

**FUND FOR LOCAL AUTHORITIES AND
GOVERNMENTS IN BULGARIA – FLAG JSC**

ANNUAL DIRECTORS' REPORT AND
INDIVIDUAL FINANCIAL STATEMENTS
31 December 2019

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General information

Board of directors:

Dobromir Prodanov Simidchiev - Chairperson
Plamen Todorov Iliev – member
Dobrinka Veselinova Krasteva – member
Evgeni Dimitrov Stoev - member
Nadiya Yordanova Dankinova - member and Executive Director
Valeriya Svetoslavova Kalcheva - Bochukova – member
Yulia Petkova Tsoleva–Ilieva – member

Registered address

Sofia, 17-19 St. Saint Cyril and Methodius Street

Business address

1 Sixth September Street, Fourth Floor, Sofia

Legal advisor

Law Firm „Lozanova and Groysman”

Servicing banks

Unicredit Bulbank AD
UBB EAD
DSK Bank EAD
Expressbank AD

Auditor

Baker Tilly Klitou and Partners OOD
1000 Sofia
5, Stara Planina Str., 5th floor

ANNUAL REPORT

**on the principal activities of
Fund for Local Authorities and Governments in Bulgaria – FLAG JSC in 2019**

This Report has been drawn up in compliance with the requirements laid down in Article 23 of the Regulation laying down the rules for exercising the rights of the government in state-owned commercial undertakings and the Commercial Act.

I. Overview

1. General information about the Fund

Fund for Local Authorities and Governments in Bulgaria – FLAG JSC is a financial institution, created on the basis of Ordinance № 4 of Council of Ministers of Republic of Bulgaria dated 7 March 2007 as an instrument of Government policy for Regional development.

FLAG is an independent legal entity with the principal activity of providing financing for municipal infrastructure projects and other projects, as well as co-financing the preparation and implementation of EU projects.

The vision of the Company is to present new opportunities for financing of municipalities' projects, including via broadening the scope of the eligible programs, to manage new financial instruments and to take part in the establishment of such, with the goal of creating of adequate financial products, which meet the needs of the Bulgarian municipalities.

2. Management

The affairs of the Fund are managed by a Board of Directors (BoD), which is composed of seven members and is responsible for all ongoing activities of the Fund.

In 2019 eighteen board meetings were held.

During the reporting period, no changes in the composition of the BoD were made.

According to the Bulgarian legislation, the Management is required to prepare annual individual financial statements that provide a true and fair view on the financial position of the Company as at the year end, its financial results and cash flows.

Management confirms that adequate accounting policies have been consistently applied in preparing the annual individual financial statements as of 31 December 2019, and reasonable and prudent judgments, assumptions and estimates have been made.

Management also acknowledges that it has applied the existing accounting standards and the individual financial statements have been prepared under the going concern principle.

Management is responsible for the proper keeping of accounting records, for the appropriate asset management and for the undertaking of all necessary measures for avoidance and detection of fraud and other irregularities.

Directors' Report

3. Human resources

In 2019 the Fund has a core staff with appropriate qualifications and experience for the performance of its lending and other activities.

The Fund operates through its administration, which includes the following structure:

- Directorate „Finance, financial instruments and risk management“;
- Directorate „Lending and monitoring“;
- Directorate „General Administration“;
- Internal Audit Unit.

The legal services, as well as the maintenance of the computer network, are outsourced.

II. Report on activities

1. Main results from lending activities in 2019

In 2019 the Fund received 90 credit requests from 41 municipalities and 1 Local initiative group for total value of BGN 106,088 thousand. In 2019 the Fund reviewed and evaluated 86 loan applications, all of which were approved. The applications were for a total value of BGN 107,961 thousand, supporting the implementation of projects for BGN 312 million.

The average percentage share of the credit in the total budget of the financed project is 34.6%. In 2019 the "typical" approved credit granted to municipalities for bridge financing averages BGN 1,370 thousand and is with an average maturity of 12 months. The average approved credit repaid with own funds is BGN 752 thousand with an average maturity of 67 months.

The table below presents information for the credits approved in 2019 by type of credits and source of repayment of the principal.

Type of credits	Number of credits in 2019	Value of approved credits (in thousand BGN)
Long-term	26	36 630
incl. bridge financing	12	25 560
incl. own contribution	14	11 070
Short-term	60	71 331
incl. bridge financing	58	70 371
incl. own contribution	2	960
Total	86	107 961

The following two tables present the structure of the lending operations of the Fund for 2019 on the basis of credits approved during the year by operational programme and source of repayment of the principal.

Directors' Report

			Amount in BGN thousand	
By Operational programme	Number of credits	Total amount (in BGN thousand)	Min.	Max.
<i>OPRD</i>	30	37 471	186	6 262
<i>OPE</i>	14	26 226	200	5 269
<i>RDP</i>	17	15 982	60	2 961
<i>CBC</i>	23	27 924	129	5 683
<i>OPHRD</i>	1	175	175	175
<i>"Beautiful Bulgaria" project</i>	1	183	183	183

			Amount in BGN thousand	
By source of repayment	Number of credits	Total amount (in BGN thousand)	Min.	Max.
Operational programmes	70	95 930	60	6 262
Own contribution	16	12 031	129	2 038

In 2019 the funds utilised under credit agreements signed with third parties amounted to BGN 95,121 thousand, while the repayments amounted to BGN 86,152 thousand.

The active credits as of 31.12.2019 are 248 amounting to BGN 178,235 thousand. Credits are split by types as follows:

- Bridge financing – BGN 91,538 thousand (45,97 % from active loans)
- Own financing – BGN 86,697 thousand (54,93 % from active loans)

2. Summary of results from activity by years

The table below shows the development of the activity of FLAG since 2009 when the application for credits started up until the end of 2019. Typical for the company's activity is that it is closely linked to the progress of the Operational programmes. This creates some cyclicity in the search for funding. Other factors affecting the volume of activity are: the timeframe within which the Managing Authorities verify expenditure, the availability of other sources of financing - interest-free loans provided by the MF, commercial bank financing at favorable interest rates linked to the observed changes in the financial market in recent years, new financial instruments that provide the necessary co-financing / OPE 2014-2020 and the financial instrument for projects under the Axis-Water/.

Approved credits – value (in BGN `000) and number

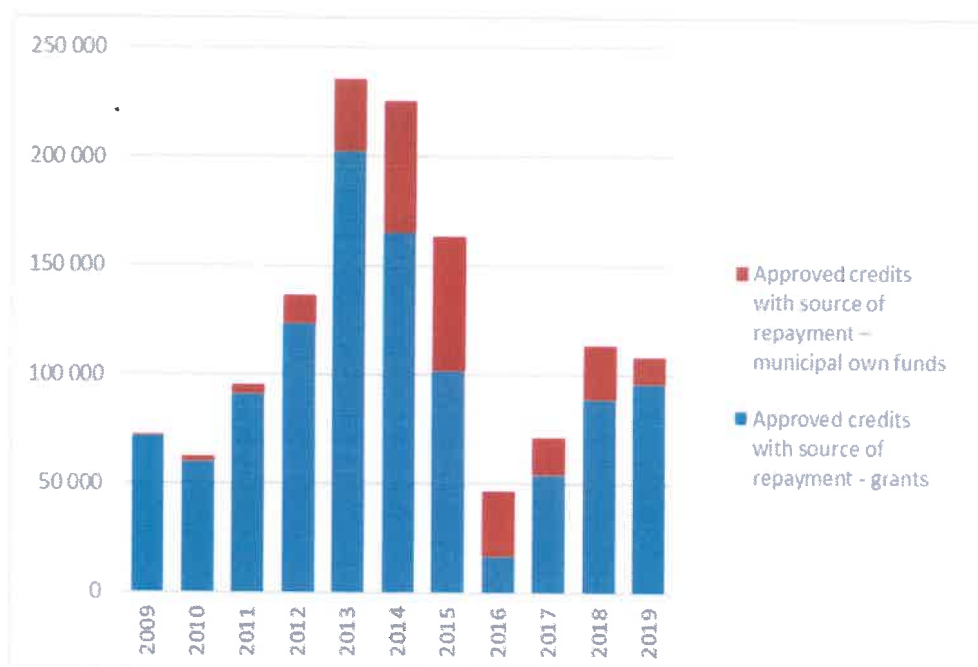
Year	Sum of approved long-term credits	Sum of approved short-term credits	Total amount of approved credits	Number of approved long-term credits	Number of approved short-term credits	Total number of credits
2009	11 290	61 486	72 776	10	60	70
2010	17 043	45 742	62 785	13	43	56
2011	44 695	50 748	95 443	44	62	106
2012	42 398	94 162	136 560	55	98	153
2013	117 170	117 886	235 056	95	153	248
2014	158 399	67 158	225 557	81	61	142
2015	65 462	97 653	163 115	50	74	124
2016	36 306	10 318	46 624	15	17	32
2017	41 099	30 475	71 574	27	42	69
2018	49 015	64 367	113 382	26	75	101
2019	36 630	71 331	107 961	26	60	86
Total	619 507	711 326	1 330 833	442	745	1 187

Approved credits, according to the source of repayment, are shown in the table below. It is evident that at the beginning of each programming period there is not a great demand for loans to finance own participation. The reason for this is that the co-financing is provided until the end of the project implementation. During the current programming period, co-financing is envisaged to be provided mainly under OP Environment where projects are not yet in an advanced stage of implementation. It should also be taken into account that a separate financial instrument has been created for this co-financing. This is the reason for the decrease in demand for loans with own participation.

Approved credits according to source of repayment (BGN `000)

	Approved credits with source of repayment - grants	Approved credits with source of repayment – municipal own funds
2009	71 846	930
2010	60 430	2 355
2011	91 384	4 059
2012	123 562	12 998
2013	202 468	32 588
2014	165 216	60 341
2015	101 936	61 179
2016	16 794	29 830
2017	54 563	17 011
2018	89 011	24 371
2019	95 930	12 031
Total	1 073 140	257 692

Directors' Report



III. FINANCIAL POSITION

1. Capital structure

The Fund implements its credit activity through its equity and through borrowed funds. The ratio between own and borrowed capital is maintained within limits, according to the ratio indicated in Section 4.

The table below reflects changes in the Fund's capital over the years.

The table shows that the company increases its equity each year, except for 2011 and 2012, when a large dividend amount was paid.

Capital (BGN '000)

	Equity	Borrowed capital	Total
2008	30 602	-	30 602
2009	63 153	51 574	114 727
2010	65 927	69 133	135 060
2011	65 628	69 349	134 977
2012	64 628	63 675	128 303
2013	65 182	86 708	151 890
2014	95 743	114 389	210 132
2015	97 152	207 057	304 209
2016	98 579	88 178	186 757
2017	99 945	84 188	184 133
2018	101 492	109 763	211 255
2019	103 009	123 352	226 352

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2. Revenue structure for 2019

The Company's revenues for 2019 amount to BGN 6,363 thousand. The revenue structure for 2019 is shown in the table below, with 87% of the total revenue of the company being generated by the lending activity.

	REVENUES	Amount in BGN thousand	Share in total revenue in %
1	Interest income from loans granted	5 529	86,89%
2	Penalty interest on loans granted	7	0,11%
3	Fees on loans granted	562	8,83%
4	Income from management and commitment fees on Fund for Sustainable Cities loans	2	0,03%
5	Dividend income	261	4,10%
6	Other income	2	0,03%
	Total	6 363	100%

3. Structure of expenses for 2019

The Company's expenses for 2019 amount to BGN 2 716 thousand (excluding the income tax expense).

The table below presents the company's expenses by type for 2019.

	EXPENSES	Amount in BGN thousand
1	Remunerations	723
2	Social securities	104
3	Accounting and Audit services	15
4	Legal and consulting services	8
5	Other hired services	47
6	Office maintenance	11
7	Communication services	7
8	Expenses for materials	11
9	Other expenses (taxes, subscription, representative expenses, etc.)	64
10	Depreciation costs	73
11	Bank charges	818
12	Interest expenses on loans	823
13	Exchange rate differences	11
14	Impairment of loans granted	260
	Total	2 975

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The table below presents the company's expenses for 2019 by type and their share in total expenses:

	EXPENSES	Amount in BGN thousand	Share in total expenses in %
1	Maintenance Costs	93	3,43%
2	Hired services	70	2,58%
3	Depreciation	73	2,69%
4	Remunerations - staff, BoD (incl. social securities)	827	30,46%
5	Bank fees including Managing bank fees	829	30,53%
6	Interest expenses	823	30,31%
	Total expenses	2 715	100%

4. Financial result for the year

	Amount in BGN thousand
Total revenues	6 363
Total expenses	(2 975)
Profit before tax	3 388

The profit before taxes for 2019 of FLAG amounts to BGN 3,388 thousand. The net profit of the company amounts to BGN 3,075 thousand.

