Microfinance Organisation
Continental City Credit LLC

Consolidated financial statements

Year ended 31 December 2018
together with independent auditor's report

Contents

Independent auditor's report

To the Participant and Supervisory Board of
Microfinance Organization Continental City Credit LLC

Opinion

We have audited the consolidated financial statements of Microfinance Organization Continental City Credit LLC (the "Company"), which comprise the consolidated statement of financial position as at 31 December 2018, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at 31 December 2018 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs).
Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the 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.

Other matter

The consolidated financial statements of the Company for the year ended 31 December 2017 were audited by another auditor who expressed an unmodified opinion on those statements on 24 May 2018.

Other information included in the Company's 2018 Annual Report

Other information consists of the information included in Company's 2018 Annual Report, other than the consolidated financial statements and our auditor's report thereon. Management is responsible for the other information. The Company's 2018 Annual Report is expected to be made available to us after the date of this auditor's report.

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

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

Responsibilities of management and Supervisory Board for the consolidated financial statements

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

In preparing the consolidated financial statements, management is responsible for assessing the 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.

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

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

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

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- 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 consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with 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 LLC

26 June 2019

Tbilisi, Georgia

Consolidated statement of financial position

As at 31 December 2018

(in thousands of Georgian Lari)

	Notes	31 December 2018	31 December 2017
Assets			
Cash and cash equivalents	6	1,334	907
Loans to customers	7	4,812	10,589
Property and equipment	8	342	284
Intangible assets		14	16
Current income tax assets		109	–
Deferred income tax assets	17	–	979
Other assets	9	1,744	3,096
Total assets		**8,355**	**15,871**
Liabilities and equity			
Liabilities			
Borrowed funds	10	8,162	7,581
Current income tax liability		–	215
Provisions	11	–	5,939
Other liabilities	12	280	170
Total liabilities		**8,442**	**13,905**
Equity			
Charter capital	13	9,446	8,429
Accumulated losses		(9,533)	(6,463)
Total equity		**(87)**	**1,966**
Total liabilities and equity		**8,355**	**15,871**

Signed and authorized for release on behalf of the management:

Tamaz Mikadze
Director
26 June 2019

Indira Tsintskladze
Chief Accountant

The notes on pages 5-35 form an integral part of these consolidated financial statements.

Consolidated statement of profit or loss and other comprehensive income

For the year ended 31 December 2018

(in thousands of Georgian Lari)

	Notes	*2018*	*2017*
Interest income calculated using effective interest rate method	14	2,768	7,584
Interest expense	14	(736)	(1,711)
Net interest income before impairment losses / recovery on interest bearing assets		**2,032**	**5,873**
Impairment (losses)/recovery on interest bearing assets	7	(977)	3,796
Net interest income		**1,055**	**9,669**
Net (loss)/gain on foreign exchange operations		(329)	748
Fee and commission expense		(122)	(174)
Other income	15	154	288
Net non-interest (loss)/income		**(297)**	**862**
Operating income		**758**	**10,531**
Provisions	11	(914)	(5,939)
Impairment losses on non-interest bearing financial assets	9	–	(2,991)
Operating expenses	16	(1,814)	(4,725)
Loss before income tax		**(1,970)**	**(3,124)**
Income tax expense	17	(1,028)	(88)
Loss for the year		**(2,998)**	**(3,212)**
Other comprehensive income		–	–
Total comprehensive loss		**(2,998)**	**(3,212)**
Attributable to:			
Owners of the parent		(2,998)	(2,933)
Non-controlling interest		–	(279)
Total comprehensive loss		**(2,998)**	**(3,212)**

Consolidated statement of changes in equity

For the year ended 31 December 2018

(in thousands of Georgian Lari)

	Notes	*Charter capital*	*Accumulated losses*	*Total equity attributable to owners of the parent*	*Non-controlling interest*	*Total equity*
31 December 2016		**4,800**	**(160)**	**4,640**	**599**	**5,239**
Total comprehensive loss		–	(2,933)	(2,933)	(279)	(3,212)
Conversion of borrowed funds from owner into charter capital	10	3,629	–	3,629	–	3,629
Decrease in non-controlling interest from acquisition of interest in CC Loan LLC		–	160	160	(160)	–
Dividends declared	13	–	(3,530)	(3,530)	(160)	(3,690)
31 December 2017		**8,429**	**(6,463)**	**1,966**	**–**	**1,966**
Impact of adopting IFRS 9	3	–	(72)	(72)	–	(72)
Restated opening balance under IFRS 9		**8,429**	**(6,535)**	**1,894**	**–**	**1,894**
Total comprehensive loss		–	(2,998)	(2,998)	–	(2,998)
Conversion of borrowed funds into charter capital	13	1,017	–	1,017	–	1,017
31 December 2018		**9,446**	**(9,533)**	**(87)**	–	**(87)**

Consolidated statement of cash flows

For the year ended 31 December 2018

(in thousands of Georgian Lari)

	Note	*2018*	*2017*
Cash flows from operating activities			
Interest received		2,914	8,530
Interest paid		(749)	(1,888)
Fee and commission paid		(122)	(79)
Operating expenses paid		(1,599)	(5,370)
Other income received		154	127
Income tax paid		(361)	(1,270)
Cash flows from operating activities before changes in operating assets and liabilities		**237**	**50**
Changes in operating assets and liabilities			
Net decrease in loans to customers		4,597	5,907
Net decrease in other assets		1,197	115
Net cash from operating activities		**6,031**	**6,072**
Cash flows from investing activities			
Purchase of property and equipment		–	(90)
Purchase of intangible assets		–	(8)
Net cash used in investing activities		**–**	**(98)**
Cash flows from financing activities			
Proceeds from other borrowed funds	10	286	3,960
Repayment of other borrowed funds	10	(5,897)	(8,930)
Dividends paid		–	(2,457)
Net cash used in financing activities		**(5,611)**	**(7,427)**
Net increase/(decrease) in cash and cash equivalents		**420**	**(1,453)**
Cash and cash equivalents, at beginning of the year		907	2,412
Effect of foreign exchange rate changes on cash and cash equivalents		7	(52)
Cash and cash equivalents, at end of the year	6	**1,334**	**907**

(in thousands of Georgian Lari)

1. Organisation

Microfinance Organisation Continental City Credit LLC (the "Company") was incorporated in Georgia on 6 March 2012. The Company is regulated by the National Bank of Georgia (the "NBG") and conducts its business in accordance with the Georgian Law on Microfinance Organisations. The Company possesses a license for microfinance operations from the National Bank of Georgia Number 583 granted on 5 May 2012. Company's identification number is 404932891.

Company's primary business consisted of disbursing mortgage and pawnshop loans.

The registered office of the Company is located on Beliashvili str. 145, Tbilisi, Georgia.

As at 31 December 2018 and 2017, 100% immediate owner of the Company was CC Continental City Capital LTD (the "Parent") incorporated in Cyprus.

As at 31 December 2018 ultimate individual shareholder having 100% control over CC Continental City Capital LTD was Rati Chelidze. As at 31 December 2017: ultimate individual shareholders of the Company were as follows:

	31 December 2017
Rati Chelidze	50.00%
Vika Bashirov	16.67%
Guy Ben-Levy	16.67%
David Uzarashvili	16.67%
Total	**100.00%**

2. Basis of preparation

General

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB").

These consolidated financial statements have been prepared on the historical cost basis except for the measurement at fair value of certain financial instruments, as explained in the accounting policies below.

Company's functional and presentation currency is the Georgian Lari (GEL). Financial information is presented in GEL rounded to the nearest thousands, unless otherwise indicated.

3. Summary of accounting policies

Changes in accounting policies

The Company has applied for the first-time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2018. The Company has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective. The nature and the impact of each amendment is described below:

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* for annual periods on or after 1 January 2018. The Company has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognizes directly in retained earnings as of 1 January 2018 and are disclosed below.

