such as collateral and guarantees to reduce the credit risk. The collateral management framework consists of a sound independent appraisal process, haircut system throughout the underwriting process, monitoring and revaluations.

Credit Risk Restructuring and Collection

A comprehensive portfolio supervision system is in place to identify weakened or problem credit exposures in a timely manner and to take prompt remedial actions. Dedicated restructuring units manage weakened borrowers across all business segments.

For the measurement of ECL, restructured borrowers may be classified either in Stage 2 or Stage 3. If overdue days after restructuring consists of more than 15 days, the loan is classified in stage 3. If overdue days consists of not less than 15 days, than the loan is classified in stage 2 and automatically gets the code that represents +31 Days on current overdue days.

Credit Quality

Depending on the type of financial asset the Bank may utilize different sources of asset credit quality information including credit scoring information from credit bureau and internally developed credit ratings.

Expected credit loss (ECL) measurement

ECL is a probability-weighted estimate of the present value of future cash shortfalls. An ECL measurement is unbiased and is determined by evaluating a range of possible outcomes. ECL measurement is based on four components used by the Bank: Probability of Default ("PD"), Exposure at Default ("EAD"), Loss Given Default ("LGD") and Discount Rate. The estimates consider forward looking information, that is, ECLs reflect probability weighted development of key macroeconomic variables that have an impact on credit risk.

The Bank uses a three-stage model for ECL measurement and classifies its borrowers across three stages: The Bank classifies its exposures as Stage 1 if no significant deterioration in credit quality occurred since initial recognition and the instrument was not credit-impaired when initially recognized. The exposure is classified to Stage 2 if the significant deterioration in credit quality was identified since initial recognition, but the financial instrument is not considered credit-impaired. The exposures for which the credit-impaired indicators have been identified are classified as Stage 3 instruments.

The Expected Credit Loss (ECL) amount differs depending on exposure allocation to one of the Stages. In the case of Stage 1 instruments, the ECL represents that portion of the lifetime ECL that can be attributed to default events occurring within the next 12 months from the reporting date. In case of Stage 2 instruments, the ECL represents the lifetime ECL, i.e. credit losses that can be attributed to possible default events during the whole lifetime of a financial instrument. Generally, lifetime is set equal to the remaining contractual maturity of the financial instrument.

Factors such as existence of contractual repayment schedules, options for extension of repayment maturity and monitoring processes held by the Bank affect the lifetime determination. In case of Stage 3 instruments, default event has already incurred and the lifetime ECL is estimated based on the expected recoveries.

Definition of default

Definition of default, as used in IFRS 9 for impairment purposes, is consistent with the definition used for the internal credit risk management and includes all financial instruments of the Bank.

The borrower is classified as defaulted if at least one of the following occurred:

- Any amount of contractual repayments is past due more than 90 days;
- The position of the loan is overdue by 15 days from the first day of loan restructuring;

Moreover, in case of existence, the bank is able to use the expert's assessment of solvency. Both of the general criteria of default is applicable for all financial instruments, regardless of its classification according to product portfolio or client segment. The criteria for the definition of default might differ in-between portfolios or segments, to address specific characteristics or available information of the loan position.

4. Financial instruments - risk management (Continued)

Significant Increase in Credit Risk ("SICR")

For every financial instrument the Bank estimates if credit risk has increased significantly after the initial recognition (Sign of increasing credit risk - "SICR"). To recognize the sign, the Bank for each financial instrument is conducting historical analysis of different factors, including, the factors that are relevant for the specific financial instrument.

Recognizing SICR can be done by the following estimation methods:

- Increasing risk of default after the initial recognition (Changes in direct or external and internal rating);
- Factual or expecting significant change in operational results of the customer;
- Changes in approaches of the management of credit risk for the financial instruments;
- Facts featuring that the Bank is not allowing the current level of the risk according to the date of initial recognition of financial instrument, particularly:
 - a) The transaction would never have been done;
 - b) The transaction would have been done, but with the different conditions (For compensating the increased risk) and/or implementing uncommon processes (Involving the employee with higher authorization in the process of credit taking);

The criteria for moving in-between the stages depends on significant increase in credit risk and default:

- If the position of the loan by the reporting date transfers to 2nd stage, the position towards the customer or the group of customers' transfers to 2nd stage for the reporting date;
- If the position of the loan by the reporting date is considered as defaulted, the position towards the customer (or the group of customers) changes to 3rd stage for the reporting date;

Exposure at default (EAD)

Default risk position parameter represents a total risk position that a bank is exposed to in the period that default is considered to happen. EAD parameter, used to measure expected credit loss, depends on time. The bank allows for use of different values of the parameter for different, future credit risk positions.

Exposure at default (EAD) parameter is used for all financial instruments at the 1st and 2nd stages (including non-defaulted purchases or impaired financial assets), regardless of specific characteristics, including the existence of predefined repayment schedule.

In the case of financial instruments at the 3rd stage (and in case of assets purchased at default or impaired financial assets), 1 EAD parameter is used, which equals the current default risk position. The current default risk position represents the amount, that is calculated based on risk position balances as at reporting date.

Probability of default (PD)

Probability of default parameter describes the likelihood of a default of a facility over a particular time horizon. It provides an estimate of the likelihood that a borrower will be unable to meet its contractual debt obligations. The PD parameter is time-dependent (i.e. has a specific term structure) and is applied to all non-defaulted contracts.

Two types of PDs are used for calculating ECLs: 12-month and lifetime PD. Lifetime PDs represent the estimated probability of a default occurring over the remaining life of the financial instrument and it is a sum of the 12 months marginal PDs over the life of the instrument. The Bank uses different statistical approaches such as the extrapolation of 12-month PDs based on migration matrixes, developing lifetime PD curves based on the historical default data and gradual convergence of long-term PD with the long-term default rate.

PD assessment approach is differentiated for different time horizons and is further adjusted due to expected influence of macroeconomic variables as forecasted for the period. Macroeconomic variables covered by these forecasts and which the Company incorporated in its ECL assessment model include GDP growth, monetary policy interest rate, nominal effective foreign exchange rate and inflation rate.

The Bank considers these forecasts to represent its best estimate of the possible outcomes, based on reliable available information.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***4. Financial instruments - risk management (Continued)**

The table below summarizes the principal macroeconomic indicators included in the economic scenarios used at December 31, 2020 for the years 2021 and 2022, for Georgia:

	<u>2021</u>	<u>2022</u>
GDP Growth		
Base scenario	5.0	4.5
Upside scenario	6.0	5.0
Downside scenario	<u>1.0</u>	<u>4.0</u>
Inflation rate		
Base scenario	3.0	3.0
Upside scenario	4.0	3.0
Downside scenario	<u>6.0</u>	<u>2.5</u>
Monetary policy interest rate		
Base scenario	8.0	7.0
Upside scenario	8.3	7.5
Downside scenario	<u>9.0</u>	<u>7.0</u>
Nominal effective exchange rate		
Base scenario	252.0	252.0
Upside scenario	259.6	267.3
Downside scenario	<u>222.4</u>	<u>229.1</u>

Predicted relationships between the key indicators and default and loss rates on various portfolios of financial assets have been developed based on analysing historical data over the past 10 years, for PD and LGD purposes, respectively. Based on this analysis, the Bank identified portfolio default key relationship with GDP growth.

The Bank has performed a sensitivity analysis on how ECL on the main portfolios would change if the key assumptions used to calculate ECL change by 10%. The table below outlines the total ECL per portfolio as at December 31, 2020, if the assumptions used to measure ECL remain as expected (amount as presented in the statement of financial position), as well as if each of the key assumptions used change by plus or minus 10%. The changes are applied in isolation for illustrative purposes, and are applied to each probability weighted scenarios used to develop the estimate of expected credit losses. In reality there will be interdependencies between the various economic inputs and the exposure to sensitivity will vary across the economic scenarios.

	<u>Average PD</u>	<u>Average LGD</u>	<u>ECL</u>
GDP growth			
As expected	11.9959%	22.7600%	(1,218,694)
+10%	11.4861%	22.7600%	(1,183,157)
-10%	12.4963%	22.7600%	(1,253,407)

Loss Given Default (LGD)

Loss given default is shown as a percentage of losses incurred after a borrower defaults, over total exposure at the time of the default.

In case of a default, the process of loss estimation is based on an assumption, that after default, the loan retains default status and is in the process of recover (non-cure assumption).

This assumption is based on a complete restoration in case of retail segment, however in case of corporate/small and medium business segments this can be additionally of differentiated as cash and cash equivalents and restoration of collateral.

