Qualified Credit Institution Microfinance Organization Rico Express LLC

Financial statements

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

Contents

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Independent auditor's report

To the Shareholder and the Supervisory Board of Qualified Credit Institution MFO Rico Express LLC

Opinion

We have audited the financial statements of Qualified Credit Institution MFO Rico Express LLC (the Company), which comprise the statement of financial position as at 31 December 2017, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2017 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (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 Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of management and Supervisory Board for the financial statements

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

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

The Supervisory Board are responsible for overseeing the Company'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 skepticism throughout the audit. We also:

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

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

Ruslan Khoroshvili

On behalf of EY Georgia LLC

Tbilisi, Georgia

14 June 2018

Statement of financial position

As of 31 December 2017

(Thousands of Georgian Lari)

	Notes	2017	2016
Assets			
Cash and cash equivalents	5	74,969	72,851
Derivative financial assets	6	585	–
Loans to customers	7	201,354	228,995
Current income tax asset		715	2,063
Property and equipment	8	14,073	14,549
Intangible assets		66	88
Deferred income tax asset	9	782	1,119
Other assets	10	13,454	5,862
Total assets		**305,998**	**325,527**
Liabilities			
Derivative financial liabilities	6	701	–
Promissory notes issued	11	134,156	187,232
Borrowed funds	12	45,652	34,609
Other liabilities	13	1,459	441
Total liabilities		**181,968**	**222,282**
Equity	14		
Charter capital		836	836
Retained earnings		119,912	98,990
Revaluation reserve		3,282	3,419
Total equity		**124,030**	**103,245**
Total equity and liabilities		**305,998**	**325,527**

Signed and authorized for release on 14 June 2018

Tamar Gogodze Executive Director

Gulida Sajaia Chief Accountant

The accompanying notes on pages 7 to 34 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December 2017

(Thousands of Georgian Lari)

	Notes	2017	2016
Interest income			
Loans to customers		51,627	53,210
Cash and cash equivalents		4,394	3,372
		56,021	**56,582**
Interest expense			
Promissory notes		(10,039)	(15,017)
Borrowed funds		(5,110)	(3,847)
		(15,149)	**(18,864)**
Net interest income		**40,872**	**37,718**
Allowance for loan impairment	7	(1,748)	(3,302)
Net interest income after allowance for loan impairment		**39,124**	**34,416**
Commission income from money transfers		3,347	3,000
Foreign exchange gains/(losses):			
- currency trading		5,906	5,287
- translation differences		(662)	(2,722)
- foreign currency derivatives		(3,345)	–
Other income		230	130
Non-interest income		**5,476**	**5,695**
Personnel expenses		(6,950)	(5,877)
Depreciation and amortization		(1,242)	(1,229)
Other general and administrative expenses	16	(2,626)	(2,925)
Non-interest expense		**(10,818)**	**(10,031)**
Profit before income tax expense		**33,782**	**30,080**
Income tax expense	9	(4,785)	(3,033)
Profit for the year		**28,997**	**27,047**
Other comprehensive income			
Other comprehensive income not to be reclassified to profit or loss in subsequent periods			
Income tax effect on revaluation of buildings	9	–	513
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods		**–**	**513**
Total comprehensive income for the year		**28,997**	**27,560**

The accompanying notes on pages 7 to 34 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December 2017

(Thousands of Georgian Lari)

	Charter capital	Retained earnings	Revaluation reserve	Total
1 January 2016	**836**	**80,281**	**3,028**	**84,145**
Profit for the year	–	27,047	–	**27,047**
Other comprehensive income for the year	–	–	513	**513**
Total comprehensive income for the year	**–**	**27,047**	**513**	**27,560**
Depreciation and transfer of revaluation reserve (Note 14)	–	122	(122)	**–**
Dividends declared (Note 14)	–	(8,460)	–	**(8,460)**
31 December 2016	**836**	**98,990**	**3,419**	**103,245**
Profit for the year	–	28,997	–	**28,997**
Total comprehensive income for the year	**–**	**28,997**	**–**	**28,997**
Depreciation and transfer of revaluation reserve (Note 14)	–	137	(137)	**–**
Dividends declared (Note 14)	–	(8,212)	–	**(8,212)**
31 December 2017	**836**	**119,912**	**3,282**	**124,030**

Statement of cash flows

For the year ended 31 December 2017

(Thousands of Georgian Lari)

	Note	2017	2016
Cash flows from operating activities			
Interest received		54,944	56,449
Interest paid		(15,297)	(19,248)
Proceeds from sale of repossessed collateral		7,472	8,980
Receipts from trading in foreign currency and foreign currency derivatives		2,677	5,287
Commissions received from money transfers		3,347	3,000
Other income received		230	130
Personnel expenses paid		(6,920)	(5,877)
Other operating expenses paid		(2,678)	(2,984)
Cash flows from operating activities before changes in operating assets and liabilities		**43,775**	**45,737**
Change in operating assets and liabilities			
Loans to customers		10,438	(5,001)
Other assets		(3,635)	(1,230)
Other liabilities		1,040	(4,509)
Net cash flows from operating activities before income tax		**51,618**	**34,997**
Income tax paid		(3,100)	(9,024)
Net cash from operating activities		**48,518**	**25,973**
Cash flows used in investing activities			
Purchase of property and equipment		(744)	(2,145)
Net cash used in investing activities		**(744)**	**(2,145)**
Cash flows used in financing activities			
Proceeds from borrowed funds	22	37,587	48,175
Repayment of borrowed funds	22	(26,621)	(39,560)
Net promissory notes repaid	22	(48,323)	(15,405)
Dividends paid	14	(8,212)	(8,460)
Net cash used in financing activities		**(45,569)**	**(15,250)**
Effect of exchange rates changes on cash and cash equivalents		(87)	(3,015)
Net increase in cash and cash equivalents		**2,118**	**5,563**
Cash and cash equivalents, beginning	5	72,851	67,288
Cash and cash equivalents, ending	5	**74,969**	**72,851**

(Thousands of Georgian Lari)

1. Principal activities

Qualified Credit Institution MFO Rico Express LLC (the "Company") was established as limited liability company on 1 July 2004 under the laws of Georgia.

