BACB
Sofia

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
as of 31 December 2018
/unaudited/

Accounting policy

The consolidated financial statements present the financial condition of the Group consisting of Bulgarian-American Credit Bank (BACB) and its subsidiaries as one reporting entity. The Group's accounting policy has been developed in compliance with the Bulgarian legislation regulating the accounting and banking activity, including the Accounting Act, the Law on Credit Institutions, BNB regulations and instructions and is disclosed in the 2017 audited consolidated financial statements.

The Group applies in 2018 consistently the accounting policy disclosed in the 2017 audited consolidated financial statements, considering the adoption of new or amended standards, effective for annual periods beginning on or after 1 January 2018, as disclosed in the last audited financial statements. The application of the new IFRS 9*: Financial instruments* as of 1 January 2018 has a significant impact on the 2018 consolidated financial statements, as disclosed further in these notes.

The unaudited consolidated financial statements as of 31 December 2018 have been prepared in all material aspects in accordance with the requirements of IAS 34 *Interim financial reporting.*

IFRS 9: Financial instruments

IFRS 9 is effective for annual periods beginning on or after 1 January 2018 and replaces IAS 39 Financial instruments: Recognition and measurement. The Group has not restated 2017 comparative information for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognized directly in retain earnings as of 1 January 2018.

Classification and measurement

IFRS 9 introduces a new approach to the classification of financial assets based on the combination of the cash flow characteristics of an asset and the business model under which a financial assets is held. The Group has developed a new Policy on the classification and measurement of financial instruments, reflecting the requirements of IFRS9. The policy provides a framework for:

a) Determining internal business models for managing financial assets – a business model is assessed at a level of aggregated portfolios of financial assets and reflects the management's expectations of how cash flows from the financial assets managed in the business model are utilized.

b) Analysis and evaluation of characteristics of contracted cash flows of financial instruments - The analysis is carried out at the level of a financial instrument and aims to ascertain that contractual cash flows represent only payments of principal and interest on the principal over the instrument's life. For standardized products, the analysis is carried out at the portfolio level. The analysis process is referred to as "SPPI (solely payments of principal and interest) test". For the purposes of the test, the Policy defines the terms "principal" and "interest".

For a basic lending agreement, the most important elements that determine the interest are the remuneration for the time value of money and credit risk, but the interest may include remuneration to cover other major risks associated with the holding of a financial asset for a certain period of time. In the analysis, the Group applies estimates and takes into consideration various relevant factors such as the currency of payments, the period for determining and paying the interest, and others.

c) Defines the approaches for initial classification and subsequent measurement.

As of 1 January 2018 the Group classifies and subsequently measures its financial assets in one of the following categories, which replaced the IAS 39 classification categories:

- Debt instruments measured at amortized cost
- Debt instruments measured at fair value through other comprehensive income, with subsequent reclassification of changes in profit or loss at derecognition
- Equity instruments at FVOCI without subsequent reclassification of changes in profit or loss at derecognition
- Financial assets at fair value through profit or loss – At present the Group does not classify any assets in this category.

The accounting treatment of financial liabilities remains substantially unchanged from that specified in IAS 39 except for the treatment of differences arising from changes in the own credit risk of financial instruments designated as at fair value through profit or loss. Under IFRS 9, these differences are recognized in other comprehensive income without subsequent reclassification in the income statement. At present the Group does not classify any liabilities in this category.

The adoption of IFRS 9 did not result in material changes in the classification and measurement of the Group's financial instruments and, accordingly, did not have a material effect on the statement of financial position and / or equity. Financial assets, which were carried at fair value before 1 January 2018 continue to be reported in the same way after the application of IFRS 9. The debt instruments classified as A-F-S under IAS 39, continue to be measured at fair value through OCI, as the business model's objective under which they are managed is to provide operating liquidity and is achieved by both - collecting contractual cash flows and sales. The Group has elected to irrevocably designate its equity investments, presented as AFS under IAS 39, as equity instruments at FVOCI. The Group manages its lending portfolio in a business model whose objective is achieved by collecting contractual cash flows. The analysis performed, shows that the characteristics of the contractual cash flows on the lending product meet the SPPI test, accordingly the loans continue to be reported at amortised cost under IFRS 9.