The possibility of inclusion of restoration of collateral in loan default is dependent on availability of cash receiving procedures and historical data.

Non-defaulted loan position

LGD parameter, designed for sub-portfolios of homogeneous non-defaulted risk position is dependent on time, in other words it is characterized by a time structure. This gives Bank more flexibility in designing LGD parameter, since the parameter refers to the time section in which the default may occur.

4. Financial instruments - risk management (Continued)

Exposure on default

LGD parameter of a defaulted risk position is not subject to a time structure, due to the fact that the risk position is already in default. The following method is characterized by specific restoration methods. According to general LGD norms, macroeconomic factors are considered under following sections:

- Correction of restoration norms;
- Correction of restoration and restoration norms, and value of collateral of a secured portfolio;

Forecasted information

While estimating credit risk, bank considers forecasted, macroeconomic factors, based on analysis of various situations. These situations include most likely, worse than likely and better than likely outcomes, with respective probabilities.

The situations mentioned above take into account the macroeconomic factors, that are published by the national bank of Georgia. Macroeconomic forecasted information for impairment basis is used for the following purposes:

- 1) Determining financial instruments, for which credit risk has significantly increased after initial recognition (Is valid only in the cases, where the bank for specific instruments or groups of instruments accounts for ongoing significant economic changes);
- 2) Determining expected credit losses by assessing various possible conditions of economic environment;

While estimating a significant increase in credit risk, bank considers the probability of a default, which represents expected risk of default in case of different outcomes and compares the indicators to the values of the indicators at the initial recognition.

While analyzing expected credit risk, the Bank determines the parameters separately, for each different outcome and gets the final value for the expected credit risk, which is later used in the process of loss reserve as a weighted probability where the weights are represented by the probabilities for individual, various outcomes.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***4. Financial instruments - risk management (Continued)****Credit quality per class of financial assets**

The credit quality of financial assets is managed by the Bank internal credit ratings, as described above. The table below shows the credit quality by class of asset for loan-related lines in the statement of financial position, based on categories specified in the tables.

As at 31 December 2020	Stage	High grade	Standard grade	Sub-standard grade	Impaired	Total
Cash and cash equivalents (Except cash on hand)		29,876,494	-	-	-	29,876,494
Mandatory cash balances with NBG		12,287,908	-	-	-	12,287,908
Investment securities		17,766,115	-	-	-	17,766,115
Loans to customers:						
Business loans	Stage 1	24,970,823	644,662	-	-	25,615,485
Business loans	Stage 2	-	-	4,729,741	-	4,729,741
Business loans	Stage 3	-	-	-	206,987	206,987
Business loans Corporate	Stage 1	4,881,405	-	-	-	4,881,405
Business loans Corporate	Stage 2	-	-	5,899,441	-	5,899,441
Credit Line	Stage 1	5,320,081	-	-	-	5,320,081
Credit Line	Stage 2	-	-	1,152,323	-	1,152,323
Mortgage loan	Stage 1	5,954,997	-	55,018	-	6,010,015
Mortgage loan	Stage 2	-	-	695,628	-	695,628
Mortgage loan	Stage 3	-	49,024	-	285,502	334,526
Consumer loans	Stage 1	3,212,023	2,840	1,440	-	3,216,303
Consumer loans	Stage 2	-	-	19,325	-	19,325
Consumer loans	Stage 3	-	3,597	-	42,730	46,327
Guarantees	Stage 1	22,957,729	-	-	-	22,957,729
		127,227,575	700,123	12,552,916	535,219	141,015,833

4. Financial instruments - risk management (Continued)

As at 31 December 2019	Stage	High grade	Standard grade	Sub-standard grade	Impaired	Total
Cash and cash equivalents (Except cash on hand)		35,509,492	-	-	-	35,509,492
Mandatory cash balances with NBG		13,512,500	-	-	-	13,512,500
Investment securities		23,280,588	-	-	-	23,280,588
Loans to customers:						
Business loans	Stage 1	16,976,883	-	-	-	16,976,883
Business loans Corporate	Stage 1	10,456,232	-	-	-	10,456,232
Business loans Corporate	Stage 2	6,189,370	-	-	-	6,189,370
Business loans Corporate	Stage 3	-	-	156,423	167,862	324,285
Credit line	Stage 1	7,226,482	-	-	-	7,226,482
Mortgage loan	Stage 1	5,581,847	187,245	-	-	5,769,092
Mortgage loan	Stage 2	-	-	222,155	-	222,155
Mortgage loan	Stage 3	47,130	-	50,594	135,883	233,607
Consumer loans	Stage 1	2,681,964	-	-	-	2,681,964
Consumer loans	Stage 2	2,335	-	4,288	-	6,623
Consumer loans	Stage 3	4,486	-	-	42,579	47,065
Guarantees	Stage 1	30,600,269	-	-	-	30,600,269
		152,069,578	187,245	433,460	346,324	153,036,607

The credit risk assessment policy for financial assets has been determined by the Bank for balance sheet exposures as follows:

- A financial asset that is not past due at the reporting date is assessed as a financial asset with high grade;
- A financial asset that is less than 30 days past due at the reporting date is assessed as a financial asset with standard grade;
- A financial asset that is past due more than 30 days and less than 90 day past the reporting date is assessed as a financial asset with sub-standard grade.

The credit risk assessment policy for financial assets has been determined by the Bank for balance sheet exposures as follows:

- Grading for Undrawn loan commitments for clients, who have loans or any other balance sheet exposures are in line with balance sheet grade. For other undrawn loan commitments, conditional undrawn loan commitments are considered to be High grade. Unconditional undrawn loan commitments are graded in line with clients' credibility monitored by the Bank's experts.
- Financial guarantees are considered High grade if the client performs under contractual conditions. If the client performs well under the contract, it is classified as standard grade, while poor performance is considered sub-standard and breach of contract impaired.

It is the Bank'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.

4. Financial instruments - risk management (Continued)

Financial guarantees and loan commitments are assessed and a provision for expected credit losses is calculated in similar manner as for loans.

For impairment allowance assessment purposes for undrawn exposures the Bank distinguishes between revocable and irrevocable loan commitments. For revocable commitments the Bank does not create impairment allowance. As for the irrevocable undisbursed exposures the Bank estimates utilization parameter (which represents expected limit utilization percentage conditional on the default event) in order to convert off-balance part of the exposure to on-balance.

Market risk

Market risk is the risk that affect the overall performance of the financial market. The main types of market risks include interest rates risk, currency risk and their levels of volatility. The market risk related to the banking activities encompasses the risk of loss on equity holdings, and the interest rate and foreign exchange risk stemming from banking intermediation activities. The Bank is exposed to interest rate and foreign exchange risks in its banking books.

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 comprehensive income 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. The Bank's deposits and loans are at fixed interest rates.

Currency risk

Foreign exchange rate risk arises from the potential change in foreign currency exchange rates, which can affect the value of a financial instrument. This risk stems from the open currency positions created due to mismatches in foreign currency assets and liabilities. 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% of the Bank's regulatory capital.

As of 31 December 2020, the Bank maintained an aggregate open currency position of -0.51% of regulatory capital (2019: 0.3%). The Bank's compliance with such limits is monitored daily by the heads of the Treasury and Financial Risk Management Departments.

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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***4. Financial instruments - risk management (Continued)**

The tables below indicate the currencies to which the Bank had significant exposure at 31 December on its monetary assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the currency rate against the GEL, with all other variables held constant on the statements of comprehensive income (due to the fair value of currency sensitive monetary assets and liabilities).