On 11 April 2007 the Company was registered as microfinance organization by the National Bank of Georgia ("NBG") with the registration number #80407. On 26 June 2013 the Company obtained status of qualified credit institution from the NBG.

Legal address of the Company is 70 Chavchavadze ave, Tbilisi, Georgia.

The Company's main activities are issuance of small and medium-sized loans to individuals collaterized by immovable and movable property (mostly precious metals and real estate), currency dealing and money transfers.

As at 31 December 2017 and 31 December 2016, Mrs Dali Urushadze was the sole owner of the Company.

2. Basis of preparation

General

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

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. Land and buildings and derivative financial instruments have been measured at fair value.

The Company's functional and presentation currency is the Georgian Lari (GEL).These financial statements are presented in thousands of Georgian Lari ("GEL") unless otherwise indicated.

Amendment of the financial statements after issue

Any changes to these financial statements after issue require approval of the Company's supervisory board. These financial statements have not yet been approved by supervisory board at the supervisory board meeting. The supervisory board meeting is usually held during the second half of the year after, issuance of these financial statements.

Changes in accounting policies

The Company applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2017. The nature and the impact of each amendment is described below:

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

The amendments require entities to provide disclosure of changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). The Bank has provided the information for both the current and the comparative period in Note 22.

No other new or revised IFRS that became effective during the reporting period had any impact on the Company's financial position or performance.

3. Summary of accounting policies

Fair value measurement

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

3. Summary of accounting policies (continued)

Fair value measurement (continued)

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

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

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

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

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

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. The Company determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below. As at 31 December 2017, all financial assets of the Company are classified as loans and receivables.

Date of recognition

All regular way purchases and sales of financial assets are recognised on the settlement date i.e. the date that the purchased asset is delivered to the Company. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Loans and receivables

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

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Financial assets (continued)

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- A financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Company has the intention and ability to hold it for the foreseeable future or until maturity;
- Other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Company has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

Cash and cash equivalents

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

Derivative financial instruments

In the normal course of business, the Company enters into foreign currency cross currency swaps in the foreign exchange market. The counterparties are mostly local banks.

The fair values are estimated based on pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of profit or loss within net gains/(losses) from foreign currencies.

Although the Company has derivative instruments for risk hedging purposes, these instruments do not qualify for hedge accounting.

Borrowed funds and issued promissory notes

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

Measurement of financial instruments at initial recognition

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

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

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Measurement of financial instruments at initial recognition (continued)

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

Offsetting of financial instruments

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

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

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

Impairment of financial assets

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

Loans to customers

For loans to customers, the Company assesses whether objective evidence of impairment exists collectively for financial assets that are not individually significant. The Company collectively assesses for impairment the groups of financial assets with similar credit risks characteristics.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets’ carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred).

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in profit or loss. Interest income continues to be accrued on the outstanding principal based on the original effective interest rate of the asset.

Lombard loans together with the associated allowance are usually written off and the collateral is repossessed when the respective loan becomes overdue for more than 120 days. Non-performing mortgage loans are written-off when collateral recovery procedures are completed and no further cash inflows are expected from the borrower or collateral, which may take up to 2 years.

If a future write-off is later recovered, the recovery is credited to the profit or loss as reversal of allowance for loan impairment.

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Company's internal credit grading system that considers past-due status, loan currency and credit product.

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

Derecognition of financial assets and liabilities

Financial assets

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

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

Financial liabilities

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

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

Taxation

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

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of 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 (applicable to undistributed profits) 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 Company's activities. These taxes are included as a component of other operating expenses.

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Precious metals

Gold and other precious metals received as repossessed collateral in settlement of loans from non-performing borrowers are initially recorded cost which equals net carrying value of the extinguished loan at repossession date. Subsequently it is measured at fair value determined at Bloomberg bid prices less expected melting costs. Changes in the fair value after initial recognition and gains/losses from disposal of gold bullions are recorded within net gains from foreign currencies.

Property and equipment

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

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

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

Property and equipment other than land and buildings are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met. Costs related to repairs and renewals are charged when incurred and included in other operating expenses, unless they qualify for capitalization.

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

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

	Years
Buildings	25
Other	5

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end. Land is not depreciated.

Intangible assets

Intangible assets include computer software and licenses. Intangible assets are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Intangible assets with finite lives are amortised over the useful economic lives of 5 to 7 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods are reviewed at least at each financial year-end.

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Provisions

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

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured.

Interest and similar income and expense

For all financial instruments measured at amortised cost interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (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 Company revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense. Fines and penalties for overdue payments on loans are recognized similar to interest income to the extend it is probable that associated economic benefits will flow to the Company. Once the value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Fee and commission income

The Company earns fee and commission from money transfers that are recognised on completion of the underlying transaction.

Foreign currency translation

The financial statements are presented in Georgian Lari, which is the Company's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the statement of profit or loss as gains less losses from foreign currencies − translation differences.

Differences between the contractual exchange rate of a transaction in a foreign currency and the National Bank of Georgia exchange rate on the date of the transaction are included in Net gains/losses from foreign currencies.

Standards issued but not yet effective

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

IFRS 9 Financial Instruments

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

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

(a) Classification and measurement

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

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

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

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

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

(b) Impairment

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

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

IFRS 15 Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*, effective for periods beginning on 1 January 2018 with early adoption permitted. IFRS 15 defines principles for recognising revenue and will be applicable to all contracts with customers. However, interest and fee income integral to financial instruments and leases will continue to fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (e.g., IFRS 9, and IFRS 16 *Leases*).