5. Financial ratios

In connection with the risk management policies and signed bank loan agreements and in order to guarantee its financial stability and ensure the effectiveness of its operations, FLAG has to maintain certain financial ratios, as follows:

- Ratio of overdue loans (loans 90 days or more past due to current exposure of all loans);
- Debt coverage ratio (debt/equity);
- Ratio of liquid assets to total assets (available cash and bank deposits with a remaining maturity of 90 days or less to total assets).

The table below presents the reported values of these ratios as of 31.12.2019.

№	Indicators	Requirements	Results as of 31.12.2019
1	Ratio of overdue loans: <i>the coefficient of the current exposure of loans past due 90 days or more in the portfolio of the Borrower no greater than 5% of the total current exposure on all loans in the portfolio.</i>	Not more than 5%	0 %
2	Ratio debt to equity: <i>"Debt" - financial debt of the Borrower; to "Equity" - Capital of the Borrower.</i>	Not more than 2.5	1.19
3	Ratio of liquid assets to total assets: <i>Liquid assets - cash and bank deposits (including in BNB) with remaining maturity of 90 days or less.</i>	Not less than 5%	11,47 %

6. Dividends and distribution of profit

In 2019 with a decision of the BoD from March 2019 the Company formed a “Reserve fund” amounting to BGN 288 thousand and after that it distributed dividends to the Government amounting to BGN 1,558 thousand, which were fully paid during the year.

IV. Participation of FLAG in the management of other financial instruments

1. Operational agreements for financial instruments Fund for Urban Development for Sofia and the South

In the procedure for selection of financial intermediaries conducted by FMFIB for the implementation of the Urban Development Fund instrument under OP Regions in Growth 2014-2020, DZZD Sustainable Cities Fund, in which partners are FLAG, FSUD, UBB AD and BCO, has been appointed as a contractor for the Urban Development Fund financial instrument for Sofia and Southern Bulgaria. On 20 September 2018, the Operational Agreements for the Assignment of the Management of the two Urban Development Funds was concluded.

In 2019, the two funds commenced their operations and fulfilled the targets set in terms of contracting and meeting certain indicators. As of December 31, 2019 the set milestones have been met.

2. Financing provided to the subsidiary FSUD EAD for the implementation of the JESSICA and UDF financial instruments

2.1. Credit line for implementation of Operational Agreement of 30 May 2012 under OPRD 2007 - 2013

With contract dated 28.11.2012 FLAG granted credit line to its subsidiary, FSUD, amounting to BGN 24,500 thousand for the purpose of investing in urban projects under JESSICA initiative.

In 2019, two utilisations were made with a total amount of BGN 254 thousand. As of December 31, 2019, FSUD's obligation to FLAG amounts to BGN 22 178 thousand, i.e. nearly 95% of the funding provided has been invested in eligible projects.

2.2. Credit Line for Implementation of Operational Agreements from 20 September 2018 under OPRD 2014 - 2020

On 28 November 2018, FLAG EAD signed a new credit line agreement with Fund for Sustainable Urban Development EAD for the amount of BGN 15 000 000 and maturity up to 31 December 2043 with the aim of providing the necessary co-financing for eligible projects under the two new urban development funds (UDF Sofia and UDF South). Eight utilizations, totaling BGN 387 thousand were made in 2019. The current exposure as of December 31, 2019 is BGN 387 thousand. With the launch of the UDF Sofia and UDF South instruments in early 2019, the disbursements are in an early stage. A more active investment of the funds provided is forthcoming in 2020. 20 projects for nearly BGN 60 million have been approved. The related funding to be provided by FSUD under the FLAG credit line is BGN 2.5 million.

3. New investment projects

With a decision of the Board of Directors of 02.10.2019, FLAG was given a mandate to negotiate with the EIB for the structuring of a new financial instrument - the Bulgarian Investment and Coordination Platform for Urban Development. The platform is a continuation and development of the city funds as well as the activities of FLAG and will provide an opportunity for financing important public and public-private projects that have no other source of funding. By the end of 2019, the Fund was actively working to collect the necessary information to provide to the EIB. A list of potential projects was drawn up and presented. The platform has the potential to become an example of partnership and cooperation, both at local and European level, and to create a bridge between the two programming periods in order to ensure sustainable local development.

V. Information and publicity

For information, publicity and transparency, FLAG maintains a website with up-to-date and complete business information.

Representatives of the Fund participated in meetings, discussion forums and trainings of the National Association of Municipalities in the Republic of Bulgaria, presenting the funding opportunities offered by the FLAG and the Urban Development Funds.

In May 2019, representatives of the Fund participated in the XXII National Meeting of Financiers from the Municipalities in the Republic of Bulgaria, organized by the NAMRB.

On June 11, 2019, a National Roundtable on Financing Energy Efficiency in Bulgaria was held. Mrs. Nadia Dankinova, Executive Director of Fund FLAG, took part in it and presented the perspectives to the financial sector in financing energy efficiency projects.

The Final Conference for 2015 - 2019, organized by the NAMRB, was held in the period 27-29 June 2019. Representatives of Fund FLAG, FSUD, as well as partners in the DZZD FSC, participated in the Municipal EXPO, which was held during the conference, presenting the possibilities for financing the municipal revenue generating projects for urban development and tourism, through financial instruments.

Representatives of Fund FLAG participated in the XI-th National Meeting of Experts on Programs and Projects in the Municipalities held in the period 13-15 November 2019. During the meeting the progress made on the implementation of the main programs was reported. Discussions held covered possible cooperation for minimizing past mistakes, ways to reduce the administrative burden, good practices, as well as the possibilities for alternative financing of municipal projects.

FLAG, as part of DZZD Sustainable Cities Fund, participated and presented itself within the FI-Campus 2019, which took place between 4-6 December 2019 in Brussels. The three-day forum is organized by the European Commission (EC) and the European Investment Bank (EIB) and brings together professionals from different fields of the European Union dealing with financial instruments, co-financed by the European Structural and Investment Funds (ESIF). The video for three urban development projects in Sofia, two funded by the Fund for Sustainable Urban Development (FSUD) and one by the Sustainable Cities Fund (FUG), was named among the three best in the fi-compass Showcase Award 2019.

VI. Monitoring

A system for periodic and ongoing monitoring has been set up. In 2019, intensive communication with the Managing Authorities of all the programs under which the municipalities requested financing,

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continued and covered the implementation of their projects, as well as the status of problematic projects already financed by FLAG. A regular link has been established to exchange information on payments and verifications made, irregularities found and others. An ongoing portfolio review and analysis of the clients' financial position are carried out in order to take the necessary actions for ensuring the regular servicing of the loans and avoiding overdue payments.

VII. Borrowed capital

The total contracted long-term credit resource as of 31.12.2019 amounts to BGN 209 million, broken down by types of loans and by creditors as follows:

- UniCredit Bulbank AD, long-term loan with repayment plan from 22 November 2016 - BGN 40,000 thousand
- UBB AD, revolving loan from 22 November 2016 - EUR 20,000 thousand / BGN 39 116 thousand /
- DSK Bank EAD, revolving loan from 17 May 2017 - BGN 40,000 thousand
- Unicredit Bulbank AD, revolving loan from 31 August 2018 - BGN 30,000 thousand
- UBB AD, revolving loan from 12 October 2018 - BGN 40,000 thousand
- Expressbank AD, revolving credit from 01.11.2018 - BGN 20,000 thousand.

As of 31 December 2019, the current credit exposure is as follows:

- UniCredit Bulbank AD - BGN 22,857 thousand
- UBB AD / 2016/- EUR 20,000 thousand / BGN 39,116 thousand /
- DSK Bank EAD - BGN 21,218 thousand
- UniCredit Bulbank AD /2018 / - BGN 30,000 thousand
- UBB AD / 2018 / - BGN 10,481 thousand
- Expressbank AD – no balance.

The total current exposure of borrowed capital as of 31.12.2019 is BGN 124 million.

VIII. Additional information to the report for 2019

1. Investments

As of December 31, 2019 FLAG JSC is the sole shareholder in “Fund for sustainable urban development” JSC, which is registered in the Registry agency on 23.04.2012.

As of December 31, 2019, FLAG holds a 5% interest in the jointly controlled company incorporated under the Obligations and Contracts Act “Fund for Sustainable Cities”.

2. Information under Art. 187 d and Art. 247 of the Commercial Act

In 2019 no shares of the Company have been issued, acquired or transferred.

The remuneration of the key management personnel for 2019 amounted to BGN 168 thousand.

As of 31.12.2019 the members of the Board of Directors have the following participation within the meaning of Art. 247, ph. 2, p. 4 of the CA:

- Nadya Yordanova Dankinova – executive director and member of the Managing Board of “Fund for sustainable urban development” JSC;
- Dobromir Simidchiev – executive director and member of the Board of Directors of "HIDROLIA" AD, shareholder in "TYUBOR" OOD with 50% share;

3. Branches and subsidiaries

In 2012, the company has established a subsidiary – “Fund for sustainable urban development” JSC, 100% owned by “Fund for local authorities and governments in Bulgaria – FLAG” JSC with share capital of BGN 5,000 thousand.

As of 31.12.2019 the company has no branches.

4. Financial risk management and financial instruments

The main financial liabilities of the Company include interest-bearing loans and borrowings, and trade and other payables. The main purpose of these financial instruments is to provide financing for the operations of the Company. The Company has financial assets such as loans granted and cash and cash equivalents.

In 2019 as in prior years the Company does not own and does not trade with derivative financial instruments.

The main risks arising from the financial instruments of the Company are interest rate risk, liquidity risk, currency risk and credit risk. The policy that the management of the Company applies to manage these risks is summarized below.

Interest rate risk

The Company is exposed to risks from changes in market interest rates, mainly regarding its long-term financial liabilities with variable (floating) interest rate. The Company's policy is to manage interest expenses by providing loans with floating interest rates.

Liquidity risk

The effective management of the Company's liquidity presumes that sufficient working capital will be available mainly through maintaining a given amount of money on deposit. A cash flow movement plan is prepared based on short-term budgets as well as based on long-term planning.

Currency risk

The Company has no purchases, sales and lending in foreign currencies and the loans received are denominated in EUR or BGN. Currently the company does not have loans granted in euro.

Credit risk

Credit risk is the risk that the clients / counterparties will not be able to pay in full the amounts due to the Company within the envisaged / agreed deadlines. As at the end of 2019 the remaining liability of third parties to the Company amounts to BGN 123,862 thousand. As at 31.12.2019 the Company has receivables on loan granted to related parties amounting to BGN 22,571 thousand.

Directors' Report

Credit risk management in FLAG EAD in 2019 is carried out by the “Lending and monitoring” Directorate and is monitored simultaneously by the Executive Director and the Board of Directors. The credit risk management function is to ensure the implementation of an appropriate investment policy in respect of the funds available and respectively, the compliance of this policy with the related procedures and controls for current monitoring of the respective loan or receivable.

The credit risk exposure is managed through an ongoing analysis of counterparties' ability to meet their contractual obligations to pay interest and principal, as well as by setting appropriate credit limits. In addition, there is ongoing monitoring of the existence of concentration of receivables in a specific counterparty, and in the case of identifying one - the respective counterparty is subject to special ongoing supervision. The accrued impairment of loans granted as at 31 December 2019 is based on the Funds' Credit loss impairment policy, developed in accordance with IFRS 9 Financial Instruments.

5. Research and development activity

In 2019, the Company has not been engaged in research and development activities.

6. Significant events after the reporting period

With a decision from 10.01.2020 the Board of Directors of FLAG EAD approved the participation of FLAG EAD in the company incorporated under the Obligations and Contracts Act “Fund for Local Development” for the purposes of supporting the “Bulgarian Platform for Urban Investments and Consultations” as a framework for cooperation between the European Investment Bank, the Fund Manager of Financial Instruments in Bulgaria and FLAG EAD.

On January 17, 2020, a Memorandum of Understanding was signed between the European Investment Bank, the Fund Manager of Financial Instruments in Bulgaria EAD and FLAG EAD.

On March 11, 2020, the World Health Organization declared a coronavirus pandemic, and on March 13, 2020, the Bulgarian government declared a state of emergency.

