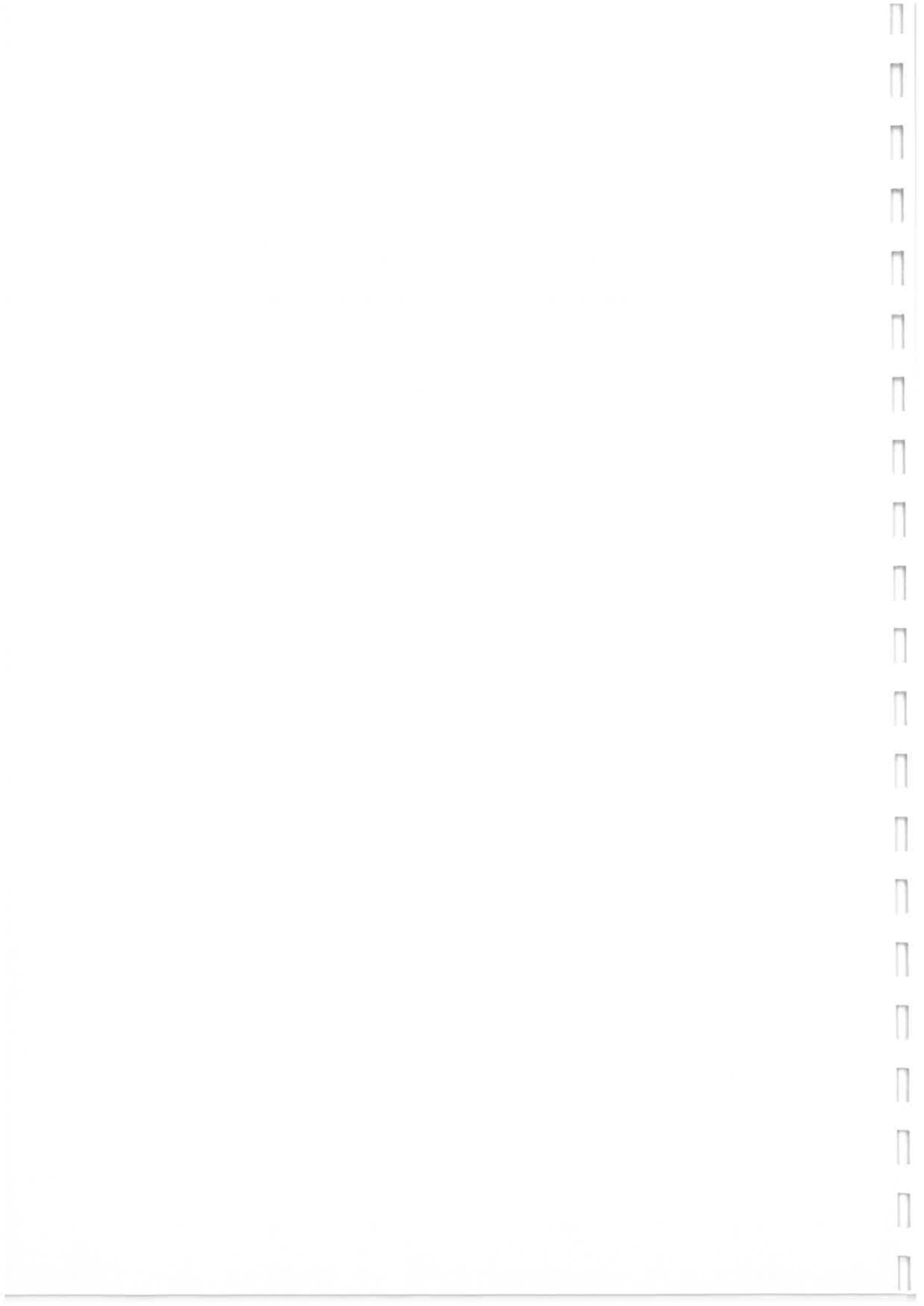


**FUND FOR LOCAL AUTHORITIES AND
GOVERNMENTS IN BULGARIA – FLAG EAD**

**CONSOLIDATED ANNUAL DIRECTORS’
REPORT AND CONSOLIDATED FINANCIAL
STATEMENTS**

31 December 2018



*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 OWNER OF FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS – FLAG EAD

Opinion

We have audited the consolidated financial statements of FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS - FLAG EAD („the Group“), which comprise the consolidated statement of financial position as at 31 December 2018, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give true and fair view of the financial position of the Group as at 31 December 2018, 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 Consolidated Financial Statements* section of our report. We are independent of the Group within the meaning of the *Code of Ethics for Professional Accountants* issued by International Ethics Standards Board for Accountants (IESBA Code) and the Independent Financial Audit Act (IFAA) applicable to our audit of the consolidated 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 consolidated financial statements and auditors report

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

ADVISORY · ASSURANCE · TAX

Baker Tilly Klitou and Partners OOD trading as Baker Tilly is a member of the global network of Baker Tilly International Ltd., the members of which are and independent legal entities.

Our opinion on the consolidated 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 consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

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

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

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

During the preparation of these consolidated financial statements management has the responsibility to make an assessment regarding Group'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 Group or to cease operations, or has no realistic alternative but to do so.

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

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

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated 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 consolidated 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 Group'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 Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities and business activities within the Group to express an opinion on the consolidated financial statements.

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.


Liliya Rangelova
CPA, Registered auditor

29 May 2019
Sofia




Krassimira Radeva – Managing Director
Baker Tilly Klitou and Partners OOD

5 Stara planina Street, Floor 5
Sofia 1000, Bulgaria



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

**CONSOLIDATED ANNUAL DIRECTORS' REPORT AND
CONSOLIDATED FINANCIAL STATEMENTS**

31 December 2018

This document is a translation of the original Bulgarian text, in case of divergence the Bulgarian original shall prevail.

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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
Nadya 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 advisors

Law Firm „Lozanova and Groysman”
Radostina Krasimirova Yaneva

Servicing banks

Unicredit Bulbank AD
UBB
DSK Bank EAD
Expressbank

Auditor

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

CONSOLIDATED REPORT
on the principal activities of
Fund for Local Authorities and Governments in Bulgaria – FLAG EAD in 2018

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.

1. General information

“Fund for Local Authorities and Governments in Bulgaria – FLAG“ EAD is a financial institution, a sole-owned joint-stock company established on the basis of Order No. 4 of the Council of Ministers of the Republic of Bulgaria of 7 March 2007 as an instrument of government policy for regional development.

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

“Fund for Sustainable Urban Development of Sofia” EAD (FSUDS) was established on 12 April 2012 as a Fund for urban development following a selection procedure by the European Investment Bank (EIB). By decision of 28 March 2017, Protocol No. 147 of the FLAG Board of Directors, the name of the “Fund for Sustainable Urban Development of Sofia” EAD (FSUDS) was changed to the “Fund for Sustainable Urban Development” EAD (FSUD). The change was registered in the Commercial Register on 5 April 2017. FSUD is a legal entity, a solely-owned joint-stock company, 100% owned by FLAG. FSUD is a financial institution exempted from the obligation to enter the register of financial institutions pursuant to Art. 2a of BNB’s Ordinance 26 on Financial Institutions.

FSUD’s activity is aimed at providing funding for eligible urban development projects by providing low-interest and long-term loans.

1.1. Equity and loan resources

The share capital of the FLAG is BGN 90 million. As of 31.12.2018 the total equity of the Group including share capital and reserves altogether amounts to BGN 102 million.

Total agreed long-term credit resource as at 31.12.2018 amounts to BGN 233 million.

Total borrowed capital as at 31.12.2018 amounts to BGN 133 million.

1.2. Management

FLAG is managed by a Board of Directors (BoD), which is composed of seven members. BoD organizes and manages the ongoing activity of the Fund in the performance of all its functions.

In 2018 sixteen board meetings were held.

At 31 December 2018 the Board of Directors is composed as follows: Dobromir Simidchiev - Chairman, Plamen Iliev - member, Valeria Kalcheva - member, Dobrinka Krasteva - member, Julia Tsolova - member, Evgeni Stoev - member and Nadya Dankinova - member and Executive Director.

FSUD has a two-tier management system - Managing and Supervisory Board.

In 2018 ten meetings of the Managing Board and eleven of the Supervisory Board were held.

Consolidated activity report

As of 31 December 2018, the Supervisory Board consists of Plamen Dermendzhiev - Chairman, Emil Savov - member and Steliyan Dimitrov - member.

The Managing Board is composed of: Victor Yotsov - Chairman, Desislava Lozanova - Deputy Chairperson and Nadya Dankinova - member and Executive Director.

According to the Bulgarian legislation, FLAG's Management should prepare consolidated financial statements for each financial year that gives a true and fair view of the Group's financial position as of the end of the year, its financial performance and its cash flows.

Management confirms that it has consistently applied adequate accounting policies in the preparation of the annual consolidated financial statements as at 31 December 2018 and has made reasonable and cautious judgments, assumptions and estimates.

The Management also confirms that it has adhered to the accounting standards in force, and the consolidated financial statements are prepared on a going concern basis.

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

1.3. Human resources

In 2018 the Group has a core staff with appropriate qualifications and experience to meet the needs of the Group.

