

**JSC MICROFINANCE ORGANIZATION
SWISS CAPITAL**

Financial Statements

Together with Independent Auditor's Report

For the year ended 31 December 2022

CONTENT:

INDEPENDENT AUDITOR'S REPORT 3

FINANCIAL STATEMENTS

STATEMENT OF COMPREHENSIVE INCOME..... 5
STATEMENT OF FINANCIAL POSITION 6
STATEMENT OF CHANGES IN EQUITY 7
STATEMENT OF CASH FLOWS 8

NOTES TO THE FINANCIAL STATEMENTS

1. General information 9
2. Basis of preparation 9
3. Critical accounting estimates and judgments 12
4. Financial instruments - risk management 13
5. Net interest income 18
6. Other income..... 18
7. Other operating expenses 19
8. Deferred tax asset 19
9. Cash and cash equivalents..... 21
10. Loans to customers 21
11. Other assets..... 25
12. Tax assets/liabilities..... 25
13. Leases 26
14. Property and equipment 27
15. Borrowed funds..... 27
16. Other liabilities..... 29
17. Share capital and reserves 29
18. Commitments and Contingencies 30
19. Transactions with related parties..... 30
20. Events after reporting period..... 31
21. Summary of significant accounting policies 32

INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Management of JSC MICROFINANCE ORGANIZATION SWISS CAPITAL

Opinion

We have audited the financial statements of JSC Microfinance Organization Swiss Capital, which comprise the statement of financial position as at 31 December 2022, and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2022, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Georgia, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

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

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

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

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

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

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

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

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



Ivane Zhuzhunashvili (Registration number SARAS-A-720718)

For and on behalf of BDO Audit LLC

Tbilisi, Georgia

17 May 2023

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- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
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The engagement partner responsible for the audit resulting in this independent auditor's report is:

Ivane Zhuzhunashvili (Registration number **SARAS-A-720718**)

For and on behalf of BDO Audit LLC

Tbilisi, Georgia

17 May 2023

JSC MICROFINANCE ORGANIZATION SWISS CAPITAL

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2022

(In '000 GEL)

	Note	2022	2021
Interest income	5	45,737	35,412
Interest expense	5	(13,438)	(9,283)
Net interest income		32,299	26,129
Loan impairment charge	10	(2,742)	(1,222)
Net interest income after impairment losses		29,557	24,907
Other income	6	4,485	3,395
Net loss on financial instruments at fair value through profit or loss	11	(1,135)	(669)
Personnel expenses		(9,601)	(7,986)
Depreciation and amortisation		(2,204)	(1,954)
Other operating expenses	7	(6,494)	(5,798)
Foreign exchange gain, net		1,151	460
Profit before income tax		15,759	12,355
Income tax expense	8	(3,255)	(2,156)
Total comprehensive income		12,504	10,199

Financial statements for the year ended 31 December 2022 were approved on behalf of Management on 17 May 2023 by:

Chief Executive Officer

Givi Kereselidze

Chief Financial Officer

Levan Panchulidze

The notes on pages 9-42 form an integral part of these financial statements.

JSC MICROFINANCE ORGANIZATION SWISS CAPITAL

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(In '000 GEL)

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Chief Financial Officer _____ Levan Panchulidze

The notes on pages 9-42 form an integral part of these financial statements.

JSC MICROFINANCE ORGANIZATION SWISS CAPITAL

STATEMENT OF FINANCIAL POSITION

As at 31 December 2022

(In '000 GEL)

	Note	31 December 2022	31 December 2021
Assets			
Cash and cash equivalents	9	10,964	7,637
Loans to customers	10	159,630	120,885
Other assets	11	860	860
Deferred tax asset	8	-	1,036
Intangible assets		384	240
Right-of-use assets	13	7,586	6,997
Property and equipment	14	2,706	1,910
Total assets		182,130	139,565
Liabilities and equity			
Liabilities			
Borrowed funds	15	100,933	68,603
Financial instruments at fair value through profit or loss		124	209
Tax liabilities	12	17	653
Deferred tax liability	8	98	-
Lease liabilities	13	7,362	7,568
Other liabilities	16	912	602
Total liabilities		109,446	77,635
Equity			
Share capital	17	4,175	4,175
Share Premium	17	2,068	2,068
Retained earnings	17	66,441	55,687
Total equity		72,684	61,930
Total liabilities and equity		182,130	139,565

The notes on pages 9-42 form an integral part of these financial statements

JSC MICROFINANCE ORGANIZATION SWISS CAPITAL**STATEMENT OF CHANGES IN EQUITY**

For the year ended 31 December 2022

(In '000 GEL)

	Share capital	Share premium	Retained earnings	Total equity
At 31 December 2020	4,175	2,068	47,458	53,701
Total comprehensive income	-	-	10,199	10,199
Dividends declared	-	-	(1,970)	(1,970)
At 31 December 2021	4,175	2,068	55,687	61,930
Total comprehensive income	-	-	12,504	12,504
Dividends declared	-	-	(1,750)	(1,750)
At 31 December 2022	4,175	2,068	66,441	72,684

The notes on pages 9-42 form an integral part of these financial statements.

JSC MICROFINANCE ORGANIZATION SWISS CAPITAL

STATEMENT OF CASH FLOWS

For the year ended 31 December 2022

(In '000 GEL)

	<u>2022</u>	<u>2021</u>
Cash flows from operating activities		
Interest received	43,920	32,655
Proceeds from loans to customers	161,747	149,255
Receipts from penalties	4,074	3,056
Loans issued to customers	(192,677)	(158,207)
Purchase of loan portfolio	(7,119)	(10,483)
Other operating expenses paid	(9,144)	(7,893)
Salaries paid	(6,839)	(5,867)
Other inflows	1,877	1,029
Other outflows	(770)	(437)
Financial instruments at fair value through profit or loss	(169)	(269)
Other taxes paid	(2,449)	(2,093)
Income tax paid	(2,962)	(797)
Interest paid	(13,186)	(9,418)
Net cash inflow (outflow) from operating activities	<u>(23,697)</u>	<u>(9,469)</u>
Cash flows from investing activities		
Purchases of property, equipment and intangible assets	(1,556)	(1,521)
Net cash outflow from investing activities	<u>(1,556)</u>	<u>(1,521)</u>
Cash flows from financing activities		
Receipts from borrowed funds excluding promissory notes	65,404	30,478
Repayment of borrowed funds excluding promissory notes	(33,409)	(17,286)
Receipts from promissory notes	500	-
Repayment of promissory notes	-	-
Principal paid on lease liabilities	(1,432)	(1,098)
Dividends paid	(1,500)	(1,970)
Net cash inflow from financing activities	<u>29,563</u>	<u>10,124</u>
Net increase (decrease) in cash and cash equivalents	4,310	(866)
Cash and cash equivalents at the beginning of the year	7,637	8,888
Effect of changes in foreign exchange rate on cash and cash equivalents	(983)	(385)
Cash and cash equivalents at the end of the year	<u><u>10,964</u></u>	<u><u>7,637</u></u>

The notes on pages 9-42 form an integral part of these financial statements.

JSC MICROFINANCE ORGANIZATION SWISS CAPITAL

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

1. GENERAL INFORMATION

JSC Microfinance Organization Swiss Capital (hereinafter - "the Company") was initially registered in 2009 in Tbilisi, Georgia. The legal address of the Company is: Didube district, Akaki Tsereteli Avenue, N118, Pavilion I, Tbilisi, Georgia. The Company is registered by Tbilisi Tax Inspection Department, under identification number 205274273.

The supreme governing body of the Company is the General Meeting of Shareholders. The supervision of the Company's operations is conducted by the Supervisory Board, members of which are appointed by the General Meeting of the Shareholders. Daily management of the Company is carried out by the Director appointed by the Supervisory Board.

The main business activity of the Company is micro lending. The Company's aim is to become one of the leading micro lenders in Georgia by leveraging its customer tailored product mix, experience and dedicated staff. The Company's credit products are consumer and business loans. Consumer loans can be collateralized by real estate, vehicles or gold. Both, immovable and movable property can be collateral for a business loan. In addition, the Company provides business loans without collateral. The Company's non-credit products are foreign exchange operations and money transfers.

For the year 2022 the Company has a head office and 28 service centers around Georgia (2021: a head office and 22 service centers).

The Company has the following shareholders:

Shareholders	31 December 2022, %	31 December 2021, %
JSC Swiss Holdings	51.00%	50.00%
Eyal Elboim	30.00%	30.00%
Amir Yoeli	17.00%	17.00%
Paata Daiauri	2.00%	2.00%
Alon Bechor	-	1.00%
	100.00%	100.00%

As at 31 December 2022 and 2021 the Company's ultimate controlling party is David Bechor who owns 61% shareholding in JSC Swiss Holdings.

As at 31 December 2022 and 2021, JSC "Microfinance Organization Swiss Capital" has a 100% ownership subsidiary company - "Swiss Capital Group" LLC. The subsidiary did not conduct substantial operations during 2022 and 2021, also it did not hold substantial assets and liabilities at the end of the reporting years. Therefore, the Group's consolidated financial statements are not different from the presented financial statements of JSC "Microfinance Organization Swiss Capital".

2. BASIS OF PREPARATION

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

The preparation of financial statements in compliance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the most appropriate application in applying the accounting policies. The areas where significant judgments and estimates have been made in preparing the financial statements are disclosed in Note 3. The principal accounting policies adopted in the preparation of the financial statements are set in Note 21.

2. BASIS OF PREPARATION (CONTINUED)

Basis of measurement

These financial statements have been prepared under the historical cost basis except for the derivative financial instruments at fair value through profit or loss.

The Company maintains its records and prepares financial statements in Georgian Lari (GEL) in accordance with International Financial Reporting Standards (IFRS) as required by Georgian legislation.

Amounts in the financial statements are presented to the nearest thousand, unless otherwise stated.

The reporting period for the Company is the calendar year from 1 January to 31 December.