The potential impact on the Company's operations as a result from these events could include:

- Considering the specifics of the client base – disruption of the regularity of municipalities' revenues resulting in difficulty paying the regular loan installments
- Increase of the extraordinary expenses of the municipalities related to urgent actions for implementation of the measures for protection of citizens, disinfection, social problems, etc.
- Delayed implementation of projects approved for funding and extension of utilization deadlines

Based on the publicly available information at the date of the separate financial statements, management has considered possible adverse scenarios regarding the anticipated development of the COVID-19 pandemic and the impact on the fund and the economic environment in which it operates. The measures taken by the state and the government's actions are taken into account and in response to the expected ones, the management of the company has taken actions aimed at limiting the risks, which include:

- Actions aimed at the staff of the Fund (ensuring the highest levels of disinfection in the office, securing a workplace that prevents the possibility of contamination, providing opportunities for working remotely - "work from home")
- Actions aimed at ensuring the continuity of the work of the suppliers (the administration/document processing is ensured through the use of forwarding companies, as well as the supply of the necessary materials for normal functioning)

Directors' Report

- Actions aimed at borrowers (maintaining constant communication, discussing options for extending the repayment period when needed, responding quickly to other indications related to decisions and changes in loan terms - extending the utilization period)
- Actions to ensure the adequate capital and liquidity position of the Fund in order to fulfil as much as possible the strategic and business plans for the coming quarters.

Due to the exceptional dynamics of the situation related to the development of the disease, the expected changes in the reactions of the Bulgarian and other governments, the initiated measures can have an uncertain result. There is a risk that, in the face of a severe but realistic long-term blocking scenario, management plans may not be sufficient to mitigate operational and liquidity risks. The management is monitoring the situation and is ready to implement additional measures, initiatives and policies if necessary.

To date, management believes that the going concern principle is appropriate in the preparation of these separate financial statements, as the Company has access to financing and sufficient liquid resources to continue its operations as a going concern.

No other events occurred after December 31, 2019, which would require additional adjustments and / or disclosures in the Company's separate financial statements for the year ended December 31, 2019.

IX. The business plan of FLAG for 2020

In 2020, the main goals of the FLAG are:

- Maintaining the market share in the provision of financing to municipalities for the implementation of projects funded with the support of EU funds. Maintaining and developing market advantages related to short periods for review and approval, reduced administrative burden, flexible solutions and providing the necessary assistance in structuring loans and preparing loan application documents.

- Successful implementation of the goals and indicators set out in the Operational Agreements with the Fund Manager of Financial Instruments in Bulgaria EAD, through support and assistance to DZZD FSC and FSUD EAD.

- Creation and launch of a quality and attractive financial product for the successful start and development of the Bulgarian Investment and Coordination Platform for Urban Development together with the European Investment Bank and the Fund Manager of Financial Instruments in Bulgaria EAD.

1. Overall assessment of loan demand

Estimates of the loan demand in 2020 are based on:

- Analysis of concluded credit agreements, which will continue to be serviced in 2020;
- Information from ISMM - indicative lists and payment schedules of OPRD and OPE; RDP information and FM of EAA and NFM, as well as OPHRD and CBC;
- Targeted consultation and information from municipalities on their attitudes and planned demand for FLAG funding;
- A set of assumptions based on the FLAG experience from 2009 to 2019;
- Analysis of the financial instruments, the stage at which they are located and the goals that are set for the financial intermediaries;
- Analysis of the market environment, the positive sides of the fund, the risks it faces and the opportunities for future development.

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Summary assessment for the expected new credit resource in 2020 in BGN thousand is presented in the table below:

Programs	Bridge financing	Co-financing	Total
OPRD	32 000 000	5 000 000	37 000 000
OPE	31 302 000	26 497 000	57 799 000
CBC	10 400 000	500 000	10 900 000
OPHRD	30 000 000	4 000 000	34 000 000
Other	5 200 000	500 000	5 700 000
Total	108 902 000	36 497 000	145 399 000

2. Financial income and result

On the basis of assumptions made, analysis of operations and estimates of income and expenditure, an operating profit, before tax and impairment loss, in the amount of BGN 3,116 thousand has been projected for 2020.

.....
 Nadya Dankinova – Executive director
 25.03.2020



*This document is a translation of the original text in Bulgarian,
in case of divergence the Bulgarian original is prevailing.*

INDEPENDENT AUDITOR'S REPORT

To the sole shareholder of FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD

Opinion

We have audited the individual financial statements of *FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD* („the Company“), which comprise the individual statement of financial position as at 31 December 2019, and the individual statement of comprehensive income, individual statement of changes in equity and individual statement of cash flows for the year then ended, and the notes to the individual financial statements, including summary of significant accounting policies.

In our opinion, the accompanying individual financial statements give true and fair view of the financial position of the Company as at 31 December 2019, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs), as adopted by European Union.

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 Individual Financial Statements* section of our report. We are independent of the Company within the meaning of the *International Code of Ethics for Professional Accountants (including International Independence Standards)* issued by International Ethics Standards Board for Accountants (IESBA Code) and the Independent Financial Audit Act (IFAA) applicable to our audit of the individual financial statements in Bulgaria and we have also fulfilled our other ethical responsibilities in accordance with the requirements of IFAA and IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information, different from the individual financial statements and auditors report

Management is responsible for the other information. Other information consists of Annual individual management report, prepared by management in accordance with Chapter Seven from Accountancy Act, but does not include the financial statements and our auditor's report.

Our opinion on the individual financial statements does not cover the other information and we do not express any form of assurance thereon, unless if it is explicitly stated in our report, and to the extent it is stated.

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

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Additional matters for reporting required by Accountancy Act

In addition to our reporting requirements in accordance with ISA, related to the Annual activity report, we have performed the procedures added to those required by the ISAs, in accordance with guidelines of the professional organization of Certified Public Accountants and Registered Auditors in Bulgaria - Institute of Certified Public Accountants (ICPA). These procedures comprise checks on the existence, as well as checks of the form and content of this other information with the purpose to support us in forming of opinion, whether the other information includes the disclosures and reporting requirements, provided in Chapter Seven of the Accountancy Act, applicable in Bulgaria.

Opinion in accordance with Art. 37, para. 6 of Accountancy Act

On the basis of the procedures performed, our opinion is that:

- a) The information, included in the Annual individual management report for the financial year is consistent with the individual financial statements for the same reporting period.
- b) The Annual individual management report has been prepared in accordance with the requirements of Chapter Seven from the Accountancy Act.

Responsibilities of Management for the Individual Financial Statements

Management is responsible for the preparation and fair presentation of these individual financial statements in accordance with IFRS, as adopted by EU 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.

During the preparation of these individual financial statements management has the responsibility to make an assessment regarding Company's ability to continue as going concern, and to disclose when it is applicable, questions related to the going concern assumption and to using the accounting framework based on going concern assumption, unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Individual Financial Statements

The objectives of our audit are to obtain reasonable assurance about whether the individual 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 Independent Financial Audit Act and 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 individual financial statements.

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

- Identify and assess the risks of material misstatement of the individual 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 entity'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 individual 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 individual financial statements, including the disclosures, and whether the individual financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the management, 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.



Ivaylo Yanchev
Registered auditor

25 March 2020
Sofia



Krassimira Radeva – Managing Director
Baker Tilly Klitou and Partners OOD

5, Stara Planina str., Floor 5
Sofia, 1000, Bulgaria

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
INDIVIDUAL STATEMENT OF COMPREHENSIVE INCOME**

For the year ended 31 December 2019

	Notes	2019 BGN'000	2018 BGN'000
Interest income	3.1	5,536	5,236
Interest expenses and charges	3.2	(1,652)	(1,646)
Dividend income		261	143
Other operating income	3.3	566	406
Net operating income		4,711	4,139
(Expenses for)/Reintegrated impairment of loans granted	9	(260)	147
Payroll expenses	3.4	(827)	(705)
Depreciation expenses	7	(73)	(27)
Other operating expenses	3.5	(163)	(229)
Profit before tax		3,388	3,325
Income tax expense	4	(313)	(300)
Profit for the year		3,075	3,025
Other comprehensive income for the year, net of taxes		-	-
Total comprehensive income for the year, net of taxes		3,075	3,025

These individual financial statements were authorized for issue by the Board of Directors on 25 March 2020.

The notes on pages 20 to 47 are an integral part of these individual financial statements.


Nadya Yordanova Dankinova
Executive Director





Kalinka Ruskova Todorova
Chief Accountant

In accordance with an Independent Auditor's Report:


Ivaylo Yanchev
Registered auditor
25 March 2020




Krassimira Radeva
Managing director
Baker Tilly Klitou and Partners OOD

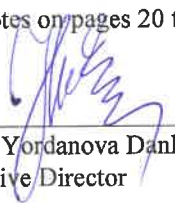
**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
INDIVIDUAL STATEMENT OF FINANCIAL POSITION**


As of 31 December 2019

	Notes	31 December	
		2019 BGN'000	2018 BGN'000
ASSETS			
Cash and cash equivalents	5	26,025	18,468
Receivables and prepayments	6	37	39
Loans granted	9	173,115	164,389
Loans granted to related parties	9,17	22,571	23,671
Deferred tax assets	4	2	2
Plant and equipment	7	15	36
Right of use assets	7	93	-
Software	7	3	6
Investment in subsidiary	8.1	5,000	5,000
Investment in joint venture	8.2	10	-
TOTAL ASSETS		226,871	211,611
EQUITY AND LIABILITIES			
Liabilities			
Payroll and social security payables	11	114	102
Tax liabilities	12	73	41
Other liabilities	13	323	213
Loans payable	10	123,352	109,763
Total liabilities		123,862	110,119
Equity			
Share capital	14.1	90,000	90,000
Statutory reserves	14.2	3,000	2,712
Retained earnings		10,009	8,780
Total equity		103,009	101,492
TOTAL EQUITY AND LIABILITIES		226,871	211,611

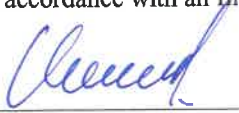
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The notes on pages 20 to 47 are an integral part of these individual financial statements.


Nadya Yordanova Dankinova
Executive Director


Kalinka Ruskova Todorova
Chief Accountant

In accordance with an Independent Auditor's Report:


Ivaylo Yanchev
Registered auditor
25 March 2020


Krassimira Radeva
Managing director
Baker Tilly Klitou and Partners OOD

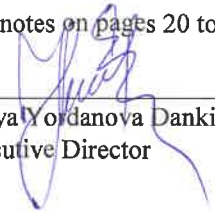
**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
INDIVIDUAL STATEMENT OF CHANGES IN EQUITY**

For the year ended 31 December 2019

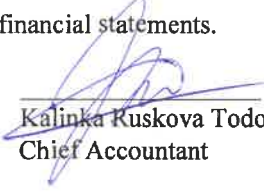
	Share capital (Note 14.1)	Retained earnings	Statutory reserves (Note 14.2)	Total
	BGN'000	BGN'000	BGN'000	BGN'000
As at 31 December 2017	90,000	7,490	2,455	99,945
<i>Effects from the application of IFRS 9 on 1 January 2018</i>	-	(179)	-	(179)
As at 1 January 2018	90,000	7,311	2,455	99,766
Profit for the year	-	3,025	-	3,025
Total comprehensive income	-	3,025	-	3,025
Dividend distribution	-	(1,299)	-	(1,299)
Transfer to reserves	-	(257)	257	-
As at 31 December 2018	90,000	8,780	2,712	101,492
As at 1 January 2019	90,000	8,780	2,712	101,492
Profit for the year	-	3,075	-	3,075
Total comprehensive income	-	3,075	-	3,075
Dividend distribution	-	(1,558)	-	(1,558)
Transfer to reserves	-	(288)	288	-
As at 31 December 2019	90,000	10,009	3,000	103,009

These individual financial statements were authorized for issue by the Board of Directors on 25 March 2020.


The notes on pages 20 to 47 are an integral part of these individual financial statements.