The approved number of personnel for 2018 is 21 employees. As of 31.12.2018 there are 4 vacant places for employees. The Group does not plan any significant changes to its human resources in 2019.

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

1.4. External auditor for 2018

With a decision from 10 August 2016, Protocol № 139 the BoD approved the results from the public tender for selection of external auditor and approved „Baker Tilly Klitou and Partners” OOD.

Subsequently this selection has been confirmed with Protocol T3-77/24.08.2016 from the Minister of Regional Development and Public Works, in his capacity of representative of Government as a sole shareholder.

1.5. Borrowed capital

In the second quarter of 2018, a procedure for selection of financing institutions for granting bank loans to FLAG was conducted. Following the completion of the procedure, contractors were selected, and three contracts were concluded with three banks for a new credit resource with a total value of BGN 90 million.

The total contracted long-term credit resource as at 31.12.2018 amounts to BGN 233 million, divided by type of loan and by creditor as follows:

- UniCredit Bulbank AD, long-term loan with repayment plan from 22.11.2016 – BGN 40 000 thousand
- UBB AD, revolving loan from 22.11.2016 - EUR 20 000 thousand /BGN 39 117 thousand/
- DSK Bank EAD, revolving loan from 17.05.2017 - BGN 40 000 thousand
- UniCredit Bulbank AD, revolving loan from 31.08.2018 - BGN 30 000 thousand
- UBB AD, revolving loan from 12.10.2018 - BGN 40 000 thousand
- Societe Generale Expressbank AD, revolving loan from 01.11.2018 – BGN 20 000 thousand
- MRDPW - through OPRD under the JESSICA instrument, conditional loan from 30.05.2012. - BGN 23 685 thousand

As at 31.12.2018 the current exposure on loans is as follows:

- UniCredit Bulbank AD - BGN 28 571 thousand
- UBB AD /2016/ - EUR 13 899 thousand /BGN 27 185 thousand/
- DSK Bank EAD - BGN 21 218 thousand
- UniCredit Bulbank AD /2018/ – BGN 30 000 thousand
- UBB AD /2018/ - BGN 0
- Societe Generale Expressbank AD – BGN 3 047 thousand
- MRDPW - through OPRD under the JESSICA instrument – BGN 22 898 thousand

The total current exposure of the Group's borrowed capital as at 31.12.2018 amounts to BGN 133 million.

1.6. Main results from lending activities in 2018

1.6.1. FLAG

In 2018, 102 requests for loans were received from 61 municipalities for a total amount of BGN 123 231 thousand. In the year 2018, 101 requests for loans were examined and evaluated, and all requests were approved with total amount of BGN 113 382 thousand, supporting the implementation of projects for BGN 488 million.

The average percentage share of the credit in the total budget of the project is 23.2%. The „typical“ loan provided to municipalities for bridge financing averaged BGN 1 040 thousand and an average maturity of 12 months. The average amount of loans repaid with own funds is BGN 1 625 thousand, with an average maturity of 86 months.

The average interest rate in 2018 is 2.957%, with a 6-month EURIBOR of 0% and a FLAG margin of 1.083%.

The table below provides information on the credits approved by FLAG in 2018 by type of credits and source of repayment of the principal.

Type of credits	Number of credits in 2018	Value of approved credits in 2018 (in thousand BGN)
Long-term	26	49 015
Incl. Bridge financing	12	25 494
Incl. Own contribution	14	23 521
Short-term	75	64 367
Incl. Bridge financing	74	63 517
Incl. Own contribution	1	850
Total	101	113 382

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD

Consolidated activity report

The following two tables present the structure of the lending operations of FLAG for 2018 based on credits approved during the year by type of project, operational program and source of repayment of the principal.

By Operational programs	Number of credits	Total amount in BGN thousand	Amount of credit in BGN thousand		Maturity in months	
			Min.	Max.	Min.	Max.
OPRD	61	73 895	102	10 330	7	120
OPE	7	21 745	460	6 000	9	120
RDP	2	377	114	263	10	12
CBC	24	15 127	97	2 409	6	120
EEA	1	741	741	741	60	60
NTEF	2	860	190	670	59	92
OPHRD	4	637	52	349	8	12

By source of repayment	Number of credits	Total amount in BGN thousand	Amount of credit in BGN thousand		Maturity in months	
			Min.	Max.	Min.	Max.
Operational programs	86	89 011	52	6 000	6	30
Own contribution	15	24 371	97	10 330	11	120

In 2018 the funds utilized under credit agreements signed with FLAG EAD amount to BGN 83 991 thousand, while the repayments amount to BGN 58 020 thousand.

In 2018 a total of 127 annexes to credit agreements with FLAG EAD were signed. The requests for annexes are mainly with the aim of extending the deadline for utilization - 38 requests, for extension of the deadline for repayment - 27, and for changing both periods - 18. The number of annexes within the category „Other“ is 44. The reasons are change of accounts, change in servicing bank and others.

The active credits of FLAG EAD as of 31.12.2018 are 236 amounting to BGN 169 265 thousand. Credits are split by types as follows:

- Bridge financing – BGN 78 922 thousand (46,6 % of active loans)
- Own financing – BGN 90 343 thousand (53,4 % of active loans)

1.6.2. FSUD

In 2018, a total of 11 disbursements for BGN 5 449 thousand were made, of which BGN 2 076 thousand from the OPRD sub-loan and BGN 3 370 thousand from the “Co-financing” sub-loan. The disbursements are under project funding agreements with „eMobility International“ AD, “Prosperitas Building” EOOD and Hospital “Pirogov” EAD and represent recycled funds.

Since the beginning of the FSUD activity and until 31 December 2018, a total of 95 disbursements have been made in the total amount of BGN 55 547 thousand, of which disbursements under the OPRD sub-loan – BGN 26 932 thousand, incl. BGN 2 329 thousand recycled funds.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD

Consolidated activity report

The breakdown of utilization per sectors for the period 2013 - 2018 in thousands of BGN is as follows:

Sector/Year	2013	2014	2015	2016	2017	2018	Total
1. Urban environment and economic activities	1 806	5 381	2 401	2 799	-	-	12 387
2. Educational, cultural and sports infrastructure	-	5 300	10 502	4 841	-	-	20 643
3. Health infrastructure	-	827	14 997	744	500	4 923	21 991
4. Integrated urban transport	-	-	-	-	-	526	526
Total:	1 806	11 508	27 900	8 384	500	5 449	55 547

As at 31 December 2018, the Fund's portfolio amounted to BGN 46 817 thousand (principal receivables on loans granted), distributed as follows: BGN 24 225 thousand provided by FSUD/sub-loan Co-financing and BGN 22 592 thousand provided by FMFIB (OPRD).

As of 31 December 2018, FSUD was able to invest 61% of the funds available for reinvestment in eligible projects, which fulfilled the first interim objective of the reinvestment phase, namely: by 31 December 2018, the Fund to allocate to Final Beneficiaries at least 50% of the reinvestment funds accrued at that date.

2. Participation of FLAG in financial instruments

2.1 Operational Agreement between FLAG, FSUD and FMFIB. Amendment Agreements. Transfer and substitution agreements.

As at 31 December 2018, the Operational Agreement between the European Investment Bank (replaced by FMFIB dated February 14, 2018), FSUD EAD and FLAG from May 30, 2012 for conditional loan is in effect.

Following the transfer of JESSICA Holding Fund functions at the end of 2017 from the Managing Authority of Operational Program Regional Development 2007-2013 (MA of OPRD) to the Fund Manager of Financial Instruments in Bulgaria EAD pursuant to the concluded Financing Agreement between the Parties, On February 14, 2018, a Transfer and Replacement Agreement to the Operational Agreement of 30 May 2012 was signed between the FMFIB, FLAG and FSUD. Under this transfer agreement, all rights, claims and obligations of MRDPW in respect of the Operating Agreement have been transferred to the FMFIB.

Subsequently, on 19 February 2018 Amendment Agreement No 6 to the Operational Agreement of 30 May 2012 was signed. This agreement regulates the use of funds during the reinvestment period and defines the overall process of liaison between FMFIB and FSUD on the implementation of the JESSICA initiative.

2.2 Participation in the procedure for selection of financial intermediaries for implementation of the “Fund for urban development” under the OPRD 2014-2020

The procedure for selecting financial intermediaries for the “Fund for Urban Development” under Operational Program “Regions in Growth” 2014-2020 was announced by the FMFIB in October 2017. The program resource, amounting to BGN 353.3 million, is intended to finance projects for urban development in 39 cities and regional tourism with territorial coverage all over Bulgaria and is divided into three separate lots - the Fund for Sofia, the Fund for Northern Bulgaria and the Fund for Southern Bulgaria.

In connection with the participation in the procedure, the Fund for Sustainable Cities (FSC), an entity established under the Obligation and Contracts Act of Republic of Bulgaria, was structured. It is established by FLAG, FSUD, UBB and the Bulgarian Consulting Organization. According to the agreement for setting-up the entity, FLAG is committed to provide 10% of the co-financing, which will be invested in eligible projects for urban development and tourism.