(in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Changes in accounting policies (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 amortised 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 realised and unrealised gains and losses, except for dividend income, are recognised in other comprehensive income with no subsequent reclassification to profit and loss.

The classification and measurement of financial liabilities remains largely unchanged from the current IAS 39 requirements.

(b) Impairment

The adoption of IFRS 9 has fundamentally changed the Company's accounting for loan impairment by replacing IAS 39 incurred loss approach with a forward-looking expected credit loss (ECL) approach. From 1 January 2018, the Company has been recording the allowance for expected credit losses for all loans and other debt financial assets not held at FVPL. Equity instruments are not subject to impairment under IFRS 9.

The allowance for expected credit losses is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12mECL). The 12mECL is the portion of LTECL that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Details of the Company's impairment methodology are disclosed in Note 22. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in section (c) below.

(c) Effect of transition to IFRS 9

The following tables set out the impact of adopting IFRS 9 on the consolidated statement of financial position and retained earnings as at 1 January 2018 including the effect of replacing IAS 39 incurred credit loss calculations with IFRS 9 ECL.

A reconciliation between the carrying amounts under IAS 39 to the balances reported under IFRS 9 as at 1 January 2018 is as follows:

		IAS 39 measurement		*Remeasurement*	*IFRS 9*	
	Ref	***Category***	***Amount***	***ECL***	***Amount***	***Category***
Financial assets						
Cash and cash equivalents	A	L&R[1]	907	–	907	Amortised cost
Loans to customers	A	L&R	10,589	(84)	10,505	Amortised cost
Other financial assets	A	L&R	928	–	928	Amortised cost
Deferred tax asset			979	12	991	
Total assets affected by IFRS 9			**13,403**	**(72)**	**13,331**	
Total liabilities			**13,905**	–	**13,905**	

[1] *L&R: Loans and receivables.*

A As of 1 January 2018, the Company's concluded that all financial assets meet the SPPI criteria and are held under business model with the aim to hold to collect contractual cash flows. Therefore, those financial assets classified as loans and receivables and measured at amortised cost previously under IAS 39, continue to be classified by Company as financial assets at amortized cost under IFRS 9.

(in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

The impact of transition to IFRS 9 on reserves and retained earnings is as follows:

	Accumulated loss
Closing balance under IAS 39 (31 December 2017)	(6,463)
Recognition of IFRS 9 ECLs	(84)
Deferred tax in relation to the above	12
Restated opening balance under IFRS 9 (1 January 2018)	**(6,535)**
Total change in equity due to adopting IFRS 9	**(72)**

The following table reconciles the aggregate opening loan loss allowances under IAS 39 and ECL allowances under IFRS 9.

	Impairment allowance under IAS 39 at 31 December 2017	***Remeasurement***	***ECL under IFRS 9 at 1 January 2018***
Impairment allowance for loans to customers	1,846	84	1,930

IFRS 15 Revenue from Contracts with Customers

IFRS 15, issued in May 2014, and amended in April 2016, establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. However, the standard does not apply to revenue associated with financial instruments and leases, and therefore, does not impact the majority of the Company's revenue including interest income, which are covered by *IFRS 9 Financial Instruments*. As a result, the majority of the Company's revenues are not impacted by the adoption of this standard.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Considerations

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine the date of the transactions for each payment or receipt of advance consideration. This Interpretation does not have any impact on the Company's consolidated financial statements.

No other standard or interpretation that became effective in 2018 had any material impact on the consolidated financial statements.

Financial assets and liabilities

Initial recognition

The Company recognizes financial assets and liabilities in its consolidated statement of financial position when it becomes a party to the contractual obligations of the instrument. Regular way purchases and sales of financial assets and liabilities are recognized using settlement date accounting. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

Initial measurement

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Financial instruments are initially measured at their fair value and, except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount.

(in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

Measurement categories of financial assets and liabilities

From 1 January 2018, the Company 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 Company classifies and measures its derivative and trading portfolio at FVPL. The Company may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

Before 1 January 2018, the Company classified its financial assets as loans and receivables (amortised cost), FVPL, available-for-sale or held-to-maturity (amortised cost).

Financial liabilities are measured at amortised cost or at FVPL when they are held for trading, are derivative instruments or the fair value designation is applied.

Loans and receivables at amortised cost

Before 1 January 2018, loans to customers included non-derivative financial assets with fixed or determinable payments that were not quoted in an active market, other than those:

- That the Company intended to sell immediately or in the near term;
- That the Company, upon initial recognition, designated as at FVPL or as available-for-sale;
- For which the Company may not recover substantially all of its initial investment, other than because of credit deterioration, which were designated as available-for-sale.

Before 1 January 2018, loans and receivables (including due from financial institutions, loans to customers and other financial assets) that had fixed or determinable payments that are not quoted in an active market were classified as 'loans and receivables'. Loans and receivables were measured at amortized cost using the effective interest method, less any impairment. Interest income was recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest was immaterial.

From 1 January 2018, the Company only measures 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).

The details of these conditions are outlined below.

Business model assessment

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

The Company'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 Company's assessment.

(in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Loans and receivables at amortised cost (continued)

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 Company's original expectations, the Company 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.

The SPPI test

As a second step of its classification process the Company 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 Company 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.

Renegotiated loans

Where possible, the Company seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.

From 1 January 2018, the Company derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI. When assessing whether or not to derecognise a loan to a customer, amongst others, the Company considers the following factors:

- Change in currency of the loan;
- Change in counterparty;
- If the modification is such that the instrument would no longer meet the SPPI criterion.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Company records a modification gain or loss in profit or loss, to the extent that an impairment loss has not already been recorded.

For modifications not resulting in derecognition, the Company also reassesses whether here has been a significant increase in credit risk or whether the assets should be classified as credit-impaired. Once an asset has been classified as credit-impaired as the result of modification, it will remain in Stage 3 until customer fully repays amount overdue.

(in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Impairment of financial assets under IAS 39

Before 1 January 2018, financial assets were assessed for indicators of impairment at the end of each reporting period. Financial assets were considered to be impaired when there was objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

Objective evidence of impairment could include:

- Significant financial difficulty of the issuer or counterparty; or
- Breach of contract, such as default or delinquency in interest or principal payments; or
- Default or delinquency in interest or principal payments; or
- It becoming probable that the borrower will enter bankruptcy or financial re-organisation; or
- Disappearance of an active market for that financial asset because of financial difficulties.

Objective evidence of impairment for a portfolio of loans and receivables could include the Company's past experience of collecting payments, an increase in the number of delayed payments in the portfolio, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortized cost, the amount of the impairment loss recognized was the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset was reduced by the impairment loss directly for all financial assets with the exception of loans and receivables, where the carrying amount is reduced through the use of an allowance account. When a loan or a receivable was considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off were credited against the allowance account. Changes in the carrying amount of the allowance account were recognized in profit or loss.

For financial assets measured at amortized cost, if, in a subsequent period, the amount of the impairment loss decreases and the decrease could be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss was reversed through profit or loss.

Derecognition of financial assets

The Company derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another party. If the Company neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Company recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Company retains substantially all the risks and rewards of ownership of a transferred financial asset, the Company continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit or loss.

Write off of loans and receivables

Loans and receivables are written off against the allowance for impairment losses when deemed uncollectible. Loans and receivables are written off after management has exercised all possibilities available to collect amounts due to the Company. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in profit or loss in the period of recovery.

Derecognition of financial liabilities

The Company derecognizes financial liabilities when, and only when, the Company's obligations are discharged, cancelled or they expire. 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. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit and loss.