The carrying amounts of the financial instruments, reported under IAS 39 and the relevant classification under IFRS 9 as of 1 January 2018, are presented in the following table:

	IAS 39			IFRS 9	
Financial assets	**Category**	**Amount**	**ECL**	**Amount**	**Category**
Cash and balances with the Central Bank	Loans	91,608	-	91,608	Amortised cost
Loans and advances to banks	Loans	35,147	(12)	35,135	Amortised cost
Loans and advances to customers	Loans	391,710	(2,540)	389,170	Amortised cost
Financial assets available-for-sale					
- debt instruments	A-F-S	27,308	-	27,308	FVOCI
- equity instruments	A-F-S	738	-	738	FVOCI
Financial assets held-to-maturity	HTM	10,493	(27)	10,466	Amortised cost
Total financial assets		**557,004**	**(2,579)**	**554,425**	

Financial liabilities					
Deposits from banks	Amortised cost	10,783	-	10,783	Amortised cost
Deposits from customers	Amortised cost	511,018	-	511,018	Amortised cost
Debt securities in issue	Amortised cost	2,775	-	2,775	Amortised cost
Other borrowed funds	Amortised cost	15,812	-	15,812	Amortised cost
Total financial liabilities		**540,388**	-	**540,388**	

Impairment

IFRS 9 introduces a fundamentally new impairment model applicable to all financial assets, which are not measured at fair value through profit or loss, including undrawn loan commitments and issued financial guarantees. The new model is a model of expected credit losses, in contrast to the current one of the incurred credit losses, which requires earlier recognition of expected credit losses.

After 1 January 2018 the Group records an allowance for expected credit losses (ECL) for all its financial assets carried at amortised cost as loans or debt instruments, for debt instruments at FVOCI, together with loan commitments and financial guarantees. Equity instruments are not subject of credit impairment.

For the purpose of applying the requirements for impairment of financial assets in IFRS 9, a policy has been developed to assess changes in credit quality and to determine expected credit losses. The policy is a framework for defining:

a. Expected credit losses for 12 months or over the life of the instrument (lifetime ECL)

Expected credit losses (ECL) are recognized based on the probability of default in the next 12 months, unless there has been significant increase in credit risk since origination, in which case the lifetime expected credit losses are recognized. Expected credit losses for 12 months represent the portion of credit losses over the instrument's lifetime due to a default that may occur within 12 months after the reporting date.

b. Approach and models for impairment of financial assets - on a collective and individual basis

The parameters affecting the amount of expected credit losses are determined collectively or individually, depending on the type and nature of the financial instruments under consideration. The Group determines the ECL individually for all instruments whose risk classification is Stage 3 as well as credit exposures to corporate clients, loans to small and medium-sized enterprises exceeding a certain amount, investments in debt securities, exposures to banks as short-term receivables from banks, blocked as collateral for repo transactions and similar. Expected credit losses are measured on a collective basis for loans grouped in portfolios on the basis of common product characteristics such as consumer and mortgage loans to individuals, loans for the implementation of projects co-financed by Eurofunds, as well as loans to small and medium-sized enterprises below the specified amount. The collective approach is applied to exposures whose risk classification is Stage 1 or Stage 2.

c. Criteria for measuring increased credit risk

For the purpose of determining the loss allowance, the Group compares the credit risk levels, i.e. the probability of default occurring at the reporting date and at the date of the initial recognition of the asset. The analysis of the changes is based on available relevant information, which is accessible to the Group and which can be justified without the use of unnecessary resources. This information includes:

- historical data on the presentation of certain financial instruments or other financial instruments with similar risk characteristics,
- data on the current presentation of the instruments under review - number of days past due
- reasoned assumptions and expectations that are expected in the future to affect the credit risk of the assets under review

d. Relevant risk classification, according to the credit quality of financial assets

The analysis of changes in the credit quality of financial assets compared to origination, determines their risk classification in three main stages as well as subsequent recognition of impairment:

- Stage 1 (Regular Exposures) - Financial assets without an indication of an increase in credit risk relative to the initial valuation. The Group recognizes 12-month ECLs for financial assets classified in Stage 1. Interest income is recognized using the effective interest method on the gross carrying amount of the instrument.
- Stage 2 – here are classified financial assets with a significant increase in credit risk but without objective evidence of impairment / grounds for incurring losses (the exposure is not in default). The Group recognizes ECLs over the entire life of the instrument when classified in Stage 2. Interest income is recognized using the effective interest method on the gross carrying amount of the instrument.

- Stage 3 (credit-impaired exposures) - here are classified financial assets with a significant increase in credit risk and with objective evidence of impairment (exposures, for which there is "default"). The Group recognizes expected credit losses over the entire life of the instrument when classified in Stage 3. Interest income is recognized using the effective interest method on the net carrying amount of the instrument, i.e. after deducting the allowance for loss.

e. Determining and modeling risk parameters

The main risk parameters affecting the size of the expected credit loss are as follows:

- Probability of default (PD) - The probability that a counterparty fails to comply with the contractual terms related to debt repayment. For collectively measured exposures the Group maintains historical information on the migration of exposures from Stage 1 / Stage 2 to Stage 3 ("Non-performance") for each individual portfolio.

The value of 12M PD is determined based on the observed deterioration rates and is calculated as a moving average over a period of at least 2 years. For individually measured exposures, the value of 12M PD is determined by the assigned credit rating according to an internal model. Data on borrower rating changes over a one-year horizon is aggregated into transaction matrices, where for each rating scale 12M PD is calculated depending on the number of cases of default. The Group adjusts the estimated historical values of 12mPD to reflect the current or expected economic conditions that may differ from those during the historical periods analyzed.

- Exposure at default (EAD) – the potential exposure amount at the time of default. The amount of the exposure at default is determined by the type of loan, taking into account both the amount of the debt and the contracted unused amounts according to the expectation for future drawdown;
- Loss given default (LGD) – the ratio of the loss on an exposure, due to the default of the counterparty to the amount of the exposure at default. For determining the LGD, the Group calculates the potential loss that would arise if an exposure migrates to default and the only source for collecting the receivable is the disposal of the collateral. The loss is measured as the difference between the exposure at default (EAD) and the realisable value of the collateral, and is presented as a percentage of the EAD. The LGD is determined individually for each exposure in the loan portfolio, depending on the collateral, and regardless of whether the probability of default is measured on an individual or collective basis.

f) Methods for calculation and presentation of expected credit losses by types of financial assets

The estimate of expected credit losses is the average value weighted for the probability of default over the life of the instrument by assessing the range of possible outcomes. Credit losses are the present value of the difference between the cash flows due under the contract and the cash flows that the Group expects to receive, taking into account the amounts and when they are expected to be received over time. When estimating the expected cash flows, account shall be taken of the flow of collateral realization and other credit facilities that are an integral part of the contract. For the purpose of determining the expected credit losses, the difference between contractual and expected cash flows is discounted by the initial effective interest rate on the transaction or the effective interest rate adjusted for the credit losses for purchased adjusted effective interest rate for purchased or initially created financial assets with credit impairment. The change in the allowance for ECL is recognized as the result of impairment in profit or loss for the period.

For *financial assets measured at amortized cost*, as loans and debt instruments, the cumulative allowance reduces the carrying amount of the instrument in the statement of financial position. For *debt instruments measured at fair value in other comprehensive income*, the expected credit loss is part of the negative change in fair value due to increased credit risk. These assets continue to be carried at fair value in the statement of financial position and the accumulated loss allowance is presented in the statement of comprehensive income. Upon subsequent derecognition of the instrument, the cumulative allowance is recognized in the profit or loss for the period.