The Fund for Sustainable Cities (FSC) successfully passed the pre-selection stage of the procedure and submitted initial tenders on 01.06.2018, as required by the Public Procurement Act documentation. After negotiations with the contracting authority, on 23.07.2018 FSC submitted its final tenders.

Consolidated activity report

The decision of the contracting authority, FMFIB, for selection of contractors for the separate positions of the procedure, was published on August 14, 2018. According to this decision, the FSC was appointed as a contractor for Lot I - Urban Development Fund for Sofia and Lot III - Urban Development Fund South.

On 20 September 2018, two operational agreements were signed to assign the management of the two urban development funds (UDF Sofia and UDF South). By the end of 2018, all internal documents were finalized and preconditions related to obtaining permission to start the business were fulfilled.

3. Financial performance

3.1 Consolidated statement and structure of income and expenses of the Group

3.1.1 Consolidated Income Statement

Total revenues of the Group for the period are BGN 5,977 thousand, and are presented split by types below:

Revenue in BGN '000	2018	Share
Interest on loans	5,975	100%
Interest on deposits	2	0%
Total	5,977	100%

- ✓ **Revenue from lending activities** – around 100% of revenues are from lending activities. The return includes interest, management and commitment fees.
- ✓ **Management of temporary free funds** – As of 31.12.2018 FLAG's contract for deposit account and for a current account with a preferential interest have expired.

Total revenue of the Group from management of temporary free funds amounts to BGN 2 thousand.

REVENUES in BGN '000		6,725
1	Interest income on loans	5,969
2	Penalty interest on loans	6
3	Fees on loans granted	735
4	Interest income on deposits	2
5	Other income	13

3.1.2 Consolidated expenses

Group of expenses	Amount in BGN thousand	Share in total expenses in %
Maintenance Costs	158	5%
Hired services	144	5%
Depreciation expense	28	1%
Remunerations - staff, BoD (including social securities)	1,001	33%
Bank fees including Managing bank fees	817	27%
Interest expenses	877	29%
Total	3,025	100%

3.1.3 Results

Profit before tax of the Group for 2018 is BGN 3,805 thousand and net profit is BGN 3,462 thousand.

3.2 Dividends and distribution of profit

In 2018, by a decision of the Board of Directors, the Group formed a reserve fund of 10% of the net profit for 2017 in the amount of BGN 289 thousand, after which it distributed a dividend to the state in the amount of BGN 1,299 thousand, which was paid during this year.

3.3 Subsidiary company

As of 31 December 2018, FLAG EAD is the sole shareholder in “Fund for Sustainable Urban Development” EAD (FSUD), which is registered in the Registry Agency on 23 April 2012. “Fund for Sustainable Urban Development” EAD (FSUD) has no subsidiaries.

As of 31.12.2018 the companies have no branches.

4. Business plan of the Group for 2019

4.1 Overall assessment of loan demand

4.1.1 FLAG

The table below shows a breakdown of the expected demand for loans in 2019.

Summary assessment for the expected new credit resource in 2019 in BGN thousand is presented in the table below:

Programs	Bridge financing	Co-financing	Total
OPRD	83 100 000	10 000 000	93 100 000
OPE	15 000 000	21 000 000	36 000 000
CBC	11 500 000	1 500 000	13 000 000
OPHRD	500 000	-	500 000
RDP and others	1 200 000	1 000 000	2 200 000
Total	111 300 000	33 500 000	144 800 000

4.1.2. FSUD

The main goals set by the management for 2019 are as follows:

- FSUD as a partner in the FSC - identification, structuring, evaluation and approval of project proposals in order to successfully invest the resource provided by OPRD 2014-2020 through FMFIB and the co-financing provided by FSC in eligible urban development and tourism projects for the regions Sofia and Southern Bulgaria;
- FSUD as a JESSICA Urban Development Fund - monitoring and control of active loans in order to minimize the risk of non-payment or overdue payments by final recipients. Successful completion of projects in process of implementation within the agreed deadlines.

4.2 Financial income and result

On the basis of assumptions made in FLAG's business plan, analysis of operations and estimates of income and expenditure for 2019, an operating profit (profit before tax and impairment loss) in the amount of BGN 3 004 thousand has been projected.

On the basis of assumptions made in FSUD's business plan, analysis of operations and estimates of income and expenditure for 2019, an operating profit (profit before tax and impairment loss) in the amount of BGN 612 thousand has been projected.

4.3 Information under Art. 187 d and Art 247 from the Commercial Act

In 2018 no own shares of the companies in the Group were acquired or transferred.

Remuneration of key management personnel in 2018 amounts to BGN 372 thousand.

As of 31.12.2018 the members of the Board of Directors of FLAG EAD, as well as the members of the Supervisory and Management Board of FSUD, have the following participations in 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” EAD; Member of the Board of Directors and Executive Director of “Fund for Local Authorities and Governments in Bulgaria – FLAG“ EAD;
- Dobromir Simidchiev – executive director and member of the Board of Directors of "HIDROLIA" AD, shareholder in "TYUBOR" OOD with 50% share;
- Plamen Ivanov Dermendzhiev – “Commercial Bank D” – member of the Managing Board;
- Emil Rumenov Savov – “Effective Solutions Group” OOD – manager and shareholder with a 50% share (i.e. BGN 3 000) in the company;
- Stelian Slavkov Dimitrov – “Geographica” OOD – shareholder with a 50% share in the company;
- Desislava Lozanova Ivanova – Atanasova – Lozanova & Groysman Law Firm – shareholder with a 50% share in the company; “Paynetiks” AD – member of the Board of Directors.

5. Research and development activity

In 2018, the Group has not been engaged in research and development activities.

6. Financial risk management and financial instruments

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

In 2018 and 2017, the Group neither owned nor traded with derivative financial instruments.

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

Interest-rate risk

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

Consolidated activity report

Liquidity risk

The effective management of the Group's liquidity presumes that sufficient working capital will be ensured 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 Group 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 Group'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 Group within the envisaged/agreed deadlines. As at the end of 2018 the remaining liability of municipalities to the Group amounts to BGN 210,226 thousand and at the end of 2017 it was BGN 181,851 thousand.

Credit risk management in FLAG EAD in 2018 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 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 a 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 2018 is based on the Funds' Credit loss impairment policy, developed in accordance with IFRS 9 Financial Instruments.

7. Significant events after the reporting period

There have been no events after 31 December 2018 which require further adjustments and/or disclosures in the financial statements of the Group for the year ended 31 December 2018.

Prepared by: Nadya Dankinova – Executive director
29 May 2019




**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**

For the year ended 31 December 2018

	Notes	2018 BGN'000	2017 BGN'000
Interest income	3.1	5,977	5,700
Interest expenses and charges	3.2	(1,694)	(1,571)
Other operating income	3.3	748	571
Net operating income		5,031	4,700
Reintegrated/ (Expenses for) impairment of loans granted	9	105	(275)
Payroll expenses	3.4	(1,001)	(899)
Depreciation expenses	7	(28)	(29)
Other operating expenses	3.5	(302)	(290)
Profit before tax		3,805	3,207
Income tax expense	4	(343)	(321)
Profit for the year		3,462	2,886
Other comprehensive income for the year, net of taxes		-	-
Total comprehensive income for the year, net of taxes		3,462	2,886

These consolidated financial statements were authorized for issue by the Board of Directors on 29 May 2019.

The notes on pages 15 to 44 are an integral part of these consolidated financial statements.


Nadya Yordanova Dankinova
Executive Director





Kalinka Ruskova Todorova
Chief Accountant

In accordance with an Independent Auditor's Report:


Liliya Rangelova
Registered auditor
29 May 2019




Krassimira Radeva
Managing director
Baker Tilly Klitou and Partners OOD

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

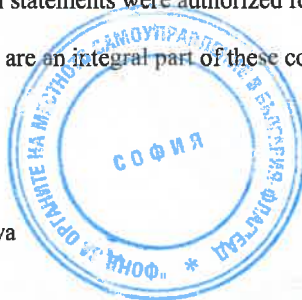
As at 31 December 2018

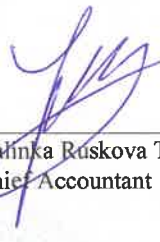
	Notes	31 December	
		2018	2017
		BGN'000	BGN'000
ASSETS			
Cash and cash equivalents	5	25,007	27,182
Receivables and prepayments	6	173	122
Loans granted	9	210,226	181,851
Deferred tax assets	4	2	1
Plant and equipment	7	36	35
Software	7	6	8
TOTAL ASSETS		235,450	209,199
LIABILITIES AND EQUITY			
Liabilities			
Payroll and social security payables	11	143	85
Income tax payable	12	56	47
Other liabilities	13	265	338
Loans payable	10	132,661	108,193
Total liabilities		133,125	108,663
Equity			
Share capital	14.1	90,000	90,000
Statutory reserves	14.2	2,796	2,507
Retained earnings		9,529	8,029
Total equity		102,325	100,536
TOTAL LIABILITIES AND EQUITY		235,450	209,199

These consolidated financial statements were authorized for issue by the Board of Directors on 29 May 2019.