Nadya Yordanova Dankinova
Executive Director





Kalinka Ruskova Todorova
Chief Accountant

In accordance with an Independent Auditor's Report:


Ivaylo Yanchev
Registered auditor
25 March 2020




Krassimira Radeva
Managing director
Baker Tilly Klitou and Partners OOD

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
INDIVIDUAL CASH FLOW STATEMENT**

For the year ended 31 December 2019

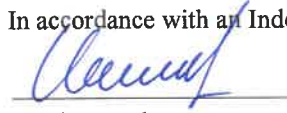
	Notes	2019 <i>BGN'000</i>	2018 <i>BGN'000</i>
Cash flows from operating activities			
Proceeds from interest on bank deposits		-	1
Loans granted to municipalities		(95,121)	(83,991)
Loans repaid by municipalities		86,152	58,020
Loans granted to related parties		(641)	(3,370)
Loans repaid by related parties		1,741	1,327
Interest received on loans granted		5,521	5,234
Payments to suppliers		(618)	(692)
Payments to personnel and for social security		(815)	(690)
Other proceeds and payments, net		523	275
Income tax paid		(281)	(311)
Net cash flows used in operating activities		(3,539)	(24,197)
Cash flows from investing activities			
Purchase of plant, equipment and software		(4)	(27)
Dividends received		261	143
Investment in joint venture		(10)	-
Net cash flows from investing activities		247	116
Cash flows from financing activities			
Loans received		34,148	47,946
Repayment of loans		(20,496)	(22,341)
Dividends paid		(1,558)	(1,299)
Interest paid		(815)	(877)
Fees and commissions paid		(382)	(316)
Payments under lease agreements		(48)	-
Net cash flows from financing activities		10,849	23,113
Net increase/(decrease) in cash and cash equivalents		7,557	(968)
Cash and cash equivalents at the beginning of the period	5	18,468	19,436
Cash and cash equivalents at the end of the period	5	26,025	18,468


These individual financial statements were authorized for issue by the Board of Directors on 25 March 2020. The notes on pages 20 to 47 are an integral part of these individual financial statements.


Nadya Yordanova Dankinova
Executive Director


Kalinka Ruskova Todorova
Chief Accountant

In accordance with an Independent Auditor's Report:


Ivaylo Yanchev
Registered auditor
25 March 2020


Krassimira Radeva
Managing director
Baker Tilly Klitou and Partners OOD

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2019

1. Corporate information

The individual financial statements of FLAG JCS (the Company) for the year ended 31 December 2019 were authorized for issue by a decision of the Board of Directors dated 25 March 2020.

FLAG JSC is a joint-stock company incorporated by virtue of Decision No 1 dated 4 July 2007 under company file 10151/2007 of the Sofia City Court, having its seat in the city of Sofia, Sofia Region, Bulgaria. The financial year of the Company ends on 31 December.

These financial statements are individual financial statements and have been prepared in accordance with the requirements of the law effective in Bulgaria.

The company has made arrangements for the process of preparing its consolidated financial statements for 2019 in accordance with IFRS, as adopted by the European Union, in force for 2019. In line with the tentative schedule the management expects that the consolidated report will be finalized and approved by the Board of Directors by 25.05.2020 at the latest and will thereafter be available to third parties.

The core activity of the Company includes financing of municipal infrastructure and other projects and co-financing the development and implementation of projects of the European Union.

As at 31 December 2019 the shareholders of the Company include:

Republic of Bulgaria represented by the Minister of Regional Development and Public Works - 100 percent.

2.1 Basis of preparation of individual financial statements

These individual financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union (EU). They have been prepared under the historical cost convention.

The preparation of financial statements in conformity with IFRS requires the use of certain accounting estimates and assumptions. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 2.2 o).

New and amended standards and interpretations

During the current year, the Company has adopted all new and amended IFRSs, which are related to its activities and are effective for the reporting period beginning on January 1, 2019.

At the date of preparation of the financial statements, the IASB / IFRIC has issued standards and interpretations that are not yet effective. Some of them have been adopted by the European Union and others not yet.

Standards, issued by IASB/IFRIC and endorsed by EU, but not yet effective and not early adopted

Standards issued by IASB/IFRIC but not yet effective and not early adopted up to the date of issuance of the Company's financial statements are listed below.

- Amendments to IAS 1 "Presentation of financial statements" and IAS 8 "Accounting policies, changes in accounting estimates and errors": Definition of Material (in force for annual periods beginning on or after 1 January 2020) - The management does not expect the adoption of these amendments to have a significant effect on the financial statements of the Company.
- Amendments to References to the Conceptual Framework for financial reporting (in force for annual periods beginning on or after 1 January 2020) - The management does not expect the adoption of these amendments to have a significant effect on the financial statements of the Company.
- Amendments to IFRS 9, IAS 39 and IFRS 7: Interest Rate Benchmark Reform (in force for annual periods beginning on or after 1 January 2020) - The management does not expect the adoption of these amendments to have a significant effect on the financial statements of the Company.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2019

2.1 Basis of preparation of individual financial statements (continued)

New standards and amendments, issued by IASB but not yet endorsed by the EU

At present, the IFRS endorsed by EU are not materially different from those approved by the IASB, with the exception of the following new standards, amendments to existing standards and new interpretations, which have not yet been endorsed by EU as at the date of these financial statements (the effective dates stated below refer to full IFRS):

- IFRS 17 "Insurance Contracts" (in force for annual periods beginning on or after 1 January 2021) - The management does not expect the adoption of this standard to have a significant effect on the financial statements of the Company.
- Amendments to IFRS 3 Business Combinations (in force for annual periods beginning on or after 01.01.2020) - The management does not expect the adoption of these amendments to have a significant effect on the financial statements of the Company.
- Amendments to IAS 1 "Presentation of Financial Statements: Classification of Liabilities as Current and Non-current" (in force for annual periods beginning on or after 01.01.2020) - The management does not expect the adoption of these amendments to have a significant effect on the financial statements of the Company.

The Company expects that the adoption of these standards and amendments to existing standards will not have a material effect on the Company's financial statements in the year of their first-time adoption.

2.2 Summary of significant accounting policies

a) Foreign currency conversion

The financial statements are presented in Bulgarian Leva (BGN), which is the Company's functional and presentation currency. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into the functional currency at the end of each month by applying the closing exchange rate published by the Bulgarian National Bank for the last working day of the respective month. All foreign currency differences are recognised in the statement of comprehensive income. Non-monetary assets and liabilities which are measured in terms of historical cost in a foreign currency are translated into the functional currency using the exchange rate as at the date of the initial transaction (acquisition).

b) Revenue recognition

Interest income

Interest income is included in the statement of comprehensive income (in profit or loss for the year), as it arises and consists of interest income on loans granted and term deposits.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of the financial assets, except for financial assets that are credit impaired (Stage 3), for which interest income is calculated by applying the effective interest rate to their amortized value (the gross carrying amount adjusted for impairment).

c) Recognition of interest expenses and fees

Interest expenses and charges are included in the statement of comprehensive income (in profit or loss for the year), when incurred, separately from interest income and comprise: interest expense on borrowings, bank fees on loans and guarantees, net loss from exchange differences.

d) Taxes

Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantially enacted by the reporting date.

Management analyses the individual items of the tax return for which the applicable tax provisions are subject to interpretation and recognises provisions where appropriate.

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS**

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

d) Taxes (continued)

Current income tax is recognised directly in the equity (and not in the statement of comprehensive income) where the tax relates to items that have been recognised directly in the equity.

Deferred income tax

Deferred income tax is provided using the liability method on all temporary differences at the reporting date arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognized for all taxable temporary differences, except:

- when the deferred tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences cannot be controlled by the Company and it is not probable that the temporary differences will reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised, except:

- when the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred income tax assets is reviewed by the Company at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

Deferred tax relating to items recognized outside profit or loss is recognized outside profit or loss. Deferred tax items are recognized in correlation to the underlying transaction either in other comprehensive income or directly in equity.

Deferred income tax assets and deferred income tax liabilities are offset by the Company only if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

e) Financial instruments – initial recognition and subsequent measurement

A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS**

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

e) Financial instruments – initial recognition and subsequent measurement (continued)

• **Financial assets**

Initial recognition, classification, and measurement

Upon initial recognition, financial assets are classified in three groups, according to which they are subsequently measured at amortized cost, at fair value through other comprehensive income, and at fair value through profit or loss. The Company initially measures financial assets at fair value and, in the case of financial assets not reported at fair value through profit or loss, plus any direct transaction costs. Exceptions are trade receivables that do not contain a significant financing component - they are measured at the transaction amount determined in accordance with IFRS 15.

The classification of financial assets upon initial recognition depends on the characteristics of the contractual cash flows of the respective financial asset and the business model within which the asset is held. In order to be classified and measured at amortized cost or at fair value through other comprehensive income, the contractual terms of the financial asset should give rise to cash flows that are solely payments of principal and interest (SPPI) on the outstanding amount of the principal. For this purpose, a SPPI test is performed on an instrument by instrument basis.

The Company's business model reflects how it manages its financial assets in order to generate cash flows. The business model determines whether the cash flows result from collecting contractual cash flows, selling the financial assets, or both.

Subsequent measurement

For the purposes of subsequent measurement, the Company's financial assets are classified in the following category:

- Financial assets at amortized cost (debt instruments)

The Company measures financial assets at amortized cost when both of the following conditions are met:

- the financial asset is held and used within a business model that is designed to hold it in order to collect the contractual cash flows from it, 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 outstanding principal amount.

Financial assets at amortized cost are subsequently measured using the effective interest rate method. They are subject to impairment. Gains and losses are recognized in the statement of comprehensive income (in profit or loss for the year), when the asset is written-off, modified or impaired.

The Company's financial assets at amortized cost include: cash and cash equivalents at banks, loans granted to related and third parties.

Interest bearing loans and other financial resources granted

All loans and other financial resources granted are initially presented at cost (nominal amount), which is taken to be the fair value of the amount provided in the transaction, net of the direct costs associated with those loans and resources provided. After initial recognition, interest-bearing loans and other resources granted are subsequently measured and presented in the statement of financial position at amortized cost, determined by applying the effective interest rate method. They are classified in this group because the Company's business model is solely with the purpose of collecting contractual cash flows from the principal and the interest. The amortized cost is calculated taking into account all types of fees, commissions and other amounts associated with these loans. Gains and losses are recognized in the statement of comprehensive income (in profit or loss for the year) as income (interest) or expense during the amortization period or when the receivables are repaid, written off or reduced.

Interest income is recognized in accordance with the stage in which the relevant loan or other receivable is allocated on the basis of the effective interest rate method.

Derecognition

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognized from the statement of financial position of the Company when:

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

e) Financial instruments – initial recognition and subsequent measurement (continued)

- the rights to the cash flows from the assets have expired, or
- the Company has transferred the contractual rights to receive the cash flows from the asset, or the Company has assumed a contractual obligation to remit those cash flows without significant delay to a third party under a transfer arrangement wherein: a) the Company has transferred substantially all the risks and rewards of ownership of the asset; or b) the Company has neither transferred nor retained substantially all the risks and rewards of ownership of the asset but has not retained control of it.

When the Company has transferred its rights to receive cash flows from the asset or has entered into a transfer agreement, it assesses whether and to what extent it retains the risks and rewards of ownership. When the Company has neither transferred nor retained substantially all the risks and rewards of ownership of the financial asset nor transferred control of the financial asset, it continues to recognize the transferred asset to the extent of its continuing involvement in the asset. In this case, the Company also recognizes the related obligation. The transferred asset and the related liability are measured on a basis that reflects the rights and obligations that the Company has retained.

Continuing involvement in the form of a guarantee on the transferred asset is measured at the lower of: the initial carrying amount of the asset and the maximum amount of remuneration that the Company may be required to pay.

Impairment of financial assets

The Company recognizes an allowance for expected credit losses on all debt instruments that are not measured at fair value through profit or loss. Expected credit losses are calculated as the difference between the contractual cash flows due under the terms of the contract and all cash flows that the Company expects to receive discounted at the original effective interest rate. Expected cash flows also include the cash flows from the sale of the collateral held or other credit enhancements that form an integral part of the terms of the contract.

For the calculation of the expected credit losses on loans granted, including cash and cash equivalents at banks, the Company applies the general approach for impairment set by IFRS 9. Under this approach, the Company applies a "three stage" impairment model based on changes in the credit quality of the financial asset subsequent to initial recognition.

Expected credit losses are recognized in two stages:

- a. A financial asset that is not credit impaired at its initial origination / acquisition is classified in Stage 1. These are loans granted to borrowers with low risk of default, with healthy and stable key financial and non-financial indicators, regularly serviced, and without any overdue amounts. Since initial recognition, the credit risk and credit quality of these financial assets are subject to continuous monitoring and analysis. Expected credit losses on financial assets classified in Stage 1 are determined on the basis of credit losses that could arise from possible events of nonperformance that could occur within the next 12 months of the life of the asset (12-month expected credit losses for the instrument).
- b. In the event that the credit risk of a financial instrument has increased significantly since initial recognition and as a result its performance deteriorates, it is classified in Stage 2. The expected credit losses of the financial assets classified in Stage 2 are determined for the total remaining life of the asset (lifetime expected credit losses).