(in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Offsetting

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liability simultaneously. Income and expense is not offset in profit or loss unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Company.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and cash in bank with original maturity of less or equal to 90 days.

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, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Company takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis.

In addition, for financial reporting purposes, fair value measurements are categorized into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

Repossessed assets

In certain circumstances, assets are repossessed following the foreclosure on loans that are in default. The Company views the repossessed assets as a form of settlement of amounts due under the defaulted loan and that it is an asset acquired and held for sale in the ordinary course of business.

Repossessed assets are initially recognized at cost and subsequently measured at the lower of carrying amount and fair value less costs to sell.

Property and equipment

Initial cost of property and equipment is assessed based on actual expenses for their acquisition that comprise purchase price, including non-refundable purchase taxes and any directly attributed costs of bringing the assets to its working condition and location for intended use. Subsequent to initial recognition property and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses, if any.

Depreciation is recognized so as to write off the cost or valuation of assets less their residual values over their useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following annual rates:

Buildings	2%
Computers	25%
Furniture and office fixtures	25%
Vehicles	20%
Leasehold improvements	20-30%
Other	25%

Leasehold improvements are amortized over the life of the related leased asset or the lease term, if lower. Expenses related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization.

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss and other comprehensive income.

(in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Intangible assets

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives. The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Derecognition of intangible assets

An intangible asset is derecognized on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognized in profit or loss and other comprehensive income when the asset is derecognized.

Impairment of non-financial assets

At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Taxation

The current income tax expense is calculated in accordance with the regulations of the Georgian tax code.

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

Deferred tax assets and liabilities are calculated in respect of temporary differences using the asset and 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.

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 utilized. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (applicable to undistributed profits) that have been enacted or substantively enacted at the reporting date.

Operating taxes

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

Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

(in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Revenue recognition

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

Interest and similar income and expense

From 1 January 2018, the Company calculates interest revenue on debt financial assets measured at amortized cost by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets (before 1 January 2018: by applying EIR to the amortized cost of financial assets). 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 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 revenue or expense.

When a financial asset becomes credit-impaired, the Company calculates interest revenue 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 Company reverts to calculating interest revenue on a gross basis.

Fee and commission income

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

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

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

Fee income from providing transaction services

Fees arising from separate transactions done by customer – are recognized on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance obligations are recognized after fulfilling the corresponding criteria.

Foreign currencies

In preparing the consolidated financial statements of the Company, transactions in currencies other than the Company's functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are translated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not translated.

The exchange rates used by the Company in the preparation of the consolidated financial statements as at year-end are as follows:

	31 December 2018	*31 December 2017*
GEL / 1 US Dollar	2.6766	2.5922
GEL / 1 Euro	3.0701	3.1044

Collateral

The Company obtains collateral in respect of customer liabilities where it is considered appropriate. The collateral normally takes the form of a lien over the customer’s assets and gives the Company a claim on these assets for both existing and future customer liabilities.

(in thousands of Georgian Lari)

4. Critical accounting judgements and key sources of estimation uncertainty

The preparation of consolidated financial statements in conformity with IFRSs 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.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Estimation uncertainty

In the process of applying the Company's accounting policies, management has used its judgments and made estimates in determining the amounts recognized in the consolidated financial statements. The most significant use of judgments and estimates are as follows:

Going concern

The Management of the Company has prepared these consolidated financial statements on a going concern basis. In making this judgement the management considered the Company's financial position, current intentions, profitability of operations and access to financial resources.

The Company's loss for the year ended 31 December 2018 amounted to GEL 2,998 thousand, interest income reduced by 64% and loan portfolio decreased by 55%. As at 31 December 2018, the Company's equity was negative and amounted to GEL87 thousand and, as the result, the Company was in breach of the Financial Leverage Ratio prescribed by the National Bank of Georgia (Note 21).

The scaling down the Company's operations was in response of changes in the legislation introduced by the National Bank of Georgia. Starting from September 2018, the National Bank of Georgia introduced upper caps of 50% on effective interest rate on loans to customers in addition, the National Bank of Georgia has approved the rules on "Supervision and Regulation of Microfinance Organization Activities " that introduced certain prudential coefficient to be maintained by the microfinance organizations.

Introduction of such restrictions significantly impacted on the profitability of lending activities of the Company. In response to that, the Management of the Company has undertaken certain actions in order to enable the Company to continue as a going concern for the foreseeable future. Such actions included the following:

- The Company effectively suspended lending activities from August 2018.
- The Company renegotiated its borrowing arrangements with the Parent by settling certain borrowings through increasing of its charter capital in 2018 and 2019 (Notes 13, 23).
- The Company's management obtained a letter from the Parent, which indicates that it intends to provide the Company with support necessary for the Company to continue fulfil its liabilities for the foreseeable future at least for 12 months after the date of issuaance of these consolidated financial statements. The management of the Company evaluated that the Parent has sufficient resources to provide the Company with financial support if necessary.

The Management of the Company is confident that following the above explained actions in response of external regulation by the National Bank of Georgia, the Company will be able to continue as a going concern in the foreseeable future.

(in thousands of Georgian Lari)

4. Critical accounting judgements and key sources of estimation uncertainty (continued)

Estimation uncertainty (continued)

Impairment of loans and receivables

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 Company's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- 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 GDP growth, and the effect on PDs, EADs and LGDs;
- Selection of forward-looking macroeconomic scenarios to derive the economic inputs into the ECL models.

The amount of allowance for loan impairment recognised in consolidated statement of financial position at 31 December 2018 was GEL 2,296 thousand (2017 – GEL 1,846 thousand measured under IAS 39). More details are provided in Notes 7 and 22.

Initial recognition of related party transactions

In the normal course of business the Company enters into transactions with its related parties. IFRS 9 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. The information on related party balances is disclosed in Note 19.

5. 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 consolidated financial statements are disclosed below. The Company intends to adopt these standards, if applicable, when they become effective.

IFRS 16 Leases

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

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

(in thousands of Georgian Lari)

5. Standards issued but not yet effective (continued)

IFRS 16 Leases (continued)

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

IFRS 16, which is effective for annual periods beginning on or after 1 January 2019, requires lessees and lessors to make more extensive disclosures than under IAS 17.

The Company plans to adopt IFRS 16 using modified retrospective approach with the cumulative effect of initially applying IFRS 16 recognised at the date of initial application. The Company will elect to apply the standard to contracts that were previously identified as leases applying IAS 17 and IFRIC 4. The Company will therefore not apply the standard to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

The Company will elect to use the exemptions proposed by the standard on lease contracts for which the lease terms ends within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value.

The Company is currently assessing the impact of adoption of IFRS 16 but does not expect any impact on equity at the date of transition.

No other standard or interpretation issued but not yet effective is expected to have any material impact on the Company's consolidated financial statements.

6. Cash and cash equivalents

	31 December 2018	*31 December 2017*
Cash on hand	7	39
Balances with banks with original maturity up to 90 days	1,327	868
Total cash and cash equivalents	**1,334**	**907**

As at 31 December 2018, all cash and cash equivalents relate to stage 1 of ECL assessment. ECLs are immaterial. Company's balances include current accounts at banks in Georgia predominantly rated Baa (Fitch) and are used for the purpose of the daily activities of the Company.