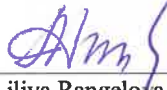
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Nadya Yordanova Dankinova
Executive Director





Kalinka Ruskova Todorova
Chief Accountant

In accordance with an Independent Auditor's Report:


Liliya Rangelova
Registered auditor
29 May 2019




Krassimira Radeva
Managing director
Baker Tilly Klitou and Partners OOD

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

For the year ended 31 December 2018


	Note	Share capital	Retained earnings	Statutory reserves	Total
		BGN'000	BGN'000	BGN'000	BGN'000
As at 1 January 2017		90,000	6,787	2,208	98,995
Profit for the year		-	2,886	-	2,886
Total comprehensive income		-	2,886	-	2,886
Dividend distribution		-	(1,345)	-	(1,345)
Transfer to reserves		-	(299)	299	-
As at 31 December 2017		90,000	8,029	2,507	100,536
<i>Effects on 1 January 2018 from application of IFRS 9</i>	2.3	-	(374)	-	(374)
As at 1 January 2018		90,000	7,655	2,507	100,162
Profit for the year		-	3,462	-	3,462
Total comprehensive income		-	3,462	-	3,462
Dividend distribution		-	(1,299)	-	(1,299)
Transfer to reserves		-	(289)	289	-
As at 31 December 2018	14	90,000	9,529	2,796	102,325

These consolidated financial statements were authorized for issue by the Board of Directors on 29 May 2019.


The notes on pages 15 to 44 are an integral part of these consolidated financial statements.


Nadya Yordanova Dankinova
Executive Director

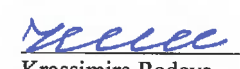



Kalinka Ruskova Todorova
Chief Accountant

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Liliya Rangelova
Registered auditor
29 May 2019




Krassimira Radeva
Managing director
Baker Tilly Klitou and Partners OOD

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
CONSOLIDATED CASH FLOW STATEMENT**

For the year ended 31 December 2018

	Notes	2018 <i>BGN'000</i>	2017 <i>BGN'000</i>
Cash flows from operating activities			
Proceeds from interest on bank deposits		2	45
Loans granted		(89,440)	(51,136)
Loans repaid		60,794	45,924
Interest received on loans granted		5,977	5,673
Payments to suppliers		(777)	(721)
Payments to personnel and for social security		(964)	(939)
Other proceeds/(payments), net		527	400
Income tax paid		(335)	(366)
Net cash flows from / (used in) operating activities		(24,216)	(1,120)
Cash flows from investing activities			
Purchase of equipment and other fixed assets		(27)	(4)
Net cash flows used in investing activities		(27)	(4)
Cash flows from financing activities			
Loans received		47,946	30,570
Repayment of loans		(23,386)	(34,657)
Dividends paid		(1,299)	(1,345)
Interest paid		(877)	(752)
Fees and commissions paid		(316)	(274)
Net cash flows from (used in) financing activities		22,068	(6,458)
Net increase / (decrease) in cash and cash equivalents		(2,175)	(7,582)
Cash and cash equivalents at the beginning of the period	5	27,182	34,764
Cash and cash equivalents at the end of the period	5	25,007	27,182


These consolidated financial statements were authorized for issue by the Board of Directors on 29 May 2019.

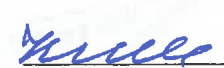
The notes on pages 15 to 44 are an integral part of these consolidated financial statements.


Nadya Yordanova Dankinova
Executive Director


Kalinka Ruskova Todorova
Chief Accountant

In accordance with an Independent Auditor's Report:


Liliya Rangelova
Registered auditor
29 May 2019


Krassimira Radeva
Managing director
Baker Tilly Klitou and Partners OOD



This document is a translation of the original Bulgarian text, in case of divergence the Bulgarian original shall prevail

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2018

1. Corporate information

The consolidated financial statements of FLAG EAD (“the Company”) and its subsidiary FSUD (“the Group”) for the year ended 31 December 2018 were authorized for issue by a decision of the Board of Directors dated 29 May 2019.

FLAG EAD 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.

In the consolidated financial statements, the investment in subsidiary (where the Group has a direct or indirect control over the operations of the entities) has been consolidated.

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

The core activity of the Group 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 2018, the shareholders of the Company include:
Republic of Bulgaria, represented by the Minister of Regional Development and Public Works – 100.00%.

2.1 Basis of preparation of the consolidated financial statements

The consolidated 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 the financial statements in conformity with IFRS requires the use of certain critical estimates and assumptions. It also requires management to exercise its judgment in the process of applying the Group’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 2.2o).

New and amended standards and interpretations

During the current year the Group adopted all the new and revised International Financial Reporting Standards (IFRS) that are relevant to its operations and are effective for accounting periods beginning on 1 January 2018.

At the date of approval of these financial statements, standards and interpretations were issued by the International Accounting Standards Board (IASB)/International Financial Reporting Interpretations Committee (IFRIC) which were not yet effective. Some of them were 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 and amendments to existing standards, issued by IASB/IFRIC but not yet effective and not early adopted up to the date of issuance of the Group’s financial statements are listed below.

- Amendment to IFRS 9 "Financial Instruments" – regarding prepayment features with negative compensation (in force for annual periods beginning on or after 1 January 2019) - The management does not expect the adoption of this amendment to have a significant effect on the financial statements of the Group.
- Amendment to IAS 28 "Investments in Associates and Joint Ventures" – regarding long-term interests in associates and joint ventures (in force for annual periods beginning on or after 1 January 2019) - The management does not expect the adoption of this amendment to have a significant effect on the financial statements of the Group.

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

For the year ended 31 December 2018

2.1 Basis of preparation of the consolidated financial statements (continued)

- IFRIC 23 "Uncertainty over Income Tax Treatments" (in force for annual periods beginning on or after 1 January 2019) - The management does not expect the adoption of this interpretation to have a significant effect on the financial statements of the Group.
- Amendment to IAS 19 "Employment Benefits" – Plan amendment, curtailment or settlement (in force for annual periods beginning on or after 1 January 2019) - The management does not expect the adoption of this amendment to have a significant effect on the financial statements of the Group.
- Amendments to different standards – Annual Improvements to IFRSs 2015-2017 Cycle – resulting from the annual project for improvements to IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) mainly aimed to eliminate contradictions and clarify wording (in force for annual periods beginning on or after 1 January 2019) - The management does not expect the adoption of these amendments to have a significant effect on the financial statements of the Group.
- IFRS 16 Leases - (in force for annual periods beginning on or after 1 January 2019). The standard represents a significant change in the presentation and accounting of lessees. It requires the recognition of assets and liabilities under all leases (financial and operating) unless they are of low value assets or for a period of less than 12 months. Upon acceptance of the standard, leases will form a "Right of use" asset and a lease liability for future payments. The Group will adopt IFRS 16 from 1 January 2019 under the modified retrospective approach. IFRS 16 establishes lessees to account for all leases under a single model that requires them to be recognized in the balance sheet, similar to accounting for a financial lease under IAS 17. The Group has reviewed and analyzed all its leases in the light of the requirements of the new IFRS 16. The standard will affect mainly the Group's operating leases as a lessee.
 - a) The Company expects to recognize "right of use" assets amounting to approximately BGN 138 thousand on 01.01.2019 and respectively lease liabilities amounting to approximately BGN 138 thousand.
 - b) The Company expects that the net profit for 2019 will decrease with approximately BGN 1 thousand as a result of adoption of the new standard.
 - c) The EBITDA is expected to increase with approximately BGN 48 thousand due to presentation of lease expenses as depreciation of the "right of use" assets and interest expenses on the lease liability.
 - d) The net cash flows from operational activities will increase and the net cash flows from financing activities will decrease with approximately BGN 48 thousand, due to the fact that the payment of principal under lease contracts will be presented in the financing activities.

New Standards and amendments, issued by IASB but not yet adopted by the EU

At present, IFRS as adopted by the EU do not significantly differ from those adopted by the IASB except from the following new standards and amendments to existing standards, which are not yet endorsed by EU as at the date of approval of these financial statements (the effective dates stated below are for IFRS in full):

- IFRS 17 "Insurance Contracts" (effective for annual periods beginning on or after 1 January 2021);
- Amendments to IAS 1 "Presentation of Financial Statements" and IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" (effective for annual periods beginning on or after 1 January 2020);
- Amendments to References to the Conceptual Framework (effective for annual periods beginning on or after 1 January 2020);
- Amendments to IFRS 3 "Business Combinations" - Definition of a Business (effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period).

The Group expects that the adoption of these standards and amendments to existing standards will not have significant impact on the financial statements of the Group in the period of initial application.

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

For the year ended 31 December 2018

2.2 Summary of significant accounting policies

a) Foreign currency conversion

The financial statements are presented in Bulgarian Leva (BGN), which is the Group'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 estimated 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

Accounting policy applicable from 1 January 2018

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 time 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 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).

Accounting policy applicable until 31 December 2017

Interest income is recognized using the effective interest rate, i.e. the interest rate that discounts exactly the estimated future cash flows over the estimated useful life of the financial instrument, or a shorter period where appropriate, to the carrying amount of the financial asset.

The calculation includes all fees and consideration paid or received by the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

(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.

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.