The effect of applying the new impairment model in IFRS 9 as of 1 January 2018, on the statement of financial position and equity, is summarized in the following table:

	EUR'000
Loans and advances to banks	(12)
Loans and advances to customers	(2,540)
Debt instruments at FVOCI	(27)
Impact on *Total assets*	**(2,579)**
Provisions	10
Impact on *Total liabilities*	10
Reserves and retained earnings	(2,650)
ECL allowance on Debt instruments at FVOCI	61
Impact on *Total liabilities and equity*	**(2,579)**

Hedge accounting

IFRS 9 introduces significantly altered model of hedge accounting, with expanded information that should be disclosed on risk management activity. The Group does not report active financial instruments for which a hedge relationship is determined, accordingly the initial application of the hedge requirements under IFRS 9 did not affect the financial statements.

Selected Notes

Cash and balances with the Central Bank

	31-12-2018	31-12-2017
Cash on hand	5,241	4,853
Balances with the Central Bank	113,232	86,755
Cash and balances with the Central Bank	118,473	91,608

As of 31 December 2018 the balances with the Central Bank include the amount of EUR 2,026 thousand (2017: EUR 472 thousand) representing BACB's participation in the Guarantee Mechanism of a system processing card-based payment transactions – BORICA.

Cash and cash equivalents reported in the consolidated statement of cash flows

For consolidated statement of cash flows purposes cash and cash equivalents include:

	31-12-2018	31-12-2017
Cash and balances with the Central Bank	118,473	91,608
Loans and advances to banks maturing within 3 months	34,341	35,147
Less: Minimum required reserve	(50,681)	(42,654)
Less: Other restricted funds	(1,554)	(1,461)
Cash and cash equivalents	100,579	82,640

The blocked funds on accounts with other banks serve as security for financial guarantees or letter of credits issued by the Group. The amounts, securing payments to card operators, are determined based on the volume of transactions in a certain period of time and these have the nature of guarantees, which can be used to cover payments made, in case of non-performance by the Bank.

Loans and advances to banks

	31-12-2018	31-12-2017
Current accounts with other banks	5,010	21,011
Deposits with other banks	27,777	12,675
Other restricted funds	1,554	1,461
Loans and advances to banks	34,341	35,147
Less: ECL allowance	(23)	-
Loans and advances to banks, net	34,318	35,147

Loans and advances to customers

The information on loans and advances to customers as of 31 December 2018 is presented in the tables bellow:

	31-12-2018	31-12-2017
Loans and advances to customers	516,069	450,340
Less: ECL allowance (2017:Provisions for impairment)	(52,253)	(58,630)
Loans and advances to customers, net	463,816	391,710

Type of Customer	31-12-2018	31-12-2017
Individuals	41,263	30,974
Corporate	474,806	419,366
Loans and advances to customers	516,069	450,340
Less: ECL allowance (2017:Provisions for impairment)	(52,253)	(58,630)
Loans and advances to customers, net	463,816	391,710

Before 1 January 2018 the Group presented loans and advances under IAS 39. Under IAS 39 as loans and advances to customers were classified non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and advances were carried at amortized cost, reflecting provisions for impairment under IAS 39.

After 1 January 2018 the Group applies the requirements of IFRS 9 and measures it loans at amortised cost only if they meet the two conditions stated in IFRS 9 as discussed in the note above:

- The loan is managed in a business model whose objective is to hold financial assets to collect contractual cash flows
- The contractual terms of the financial asset give rise to cash flows that are solely payments of principle and

The Group has performed analysis of its lending portfolio and determined that as of 1 January 2018 all of the loans met the two conditions. Accordingly the loans are classified as financial assets measured at amortised cost. All loans and advances are recorded on the balance sheet when cash is disbursed to borrowers. The Group records the unutilized loan commitments off the balance sheet.

After 1 January 2018 the Group applies the expected credit loss model in IFRS 9 on its loans and advances, as described in the accounting policy note. The risk classification of loans and advances is set in 3 stages depending on risk characteristics and credit risk level.