Going concern

These financial statements have been prepared on the assumption that the Company is a going concern and will continue its operations for the foreseeable future. The management and the shareholders have the intention to further develop the business of the Company in Georgia. The Management is not aware of any significant uncertainties that may give rise to significant doubts about the Company's ability to continue as a going concern. Therefore, the Management believes that going concern assumption is appropriate for the Company.

ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

a) *New standards, interpretations and amendments effective from 1 January 2022:*

STANDARDS AND AMENDMENTS MANDATORILY EFFECTIVE FROM 1 JANUARY 2022

Annual Improvements to IFRS: 2018-2020 Cycle. In May 2020, the IASB issued minor amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards, IFRS 9 Financial Instruments, IAS 41 Agriculture and the Illustrative Examples accompanying IFRS 16 Leases.

Conceptual Framework for Financial Reporting (Amendments to IFRS 3). In May 2020, the IASB issued amendments to IFRS 3, which update a reference to the Conceptual Framework for Financial Reporting without changing the accounting requirements for business combinations. The amendments introduce an exception to the general recognition requirement for liabilities and contingent liabilities acquired in a business combination that is within the scope of IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IFRIC 12 Service Concession arrangements.

IAS 37 Provisions, Contingent Liabilities and Contingent Assets (Amendment - Onerous Contracts - Cost of Fulfilling a Contract). In May 2020, the IASB issued amendments to IAS 37, added paragraph 68A to specify which costs an entity includes in determining the cost of fulfilling a contract for the purposes of assess whether the contract is onerous. These amendments are expected to result in more contracts being accounted for as onerous contracts because they increase the scope of costs that are included in the onerous contract assessment.

IAS 16 Property, Plant and Equipment (Amendment - Proceeds before Intended Use). In May 2020, the IASB issued amendments to IAS 16, which prohibit a company from deducting amounts received from selling items produced while the company is preparing the asset for its intended use from the cost of property, plant and equipment. Instead, a company will recognise such sales proceeds and any related costs in profit or loss rather than offset against the cost of the property.

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

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

STANDARDS AND AMENDMENTS MANDATORILY EFFECTIVE FROM 1 JANUARY 2023

IFRS 17 Insurance Contracts. IFRS 17 introduces an internationally consistent approach to the accounting for insurance contracts. Prior to IFRS 17, significant diversity has existed worldwide relating to the accounting for and disclosure of insurance contracts, with IFRS 4 permitting many previous (non-IFRS) accounting approaches to continue to be followed. IFRS 17 will result in significant changes for many insurers, requiring adjustments to existing systems and processes.

The new standard takes the view that insurance contracts combine features of a financial instrument and a service contract, and that many generate cash flows that vary substantially over time. It therefore takes the approach of:

2. BASIS OF PREPARATION (CONTINUED)

- Combining current measurement of future cash flows with recognising profit over the period that services are provided under the contract
- Presenting insurance service results (including insurance revenue) separately from insurance finance income or expenses, and
- Requiring an entity to make an accounting policy choice for each portfolio whether to recognise all insurance finance income or expenses for the reporting period in profit or loss, or to recognise some in other comprehensive income.

Subsequent to the issue of IFRS 17, amendments to the standard and deferral of effective dates have been made.

Disclosure of Accounting Policies (Amendment to IAS 1 and IFRS Practice Statement 2). In February 2021, the IASB issued amendments to IAS 1, which change the disclosure requirements with respect to accounting policies from 'significant accounting policies' to 'material accounting policy information'. The amendments provide guidance on when accounting policy information is likely to be considered material. The amendments to IAS 1 are effective for annual reporting periods beginning on or after 1 January 2023, with earlier application permitted. As IFRS Practice Statements are non-mandatory guidance, no mandatory effective date has been specified for the amendments to IFRS Practice Statement 2.

Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12). In May 2021, the IASB issued amendments to IAS 12, which clarify whether the initial recognition exemption applies to certain transactions that result in both an asset and a liability being recognised simultaneously (e.g. a lease in the scope of IFRS 16). The amendments introduce an additional criterion for the initial recognition exemption under IAS 12.15, whereby the exemption does not apply to the initial recognition of an asset or liability which at the time of the transaction, gives rise to equal taxable and deductible temporary differences.

STANDARDS AND AMENDMENTS MANDATORILY EFFECTIVE FROM 1 JANUARY 2024

Lease Liability in a Sale and Leaseback (Amendment to IFRS 16). The IFRS Interpretations Committee issued an agenda decision in June 2020 - Sale and leaseback with Variable Payments. This matter was referred to the IASB for standard setting for some aspects. The IASB issued the final amendments in September 2022.

The Amendments provide a requirement for the seller-lessee to determine 'lease payments' or 'revised lease payments' in a way that the seller-lessee would not recognise any amount of the gain or loss that relates to the right of use retained by the seller-lessee.

IAS 1 Presentation of Financial Statements (Amendment - Classification of Liabilities as Current or Non-Current, Non-current Liabilities with Covenants). The IASB issued amendments to IAS 1 - Classification of Liabilities as Current or Non-current in January 2020, which have been further amended partially by amendments Non-current Liabilities with Covenants issued in October 2022.

The amendments require that an entity's right to defer settlement of a liability for at least twelve months after the reporting period must have substance and must exist at the end of the reporting period. Classification of a liability is unaffected by the likelihood that the entity will exercise its right to defer settlement for at least twelve months after the reporting period.

If an entity's right to defer is subject to the entity complying with specified conditions, such conditions affect whether that right exists at the end of the reporting period, if the entity is required to comply with the condition on or before the end of the reporting period and not if the entity is required to comply with the conditions after the reporting period. The amendments also provide clarification on the meaning of 'settlement' for the purpose of classifying a liability as current or non-current

As a result of the COVID-19 pandemic, the Board deferred the effective date of the amendments by one year to annual reporting periods beginning on or after 1 January 2024.

The Company does not think these changes will have material effect on the Company financial statements.

Other

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

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised 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.

Determination of collateral value. Management monitors market value of collateral on a regular basis. Management uses its experienced judgment to adjust the fair value to reflect current circumstances. The amount and type of collateral depends on the assessment of credit risk of the counterparty.

Measurement of expected credit losses. The following are key estimations that the management have used in the process of applying the Company's accounting policies and that have the most significant effect on the loss allowances for expected credit losses:

- Probability of default: PD constitutes a key input in measuring ECL. PD is an estimate of the likelihood of default over a given time horizon, the calculation of which includes historical data, assumptions and expectations of future conditions.
- Loss Given Default: LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, taking into account cash flows from collateral and integral credit enhancements.
- Establishing forward-looking scenarios: When measuring ECL the Company uses reasonable and supportable forward-looking information, which is based on assumptions for the future movement of different economic drivers and how these drivers will affect each other.

Lease term, incremental borrowing rate (IBR) and lease payments. The lease term is defined as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease (including the renewal option implied through customary business practices) if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease if it is reasonably certain not to be exercised. Management applies judgement to determine the lease term when lease contracts include renewal options that are exercisable only by the Company. It considers all relevant factors that create an economic incentive to exercise the renewal option. After the commencement date, the Company reassesses the lease term if there is a significant event or a change in circumstances that is within its control and affects its ability to exercise (or not to exercise) the option to renew, or to terminate the lease.

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

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

Useful lives of property, plant and equipment. Property, plant, and equipment are depreciated or amortised over their useful lives. Useful lives are based on the management's estimates of the period that the assets will generate revenue, which are periodically reviewed. Changes to estimates can result in significant variations in the carrying value and amounts charged to the statement of comprehensive income in specific periods.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

4. FINANCIAL INSTRUMENTS - RISK MANAGEMENT

Like other financial institutions, the Company is exposed to risks that arise from its use of financial instruments. This note describes the Company's objectives, policies and processes for managing those risks and the methods used to measure them. Further quantitative information in respect of these risks is presented throughout these financial statements.

Management of risk is fundamental to the business and is an essential element of the Company's operations. The Company is exposed through its operations to the following financial risks:

- Credit risk
- Liquidity risk
- Market risk:
 - Interest rate risk
 - Currency risk

Principal financial instruments

The principal financial instruments used by the Company, from which financial instrument risk arises, are as follows:

	31 December 2022	31 December 2021
Cash and cash equivalents	10,964	7,637
Loans to customers	159,630	120,885
Other financial assets	318	384
Borrowed funds	100,933	68,603
Other financial liabilities	912	602
Lease liabilities	7,362	7,568

General objectives, policies and processes

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

The Supervisory Board, together with its committees have overall responsibility for the determination of the Company's risk management objectives and policies and, whilst retaining ultimate responsibility for them, it has delegated the authority for designing and operating processes that ensure the effective implementation of the objectives and policies to the Company's finance function.

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

The overall objective of the Board is to set policies that seek to reduce risks as far as possible without unduly affecting the Company's competitiveness and flexibility. Further details regarding these policies are set out below.

Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises as a result of the lending and other transactions with counterparties giving rise to financial assets.

The main business of the Company is to provide micro-loans. Respectively credit risk is of crucial importance in the Micro Financing Organisations (MFO) risk management. To avoid significant financial damage caused by this, the Company uses various methods to identify and manage effectively the credit risks.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

4. FINANCIAL INSTRUMENTS - RISK MANAGEMENT (CONTINUED)

The Company's credit policy is determined by the Credit Manual, where all the related procedures and requirements, along with respective controls are clearly defined, including loan disbursement, monitoring of delinquent loans, etc.

The Company established a number of credit committees which are responsible for approving credit limits.

The Credit Committee is the analytical body responsible for analysing the information in the loan applications, assessing and reducing the credit risks as much as possible. The Credit Committee is the independent body within MFO and authorized to make the final decision about financing or rejecting the loan application.

Accuracy and correctness of information presented to the Credit Committee is the responsibility of the credit officer, who fills in the initial application after the due scrutiny of the applicant's business and its credit risks. Eventually the Credit Committee members assess the application against the established criteria (applicant's credit history, financial condition, competitive ability, etc.).