	GEL	USD	EUR	OTHER	31.12.2020
Financial assets					
Cash and cash equivalents	18,426,537	11,154,731	7,402,606	184,524	37,168,398
Mandatory cash balances with NBG	-	11,369,867	918,041	-	12,287,908
Loans to customers before allowance for impairment	38,244,346	19,883,241	-	-	58,127,587
Investment securities	17,766,115	-	-	-	17,766,115
Other financial assets	348,929	13,191	20,115	22	382,257
	74,785,927	42,421,030	8,340,762	184,546	125,732,265
Financial liabilities					
Customer accounts	19,248,142	39,292,881	8,351,580	245,537	67,138,140
Amounts due to credit institutions	-	2,551,866	-	-	2,551,866
Lease liabilities	811,780	175,872	-	-	987,652
Other financial liabilities	210,185	80,912	25,519	12,184	328,800
	20,270,107	42,101,531	8,377,099	257,721	71,006,458
Open balance sheet position	54,515,820	319,499	(36,337)	(73,175)	
	GEL	USD	EUR	OTHER	31.12.2019
Financial assets					
Cash and cash equivalents	8,774,482	26,365,143	4,163,806	273,926	39,577,357
Mandatory cash balances with NBG	-	12,462,336	1,050,164	-	13,512,500
Loans to customers before allowance for impairment	33,261,452	16,872,306	-	-	50,133,758
Investment securities	23,280,588	-	-	-	23,280,588
Other financial assets	42,563	7,792	2,549	128,906	181,810
	65,359,085	55,707,577	5,216,519	402,832	126,686,013
Financial liabilities					
Customer accounts	12,497,886	52,761,833	5,156,549	412,291	70,828,559
Amounts due to credit institutions	-	2,200,857	-	-	2,200,857
Lease liabilities	169,998	279,911	-	-	449,909
Other financial liabilities	254,582	296,280	592	13,161	564,615
	12,922,466	55,538,881	5,157,141	425,452	74,043,940
Open balance sheet position	52,436,619	168,696	59,378	(22,620)	

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***4. Financial instruments - risk management (Continued)**

The following table details the Bank's sensitivity to a 20% increase and decrease in the USD and EUR against the GEL. 20% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 20% change in foreign currency rates.

Impact on net profit and equity based on asset values:

31.12.2020	USD impact		EUR impact		Other currency impact	
	20%	-20%	20%	-20%	20%	-20%
Profit/(loss)	63,900	(63,900)	(7,267)	7,267	(14,635)	14,635

31.12.2019	USD impact		EUR impact		Other currency impact	
	20%	-20%	20%	-20%	20%	-20%
Profit/(loss)	33,739	(33,739)	11,876	(11,876)	(4,524)	4,524

Liquidity Risk

The liquidity risk is the risk that the Bank either does not have sufficient financial resources available to meet all of its obligations and commitments as they fall due or can access those resources only at a high cost. The risk is managed by the Financial Risk Management and Treasury Departments and is monitored by the Asset-Liability Committee.

The Bank's approach to mitigate liquidity risk are procedures, policies, limits and daily management, that is in compliance with the risk appetite, risk and business strategy of the Bank.

The main liquidity risk mitigation techniques are building liquidity reserves, diversifying funding sources and extending financing maturities.

Statutory requirement

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 GEL, and LCR of 100.0% in foreign currency and total LCR of 100% on a daily basis.

As of 31 December 2020, the Bank's total LCR stood at 207.6% (2019: 213.2%), the LCR in GEL was 425.4% (2019: 871.6%) and the LCR in foreign currency was 123.1% (2019: 125.5%).

Analysis by remaining contractual maturities

The tables below summarise the maturity profile of the Bank's financial liabilities as of 31 December 2020 and as of 31 December 2019 based on contractual undiscounted repayment obligations.

Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

(Georgian Lari)

4. Financial instruments - risk management (Continued)

	Within one year	More than one year	Total 31.12.2020
Financial liabilities			
Customer accounts	66,637,588	500,552	67,138,140
Amounts due to credit institutions	2,551,866	-	2,551,866
Lease liabilities	333,873	801,198	1,135,071
Other financial liabilities	355,193	-	355,193
	69,878,520	1,301,750	71,180,270
Undrawn loan commitments	2,513,558	-	2,513,558
Guarantees	17,469,208	5,488,521	22,957,729
Total potential future payments for financial obligations	19,982,766	5,488,521	25,471,287
	Within one year	More than one year	Total 31.12.2019
Financial liabilities			
Customer accounts	69,970,558	858,001	70,828,559
Amounts due to credit institutions	2,200,857	-	2,200,857
Lease liabilities	177,342	446,378	623,720
Other financial liabilities	564,615	-	564,615
	72,913,372	1,304,379	74,217,751
Undrawn loan commitments	1,830,379	-	1,830,379
Guarantees	23,079,542	7,520,727	30,600,269
Total potential future payments for financial obligations	24,909,921	7,520,727	32,430,648

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 Bank 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 Bank's operations and liquidity needs.

Term Deposits included in the customer accounts are classified based on remaining contractual maturities, according to the Georgian Civil Code, however, individuals have the right to withdraw their deposits prior to maturity if they partially or fully forfeit their right to accrued interest and the Bank is obliged to repay such deposits upon the depositor's demand. Based on the Bank's deposit retention history, the management does not expect that many customers will require repayment on the earliest possible date; accordingly, the table does not reflect the management's expectations as to actual cash outflows.

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.

4. Financial instruments - risk management (Continued)

Customer deposits diversification by number and type of depositors and the past experience of the Bank 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 table on the basis of the statistical data accumulated by the Bank during the previous periods and assumptions made regarding the “permanent” part of current account balances.

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 and strategic 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 conducts the following activities for the reason to manage the operational risk:

- Accounting and reporting incidents;
- Estimation of risk and control
- Conducting and audit of information systems on a regular basis and testing penetrability
- Estimation of risks related to outsourced operations
- Plan of the business continuity and stress-tests

Compliance with Bank standards is supported by a program 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.

COVID-19 pandemic impact risk

In the end of 2019 year New Corona virus (COVID-19) was spread in China. The World Health Organization has declared the rapidly spreading coronavirus outbreak a pandemic as of March 11, 2020.

The outlook remains subject to significant uncertainty. The path of the pandemic, the availability of effective treatments, and the associated impact on economic activity, are inherently difficult to predict. Consequently, economic activity in services will continue to suffer in the near term. On the upside, a faster than expected development and distribution of an effective vaccine could boost confidence, support a rebound in tourism and investment, and accelerate the recovery.

At the end of March 2020, the NBG introduced an updated supervisory plan for the Georgian banking sector, aimed at alleviating the negative financial and economic challenges created by the global COVID-19 pandemic in Georgia. The measures, which were introduced with immediate effect, were mainly focused on capital adequacy and liquidity initiatives that allow banks to use existing regulatory capital buffers to support customers in the current financially stressed circumstances, to continue normal business activities as far as possible, and to support the economy through ongoing lending operations.

Through mobilisation of financing from international organisations and through its anti-crisis stimulus plan, the Government announced a series of support measures and packages for individuals and businesses to mitigate the negative economic impact of COVID-19.

The Bank is monitoring the developing economic trends on the back of the COVID-19 pandemic and its impact on the business, customers and employees on an ongoing basis. There is still significant uncertainty over the magnitude of the global slowdown that will result from this pandemic, and the Bank will continue to take appropriate actions to proactively manage evolving circumstances.

4. Financial instruments - risk management (Continued)

IFRS 7 fair value measurement hierarchy

IFRS 7 requires certain disclosures which require the classification of financial assets and financial liabilities measured at fair value using a fair value hierarchy that reflects the significance of the inputs used in making the fair value measurement. The fair value hierarchy has the following levels:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) (Level 2); and
- Inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

The level in the fair value hierarchy within which the financial asset or financial liability is categorised is determined on the basis of the lowest level input that is significant to the fair value measurement. Financial assets and financial liabilities are classified in their entirety into only one of the three levels.

The Bank has no financial assets or liabilities measured at fair value; accordingly, they are not presented under the IFRS 7 fair value measurement hierarchy. All the financial instruments of the Bank are recognized with amortized costs. Management of the Bank considers that the carrying amounts of financial liabilities recorded in the financial statements approximate their fair values.

The fair value of cash and cash equivalents was determined using level 1 measurement, fair values of other financial assets and liabilities were determined using level 2 and 3 measurement.

5. 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 Bank's capital is monitored using, among other measures, the ratios established by the NBG.

The Bank is in compliance with all internal and external capital requirements for the years 2020 and 2019.

NBG Basel 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).

At the end of March 2020, NBG introduced an updated supervisory plan for the Georgian banking sector, aimed at alleviating the negative financial and economic challenges created by the global COVID-19 pandemic in Georgia.