Information on risk classification of loans and advances and accumulated ECL allowance as of 31 December 2018 is presented in the tables bellow:

Exposures to:	Stage 1	Stage 2	Stage 3	2018 TOTAL	2017 TOTAL
Corporates, assessed on an individual basis	315,674	12,412	114,032	442,118	132,172
Corporates, assessed on a collective basis	27,749	1,689	3,251	32,689	287,193
Individuals, assessed on an individual basis	-	-	2,597	2,597	3,784
Individuals, assessed on a collective basis	38,049	616	-	38,665	27,191
Loans and advances to customers, net	381,472	14,717	119,880	516,069	450,340

ECL on Exposures to:	Stage 1	Stage 2	Stage 3	2018 TOTAL	2017 TOTAL
Corporates, assessed on an individual basis	698	1	48,704	49,403	57,216
Corporates, assessed on a collective basis	80	41	802	923	52
Individuals, assessed on an individual basis	-	-	1,539	1,539	1,122
Individuals, assessed on a collective basis	284	104	-	388	240
ECL allowance (2017:Provisions for impairment)	1,062	146	51,045	52,253	58,630

**The information as of 31 December 2017 is presented under IAS 39.*

During the reporting period management decided to write off the balance sheet unrecoverable receivables in the amount of EUR 10,837 thousand against accumulated ECL allowance. The ECL expense on loans recognized in profit or loss for the period is EUR 1,780 thousand.

As of 31 December 2018 Loans and advances to customers include finance lease receivables in the total net amount of EUR 15,986 thousand (2017: 3,015). The tables below contain information, regarding the lease receivables, as of 31 December 2018 and 31 December 2017:

2018

	Up to 1 year	1 to 5 years	Over 5 years	Total
Gross investment in finance leases	2561	9,182	7,771	19,514
Unearned future income on finance leases	(751)	(2,161)	(616)	(3,528)
Net minimum lease payments	1,810	7,021	7,155	15,986

2017

	Up to 1 year	1 to 5 years	Over 5 years	Total
Gross investment in finance leases	530	1,749	1,485	3,764
Unearned future income on finance leases	(163)	(420)	(166)	(749)
Net minimum lease payments	367	1,329	1,319	3,015

Investment in securities, that are not measured at fair value in profit or loss

Before 1 January 2018 the Group classified its investments in securities under IAS 39 in two categories – financial assets available for sale (AFS) and financial assets held to maturity (HTM), depending on the management objectives at inception. The financial assets available for sale were subsequently measured at fair value with changes recognised in OCI. The HTM financial assets were measured at amortised cost.

After 1 January 2018 the Group applies the requirements of IFRS 9 and classifies the investments in securities in one of the following categories, based on the business model within they are managed and their contractual cash flow characteristics:

- Debt instruments measured at FVOCI, with subsequent reclassification of changes in profit or loss at derecognition
- Equity instruments at FVOCI without subsequent reclassification of changes in profit or loss at derecognition
- Debt instruments measured at amortized cost

The following table presents information on the investments in securities as of 31 December 2018 and 2017:

	31-12-2018	31-12-2017
Financial Assets Available-for-Sale		
BGN Bulgarian Government Bonds	-	13,890
EUR Bulgarian Government Bonds	-	10,185
EUR Corporate Bonds	-	3,233
Equity securities	-	738
Financial Assets Available-for-Sale	-	28,046
Incl. collateral on attracted funds from the state		
BGN Bulgarian Government Bonds	-	*2,875*
EUR Bulgarian Government Bonds	-	*2,420*
Total	-	*5,295*
Debt instruments at FVOCI		
BGN Bulgarian Government Bonds	11,439	-
EUR Bulgarian Government Bonds	9,859	-
EUR Corporate Bonds	4,137	-
Debt instruments at FVOCI	25,435	-
Incl. collateral on attracted funds from the state		
BGN Bulgarian Government Bonds	*1,480*	-
EUR Bulgarian Government Bonds	*1,010*	-
Total	*2,490*	-
Equity instruments at FVOCI		
BGN Investments	365	-
USD Investments	445	-
Equity instruments at FVOCI	810	-
Financial Assets Held-to-Maturity		
BGN Bulgarian Government Bonds	-	10,493
Debt instruments at amortised cost		
Български държавни облигации в евро	10,363	-
Минус: Коректив за кредитни загуби	(26)	-
Debt instruments at amortised cost	10,337	-
Incl. collateral on attracted funds from the state		
EUR Bulgarian Government Bonds	*10,363*	*10,493*

Unrealized gains and losses arising from changes in the fair value of debt investments at FVOCI are recognized in equity, net of taxes. When the securities are derecognized, the related accumulated fair value adjustments are included in the profit or loss for the period. During the reporting period the Group recorded a gain of EUR 82 thousand on disposal of such financial assets.