Exposure to credit risk is also managed, in part, by securing loans with real estate or other materially valuable item.

Assessment of the applicant's creditworthiness through complete monitoring of its business allows timely avoiding the risk of financial loss. Monitoring is performed by credit officers who report the results to the management. For timely response to potential risks, monitoring results are presented to the management on a regular basis. The monitoring system helps to manage credit risks and timely neutralize them.

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date in the statement of financial position was:

	31 December 2022	31 December 2021
Cash and cash equivalents (excluding cash on hand)	5,444	4,140
Loans to customers	159,630	120,885
Other financial assets	318	384
	165,392	125,409

The Company's credit department reviews ageing analysis of outstanding loans and follows up past due balances. Management therefore considers it to be appropriate to provide ageing and other information about credit risk as disclosed in Note 10 and Note 21.

Market risk

Market risk is the risk that the fair value of a financial instrument will decrease because of changes in market factors.

Market risk arises from the Company's use of interest bearing, tradable and foreign currency financial instruments. It is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates (interest rate risk) and foreign exchange rates (currency risk).

Interest rate risk

Interest rate risk arises from potential changes in market interest rates that can adversely affect the fair values of the financial assets and liabilities of the Company. This risk can arise from maturity mismatches of assets and liabilities, as well as from the re-pricing characteristics of such assets and liabilities.

The table below summarises the Company's exposure to interest rate risks. The table presents the aggregated amounts of the Company's interest-bearing financial assets and interest-bearing financial liabilities at carrying amounts:

	31 December 2022	31 December 2021
Total interest bearing financial assets	165,074	125,025
Total interest bearing financial liabilities	(108,295)	(76,171)
	56,779	48,854

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

4. FINANCIAL INSTRUMENTS - RISK MANAGEMENT (CONTINUED)

The information about maturities of interest-bearing financial assets and interest-bearing financial liabilities is given in liquidity risk quantitative disclosures below.

The Company performs analysis of interest rate risk sensitivity.

The Company's all interest-bearing assets and liabilities are at fixed interest rates except for several borrowings. Total outstanding balances of these borrowings are GEL65,910 thousand as at 31 December 2022 (2021: GEL37,910 thousand).

The Company's Management estimates that market interest rate fluctuations by 1% will affect profit or loss by GEL659 thousand (2021: GEL379 thousand).

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.

The Company's exposure to foreign currency exchange rate risk as at 31 December 2022 is presented in the table below:

Financial assets	GEL	USD	Other currencies	Total
Cash and cash equivalents	5,239	3,798	1,927	10,964
Loans to customers	158,222	1,408	-	159,630
Other financial assets	318	-	-	318
	163,779	5,206	1,927	170,912
Financial liabilities				
Borrowed funds	98,472	2,461	-	100,933
Other financial liabilities	912	-	-	912
Lease liabilities	379	6,983	-	7,362
	99,763	9,444	-	109,207
Open balance sheet position	64,016	(4,238)	1,927	61,705

The Company's exposure to foreign currency exchange rate risk as at 31 December 2021 is presented in the table below:

Financial assets	GEL	USD	Other currencies	Total
Cash and cash equivalents	3,504	3,414	719	7,637
Loans to customers	118,423	2,462	-	120,885
Other financial assets	384	-	-	384
	122,311	5,876	719	128,906
Financial liabilities				
Borrowings	64,168	4,435	-	68,603
Other liabilities	602	-	-	602
Lease liabilities	416	7,152	-	7,568
	65,186	11,587	-	76,773
Open balance sheet position	57,125	(5,711)	719	52,133

The principal amounts of outstanding forward foreign exchange contracts amounted GEL4,000 (USD1,434) thousand and GEL5,000 (USD1,547) thousand as at 31 December 2022 and 2021, respectively.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

4. FINANCIAL INSTRUMENTS - RISK MANAGEMENT (CONTINUED)

To manage foreign currency exchange rate risks, the Company enters into a USD/GEL forward contract with local commercial banks. These financial instruments are mainly used for managing foreign currency exchange risks related to future lease payments.

Currency risk sensitivity

The following table details the Company's sensitivity to a 20% increase and decrease in the USD against the GEL. 20% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates.

Impact on total comprehensive income and equity based on asset values, considering the effect of forward contracts can be presented as follows:

	31 December 2022		31 December 2021	
	+20%	-20%	+20%	-20%
Currency rate sensitivity				
USD impact	(48)	48	(142)	142
Other impact	385	(385)	144	(144)
	337	(337)	2	(2)

Liquidity risk

Liquidity risk refers to the availability of sufficient funds to meet loan repayments and other financial commitments associated with financial instruments as they actually fall due. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching of the maturities and interest rates of assets and liabilities is fundamental to liquidity management. It is unusual for financial institutions ever to be completely matched since business transactions are often of an uncertain term and of different types. An unmatched position potentially enhances profitability but can also increase the risk of losses.

The Company maintains liquidity management with the objective of ensuring that funds will be available at all times to meet all cash flow obligations as they become due. The liquidity policy is reviewed and approved by Supervisory Board. The Company seeks to actively support a diversified and stable funding base comprising long-term and short-term loans from banks, related parties, promissory notes, in order to be able to respond quickly and smoothly to unforeseen liquidity requirements.

In order to manage liquidity risk, the Company performs regular monitoring of future expected cash flows, which is a part of assets/liabilities management process. Liquidity position is monitored by the Finance Department. Under the normal market conditions, information on the liquidity position are presented to the Management periodically.

An analysis of the liquidity is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the Company.

Liquidity of financial liabilities as at 31 December 2022 can be presented as follows:

Financial liabilities	On demand and less than 1 month	More than 1 month and less than 1 year	More than 1 year	Total
Borrowed funds	1,412	36,697	84,396	122,505
Other financial liabilities	330	582	-	912
Lease liabilities	149	1,789	7,066	9,004
	1,891	19,068	91,462	132,421

As at 31 December 2022 the Company was in breach with some non-financial covenants for loans from local financial institutions with total amount of GEL52,212 thousand. The loans were subject of significant risk as a result of breach. However, the Company obtained waivers from financial institutions before the end of the reporting period. According to the waivers, banks do not require early repayment of loans.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

4. FINANCIAL INSTRUMENTS - RISK MANAGEMENT (CONTINUED)

Liquidity of financial liabilities as at 31 December 2021 can be presented as follows:

Financial liabilities	On demand and less than 1 month	More than 1 month and less than 1 year	More than 1 year	Total
Borrowings	32,742	7,410	28,451	68,603
Other financial liabilities	-	602	-	602
Lease liabilities	156	1,774	7,158	9,088
	32,898	9,786	35,609	78,293

As at 31 December 2021 the Company was in breach with some financial covenants for loans from local financial institutions with total amount of GEL32,108 thousand. The loans were subject of significant risk as a result of breach. As at 31 December 2021 the Company has classified all loans as on demand, as it obtained waivers from financial institutions after the reporting date. According to the waiver, bank does not require early repayment of loans.

Management believes that the Company has sufficient liquidity to meet its recognised and off-balance sheet obligations.

Management of capital

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 operate sufficiently; and
- To comply with the capital requirements set by NBG and borrowers.
- To provide an adequate return to shareholders.

The Company sets the amount of capital it requires in proportion to risk. The Company manages its capital structure and adjusts 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 shareholders, return capital to shareholders, issue new shares, or sell assets to reduce debt.

The Company is in compliance with minimum statutory capital requirements of GEL1,000,000 as defined by the National Bank of Georgia as at 31 December 2022 and 2021, respectively.

Fair value measurement

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

4. FINANCIAL INSTRUMENTS - RISK MANAGEMENT (CONTINUED)

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the quantity held by the entity.

Fair value measurement requires judgement for interpretation of market data. 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.

Derivative Financial instruments are measured at fair value by the level 2 in the fair value hierarchy.

Fair value of cash and cash equivalents is measured based on level 1. Fair values of all other financial assets and financial liabilities are measured on level 3. Fair values of these financial assets and financial liabilities approximate their book values, except for loans to customers. Fair value of loans to customers is disclosed in Note 10.

5. NET INTEREST INCOME

	<u>2022</u>	<u>2021</u>
Interest income calculated using effective interest method from:		
Loans to customers	45,518	35,232
Current bank accounts	219	180
	<u>45,737</u>	<u>35,412</u>
Interest expense from:		
Loans and borrowings	(12,858)	(8,776)
Lease liabilities	(580)	(507)
	<u>(13,438)</u>	<u>(9,283)</u>
Net interest income	<u>32,299</u>	<u>26,129</u>

6. OTHER INCOME

	<u>2022</u>	<u>2021</u>
Income from penalty and early commission fee	4,074	3,057
Gain from sale of repossessed assets	190	92
Other income	221	246
	<u>4,485</u>	<u>3,395</u>

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

7. OTHER OPERATING EXPENSES

	<u>2022</u>	<u>2021</u>
Marketing and advertising	(1,738)	(1,737)
Legal and other professional services*	(817)	(991)
Utilities and communication	(673)	(640)
Bank fees	(666)	(411)
Consumables and office supplies	(572)	(445)
Loss from portfolio sale	(506)	(344)
Insurance	(345)	(221)
Repairs and maintenance	(212)	(132)
Fuel	(136)	(108)
Short-term leases	(116)	(152)
Security	(113)	(91)
Business trips	(41)	(28)
Other	(559)	(498)
	<u>(6,494)</u>	<u>(5,798)</u>

*Audit fee for the financial statements was 56 thousand (2021: 64 thousand).