Revenue under IFRS 15 will need to be recognised as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard will also specify a comprehensive set of disclosure requirements regarding the nature, extent and timing as well as any uncertainty of revenue and corresponding cash flows with customers.

The Company is currently evaluating impact of IFRS 15 however it does not expect it to be significant considering that most of its revenue streams are outside the scope of the new standard.

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

IFRS 16 Leases

The IASB issued the new standard for accounting for leases − IFRS 16 *Leases* in January 2016. The new standard does not significantly change the accounting for leases for lessors. However, it does require lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right of-use assets. Lessees must apply a single model for all recognised leases, but will have the option not to recognise 'short-term' leases and leases of 'low-value' assets. Generally, the profit or loss recognition pattern for recognised leases will be similar to today's finance lease accounting, with interest and depreciation expense recognised separately in the statement of profit or loss.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted provided the new revenue standard, IFRS 15, is applied on the same date.

The Company does not anticipate early adopting IFRS 16 and is currently evaluating its impact.

4. Significant accounting judgments and estimates

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses.

Estimation uncertainty

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

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Please refer to Note 19.

Allowance for loan impairment

The Company regularly reviews its loans and receivables to assess impairment. The Company 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. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Company uses its experienced judgment to adjust observable data for a group of loans or receivables to reflect current circumstances. The amount of allowance for loan impairment recognized in statement of financial position at 31 December 2017 was 2,613 (2016: 2,831). More details are provided in Note 7.

(Thousands of Georgian Lari)

4. Significant accounting judgments and estimates (continued)

Estimation uncertainty (continued)

Revaluation of land and buildings

The Company carries its land and buildings at fair value. The Company engaged independent valuation specialists to determine fair value as at 31 December 2015 for land and buildings. For revaluation, the valuator used a valuation technique based on comparable market data as well as assumptions on capitalization rates. The key assumptions used to determine the fair value of the Company's land and buildings are further explained in Note 19. As at 31 December 2017, the Company analysed available market information in relation to its land and buildings and concluded that the estimated fair value of its land and buildings was not materially different from their carrying value, and accordingly, no revaluation was required.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2017	**2016**
Cash on hand	32,906	15,745
Current accounts with other credit institutions	42,063	56,217
Cash in transit	–	889
	74,969	**72,851**

As at 31 December 2017, GEL 39,781 or 95% (2016: GEL 53,670 or 94%) of current accounts with other credit institutions is placed within three (2016: three) Georgian banks that have ratings from B+ to BB- (Fitch).

6. Derivative financial instruments

The Company enters into derivative financial instruments to mitigate currency risk. The table below shows the fair values of derivative financial instruments as at 31 December 2017, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate volume of transactions outstanding at the year end and are not indicative of the credit risk.

		Fair values	
	Notional amount	**Asset**	**Liability**
Foreign exchange contracts			
Cross-currency swaps – domestic	100,608	585	(701)

Cross-currency swaps are contractual agreements between two parties to exchange movements in foreign currency rates based on specified notional amounts.

7. Loans to customers

The Company issues small and medium-sized loans to individuals: mortgage loans secured by real estate, and lombard loans secured by precious metals (mostly gold) and jewellery.

Lombard loans are issued normally from 1 month to 6 months period, with an option to roll-over at the mutual agreement of the borrower and the Company. Mortgage loans are normally issued for 35 months period.

(Thousands of Georgian Lari)

7. Loans to customers (continued)

Loans to customers comprise:

	2017	2016
Lombard loans	146,642	146,653
Mortgage loans	57,325	85,173
Gross loans to customers	**203,967**	**231,826**
Less: allowance for impairment	(2,613)	(2,831)
Loans to customers	**201,354**	**228,995**

Allowance for impairment of loans to customers

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

	Lombard loans	Mortgage loans	Total
At 1 January 2017	**1,126**	**1,705**	**2,831**
Charge for the year	565	1,183	**1,748**
Amounts written off	(608)	(1,358)	**(1,966)**
At 31 December 2017	**1,083**	**1,530**	**2,613**

	Lombard loans	Mortgage loans	Total
At 1 January 2016	**1,465**	**1,031**	**2,496**
Charge for the year	1,102	2,200	**3,302**
Amounts written off	(1,441)	(1,526)	**(2,967)**
At 31 December 2016	**1,126**	**1,705**	**2,831**

Management estimates loan impairment for loans to customers based on its past historical loss experience. The objective evidence of impairment used by management in determining the impairment losses for loans to customers include overdue payments under the loan agreement.

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

- Precious metals;
- Real estate.

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

(Thousands of Georgian Lari)

7. Loans to customers (continued)

Collateral and other credit enhancements (continued)

Below is summary of loans to customers secured by various types of collateral, presenting the carrying value of respective loans but not the fair value of the collateral provided:

	2017	Share in the loan portfolio %	2016	Share in the loan portfolio %
Loans secured by precious metals	133,763	65%	133,238	57%
Loans secured by real estate	57,325	28%	85,173	37%
Loans secured by jewellery	11,852	6%	12,272	5%
Loans secured by issued promissory notes	65	0%	203	0%
Unsecured loans	962	1%	940	1%
Gross loan to customers	**203,967**	**100%**	**231,826**	**100%**
Less allowance for impairment	(2,613)		(2,831)	
Total loans to customers	**201,354**		**228,995**	

The Company has a right to re-pledge the collateral received under lombard loans in absence of default of customer. As at 31 December 2017, fair value of precious metals held as collateral under lombard loans was equal to GEL 186,828 (2016: GEL 168,160).

As at 31 December 2017, collateral with fair value of GEL 63,036 (2016: GEL 72,463) in form of precious metals pledged by customers under lombard loans was re-pledged under borrowed funds from Georgian banks (Note 12).