Following capital adequacy initiatives were introduced:

- Combined buffer - the conservation buffer requirement of 2.5% of risk-weighted assets has been reduced to 0%;
- Pillar 2 requirements:
 - Currency induced credit risk buffer (CICR) requirement reduced by two-thirds.
 - The phase-in of additional credit portfolio concentration risk buffer (HHI) and net GRAPE buffer requirements on Common Equity Tier 1 (CET1) and Tier 1 capital, planned at the end of March 2020, has been postponed indefinitely; however, the phase-in of additional HHI and GRAPE buffer requirements were postponed till end of March 2021 as subsequently instructed by the NBG.
 - The possibility of fully or partially releasing the remaining requirements of Pillar 2 buffers (HHI, CICR, net GRAPE), if necessary, remains open.
- During the period the banks are allowed to partially or fully use the Pillar 2 and conservation buffers, the banks are restricted to make capital distribution in any form.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***5. Capital management (Continued)**

NBG requested the Georgian banks to create general provisions under the local accounting basis in the first quarter of 2020, the accounting basis is that used for calculation of capital adequacy ratios. The specific quantum of the provision reflects the NBG's current expectation of estimated credit losses on the lending book of the banking system for the entire economic cycle, given current economic expectations. The NBG considers the banking system capital ratios to be sufficiently in excess of the expected minimum capital requirements, to be able to absorb this upfront general provision, whilst maintaining sufficiently comfortable buffers over the required minimum capital ratios.

As at 31 December 2020 and 2019 Common Equity Tier 1 Capital (CET I), Tier I Capital (Tier I) and Total Capital ratios were set at 4.50%, 6.00% and 8.00% respectively in addition to which the Bank had to maintain Pillar I Buffers and Pillar II requirements.

Capital Conservation and Countercyclical buffers are both set at 0.00% (2019: 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 addition 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 2020, the Bank had to maintain CICR buffer of 0.26% (As of 31 December 2019 - 0.79%), primary due to percentage share of foreign currency denominated loans to customers, Credit Portfolio Concentration Risk of 1.28% (HHI Buffer) (2019: 1.28%), Net Grape of 3.10% and Net Stress-Test buffer of 0.00% for 31 December 2020 and 2019.

As of 31 December 2020, under total Basel III requirements the Bank was required to maintain a minimum Total Capital adequacy ratio of 12.64% (2019: 15.67%) of the risk-weighted exposures (RWE), minimum Tier 1 Capital adequacy ratio of 7.07% (2019: 9.97%) of the RWE and Common Equity Tier 1 Capital adequacy ratio of 5.30% (2019: 8.10%) of the RWE computed based on the Bank's stand-alone financial statements prepared in accordance with the NBG requirements.

As of 31 December 2020, and 31 December 2019 the Bank maintained minimum capital requirements in accordance to capital adequacy regulation approved and published on 28 October 2013 by the NBG (Decree N100/04) and adjusted for NBG's discretionary items, became effective on 30 June 2014.

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

	<u>2020</u>	<u>2019</u>
Owner's capital	50,000,000	50,000,000
Retained earnings according to NBG regulations	7,150,958	5,742,852
Less: Intangible assets	(702,502)	(624,502)
Primary capital	56,448,456	55,118,350
General reserves according to NBG regulations	1,223,485	1,233,882
Secondary capital	1,223,485	1,233,882
Regulatory capital	57,671,941	56,352,232
Risk weighted assets according to the NBG regulations	121,972,234	108,740,608
Primary capital ratio (primary capital/RWA)	46.28%	50.69%
Regulatory capital ratio (Regulatory capital/RWA)	47.28%	51.82%

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***6. Cash and cash equivalents**

Cash and cash equivalents can be presented as follows:

	<u>31.12.2020</u>	<u>31.12.2019</u>
Cash balances with NBG (other than mandatory reserve deposits)	25,553,303	7,652,342
Cash on hand	7,291,904	4,067,865
Correspondent accounts with other banks	4,323,191	4,915,550
Overnight placements with other banks	-	22,941,600
	<u>37,168,398</u>	<u>39,577,357</u>

Cash balances on bank accounts can be classified as risk free, considering that the banks where the Bank has current accounts are reliable and well-known Georgian credit institutions.

Qualitative information about cash and cash equivalents are provided in Note 4.

Credit rating of correspondent accounts and overnight placements up to 90 days with other banks is as follows:

	<u>31.12.2020</u>	<u>31.12.2019</u>
B	4,292,307	10,522,578
BB-	30,884	17,334,572
	<u>4,323,191</u>	<u>27,857,150</u>

The table contains ratings of Fitch Ratings international agency.

As at 31 December 2020 Fitch Ratings for Georgia's Long-Term Foreign and Local-Currency Issuer Default Ratings (IDRs) are 'BB' with a negative outlook (as at 31 December 2019: 'BB-' with a positive outlook). The issue ratings on Georgia's long-term senior unsecured foreign and local-currency bonds are also affirmed at 'BB'. The Country Ceiling is affirmed at 'BB' and the Short-term Foreign and Local-Currency IDRs at 'B'.

7. Mandatory cash balances with the National Bank of Georgia

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

Mandatory reserves in NBG amounts to GEL12,287,908 as of 31 December 2020 (GEL13,512,500 as of 31 December 2019). Qualitative information about mandatory reserves with the NBG are provided in Note 4.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***8. Loans to customers**

Loans to customers are presented as follows:

	<u>31.12.2020</u>	<u>31.12.2019</u>
Long-term Loans		
Trade and service sector	31,840,542	31,641,534
Individuals	12,017,087	10,436,961
Construction sector	3,336,631	1,473,125
Transportation and telecommunication sector	2,403,791	622,818
Other sectors	400,746	-
	<u>49,998,797</u>	<u>44,174,438</u>
Short-term Loans		
Trade and service sector	4,318,398	3,315,136
Construction sector	1,858,000	1,262,080
Individuals	460,659	33,058
	<u>6,637,057</u>	<u>4,610,274</u>
Accrued interest	1,403,805	1,284,148
Overdue loans	87,052	64,882
Accrued penalties and fines on short-terms loans to individuals	22	16
Accrued penalties and fines on long-term loans to individuals	854	-
Total loans to customers before impairment	<u>58,127,587</u>	<u>50,133,758</u>
Impairment reserve	(1,218,694)	(702,779)
Loans to customers at amortized cost	<u><u>56,908,893</u></u>	<u><u>49,430,979</u></u>

A reconciliation of the allowance for impairment of loans to customers was as follows:

	<u>2020</u>	<u>2019</u>
Balance as at 1 January:	<u>(702,779)</u>	<u>(704,406)</u>
Charge for the year	(515,915)	1,627
Balance as at 31 December:	<u><u>(1,218,694)</u></u>	<u><u>(702,779)</u></u>

Qualitative information about loans to customers are provided in Note 4.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***8. Loans to customers (Continued)**

An analysis of charges in the gross carrying value and corresponding ECL in relation to Segment_1 during the year ended 31 December 2020 is as follows:

Segment_1	Stage 1	Stage 2	Stage 3	Total
Balance as at 31-12-2019	5,769,092	222,155	233,607	6,224,854
New loans originated	1,510,111	-	-	1,510,111
Transfer to Stage 1	50,594	-	(50,594)	-
Transfer to Stage 2	(418,853)	418,853	-	-
Transfer to Stage 3	(135,157)	-	135,157	-
Repaid loans	(613,784)	-	-	(613,784)
Net charge for the year	(151,988)	54,620	16,356	(81,012)
Balance as at 31-12-2020	6,010,015	695,628	334,526	7,040,169

Segment_1	Stage 1	Stage 2	Stage 3	Total
ECL as at 31-12-2019	5,186	12,437	122,864	140,487
New loans originated	17,545	-	-	17,545
Transfer to Stage 1	26,610	-	(26,610)	-
Transfer to Stage 2	(1,967)	1,967	-	-
Transfer to Stage 3	(81)	-	81	-
Repaid loans	(397)	-	-	(397)
Net charge for the year	23,299	104,697	104,690	232,686
ECL as at 31-12-2020	70,195	119,101	201,025	390,321

An analysis of charges in the gross carrying value and corresponding ECL in relation to Segment_2 during the year ended 31 December 2020 is as follows:

Segment_2	Stage 1	Stage 2	Stage 3	Total
Balance as at 31-12-2019	2,681,964	6,623	47,065	2,735,652
New loans originated	1,525,782	-	-	1,525,782
Transfer to Stage 1	6,623	(6,623)	-	-
Transfer to Stage 2	(26,963)	26,963	-	-
Transfer to Stage 3	(27,313)	-	27,313	-
Repaid loans	(581,151)	-	(21,544)	(602,695)
Net charge for the year	(362,639)	(7,638)	(6,507)	(376,784)
Balance as at 31-12-2020	3,216,303	19,325	46,327	3,281,955