8. DEFERRED TAX ASSET

	<u>2022</u>	<u>2021</u>
At 1 January	1,036	1,347
Recognized in profit and loss		
Tax expense	(414)	(127)
Derecognized deferred tax assets	(720)	(184)
At 31 December	(98)	1,036

Temporary differences as at 31 December 2022 can be presented as follows:

	Asset	Liability	Net	(Charged)/ credited to comprehensive income 2022
	<u>2022</u>	<u>2022</u>	<u>2022</u>	<u>2022</u>
Temporary differences				
Loans to customers	720	-	720	(278)
Cash and cash equivalents	4	-	4	1
Property and equipment	-	(179)	(179)	(23)
Intangible assets	25	-	25	(2)
Loans and borrowings	7	-	7	4
Other assets	10	-	10	3
Other liabilities	68	-	68	1
Right of use assets	-	(1,137)	(1,137)	(89)
Lease liabilities	1,104	-	1,104	(31)
	<u>1,938</u>	<u>(1,316)</u>	<u>622</u>	<u>(414)</u>
Derecognized deferred tax assets				
Loans to customers	(720)	-	(720)	(720)
	<u>(720)</u>	<u>-</u>	<u>(720)</u>	<u>(720)</u>
Tax assets/(liabilities)	1,218	(1,316)	(98)	(1,134)
Set off of tax	(1,316)	1,316	-	-
Net tax assets	(98)	-	(98)	(1,134)

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

8. DEFERRED TAX ASSET (CONTINUED)

Temporary differences as at 31 December 2021 can be presented as follows:

	Asset	Liability	Net	(Charged)/ credited to comprehensive income
	2021	2021	2021	2021
Temporary differences				
Loans to customers	1,182	-	1,182	4
Cash and cash equivalents	3	-	3	(2)
Property and equipment	-	(156)	(156)	(66)
Intangible assets	27	-	27	8
Loans and borrowings	3	-	3	(14)
Other assets	7	-	7	(7)
Other liabilities	67	-	67	13
Right of use assets	-	(1,048)	(1,048)	(235)
Lease liabilities	1,135	-	1,135	172
	<u>2,424</u>	<u>(1,204)</u>	<u>1,220</u>	<u>(127)</u>
Derecognized deferred tax assets				
Loans to customers	(184)	-	(184)	(184)
	<u>(184)</u>	<u>-</u>	<u>(184)</u>	<u>(184)</u>
Tax assets/(liabilities)	2,240	(1,204)	1,036	(311)
Set off of tax	(1,204)	1,204	-	-
Net tax assets	<u>1,036</u>	<u>-</u>	<u>1,036</u>	<u>(311)</u>

Income tax expense can be presented as follows:

	2022	2021
Current tax	(2,201)	(1,845)
Effect of temporary differences	(414)	(127)
Effect of derecognized deferred tax assets	(720)	(184)
Adjustment for over provision in previous periods	80	-
	<u>(3,255)</u>	<u>(2,156)</u>

Reconciliation of income tax expense based on statutory rate with actual income tax is as follows:

	2022	2021
Profit before income tax	15,759	12,355
Applicable tax rate	15%	15%
Theoretical income tax	(2,364)	(1,853)
Derecognition of temporary differences on loans to customers *	(720)	(184)
Origination and reversal of permanent differences	(171)	(119)
	<u>(3,255)</u>	<u>(2,156)</u>

* On December 27, 2022, Georgian law was published that made an amendment into the Tax Code of Georgia (Hereinafter "GTC"). It came into the force from January 1, 2023. The mentioned amendments have following effects on the Company: Before the amendment, according to the Tax Code of Georgia, it was determined that banking institutions, credit unions, microfinance organizations and loan providers would be taxed under the new (Estonian) corporate income tax (CIT) regime from January 1, 2023. The amendment stipulated that the time schedule will no longer be established and in the future these entities will be taxed again according to the old CIT regime, namely according to the difference between the gross income gained during a calendar year and the deductions according to GTC (Article 97, Paragraph 12).

Also, a new section 4 was added to the Article 98 of GTC, which determines CIT rate, according to which the taxable profit of a banking institution, credit union, microfinance organization and loan provider shall be taxed at the rate of 20%.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

8. DEFERRED TAX ASSET (CONTINUED)

Although, taxation will be done according to the so-called old regime of CIT, the method of recognition of income and expenses determined by the GTC for the financial sector has been changed. In particular, the new section 5 has been added to the article 142 of GTC, that defines the moment of earning of income under the accrual method. According to this amendment from January 1, 2023, banking institutions, credit unions and microfinance organizations shall recognize interest income accrued on loans in accordance with International Financial Reporting Standards (IFRS). As for the deduction of allocations to reserve funds, according to the updated Article 109 of the GTC, from January 1, 2023, the mentioned persons will deduct the reserves for possible loan losses from the gross income according to the International Financial Reporting Standards (IFRS), instead of the rule established by the National Bank of Georgia. Due to the mentioned change, the Company has fully derecognized temporary differences on loans to customers at the end of 2022. The derecognition of temporary differences was related to the derecognition of the deferred tax asset arising from temporary differences on loans to customers during 2022 as well as on December 31, 2021.

9. CASH AND CASH EQUIVALENTS

	<u>31 December 2022</u>	<u>31 December 2021</u>
Cash on hand	5,520	3,497
Bank balances	5,444	4,140
	<u>10,964</u>	<u>7,637</u>

None of the balances of cash and cash equivalents are past due. No loss allowance is recognized for balances with banks due to short-term nature.

Additional information about the currency and liquidity of cash and cash equivalents are disclosed in the Note 4.

10. LOANS TO CUSTOMERS

	<u>31 December 2022</u>	<u>31 December 2021</u>
Principle	168,688	128,743
Interest	5,303	5,617
Impairment allowance	(14,361)	(13,475)
	<u>159,630</u>	<u>120,885</u>

Loans to customers with the amount GEL113,256 thousand and GEL72,752 thousand were pledged as collaterals for their respective borrowings as at 31 December 2022 and 2021, respectively.

Fair value of loans to customers is GEL162,948 thousand as at 31 December 2022. Difference between carrying amount and fair value of the loans amounts to GEL3,318 thousand. Fair value of loans to customers was GEL123,075 thousand as at 31 December 2021. Difference between carrying amount and fair value of the loans amounted to GEL2,190 thousand.

The fair value of loans to customers are estimated using future cash flows expected to be received 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.

The Company has purchased gold, ipo and auto portfolios in 2022 with total value of GEL7,158 thousand and gold portfolios in 2021 with total value of GEL10,483 thousand. The company conducted concentration test under IFRS 3 and, as a result, did not consider the operation as a business combination.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

10. LOANS TO CUSTOMERS (CONTINUED)

Portfolio distribution as at 31 December 2022, by loan type is as follows:

	<u>Gross Amount</u>	<u>Stage 1</u>	<u>Stage 2</u>	<u>Stage 3</u>	<u>Total ECL</u>
Loans collateralized by real estate	17,643	(350)	(84)	(1,239)	(1,673)
Loans collateralized by vehicles	114,964	(2,401)	(592)	(7,367)	(10,360)
Loans collateralized by gold	39,292	(320)	(54)	(507)	(881)
Other uncollateralized consumer loans	2,092	(12)	(10)	(1,425)	(1,447)
	<u>173,991</u>	<u>(3,083)</u>	<u>(740)</u>	<u>(10,538)</u>	<u>(14,361)</u>

Portfolio distribution as at 31 December 2021, by loan type is as follows:

	<u>Gross Amount</u>	<u>Stage 1</u>	<u>Stage 2</u>	<u>Stage 3</u>	<u>Total ECL</u>
Loans collateralized by real estate	12,595	(251)	(58)	(1,409)	(1,718)
Loans collateralized by vehicles	85,197	(1,876)	(449)	(6,266)	(8,591)
Loans collateralized by gold	33,810	(724)	(24)	(313)	(1,061)
Other uncollateralized consumer loans	2,758	(7)	(8)	(2,090)	(2,105)
	<u>134,360</u>	<u>(2,858)</u>	<u>(539)</u>	<u>(10,078)</u>	<u>(13,475)</u>

Analysis by credit quality of loans outstanding at 31 December 2022 is as follows:

<i>Loans collateralized by real estate</i>	<u>Gross Amount</u>	<u>ECL</u>	<u>Net Amount</u>	<u>ECL %</u>
-no overdue	14,318	(400)	13,918	3%
-overdue less than 31 days	893	(72)	821	8%
-overdue 31-60 days	107	(25)	82	23%
-overdue 61-90 days	73	(36)	37	49%
-overdue more than 90 days	2,252	(1,140)	1,112	51%
	<u>17,643</u>	<u>(1,673)</u>	<u>15,970</u>	<u>9%</u>

<i>Loans collateralized by vehicles</i>	<u>Gross Amount</u>	<u>ECL</u>	<u>Net Amount</u>	<u>ECL %</u>
-no overdue	94,210	(2,132)	92,078	2%
-overdue less than 31 days	6,533	(468)	6,065	7%
-overdue 31-60 days	968	(225)	743	23%
-overdue 61-90 days	823	(309)	514	38%
-overdue more than 90 days	12,430	(7,226)	5,204	58%
	<u>114,964</u>	<u>(10,360)</u>	<u>104,604</u>	<u>9%</u>

<i>Loans collateralized by gold</i>	<u>Gross Amount</u>	<u>ECL</u>	<u>Net Amount</u>	<u>ECL %</u>
-no overdue	33,507	(389)	33,118	1%
-overdue less than 31 days	2,414	(123)	2,291	5%
-overdue 31-60 days	937	(68)	869	7%
-overdue 61-90 days	461	(41)	420	9%
-overdue more than 90 days	1,973	(260)	1,713	13%
	<u>39,292</u>	<u>(881)</u>	<u>38,411</u>	<u>2%</u>

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

10. LOANS TO CUSTOMERS (CONTINUED)

<i>Other uncollateralized consumer loans</i>	Gross Amount	ECL	Net Amount	ECL %
-no overdue	187	(17)	170	9%
-overdue less than 31 days	13	(3)	10	23%
-overdue 31-60 days	21	(8)	13	38%
-overdue 61-90 days	-	-	-	0%
-overdue more than 90 days	1,871	(1,419)	452	76%
	2,092	(1,447)	645	69%