The management of the Company has developed a policy and a set of criteria for analyzing, identifying and assessing the occurrence of "significant increase in the credit risk".

In the event that the credit risk of a financial asset increases to the point indicating that a default event has occurred, the financial asset is considered impaired and is classified in Stage 3. At this stage, the losses incurred for the entire remaining life (term) of the respective asset are calculated and determined.

The management of the Company has performed relevant analyzes, based on which it has defined a set of criteria for non-performing events in accordance with the specifics of the respective financial instrument. One of these is contractual payments that are over 90 days past due, unless there are circumstances that render this claim rebuttable for certain financial instruments. Meanwhile, other events, based on internal and external information, are also monitored for indication that the debtor is not able to repay all outstanding contractual amounts, incl. after taking into account all credit reliefs provided by the Company.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

e) Financial instruments – initial recognition and subsequent measurement (continued)

The Company adjusts the expected credit losses, determined based on historical data, with estimated macroeconomic indicators that are found to be correlated and are expected to affect the amount of expected credit losses in the future.

Derecognition

Impaired financial assets are written off when there is no reasonable expectation of collection of contractual cash flows.

- **Financial liabilities**

Initial recognition, classification, and measurement

The Company's financial liabilities include trade and other payables, loans and other borrowed funds. Upon initial recognition, they are usually classified as liabilities at amortized cost.

Initially, all financial liabilities are recognized at fair value, and in the case of loans and borrowings and trade and other payables, net of directly related transaction costs.

Subsequent measurement

Subsequent measurement of financial liabilities depends on their classification. They are usually classified and measured at amortized cost.

Classification groups

Loans received and other borrowed funds

In the statement of financial position, all loans and other borrowed financial resources are initially presented at acquisition cost (nominal amount), which is taken to be the fair value of the transaction proceeds net of the direct costs associated with those loans and borrowed resources. After initial recognition, interest-bearing loans and other borrowed funds are subsequently measured and presented in the statement of financial position at amortized cost, determined by applying the effective interest rate method. The amortized cost is calculated taking into account all types of fees, commissions and other expenses, incl. discount or premium associated with these loans. Gains and losses are recognized in the statement of comprehensive income (in profit or loss for the year) as financial income or financial expenses (interest) during the amortization period or when the liabilities are written off or reduced.

Interest expenses are recognized over the term of the financial instrument based on the effective interest rate method. Interest-bearing loans and other borrowed financial resources are classified as current, except for the portion of them for which the Company has an unconditional right to settle its liability for more than 12 months from the end of the reporting period.

Derecognition

A financial liability is derecognized when, and only when the obligation specified in the contract is either discharged or cancelled or expires. When an existing liability is replaced by another from the same lender on substantially different terms or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the statement of comprehensive income (in profit or loss for the year).

Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when, and only when, there is a currently enforceable legal right to off-set the recognized amounts and the Company intends either to settle on a net basis or to realize the assets and settle the liabilities simultaneously.

This requirement stems from the idea for the real economic substance of the Company's relationships with a certain counterparty and that, in the presence of these two requirements, the expected actual cash flow and the benefits for the enterprise are the net cash flows, i.e. the net amount reflects the actual right or obligation of the Company regarding these financial instruments - in all circumstances to receive or pay only the net amount. If these conditions are not simultaneously met, it is assumed that the Company's rights and obligations in respect of such balances (financial instruments) are not exhausted in all situations solely by the receipt or payment of the net amount.

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS**

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

e) Financial instruments – initial recognition and subsequent measurement (continued)

The offsetting policy also relates to the assessment, presentation and management of the actual credit and liquidity risk associated with these balances.

The criteria that apply in establishing that the entity has "currently enforceable legal right to off-set" are:

- the right to set-off must be available today rather than being contingent on a future event
- it must be exercisable and legally enforceable, both in the normal course of business and in the event of default, insolvency or bankruptcy.

The applicability of the criteria is assessed against the requirements of the Bulgarian legislation and the established agreements between the parties. The condition that the entity has a "currently enforceable legal right to off-set" must always be assessed together with the condition for "mandatory intention to settle these balances on a net basis".

f) IFRS 13 Fair value measurement

At each reporting date the Company applies IFRS 13 Fair value measurement to the financial instruments and non-financial assets measured at fair value. The fair value is the price that would be obtained for the sale of an asset or paid for the transfer of a liability in an arm's length transaction between market participants at the valuation date.

Fair value measurement is based on the assumption that the sale of the asset or the transfer of the liability takes place on:

- the principal market for the asset or liability,
- in the absence of such market, the market that is most advantageous for the asset or liability.

The main or the most favorable market should be accessible to the Company.

The fair value of the asset or liability is determined by assuming that market participants will use this value in the valuation of the asset or liability and will act in line with their best economic interest.

The fair value of the non-financial assets is determined by taking into account the ability of the participants to generate economic benefits by using the asset or selling it to another counterparty in the market who will use it with maximum efficiency.

The Company is applying valuation techniques that are appropriate in the circumstances, maximizing the use of observable parameters and minimizing the use of ones that cannot be observed.

All assets and liabilities measured at fair value or for which fair value is disclosed are arranged into the following three levels of the fair value hierarchy based on the hypotheses underlying the valuation techniques:

- Level 1 — Quoted (unadjusted) prices on active markets for identical assets or liabilities;
- Level 2 — Valuation techniques, which allow the fair value parameters to be observed directly or indirectly;
- Level 3 — Valuation techniques, under which the parameters for arriving at the fair value cannot be observed directly.

As at each balance sheet date the Management carries out an analysis of the changes of the fair value of the assets and liabilities and monitors their impact on the financial statements in line with the approved accounting policy. The Company must ascertain whether or not a change has occurred in the categorization of assets or liabilities in accordance with the hypotheses underlying the valuation techniques. With the assistance of certified valuers the management compares each change in the fair value of the assets and liabilities with observable parameters in order to ascertain that the changes are reasonable.

The Company determines the assets and liabilities whose fair value should be disclosed based on their nature, risk and level in the hierarchy as noted above.

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS**

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

g) Share capital and reserves

The share capital is presented at the par value of shares issued and paid. The Company is obliged to set aside a *Reserve Fund* in accordance with the Commercial Act. Sources for the fund may include:

- portion of the profit set by the sole owner of the capital, but no less than 1/10 until the funds in the Reserve Fund reach 1/10 of the capital;
- funds, received in excess of par value of shares at issue thereof;
- other sources in accordance with a decision at the General Meeting.

The Reserve Fund may be used only to cover current and prior year losses. When the Reserve Fund reaches the minimum amount set out in the Articles of Association, the excess may be used to increase the share capital.

h) Plant and equipment

Items of plant and equipment are stated at cost, net of accumulated depreciation and any accumulated impairment losses. Such cost includes the cost of replacing parts of the plant and equipment and borrowing costs for long-term construction projects if the recognition criteria are met. When a major inspection of an item of plant and/or equipment is performed, its cost is recognized in the carrying amount of the respective assets as a replacement if the recognition criteria are satisfied. All other repair and maintenance costs are recognized in the statement of comprehensive income for the period in which they have been incurred.

Depreciation is calculated on a straight line basis over the estimated useful life of the assets, as follows:

Computers	2 years
Plant and equipment	5 years
Motor vehicles	4 years
Fixtures and fittings	5 years

An item of plant and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the statement of comprehensive income for the year in which the asset is derecognized.

i) Software

Software is measured on initial recognition at cost, less any accumulated amortisation and accumulated impairment losses.

Amortisation is calculated on a straight-line basis over the estimated useful life of the assets, as follows:

Software	2 years
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The assets' residual values, useful lives and methods of depreciation/amortisation are reviewed at each financial year end, and are adjusted prospectively, if appropriate.

j) Impairment of fixed tangible assets (FTAs)

Assets that are subject to depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

k) Leases

Accounting policy applicable from 01.01.2019

Company as a lessee

Identifying a lease

A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Initial recognition and measurement

At the commencement date of the lease (the date on which the underlying asset is available for use) the Company recognizes a “right of use” asset and a lease liability.

The cost of the right-of-use asset includes:

- the amount of the lease liability as initially measured;
- any lease payments made at or before the commencement date, less any lease incentives received;
- any initial direct costs incurred by the lessee;
- an estimate of costs to be incurred in dismantling and removing the underlying asset.

The Company depreciates the right of use assets on a straight line basis for the shorter of: the useful life of the right of use asset and the lease term.

The right of use assets are included in Property, plant and equipment in the statement of financial position, and their depreciation – in Expenses for depreciation in the statement of comprehensive income.

The lease liability includes the net present value of the following lease payments:

- fixed payments, less any lease incentives receivable;
- variable lease payments that depend on an index or a rate;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option;
- payments of penalties for terminating the lease;
- amounts expected to be payable by the lessee under residual value guarantees.

The lease payments are discounted using the interest rate implicit in the lease, if that rate can be readily determined or with the Company’s incremental borrowing rate, which is the rate of interest that would apply if the entity had to borrow the funds over a similar term, with a similar security, in a similar economic environment.

Lease payments are comprised of a certain portion of the finance costs (interest) and a corresponding portion of the lease liability (principal). Finance costs are charged to the statement of comprehensive income on a systematic basis during the period of the lease so as to achieve a constant interest rate on the remaining outstanding part of the principal of the lease liability.

Subsequent measurement

The company has selected to apply the cost model for all of its right of use assets. The assets are measured at cost less accumulated depreciation and accumulated impairment losses and adjusted for any remeasurements of the lease liability.

The Company subsequently measures the lease liability by:

- increasing the carrying amount to reflect the accrued interest;
- reducing the carrying amount to reflect the lease payments made;
- remeasuring the carrying amount of the liability to reflect any reassessments or lease modifications.

Accounting for lease reassessments and lease modifications

Following lease reassessment, the lessee recognises the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset. However, if the carrying amount of the right-of-use asset is lower, any remaining amount of the remeasurement is recognized in profit or loss.

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS**

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

k) Leases (continued)

A lessee shall account for a lease modification as a separate lease if both:

- the modification increases the scope of the lease by adding the right to use one or more underlying assets; and
- the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.

Payments in relation to short-term leases and leases of low value assets, as well as variable lease payments, which are not included in the lease liability, are directly expensed in the statement of comprehensive income on a straight line basis over the period of the lease.

Company as a lessor

IFRS 16 does not introduce significant changes in the accounting treatment of leases by the lessors. They continue to classify every lease agreement as either a finance or operating lease, applying rules similar to those in IAS 17, which are essentially transferred to the new IFRS 16.

Accounting policy applicable until 31.12.2018

Leases in which a significant portion of the risks and rewards are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

l) Investments

• Investments in subsidiaries and consolidation

Subsidiaries are all entities (including structured entities) in which the Company has the power to manage the financial and operating policies, and has over 50% of the voting rights. The Company assess that control exists when it does not hold over 50% of the voting rights but is in a position to manage the financial and operating policies under de-facto control.

• Investments in joint ventures

A joint venture is a joint arrangement in which the parties that have joint control over the arrangement have rights over the net assets of the arrangement.

Investments in joint ventures are carried at cost less accumulated impairment.

m) Cash and cash equivalents

Cash and short-term deposits in the statement of financial position comprise cash in bank accounts, cash on hand, and short-term deposits with an original maturity of twelve months or less that are available to the Company on demand without incurring significant financial losses.

For the purposes of the cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above.

Subsequent measurement

Cash and cash equivalents at banks are subsequently presented at amortized cost less accumulated impairment for expected credit losses.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

n) Provisions

General

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all the expenditures for settling the provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain.

The expense relating to any provision is presented in the statement of comprehensive income net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

o) Significant accounting judgments, estimates and assumptions

The preparation of the separate financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amount of the respective assets or liabilities in the future.

Estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that carry a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Calculation of expected credit losses on loans granted, guarantees, and cash and cash equivalents

The measurement of expected credit loss for financial assets carried at amortized cost (loans granted, receivables, contract assets, cash and cash equivalents), as well as financial guarantees provided, is an area requiring the use of complex models and material assumptions for future economic conditions and credit behavior of customers and debtors (for example, the likelihood that counterparties will default on their obligations and the resulting losses).

In applying these requirements, the Company's management makes a number of material judgments, such as: (a) establishing criteria for identifying and assessing a significant increase in credit risk; (b) selecting appropriate models and assumptions to measure expected credit losses; (c) the formation of groups of similar financial assets (portfolios) for the purpose of measuring expected credit losses; (d) establishing and assessing the relationship between historical default rates and the behavior of certain macro indicators in order to reflect the effects of forecasts for those macro indicators in calculating expected credit losses in future.