7. Loans to customers

Loans to customers comprise the following products:

	31 December 2018	*31 December 2017*
Mortgage loans	4,177	6,802
Payday loans	1,657	3,277
Consumer loans	994	1,519
Pawnshop loans	280	837
	7,108	**12,435**
Less allowance for impairment losses	(2,296)	(1,846)
Total loans to customers	**4,812**	**10,589**

(in thousands of Georgian Lari)

7. Loans to customers (continued)

An analysis of changes in the ECL in relation to loans to customers during the year ended 31 December 2018 is as follows:

Mortgage loans	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	–	–	**943**	**943**
Assets repaid	–	–	(51)	**(51)**
Impact on period end ECL of exposures transferred between stages during the period and changes in models and inputs	–	–	443	**443**
Unwinding of discount	–	–	33	**33**
Foreign exchange and other movements	–	–	(81)	**(81)**
At 31 December 2018	–	–	**1,287**	**1,287**

Payday loans	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**21**	**559**	**368**	**948**
New assets originated or purchased	2	–	–	**2**
Assets repaid	(13)	(147)	(2)	**(162)**
Assets sold	–	–	(669)	**(669)**
Transfers to Stage 2	(4)	4	–	–
Transfers to Stage 3	–	(125)	125	–
Impact on period end ECL of exposures transferred between stages during the period and changes in models and inputs	(6)	(147)	726	**573**
Unwinding of discount	–	–	25	**25**
At 31 December 2018	–	**144**	**573**	**717**

Consumer and pawnshop loans	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**15**	**1**	**23**	**39**
New assets originated or purchased	101	–	–	**101**
Assets repaid	(9)	(1)	(1)	**(11)**
Transfers to Stage 2	(55)	55	–	–
Transfers to Stage 3	–	(42)	42	–
Impact on period end ECL of exposures transferred between stages during the period and changes in models and inputs	20	14	125	**159**
Foreign exchange and other movements	2	–	2	**4**
At 31 December 2018	**74**	**27**	**191**	**292**

The significant changes in the gross carrying amount of the loan portfolio that contributed to the changes in the loss allowance were:

- Sale of Stage 3 payday loan portfolio with gross carrying value of GEL 778 thousand.
- Decrease of loan portfolio through scheduled repayments and prepayments

(in thousands of Georgian Lari)

7. Loans to customers (continued)

Comparative amounts of allowance for impairment for the year ended 31 December 2017 represent allowance account for credit losses and reflect measurement basis under IAS 39:

	Loans to customers
1 January 2016	**(2,355)**
Charge	(3,312)
31 December 2016	**(5,652)**
Charge	(706)
Recovery of allowance on loans disposal (Note 11)	4,502
31 December 2017	**(1,846)**

As at 31 December 2018 and 2017 the Company had no exposure which individually exceeded 10% of the Company's equity.

As at 31 December 2018 and 2017, 100% of the loans are granted to Georgian nationals, which represents a significant geographical concentration in one region.

Modified and restructured loans

The Company derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan.

The table below includes Stage 2 and 3 assets that were modified during the period, with the related modification (loss)/gain incurred by the Company.

	2018
Loans modified during the period	
Amortised cost before modification	3,221
Modification gain (loss)	–

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 mortgage loans are collateralised. The main types of collateral are mostly land and other real estate.

In the absence of collateral or other credit enhancement mechanisms, the allowance for expected credit losses on loans to customers in Stage 3 as at 31 December 2018 would be higher by:

	2018
Mortgage loans	1,535
Total impairment allowance for loans to customers	**1,535**

The table below summarizes carrying value of loans to customers analyzed by type of collateral obtained by the Company:

	31 December 2018	*31 December 2017*
Loans collateralized by pledge of real estate	4,177	6,801
Unsecured loans	2,651	4,796
Other collateral	280	838
Less allowance for impairment losses	(2,296)	(1,846)
Total loans to customers	**4,812**	**10,589**

(in thousands of Georgian Lari)

7. Loans to customers (continued)

Collateral and other credit enhancements (continued)

During the years ended 31 December 2018 and 2017 the Company received non-financial assets by taking possession of collateral it held as security. As at 31 December 2018 and 2017 such assets in the amount of GEL 1,254 thousand and GEL 1,748 thousand (Note 9), respectively, are included in other assets.

8. Property and equipment

Property and equipment comprise:

	Buildings	*Computers*	*Vehicles*	*Furniture and office equipment*	*Leasehold improvements*	*Other*	*Total*
At cost							
31 December 2016	–	**152**	**333**	**62**	**234**	**93**	**874**
Additions	–	26	62	2	–	–	90
Disposals		(19)	–	(3)	(59)	–	(81)
31 December 2017		**159**	**395**	**61**	**175**	**93**	**883**
Additions	–	5	–	–	–	–	5
Transfers	165	–	–	–	–	–	165
Disposals	–	(11)	–	(3)	–	–	(14)
31 December 2018	**165**	**153**	**395**	**58**	**175**	**93**	**1039**
Accumulated depreciation							
31 December 2016	–	**79**	**102**	**48**	**181**	**84**	**494**
Depreciation charge	–	32	76	9	53	6	176
Eliminated on disposals		(9)	–	(3)	(59)	–	(71)
31 December 2017	**–**	**102**	**178**	**54**	**175**	**90**	**599**
Depreciation charge	2	31	74	3	–	–	110
Eliminated on disposals	–	(10)	–	(2)	–	–	(12)
31 December 2018	**2**	**123**	**252**	**55**	**175**	**90**	**697**
Net book value							
As at 31 December 2017	**–**	**57**	**217**	**7**	**–**	**3**	**284**
As at 31 December 2018	**163**	**30**	**143**	**3**	**–**	**3**	**342**

As at 31 December 2018 and 2017 included in property and equipment were fully depreciated assets totaling GEL 387 thousand and GEL 385 thousand, respectively.

(in thousands of Georgian Lari)

9. Other assets

Other assets comprise:

	31 December 2018	*31 December 2017*
Other financial assets		
Accounts receivable	333	3,919
Allowance for impairment loss	–	(2,991)
Total other financial assets	**333**	**928**
Other non-financial assets		
Repossessed assets	1,254	1,748
Investment property	128	347
Advances paid	29	70
Other	–	3
Total other non-financial assets	**1,411**	**2,168**
Total other assets	**1,744**	**3,096**

As at 31 December 2018, accounts receivable included Stage 1 receivable from FINSEC LLC (Note 11) in amount of GEL 223 thousand (1 January 2018: 3,776 in Stage 3). The ECL on that receivable immaterial as at 31 December 2018 (1 January 2018: GEL 2,991 thousand). Significant change in gross carrying value of accounts receivable that contributed to change in respective ECL during the period was write-off of uncollectible amounts of GEL 2,991 thousand.

The movements in allowance for impairment losses on other financial assets were as follows:

	Other financial assets
31 December 2017	**–**
Charge	2,991
31 December 2017	**(2,991)**
Write-off	2,991
31 December 2018	**–**

Repossessed assets as at 31 December 2018 and 2017 include land and buildings in the amount of GEL 1,254 thousand and GEL 1,748 thousand, respectively, which are measured at the lower of cost and fair value less cost to sell.

As at 31 December 2018 and 2017, repossessed assets totaling GEL 755 thousand and GEL 500 thousand, respectively, were pledged as collateral under loans received from financial institutions.

10. Borrowed funds

Borrowed funds comprise:

	31 December 2018	*31 December 2017*
Non-current borrowed funds		
Secured loans from financial institutions	594	1,063
Unsecured loans from related parties	1,641	–
Total non-current borrowed funds	**2,235**	**1,063**
Current borrowed funds		
Unsecured loans from individuals	–	6,337
Secured loans from financial institutions	129	181
Unsecured loans from related parties	5,798	–
Total current borrowed funds	**5,927**	**6,518**
Total borrowed funds	**8,162**	**7,581**

On 31 December 2018 and 2017 respectively the Parent of the Company made a decision to settle loans disbursed to the Company in the amount of GEL 1,017 thousand and GEL 3,629 thousand by increasing charter capital of the Company.