8. Property and equipment

The movements in property and equipment were as follows:

	Land and buildings	Computers and communication	Office equipment	Vehicles	Total
Cost / revalued amount					
31 December 2016	**13,103**	**2,734**	**806**	**1,057**	**17,700**
Additions	385	204	155	–	**744**
31 December 2017	**13,488**	**2,938**	**961**	**1,057**	**18,444**
Accumulated depreciation					
31 December 2016	**(506)**	**(1,615)**	**(395)**	**(635)**	**(3,151)**
Depreciation charge	(524)	(414)	(133)	(149)	**(1,220)**
31 December 2017	**(1,030)**	**(2,029)**	**(528)**	**(784)**	**(4,371)**
Net book value					
31 December 2016	**12,597**	**1,119**	**411**	**422**	**14,549**
31 December 2017	**12,458**	**909**	**433**	**273**	**14,073**

(Thousands of Georgian Lari)

8. Property and equipment (continued)

	Land and buildings	Computers and communication	Office equipment	Vehicles	Total
Cost / revalued amount					
31 December 2015	**11,767**	**2,312**	**550**	**967**	**15,596**
Additions	1,336	463	256	90	**2,145**
Disposals and write-offs	–	(41)	–	–	**(41)**
31 December 2016	**13,103**	**2,734**	**806**	**1,057**	**17,700**
Accumulated depreciation					
31 December 2015	**–**	**(1,213)**	**(321)**	**(449)**	**(1,983)**
Depreciation charge	(506)	(402)	(111)	(186)	**(1,205)**
Disposals and write-offs	–	–	37	–	**37**
31 December 2016	**(506)**	**(1,615)**	**(395)**	**(635)**	**(3,151)**
Net book value					
31 December 2015	**11,767**	**1,099**	**229**	**518**	**13,613**
31 December 2016	**12,597**	**1,119**	**411**	**422**	**14,549**

The Company engaged an independent valuer to determine the fair value of its buildings. Fair value is determined by reference to market-based evidence. The date of the revaluation was 31 December 2015. More details about the fair value of buildings are disclosed in Note 19.

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

2017	**Buildings**	**Land**
Cost	11,868	235
Accumulated depreciation and impairment	(2,805)	(122)
Net carrying amount	**9,063**	**113**

2016	**Buildings**	**Land**
Cost	11,483	235
Accumulated depreciation and impairment	(2,418)	(122)
Net carrying amount	**9,065**	**113**

The Company's buildings with the carrying value of GEL 1,874 (2016: GEL 1,965) are used as a collateral for the loan obtained from a Georgian bank (Note 12).

9. Income tax

The corporate income tax expense comprises:

	2017	**2016**
Current tax charge	(4,448)	(4,432)
Deferred tax charge/(credit) − origination and reversal of temporary differences	(337)	1,912
Less: deferred tax recognized in other comprehensive income	–	(513)
Income tax expense	**(4,785)**	**(3,033)**

Georgian legal entities have to file individual corporate income tax declarations. Standard corporate income tax rate for companies comprised 15% for 2017 and 2016.

(Thousands of Georgian Lari)

9. Income tax (continued)

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

	2017	2016
Profit before tax	**33,782**	**30,080**
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	**(5,067)**	**(4,512)**
Adjustment to current tax of prior period	–	(156)
Tax exempt income	659	513
Non-deductible expenditures	(377)	(30)
Effect of change in income tax legislation (a)	–	1,152
Income tax expense	**(4,785)**	**(3,033)**

(a) 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 organization, for which the effective date is 1 January 2019. Under the new regulation, corporate income tax will be levied on profit distributed as dividends to the shareholders that are individuals or non-residents of Georgia, rather than on profit earned as under the current regulation. The amount of tax payable on a dividend distribution will be calculated as 15/85 of the amount of net distribution. The companies will be able to offset 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. Dividends distributions between Georgian resident companies will not be subject to corporate income tax.

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

As a result of new regulation coming the Company recognized income tax expense resulting from reversal of deferred tax assets and liabilities in net amount of GEL 1,152 in profit or loss for the year ended 31 December 2017.

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

(Thousands of Georgian Lari)

9. Income tax (continued)

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

	2015	Origination and reversal of temporary differences: In the statement of profit or loss	Origination and reversal of temporary differences: In other comprehensive income	2016	Origination and reversal of temporary differences in the statement of profit or loss	2017
Tax effect of deductible temporary differences						
Loans to customers, net	619	236	–	855	(284)	571
Promissory notes issued	326	(20)	–	306	(124)	182
Derivative financial instruments	–	–	–	–	11	11
Intangible assets	4	1	–	5	–	5
Other assets	45	229	–	274	(98)	176
Deferred tax asset	**994**	**446**	**–**	**1,440**	**(495)**	**945**
Tax effect of taxable temporary differences						
Property and equipment	(1,787)	953	513	(321)	158	(163)
Deferred tax (liability)/asset	**(793)**	**1,399**	**513**	**1,119**	**(337)**	**782**

10. Other assets

Other assets comprise:

	2017	2016
Receivables from money transfer companies	7,223	3,283
Receivables from sales of gold bullions	2,586	–
Gold bullions	2,055	1,303
Repossessed jewellery	829	921
Other	761	355
	13,454	**5,862**

11. Promissory notes issued

As of 31 December 2017 and 2016, the Company had issued short-term (mainly 1 year) interest-bearing promissory notes denominated in GEL, EUR and USD:

Currencies	2017	2016
USD	124,874	173,184
GEL	7,156	11,188
EUR	2,126	2,860
	134,156	**187,232**

(Thousands of Georgian Lari)

12. Borrowed funds

As at 31 December 2017 the Company obtained borrowings denominated in GEL from Georgian banks with interest rates ranging from 10% to 14% (2016: from 12% to 13%), linked to the NBG refinancing rate.