If the financial position and performance of municipalities deteriorate (more than expected), the value of receivables to be written off in subsequent reporting periods may be greater than that expected at the date of the statement of financial position.

Corporate income tax

A significant judgement is required to determine the overall tax provision. There are many transactions and calculations, for which the final tax cannot be determined precisely in the normal course of activity. The Company recognises liabilities for estimated tax payables in the event of future tax audits based on the management's judgement as to whether additional taxes will be assessed or not. When the tax finally set as due as a result of such events differs from the one initially reported, the corresponding differences will be reported in the short-term corporate income tax payables and will have an effect on the deferred taxes for the period in which this clarification has been made.

Estimated useful lives of property, plant and equipment

Management uses significant accounting estimates and judgements for the purpose of determining the useful lives of its property, plant and equipment, which are based on a study and judgements of the technical staff that assesses the useful lives of tangible and intangible assets.

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS**

For the year ended 31 December 2019

2.3 Effects from the initial application of IFRS 16

IFRS 16 Leases, adopted by the EU on October 31, 2017, applicable for annual periods beginning on or after 1 January 2019, introduces a detailed model for identification of leases and their treatment in the financial statements of both lessors and lessees. IFRS 16 replaces IAS 17 Leases and the related interpretations: IFRIC 4 Determining whether an arrangement contains a lease, SIC 15 Operating leases – Incentives, and SIC 27 Evaluating the substance of transactions involving the legal form of a lease. IFRS 16 removes the distinction between operating and finance lease in the accounting of the lessee and requires the recognition of right of use assets and lease liabilities for all lease contracts. The accounting requirements for lessors are essentially unchanged. The purpose of the standard is to improve the comparability of the financial statements and to provide information to users about the risks related to lease contracts.

The Company has selected to adopt IFRS 16 Leases using the modified retrospective approach. In line with this approach the comparative information for 2018 has not been restated. Instead the cumulative effect of the first time adoption of the standard has been recognized as an adjustment to the opening balance of retained earnings as of 01.01.2019. On the date of the initial application the Company has recognized lease liabilities under IFRS 16 equal to the present value of all outstanding lease payments discounted at the interest rate implicit in the lease or the incremental borrowing rate of the lessee.

The average incremental borrowing rate applied in the initial recognition of the lease liabilities as of 01.01.2019 is 3%.

In terms of leases that were classified as finance leases under IAS 17, the carrying amount of the right-of-use asset and the lease liability at the date of initial application of IFRS 16 is the carrying amount of the lease asset and lease liability immediately before that date as measured under IAS 17.

The Company has applied the following exemptions and practical expedients upon the initial application of IFRS 16:

- Leases of low value assets and leases of up to 12 months are excluded from the scope;
- The value of the right of use assets are set as equal to the lease liabilities, after adjusting for prepaid / accrued lease payments recognized in the statement of financial position immediately before the date of initial application;

The cumulative effect from the initial application of IFRS 16 for each item in the statement of financial position as of 1 January 2019 is as follows:

STATEMENT OF FINANCIAL POSITION	31.12.2018 As originally accounted for BGN'000	Effect from application of IFRS 16 BGN'000	01.01.2019 restated BGN'000
ASSETS			
Cash and cash equivalents	18,468	-	18,468
Receivables and prepayments	39	-	39
Loans granted	164,389	-	164,389
Loans granted to related parties	23,671	-	23,671
Deferred tax assets	2	-	2
Plant and equipment	36	-	36
Right of use assets	-	138	138
Software	6	-	6
Investment in subsidiary	5,000	-	5,000
TOTAL ASSETS	211,611	138	211,749

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS**

For the year ended 31 December 2019

2.3 Effects from the initial application of IFRS 16 (continued)

STATEMENT OF FINANCIAL POSITION	31.12.2018 As originally accounted for BGN'000	Effect from application of IFRS 16 BGN'000	01.01.2019 restated BGN'000
LIABILITIES AND EQUITY			
Liabilities			
Payroll and social security payables	102	-	102
Tax liabilities	41	-	41
Other liabilities	213	138	351
Loans payable	109,763	-	109,763
Total liabilities	110,119	138	110,257
Equity			
Share capital	90,000	-	90,000
Statutory reserves	2,712	-	2,712
Retained earnings	8,780	-	8,780
Total equity	101,492	-	101,492
TOTAL LIABILITIES AND EQUITY	211,611	138	211,749

3. Income and expenses

3.1 Income from interest

	<u>2019</u> BGN'000	<u>2018</u> BGN'000
Interest income on deposits and bank accounts	-	1
Income on loans granted and receivables	5,536	5,235
Total interest income	5,536	5,236

3.2 Interest expenses and charges

	<u>2019</u> BGN'000	<u>2018</u> BGN'000
Interest expenses on loans and borrowings	823	877
Expenses on fees, commissions and foreign exchange differences	829	769
Total interest expenses and charges	1,652	1,646

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
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For the year ended 31 December 2019

3. Income and expenses (continued)

3.3 Other operating income

	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Income from management and commitment fees	564	404
Insurance income	2	2
Total other operating income	<u>566</u>	<u>406</u>

3.4 Payroll costs

	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Salaries and wages	723	622
Social securities	104	83
Total payroll costs	<u>827</u>	<u>705</u>

3.5 Other operating expenses

	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Accounting and audit services	15	27
Rent	-	56
Materials	11	16
Legal services	8	7
Communication services	7	6
Hardware maintenance	6	6
Consulting services	-	29
Social expenditure	21	13
Insurances	2	2
Training	28	5
Other	65	62
Total other operating expenses	<u>163</u>	<u>229</u>

4. Income tax

The main components of the income tax expense for the years ended 31 December 2019 and 2018 include:

	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Current income tax expense	313	301
Deferred income taxes related to occurrence and reversal of temporary differences	-	(1)
Income tax expense	<u>313</u>	<u>300</u>

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4. Income tax (continued)

In 2019 the applicable statutory tax rate is 10% (2018: 10%).

Reconciliation between income tax expense and the accounting profit multiplied by the statutory tax rate for the years ended 31 December 2019 and 31 December 2018 is presented below:

	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Accounting profit before taxes	3,388	3,325
Income tax expense at statutory tax rate of 10% for 2019 (2018: 10%)	339	333
Permanent differences	<u>(26)</u>	<u>(33)</u>
Income tax expense	<u>313</u>	<u>300</u>

As of 31.12.2019 the Company owes corporate income tax amounting to BGN 73 thousand. (31.12.2018: BGN 41 thousand).

Deferred income tax is linked to the following balance sheet positions:

	<u>Temporary difference</u>	<u>Tax</u>	<u>Temporary difference</u>	<u>Tax</u>
	31.12.2019	31.12.2019	31.12.2018	31.12.2018
	<i>BGN '000</i>	<i>BGN '000</i>	<i>BGN '000</i>	<i>BGN '000</i>
Unpaid income to individuals and related social security expense	<u>20</u>	<u>2</u>	<u>19</u>	<u>2</u>

5. Cash and cash equivalents

	31 December	
	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Cash in hand and in current accounts	<u>26,025</u>	<u>18,468</u>
Total cash and cash equivalents	<u>26,025</u>	<u>18,468</u>

Cash in bank accounts bears floating interest rates based on the daily interest rates on bank deposits. The fair value of cash and short-term deposits equals their carrying amount.

The present and future receivables on the bank accounts of FLAG EAD are pledged as collateral under bank loan agreements concluded with Unicredit Bulbank AD, UBB AD, DSK Bank EAD and Expressbank (Note 10).

As a result of the analyzes made and the methodology used to calculate expected credit losses on cash and cash equivalents, management determined that no impairment of cash and cash equivalents was required. Therefore, the Company has not recognized an allowance for expected credit losses as of 1 January 2019 and 31 December 2019.

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
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6. Receivables and prepayments

	31 December	
	2019	2018
	<i>BGN'000</i>	<i>BGN'000</i>
Other receivables	37	39
Total receivables and prepayments	37	39

Other receivables comprise contingent fees for loan assessment, advances to suppliers, guarantees provided and non-financial deferred expenses.

7. Plant and equipment, software, and right of use assets

	Hardware	Fixtures and equipment	Plant and equipment	Vehicles	Software	Other Fixed Assets	Right of use assets	Total
	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>
Book value:								
As of 1 January 2018	36	10	22	49	29	6	-	152
Additions	21	-	-	-	6	-	-	27
As of 31 December 2018	57	10	22	49	35	6	-	179
Recognized on 1 January 2019 under IFRS 16	-	-	-	-	-	-	138	138
Additions	4	-	-	-	-	-	-	4
As of 31 December 2019	61	10	22	49	35	6	138	321
Depreciation:								
As of 1 January 2018	(33)	(9)	(20)	(22)	(21)	(5)	-	(110)
Depreciation charge	(4)	(1)	(1)	(12)	(8)	(1)	-	(27)
As of 31 December 2018	(37)	(10)	(21)	(34)	(29)	(6)	-	(137)
Depreciation charge	(11)	-	(1)	(13)	(3)	-	(45)	(73)
As of 31 December 2019	(48)	(10)	(22)	(47)	(32)	(6)	(45)	(210)
Carrying amount								
As of 1 January 2018	3	1	2	27	8	1	-	42
As of 31 December 2018	20	-	1	15	6	-	-	42
As of 31 December 2019	13	-	-	2	3	-	93	111

The recognized right of use assets are related to the right to use the office in which the Company is located.

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8.1. Investment in subsidiary

By a decision of the sole owner of FLAG EAD, the Ministry of Regional Development and Public Works, from 03.04.2012, and after a meeting of the Board of Directors of the Fund, a new company was incorporated – “Fund for Sustainable Urban Development of Sofia” EAD, with share capital of BGN 500 thousand. The company was registered on 23 April 2012 with the Registry Agency and the share capital was paid in full by FLAG EAD. The purpose of the newly established subsidiary is to implement financing under the European programme JESSICA in accordance with a trilateral agreement signed by EIB, FLAG EAD and FSUDS EAD.

On December 14, 2015, a transfer and replacement agreement was signed between the EIB, MRDPW, FSUDS EAD and FLAG EAD, according to which, as of 01.01.2016 due to the expiry of the EIB's commitment to the Jessica Initiative, all EIB rights and obligations under the Operational Agreement will be transferred to the MRDPW until the Fund Manager of Financial Instruments in Bulgaria EAD becomes operational.

As of December 31, 2018, all rights and obligations of the MRDPW under the Operational Agreement have been transferred to the FMFIB.

By Protocol TZ-12 of 22 March 2017 the Minister of Regional Development and Public Works, in its capacity of representative, authorizes FLAG EAD to acquire long-term financial assets in the subsidiary “Fund for Sustainable Urban Development of Sofia” EAD amounting to 4,500,000 BGN, representing 4,500 new, ordinary, available, shares with nominal value of BGN 1,000 each. With this act and following a decision of the Fund's Board of Directors on 28 March 2017, it was proceeded to the registration of the change and the respective increase of the capital of “Fund for Sustainable Urban Development of Sofia” EAD from BGN 500,000 to BGN 5,000,000. On 4 May 2017 the name of the company was changed to “Fund for Sustainable Urban Development” EAD.

8.2. Investment in joint venture

On December 13, 2017, an agreement was concluded between FLAG JSC, FSUD JSC, Cibank EAD, United Bulgarian Bank AD (UBB) and Bulgarian Consulting Organization EOOD (BCO) for establishment of company incorporated Under the Obligations and Contracts Act “Fund for Sustainable Cities” (FSC). The purpose of the newly established company is to participate in a procurement procedure with the subject “Implementation of a financial instrument Urban Development Fund, financed by funds from the Operational Program“ Regions in Growth” 2014-2020. The company is managed jointly by all the founders. According to the founding agreement, the share of FLAG is 5%. In 2019 FLAG invested BGN 10 thousand in FSC.

9. Loans granted

	31 December	
	2019	2018
	<i>BGN'000</i>	<i>BGN'000</i>
Loans granted to municipalities	178,235	169,265
Accrued, but unpaid interest related to loans granted to municipalities	123	107
Impairment of loans granted to municipalities	(5,243)	(4,983)
Total loans granted to municipalities, net	173,115	164,389
Loans granted to related parties	22,566	23,665
Accrued, but unpaid interest on loans granted to related parties	5	6
Total loans granted to related parties	22,571	23,671
Total loans granted	195,686	188,060

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9. Loans granted (continued)

Loans granted include loans provided to municipalities, two LIGs and one state-owned company. One part of the loans - BGN 91,534 thousand is used for bridge financing under European programs, and BGN 86,701 thousand is for funding of municipalities' own activities.