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

For the year ended 31 December 2018

2.2 Summary of significant accounting policies (continued)

d) Taxes (continued)

Deferred income tax

Deferred income tax is provided using the liability method on 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 Group and it is probable that the temporary differences will not 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 Group 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 Group 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.

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

For the year ended 31 December 2018

2.2 Summary of significant accounting policies (continued)

e) Financial instruments – initial recognition and subsequent measurement

Accounting policy applicable from 1 January 2018

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.

- **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 Group 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 Group'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 the subsequent valuation, the Group's financial assets are classified in the following category:

• Financial assets at amortized cost (debt instruments)

The Group 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 Group'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 provided

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 Group's business model is solely for the purpose of collecting contractual cash flows of principal and 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.

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

For the year ended 31 December 2018

2.2 Summary of significant accounting policies (continued)

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

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 Group when:

- the rights to the cash flows from the assets have expired, or
- the Group has transferred the contractual rights to receive the cash flows from the asset, or the Group has assumed a contractual obligation to remit those cash flows without significant delay to a third party under a transfer arrangement wherein: a) the Group has transferred substantially all the risks and rewards of ownership of the asset; or b) the Group 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 Group 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 Group 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 Group 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 Group 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 Group may be required to pay.

Impairment of financial assets

The Group 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 Group 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 Group applies the general approach for impairment set by IFRS 9. Under this approach, the Group 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 default 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 Group 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.

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

For the year ended 31 December 2018

2.2 Summary of significant accounting policies (continued)

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

The management of the Group 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 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 Group.

The Group 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.

Accounting policy applicable until 31 December 2017

Initial recognition

Financial assets within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* are classified as either financial assets at fair value through profit or loss, or loans and receivables, or held-to-maturity investments, or available-for-sale financial assets, or derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial assets at initial recognition.

Financial assets are recognized initially at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

Purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the market place (regular purchases) are recognized on the trade (transaction) date, which is the date on which the Group committed to purchase or sell the asset.

Financial assets of the Group include cash and cash equivalents, loans granted, trade and other receivables.

Subsequent measurement

The subsequent measurement of financial assets depends on their classification, as follows:

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement loans and receivables are subsequently carried at amortised cost using the effective interest rate method (EIR), less any allowance for impairment. Amortised cost is calculated considering any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The EIR amortisation is included in finance income in the statement of comprehensive income. The losses arising from impairment are recognised as other expenses in the statement of comprehensive income.

Derecognition

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

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

When the Group has transferred its rights to receive cash flows from a financial asset or has entered a transfer agreement, and has neither transferred nor retained substantially all the risks and rewards of ownership of the asset, but has retained control of the asset, the asset is recognized to the extent of the Group’s continuing involvement in the asset. In that case the Group also recognizes the associated liability. The transferred asset and the related liability are recognized on a basis that reflects the rights and obligations that the Group has retained.

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2.2 Summary of significant accounting policies (continued)

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

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Impairment of financial assets

Financial assets carried at amortised cost

For financial assets carried at amortised cost, the Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has occurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the expected future cash flows is discounted at the financial asset's original effective interest rate.

Evidence of impairment may include indications that the debtors or a group of debtors are experiencing significant financial difficulty, default or delinquency in interest or principal payments, there is probability that they will enter bankruptcy or other financial reorganization, or where observable data indicate that there is a measurable decrease in the expected future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial assets at amortised cost

Due to its specific activity, the Group accrues allowance for impairment as follows:

Specific impairment

The purpose of the specific impairment is to adjust the value of specific loans granted, for which objective evidence of impairment exists, to their recoverable amount and to set aside provisions reflecting the risk of non-repayment of the respective loans.

Impairment on a portfolio basis

Impairment is charged in consideration of the common risk nature of the portfolio and takes into account the overall structure of the loan portfolio, the amount of receivables overdue as at the reporting date and the management's expectations as to the recoverable amount of loans granted.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the statement of comprehensive income. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Loans granted and the related allowances are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is recognized in the statement of comprehensive income.

- Financial liabilities

Accounting policy applicable from 1 January 2018

Initial recognition, Classification, and Measurement

The Group'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.

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For the year ended 31 December 2018

2.2 Summary of significant accounting policies (continued)

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

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 Group 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.

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 Group'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 Group 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 Group'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.

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.

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2.2 Summary of significant accounting policies (continued)

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

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".

Accounting policy applicable until 31 December 2017

Initial recognition and measurement

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as effective hedging instruments, as appropriate. The Group determines the classification of its financial liabilities at initial recognition.

Financial liabilities are recognized initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs.

The Group's financial liabilities include interest-bearing loans and trade and other liabilities.

Subsequent measurement

The subsequent valuation of financial liabilities depends on their classification as follows:

Loans and borrowings

After initial recognition, interest-bearing loans are subsequently measured by the Group at amortised cost using the EIR method. Gains and losses relating to loans and borrowings are recognized in the statement of comprehensive income for the period when the liabilities are derecognized as well as through the amortisation process.

Amortised cost is calculated by considering any discounts or premiums on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included in interest expenses in the statement of comprehensive income.

Derecognition

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

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

f) IFRS 13 Fair value measurement

At each reporting date the Group applies IFRS 13 Fair value measurement to the financial instruments and non-financial assets measured at fair value. The fair value is that, which 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 market 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 Group.

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 contractor in the market who will use it with maximum efficiency.

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2.2 Summary of significant accounting policies (continued)

f) IFRS 13 Fair value measurement (continued)

The Group is applying evaluation 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 for the purposes of whose valuation a fair market value is used or disclosed are arranged into the following three hierarchical levels based on the hypotheses underlying the valuation techniques:

- Level 1 — Quoted (unadjusted) prices on active markets of identical assets or liabilities;
- Level 2 — Valuation techniques, which allow all 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 Group 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 Group determines the assets and liabilities whose fair value should be disclosed based on their nature, risk and level in the hierarchy as noted above.

g) Share capital and reserves

The share capital is presented at the par value of shares issued and paid. The Group 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.

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For the year ended 31 December 2018

2.2 Summary of significant accounting policies (continued)

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).

k) Leases

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) Subsidiaries and consolidation

Subsidiaries are all entities (including structured entities) controlled by the Group. The Group controls an entity when it has rights over the entity in which it has invested, it is exposed to variable returns from its involvement with the entity and has the ability to affect those returns.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences and they are deconsolidated from the date that control ceases. All intra-group transactions, account balances and unrealized gains, arising from to intra-group transactions, are eliminated in the consolidation. The unrealized losses are also eliminated, unless the transaction provides an evidence for impairment of the assets transferred. Where necessary, the accounting policies of the subsidiaries have been changed in order to be consistent with those applied by the Group.

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 Group 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

Accounting policy applicable from 1 January 2018

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

Accounting policy applicable until 31 December 2017

Cash and cash equivalents at banks are subsequently presented at amortized cost less accumulated impairment losses on actually incurred credit losses.

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For the year ended 31 December 2018

2.2 Summary of significant accounting policies (continued)

n) Provisions

General

Provisions are recognized when the Group 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 Group 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 consolidated 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:

Accounting policy applicable from 1 January 2018

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 Group'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.

Accounting policy applicable until 31 December 2017

Impairment of financial receivables

The Group uses an allowance account to record the provision for impairment of doubtful and bad debts. Management assesses the adequacy of this impairment based on an ageing analysis of the receivables, historical experience as to the write-off rates of bad debts, as well as solvency analysis of the respective debtor, changes in the contractual payment terms, etc. If the financial position and financial performance of debtors deteriorate (more than expected), the amount of the receivables to be written off in the next reporting periods may be higher than the one estimated 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 Group 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.

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For the year ended 31 December 2018

2.2 Summary of significant accounting policies (continued)

o) Significant accounting judgments, estimates and assumptions (continued)

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.

2.3. Effects from the initial application of IFRS 9 and IFRS 15

The Group has selected to apply IFRS 15 Revenue from Contracts with Customers for the first time under the modified retrospective approach. When adopting IFRS 9 Financial instruments the Company has applied the exemptions upon its initial application. All adjustments resulting from the initial application of the two new standards are reported in equity (to “retained earnings”) as of January 1, 2018. Comparative information for 2017 has not been restated. It is presented and disclosed in accordance with the requirements of IAS 39 Financial Instruments: Recognition and Measurement (replaced), IFRS 7 Financial Instruments: Disclosures, IAS 18 Revenue (replaced) and IAS 11 Construction Contracts (replaced) and related interpretations.

IFRS 9 Financial instruments replaces the provisions of IAS 39 Financial instruments: Recognition and Measurement in relation to the recognition, classification and valuation of financial assets and financial liabilities, de-recognition of financial instruments, impairment of financial assets and hedge accounting. New classification criteria and groups of financial assets are introduced, as well as new rules for their subsequent valuation and the recognition of interest income. Upon the initial adoption of IFRS 9 Financial instruments, the Group has taken the exemptions, applying the requirements of the standard on contracts for financial instruments opened at 01.01.2018.

IFRS 15 Revenue from contracts with customers replaces IAS 18 Revenue, which includes contracts for goods and services, as well as IAS 11 Construction contracts, which encompasses construction contracts and the related SIC and IFRIC. The adoption of the new IFRS 15 Revenue from contracts with customers significantly increases the use of judgements on revenue recognition and provides guidance on the recognition of contract costs.