The debt instruments at FVOCI are subject of impairment under IFRS 9 model. The ECLs on debt instruments at FVOCI do not reduce the carrying amount of the assets in the statement of financial position and they remain at fair value. The accumulated ECLs allowance on such instruments is recognised in OCI with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to profit or loss upon derecognition of the asset. As of 31 December 2018 all debt instruments at FVOCI are classified in Stage 1 and the cumulative ECL allowance is EUR 60 thousand.

As of 1 January 2018 the Group has elected to designate its previous AFS equity investments as equity instruments at FVOCI, due to the fact that they are not held for trading. Unrealized gains and losses arising from changes in fair value of equity investments at FVOCI are recognized in revaluation reserve and are not recycled in profit or loss upon derecognition of the asset. The equity instruments at FVOCI are not subject of impairment under IFRS 9 and no ECL allowance is recognised for such assets.

As of 31 December 2018 the Group reports equity investments in the amount of EUR 810 thousand (2017: 738 EUR) representing shareholding in a special investment company and shares in Visa Inc in the form of convertible preferred stocks class C. The fair value of investments in equity securities is determined based on evaluation models using indirect market information.

An evaluation model is used for measuring the Group's investment in equity securities of a special investment company as there is no active market data for the securities. The model is based on evaluation of its assets and expected cash flows from their sale. As of 31 December 2018 the carrying amount of the investment is EUR 364 thousand (2017: 364 EUR).

As of 31 December 2018 the fair value of Visa Inc convertible preferred stocks class C is estimated at EUR 445 thousands (2017: 372 EUR). The model for valuation of Visa investment is based on the information for the potential conversion ratio to Visa Inc class A common stocks, information for the market value of Visa Inc class A common stocks and takes into account the lack of liquidity due to the restrictions of transfer within 12 years period after closing.

Before 1 January 2018 the Group presented its investments in Bulgarian government bonds with fixed or determinable payments and fixed maturity, which the Group had the intention and ability to hold to maturity, as financial assets held-to-maturity. Such assets were stated at amortised cost. After 1 January 2018 the management has determined that these investments meet the conditions in IFRS 9 and therefore they continue to be presented at amortised cost.

The amortised cost is calculated using the effective interest rate and taking into account any discount or premium and fees on acquisition. The amortization is recognized as interest income in the statement of income for the period. The interest income on debt instruments at amortised cost for the period 1 January – 31 December 2018 amounts to EUR 151 thousand.

The debt instruments at amortised cost are subject of impairment under IFRS 9 model. The ECLs on debt instruments at amortised cost reduce the carrying amount of the assets in the statement of financial position, with a corresponding charge to profit or loss. As of 31 December 2018 all debt instruments at amortised cost are classified in Stage 1 and the cumulative ECL allowance is EUR 26 thousand.

As at 31 December 2018 some of BACB's investments in securities are pledged as collateral for attracted funds from the state budget, as disclosed in the table above.

Government Bonds sold under agreements to repurchase at a specific future date (repo deals) are not derecognized from the statement of financial position. The corresponding cash received is reported as deposit to banks or customers depending on the counterparty in the contract. The difference between the sale and repurchase prices is treated as interest expense in the income statement and accrued over the life of the agreement.

Investment properties and assets held for sale

Under certain circumstances or following the foreclosure on loans that are in default the Group acquires properties that are held for future disposal. Such assets are classified as held for sale or as investment properties depending on management intention and possibility for near realization.