Segment_2	Stage 1	Stage 2	Stage 3	Total
ECL as at 31-12-2019	4,010	423	24,754	29,187
New loans originated	19,670	-	-	19,670
Transfer to Stage 1	423	(423)	-	-
Transfer to Stage 2	(40)	40	-	-
Transfer to Stage 3	(41)	-	41	-
Repaid loans	(873)	-	(21,544)	(22,417)
Net charge for the year	15,285	3,030	22,418	40,733
ECL as at 31-12-2020	38,434	3,070	25,669	67,173

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***8. Loans to customers (Continued)**

An analysis of charges in the gross carrying value and corresponding ECL in relation to Segment_3-4 during the year ended 31 December 2020 is as follows:

Segment_3-4	Stage 1	Stage 2	Stage 3	Total
Balance as at 31-12-2019	34,659,597	6,189,370	324,285	41,173,252
New loans originated	29,588,883	-	-	29,588,883
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	(4,359,312)	4,359,312	-	-
Transfer to Stage 3	(247,084)	-	247,084	-
Repaid loans	(20,204,445)	-	(324,285)	(20,528,730)
Net charge for the year	(3,620,668)	1,232,823	(40,097)	(2,427,942)
Balance as at 31-12-2020	35,816,971	11,781,505	206,987	47,805,463

Segment_3-4	Stage 1	Stage 2	Stage 3	Total
ECL as at 31-12-2019	33,079	329,357	170,669	533,105
New loans originated	192,404	-	-	192,404
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	(4,004)	4,004	-	-
Transfer to Stage 3	(228)	-	228	-
Repaid loans	(19,966)	-	(324,285)	(344,251)
Net charge for the year	(112,535)	227,531	264,946	379,942
ECL as at 31-12-2020	88,750	560,892	111,558	761,200

An analysis of charges in the gross carrying value and corresponding ECL in relation to Segment_1 during the year ended 31 December 2019 is as follows:

Segment_1	Stage 1	Stage 2	Stage 3	Total
Balance as at 01-01-19	5,045,048	2,603	185,731	5,233,382
New loans originated	2,274,030	-	-	2,274,030
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	(225,420)	225,420	-	-
Transfer to Stage 3	(106,460)	-	106,460	-
Repaid loans	(653,982)	(2,603)	-	(656,585)
Net charge for the year	(564,124)	(3,265)	(58,584)	(625,973)
Balance as at 31-12-2019	5,769,092	222,155	233,607	6,224,854

Segment_1	Stage 1	Stage 2	Stage 3	Total
ECL as at 01-01-19	7,444	1,054	140,129	148,627
New loans originated	1,350	-	-	1,350
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	(327)	327	-	-
Transfer to Stage 3	(153)	-	153	-
Repaid loans	(951)	(1,054)	-	(2,005)
Net charge for the year	(2,177)	12,110	(17,418)	(7,485)
ECL as at 31-12-2019	5,186	12,437	122,864	140,487

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***8. Loans to customers (Continued)**

An analysis of charges in the gross carrying value and corresponding ECL in relation to Segment_2 during the year ended 31 December 2019 is as follows:

Segment_2	Stage 1	Stage 2	Stage 3	Total
Balance as at 01-01-19	3,405,342	43,963	224,243	3,673,548
New loans originated	1,051,787	-	-	1,051,787
Transfer to Stage 1	95,457	(43,963)	(51,494)	-
Transfer to Stage 2	(13,443)	13,443	-	-
Transfer to Stage 3	(25,020)	-	25,020	-
Repaid loans	(1,365,580)	-	-	(1,365,580)
Net charge for the year	(466,579)	(6,820)	(150,704)	(624,103)
Balance as at 31-12-2019	2,681,964	6,623	47,065	2,735,652

Segment_2	Stage 1	Stage 2	Stage 3	Total
ECL as at 01-01-19	21,241	17,797	158,222	197,260
New loans originated	1,564	-	-	1,564
Transfer to Stage 1	53,561	(17,797)	(35,764)	-
Transfer to Stage 2	(83)	83	-	-
Transfer to Stage 3	(153)	-	153	-
Repaid loans	(8,509)	-	-	(8,509)
Net charge for the year	(63,611)	340	(97,857)	(161,128)
ECL as at 31-12-2019	4,010	423	24,754	29,187

An analysis of charges in the gross carrying value and corresponding ECL in relation to Segment_3-4 during the year ended 31 December 2019 is as follows:

Segment_3-4	Stage 1	Stage 2	Stage 3	Total
Balance as at 01-01-19	25,517,860		469,791	25,987,651
New loans originated	26,340,068	-	-	26,340,068
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	(6,067,068)	6,067,068	-	-
Transfer to Stage 3	-	-	-	-
Repaid loans	(9,168,640)	-	-	(9,168,640)
Net charge for the year	(1,962,623)	122,302	(145,506)	(1,985,827)
Balance as at 31-12-2019	34,659,597	6,189,370	324,285	41,173,252

Segment_3-4	Stage 1	Stage 2	Stage 3	Total
ECL as at 01-01-19	27,584	-	330,935	358,519
New loans originated	25,519	-	-	25,519
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	(6,430)	6,430	-	-
Transfer to Stage 3	-	-	-	-
Repaid loans	(10,149)	-	-	(10,149)
Net charge for the year	(3,445)	322,927	(160,266)	159,216
ECL as at 31-12-2019	33,079	329,357	170,669	533,105

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***8. Loans to customers (Continued)****Concentration of loans to customers**

As of 31 December 2020, the concentration of loans granted by the Bank to ten largest third-party borrowers comprised GEL21,071,690 accounting for 37.15 % of the gross loan portfolio of the Bank (2019: GEL 22,762,323 and 45.4% respectively). An allowance of GEL354,012 (2019: GE913,378) was established against these loans.

The amount of collateral required depend on an assessment of the credit risk of the counterparty. The Bank keeps real estate property as collaterals for loans issued.

The effect of collaterals as of 31 December 2020 and 2019 can be presented as follows:

	Gross carrying amount of loans 31.12.2020	ECL	Fair value of Collateral
Segment 1 - "Mortgage"	7,040,169	(390,321)	16,705,988
Segment 2 - „Consumer loan"	3,281,955	(67,173)	8,346,570
Segment 3,4 - "Corporate" and "SME" (Small and medium entities);	47,805,463	(761,200)	96,331,385
	58,127,587	(1,218,694)	121,383,943
	Gross carrying amount of loans 31.12.2019	ECL	Fair value of Collateral
Segment 1 - "Mortgage"	6,224,854	(140,487)	15,049,323
Segment 2 - „Consumer loan"	2,735,652	(29,187)	9,617,922
Segment 3,4 - "Corporate" and "SME" (Small and medium entities);	41,173,252	(533,105)	85,696,871
	50,133,758	(702,779)	110,364,116

9. Investment securities

Investment securities can be presented as follows:

Investment securities as at 31.12.2018	28,705,073	
Purchases	35,457,813	
Discount	1,799,702	
Redemption at maturity	(42,682,000)	
Investment securities as at 31.12.2019	23,280,588	
Purchases	48,802,553	
Discount	1,779,974	
Redemption at maturity	(56,097,000)	
Investment securities as at 31.12.2020	17,766,115	
Investment securities	31.12.2020	31.12.2019
Treasury bills of the Ministry of Finance of Georgia	17,766,115	21,308,290
Certificates of deposit of the NBG	-	1,972,298
	17,766,115	23,280,588

Qualitative information about investment securities are provided in Note 4.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***10. Intangible assets**

Intangible assets can be presented as follows:

Historical cost	Software and License
31.12.2018	640,203
Additions	379,813
31.12.2019	1,020,016
Additions	166,926
31.12.2020	1,186,942
Amortization	
31.12.2018	(328,686)
Amortization charge	(66,828)
31.12.2019	(395,514)
Amortization charge	(88,926)
31.12.2020	(484,440)
Net book value	
31.12.2019	624,502
31.12.2020	702,502

11. Right-of-use assets and lease liabilities

The Bank has leased administrative office and service centers. Lease payments are in GEL as well as in USD. Incremental borrowing rate for the leases denominated in USD and GEL amounted to 4.4% and 7.25% - 13.00%, respectively.