The cumulative effect of the initial application of IFRS 15 is insignificant and is therefore not reflected in these financial statements.

The effects of applying IFRS 9 as of 1 January 2018 are set out below:

Statement of financial position	Note	31.12.2017 before IFRS 9 effect	Effect from application of IFRS 9	01.01.2018 after application of IFRS 9
		BGN'000	BGN'000	BGN'000
ASSETS				
Cash and cash equivalents		27,182	-	27,182
Receivables and prepayments		122	-	122
Loans granted	9	181,851	(374)	181,477
Deferred tax assets		1	-	1
Plant and equipment		35	-	35
Software		8	-	8
TOTAL ASSETS		209,199	(374)	208,825
LIABILITIES AND EQUITY				
Liabilities				
Payroll and social security payables		85	-	85
Income tax payable		47	-	47
Other liabilities		338	-	338
Loans payable		108,193	-	108,193
Total liabilities		108,663	-	108,663

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2.3. Effects from the initial application of IFRS 9 and IFRS 15 (continued)

Statement of financial position	Note	31.12.2017 before IFRS 9 effect BGN'000	Effect from application of IFRS 9 BGN'000	01.01.2018 after application of IFRS 9 BGN'000
Equity				
Share capital		90,000	-	90,000
Statutory reserves		2,507	-	2,507
Retained earnings		8,029	(374)	7,655
Total equity		100,536	(374)	100,162
TOTAL LIABILITIES AND EQUITY				
		209,199	(374)	208,825

3. Income and expenses

3.1 Income from interest

	2018 BGN'000	2017 BGN'000
Interest income on deposits and bank accounts	2	45
Income on loans granted and receivables	5,975	5,655
Total interest income	5,977	5,700

3.2. Interest expenses and charges

	2018 BGN'000	2017 BGN'000
Interest expenses on loans and borrowings	877*	751
Expenses on fees, commissions and foreign exchange differences	817	820
Total interest expenses and charges	1,694	1,571

3.3 Other operating income

	2018 BGN'000	2017 BGN'000
Management fee and commitment fee	735	562
Other	13	9
Total other operating income	748	571

3.4 Payroll costs

	2018 BGN'000	2017 BGN'000
Salaries and wages	901	808
Social securities	100	91
Total payroll costs	1,001	899

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3. Income and expenses (continued)

3.5 Other operating expenses

	2018	2017
	<i>BGN'000</i>	<i>BGN'000</i>
Accounting and audit services	48	37
Rent	56	56
Materials	18	22
Legal services	18	16
Communication services	8	8
Hardware maintenance	6	6
Consulting services	50	24
Social expenditure	14	14
Insurances	2	2
Other	82	105
Total other operating expenses	302	290

4. Income tax

The main components of the income tax expense for the years ended 31 December 2018 and 2017 include:

	2018	2017
	<i>BGN'000</i>	<i>BGN'000</i>
Current income tax expense	344	320
Deferred income taxes related to occurrence and reversal of temporary differences	(1)	1
Income tax expense	343	321

In 2018 the applicable statutory tax rate is 10% (2017: 10%).

Reconciliation between income tax expense and the accounting profit multiplied by the statutory tax rate for the years ended 31 December 2018 and 31 December 2017 is presented below:

	2018	2017
	<i>BGN'000</i>	<i>BGN'000</i>
Accounting profit before taxes	3,805	3,207
Income tax expense at statutory tax rate of 10% for 2018 (2017: 10%)	381	321
Permanent differences	(38)	-
Income tax expense	343	321

As of 31.12.2018 the Group owes corporate income tax amounting to BGN 56 thousand. (31.12.2017: BGN 47 thousand).

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

	Temporary difference	Tax	Temporary difference	Tax
	31.12.2018	31.12.2018	31.12.2017	31.12.2017
	<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	19	2	14	1

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5. Cash and cash equivalents

	31 December	
	2018	2017
	<i>BGN'000</i>	<i>BGN'000</i>
Cash in hand and in current accounts	24,703	10,023
Short-term bank deposits	-	15,034
Funds in a special account	69	1,915
Funds in a reserve account	235	210
Total cash and cash equivalents	25,007	27,182

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). A pledge in favor of FMFIB has been established on the funds in the special and reserve accounts.

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 Group has not recognized an allowance for expected credit losses as of 1 January 2018 and 31 December 2018.

6. Receivables and prepayments

	31 December	
	2018	2017
	<i>BGN'000</i>	<i>BGN'000</i>
Receivables under management fee – FMFIB / MRDPW	110	85
Deferred expenses	-	5
Advances to suppliers	21	6
Other receivables	42	26
Total receivables and prepayments	173	122

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

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7. Plant and equipment, software

	Hardware	Fixtures and equipment	Plant and equipment	Vehicles	Software	Other Fixed Assets	Total
	BGN'000	BGN'000	BGN'000	BGN'000	BGN'000	BGN'000	BGN'000
Book value:							
As of 1 January 2017	42	10	22	49	29	6	158
Additions	4	-	-	-	-	-	4
Disposals	(5)	-	-	-	-	-	(5)
As of 31 December 2017	41	10	22	49	29	6	157
Additions	21	-	-	-	6	-	27
Disposals	-	-	-	-	-	-	-
As of 31 December 2018	62	10	22	49	35	6	184
Depreciation:							
As of 1 January 2017	(38)	(8)	(16)	(10)	(13)	(5)	(90)
Depreciation charge	(4)	(1)	(4)	(12)	(8)	-	(29)
Written-off depreciation	5	-	-	-	-	-	5
As of 31 December 2017	(37)	(9)	(20)	(22)	(21)	(5)	(114)
Depreciation charge	(4)	(1)	(2)	(12)	(8)	(1)	(28)
Written-off depreciation	-	-	-	-	-	-	-
As of 31 December 2018	(41)	(10)	(22)	(34)	(29)	(6)	(142)
Carrying amount							
As of 1 January 2017	4	2	6	39	16	1	68
As of 31 December 2017	4	1	2	27	8	1	43
As of 31 December 2018	21	-	-	15	6	-	42

8. Subsidiary company

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” 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 FSUD EAD.

On December 14, 2015, a transfer and replacement agreement was signed between the EIB, MRDPW, FSUD 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 MRDPW rights and obligations 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” EAD amounting to 4,500,000 BGN, representing 4,500 new, ordinary, available, shares with nominal value of BGN 1,000. 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” EAD from BGN 500,000 to BGN 5,000,000.

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9. Loans granted

	31 December	
	2018	2017
	BGN'000	BGN'000
Loans granted to municipalities	169,265	143,294
Accrued, but unpaid interest related to loans granted to municipalities	107	107
Impairment of receivables related to loans granted to municipalities	(4,983)	(4,951)
Total loans granted to municipalities, net	164,389	138,450
Loans granted for urban development projects under Jessica initiative	46,817	44,142
Accrued, but unpaid interest	24	26
Impairment of receivables related to loans granted	(1,004)	(767)
Total loans granted under Jessica initiative, net	45,837	43,401
Total loans granted	210,226	181,851

Loans granted represent loans provided to municipalities, two local initiative groups, and one state-owned company as well as loans granted under Jessica initiative. One part of the loans granted – BGN 78,922 thousand is used as bridge financing under European programs and BGN 90,343 thousand for financing of municipalities' own activities. As of 31.12.2017 bridge financing loans amounted to BGN 41,019 thousand and those for financing own activities amounted to BGN 102,275 thousand.

As at 31.12.2018 the loans granted under Jessica initiative amount to BGN 46,817 thousand (31.12.2017: BGN 44,142 thousand).

Loans granted are secured mainly with specific pledges over the future receivables of the municipalities under the grant agreements and the future own revenue of the municipalities. Loans granted to beneficiaries under the Jessica program are secured by various types of collateral (mortgages of land and buildings, pledges of receivables, etc.), which at any time must exceed 125% of the amount of the unpaid principal, interest and fees on the loan at the time. Current and future receivables on loans granted by FLAG EAD are pledged as collateral per bank loans from UniCredit Bulbank AD, UBB AD, DSK Bank EAD and Expressbank (Note 10).

As at 31.12.2017 the impairment of receivables on loans granted is made in accordance with the Impairment policy adopted by FLAG EAD and is portfolio based. The specific impairment is accrued after the review of the loans granted to specific borrowers. The assessment is made in accordance with the Funds' Impairment policy for credit losses.

As of 31.12.2017 the impairment of bridge financing loans amounts to BGN 205 thousand, the impairment of loans repaid by own funds amounts to BGN 4,746 thousand and the impairment of loans under Jessica initiative - BGN 767 thousand.