As at 31 December 2017, the borrowings with carrying value of GEL 45,652 (2016: 34,609) are secured by the gold with fair value of GEL 63,036 (2016: 72,463) obtained from borrowers as collateral that the Company has right to re-pledge in absence of default of the customer (Note 7).

The Company's buildings with the carrying value of GEL 1,874 (2016: GEL 1,965) are pledged as collateral for the loan obtained from a Georgian bank (Note 12).

13. Other liabilities

Other liabilities consisted of the following:

	2017	2016
Payables related to money transfer activities	216	–
Tax payables other than income tax	1,243	441
	1,459	**441**

14. Equity

Charter capital represents the nominal amount of capital in the founding documentation of the Company and is subject to state registration. As at 31 December 2017, charter capital of the Company amounted to GEL 836 (2016: GEL 836).

Dividends

In accordance with Georgian legislation the Company can distribute dividends from its annual or semi-annual profits.

In 2017, the Company declared and fully paid GEL 8,212 (2016: 8,460) dividends to the shareholder.

Nature and purpose of revaluation reserve

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

Movement of the revaluation reserve can be presents as follow:

At 1 January 2016	**3,028**
Effect of change in income tax legislation (Note 9)	513
Depreciation and transfer of revaluation reserve	(122)
At 31 December 2016	**3,419**
Depreciation and transfer of revaluation reserve	(137)
At 31 December 2017	**3,282**

(Thousands of Georgian Lari)

15. Commitments and contingencies

Operating environment

Georgia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Georgian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

Legal

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

Commitments and contingencies

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

	2017	2016
Operating lease commitments		
Not later than 1 year	351	398
Later than 1 year but not later than 5 years	810	665
Later than 5 years	432	545
	1,593	**1,608**

16. Other general and administrative expenses

Other general and administrative expenses comprise:

	2017	2016
Communication and utility	601	484
Occupancy and rent	534	486
Repair and maintenance of property and equipment	197	186
Legal and consulting cost	187	171
Business trip expense	175	148
Security cost	162	144
Operating taxes	146	143
Representative expenses	108	165
Bank commission	92	69
Advertisement cost	87	212
Office equipment and stationery	84	97
Write down of inventories to net realizable value	–	301
Other	253	319
	2,626	**2,925**

(Thousands of Georgian Lari)

17. Risk management

Introduction

Risk is inherent in the Company's activities but it is managed through a process of ongoing identification, measurement and monitoring. This process of risk management is critical to the Company's continuing profitability. Top management is responsible for and is directly involved in most of the risk management activities. The Supervisory Board of the Company takes appropriate risk management decisions (that cover both financial risk described below, and business risks such as changes in the environment, technology and industry) on its regular meetings that are conducted at least twice a month. Formalized risk management process is currently being developed. The Company is exposed mostly to credit risk, liquidity risk and foreign exchange risk. It is also subject to operational risks.

Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

The Company's maximum exposure to credit risk equals the carrying value of its cash (other than cash on hand), loans issued, receivables and derivative financial assets.

Credit risks associated with lombard loans is mainly managed by requesting collaterals for the loans. In addition the Company limits and monitors the amount of lombard loans granted to one borrower (maximum GEL 50 thousand) and there are no individual borrowers with significant balance in relation to the total lombard loans balance.

For mortgage loans the requesting person first fills the loan application which is discussed and analysed by the credit department of the Company. If the application is accepted as eligible by the credit department, then the face-to-face interview with the customer is conducted by the Company's director and the chairman of the supervisory board. If the Company's director and the chairman of the supervisory board conclude that the credit risk for this client is at acceptable level then the property subject to mortgage is assessed and the mortgage loan is issued in the amount not exceeding 30% of the property's liquidation value, which is the estimated amount which can be received selling the asset more quickly than it would be for unforced sale to independent willing buyer.

For a lombard loan, if the borrower fails to pay for more than 30 days the Company sends official warning letter to the customer and if the borrower still fails to pay amount due for 60 days, or sometimes for 120 days, then the Company writes-off the loan and sells collateral.

For mortgage loans, the official warning letter is sent if the borrower fails to pay for more than 15 days and the letter is also published in a newspaper. If the borrower fails to pay amounts due on time the Company's personnel contacts the client via phone call or SMS and request to cover the amount. Normally, the Company goes to court requesting sale of collateralized immovable property only when the loan is more than 120 days overdue. Though there are some cases, when the Company tries to re-negotiate loan terms with client to avoid selling mortgaged property. Normally, the courts satisfy the Company's request and the assets are sold to cover the amount owed by borrower to the Company, but often penalties are not covered. Court dealings may take about a year and the enforcement process may take three more months.

The maximum exposure to credit risk for the components of the statement of financial position is best represented by their carrying amounts. For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 7.

(Thousands of Georgian Lari)

17. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets

The table below shows the credit quality by class of asset for in the statement of financial position.

31 December 2017	Notes	Neither past due nor impaired High grade	Neither past due nor impaired Not rated	Past due but not impaired	Total
Cash and cash equivalents, except for cash on hand	5	42,063	–	–	**42,063**
Loans to customers	7	–	196,543	7,424	**203,967**
Lombard loans		–	*141,530*	*5,112*	***146,642***
Mortgage loans		–	*55,013*	*2,312*	***57,325***

31 December 2016	Notes	Neither past due nor impaired High grade	Neither past due nor impaired Not rated	Past due but not impaired	Total
Cash and cash equivalents, except for cash on hand	5	57,106	–	–	**57,106**
Loans to customers	7	–	221,678	10,148	**231,826**
Lombard loans		–	*139,794*	*6,859*	***146,653***
Mortgage loans		–	*81,884*	*3,289*	***85,173***

The Company does not have internal credit rating system to evaluate credit quality of loans to customers that are neither past due nor impaired. The Company keeps cash equivalents in banks that it considers high grade of credit quality.