Analysis by credit quality of loans outstanding at 31 December 2021 is as follows:

<i>Loans collateralized by real estate</i>	Gross Amount	ECL	Net Amount	ECL %
-no overdue	9,976	(412)	9,564	4%
-overdue less than 31 days	386	(54)	332	14%
-overdue 31-60 days	-	-	-	0%
-overdue 61-90 days	-	-	-	0%
-overdue more than 90 days	2,233	(1,252)	981	56%
	12,595	(1,718)	10,877	14%

<i>Loans collateralized by vehicles</i>	Gross Amount	ECL	Net Amount	ECL %
-no overdue	68,409	(1,702)	66,707	2%
-overdue less than 31 days	4,779	(337)	4,442	7%
-overdue 31-60 days	687	(167)	520	24%
-overdue 61-90 days	535	(197)	338	37%
-overdue more than 90 days	10,787	(6,188)	4,599	57%
	85,197	(8,591)	76,606	10%

<i>Loans collateralized by gold</i>	Gross Amount	ECL	Net Amount	ECL %
-no overdue	28,764	(752)	28,012	3%
-overdue less than 31 days	1,976	(75)	1,901	4%
-overdue 31-60 days	760	(31)	729	4%
-overdue 61-90 days	541	(27)	514	5%
-overdue more than 90 days	1,769	(176)	1,593	10%
	33,810	(1,061)	32,749	3%

<i>Other uncollateralized consumer loans</i>	Gross Amount	ECL	Net Amount	ECL %
-no overdue	174	(33)	141	19%
-overdue less than 31 days	1	-	1	0%
-overdue 31-60 days	4	(2)	2	50%
-overdue 61-90 days	4	(2)	2	50%
-overdue more than 90 days	2,575	(2,068)	507	80%
	2,758	(2,105)	653	76.32%

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

10. LOANS TO CUSTOMERS (CONTINUED)

Movements in the loan impairment allowance for the year ended 31 December 2022 are as follows:

	Stage 1	Stage 2	Stage 3	
	12 month ECL	Lifetime ECL- not credit- impaired	Lifetime ECL- credit- impaired	Total
Balance as at 1 January 2022	2,858	539	10,078	13,475
New loans issued and purchased	4,137	35	87	4,259
Transfer to Stage 1	198	(198)	-	-
Transfer to Stage 2	(3,987)	3,987	-	-
Transfer to Stage 3	-	(4,478)	4,478	-
Repaid loans	(1,575)	(256)	(2,651)	(4,482)
Write off for the year	-	-	(1,980)	(1,980)
Recoveries of previously written off	-	-	124	124
Changes due to change in credit-risk	1,452	1,111	402	2,965
Balance at 31 December 2022	3,083	740	10,538	14,361

Movements in the loan impairment allowance for the year ended 31 December 2021 are as follows:

	Stage 1	Stage 2	Stage 3	
	12-month ECL	Lifetime ECL- not credit- impaired	Lifetime ECL- credit- impaired	Total
Balance as at 1 January 2021	2,773	654	9,979	13,406
New loans issued and purchased	4,172	33	46	4,251
Transfer to Stage 1	229	(229)	-	-
Transfer to Stage 2	(2,833)	2,833	-	-
Transfer to Stage 3	-	(3,273)	3,273	-
Repaid loans	(1,855)	(291)	(2,051)	(4,197)
Write off for the year	-	-	(1,314)	(1,314)
Recoveries of previously written off	-	-	161	161
Changes due to change in credit-risk	372	812	(16)	1,168
Balance at 31 December 2021	2,858	539	10,078	13,475

Movements in the gross amount of issued loans for the year ended 31 December 2022 are as follows:

	Stage 1	Stage 2	Stage 3	
	12 month ECL	Lifetime ECL- not credit- impaired	Lifetime ECL- credit- impaired	Total
Balance as at 1 January 2022	110,968	4,241	19,151	134,360
New loans issued and purchased	271,939	1,792	4,767	278,498
Transfer to Stage 1	8,714	(8,714)	-	-
Transfer to Stage 2	(26,380)	26,380	-	-
Transfer to Stage 3	-	(10,927)	10,927	-
Repaid loans	(216,673)	(8,073)	(11,693)	(236,439)
Write off for the year	-	-	(2,128)	(2,128)
Recoveries of previously written off	-	-	124	124
Foreign exchange loss	(125)	(13)	(286)	(424)
Balance at 31 December 2022	148,443	4,686	20,862	173,991

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

10. LOANS TO CUSTOMERS (CONTINUED)

Movements in the gross amount of issued loans for the year ended 31 December 2021 are as follows:

	Stage 1	Stage 2	Stage 3	
	12 month ECL	Lifetime ECL- not credit- impaired	Lifetime ECL- credit- impaired	Total
Balance as at 1 January 2021	89,861	3,690	18,014	111,565
New loans issued and purchased	224,097	2,380	4,269	230,746
Transfer to Stage 1	7,223	(7,223)	-	-
Transfer to Stage 2	(23,937)	23,937	-	-
Transfer to Stage 3	-	(9,729)	9,729	-
Repaid loans	(186,047)	(8,805)	(11,613)	(206,465)
Write off for the year	-	-	(1,369)	(1,369)
Recoveries of previously written off	-	-	161	161
Foreign exchange loss	(229)	(9)	(40)	(278)
Balance at 31 December 2021	110,968	4,241	19,151	134,360

The primary factors that the Company considers whether a loan is impaired are its overdue status, financial position of a borrower and reliability of related collateral, if any. Detailed information about impairment policy is disclosed in the Note 21.

11. OTHER ASSETS

	31 December 2022	31 December 2021
Prepayments	362	476
Assets of repossessed collateral	180	-
Collateral for forward contracts*	-	250
Other receivables	318	134
	860	860

*Foreign exchange risk arises when the Company enters into transactions denominated in a currency other than its functional currency. Where the risk to the Company is considered to be significant, the Company's treasury will enter into a USD/GEL exchange forward contracts with a local commercial banks. The collateral for forward contracts at 31 December 2021 comprised cash collaterals transferred to the bank until the agreements were matured. At 31 December 2022 the Company doesn't have cash collateral transferred to banks for forward contracts, since contracts are collateralized with the credit lines.

The principal amounts of outstanding forward foreign exchange contracts amounted GEL4,000 (USD1,434) thousand and GEL5,000 (USD1,547) thousand as at 31 December 2022 and 2021, respectively.

Total loss from fair value change of forward contracts amounted to GEL1,135 thousand and GEL669 thousand during the 2022 and 2021 years, respectively.

12. TAX LIABILITIES

According to the Georgian Tax Legislation, the Company should pay taxes on unified treasury code applicable for all taxes. As a result, as at 31 December 2022 and 2021 the Company presents tax liabilities and assets on a net basis, amounting GEL17 thousand (liability) and GEL653 thousand (liability), respectively.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

13. LEASES

The Company leases a head office, land, warehouse and 28 service centers (2021: 22 service centers) around Georgia.

The Company has 36 contracts, rent for these spaces are fixed over the lease term and are denominated in USD and GEL. Lease terms are determined between 2 and 10 years in 2022 and 2021.

Incremental borrowing rates were between 7.02%-8.95% and 10.74%-14.27% for USD and GEL denominated leases for the year ended 2022 (2021: USD denominated 6.24%-7.89%, GEL denominated 10.74%-14.27%).

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

	Branches	Other	Total
At 31 December 2020	5,233	484	5,717
Addition	1,499	-	1,499
Effect on modification to lease terms	1,156	174	1,330
Depreciation	(1,307)	(88)	(1,395)
Disposal	(154)	-	(154)
At 31 December 2021	6,427	570	6,997
Addition	2,221	-	2,221
Effect on modification to lease terms	166	-	166
Depreciation	(1,494)	(88)	(1,582)
Disposal	(216)	-	(216)
At 31 December 2022	7,104	482	7,586

Lease liabilities can be presented as follows:

	Branches	Other	Total
At 31 December 2020	5,810	613	6,423
Addition	1,499	-	1,499
Effect on modification to lease terms	1,156	174	1,330
Interest expense	486	21	507
Lease payments	(1,441)	(119)	(1,560)
Disposal	(225)	-	(225)
Foreign exchange movements	(393)	(13)	(406)
At 31 December 2021	6,892	676	7,568
Addition	2,221	-	2,221
Effect on modification to lease terms	166	-	166
Interest expense	554	26	580
Lease payments	(1,903)	(108)	(2,011)
Disposal	(192)	-	(192)
Foreign exchange movements	(931)	(39)	(970)
At 31 December 2022	6,807	555	7,362

Liquidity analysis for lease liabilities as at 31 December 2022 can be presented as follows:

	Up to 3 months	Between 3 and 12 months	Between 1 and 2 years	Between 2 and 5 years	Over 5 years	Total
Lease liabilities	466	1,472	1,972	3,801	1,293	9,004

Liquidity analysis for lease liabilities as at 31 December 2021 can be presented as follows:

	Up to 3 months	Between 3 and 12 months	Between 1 and 2 years	Between 2 and 5 years	Over 5 years	Total
Lease liabilities	478	1,452	1,868	4,622	668	9,088

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

14. PROPERTY AND EQUIPMENT

Historical cost	Vehicles	Furniture	IT equipment	Leasehold improvements	Total
Historical cost 31.12.2020	187	770	1,163	555	2,675
Additions	19	237	401	832	1,489
Disposals	(8)	-	-	(19)	(27)
Historical cost 31.12.2021	198	1,007	1,564	1,368	4,137
Additions	12	213	252	869	1,346
Disposals	(7)	-	-	-	(7)
Historical cost 31.12.2022	203	1,220	1,816	2,237	5,476
Accumulated depreciation					
Accumulated depreciation 31.12.2020	(144)	(416)	(788)	(463)	(1,811)
Depreciation for the year	(18)	(156)	(157)	(85)	(416)
Accumulated depreciation of disposals	-	-	-	-	-
Accumulated depreciation 31.12.2021	(162)	(572)	(945)	(548)	(2,227)
Depreciation for the year	(9)	(141)	(205)	(190)	(545)
Accumulated depreciation of disposals	2	-	-	-	2
Accumulated depreciation 31.12.2022	(169)	(713)	(1,150)	(738)	(2,770)
Net book value					
As at 31 December 2021	36	435	619	820	1,910
As at 31 December 2022	34	507	666	1,499	2,706

15. BORROWED FUNDS

	31 December 2022	31 December 2021
Principal	100,199	68,097
Interest	734	506
	100,933	68,603

The Company's major lenders are local financial institutions.