(in thousands of Georgian Lari)

10. Borrowed funds (continued)

As at 31 December 2018, terms and conditions of outstanding borrowed funds were as follows:

	Currency	*Nominal interest rate*	*Year of maturity*	*31 December 2018*
Secured loans from financial institutions	USD	10%	2023	723
Unsecured loans from related parties	USD	5%-9%	2019-2023	7,439
Total borrowed funds				**8,162**

Unsecured loans with carrying value of GEL 1,960 thousand from related parties are convertible to Company's charter capital at any time until their contractual maturity at lender's discretion. No equity component was recognized respect of that convertible instruments under IAS 32 Financial Instruments: Presentation requirements.

As at 31 December 2017, terms and conditions of outstanding borrowed funds were as follows:

	Currency	*Nominal interest rate*	*Year of maturity*	*31 December 2017*
Unsecured loans from individuals	USD	7%-13%	On demand	6,337
Secured loans from financial institutions	USD	9%-10%	2021	1,244
Total borrowed funds				**7,581**

The table below details changes in the Company's other borrowed funds arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the Company's consolidated statement of cash flows as cash flows from financing activities.

	1 January 2018	*Cash receipts*	*Cash repayments*	*Borrowings recognized at modification of loan sales agreement (Note 11)*	*Settlement through equity (Note 13)*	*Change in accrued interest*	*Foreign exchange*	*31 December 2018*
Borrowed funds	7,581	286	(5,897)	6,853	(1,017)	(16)	372	8,162

	1 January 2017	*Cash receipts*	*Cash repayments*	*Settlement of dividends payable through borrowed funds*	*Settlement through equity*	*Borrowed funds transferred to another party (Note 13)*	*Change in accrued interest*	*Foreign exchange*	*31 December 2017*
Borrowed funds	23,105	–	(4,970)	1,233	(3,629)	(6,545)	(177)	(1,436)	7,581

11. Provisions

As described in Note 4, introduction of the new regulations by the National Bank of Georgia significantly impacted the lending activities of the Company. In 2017, the management of the Company decided to enhance its loans underwriting policies and to dispose past-due loan portfolio in order to increase quality of loan portfolio.

Changes in the legislative framework raised opportunities for debt collection companies. On this basis, FINSEC LLC was incorporated in July 2017 by the experts in debt collection industry. The Management of the Company approached to the owners and management of FINSEC LLC to negotiate past-due loan portfolio selling transaction and take over the collections activity from the Company. At the same time, FINSEC LLC had similar negotiations with other payday lenders in order to efficiently manage the recovery costs.

On July 9, 2017, CC Loan LLC formed two agreements ("Sales Agreement") with FINSEC LLC for the sale of the part of its doubtful loan portfolio. The total consideration negotiated for the assets sold amounted to GEL 10,083 thousand which was equivalent to the gross carrying value of the loans sold. As at the date of sale, the net carrying value of the sold loans amounted to GEL 5,581 thousand. GEL 4,502 thousand, the difference between sales price and the net carrying value, was recorded as a recovery of impairment losses (See Note 7).

(in thousands of Georgian Lari)

11. Provisions (continued)

Under the Sales Agreement N1, the Group sold loan portfolio with the gross carrying value of GEL 8,428 thousand for a consideration of equaling to the same amount. Consideration receivable were split into the following streams: in exchange of the loans, FINSEC LLC assumed liabilities (borrowed funds of the Company) in the amount of GEL 7,851 thousand ("Non-Cash Consideration") and the remaining consideration in the amount of GEL 577 thousand ("Cash Consideration") repayable within 5 months from the date of the Sales Agreement N1.

Under the Sales Agreement N2, the Group sold a loan portfolio with the gross carrying value of GEL 1,655 thousand for a consideration of equaling to the same amount. Consideration receivable was repayable within 12 months from the date of the Sales Agreement N2.

In September, 2017 the Group formed additional Sales Agreement N3 to sell gross loan portfolio amounting to GEL 221 thousand for the same amount of cash consideration to be received.

On 31 December 2017, the Company amended terms of the Sales Agreement N1 that resulted in a reduction of Non-Cash Consideration from GEL 7,851 thousand to GEL 6,545 thousand with respective increase in Cash Consideration receivable. The Company recognized transferred liabilities in the amount GEL 1,306 thousand as borrowed funds in the consolidated statement of financial position as a result of change in terms of the Sales Agreement N1.

The Company's management considered the renegotiation of Sales Agreements as an impairment trigger and recognised GEL 2,991 thousand as an impairment allowance on receivables from FINSEC LLC as at 31 December 2017 (Note 9).

In January 2018, all Sales Agreements were amended to change the price of the sold loan portfolios. The renegotiated price of the transaction equaled to GEL 768 thousand, payable in cash over 12 months, while Non-Cash Consideration was cancelled. As the result of that amendment, the Company recognized borrowed funds of GEL 6,853 thousand and written-off receivables due from FINSEC LLC of GEL 2,991 thousand against allowance.

The Company's management committed and were certain that cancellation of Sales Agreements would occur and recognised provision for obligation, the difference between re-estimated market price and the initially agreed price of the loans, in the amount of GEL 5,939 thousand through profit or loss as at 31 December 2017. In January 2018, following the amendment of the Sales Agreements, the Company further recognized additional provision charge in profit or loss of GEL 914 thousand for the difference between fair value of the assumed borrowed funds and carrying value of provision as at 31 December 2018, and derecognized respective provision.

The movements in provisions and allowance for other financial assets were as follows:

	Other financial assets (Note 9)	*Other provisions*
31 December 2016	**–**	**–**
Charge	(2,991)	(5,939)
31 December 2017	**(2,991)**	**(5,939)**
Charge	–	(914)
Write-off	2,991	6,853
31 December 2018	**–**	**–**

12. Other liabilities

Other liabilities comprise accounts payable of GEL 280 thousand (31 December 2017: GEL 170 thousand).

(in thousands of Georgian Lari)

13. Charter capital and reserves

As at 31 December 2018 and 2017 the Company's total paid in charter capital was GEL 9,446 thousand and GEL 8,429 thousand, respectively.

As described in Note 10, on 31 December 2018 and 2017, the Parent of the Company made a decision to settle certain borrowed funds in the amount of GEL 1,017 thousand and 3,629 thousand respectively, by increasing charter capital of the Company.

The owners of the Company are entitled to receive dividends as declared from time to time and at the shareholders meetings of the Company.

In accordance with Georgian legislation the Company's distributable reserves are limited to the balance of retained earnings as recorded in the Company's consolidated financial statements prepared in accordance with IFRS.

In 2018, Company did not distribute any dividends. In 2017, dividends of GEL 3,690 thousand were declared and settled.

14. Net interest income

	31 December 2018	***31 December 2017***
Financial assets measured at amortized cost		
Loans to customers	2,759	7,558
Due from financial institutions	9	26
Total interest income calculated using effective interest rate method	**2,768**	**7,584**
Interest expense on financial liabilities measured at amortized cost		
Borrowed funds	(736)	(1,711)
Total interest expense	**(736)**	**(1,711)**
Net interest income before impairment losses on interest bearing assets	**2,032**	**5,873**

15. Other income

	2018	***2017***
Income from operating lease	74	88
Other income	80	200
Total other income	**154**	**288**

16. Operating expenses

Operating expenses comprise:

	2018	***2017***
Staff costs	829	2,797
Rent	242	443
Professional services	241	272
Depreciation and amortization	110	193
Marketing and advertising	11	188
Utilities and communication	103	156
Other expenses	278	676
Total operating expenses	**1,814**	**4,725**

Auditor's remuneration

Professional services expenses include auditor's remuneration. Remuneration of the Company's auditor for the audit of Company's annual financial statements for the years ended 31 December 2018 and 2017 comprised GEL 65 thousand and GEL 114 thousand, respectively.

(in thousands of Georgian Lari)

17. Income taxes

The Company measures and records its current income tax payable and its tax bases in its assets and liabilities in accordance with the tax regulations, which may differ from IFRS.