In 2018, a new impairment policy for expected credit losses was adopted in accordance with IFRS 9, according to which, as of 31 December 2018, a provision for expected credit losses for bridge financing loans and loans repaid by own funds of BGN 4,983 thousand was calculated, along with a provision for expected credit losses on loans under the Jessica program in the amount of BGN 1,004 thousand.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
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9. Loans granted (continued)

The changes in the accrued impairment on loans granted in 2018 and 2017 are as follows:

	<i>Impairment of receivables from loans granted</i>
As of 1 January 2017 incl.	<u>(5,443)</u>
- for bridge financing	(107)
- for own financing	(4,908)
- for loans under Jessica initiative	(428)
(Accrued) / Reintegrated during the year - incl.	(275)
- for bridge financing	(98)
- for own financing	162
- for loans under Jessica initiative	(339)
As of 31 December 2017 as per IAS 39	<u>(5,718)</u>
- for bridge financing	(205)
- for own financing	(4,746)
- for loans under Jessica initiative	(767)
Amounts recognized in the opening balance of retained earnings from the first-time adoption of IFRS 9 under the modified retrospective approach	<u>(374)</u>
The opening balance of the loss adjustment as of 1 January 2018, calculated under IFRS 9	<u>(6,092)</u>
Reduction in credit loss adjustment, recognized in profit or loss during the year	<u>105</u>
As of 31 December 2018	<u>(5,987)</u>

10. Loans payable

	Maturity	31 December	
		2018	2017
		<i>BGN'000</i>	<i>BGN'000</i>
Long-term revolving loan payable to UniCredit Bulbank	August 2020	30,000	-
Revolving loan payable to DSK	May 2024	21,218	14,549
Long-term loan payable to UniCredit Bulbank	November 2023	28,571	34,286
Revolving loan payable to UBB	November 2023	27,185	35,579
Long-term loan payable to Expressbank	October 2025	3,047	-
Deferred fees under loan agreements		(275)	(244)
Accrued interest due		17	18
Total loans payable to banks		<u>109,763</u>	<u>84,188</u>
Loans payable to FMFIB / MRDPW	June 2035	22,898	24,005
Total loans payable to FMFIB / MRDPW		<u>22,898</u>	<u>24,005</u>
Total loans payable		<u>132,661</u>	<u>108,193</u>

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10. Loans payable (continued)

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 2018, the amount of BGN 21,218 thousand is utilized (as of 31.12.2017 - BGN 14,549 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 31.12.2018 the utilized amount is BGN 28,571 thousand (as of 31.12.2017 - BGN 34,286 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 Cibank EAD (presently UBB AD) for the amount of EUR 20,000 thousand for a period of 84 months. As of December 31, 2018, EUR 13,899 thousand (BGN 27,185 thousand) are utilized. As of December 31, 2017, EUR 18,191 thousand (BGN 35,579 thousand) were utilized. The agreed interest rate on this loan is based on a six-month EURIBOR plus margin.

Under a contract concluded on 01.11.2018 with Societe Generale Expressbank AD, the utilized amount is 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. As of 31.12.2018 no utilizations have been made.

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

On 30 May 2012 an Operational Agreement was signed between the European Investment Bank (EIB) (replaced by MRDPW as of 01.01.2016), "Fund for Sustainable Urban Development" (FSUD) EAD and "Fund for Local Authorities and Governments in Bulgaria – FLAG" EAD, under which EIB provides to FSUD a contingent loan of BGN 24,600 thousand. The purpose of the loan is to provide funding for eligible urban development projects under the JESSICA initiative (Joint European Support for Sustainable Investment in City Areas).

FSUD should keep the loan in disbursement account until funds are granted for eligible projects for urban development through Project funding agreements. An annual interest rate agreed between the parties shall be accrued on the funds in the disbursement account. This interest should be capitalized and added to the resources that can be provided to final recipients under Project funding agreements.

The loan funds can be used only to finance urban development projects. All amounts repaid by final recipients under On-lending agreements and/or Equity investment agreements are deposited in a "Reserve account" and are kept there by FSUD until a payment date to the EIB. On each payment date FSUD pays EIB an amount equal to the positive balance of the reserve account. Payment dates are the last day of each six-month period following the date the loan was provided up until maturity.

The reserve account should carry an annual interest rate of the 3-month SOFIBOR plus spread, but the overall interest rate cannot be below zero.

FSUD and FLAG are required to ensure that the Co-financing provided to each final recipient is at least equal to the funds provided to the same recipient under the EIB loan through a project funding agreement.

Under Amendment Agreements № 1 and № 2 to the Operational Agreement with EIB, the term for disbursing the loan funds to final recipients was extended to 31.12.2015. In line with these additional agreements, EIB has withheld an "administration amount" of BGN 923 thousand from the funds intended for the JESSICA initiative, with which the loan amount has been reduced.

In addition, in accordance with Amendment Agreements № 1 and № 2, on each payment date until 31.12.2015, instead of payment to EIB, FSUD shall transfer from the reserve account to the disbursement account the amount received from final recipients up to the "administration amount".

Pursuant to Amendment agreement № 4 to the Operational Agreement, signed on 11.12.2015, the final disbursement date is extended to 30.06.2016. The payment dates are changed to: 15 February, 15 May, 15 August, and 15 November. The term "full disbursement date" is included being the date on which FSUD has disbursed to final recipients 100% of the Contingent loan together with any interest accrued on the disbursement account reduced with the amount of the management fee from EIB paid until 31 December 2015 from the disbursement account.

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10. Loans payable (continued)

The full disbursement date cannot be later than the final disbursement date. The term “recycling period” is also introduced being the period starting from the full disbursement date and ending on 31 December 2025. On each payment date during the recycling period, instead of making payments to EIB, FSUD shall be authorized to transfer an amount equal to the positive balance of the reserve account to the disbursement account for the purposes of the reinvestment procedure. Normal repayment of the loan begins after the expiry of the recycling period or, in case the full disbursement date has not occurred – following the final disbursement date.

A transfer and substitution agreement was signed between EIB, MRDPW, FSUD EAD and FLAG EAD on 14.12.2015, whereby due to expiry of the mandate of EIB as manager of the JHF Bulgaria, as of 01.01.2016 all rights and obligations of EIB under the Operational agreement were transferred to MRDPW (OPRD Managing Authority).

Amendment agreement № 5 to the Operational Agreement from 30 May 2012 was signed on 08.07.2016. By virtue of this agreement, as of October 31, 2016 the amount of overall "Co-financing" should be at least equal to the amount of the Contingent loan.

In 2017 a procedure for transferring the rights and obligations of MA of OPRD in relation to the Operational Agreement to FMFIB EAD was initiated. In this regard, the Managing and Supervisory Boards of FSUD EAD took the necessary decisions for signing a transfer and replacement agreement between MRDPW, FLAG, FSUD and FMFIB. Permission was also required from the sole owner of the capital of FLAG EAD – the Government represented by the minister of regional development and public works. The authorization was received on 9 November 2017, and the Agreement was signed on 14.02.2018.

In connection with the above-mentioned Transfer and replacement agreement, Amendment agreement No 6 was also initiated and agreed on during the year. Its purpose is to regulate the relations between FSUD EAD, FLAG EAD and FMFIB EAD after FMFIB EAD takes over the responsibility for the management of the JESSICA initiative. In 2017 all authorizations for the conclusion of this agreement were received, except for the approval by the Minister of Regional development and public works, as Principal of FLAG. Amendment Agreement No 6 was signed on 19.02.2018. According to this agreement, FSUD will pay to FMFIB on each payment date (February 15, May 15, August 15 and November 15) the amount on the Reserve Account balance less the funds paid for and/ or reserved for payment of the management fee. Disbursements during the Reinvestment Period are made after written disbursement requests are sent to FMFIB.

11. Payroll and social security payables

Payables to personnel and for social security at 31 December 2018 are allocated as follows:

	31 December	
	2018	2017
	<i>BGN'000</i>	<i>BGN'000</i>
Payables to personnel	123	68
Payables for social security	20	17
Total payables to personnel and for social security	143	85

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12. Income tax payable

The movements in tax receivables/payables for 2018 and 2017 are as follows:

	31 December	
	2018	2017
	<i>BGN'000</i>	<i>BGN'000</i>
Tax payable as at 1 January	(47)	(93)
Tax paid throughout the year	335	366
Tax accrued for the year (Note 4)	(344)	(320)
Tax payable as at 31 December	(56)	(47)

13. Other liabilities

	31 December	
	2018	2017
	<i>BGN'000</i>	<i>BGN'000</i>
Other liabilities	265	338
<i>incl. Contingent fee for loan applicants</i>	<i>81</i>	<i>50</i>
<i>Good performance guarantee</i>	<i>131</i>	<i>280</i>
<i>Payables to suppliers</i>	<i>49</i>	<i>2</i>
<i>Other</i>	<i>4</i>	<i>6</i>
Total other liabilities	265	338

14. Share capital and reserves

14.1 Share capital

	31 December	
	2018	2017
	<i>BGN'000</i>	<i>BGN'000</i>
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 2018 and 31 December 2017 the issued registered share capital was fully paid-in.

14.2 Statutory reserves

Statutory reserves are formed by FLAG EAD as a distribution of the profit as provided for 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 31.12.2018 statutory reserves amount to BGN 2,796 thousand (2017: BGN 2,507 thousand).

15. Dividend distribution

In accordance with ordinance № 2 of the Council of Ministers dated 07.03.2018 the dividends distributed in 2018 to the sole shareholder amount to BGN 1,299 thousand (2017: BGN 1,345 thousand). Dividend per share is BGN 14,43 (2017: BGN 14,94).