Investment properties are properties (land or building or both) held primarily to earn rentals or for capital appreciation or both and are not involved in the operating activity of the Group. Investment properties are measured initially at cost, including transaction costs. For their measurement after initial recognition the Group elected to apply the fair value model. The fair value model in accordance with the *IAS 40 Investment properties* requires the investment properties to be stated at their fair value. No depreciation is accrued. A gain or loss arising from a change in the fair value of investment property is recognized in profit or loss for the period in which it arises. The fair value is measured in accordance with *IFRS 13 Fair value measurement* and *IAS 40* states some additional requirements in respect of valuation of investment properties.

During the reporting period the Group sold properties classified as investment properties with a carrying amount of 1,649 thousand and acquired new investment properties in the amount of EUR 159 thousand. Real estate for the amount of EUR 14,926 thousand presented previously as assets held for sale is reclassified to investment properties. In 2018 the Group has signed two contracts for transferring the right to construct over an own land plots in Sofia. In return BACB will receive residential and commercial units in the building to be constructed by the contractor. The units are expected to be realized through sale, therefore the assets are reclassified out of investment property category and the amount of EUR 5,995 thousand is presented as assets under development and future sale in Other assets item in the statement of financial position.

The book value of investment properties held at 31 December 2018 is EUR 44,588 thousands (2017: 37,135).

Real estate and other tangible assets acquired from disposal of collateral on foreclosed loans or assets acquired exclusively with a view to subsequent disposal in the near future are classified as assets held for sale and are initially measured at cost. The classification of properties as assets held for sale happens at initial recognition and depends on the Management intention and their plan for assets disposal. After initial recognition, such assets are carried at the lower of their carrying amount or at their fair value less the cost for the transaction. No depreciation is accrued on such assets.

As of 31 December 2018 the balance sheet value of assets held for sale is EUR 12,850 thousand (2017: 28,069). The Group classified newly acquired properties in the amount of EUR 3,977 thousand as assets held for sale during the reporting period and sold properties with a carrying value of EUR 4,257 thousand (EUR 2,698 thousand under finance lease). Assets held for sale in the amount of EUR 14,926 thousand were reclassified as investment properties.

The acquisition of properties in the amount of EUR 3,774 thousand was settled against direct reduction of loan portfolio.

Tangible and intangible assets

Initially the items of tangible or intangible assets are recognized at cost, including all transaction costs. There are two alternatives for measurement after initial recognition – the cost model and the revaluation model. The Group presents its own office buildings at revalued amount and all other tangible and intangible assets using the cost model. During the reporting period no changes have been made to the expected terms and methods of depreciation.

As of 31 December 2018 the balance sheet value of the tangible and intangible assets is EUR 4,372 thousand (2017: 4,427) and EUR 454 thousand (2017: 412) respectively.

Investments in subsidiaries - consolidation

As of 31 December 2018 BACB has two subsidiaries subject to consolidation – BACB Finance EAD and BACB Trade EAD.

BACB Finance EAD is a fully owned subsidiary providing financial services and acting as supporting company for the banking activity. The subsidiary orientates its core business in providing finance lease, trade finance and consumer loans to customers using its own funds or BACB financing if needed. In 2015 BACB Finance EAD was registered as a financial institution under the requirements of BNB Regulation #26.

BACB Trade EAD is a joint stock company 100% owned by BACB registered in June 2013 with main activity financial and business consulting.

BACB prepares its consolidated financial statements in accordance with the applicable accounting standards. At acquisition the subsidiaries are accounted for by applying the purchase method according to the requirements of *IFRS 3 Business combinations.* Goodwill acquired in a business combination is presented in the consolidated balance sheet as an asset which is not amortized. Goodwill is tested for impairment annually in accordance with *IAS 36 Impairment of assets.* All inter-company transactions, balances and unrealized gains on inter-company transactions are eliminated in consolidation process.