Past due loans to customers include those that are only past due by a few days. An analysis of past due loans, by age, is provided below.

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

31 December 2017	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
Loans to customers					
Lombard loans	2,494	1,242	810	566	**5,112**
Mortgage loans	335	86	41	1,850	**2,312**
Total	**2,829**	**1,328**	**851**	**2,416**	**7,424**

31 December 2016	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
Loans to customers					
Lombard loans	3,162	1,259	927	1,511	**6,859**
Mortgage loans	1,067	261	–	1,961	**3,289**
Total	**4,229**	**1,520**	**927**	**3,472**	**10,148**

See Note 7 for more detailed information with respect to the allowance for impairment of loans to customers.

(Thousands of Georgian Lari)

17. Risk management (continued)

Credit risk (continued)

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue (or, in case of lombard loans, rolled-over in excess of the original maturity date) or there are any known difficulties in the expected cash flows of from groups of assets sharing similar credit risk characteristics, or infringement of the original terms of the contract. The Company assesses allowances only on collective basis as it does not have any individually significant loans.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to customers that are not individually significant. Allowances are evaluated on each reporting date with each portfolio receiving a separate review. The Company identifies groups of loans that share similar credit risk profile based on product, loan currency and number of overdue days.

The collective assessment takes account of impairment that is likely to be present in the portfolio. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, the appropriate delay between the times a loss is likely to have been uncured and the time it will be identified, and expected receipts and recoveries once impaired. The management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Company's overall policy.

Liquidity risk and funding management

Liquidity risk is the risk that the Company will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to funding base represented by promissory notes, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

Analysis of financial liabilities by remaining contractual maturities

The tables below summarize the maturity profile of the Company's financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Company expects that it will be able to refinance or roll-over repayment on the earliest date the Company could be required to pay and the table does not reflect the expected cash flows indicated by the Company's promissory notes refinancing history.

31 December 2017	**Up to 1 month**	**1 to 3 months**	**3 months to 1 year**	**1 to 5 years**	**Total**
Borrowed funds	546	932	21,438	32,565	**55,481**
Promissory notes	45,335	25,379	67,245	305	**138,264**
Derivative financial liabilities	100,608	–	–	–	**100,608**
Other financial liabilities	216	–	–	–	**216**
Total undiscounted financial liabilities	**146,705**	**26,311**	**88,683**	**32,870**	**294,569**

31 December 2016	**Up to 1 month**	**1 to 3 months**	**3 months to 1 year**	**1 to 5 years**	**Total**
Borrowed funds	520	3,236	21,956	12,748	**38,460**
Promissory notes	86,556	25,180	82,151	–	**193,887**
Total undiscounted financial liabilities	**87,076**	**28,416**	**104,107**	**12,748**	**232,347**

(Thousands of Georgian Lari)

17. Risk management (continued)

Market risk

Currency risk

Foreign currency denominated assets and liabilities give rise to foreign exchange exposure. The management controls currency risk by issuing loans and obtaining funding in the same currencies.

Included in the next tables are the Company's financial assets and financial liabilities at carrying amounts, categorized by currency (presented in GEL equivalents).

The following table shows the foreign currency exposure structure of financial assets and liabilities:

31 December 2017	GEL	USD	EUR	RUB	Other	Total
Cash and cash equivalents	31,693	33,197	6,028	3,564	487	**74,969**
Loans to customers	95,303	104,483	1,568	–	–	**201,354**
Other financial assets	106	4,343	4,907	568	–	**9,924**
Total	**127,102**	**142,023**	**12,503**	**4,132**	**487**	**286,247**
Promissory notes issued	(7,156)	(124,874)	(2,126)	–	–	**(134,156)**
Borrowed funds	(45,652)	–	–	–	–	**(45,652)**
Other financial liabilities	(14)	(8)	(191)	(3)	–	**(216)**
Total	**(52,822)**	**(124,882)**	**(2,317)**	**(3)**	**-**	**(180,024)**
The effect of derivatives held for risk management	(100,608)	100,034	–	–	–	**(574)**
Net position after derivatives held for risk management purposes	**(26,328)**	**117,175**	**10,186**	**4,129**	**487**	**105,649**

31 December 2016	GEL	USD	EUR	RUB	Other	Total
Cash and cash equivalents	11,413	56,412	3,058	1,640	328	**72,851**
Loans to customers	53,184	173,226	2,585	–	–	**228,995**
Other financial assets	15	835	2,198	235	–	**3,283**
Total	**64,612**	**230,473**	**7,841**	**1,875**	**328**	**305,129**
Promissory notes issued	(11,188)	(173,184)	(2,860)	–	–	**(187,232)**
Borrowed funds	(34,609)	–	–	–	–	**(34,609)**
Total	**(45,797)**	**(173,184)**	**(2,860)**	**–**	**–**	**(221,841)**
Currency position	**18,815**	**57,289**	**4,981**	**1,875**	**328**	**83,288**

(Thousands of Georgian Lari)

17. Risk management (continued)

Exchange rate sensitivity analysis

A weakening of the GEL, as indicated below, against the USD, EUR and RUB at 31 December 2017 and 2016 would have increased (decreased) profit or loss by the amounts shown below. This analysis is on pre- tax basis and is based on foreign currency exchange rate variances that the Company considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

	2017		2016	
Currency	**Change in currency rate in %**	**Effect on profit**	**Change in currency rate in %**	**Effect on profit**
USD	13.5%/(9.5%)	15,819/(11,132)	14%/(7%)	8,020/(4,010)
EUR	16%/(12%)	1,630/(1,222)	17.5%/(10.5%)	872/(523)
RUB	17%/(17%)	702/(702)	30%/(15%)	563/(281)

Interest rate risk

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

The sensitivity of the statement of profit or loss is the effect of the assumed changes in interest rates on the interest expense for one year on floating rate financial liabilities linked to the NBG refinancing rate as at 31 December.