Non-current liabilities	31 December 2022	31 December 2021
Secured loans from financial institutions	76,356	26,283
Unsecured promissory notes and other long-term loans	151	2,168
	76,507	28,451
Current liabilities		
Secured loans from financial institutions	19,428	35,361
Unsecured promissory notes and other short-term loans	4,998	3,805
Unsecured loans from a related party	-	986
	24,426	40,152
Total liabilities	100,933	68,603

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

15. BORROWED FUNDS (CONTINUED)

As per contracts with financial institutions, borrowings are collateralized with the certain amounts of loans to customers, additionally refer to Note 10.

Terms and conditions of outstanding loans were as follows:

	<u>Currency</u>	<u>Nominal interest rate</u>	<u>Year of maturity</u>	<u>31 December 2022</u>	<u>31 December 2021</u>
Unsecured promissory notes and other long-term loans	USD	6.5%	2024	151	2,168
Secured loans from financial institutions	GEL	5.0%-5.5%+NGB Refinance Rate - 13.90%-14.50%	2023-2024	95,784	61,644
Unsecured loans from a related party	USD	12%	2022	-	986
Unsecured promissory notes and other short-term loans	USD	5%-7.5%	2023	2,310	1,281
Unsecured promissory notes and other short-term loans	GEL	14%-16.5%	2023	2,688	2,524
				100,933	68,603

Part of the Company's short and long-term loan contracts contain different financial and other covenants. There is a regular communication between the lenders and the Company regarding the covenants.

As at 31 December 2022 the Company was in breach with some non-financial covenants for loans from local financial institutions with total amount of GEL52,212 thousand. The loans were subject of significant risk as a result of the breach. The Company had communication about this case in 2022 with financial institutions and got waiver from the banks for the breaches before the reporting date. According to the waiver, the banks do not require early repayment of loans.

As at 31 December 2021 the Company was in breach with some financial covenants for loans from local financial institution with total amount of GEL32,108 thousand. As at 31 December 2021 the Company had classified all loans as on demand, as it obtained waivers from financial institutions after the reporting date. According to the waiver, the banks did not require early repayment of loans.

For detailed information regarding loan covenants, refer to Note 18.

Additional information on borrowed funds is disclosed in Note 4.

Changes in borrowings arising from financing activities, including both changes arising from cash flows and non-cash changes can be presented as follows:

	<u>Loans from financial institutions</u>	<u>Other borrowings</u>	<u>Total</u>
As at 31 December 2021	61,645	6,958	68,603
Cash flows	21,879	(2,010)	19,869
Non-cash flows			
- Interest accrued in period	12,263	595	12,858
- Effects of foreign exchange	(4)	(393)	(397)
As at 31 December 2022	95,783	5,150	100,933

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

15. BORROWED FUNDS (CONTINUED)

	Loans from financial institutions	Other borrowings	Total
As at 31 December 2020	38,865	17,022	55,887
Cash flows	15,594	(11,344)	4,250
Non-cash flows			
- Interest accrued in period	7,186	1,590	8,776
- Effects of foreign exchange	-	(310)	(310)
As at 31 December 2021	61,645	6,958	68,603

16. OTHER LIABILITIES

	31 December 2022	31 December 2021
Dividends payable	250	-
Bonuses payable	324	230
Other liabilities	338	372
	912	602

17. SHARE CAPITAL AND RESERVES

Shareholders	31 December 2022, %	Type	31 December 2021, %	Number of shares, 2022	Number of shares, 2021
JSC Swiss Holdings	51.00%	Ordinary	50.00%	1,275,120	1,250,000
Eyal Elboim	30.00%	Ordinary	30.00%	749,880	749,880
Amir Yoeli	17.00%	Ordinary	17.00%	425,000	425,000
Paata Daiauri	2.00%	Ordinary	2.00%	50,000	50,000
Alon Bechor	-	Ordinary	1.00%	-	25,120
	100.00%		100.00%	2,500,000	2,500,000

All shares have a nominal value of USD 1.

Share premium

As at 31 December 2022 and 2021 the Company has share premium of GEL2,068 thousand which represents a difference between the par value of issued ordinary shares and the fair value of actual consideration received.

Dividends

The shareholders are entitled to receive dividends as declared by the Company and are entitled to one vote per share at annual and general meeting of the Company.

In 2022, based on the decision of the Supervisory Board, dividends with amount of GEL1,750 thousand were declared and GEL1,500 thousand were paid to the shareholders (Amir Yoeli, Eyal Elboim and JSC Swiss Holdings) (2021: GEL1,970 thousand were declared and paid to the shareholder (Amir Yoeli)).

Declared dividends can be presented as follows:

Name of the shareholder	2022	2021
JSC Swiss Holdings	911	-
Eyal Elboim	536	-
Amir Yoeli	303	1,970
	1,750	1,970

18. COMMITMENTS AND CONTINGENCIES

Litigation

In the ordinary course of business, the Company is subject to legal actions and complaints. However, the 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.

NBG regulations

On 5 July 2018 the president of the National Bank of Georgia has approved regulation on assets classification and the creation of reserves for possible losses by Microfinance Organisations.

The Management states that the Company is in compliance with the requirements of NBG for 2022, except for the pledged assets to total capital ratio which was breached in 2022. The Company received a waiver from NBG before the reporting date, that set the mentioned coefficient limit at 200% until 1 May 2023. Additionally, the Company has received a waiver from NBG post-balance-sheet, setting the mentioned coefficient limit at 200% until 1 May 2024. It should be noted the assessment of compliance with other ratios relies on estimates and assumptions and may involve a series of complex judgments about future events and could be differed from the judgments of regulators.

Management report

In accordance with the Law on accounting, reporting and auditing (article 7) the Company has an obligation to prepare and submit Management Report to the State Regulatory Authority, together with Independent Auditors' Report no later than 1 October of the year following the reporting period. The Company has fulfilled this obligation at the date of issue of the financial statements.

Taxes

Georgian tax legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Company may be challenged by the relevant authorities. As per currently effective tax legislation in Georgia fiscal periods remain open to review by the authorities in respect of taxes for 3 calendar years preceding the period of review.

Provisions for tax liabilities are recognised when the amount can be measured reliably. No provision is recognised for uncertain tax positions if no reliable estimate can be made. The Company's management believes that Georgian tax legislation does not give raise to any further obligation other than already recorded and the Company's tax positions will be sustained.

Compliance with covenants

The Company is subject to certain covenants related primarily to its borrowings. Covenants mainly relate to: maintaining certain financial and operating ratios, maintaining certain quality of portfolio, limits of funds received and distributed to shareholders and management of shares, agreeing on significant expenses prior to incurring them, using Company's property as collateral etc.

Non-compliance with such covenants may result in negative consequences for the Company including growth in the cost of borrowings and going concern. The Company was not in compliance with covenants with some lenders as at 31 December 2022 and 2021. For details refer to Note 15.

19. TRANSACTIONS WITH RELATED PARTIES

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

19. TRANSACTIONS WITH RELATED PARTIES (CONTINUED)

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

Related party balances and transactions as and for the year ended 31 December 2022:

Financial statement caption	Note	Shareholders	Other related parties
Lease liabilities	13	-	25
Interest expense	5	(62)	(4)
Other operating expenses	7	-	(32)
Other liabilities	16	(250)	(244)

Related party balances and transactions as and for the year ended 31 December 2021:

Financial statement caption	Note	Shareholders	Other related parties
Borrowed funds	15	986	-
Lease liabilities	13	-	31
Other assets	11	25	-
Other liabilities	16	-	(174)
Interest expense	5	(190)	-
Other operating expenses	7	-	(235)

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

	2022	2021
Key management personnel compensation:		
- Short term employee benefits including salaries and bonuses	(2,562)	(2,221)

20. EVENTS AFTER REPORTING PERIOD

During 2023, the Company has borrowed additional funds from local financial institutions. Total value of the loans is GEL7,000 thousand. Loans are nominated in GEL and have a variable interest rate, that is 5%+NBG refinance rate.

As per contracts with financial institutions, borrowings are collateralized with the certain amounts of loans to customers.

In addition, during 2023, terms of the loans with total balance of GEL11,200 thousand as at 31 December 2022 were changed and they were prolonged by up to 2 years.

Starting from 1 January 2023, until the issuance of these financial statements, the Company has paid dividends with total amount of GEL1,250 thousand, out of which, GEL250 thousand was paid for dividends declared in 2022, and the rest was declared in 2023, based on the decision of the Supervisory Board.

According to the share purchase agreement dated 28 April, 2023, A.I Investments LLC bought 1% share from the Company's shareholder JSC Swiss Holdings.

21. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principal accounting policies applied in the preparation of these financial statements are set out below. These policies are consistently applied to all the years presented, unless otherwise stated.

FOREIGN CURRENCY TRANSLATION

The functional currency of the Company is the currency of the primary economic environment in which the entity operates. The Company's functional and presentation currency is the national currency of Georgia, Lari.

Monetary assets and liabilities are translated into functional currency at the official exchange rate for the respective balance sheet dates. Foreign exchange gains and losses resulting from the settlement of transactions and from the translation of monetary assets and liabilities at year-end official exchange rates are recognized in the statement of comprehensive income. Translation at year-end rates does not apply to nonmonetary items.

At 31 December 2022 and 2021 the closing exchange rates used for translating foreign currency balances to GEL/USD were 2.7020 and 3.0976, respectively.