The Company is subject to certain permanent tax differences due to the non-tax deductibility of certain expenses and a tax free regime for certain income.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences mostly relate to different methods of income and expense recognition as well as to recorded values of certain assets and liabilities.

The tax rate used for the reconciliations below is the corporate tax rate of 15% payable by corporate entities in Georgia on taxable profits under tax law in that jurisdiction.

Deferred income tax assets/(liabilities) on temporary differences as at 31 December 2018 and 2017 comprise:

	31 December 2018	***31 December 2017***
Loans to customers	113	245
Property and equipment	(42)	(33)
Intangible assets	–	15
Borrowings	–	3
Other assets	–	397
Other liabilities	–	(6)
Provisions	–	891
Deferred income tax asset	**71**	**1,511**
Unrecognized deferred tax asset	(71)	(533)
Net deferred tax asset	**–**	**979**

The corporate income tax expense comprises:

	2018	***2017***
Current year tax charge	37	309
Deferred taxation charge due to origination and reversal of temporary differences	991	(221)
Total income tax expense	**1,028**	**88**

The income tax rate applicable to the Company's income is 15%. The effective income tax rate differs from the statutory income tax rate. A reconciliation of the income tax expense on statutory rates with actual is as follows:

	2018	***2017***
Loss before tax	**(1,970)**	**(3,124)**
Statutory tax rate	15%	15%
Theoretical income tax benefit at the statutory rate	**(295)**	**(469)**
Non-deductible expenses	35	24
Changes in tax base (a)	1,288	–
Change in tax regulations (b)	–	533
Income tax expense	**1,028**	**88**

(a) In 2018, the management reassessed tax bases of other assets and provisions and concluded that no deductible temporary differences exist in their respect.

(b) 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 the banks, insurance companies and microfinance organization, for which the effective date was initially set at 1 January 2019, subsequently amended in 2018 to 1 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 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.

(in thousands of Georgian Lari)

17. Income taxes (continued)

Following the enactment of the amendments, the Company remeasured its deferred tax assets and liabilities at the tax rates that were expected to apply to the period when the asset is realised or the liability is settled. As IAS 12 *Income Taxes* requires, the 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 2023 (31 December 2017: starting from 1 January 2019) for the purpose of deferred tax measurement as at 31 December 2018. Accordingly, the Company did not recognize GEL 533 thousand deferred tax asset as at 31 December 2017 attributable to temporary differences that were expected to be reversed after 1 January 2019.

As at 31 December 2018, the management evaluated recoverability of Company's deferred tax assets for the period until 1 January 2023 and concluded that no future taxable profits will be available against which deferred tax asset could be utilized. Accordingly, no deferred tax asset was recognized in the consolidated statement of financial position as at 31 December 2018.

18. Commitments and contingencies

In the normal course of business, the Company is a party to financial instruments with on-balance sheet risk in order to meet the needs of their counterparties. These instruments, involving varying degrees of credit risk, are reflected in the consolidated statement of financial position.

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.

Taxation

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

In the event of a breach of tax legislation, no liabilities for additional taxes, fines or penalties may be imposed by the tax authorities after three years have passed since the end of the year in which the breach occurred.

As at 31 December 2018 management believes that its interpretation of the relevant legislation is appropriate and that the Company's tax positions will be sustained.

(in thousands of Georgian Lari)

19. Transactions with related parties

Related parties include the Parent and and members of key management personnel.

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

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Company had the following balances and transactions with related parties:

	31 December 2018		*31 December 2017*	
	Related party balances	***Total category as per the consolidated financial statements caption***	***Related party balances***	***Total category as per the consolidated financial statements caption***
Borrowed funds	7,439	8,162	–	7,581
- the Parent	7,439	–	–	–
Other liabilities	97	280	–	170
- the Parent	97	–	–	–

The remuneration of directors and other members of key management were as follows:

	31 December 2018		*31 December 2017*	
	Related party transactions	***Total category as per the consolidated financial statements caption***	***Related party transactions***	***Total category as per the consolidated financial statements caption***
Key management personnel compensation				
- short-term employee benefits	141	829	798	2,797

Included in profit or loss for the years ended 31 December 2018 and 2017 are the following amounts which were recognized in transactions with related parties:

	31 December 2018		*31 December 2017*	
	Related party transactions	***Total category as per the consolidated financial statements caption***	***Related party transactions***	***Total category as per the consolidated financial statements caption***
Interest expense	619	736	(236)	(1,711)
- the Parent	619	–	(236)	–

(in thousands of Georgian Lari)

20. Fair value of financial instruments

IFRS defines fair value as 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 estimated fair values of financial instruments have been determined by the Company using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. Georgia continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may be outdated or reflect distress sale transactions and therefore not represent fair values of financial instruments. Management has used all available market information in estimating the fair value of financial instruments.

Fair value of financial assets and financial liabilities that are not measured at fair value on a recurring basis (but fair value disclosures are required).

Cash and cash equivalents – cash and cash equivalents are carried at amortized cost which approximates their current fair value.

Other financial assets and financial liabilities – other financial assets and liabilities are mainly represented by short-term receivables and payables, therefore the carrying amount is assumed to be reasonable estimate of their fair value.

Loans to customers and borrowed funds – the estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received/paid discounted at current interest rates of new instruments with similar credit risk and remaining maturity. Discount rates depend on currency, maturity of the instrument and credit risk of the counterparty. For liabilities with demand feature, fair value was determined to be equal to nominal amount.

The Company estimated the fair value of loans to customers and borrowed funds and due to relatively short-term lifetime of the instruments carrying values approximated to fair value.

	Fair value	***31 December 2018***		***31 December 2017***	
	Hierarchy	***Carrying value***	***Fair value***	***Carrying value***	***Fair value***
Loans to customers	3	4,812	4,812	10,589	10,589
Borrowed funds	3	8,162	8,162	7,581	7,581

21. Capital management

The Company's objectives when maintaining capital are:

- To safeguard the Company's ability to continue as a going concern, so that it can continue to provide returns for Parent; and
- To provide an adequate return to Parent by pricing services commensurately with the level of risk
- To comply with the capital requirements of the National Bank of Georgia.

The Company sets the amount of capital it requires in proportion to risk. The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to the Parent, return capital to the Parent, or sell assets to reduce debt.

- As stated in Note 4, the Company was in breach of the Financial Leverage Ratio set by the National Bank of Georgia as at 31 December 2018:

	31 December 2018
Total equity	(87)
Total assets	8,355
Financial leverage ratio	**(1.04)%**
Minimal requirement	16%

In June 2019, the Company mitigated the breach through conversion of borrowed funds of GEL 1,999 thousand to charter capital (Note 23).

As at 31 December 2018 Company holds minimum statutory capital requirements of National Bank of Georgia – the minimum cash contribution in the equity no less than GEL 500 thousand.

(in thousands of Georgian Lari)

22. Risk management policies

Management of risk is fundamental to the Company's business and is an essential element of the Company's operations. The main risks inherent to the Company's operations are those related to the following:

- Credit risk;
- Liquidity risk;
- Market risk;
- Operational risk;

To enable and apply high-performance risk policies, the Company has established a risk management framework, whose main purpose is to protect the Company from unacceptable level of risk and allow it to achieve its performance objectives. Through the risk management framework, the Company manages the following risks:

Credit risk

The Company is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

As described in Note 4, the Company suspended lending activities in 2018. Credit risk management procedures described below apply to periods before that suspension.

Risk management and monitoring was performed within set limits of authority. These processes were performed by the Credit Committees and the Company's Management Board. Before any application was made by the Credit Committee, all recommendations on credit processes (borrower's limits approved, or amendments made to loan agreements, etc.) were reviewed and approved by the Risk Management Department of Head Office. Daily risk management was performed by the Heads of Credit Departments.