The table reflects liabilities that are exposed to fluctuation in interest rate risk as of 31 December 2017 and 2016:

	2017	2016
Borrowed funds	45,652	34,609

Interest rate sensitivity analysis

The following table demonstrates the sensitivity to a reasonable possible change in the floating interest rates, with all other variables held constant, of the Company's statement of profit or loss and equity (before tax).

2017		2016	
Change in the NBG refinancing rate, basis points	**Effect on profit and equity before tax**	**Change in the NBG refinancing rate, basis points**	**Effect on profit and equity before tax**
100/(100)	324/(324)	150/(150)	417/(417)

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Company mitigates operational risk mostly by direct involvement of top management in Company's processes and operations, including assess, authorization and reconciliation procedures.

(Thousands of Georgian Lari)

18. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 17 "Risk management" for the Company's contractual undiscounted repayment obligations.

	2017			2016		
	Within one year	**More than one year**	**Total**	**Within one year**	**More than one year**	**Total**
Cash and cash equivalents	74,969	–	**74,969**	72,851	–	**72,851**
Derivative financial assets	585	–	**585**	–	–	**–**
Loans to customers	181,901	19,453	**201,354**	164,339	64,656	**228,995**
Current income tax asset	715	–	**715**	2,063	–	**2,063**
Property and equipment	–	14,073	**14,073**	–	14,549	**14,549**
Intangible assets	–	66	**66**	–	88	**88**
Deferred income tax asset	–	782	**782**	–	1,119	**1,119**
Other assets	13,454	–	**13,454**	5,862	–	**5,862**
Total	**271,624**	**34,374**	**305,998**	**245,115**	**80,412**	**325,527**
Derivative financial liabilities	701	–	**701**	–	–	**–**
Promissory notes issued	133,876	280	**134,156**	187,232	–	**187,232**
Borrowed funds	17,737	27,915	**45,652**	22,505	12,104	**34,609**
Other liabilities	1,459	–	**1,459**	441	–	**441**
Total	**153,773**	**28,195**	**181,968**	**210,178**	**12,104**	**222,282**
Net	**117,851**	**6,179**	**124,030**	**34,937**	**68,308**	**103,245**

The table above does not reflect historical pattern of loans to customers and promissory notes issued prolongations, roll-over and refinancing.

19. Fair value measurements

Fair value measurement procedures

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

The Company's financial department determines the policies and procedures for fair value measurement for Company's assets including derivatives. The estimated fair values of all financial assets and liabilities are calculated using discounted cash flow techniques based on estimated future cash flows and discount rates for similar instruments at the reporting date.

As at 31 December 2017 and 2016, the Company does not have any financial instruments, other than loans to customers, for which fair value is based on valuation techniques involving the use of significant non-market observable inputs.

(Thousands of Georgian Lari)

19. Fair value measurements (continued)

Fair value hierarchy

The Company measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

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

The tables below analyses property and equipment and financial instruments value at 31 December 2017 and 31 December 2016, by the level in the fair value hierarchy into which the fair value measurement is categorized. The amounts are based on the values recognized in the statement of financial position:

		Fair value measurement using		
At 31 December 2017	**Date of valuation**	**Quoted prices in active markets (Level 1)**	**Significant observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Assets and liabilities measured at fair value				
Property and equipment – lands and buildings	31 December 2015	–	–	12,458
Derivative financial assets	31 December 2017	–	585	–
Derivative financial liabilities	31 December 2017	–	701	–
Assets and liabilities for which fair values are disclosed				
Cash and cash equivalents	31 December 2017	32,906	42,063	–
Loans to customers	31 December 2017	–	–	201,200
Other financial assets	31 December 2017	–	9,924	–
Promissory notes issued	31 December 2017	–	134,988	–
Borrowings	31 December 2017	–	45,652	–
Other financial liabilities	31 December 2017	–	216	–

(Thousands of Georgian Lari)

19. Fair value measurements (continued)

Fair value hierarchy (continued)

		Fair value measurement using		
At 31 December 2016	**Date of valuation**	**Quoted prices in active markets (Level 1)**	**Significant observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Assets measured at fair value				
Property and equipment − lands and buildings	31 December 2015	−	−	12,597
Assets and liabilities for which fair values are disclosed				
Cash and cash equivalents	31 December 2016	15,745	57,106	−
Loans to customers	31 December 2016	−	−	230,687
Other financial assets	31 December 2016	−	3,283	−
Promissory notes issued	31 December 2016	−	188,632	−
Borrowed funds	31 December 2016	−	34,609	−

During the year ended 31 December 2016, the Company transferred borrowed funds and promissory notes issued from level 3 to level 2 of the fair value hierarchy. The reason for the transfers from level 3 to level 2 is that the borrowed funds are obtained at floating interest rates and current market conditions are reflected in its carrying value, as for promissory notes, promissory notes' portfolio consists of homogenous short-term financial instruments which are issued at fixed interest rates.

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

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

	2017			2016		
	Carrying value	**Fair value**	**Unrecog-nised loss**	**Carrying value**	**Fair value**	**Unrecog-nised gain/(loss)**
Financial assets						
Cash and cash equivalents	74,969	74,969	−	72,851	72,851	−
Loans to customers	201,354	201,200	(154)	228,995	230,687	1,692
Other financial assets	9,924	9,924	−	3,283	3,283	−
Financial liabilities						
Promissory notes issued	134,156	134,988	(832)	187,232	188,632	(1,400)
Borrowed funds	45,652	45,652	−	34,609	34,609	−
Other financial liabilities	216	216	−	−	−	−
Total unrecognised change in fair value			**(986)**			**292**

(Thousands of Georgian Lari)

19. Fair value measurements (continued)

Valuation techniques and assumptions

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

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid, due on demand or having a short term maturity (less than three months), as well as for floating rate assets and liabilities it is assumed that the carrying amounts approximate to their fair value.