FINANCIAL INSTRUMENTS

In according to IFRS 9 - „Financial instruments”, the Company classifies all of its financial assets based on the business model. IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). All of the Company's financial assets are measured at amortised cost.

All derivative instruments are measured at fair value through profit or loss (FVTPL).

Initial recognition of financial instruments

Financial assets and financial liabilities are recognised in the Company's financial position when the Company becomes a party to the contractual provisions of the instrument.

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

If the transaction price differs from fair value at initial recognition, the Company accounts for such difference as follows:

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

FINANCIAL ASSETS

Classification and subsequent measurement

On initial recognition, a financial asset is classified into one of the following measurement categories: amortised cost; fair value through other comprehensive income (FVOCI); or fair value through profit or loss (FVTPL).

FINANCIAL ASSETS AT AMORTIZED COST

Financial asset at amortised cost is the most relevant measurement category to the Company. The Company measures financial assets at amortised cost if both of the following conditions are met:

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

21. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial assets at amortised cost are subsequently measured using the effective interest (EIR) method and are subject to impairment. Gains and losses are recognised in profit or loss when the asset is derecognised, modified or impaired.

FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

A financial asset is measured at fair value through other comprehensive income if it meets both of the following conditions and is not designated as at fair value through profit or loss:

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

FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

All financial assets not classified as measured at amortised cost or FVOCI as described above are measured at FVTPL. This includes all derivative financial assets.

The Company's all financial assets are measured at amortised cost, except Derivative financial assets.

BUSINESS MODEL ASSESSMENT

There are three business models available under IFRS 9:

- Hold to collect: It is intended to hold the asset to maturity to earn interest, collecting repayments of principal and interest from the counterparty.
- Hold to collect and sell: this model is similar to the hold to collect model, except that the entity may elect to sell some or all of the assets before maturity as circumstances change or to hold the assets for liquidity purposes.
- Other: all those models that do not meet the 'hold to collect' or 'hold to collect and sell' qualifying criteria.

The assessment of business model requires judgment based on facts and circumstances at the date of the assessment. The business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios per instrument type and is based on observable factors.

The Company has considered quantitative factors and qualitative 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 key management personnel; the risks that affect the performance of the business model and, in particular, the way those risks are managed; and how managers of the business are compensated.

Financial assets that are held for trading or are managed and whose performance is evaluated on a fair value basis are measured at FVTPL, because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

SOLELY PAYMENTS OF PRINCIPAL AND INTEREST (SPPI)

If a financial asset is held in either to a Hold to Collect or a Hold to Collect and Sell business model, then assessment to determine whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding at initial recognition is required to determine the classification. The SPPI test is performed on an individual instrument basis.

Contractual cash flows, that represent solely payments of principal and Interest on the principal amount outstanding, are consistent with basic lending arrangement. Interest is consideration for the time value of money and the credit risk associated with the principal amount outstanding during a particular period of time. It can also include consideration for other basic lending risks (e.g. liquidity risk) and costs (e.g. administrative costs) associated with holding the financial asset for a particular period of time, and a profit margin that is consistent with a basic lending arrangement.

In assessing whether the contractual cash flows are SPPI, the Company considers whether the contractual terms of the financial asset contain a term that could change the timing or amount of contractual cash flows arising over the life of the instrument which could affect whether the instrument is considered to meet the SPPI test.

21. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

If the SPPI test is failed, such financial assets are measured at FVTPL with interest earned recognised in other interest income.

DERECOGNITION OF FINANCIAL ASSETS

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognised (i.e., removed from the Company's statement of financial position) when:

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

IMPAIRMENT OF FINANCIAL ASSETS

Bases for ECL principles

In according to IFRS 9 requirements the Company records an allowance for expected credit loss (ECL) on all of its debt financial assets at amortised cost or FVOCI.

Equity instruments are not subject to impairment under IFRS 9.

The allowance is based on the ECL associated with the probability of default in the next 12 months unless there has been a significant increase in credit risk since origination, in which case the allowance is based on the ECL over the life of the asset. If the financial asset meets the definition of purchased or originated credit impaired, the allowance is based on the change in the lifetime ECL.

Under IFRS 9, The Expected Credit Loss (ECL) is recognized as soon as a financial asset is recognized. The Company first evaluates individually whether objective evidence of impairment exists for loans that are individually significant. It then collectively assesses loans that are not individually significant and loans which are significant but for which there is no objective evidence of impairment available under the individual assessment.

Collectively assessed loans are grouped on the basis of shared credit risk characteristics, collateral type and product type.

Three stage approach

IFRS 9 introduces a three stage approach to impairment for Financial Instruments that are performing at the date of origination or purchase. This approach is summarised as follows:

Stage 1: The Company recognizes a credit loss allowance at an amount equal to 12-month expected credit losses. This represents the portion of lifetime expected credit losses from default events that are expected within 12 months of the reporting date, assuming that credit risk has not increased significantly after initial recognition. For those financial assets with a remaining maturity of less than 12 months, a PD is used that corresponds to the remaining maturity.

Stage 2: The Company recognizes a credit loss allowance at an amount equal to lifetime expected credit losses for those Financial Instruments which are considered to have experienced a significant increase in credit risk since initial recognition. This requires the computation of ECL based on lifetime probability of default that represents the probability of default occurring over the remaining lifetime of the Financial Instrument.

Allowance for credit losses are higher in this stage because of an increase in credit risk and the impact of a longer time horizon being considered compared to 12 months in Stage 1. Financial Instruments in stage 2 are not yet deemed to be credit-impaired.

Stage 3: If the Financial Instrument is credit-impaired, it is then moved to stage 3. The Company recognizes a loss allowance at an amount equal to lifetime expected credit losses, reflecting a Probability of Default (PD) of 100 % for those Financial Instruments that are credit-impaired.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

21. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allocating issued loans on stages based on overdue days are as follows:

Collateral type	Stage 1	Stage 2	Stage 3
Real estate	0-30	31-90	>90
Vehicles	0-30	31-90	>90
Gold	0-30	31-90	>90
Uncollateralized	0-30	31-90	>90

The Company automatically assigns stage 1 to the loan when it is issued. The loan is transferred to stage 2 if one of the following events occur:

- a) 31 days past due;
- b) Loan restructuring;
- c) Initiation of legal proceedings on collateral by third party;
- d) Criminal case against debtor or co-debtor;
- e) Loss of job by the borrower;
- f) Liquidation of a large part of the borrower's business;
- g) Significant deterioration of the sector in which the borrower operates.

The loan is transferred from stage 2 to stage 1 if following events occur:

- h) Overdue days are between 0 and 30;
- i) Improvement of the circumstances for which the loan was moved to stage 2.

Restructured loans aren't transferred back to stage 1.

Defaulted loans are immediately moved to stage 3 and aren't subjected to transferring to the previous stages.

Definition of default

Default status is assigned/applied to the loan if one of the following events occur:

- a) 91 days past due;
- b) Death or disappearance of the debtor or co-debtor;
- c) Destruction or disappearance of collateral;
- d) Bankruptcy or liquidation of the business (Relevant in case of business loans).

The definition of default is in line with relevant regulations taking into account the 90 days past due cap presumption IFRS 9.

The loans for which the Company recognizes default are credit-impaired loans.

Loan Restructuring

Restructuring operation/transaction is made within current liability. The agreement about changes in loan term is formed between the Company and borrower and the recalculation of loan schedule is done afterwards.

Loan restructuring is considered as change in credit risk for the Company. Restructured loans are not moved directly to stage 3 because such modification does not lead to material losses for the Company. Accordingly, restructured loans are moved to Stage 2. Restructured loans aren't transferred back to stage 1.

Significant increase in credit risk

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

21. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The quantitative information is a primary indicator of significant increase in credit risk and is based on the change in lifetime PD by comparing:

- the remaining lifetime PD at the reporting date; with
- the remaining lifetime PD for this point in time that was estimated based on facts and circumstances at the time of initial recognition of the exposure.

As a backstop, the Company considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due.

The Company monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that:

- The criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- The criteria do not align with the point in time when an asset becomes 30 days past due; and

There is no unwarranted volatility in loss allowance from transfers between 12-months PD (probability of default) and lifetime PD.

Forward-looking information

Under IFRS 9, the allowance for credit losses is based on reasonable and supportable forward looking information obtainable without undue cost or effort, which takes into consideration past events, current conditions and forecasts of future economic conditions.

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 analyzed:

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

Forecasting of forward-looking information

The Company uses last 5 years statistics (in case of existence) updated annually to estimate correlation between default rates and macroeconomic variables (GDP growth, inflation) and when calculating expected credit loss, specific macroeconomic forecast scenarios are taken into account if only correlation with inflation and GDP growth is more than 0.3 and less than -0.5, accordingly.

The Company uses baseline, upside and adverse scenarios provided by National Bank of Georgia. Based on the recommendation of National Bank of Georgia, probability of 50% is assigned to the baseline scenario, while the upside and adverse scenarios are given probability of 25%. The Company uses Vasicek model to adjust probability of default for forward-looking information.

As at 31 December 2022 the correlation between Company's default rates and macroeconomic variables was not strong enough to consider them for expected credit loss' calculation.

Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

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

Expected credit loss is measured separately for all segments. These parameters are generally derived from internally developed statistical models and other historical data. They are adjusted to reflect forward-looking information as described above. The variables (excluding EAD) are calculated annually. EAD is updated every time the loan loss provision is calculated.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

21. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**Probability of default (PD)**

PD estimates are estimates at a certain date, which are calculated based on statistical rating models.

If a counterparty or exposure migrates between ratings classes, then this will lead to a change in the estimate of the associated PD. PDs are estimated considering the contractual maturities of exposures.