The Company structured the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or group of borrowers, and to industry segments. Limits on the level of credit risk by a borrower are approved by the Management Board. Actual exposures against limits are monitored on a regular basis.

Impairment assessment

The Company has adopted a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. Based on the above process, the Company combines its financial assets into Stage 1, Stage 2, Stage 3, as described below:

Stage 1	When financial assets are first recognised, the Company recognises an allowance based on 12mECL. Stage 1 financial assets also include facilities where the credit risk has decreased and the financial asset has been reclassified from Stage 2.
Stage 2	When a loan has shown a significant increase in credit risk since origination, the Company records an allowance for the LTECL. Stage 2 includes mortgage, consumer and pawnshop loans overdue from 31 to 90-day arrears and payday loans overdue from 15 to 60 days overdue. Stage 2 loans also include facilities, where the credit risk has improved so that the loan is no longer credit-impaired and the loan has been reclassified from Stage 3.
Stage 3	Loans considered credit-impaired. Stage 3 includes mortgage, consumer and pawnshop loans overdue more than 90-day arrears and more than 60 days in arrears for the payday loans. The Company records an allowance for the LTECL.

The Company considers a financial instrument defaulted and therefore recognises it as Stage 3 (credit-impaired) for ECL calculations, when the borrower becomes 90 days past due on its contractual payments for at least one of the transactions with a counterparty, or there are other indicators of impairment for the mortgage, consumer and pawnshop and 60 days past due for the payday loans.

The Company calculates ECL on a collective basis for all classes of financial assets which it groups into homogeneous portfolios, based on a combination of internal and external characteristics of the assets.

(in thousands of Georgian Lari)

22. Risk management policies (continued)

Credit risk (continued)

The key elements of the ECL calculations are outlined below:

PD	Is a calculated estimate of the probability of default over a given time interval and is determined based on the risk-segment and the overdue group for a relevant period (12 months or the lifetime of an instrument (Lifetime PD). Values are determined based on internal statistics using migration matrices). Current and expected changes in the macroeconomic situation are used as forecast information. A default may happen over the assessed period, if the financial asset has not been previously derecognised and is still in the portfolio.
EAD	The amount of assets at risk (EAD) is an estimate of the exposure at default.
LGD	Is the level of losses arising in the case where a default occurs and considering time value of money (discounting at effective interest rate). LGD is based on the difference between the contractual cash flows due and those that the Company receives and would expect to receive, taking into account the asset realisation experience. The values of LGD are determined using models developed on the basis of internal statistics.

Definition of default

The Company considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. In addition Company considers following factors which indicate default:

- Credit exposures appears in arears by more than 90 days for mortgage, consumer and pawnshop;
- Credit exposures appears in arears by more than 60 days for payday portfolio;
- Bankruptcy proceedings of the borrower have been initiated;
- The Company has initiated court procedures against the borrower;
- Breach of covenants or conditions, unless the Company has decided to waive or modify the covenant or condition;
- Specific information on the client's business or changes in the client's market environment that as or is expected to have a significant negative impact on the future cash flow.

The Company considers amounts due from banks defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

PD estimation process

PD estimates are estimates at a certain date, which are calculated based on statistical data. For the purposes of PD calculations, loan portfolio is divided (by each separate product segment) in delinquency buckets, as follows:

- Stage 1 – not overdue loans;
- Stage 1 – loans overdue 1 to 30 days (payday loans – from 1 to 15 days);
- Stage 1 – restructured loans overdue less than 90 days (R1);
- Stage 2 – loans overdue 31 to 60 days (payday loans – 16 -30 days);
- Stage 2 – loans overdue 61 to 90 days;
- Stage 2 – restructured loans overdue less than 90 days (R1);
- Stage 3 – loans overdue more than 90 days; defaulted loans; (payday loans – more than 61 days);
- Stage 3 – restructured loans overdue more than 90 days (R2).

If a counterparty or exposure migrates between buckets, then this will lead to a change in the estimate of the associated PD. PDs are calculated based on two-year average and then PD migration percentage matrixes are averaged for analysis period.

(in thousands of Georgian Lari)

22. Risk management policies (continued)

Credit risk (continued)

Incorporation of forward-looking information

The Company incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL.

The Company has identified and documented the key drivers of credit risk and credit losses for the portfolio using an analysis of historical data, has assessed impact of macro-economic variables on probability of default and recovery rate. The following macro-economic variables were involved in the analysis:

- Real growth rate of GDP of Georgia;
- Inflation rate;
- Exchange rates.

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 2 years. Macroeconomic factors regularly published by the National Bank of Georgia are applied. Based on this analysis, the Company identified portfolio default correlation with Georgia's real GDP growth rate.

Key drivers	*2019*	*2020*	*2021*
GDP growth, %			
Upside (25% probability)	6.5%	5.5%	5.0%
Base case (50% probability)	5.0%	5.0%	5.0%
Downside (25% probability)	2.0%	2.5%	3.5%

Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too. To calculate the EAD for a Stage 1 loan, the Company assesses the possible default events within 12 months for the calculation of the 12mECL. For Stage 2, Stage 3 and POCI financial assets, the exposure at default is considered for events over the lifetime of the instruments.

Loss given default

The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered.

The Company segments loans to customers into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type, maturity terms) as well as borrower characteristics.

Loss given default is calculated based on historical defaults and respective recoveries during two years. Historical recovery percentages are discounted cash flow basis using the effective interest rate as the discounting factor.

Significant increase in credit risk

The Company continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Company assesses whether there has been a significant increase in credit risk since initial recognition.

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, the Company compares the risk of a default occurring on the financial instrument at the reporting date based on the remaining maturity of the instrument with the risk of a default occurring that was anticipated for the remaining maturity at the current reporting date when the financial instrument was first recognised. In making this assessment, the Company considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort, based on the Company's historical experience and expert credit assessment including forward-looking information. If contractual payments are more than 30 days past due (15 days for payday loans) or credit has been renegotiated, Company considers the credit risk is deemed to have increased significantly since initial recognition.

(in thousands of Georgian Lari)

22. Risk management policies (continued)

Credit risk (continued)

Significant increase in credit risk (continued)

Collateral

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 mortgages over residential properties or other assets.

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 impairment losses.

Credit quality of loans to customers

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

Loans to customers	*Stage 1*	*Stage 2*	*Stage 3*	*Total gross carrying value*
Not overdue	1,008	792	–	1,800
1 to 15 days overdue	40	43	–	83
16 to 30 days overdue	120	63	–	183
31 to 60 days overdue	–	146	–	146
61 to 90 days overdue	–	41	245	286
Restructured loans overdue less than 90 days (R1)	575	152	12	739
Loans overdue more than 90 days; defaulted loans	–	–	2,076	2,076
Restructured loans overdue more than 90 days (R2)	–	–	1,795	1,795
Total loans to customers	**1,743**	**1,237**	**4,128**	**7,108**

(in thousands of Georgian Lari)

22. Risk management policies (continued)

Credit risk (continued)

The table below shows gross balances under IAS 39 as at 31 December 2017 based on the overdue days of the loans to customers:

As at 31 December 2017	*Gross loans*	*Provision for impairment*	*Net loans*	*Provision for impairment to gross loans*
Mortgage loans				
Not past due	1,887	(11)	1,876	0.6%
Overdue:				
up to 30 days	538	–	538	0.0%
31 to 60 days	77	–	77	0.0%
61 to 90 days	23	–	23	0.0%
91 to 180 days	94	(8)	86	8.5%
over 180 days	4,183	(979)	3,204	23.4%
Total mortgage loans	**6,802**	**(998)**	**5,804**	**14.7%**
Consumer loans				
Not past due	1,472	(22)	1,450	1.5%
Overdue:				
up to 30 days	35	(2)	33	5.7%
31 to 60 days	1	–	1	–
61 to 90 days	2	(2)	–	100.0%
91 to 180 days	5	(5)	–	100.0%
over 180 days	4	(4)	–	100.0%
Total consumer loans	**1,519**	**(35)**	**1,484**	**2.3%**
Pawnshop loans				
Not past due	813	(12)	801	1.5%
Overdue:				
up to 30 days	–	–	–	–
31 to 60 days	–	–	–	–
61 to 90 days	–	–	–	–
91 to 180 days	–	–	–	–
over 180 days	24	(24)	–	100.0%
Total pawnshop loans	**837**	**(36)**	**801**	**4.3%**
Payday loans				
Not past due	2,496	(235)	2,261	9.4%
Overdue:				
up to 30 days	347	(146)	201	42.1%
31 to 60 days	123	(98)	25	79.7%
61 to 90 days	74	(66)	8	89.2%
91 to 180 days	214	(209)	5	97.7%
over 180 days	23	(23)	–	100.0%
Total payday loans	**3,277**	**(777)**	**2,500**	**23.7%**
Total loans to customers	**12,435**	**(1,846)**	**10,589**	**14.8%**

(in thousands of Georgian Lari)

22. Risk management policies (continued)

Liquidity risk

Liquidity risk management

Liquidity risk refers to the availability of sufficient funds to meet financial commitments associated with financial instruments as they actually fall due.

The Management board controls these types of risks by means of maturity analysis, determining the Company's strategy for the next financial period. In order to manage liquidity risk, the Company performs daily monitoring of future expected cash flows.

An analysis of liquidity risk is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the Company. The amounts disclosed in these tables do not correspond to the amounts recorded in the consolidated statement of financial position as the presentation below includes a maturity analysis for financial assets and liabilities that indicates the total remaining contractual payments (including interest payments), which are not recognized in the consolidated statement of financial position under the effective interest rate method.

	Up to 1 month	*1 month to 3 months*	*3 month to 1 year*	*1 year to 5 years*	*Over 5 years*	*31 December 2018 Total*
Financial liabilities						
Borrowed funds	5,870	69	302	2,703	–	8,944
Other financial liabilities	337	–	–	–	–	337
otal financial liabilities	**6,207**	**69**	**302**	**2,703**	–	**9,281**

	Up to 1 month	*1 month to 3 months*	*3 month to 1 year*	*1 year to 5 years*	*Over 5 years*	*31 December 2017 Total*
Financial liabilities						
Borrowed funds	2,777	432	3,591	1,104	198	8,102
Other financial liabilities	170	–	–	–	–	170
Total financial liabilities	**2,947**	**432**	**3,591**	**1,104**	**198**	**8,272**

As at 31 December 2018, borrowed funds in "up to 1 month" category include GEL 1,960 thousand borrowings from the Parent convertible to Company's charter capital at lender's discretion at any time (Note 10). Contractual maturity of those borrowed funds is 2023.

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:

	2018			*2017*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	1,334	–	**1,334**	907	–	**907**
Loans to customers	1,683	3,129	**4,812**	9,180	1,409	**10,589**
Property and equipment	–	342	**342**	–	284	**284**
Intangible assets	–	14	**14**	–	16	**16**
Current income tax assets	109	–	**109**	–	–	**–**
Deferred income tax assets	–	–	**–**	979	–	**979**
Other assets	1,744	–	**1,744**	3,096	–	**3,096**
Total	**4,870**	**3,485**	**8,355**	**13,162**	**1,709**	**15,871**
Borrowed funds	6,241	1,921	**8,162**	6,800	781	**7,581**
Current income tax liability	–	–	–	215	–	**215**
Provisions	–	–	–	5,939	–	**5,939**
Other liabilities	9280	–	**280**	170	–	**170**
Total	**6,251**	**1,921**	**8,442**	**13,124**	**781**	**13,905**
Net	**(1,651)**	**1,564**	**(87)**	**1,038**	**928**	**1,966**

(in thousands of Georgian Lari)

22. Risk management policies (continued)

Market risk

Market risk is the risk that the Company's earnings or capital or its ability to meet business objectives will be adversely affected by changes in the level or volatility of market rates or prices. Market risk covers interest rate risk, currency risk and other pricing risks that the Company is exposed to. There have been no changes as to the way the Company measures risk or to the risk it is exposed or the manner in which these risks are managed and measured.

Interest rate and market risks are managed by matching the Company's interest rate position, which provides the Company with a positive interest margin. Management board conducts monitoring of the Company's current financial performance, estimates the Company's sensitivity to changes in interest rates and its influence on the Company's profitability.

Interest rate risk

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

The Company does not have any material financial assets and liabilities at floating rates and thus is not materially exposed to interest rate risk.

Currency risk

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Company is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

Management controls currency risk by monitoring the open currency position on the estimated basis of Georgian Lari devaluation and other macroeconomic indicators, which gives the Company an opportunity to minimize losses from significant currency rates fluctuations toward its national currency.

The Company's open positions by the major currencies in which it holds the assets and liabilities are presented below:

	GEL	*USD*	*EUR*	*31 December 2018 Total*
Financial assets				
Cash and cash equivalents	245	1,089	–	1,334
Loans to customers	1,962	2,850	–	4,812
Other financial assets	333	–	–	333
Total financial assets	**2,540**	**3,939**	–	**6,479**
Financial liabilities				
Borrowed funds	–	8,162	–	8,162
Other financial liabilities	184	95	1	280
Total financial liabilities	**184**	**8,257**	**1**	**8,442**
Open position	**2,356**	**(4,318)**	**(1)**	**(1,963)**

	GEL	*USD*	*EUR*	*31 December 2017 Total*
Financial assets				
Cash and cash equivalents	593	313	1	907
Loans to customers	5,637	4,952	–	10,589
Other financial assets	928	–	–	928
Total financial assets	**7,158**	**5,265**	**1**	**12,424**
Financial liabilities				
Borrowed funds	–	7,581	–	7,581
Other financial liabilities	170	–	–	170
Total financial liabilities	**170**	**7,581**	**–**	**7,751**
Open position	**6,988**	**(2,316)**	**1**	**4,673**

(in thousands of Georgian Lari)

22. Risk management policies (continued)

Currency risk sensitivity

The following table details the Company's sensitivity to a reasonably possible changes in GEL/USD exchange rate, determined based on the forecasts published by the National Bank of Georgia. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a reasonably possible change in foreign currency rates.

Impact on net profit and equity based on asset values as at 31 December 2018 and 2017:

	31 December 2018		***31 December 2017***	
	GEL/USD +10%	***GEL/USD -15%***	***GEL/USD +30%***	***GEL/USD -30%***
Impact on profit or loss before tax	(432)	648	(694)	694
Impact on equity	(21)	32	(589)	589

Limitations of sensitivity analysis

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analyses do not take into consideration that the Company's assets and liabilities are actively managed. Additionally, the financial position of the Company may vary at the time that any actual market movement occurs. For example, the Company's financial risk management strategy aims to manage the exposure to market fluctuations. As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation and taking other protective action. Consequently, the actual impact of a change in the assumptions may not have any impact on the liabilities, whereas assets are held at market value in the consolidated statement of financial position. In these circumstances, the different measurement bases for liabilities and assets may lead to volatility in shareholder equity.

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Company's view of possible near-term market changes that cannot be predicted with any certainty; and the assumption that all interest rates move in an identical fashion.

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 cannot expect to eliminate all operational risks, but it endeavors to manage these risks through a control framework and by monitoring and responding to potential risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes.

23. Subsequent events

On 14 June and 24 June 2019, the Parent converted GEL 274 thousand and GEL 1,725 thousand, respectively, borrowed funds to Company's charter capital.