As of December 31, 2018 loans for bridge financing and funding of own activities are BGN 78,922 thousand and BGN 90,343 thousand, respectively.

Current and future receivables under loans granted are pledged as collateral under bank loan agreements concluded with UniCredit Bulbank AD, UBB AD, DSK Bank EAD and Expressbank (Note 10).

In 2019, a provision for expected credit losses in the amount of BGN 5,243 thousand has been calculated in accordance with IFRS 9. The provision for expected credit losses on loans classified within Stage 1 is in the amount of BGN 2,907 thousand, and the impairment on loans in Stage 2 - BGN 2,336 thousand.

In 2018, a new impairment policy for expected credit losses was adopted in accordance with IFRS 9, according to which as at 31 December 2018 a provision for expected credit losses in the amount of BGN 4,983 thousand has been calculated. The provision for expected credit losses on loans classified within Stage 1 is in the amount of BGN 2,760 thousand, and the impairment on loans in Stage 2 - BGN 2,223 thousand.

The loans granted are mainly secured by a special pledge on the future receivables of the municipality under the grant contracts and the future own revenues of the municipality.

The changes in the accrued impairment on loans granted in 2019 and 2018 are as follows:

	<i>Impairment of receivables on loans granted</i>
Amounts recognized in the opening balance of retained earnings upon the first-time adoption of IFRS 9 under the modified retrospective approach	<u>(179)</u>
Opening balance of impairment allowance as of 1 January 2018, calculated under IFRS 9	<u>(5,130)</u>
Reduction in credit loss adjustment, recognized in profit or loss during the year	<u>147</u>
As of 31 December 2018	<u>(4,983)</u>
Increase in credit loss adjustment, recognized in profit or loss during the year	<u>(260)</u>
As of 31 December 2019	<u>(5,243)</u>

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10. Loans payable

	Maturity	31 December	
		2019	2018
		<i>BGN'000</i>	<i>BGN'000</i>
Long-term revolving loan payable to UniCredit Bulbank	August 2020	30,000	30,000
Revolving loan payable to DSK	May 2024	21,218	21,218
Long-term loan payable to UniCredit Bulbank	November 2023	22,857	28,571
Revolving loan payable to UBB	November 2023	39,116	27,185
Long-term loan payable to Expressbank	October 2025	-	3,047
Revolving loan payable to UBB	October 2025	10,481	-
Deferred fees under loan agreements		(341)	(275)
Accrued interest due		21	17
Total loans payable		123,352	109,763

The loan agreements of FLAG are listed in the table above:

- The revolving loan from Unicredit Bulbank AD was concluded on 31.08.2018 and has a two-year term, and as of 31.12.2018 it has been fully utilized. The agreed interest rate on this loan is based on the basic interest rate plus margin.
- Under the contract with DSK Bank, effective at the end of 2019, the amount of BGN 21,218 thousand has been utilized (as of 31.12.2018 - BGN 21,218 thousand). The agreed interest rate on this loan is based on the basic interest rate plus margin.
- The contract with Unicredit Bulbank AD dated November 22, 2016 is for BGN 40,000 thousand, for a period of 84 months. As of 31.12.2019 the utilized amount is BGN 22,857 thousand (as of 31.12.2018 - BGN 28,571 thousand). The agreed interest rate on this loan is based on the basic interest rate plus margin.
- On November 22, 2016, a revolving loan agreement was signed with UBB AD for the amount of EUR 20,000 thousand for a period of 84 months. As of December 31, 2019, EUR 20,000 thousand (BGN 39,116 thousand) are utilized. As of December 31, 2018, EUR 13,899 thousand (BGN 27,185 thousand) were utilized. The agreed interest rate on this loan is based on a six-month EURIBOR plus margin.
- As at 31.12.2019 there are no obligations under the contract concluded on 01.11.2018 with Expressbank AD (as at 31.12.2018 the amount utilized was BGN 3,047 thousand). The agreed interest rate is fixed.
- Another loan contract was signed with UBB AD on 12.10.2018 for the amount of BGN 40,000 thousand. The utilization under it is BGN 10,481 thousand. As of 31.12.2018 no utilizations have been made.

The collaterals on the bank loans from UniCredit Bulbank AD, UBB AD, DSK Bank EAD and Expressbank AD include pledges on the current and future receivables on FLAG's bank accounts and current and future receivables on loans granted (Note 5 and Note 9).

11. Payroll and social security payables

Payables to staff and for social security as of December 31, 2019 relate to accrued wages and additional remunerations (bonuses) for December 2019 and are as follows:

	31 December	
	2019	2018
	<i>BGN'000</i>	<i>BGN'000</i>
Payables to personnel	95	87
Payables for social security	19	15
Total payables to personnel and for social security	114	102

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12. Income tax payables

	2019	2018
	<u>BGN'000</u>	<u>BGN'000</u>
Tax payable as at 1 January	41	51
Tax paid throughout the year	(281)	(311)
Tax accrued for the year (Note 4)	313	301
Tax payable as at 31 December	73	41

13. Other liabilities

	31 December	
	2019	2018
	<u>BGN'000</u>	<u>BGN'000</u>
Other liabilities	323	213
<i>incl. Contingent fee for loan applicants</i>	58	81
<i>Good performance guarantee</i>	126	126
<i>Payables to suppliers</i>	45	6
<i>Lease liabilities</i>	94	-
Total other liabilities	323	213

14. Share capital and reserves

14.1 Share capital

	31 December	
	2019	2018
	<u>BGN'000</u>	<u>BGN'000</u>
90,000 ordinary shares with a nominal value of BGN 1,000 each	90,000	90,000
Total share capital	90,000	90,000

At 31 December 2019 and 31 December 2018 the issued registered capital is fully paid-in.

14.2 Statutory reserves

Statutory reserves are formed by FLAG JCS as profit distribution under Article 246 of the Commercial Act. They are set aside until the amount reaches one tenth or more of the share capital. Sources to form the statutory reserves include at least one tenth of the net profit, share premiums and funds set out in the Articles of Association or in accordance with a decision of the General Meeting of Shareholders.

The statutory reserves may only be used to cover current and prior reporting period losses. As at 31 December 2019 statutory reserves amount to BGN 3,000 thousand (2018: BGN 2,712 thousand).

15. Dividend distribution

In accordance with ordinance № 1 of the Council of Ministers dated 07.06.2019 dividends were distributed to the sole shareholder in 2019 in the amount of BGN 1,558 thousand (2018: BGN 1,299 thousand). Dividend per share is BGN 17,31 (2018: BGN 14,43).

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For the year ended 31 December 2019

16. Commitments and contingent liabilities

Legal claims

As at 31 December 2019 and 31 December 2018 there were no litigations against the Company.

Guarantees

The Company has not provided any guarantees as of 31 December 2019 and 31 December 2018.

Loan commitments

As of 31.12.2019 the Company has loan commitments related to twelve loan contracts with municipalities amounting to BGN 28,125 thousand, under which no funds have been utilized at the year end. The loan commitments at the end of the previous year were twelve amounting to BGN 15,215 thousand.

Commitments related to rents / operating leases

The Company has an office lease contract, which entered into force on 01.03.2013 and is valid until 31.01.2022.

17. Related party disclosures

Composition of the related parties

Shareholder – sole owner

The Republic of Bulgaria through the Ministry of Regional Development and Public Works is the sole owner of the shares of FLAG JSC.

“Fund for sustainable urban development” JSC is a fully-owned subsidiary of FLAG JSC with a share capital of BGN 5,000 thousand fully paid by FLAG JSC.

„Fund for sustainable cities“ (FSC) – a jointly controlled entity.

Remuneration of management staff

In 2019, the remuneration of management staff amounted to BGN 187 thousand (2018: BGN 162 thousand).

Related party transactions

In 2012 an Operational agreement was signed between EIB, the subsidiary FSUDS JSC and FLAG JSC. On 14.12.2015 a transfer and substitution agreement was signed between EIB, Ministry of Regional Development and Public Works, FSUDS JSC and FLAG JSC whereby as of 01.01.2016 due to the expiration of the EIB's commitment to the initiative Jessica in Bulgaria, all rights and obligations of EIB under the Operational agreement are transferred to the Ministry of Regional Development and Public Works until the “Fund manager of financial instruments in Bulgaria” (FMFIB) JSC starts functioning.

On February 14, 2018, a transfer and substitution agreement was concluded between MRDPW and the Fund Manager of Financial Instruments in Bulgaria EAD whereby MRDPW transfers to FMFIB all its claims, rights and obligations arising out of or in connection with the Operational Agreement.

Under an additional credit line agreement signed between FSUDS JSC and FLAG JSC a loan in the total amount of BGN 24,500 thousand was agreed.

During 2019 BGN 254 thousand of the loan were utilized, BGN 1,741 thousand were repaid, BGN 410 thousand interest income was accrued, interest of BGN 411 thousand was received and there is unpaid interest of BGN 5 thousand at the end of the year.

During 2018, BGN 3,370 thousand were utilized under the loan, BGN 1,327 thousand were repaid, interest of BGN 408 thousand was accrued and received and there was a balance of BGN 6 thousand unpaid interest at the end of the year.

During 2018 FSUD and FLAG signed a new credit line agreement for the amount of BGN 15 million. As of 31.12.2019, BGN 387 thousand was utilized under this credit line (there are no utilizations as of December 31, 2018).

During 2019, FOMSB FLAG EAD reported dividend income received from FSUD EAD in the amount of BGN 261 thousand (2018 - BGN 143 thousand).

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
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For the year ended 31 December 2019

18. Financial risk management objectives and policies

The main financial liabilities of the Company comprise interest-bearing loans and borrowings, and trade and other payables. The main objective of these financial instruments is to secure financing of the Company's operations. The Company has financial assets such as loans granted, cash and short-term deposits, which arise directly from its operations.

In 2019 and 2018, the Company neither owned nor traded with derivative financial instruments.

The main risks arising from the Company's financial instruments are interest rate risk, liquidity risk, currency risk and credit risk. The management reviews and agrees policies for managing each of these risks which are summarised below.

Interest-rate risk

The Company's exposure to the risk of changes in market interest rates relates primarily to the Company's long-term financial liabilities with variable (floating) interest rates. The Company's policy is to manage its interest expenses through granting loans with floating interest rates.

Sensitivity to possible changes in interest rates (through the effect on loans granted and loans payable with floating interest rates) of the Company's profit before tax, with all other variables held constant is presented below.