The Company uses last 5 years statistics in case of existence (but not less than 2 years) to determine probability of default. This figure is calculated separately for all segments by applying migration matrix to the loan portfolio, which shows the probability that the loan portfolio will move from one bucket to another. Migration matrix is divided into following buckets:

Bucket	Days overdue	Restructuring status	Stage
1	Closed		
2	0	No	I
3	1-30	No	I
4	31-60	No	II
5	61-90	No	II
6	0-90	Yes	II
7	>90	Yes	III
8	>90	No	III

In case of default, default probability of 100% is assigned to the loan.

Exposure at default (EAD)

Exposure of default (EAD): The EAD represents an estimate of the exposure to credit risk at the time of a potential default occurring during the life of a financial asset. It represents the cash flows outstanding at the time of default, considering expected repayments, interest payments and accruals discounted at the EIR, that must not exceed the limits set by the legislation.

EAD is calculated separately for all segments and is used to determine the amount of portfolio that may be subjected to credit risk at the moment of default. This figure is measured from outstanding loan amount considering expected changes and assuming that default occurs in the mid-year. Expected changes are the scheduled principal repayments till the forecasted overdue date and interest accrued from overdue date till the date when the loan becomes default.

Prepayment rate calculated on historical data is also considered and it reduces outstanding balance till the default date (It is used in calculations if only the average maturity of the loan exceeds 12 months). Exposure at default is calculated for each year during the weighted average contractual maturity of the portfolio.

Loss given default (LGD)

LGD is used to determine the amount of losses that may arise in case of default. In order to calculate loss given default, the Company uses loan amounts that were defaulted during last 5 years (in case of existence) and related cash inflows from default moment till reporting date.

Cash inflows are discounted by the weighted average effective interest rate that must not exceed the limits set by the legislation. Loss given default is calculated separately for all segments.

INTEREST INCOME RECOGNITION

For Financial Instruments in Stage 1 and Stage 2, the Company calculates interest income by applying the Effective Interest Rate (EIR) to the gross carrying amount. Interest income for financial assets in Stage 3 is calculated by applying the EIR to the amortised cost (i.e. the gross carrying amount less credit loss allowance). For Financial Instruments classified as purchased or originated credit-impaired only, interest income is calculated by applying a credit adjusted EIR to the amortised cost of these purchased or originated credit-impaired assets.

21. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FINANCIAL LIABILITIES

In according to IFRS 9 financial liabilities could be classified for one of these categories - “Financial liability at fair value through profit or loss” and “Other financial liabilities”. The Company has estimated which business model was sufficient to the Company’s financial liabilities and has classified them as “Other financial liabilities”, except derivatives.

Derivatives are measured at amortized cost or at fair value through profit or loss (FVTPL).

The Company’s other financial liabilities comprise other liabilities, lease liabilities and borrowings.

Other financial liabilities are initially recognised at fair value plus transaction costs that are directly attributable to their release. The liabilities of such interest are subsequently recorded at amortized cost using the effective interest rate method which ensures accrual of interest on the carrying amount of the financial liability at constant rate. Interest expenses for any financial liability include the initial transaction costs and any additional charges for the redemption of the obligation.

Offsetting of financial assets and liabilities

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

Derecognition of financial liabilities

The Company derecognises financial assets when, and only when, when the rights to receive cash flows from the contract expires or these rights shall be transferred to the other party along with all risks and benefits related to the right of ownership. Any share in the financial asset which is retained by the Company shall be recognized as a separate asset or liability.

The Company derecognises 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 derecognised and the consideration paid and payable is recognised in other comprehensive income.

FAIR VALUE MEASUREMENT

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

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

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

LOANS TO CUSTOMERS AND RECEIVABLES

Loans to customers and other receivables included in other assets in the statement of financial position are non-derivative financial assets measured at amortised cost. Loans to customers and other receivables are initially measured at fair value and subsequently at their amortised cost using the effective interest method.

21. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, non-restricted cash on current accounts in banks, and non-restricted cash on bank deposits. Bank deposits with original maturities of more than three months that can be converted into cash after a short notice to a bank and bear insignificant risk of change in value are also classified as cash and cash equivalents.

The Company creates allowance for cash and cash equivalents which are held in commercial banks. To estimate default probability the Company uses rating given to financial organization by Standard & Poor's, and default probability according to the rating. Each year the Company conducts a test to determine how accurately the probability of default, as well as 1-year ECL calculated according to IFRS 9 reflects the reality.

For this, the Company uses historical data of model PD. The test is assumed to be passed if the difference between model PD and historical default rate does not exceed one standard deviation. Otherwise, the Company determines the reasons for the deviation and makes appropriate adjustments according to it.

Impairment reserve of cash and cash equivalents is immaterial as at 31 December 2022 and 2021, therefore it is not presented in the financial statements.

DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments included in financial assets at fair value through profit or loss in the statement of financial position comprise foreign currency forward contracts.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at fair value. All derivatives are carried as financial assets when their fair value is positive and as financial liabilities when their fair value is negative.

Changes in the fair value of derivatives are recognised immediately in profit or loss.

BORROWED FUNDS AND OTHER LIABILITIES

Borrowed funds and other liabilities are initially recognised at fair value. Subsequently they are stated at amortised cost and any difference between net proceeds and the redemption value is recognised in the statement of comprehensive income over the period of the borrowings, using the effective interest method.

LEASES

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

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

Lease liabilities are measured at the present value of the contractual payments due to the lessor over the lease term, with the discount rate determined by reference to the rate inherent in the lease unless (as is typically the case) this is not readily determinable, in which case the Company's incremental borrowing rate on commencement of the lease is used.

Right of use assets are initially measured at the amount of the lease liability, reduced for any lease incentives received, and increased for:

- Lease payments made at or before commencement of the lease;
- Initial direct costs incurred; and
- The amount of any provision recognised where the Company is contractually required to dismantle, remove or restore the leased asset.

Subsequent to initial measurement lease liabilities increase as a result of interest charged at a constant rate on the balance outstanding and are reduced for lease payments made. Right-of-use assets are amortised on a straight-line basis over the remaining term of the lease or over the remaining economic life of the asset if, rarely, this is judged to be shorter than the lease term. The right of use assets were depreciated for a period of 2-10 years during the current and comparable period.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2022

(In '000 GEL)

21. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

When the Company revises its estimate of the term of any lease (because, for example, it re-assesses the probability of a lessee extension or termination option being exercised), it adjusts the carrying amount of the lease liability to reflect the payments to make over the revised term, which are discounted at the updated discount rate that applied on lease commencement. The carrying value of lease liabilities is similarly revised when the variable element of future lease payments dependent on a rate or index is revised. In both cases an equivalent adjustment is made to the carrying value of the right-of-use asset, with the revised carrying amount being amortised over the remaining (revised) lease term.

REPOSSESSED COLLATERAL

Repossessed collateral represents non-financial assets acquired by the Company in settlement of overdue loans. The assets are initially recognised at fair value when acquired and included in property and equipment, investment property or inventories within other assets depending on their nature and the intention in respect of recovery of these assets and are subsequently remeasured and accounted for in accordance with the accounting policies for these categories of assets. Assets, that are classified as inventories, are valued at lower of book value and net realizable value.

PROPERTY AND EQUIPMENT

All property and equipment are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the statement of comprehensive income during the financial period in which they are incurred.

Depreciation is calculated using the straight-line method to allocate their cost or devalued amounts to their residual values over their estimated useful lives, as follows:

Group	Useful life (year)
Vehicles	5
Furniture	5
IT equipment	2-5
Leasehold improvements	7-10

Expenses related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization.

The assets' useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

IMPAIRMENT OF TANGIBLE AND INTANGIBLE ASSETS OTHER THAN GOODWILL

At each reporting date, the Company reviews the carrying amounts of its tangible 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. Where 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.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

21. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in the statement of comprehensive income.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years.

A reversal of an impairment loss is recognized immediately in the statement of comprehensive income.

TAXATION

The tax expense for the period comprises current and deferred tax. Tax is recognized in the statement of comprehensive income, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case the tax is also recognized in other comprehensive income or directly in equity, respectively.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the country where the Company operates and generates taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate based on amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit and loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized, or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity where there is an intention to settle the balances on a net basis.

SHARE CAPITAL, SHARE PREMIUM AND DIVIDENDS

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

When share capital is increased, any difference between the registered amount of share capital and the fair value of actual consideration received is recognized as share premium

Other reserves represent share issued by the Company and transferred to existing shareholders as an increase of share capital free of charge.

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

RECOGNITION OF INTEREST INCOME AND EXPENSE

Interest income and expense are recorded in the statement of comprehensive income for all debt instruments on an accrual basis using the effective interest method. This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents.

21. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

All other fees, commissions and other income and expense items are generally recorded on an accrual basis by reference to completion of the specific transaction assessed based on the actual service provided as a proportion of the total services to be provided.

Additional information for recognition of interest income is disclosed above, in the article “**INTEREST INCOME RECOGNITION**”.

STAFF COSTS AND RELATED CONTRIBUTIONS

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

RECOGNITION OF OPERATING AND ADMINISTRATIVE EXPENSES

Operating and administrative expenses are recognized in the statement of comprehensive income if there arises any decrease of future economic profit related to the decrease of an asset or increase of a liability that can be reliably assessed.

Operating and administrative expenses are recognized in the statement of comprehensive income immediately, if the expenses do not result in future economic profit any more, or if future economic profit do not meet or stop to meet the requirements of recognition as an asset in the balance sheet.

EVENTS AFTER THE REPORTING PERIOD

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

PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Contingent liabilities are not reflected in the financial statements, except for the cases when the outflow of economic benefits is likely to begin and the amount of such liabilities can be reliably measured. The information on contingent liabilities is disclosed in the Notes to the financial statements except for cases when the outflow of economic benefits is unlikely.

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

A provision is a liability of uncertain timing or amount. A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

A legal obligation is an obligation that derives from:

- (a) A contract (through its explicit or implicit terms);
- (b) Legislation; or
- (c) Other operation of law.

A constructive obligation is an obligation that derives from an entity's actions where:

- (a) By an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- (b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.