Right-of-use assets can be presented as follows:

	2020	2019
At 1 January	497,954	430,106
Additions	754,480	205,407
Amortization	(276,599)	(137,559)
At 31 December	975,835	497,954

Lease liabilities can be presented as follows:

	2020	2019
At 1 January	449,909	430,106
Additions	754,480	205,407
Interest expense	71,527	20,602
Lease payments	(387,492)	(254,832)
VAT Payment	45,511	26,885
Foreign exchange rate movements	53,717	21,741
At 31 December	987,652	449,909

Qualitative information about lease liabilities are provided in Note 4.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***12. Property and equipment**

Property and equipment can be presented as follows:

Historical cost	Land and Buildings	Lease hold improvements	Furniture and fittings	Computers and office equipment	Other	Total
At 31 December 2018	2,785,357	1,036,318	1,236,435	843,649	368,916	6,270,675
Additions	-	370,088	169,269	44,789	97,126	681,272
Disposals	-	-	-	(6,882)	-	(6,882)
At 31 December 2019	2,785,357	1,406,406	1,405,704	881,556	466,042	6,945,065
Additions	-	648,525	448,327	93,387	437,652	1,627,891
At 31 December 2020	2,785,357	2,054,931	1,854,031	974,943	903,694	8,572,956
Accumulated depreciation						
At 31 December 2018	(86,924)	(727,163)	(639,146)	(659,033)	(119,478)	(2,231,744)
Depreciation charge disposals	(41,518)	(124,330)	(156,000)	(76,295)	(52,066)	(450,209)
	-	-	-	6,446	-	6,446
At 31 December 2019	(128,442)	(851,493)	(795,146)	(728,882)	(171,544)	(2,675,507)
Depreciation charge	(41,632)	(264,523)	(218,115)	(77,803)	(76,083)	(678,156)
At 31 December 2020	(170,074)	(1,116,016)	(1,013,261)	(806,685)	(247,627)	(3,353,663)
Net book value						
31.12.2019	2,656,915	554,913	610,558	152,674	294,498	4,269,558
31.12.2020	2,615,283	938,915	840,770	168,258	656,067	5,219,293

Some of the property and equipment with the historical cost of GEL1,528,291 as at 31 December 2020 (31 December 2019: GEL1,355,545) are Fully depreciated but still used by the Bank.

13. Amounts due to credit institutions

Amounts due to credit institutions mostly represent deposits of JSC Ziraat Bank Azerbaijan. Amounts due to credit institutions are amounted to GEL 2,551,866 as of 31 December 2020 (GEL2,200,857 as of 31 December 2019).

Qualitative information about amounts due to credit institutions are provided in Note 4.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***14. Customer accounts**

Customer accounts can be presented as follows:

	31.12.2020	31.12.2019
Current accounts	52,830,886	38,363,834
Deposits	14,307,254	32,464,725
	67,138,140	70,828,559
Held as security against guarantees issued (Note 21)	954,962	1,738,375

At 31 December 2020, amounts due to customers of GEL 27,922,328 (42%) were due to the ten largest customers (31 December 2019: GEL39,771,264 (56%)).

Customer accounts include accounts with the following types of customers:

	31.12.2020	31.12.2019
Legal entities	54,236,278	56,424,021
Individuals	12,901,862	14,404,538
	67,138,140	70,828,559

Customer accounts by economic sector are as follows:

	31.12.2020		31.12.2019	
	Amount	%	Amount	%
Trade	31,674,143	47%	22,935,040	32%
Individuals	12,873,965	19%	14,950,358	21%
Real estate constructions	12,764,671	19%	27,100,152	38%
Mining	6,498,408	10%	3,582,435	5%
Other	3,326,953	5%	2,260,574	3%
	67,138,140	100%	70,828,559	100%

Qualitative information about customer accounts are provided in Note 4.

15. Share Capital

As of 31 December 2020, and 2019, the authorised share capital of the Bank comprised 50,000,000 ordinary shares. All of them were issued and fully paid as of 31 December 2020 and 2019. Each share has nominal value of GEL1.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***16. Interest income and expenses**

Interest income and expenses can be presented as follows:

Interest income	2020	2019
Loans to customers	4,934,196	4,231,570
Held-to-maturity investments	1,779,974	1,799,702
Receivables from credit institutions	561,224	872,075
	7,275,394	6,903,347
Interest expense	2020	2019
Deposits from legal entities	(230,072)	(179,584)
Deposits from individuals	(112,714)	(149,905)
Financial liabilities measured at amortized cost	(71,527)	(20,602)
Deposits from non-resident banks	(47,148)	(112,020)
	(461,461)	(462,111)

17. Fee and commission income, net

Fee and commission income, net can be presented as follows:

Fee and commission income	2020	2019
Customer current accounts commissions	576,085	675,572
Income from guarantees issued	528,986	530,752
Cash operations	211,896	200,896
Cash collections and transportation	38,000	48,000
	1,354,967	1,455,220
Fee and commission expense		
Settlements operations	(292,060)	-
Commission income related to international operations	(205,679)	(268,477)
Cash collections and transportation	(108,200)	(118,500)
Cash operations	(60,717)	(72,448)
Nostro accounts commissions	(12,270)	(15,680)
	(678,926)	(475,105)
Net fee and commission income	676,041	980,115

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***18. General and administrative expenses**

General and administrative expenses can be presented as follows:

	2020	2019
Employee benefit expenses	(2,969,543)	(2,531,443)
Depreciation and amortization	(1,043,681)	(654,596)
Software license and support expenses	(466,121)	(294,048)
Security expenses	(216,179)	(161,470)
Utilities	(162,231)	(136,401)
Taxes other than income tax	(79,619)	(61,956)
Representative expenses	(78,237)	(89,150)
Communication expenses	(75,788)	(61,464)
Professional services*	(73,294)	(100,874)
Property insurance	(71,256)	(68,948)
Transaction insurance	(23,306)	(18,216)
Short-term and low value rent expenses	(11,201)	(10,618)
Other expenses	(241,358)	(302,518)
	(5,511,814)	(4,491,702)

(*) - In 2020 Professional services contain audit of financial statements expenses with the amounts of GEL29,446 (2019: GEL6,608).

19. Income tax expenses

Income tax expenses can be presented as follows:

	2020	2019
Current tax	-	(223,312)
Effect of temporary differences	(224,163)	(151,500)
	(224,163)	(374,812)
	2020	2019
Profit before tax	2,999,493	4,590,041
Applicable tax rate	15%	15%
Theoretical income tax	(449,924)	(688,506)
Not recognized temporary differences	(140,588)	-
Effect of Permanent differences*	366,349	313,694
	(224,163)	(374,812)

(*) - Effect of Permanent differences is mostly comprised of Interest income accrued on state securities and the NBG deposits. The tax rate for interest income on state securities and the NBG deposits is 0%.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***19. Income tax expenses (Continued)**

Deferred income tax liabilities and its movement can be presented as follows:

Effect of temporary differences	31.12.2018	Recognized in profit/loss	31.12.2019	Recognized in profit/loss	31.12.2020
Property and equipment	(37,988)	(618)	(38,606)	(5,907)	(44,513)
Intangible assets	(7,006)	(4,480)	(11,486)	(2,745)	(14,231)
Loans to customers	(51,249)	(122,302)	(173,551)	(246,440)	(419,991)
Impairment provision for guarantees issued	(70,533)	(16,893)	(87,426)	21,950	(65,476)
Right-of-use assets	-	(7,207)	(7,207)	8,979	1,772
Tax liabilities	(166,776)	(151,500)	(318,276)	(224,163)	(542,439)
Net tax liabilities	(166,776)	(151,500)	(318,276)	(224,163)	(542,439)

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. On 5 May 2018 amendment was made in tax code and the date was revised to January 2023. 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.

The tax rate for banks for profits other than on state securities was 15% for 2020 and 2019.

20. Transactions with related parties

Related parties or transactions with related parties, as defined by IAS 24 "Related party disclosures", represent:

- Parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Bank (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Bank that gives them significant influence over the Bank; and that have joint control over the Bank;
- Members of key management personnel of the Bank or its parent;
- Close members of the family of any individuals referred to in (a) or (b);
- Parties that are entities controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (c) or (b);

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. Details of transactions between the Bank and other related parties are disclosed below:

31.12.2020	Entities under common control	Key management	Shareholder
Assets			
Deposits placed	-	-	4,292,307
Loans issued	-	35,841	
Liabilities			
Amounts due to credit institutions	2,551,447	-	-
Customer accounts	-	109,546	-
	5,840	-	-

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***20. Transactions with related parties (Continued)**

31.12.2019		Entities under common control	Key management
Assets			
Deposits placed		10,522,776	-
Loans issued		-	42,838
Liabilities			
Amounts due to credit institutions		2,200,857	-
Customer accounts		-	15,618
2020	Shareholder	Entities under common control	Key management
Interest income	-	-	222
Key management compensation	-	-	(749,037)
Interest expense	-	(42,686)	-
2019	Share holder	Entities under common control	Key management
Interest income	73,368	-	6,121
Key Management compensation	-	-	(497,620)
Interest expense	(79,633)	(59,000)	-
Collateral expense	(12,523)	-	-

21. Commitments and contingencies

Legal cases - As at 31 December 2020 and 2019 the Bank has no legal actions and complaints. Management seeks both internal and external professional advices and believes that the ultimate liability, if any, arising from actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank. Related to above mentioned no provision is accrued in the financial statements.