Financial assets and financial liabilities carried at amortized cost

The fair value of loans to customers, promissory notes issued and borrowed funds is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

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

The following tables show descriptions of significant unobservable inputs to level 3 valuations of properties and revalued properties and equipment as at 31 December 2015:

	Fair value, GEL	Valuation technique	Significant unobservable inputs	Range (weighed average)
Land and buildings	**11,767**			
Land	113	Market approach	Price per square meter, in GEL	127-1,894 (977)
Property 1	2,786	Market approach	Price per square meter, in GEL	690-3,030 (2,383)
Property 2	534	Income approach	Potential gross annual revenue (in GEL) per sq. m. and capitalization rate	407-407 (407); 13.4%
Property 3	991	Market approach	Price per square meter, in GEL	1,294-1,321 (1,311)
Property 4	793	Income approach	Potential gross annual revenue (in GEL) per sq. m. and capitalization rate	740-870 (792); 14.4%
Property 5	3,344	Market approach	Price per square meter, in GEL	1,751-5,436 (2,761)
Property 6	3,206	Income approach	Potential gross annual revenue (in GEL) per sq. m. and capitalization rate	386-1,423 (532); 13.4%-15.4% (14.8%)

Decrease in price per square meter and potential gross annual revenue per square meter or increase in capitalization rate would result in decrease in fair value of the properties

Reconciliation of carrying value of land and buildings categories in level 3 of fair value hierarchy for the years ended 31 December 2017 and 2016 is presented in Note 8. As at 31 December 2017, the Company concluded, based on overall analysis of Georgian real estate market, that carrying value of its land and buildings does not differ significantly from their fair value. Accordingly, no revaluation of Company's land and buildings was performed as at 31 December 2017.

(Thousands of Georgian Lari)

20. Related party disclosures

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

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

The outstanding balances of related party transactions are as follows:

	2017			2016	
	Shareholder	**Key management personnel**	**Other related parties**	**Key management personnel**	**Other related parties**
Loans outstanding at 1 January, gross	**–**	**53**	**151**	**59**	**67**
Loans issued during the year	–	8	–	49	149
Loan repayments during the year	–	(7)	(18)	(64)	(75)
Other movements	–	(2)	(3)	9	10
Loans outstanding at 31 December, gross	**–**	**52**	**130**	**53**	**151**
Less: allowance for impairment at 31 December	–	(1)	(2)	–	–
Loans outstanding at 31 December, net	**–**	**51**	**128**	**53**	**151**
Promissory notes at 1 January	**–**	**402**	**424**	**407**	**355**
Promissory notes issued during the year	219	1,317	725	4,799	430
Promissory notes repaid during the year	–	(1,384)	(731)	(5,080)	(525)
Other movements	14	(8)	(4)	276	164
Deposits at 31 December	**233**	**327**	**414**	**402**	**424**

Other related parties are mostly represented by close family members of key management personnel and the shareholder.

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

	For the year ended 31 December					
	2017			**2016**		
	Shareholder	**Key management personnel**	**Other related parties**	**Shareholder**	**Key management personnel**	**Other related parties**
Interest income on loans	–	4	8	–	7	9
Interest expense on promissory notes	(13)	(22)	(34)	–	(32)	(36)
Rent expense	(96)	(12)	(36)	(96)	(12)	(34)

Compensation of key management personnel was comprised of the following:

	2017	2016
Salaries and other short-term benefits	1,008	954

(Thousands of Georgian Lari)

21. Capital adequacy

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

During the past year, the Company had complied in full with all its externally imposed capital requirements.

The primary objectives of the Company's capital management are to ensure that the Company complies with externally imposed capital requirements and that the Company maintains healthy capital ratios in order to support its business and to maximize shareholders' value.

NBG capital adequacy ratio

The NBG requires qualified credit institutions to maintain a gearing (equity to assets) ratio of 20%. As of 31 December 2017 and 2016, the Company's gearing ratio was as follows:

	2017	2016
Equity	124,030	103,245
Assets	305,998	325,527
Equity to assets ratio as 31 December	41%	32%

22. Changes in liabilities arising from financing activities and other non-cash movements

	Promissory notes issued*	Borrowed funds	Total liabilities from financing activities
Carrying amount at 31 December 2015	**185,936**	**25,994**	**211,930**
Proceeds from issue	–	48,175	**48,175**
Payment of principal	(15,405)	(39,560)	**(39,560)**
Change in accrued interest	(384)	–	**(384)**
Foreign currency translation	17,085	–	**17,085**
Carrying amount at 31 December 2016	**187,232**	**34,609**	**221,841**
Proceeds from issue	–	37,587	**37,664**
Payment of principal	(48,323)	(26,621)	**(26,621)**
Change in accrued interest	(225)	77	**(225)**
Foreign currency translation	(4,528)	–	**(4,528)**
Carrying amount at 31 December 2017	**134,156**	**45,652**	**179,808**

* Proceeds from issue and payments of principal on promissory notes are presented on a net basis as their turnover is quick, the amounts are large, and the maturities are short.

Other material non-cash movements mostly represent repossession of gold pledged as collateral under defaulted loans to customers that amounted to GEL 10,816 for the year ended 31 December 2017 (2016: GEL 8,980).

23. Events after the reporting period

On 12 June 2018, amendments to the Georgian tax law in respect of corporate income tax became enacted. Under the new regulation banks, insurance companies credit unions and microfinance organization so called "Estonian model" of taxation (Note 9) was postponed from 1 January 2019 to 1 January 2023.

New legislation is expected to have an impact on the Company's deferred tax assets and liabilities and respective income tax charges as at 31 December 2018 and for the year then ending.