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16. Commitments and contingent liabilities

Legal claims

As at 31 December 2018 and 31 December 2017 there were no litigations against the Group.

Loan commitments

As of 31.12.2018 the Group has loan commitments related to twelve loan contracts with municipalities amounting to BGN 15,215 thousand, under which no funds have been utilized at the year end. The loan commitments at the end of the previous year were eight amounting to BGN 8,479 thousand.

Commitments related to rents / operating leases

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

17. Related party disclosure

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 EAD.

The Fund for Sustainable Urban Development EAD is a fully owned subsidiary of FLAG EAD with a share capital of BGN 5,000 thousand fully paid by FLAG EAD.

As of 31.12.2017 the Group's obligation under loans from MRDPW amounts to BGN 24,005 thousand.

In 2017 the Group has reported other financial revenues from management fee from MRDPW amounting to BGN 169 thousand.

As of 31.12.2017 the Group has management fee receivables from MRDPW in the amount of BGN 85 thousand.

Remuneration of management staff

In 2018 the expenses for remuneration of management staff amount to BGN 372 thousand (2017: BGN 343 thousand).

18. Financial risk management objectives and policies

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

In 2018 and 2017, the Group neither owned nor traded with derivative financial instruments.

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

Interest-rate risk

The Group's exposure to the risk of changes in market interest rate relates primarily to the Group's long-term financial liabilities with variable (floating) interest rates. The Group'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 borrowings with floating interest rates) of the Group's profit before tax, with all other variables held constant is presented below.

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18. Financial risk management objectives and policies (continued)

Interest-rate risk (continued)

	<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)
2017		
Loans payable in EUR	+0.5%	(178)
Loans payable in BGN	+0.5%	(244)
Loans granted in BGN	+0.5%	828
Loans payable in EUR	-1%	356
Loans payable in BGN	-1%	488
Loans granted in BGN	-1%	(1,656)

Liquidity risk

The effective management of the Group's liquidity presumes that sufficient working capital will be ensured 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.

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

Liabilities

As at 31 December 2018

	<u>On demand</u>	<u>< 3 months</u>	<u>3-12 months</u>	<u>1-5 years</u>	<u>> 5 years</u>	<u>Total</u>
	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>
Interest-bearing loans and borrowings	-	238	6,398	82,688	24,781	114,105
Borrowings under loan contract with FMFIB/ MRDPW	-	3	1,069	8,548	13,278	22,898
Trade and other payables	-	200	-	65	-	265
	<u>-</u>	<u>441</u>	<u>7,467</u>	<u>91,301</u>	<u>38,059</u>	<u>137,268</u>

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18. Financial risk management objectives and policies (continued)

Liquidity risk (continued)

As at 31 December 2017

	On demand	< 3 months	3-12	1-5	> 5 years	Total
	BGN'000	BGN'000	months	years	BGN'000	BGN'000
Interest-bearing loans and borrowings	-	229	6,357	25,692	56,391	88,669
Borrowings under loan contract with MRDPW	-	-	-	-	24,005	24,005
Trade and other payables	-	206	66	65	-	337
	-	435	6,423	25,757	80,396	113,011

The maturity structure of the 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>	Total amount
Cash and cash equivalents	25,007	-	25,007
Other receivables	152	-	152
Loans granted	92,487	117,739	210,226
Total assets	117,646	117,739	235,385
Liabilities	<i>Within 1 year</i>	<i>Over 1 year</i>	Total amount
Loans payable to banks	5,732	104,031	109,763
Loan payable to FMFIB/ MRDPW	1,072	21,826	22,898
Other liabilities	200	65	265
Total liabilities	7,004	125,922	132,926

The maturity structure of the assets and liabilities at 31 December 2017 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>	Total amount
Cash and cash equivalents	27,182	-	27,182
Other receivables	111	-	111
Loans granted	60,059	121,792	181,851
Total assets	87,352	121,792	209,144
Liabilities	<i>Within 1 year</i>	<i>Over 1 year</i>	Total amount
Loans payable to banks	5,732	78,456	84,188
Loan payable to MRDPW	-	24,005	24,005
Other liabilities	272	65	337
Total liabilities	6,004	102,526	108,530

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18. Financial risk management objectives and policies (continued)

Currency risk

The Group 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 Group'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 Group within the envisaged/agreed deadlines.

As at the end of 2018 the remaining liability of municipalities to the Group amounts to BGN 169,372 thousand and at the end of 2017 it was BGN 143,401 thousand.

As at the end of 2018 the remaining liability of the loan recipients under Jessica program to the Group amounts to BGN 46,841 thousand and at the end of 2017 it was BGN 44,168 thousand.

Credit risk management in FLAG EAD in 2018 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 Group measures the credit risk of loans to third parties using Probability of default (PD), Exposure at default (EAD) and Loss given default (LGD).

To determine credit risk, the Group'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 Group 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
- Increase in the total debt of the borrower
- Delay of the start of the funded project or other factors with a negative effect on future cash flows
- 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 Group 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).

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18. Financial risk management objectives and policies (continued)

Credit risk (continued)

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 Group at the time of default;
- LGD represents the Group's expectation of the amount of default loss.

The discount rate used to calculate the Expected Credit Loss (ECL) is the instrument's original effective interest rate. Forecast information was also used to determine the 12-month and lifetime PD, EAD and LGD. The Group'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>31.12.2018</i>	<i>Internal credit risk category</i>	<i>Expected credit loss (IFRS 9)</i>	<i>Gross book value</i>	<i>Impairment Loss (adjustment)</i>	<i>Book value</i>
			<i>BGN '000</i>	<i>BGN '000</i>	<i>BGN '000</i>
		<i>12-month period</i>			
Loans granted to third parties	Stage 1		198,030	(3,336)	194,694
Loans granted to third parties	Stage 2	<i>Lifetime</i>	18,183	(2,651)	15,532
			216,213	(5,987)	210,226

<i>31.12.2017</i>	<i>Internal credit risk category</i>	<i>Classification under IAS 39</i>	<i>Gross book value</i>	<i>Impairment Loss (adjustment)</i>	<i>Book value</i>
			<i>BGN '000</i>	<i>BGN '000</i>	<i>BGN '000</i>
		<i>Loans and receivables</i>			
Loans granted to third parties	-		187,569	(5,718)	181,851
			187,569	(5,718)	181,851

The Group has implemented a similar credit risk management and assessment policy until 31 December 2017, except for the measurement of impairment losses.

The Group's maximum exposure to credit risk at 31 December 2018 and 31 December 2017 is as follows:

	<i>2018</i>		<i>2017</i>	
	<i>Gross</i>	<i>Net</i>	<i>Gross</i>	<i>Net</i>
Exposure				
Cash and cash equivalents	25,007	25,007	27,182	27,182
Loans granted	216,213	210,226	187,569	181,851
Other receivables	152	152	111	111
Total balance sheet items	241,372	235,385	214,862	209,144

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18. Financial risk management objectives and policies (continued)

Capital management

The main objective of the Group'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 Group manages its capital structure and adjusts it, if necessary, in the light of changes in economic conditions. The group is subject to the Decree of the Council of Ministers on distribution of dividends to the Ministry of Regional Development and Public Works. In 2018, as in 2017, there are no changes in the Group's capital management goals, policies or processes.

The Group monitors its equity through the financial result for the reporting period as follows:

	2018	2017
	<i>BGN'000</i>	<i>BGN'000</i>
Net profit	3,462	2,886

With respect to credit agreements concluded, FLAG has an obligation to comply with the requirements regarding certain financial indicators that have been set out in the contracts. In this way, the Fund will guarantee its financial stability and assurance of its effective operation.

The indicators are as follows:

- Ratio of overdue loans / current exposure of loans overdue for 90 days or more in the Fund's portfolio to current exposure of all loans in the portfolio /
- Debt coverage ratio – Debt/ Equity
- Ratio of liquid to total assets / liquid assets - cash and bank deposits with a residual maturity of 90 days or less /

19. Cash flows from financing activities

Movement of liabilities arising from financing activities

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

	1.1.2018	<i>Dividend distribution</i>	<i>Change in cash flows from financing activities</i>	<i>Interest accrued</i>	<i>Other non- monetary changes</i>	31.12.2018
	<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	108,193	-	23,367	877	224	132,661
Dividend payables	-	1,299	(1,299)	-	-	-
Total	108,193	1,299	22,068	877	224	132,661

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

For the year ended 31 December 2018

19. Cash flows from financing activities (continued)

	<i>1.1.2017</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>31.12.2017</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	112,314	-	(5,113)	751	241	108,193
Dividend payables	-	1,345	(1,345)	-	-	-
Total	112,314	1,345	(6,458)	751	241	108,193

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 fair value of financial instruments is determined in accordance with the valuation methodology, corresponding to level 3 of the fair value hierarchy described in note 2.2 Summary of significant accounting policies, f) IFRS 13 Fair value measurement.

The Group 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 the financial instruments, which 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 values.

21. Events after the reporting period

There are no subsequent events after 31 December 2018, which require adjustments and/ or disclosure in the consolidated financial statements of the Group for the year ending 31 December 2018.