Deposits from customers

The information on deposits from customers as of 31 December 2018 is presented in the tables bellow:

By type of currency	31-12-2018		31-12-2017	
	Demand deposits	Term deposits	Demand deposits	Term deposits
in BGN	82,216	184,088	71,386	155,525
in EUR	41,765	234,507	23,956	215,210
in USD	11,596	48,817	7,311	36,507
Other	802	343	753	370
Total	136,379	467,755	103,406	407,612

By type of customer	31-12-2018		31-12-2017	
	Demand deposits	Term deposits	Demand deposits	Term deposits
Non-bank financial institutions	10,598	7,309	3,007	8,352
Corporate	98,673	114,560	75,930	80,149
Individuals	27,108	345,886	24,469	319,111
Total	136,379	467,755	103,406	407,612

Other borrowed funds

The amounts payable under agreements for short-term or long-term financing that are not deposits from customers are presented in the statement of financial position as *Other borrowed funds.*

Borrowed funds are initially recognized at cost, i.e. fair value of consideration received at the time the liability has been incurred, net of transaction costs. Borrowings are subsequently stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the income statement over the period of the borrowing using the effective interest method.

In July 2015 the Group signed an agreement with the Bulgarian Development Bank (BDB) for participation in its partnership program for indirect financing of micro, small and medium-sized companies. The program is developed to provide low-interest rate financing to Bulgarian companies and support the business in creating new jobs and investing in regions with high unemployment. According to the agreement BDB will provide to the Group up to BGN 35 million credit line for financing of eligible projects under the program.

In November 2018 The Group signed a new agreement with BDB which is the first agreement for BDB under the EU COSME+ Program to support the small and medium-sized business in Bulgaria. COSME+ Program is implemented with the support of the European Fund for Strategic Investments. Its purpose is to facilitate the access to long-term and cheap financing for SME companies while reducing the requirements towards the collateral under the loans. Under the agreement the Group will receive up to 10 million EUR for a 10 year period for providing investment loans, working capital and guarantees to its clients.

As of 31 December 2018 the long-term borrowed funds amount to EUR 18,708 thousand (2017: 15,812) and represent amounts due to BDB under the agreements as described.

Debt Securities in Issue

In September 2014 BACB issued a floating rate mortgage bond with a nominal value of EUR 5 million. The bond principal is amortizing over five year term. According to the bond repayment schedule payment of principal of EUR 1,550 thousand and interest was made in 2018.

As of 31 December 2018 the Group's obligations related to debt securities in issue are EUR 1,616 thousand (2017: 2,775), including accrued interest.

Share Capital and reserves

During the reporting period there are no changes to the BACB registered share capital. After the Bank's shares have been listed on the Bulgarian Stock Exchange–Sofia in April 2006 the ownership structure has been diversified among local and international investors. As of 31 December 2018 CSIF AD is the largest shareholder owning 61.43% of the registered share capital.

Related Party transactions

According to the IAS 24 *Related party disclosures*, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. The entities in the Group consider as related parties the members of their key management personnel and entities owned, controlled or significantly influenced by such persons.

The Group enters into transactions with related parties in the normal course of business. These transactions are carried out at market rates and include mainly loans and deposits. The related parties with which the Bank carried out transactions during 2018 are as follows:

Related party	**Relationship**
CSIF AD	shareholder controlling the bank
Other related entities	entities that are controlled or significantly influenced by CSIF AD or a person of management personnel
Management	Members of the Supervisory Board and the Management Board of BACB

The transactions with the consolidated subsidiaries are eliminated for the purpose of this report.

The information on related parties' transactions and the related income and expense as of 31 December 2018 is summarized as follows:

EUR'000	Balance at 31 December 2018	Net income /(expense) on transactions with related parties
Loans and advances to customers	3,078	139
Deposits from customers-CSIF AD	4,958	1
Deposits from customers-management	11,719	(58)
Deposits from customers-other related entities	3,367	42
Other operating income	-	22
Other operating expense	-	(162)
Administrative expenses – services	-	(629)
Off-balance sheet liabilities		
Bank guarantees	473	
Unutilized commitments on loans	31	

Taxation

Income tax expense is based on taxable profit for the year for any of the consolidated entities and includes deferred taxation. The corporate tax rate for 2018 is 10%.

Other taxes that are not directly attributable to the income for the period are recognized as operating expense.