Taxes - Georgian tax legislation in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result the Bank may be assessed additional taxes, penalties and interest. The Bank believes that it has already made all tax payments, and therefore no allowance has been made in the financial statements. Tax years remain open to review by the tax authorities for three years.

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

Management report - In accordance with the Law on accounting, reporting and auditing (article 7) the Bank has an obligation to prepare and submit Management Report to the State Regulatory Authority, together with Independent Auditors' Report no later than 1 October of the year following the reporting period. The Company has not fulfilled this obligation at the date of issue of the financial statements.

Credit related commitments and financial guarantees - The primary purpose of these instruments is to ensure that funds are available to a customer as required. Financial guarantees represent the irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2020

*(Georgian Lari)***21. Commitments and contingencies (Continued)**

Commitments to extend credit represent unused portions of authorisations to prolong credit in the form of loans or guarantees. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of loss is lower than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank monitors the term to maturity of credit related commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term ones.

	<u>2020</u>	<u>2019</u>
Credit related commitments		
Guarantees	22,957,729	30,600,269
Undrawn loan commitments	2,513,558	1,830,379
Commitments and contingencies (before deducting collateral)	<u>25,471,287</u>	<u>32,430,648</u>
Less - cash held as security against guarantees issued (Note 14)	954,962	1,738,375
Commitments and contingencies	<u>24,516,325</u>	<u>30,692,273</u>

22. Events after the reporting period

There are no significant events after the reporting period to disclose in the financial statements.

23. Significant accounting policies**23.1 Foreign currency translation****a) Functional and presentation currency**

Items included in the financial Statements are measured using the currency of the primary economic environment in which the Bank operates ('the functional currency'). Financial Statements are presented in Georgian lari, which is the Bank's functional and presentation currency.

b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are premeasured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of comprehensive income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions.

Foreign exchange gains and losses that relate to monetary items are presented in the statement of comprehensive income within "Exchange rate gain, net".

The closing rate of exchange used for translating foreign currency balances was:

	<i>Official rate of the National Bank of Georgia</i>	
	<u>USD</u>	<u>EUR</u>
Exchange rate as at 31.12.2020	3.2766	4.0233
Exchange rate as at 31.12.2019	2.8677	3.2095

23. Significant accounting policies (Continued)

23.2 Financial Instruments

Financial assets

Initial measurement of financial assets

Financial assets are initially recognised at fair value plus transaction costs that are directly attributable to their acquisition or issue and are subsequently carried at amortised cost using the effective interest rate method, less provision for impairment.

Financial assets- Classification and subsequent measurement

The Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortised cost;
- FVOCI;
- FVPL.

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. The Bank classifies all the of its financial assets under "Financial assets measured at amortized cost" category.

The Bank only measures amounts due from credit institutions, loans to customers and other financial assets at amortised cost if both of the following conditions are met:

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

Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected);
- The expected frequency, value and timing of sales are also important aspects of the Bank's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the bank does not change the classification of the remaining financial assets held in that business model but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

23. Significant accounting policies (Continued)

The SPPI test

As a second step of its classification process the Bank assesses the contractual terms of financial asset to identify whether they meet the SPPI test. 'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

Financial assets - reclassification

Financial instruments are reclassified only when the business model for managing the portfolio as a whole changes. The reclassification has a prospective effect and takes place from the beginning of the first reporting period that follows after the change in the business model. The Bank did not change its business model during the current and comparative period and did not make any reclassifications.

Impairment - credit loss allowance for ECL

The Bank assesses, on a forward-looking basis, the ECL for debt instruments measured at AC and FVOCI and for the exposures arising from loan commitments and financial guarantee contracts. The Bank measures ECL and recognises credit loss allowance at each reporting date. The measurement of ECL reflects: (i) an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, (ii) time value of money and (iii) all reasonable and supportable information that is available without undue cost and effort at the end of each reporting period about past events, current conditions and forecasts of future conditions.

The Bank applies a three-stage model for impairment, based on changes in credit quality since initial recognition:

Stage 1: A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial assets in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that results from default events possible within the next 12 months or until contractual maturity, if shorter ("12 Months ECL");

Stage 2: If the Bank identifies a significant increase in credit risk ("SICR") since initial recognition, the asset is transferred to Stage 2 and its ECL is measured based on ECL on a lifetime basis ("Lifetime ECL"). If a SICR is no longer observed, instrument will move back to Stage 1.

Stage 3: Credit impaired assets are transferred to Stage 3 and allowance for Lifetime ECL is recognized. The Bank's definition of credit impaired assets and definition of default is based on the occurrence of one or more loss events, described further in Note 4.

Change in ECL is recognized in statement of comprehensive income with a corresponding allowance reported as a decrease in carrying value of the financial asset on the statement of financial position. For financial guarantees, provision for ECL is reported as a liability in Provisions for Liabilities and Charges.

23. Significant accounting policies (Continued)

Financial assets - derecognition and modification

The Bank derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Bank has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership, but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

The Bank sometimes renegotiates or otherwise modifies the contractual terms of the financial assets. The Bank assesses whether the modification of contractual cash flows is substantial considering, among other, the following factors: change in interest rate due to market environment changes, change in the currency denomination; consolidation of two or more loans into one new loan; change in counterparty; loan with no schedule is replaced with loan with schedule or vice versa;

Based on below shown internally developed methodology there are certain qualitative triggers which lead to asset derecognition with no further quantitative testing required. These qualitative criteria are included in the list below:

- Change in contract currency;
- Consolidation of two or more loans into one new loan;
- Change in counterparty;
- Loan with no schedule is replaced with loan with schedule or vice versa;
- Change in contractual interest rate due to market environment changes.

The Bank compares the original and revised expected cash flows to assets whether the risks and rewards of the asset are substantially different as a result of the contractual modification. It should be assessed whether change in contractual cash flow is significant (significance defined as 10% change). If the test result is above 10% threshold, loan should be derecognized, whereas if the test is passed and result is below or equal to 10%, financial asset can be assessed as modified.

If the risks and rewards do not change, the modified asset is not substantially (10% test) different from the original asset and the modification does not result in derecognition. The Bank recalculates the gross carrying amount by discounting the modified contractual cash flows by the original effective interest rate or, when applicable, the revised effective interest rate and recognises a modification gain or loss in profit or loss. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

Offsetting

Financial assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

Financial liabilities

Financial liabilities are classified as subsequently measured at AC. Other financial liabilities include: Amounts due to credit institutions, customer accounts, lease liabilities and other liabilities.

Other financial liabilities are initially recognised at fair value net of any transaction costs directly attributable to the issue of the instrument. Such interest-bearing liabilities are subsequently measured at amortised cost using the effective interest rate method, which ensures that any interest expense over the period to repayment is at a constant rate on the balance of the liability carried in the statement of financial position. For the purposes of each financial liability, interest expense includes initial transaction costs and any premium payable on redemption, as well as any interest or coupon payable while the liability is outstanding.

23. Significant accounting policies (Continued)

23.3 Cash and cash equivalents

Cash and cash equivalents are items which are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. Cash and cash equivalents include cash on hand, amounts due from the National Bank of Georgia (NBG), excluding mandatory reserves, and all interbank placements and interbank receivables with original maturities of less than three months. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents.

23.4 Mandatory cash balances with the National Bank of Georgia

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

23.5 Investment securities

Based on the business model and the cash flow characteristics, the Bank classifies investments in debt securities as carried at AC, FVOCI or FVTPL. Debt securities are carried at AC if they are held for collection of contractual cash flows and where those cash flows represent SPPI, and if they are not voluntarily designated at FVTPL in order to significantly reduce an accounting mismatch. All the investment securities possessed by the Bank are held for the specified period and are carried at amortized cost.

23.6 Financial guarantees

Financial guarantees require the Bank to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight-line basis over the life of the guarantee. At the end of each reporting period, the guarantees are measured at the higher of (i) the amount of the loss allowance for the guaranteed exposure determined based on the expected loss model and (ii) the remaining unamortised balance of the amount at initial recognition.