	<u>Increase/Decrease in interest rates</u>	<u>Effect on the pre-tax profit</u> <i>BGN '000</i>
2019		
Loans payable in EUR	+0.5%	(196)
Loans payable in BGN	+0.5%	(423)
Loans granted in BGN	+0.5%	1,004
Loans payable in EUR	-1%	391
Loans payable in BGN	-1%	846
Loans granted in BGN	-1%	(2,008)

	<u>Increase/Decrease in interest rates</u>	<u>Effect on the pre-tax profit</u> <i>BGN '000</i>
2018		
Loans payable in EUR	+0.5%	(136)
Loans payable in BGN	+0.5%	(399)
Loans granted in BGN	+0.5%	965
Loans payable in EUR	-1%	272
Loans payable in BGN	-1%	798
Loans granted in BGN	-1%	(1,929)

Liquidity risk

The effective management of the Company's liquidity presumes that sufficient working capital will be available mainly through maintaining a given amount of money on deposit. A cash flow movement plan is prepared based on short-term budgets as well as based on long-term planning.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
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For the year ended 31 December 2019

18. Financial risk management objectives and policies (continued)

Liquidity risk (continued)

As at 31 December the maturity structure of the Company's financial and other liabilities, based on the agreed undiscounted payments, is presented below:

Liabilities

As of 31 December 2019

	<u>On demand</u>	<u>< 3 months</u>	<u>3-12</u>	<u>1-5</u>	<u>> 5 years</u>	<u>Total</u>
	<i>BGN'000</i>	<i>BGN'000</i>	<i>months</i>	<i>years</i>	<i>BGN'000</i>	<i>BGN'000</i>
Interest-bearing loans and borrowings	-	289	36,461	80,554	10,582	127,886
Trade and other payables	-	180	34	109	-	323
	-	469	36,495	80,663	10,582	128,209

As of 31 December 2018

	<u>On demand</u>	<u>< 3 months</u>	<u>3-12</u>	<u>1-5</u>	<u>> 5 years</u>	<u>Total</u>
	<i>BGN'000</i>	<i>BGN'000</i>	<i>months</i>	<i>years</i>	<i>BGN'000</i>	<i>BGN'000</i>
Interest-bearing loans and borrowings	-	238	6,398	82,688	24,781	114,105
Trade and other payables	-	153	-	60	-	213
	-	391	6,398	82,748	24,781	114,318

The maturity structure of the Company's assets and liabilities at 31 December 2019 has been developed based on the expectations of management regarding the recoverability/settlement of amounts:

Assets	<u>Within 1 year</u>	<u>Over 1 year</u>	<u>Total amount</u>
Cash and cash equivalents	26,025	-	26,025
Other receivables	37	-	37
Loans granted	102,080	93,606	195,686
Total assets	128,152	93,606	221,748
Liabilities	<u>Within 1 year</u>	<u>Over 1 year</u>	<u>Total amount</u>
Other liabilities	214	109	323
Loans payable	35,737	87,615	123,352
Total liabilities	35,951	87,724	123,675

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18. Financial risk management objectives and policies (continued)

Liquidity risk (continued)

The maturity structure of the Company's assets and liabilities at 31 December 2018 has been developed based on the expectations of management regarding the recoverability/settlement of amounts:

Assets	<i>Within 1 year</i>	<i>Over 1 year</i>	<i>Total amount</i>
Cash and cash equivalents	18,468	-	18,468
Other receivables	39	-	39
Loans granted	90,994	97,066	188,060
Total assets	109,501	97,066	206,567
Liabilities	<i>Within 1 year</i>	<i>Over 1 year</i>	<i>Total amount</i>
Other liabilities	153	60	213
Loans payable	5,732	104,031	109,763
Total liabilities	5,885	104,091	109,976

Currency risk

The Company has no purchases, sales and lending in foreign currencies and the loans received are denominated in EUR or BGN. Since the exchange rate BGN / EUR is fixed at 1.95583, the currency risk arising from Company's exposures in EUR is not significant.

Credit risk

Credit risk is the risk that the clients/counterparties will not be able to pay in full the amounts due to the Company within the envisaged/agreed deadlines.

As at the end of 2019 the remaining liability of municipalities to the Company amounts to BGN 178,358 thousand and at the end of 2018 it was BGN 169,372 thousand.

As of 31.12.2019 the Company has receivables under loan granted to related parties amounting to BGN 22,571 thousand (2018: BGN 23,671 thousand).

Credit risk management in 2019 is carried out by the "Lending and monitoring" Directorate and is monitored simultaneously by the Executive Director and the Board of Directors. The credit risk management function is to ensure the implementation of an appropriate investment policy in respect of the funds available and respectively, the compliance of this policy with the related procedures and controls for current monitoring of the respective loan, deposit or receivable.

The credit risk exposure is managed through a current analysis of the ability of the counterparties/servicing banks to comply with their contractual obligations to pay interest and principal, as well as through setting appropriate credit limits. Cash deposits are placed with first-class banks having good reputation at the Bulgarian market. In compliance with the adopted internal rules for contracting cash deposits, invitations to submit an offer are sent only to banks that have the right to operate in the territory of the Republic of Bulgaria and have an assigned and not withdrawn (valid at the time of offer submission) credit rating not lower than a) BB assigned by the rating agencies Standard and Poor's or Fitch, b) Ba2 assigned by Moody's or c) BBB- assigned by BCRA.

Furthermore, subject to current monitoring is also the existence of concentration of receivables from a particular counterparty, and if such is identified – the respective counterparty is subject to special current supervision.

The Company measures the credit risk of loans granted to third and related parties using Probability of default (PD), Exposure at default (EAD) and Loss given default (LGD).

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For the year ended 31 December 2019

18. Financial risk management objectives and policies (continued)

Credit risk (continued)

To determine credit risk, the Company's management uses internal estimates prepared with the assistance of external experts that reflect the probability of default for individual counterparties. The activity, financial position of the borrower and the value of the collateral received are included in the risk assessment.

The Company considers that a financial instrument has undergone a significant increase in credit risk (moving from Stage 1 to Stage 2) when one or more of the following quantitative or qualitative criteria are met:

- Delay of two consecutive monthly installments (principal and / or interest payments)
- Worsening of the borrower's financial indicators
- Deviation from budget parameters for the year by more than 20%
- Difficulties in settling liabilities to third parties
- Increase in the overdue amounts
- Inclusion in the list of municipalities subject to financial rehabilitation of the Ministry of Finance
- Presence of frozen accounts

The criteria used to determine a significant increase in credit risk are monitored and reviewed periodically by the Executive Director.

The Company determines that a financial instrument is in default and with a credit loss (transfer from Stage 1 or Stage 2 to Stage 3) when it meets one or more of the following criteria:

- Loans with delayed payments of three or more consecutive monthly installments (principal and / or interest payments).

Calculation of expected credit losses

Expected credit losses are calculated by discounting the resulting value of the product of: probability of default (PD), Exposure at default (EAD) and Loss given default (LGD), determined as follows:

- PD represents the probability that the borrower will default on its financial obligation either within the next 12 months or throughout the life of the financial asset;
- EAD is the amount due to the Company at the time of default;
- LGD represents the Company's expectation of the amount of loss in case of default.

The discount rate used to calculate the Expected Credit Loss (ECL) is the instrument's original effective interest rate. Forecast information is also used in the calculation of the 12-month and lifetime PD, EAD and LGD.

The Company's management has performed a historical analysis and identified the major economic variables that affect credit risk and expected credit losses.

The table below presents the quality of financial assets arising from loans granted to third parties according to the credit rating accepted:

<i>31.12.2019</i>	<i>Internal credit risk category</i>	<i>Expected credit loss (IFRS 9)</i>	<i>Gross carrying amount BGN '000</i>	<i>Impairment Loss (adjustment) BGN '000</i>	<i>Carrying amount BGN '000</i>
Loans granted to third parties (principal)	Stage 1	12 months	166,133	(2,907)	163,226
Loans granted to third parties (principal)	Stage 2	Lifetime	<u>12,102</u>	<u>(2,336)</u>	<u>9,766</u>
			<u>178,235</u>	<u>(5,243)</u>	<u>172,992</u>

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18. Financial risk management objectives and policies (continued)

Credit risk (continued)

31.12.2018	Internal credit risk category	Expected credit loss (IFRS 9)	Gross carrying amount BGN '000	Impairment Loss (adjustment) BGN '000	Carrying amount BGN '000
Loans granted to third parties (principal)	Stage 1	12 months	157,748	(2,760)	154,988
Loans granted to third parties (principal)	Stage 2	Lifetime	11,517	(2,223)	9,294
			169,265	(4,983)	164,282

The Company has estimated the expected credit losses on loans granted to related parties and has concluded that they are insignificant.

The Company's maximum exposure to credit risk at 31 December 2019 and 31 December 2018 is as follows:

	2019		2018	
	Gross	Net	Gross	Net
Exposure				
Cash and cash equivalents	26,025	26,025	18,468	18,468
Loans granted	200,929	195,686	193,043	188,060
Other receivables	37	37	39	39
Total assets	226,991	221,748	211,550	206,567

The main objective of the Company's capital management is to provide a stable credit rating and capital indicators, with a view to the continued functioning of the business and maximizing its value for the shareholder. The Company manages its capital structure and adjusts it, if necessary, in the light of changes in economic conditions. The Company is subject to the Decree of the Council of Ministers on distribution of dividends to the Ministry of Regional Development and Public Works. In 2019, as in 2018, there are no changes in the Company's capital management goals, policies or processes.

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19. Cash flows from financing activities

Reconciliation of the movement of liabilities arising from financing activities

The table below presents the changes in financial liabilities, both monetary and non-monetary. Liabilities arising from financing activities are those for which cash flows are or future cash flows will be classified in the Company's cash flow statement as cash flows from financing activities.

	<i>1.1.2019</i>	<i>Dividend distribution</i>	<i>Change in cash flows from financing activities</i>	<i>Interest accrued</i>	<i>Other non-monetary changes</i>	<i>31.12.2019</i>
	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>
Loans payable	109,763	-	12,455	815	319	123,352
Dividend payables	-	1,558	(1,558)	-	-	-
Lease liabilities	-	-	(48)	4	138	94
Total	109,763	1,558	10,849	819	457	123,446

	<i>1.1.2018</i>	<i>Dividend distribution</i>	<i>Change in cash flows from financing activities</i>	<i>Interest accrued</i>	<i>Other non-monetary changes</i>	<i>31.12.2018</i>
	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>
Loans payable	84,188	-	24,412	877	286	109,763
Dividend payables	-	1,299	(1,299)	-	-	-
Total	84,188	1,299	23,113	877	286	109,763

20. Financial instruments

Fair values

Fair value is the amount for which a financial instrument could be exchanged or settled between knowledgeable, willing parties in an arm's length transaction, and which serves as the best indicator of its market price in an active market.

The Company determines the fair value of its financial instruments based on available market information or if none, by the means of appropriate valuation models. The fair value of financial instruments that are actively traded in organized financial markets is determined based on the “buy” quotes at the end of the last business day of the reporting period. The fair value of financial instruments, for which no active market exists, is determined on the basis of valuation models. These include the use of recent market transactions between knowledgeable, fair and willing parties; use of the current fair value of another instrument with similar characteristics; analysis of discounted cash flows or other valuation techniques.

The management of FLAG EAD believes that the fair values of financial instruments that include cash and short-term deposits, trade and other receivables, interest-bearing loans and borrowings, trade and other payables do not differ from their carrying amounts and the applicable interest rates change according to market conditions. The Company has analyzed the fair values of fixed-rate deposits and considers that they approximate their carrying amounts.

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS**

For the year ended 31 December 2019

21. Events after the reporting period

With a decision from 10.01.2020 the Board of Directors of FLAG EAD approved the participation of FLAG EAD in the company incorporated under the Obligations and Contracts Act “Fund for Local Development” for the purposes of supporting the “Bulgarian Platform for Urban Investments and Consultations” as a framework for cooperation between the European Investment Bank, the Fund Manager of Financial Instruments in Bulgaria and FLAG EAD.

On January 17, 2020, a Memorandum of Understanding was signed between the European Investment Bank, the Fund Manager of Financial Instruments in Bulgaria EAD and FLAG EAD.

On March 11, 2020, the World Health Organization declared a coronavirus pandemic, and on March 13, 2020, the Bulgarian government declared a state of emergency.

The potential impact on the Company's operations as a result from these events could include:

- Considering the specifics of the client base – disruption of the regularity of municipalities’ revenues resulting in difficulty paying the regular loan installments
- Increase of the extraordinary expenses of the municipalities related to urgent actions for implementation of the measures for protection of citizens, disinfection, social problems, etc.
- Delayed implementation of projects approved for funding and extension of utilization deadlines

Based on the publicly available information at the date of the separate financial statements, management has considered possible adverse scenarios regarding the anticipated development of the COVID-19 pandemic and the impact on the fund and the economic environment in which it operates. The measures taken by the state and the government's actions are taken into account and in response to the expected ones, the management of the company has taken actions aimed at limiting the risks, which include:

- Actions aimed at the staff of the Fund (ensuring the highest levels of disinfection in the office, securing a workplace that prevents the possibility of contamination, providing opportunities for working remotely - "work from home")
- Actions aimed at ensuring the continuity of the work of the suppliers (the administration/document processing is ensured through the use of forwarding companies, as well as the supply of the necessary materials for normal functioning)
- Actions aimed at borrowers (maintaining constant communication, discussing options for extending the repayment period when needed, responding quickly to other indications related to decisions and changes in loan terms - extending the utilization period)
- Actions to ensure the adequate capital and liquidity position of the Fund in order to fulfil as much as possible the strategic and business plans for the coming quarters.

Due to the exceptional dynamics of the situation related to the development of the disease, the expected changes in the reactions of the Bulgarian and other governments, the initiated measures can have an uncertain result. There is a risk that, in the face of a severe but realistic long-term blocking scenario, management plans may not be sufficient to mitigate operational and liquidity risks. The management is monitoring the situation and is ready to implement additional measures, initiatives and policies if necessary.

To date, management believes that the going concern principle is appropriate in the preparation of these separate financial statements, as the Company has access to financing and sufficient liquid resources to continue its operations as a going concern.

No other events occurred after December 31, 2019, which would require additional adjustments and / or disclosures in the Company's separate financial statements for the year ended December 31, 2019.