23.7 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.

Georgia also has various operating taxes, which are assessed on the Bank's activities. These taxes are included as a component of general and administration expenses.

23. Significant accounting policies (Continued)**23.8 Property and equipment**

Property and equipment are stated at cost, less accumulated depreciation and impairment losses, where required.

Land is not depreciated. Depreciation is charged on the carrying value of property and equipment and is designed to write off assets over their useful economic lives.

Group	Useful lives
Buildings	50
Computers and office equipment	4
Furniture	6
Leasehold improvement	5
Other	4-5

The assets' useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. Losses arising from the retirement of property and equipment are included in profit or loss as incurred.

23.9 Intangible assets

The Bank's intangible assets have definite useful lives and primarily include computer software and licenses. Intangible assets acquired separately are reported at cost less accumulated amortization and accumulated impairment losses, if any. The estimated useful lives and amortization method is reviewed at the end of each annual reporting period and adjusted if needed. Useful lives of the intangible assets of the Bank is determined as 10 Years.

23.10 Amounts due to credit institutions

Amounts due to credit institutions are recorded when counterparty banks advance money or other assets to the Bank. Amounts due to credit institutions represent non-derivative liabilities and are carried at AC.

23.11 Customer accounts

Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at AC.

23.12 Share capital

Ordinary shares with discretionary dividends are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

23.13 Dividends

Dividends are recorded in equity in the period in which they are declared. Any dividends declared after the end of the reporting period and before the financial statements are authorised for issue, are disclosed in the subsequent events note.

23. Significant accounting policies (Continued)

23.14 Recognition of income and expenses

The Bank calculates interest income on debt financial assets measured at amortized cost or at FVOCI by applying the EIR to the gross carrying amount of financial assets other than credit-impaired. EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (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 Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest revenue or expense.

When a financial asset becomes credit-impaired, the Bank calculates interest income by applying the effective interest rate to the net amortised cost of the financial asset. If the financial assets cures and is no longer credit-impaired, the Bank reverts to calculating interest revenue on a gross basis.

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates interest income by calculating the credit-adjusted EIR and applying that rate to the amortised cost of the asset. The credit-adjusted EIR is the interest rate that, at original recognition, discounts the estimated future cash flows (including credit losses) to the amortised cost of the POCI assets.

Fee and commission income

The Bank earns fee and commission income be divided into the following 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 as respective performance obligations are satisfied.

- *Fee income earned at a point in time*

Fees arising from settlement, remittances, bill payments and cash operations are recognized upon completion of underlying transactions. Each operation is treated as a separate performance obligation.

23.15 Contingent Liabilities and Contingent Assets, Provisions

Contingent liabilities are not reflected in the financial statements, except for the cases when the outflow of economic benefits is likely to origin and the amount of such liabilities can be reliably measured.

Contingent assets are not reflected in the financial statements, but the information on them is disclosed when inflow of economic benefits is probable. If economic benefits are sure to occur, an asset and related income are recognized in the financial statements for the period, when the evaluation change occurred.

A provision is a liability of uncertain timing or amount. A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

23.16 Leases

Bank as lessee

Identifying the lease

A contract is, or contains, a lease when it conveys the right to use an underlying asset for a period of time, in exchange for consideration. At inception of a contract, the Bank assesses whether it meets the two following cumulative conditions to be qualified as a lease:

- its execution involves the use of an identified asset, and
- it conveys the right to direct the use of that identified asset.

23. Significant accounting policies (Continued)

Initial recognition

All leases are accounted for by recognising a right-of-use asset and a lease liability except for:

- Leases of low value assets; and
- Leases with a duration of 12 months or less.

Leases are recognized on the Bank's balance sheet as follows:

- An asset representing the right to use the underlying asset over the lease term;
- A liability for the obligation to pay the lease payments.

Lease liabilities are measured at the present value of the contractual payments due to the lessor over the lease term, with the discount rate determined by reference to the rate inherent in the lease unless this is not readily determinable, in which case the Bank's incremental borrowing rate on commencement of the lease is used. Variable lease payments are only included in the measurement of the lease liability if they depend on an index or rate. In such cases, the initial measurement of the lease liability assumes the variable element will remain unchanged throughout the lease term. Other variable lease payments are expensed in the period to which they relate.

On initial recognition, the carrying value of the lease liability also includes:

- amounts expected to be payable under any residual value guarantee;
- the exercise price of any purchase option granted in favour of the Bank if it is reasonably certain to assess that option;
- any penalties payable for terminating the lease, if the term of the lease has been estimated on the basis of termination option being exercised.

At the commencement date, the Bank measures the right-of-use asset at cost. The cost of the right-of-use asset is comprised:

- The amount of the initial measurement of the lease liability;
- lease payments made at or before commencement of the lease;
- initial direct costs incurred; and
- the amount of any provision recognised where the Bank is contractually required to dismantle, remove or restore the leased asset (typically leasehold dilapidations).

Subsequent measurement

Subsequent to initial measurement lease liabilities increase as a result of interest charged at a constant rate on the balance outstanding and are reduced for lease payments made. Right-of-use assets are amortised on a straight-line basis over the remaining term of the lease or over the remaining economic life of the asset if, rarely, this is judged to be shorter than the lease term.

When the Bank revises its estimate of the term of any lease (because, for example, it re-assesses the probability of a lessee extension or termination option being exercised), it adjusts the carrying amount of the lease liability to reflect the payments to make over the revised term, which are discounted at the revised discount rate.

The carrying value of lease liabilities is similarly revised when the variable element of future lease payments dependent on a rate or index is revised, except the discount rate remains unchanged. In both cases an equivalent adjustment is made to the carrying value of the right-of-use asset, with the revised carrying amount being amortised over the remaining (revised) lease term. If the carrying amount of the right-of-use asset is adjusted to zero, any further reduction is recognised in profit or loss.

When the Bank renegotiates the contractual terms of a lease with the lessor, the accounting depends on the nature of the modification:

- if the renegotiation results in one or more additional assets being leased for an amount commensurate with the standalone price for the additional rights-of-use obtained, the modification is accounted for as a separate lease in accordance with the above policy;
- in all other cases where the renegotiated increases the scope of the lease (whether that is an extension to the lease term, or one or more additional assets being leased), the lease liability is remeasured using the discount rate applicable on the modification date, with the right-of-use asset being adjusted by the same amount;

23. Significant accounting policies (Continued)

- if the renegotiation results in a decrease in the scope of the lease, both the carrying amount of the lease liability and right-of-use asset are reduced by the same proportion to reflect the partial of full termination of the lease with any difference recognised in profit or loss. The lease liability is then further adjusted to ensure its carrying amount reflects the amount of the renegotiated payments over the renegotiated term, with the modified lease payments discounted at the rate applicable on the modification date. The right-of-use asset is adjusted by the same amount.

The Bank elects, by class of underlying asset, not to separate non-lease components from lease components, and instead accounts for each lease component and any associated non-lease components as a single lease component.

Determination of lease term

The lease term is defined as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease (including the renewal option implied through customary business practices) if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease if it is reasonably certain not to be exercised.

Management applies judgement to determine the lease term when lease contracts include renewal options that are exercisable only by the Bank. It considers all relevant factors that create an economic incentive to exercise the renewal option. After the commencement date, the Bank reassesses the lease term if there is a significant event or a change in circumstances that is within its control and affects its ability to exercise (or not to exercise) the option to renew, or to terminate the lease.

Determination of incremental borrowing rate (IBR)

IBR is the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right of use asset in a similar economic environment.

The management applies judgement to estimate the IBR. The management uses an observable information to determine the base rate and adjustments for the lessee specific factors and the asset factors (the adjustment for security).

Determination of lease payments

In Georgia it is customary that lease renewal option is implied through customary business practices and not all renewal options are documented within the lease agreements. In such cases, the initial measurement of the lease liability assumes the payment for renewal period will remain unchanged throughout the lease term.

Short-term leases and leases of low-value assets

The Bank applies the recognition exemption for short-term leases (i.e. lease with a lease term of 12 months or less from the commencement date) and leases of low-value assets. Associated lease payments are recognized as an expense in the income statement on a straight-line basis over the lease term.

23.17 Staff costs and related contributions

Wages, salaries, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Bank.

23.18 Events after the reporting period

Events after the reporting period and events before the date of financial statements authorization for issue that provide additional information about the Bank's financial statements are reported in the financial statements. Post-balance sheet events that do not affect the financial position of the Bank at the balance sheet date are disclosed in the Notes to the financial statements when material.