For the year ended 31 December 2016

## 1. Corporate information

The consolidated financial statements of FLAG JSC ("the Company") and its subsidiary ("the Group") for the year ended 31 December 2016 were authorized for issue by a decision of the Board of Directors dated 19 May 2017.

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

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 for consideration and co-financing the development and implementation of projects of the European Union.

As at 31 December 2016, 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 2016. This adoption did not have a material effect on the accounting policies of the Group.

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. The Board of Directors expects that the adoption of these accounting standards in future periods will not have a material effect on the financial statements of the Group.

### *Standards issued by IASB/IFRIC and endorsed by EU, but not yet effective and not earlier applied*

Standards issued but not yet effective and not early adopted up to the date of issuance of the Group's financial statements are listed below. The Group intends to adopt these standards when they become effective.

**IFRS 9 Financial Instruments**
The new standard is effective for annual periods beginning on or after January 1, 2018. The Group is in process of assessing the impact of the new standard on its financial position or performance.

**IFRS 15 Revenue from Contracts with Customers**
The new standard is effective for annual periods beginning on or after January 1, 2018. The Group is in process of assessing the impact of the new standard on its financial position or performance.

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

***Standards issued by IASB, but not yet effective and not yet endorsed by EU***

**IFRS 14 Regulatory Deferral Accounts**
The new standard is effective for annual periods starting on or after 1 January 2016. Endorsement process is postponed by EU for indefinite period. The Group is in process of assessing the impact of the new standard on its financial statements.

**IFRS 16 Leases**
The new standard is effective for annual periods starting on or after 1 January 2019. The Group is in the process of assessing the impact of the new standard on its financial statements.

**Amendments to IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture.**
The effective date is deferred indefinitely. The adoption of these amendments by EU is postponed. The Group is in the process of assessing the impact of the amendments on its financial statements.

**Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealized Losses**
These amendments are effective for annual periods starting on or after 1 January 2017. The Group is in the process of assessing the impact of the amendments on its financial statements.

**Amendments to IAS 7: Disclosure Initiative**
These amendments are effective for annual periods starting on or after 1 January 2017. The Group is in the process of assessing the impact of the amendments on its financial statements.

**Clarifications to IFRS 15: Revenue from Contracts with Customers**
These clarifications are effective for annual periods starting on or after 1 January 2018. The Group is in the process of assessing the impact of the clarifications on its financial statements.

**Amendments to IFRS 2: Classification and Measurement of Share - based Payment Transactions**
These amendments are effective for annual periods starting on or after 1 January 2018. The Group is in the process of assessing the impact of the amendments on its financial statements.

**Amendments to IFRS 4: Application of IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts**
These amendments are effective for annual periods starting on or after 1 January 2018. The Group is in the process of assessing the impact of the amendments on its financial statements.

**Annual Improvements to IFRS Standards 2014-2016 cycle**
These improvements are effective for annual periods starting on or after 1 January 2017. The Group is in the process of assessing the impact of the improvements on its financial statements.

**IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration**
This interpretation is effective for annual periods starting on or after 1 January 2018. The Group is in the process of assessing the impact of the interpretation on its financial statements.

**Amendments to IAS 40: Transfer of Investment Property**
These amendments are effective for annual periods starting on or after 1 January 2018. The Group is in the process of assessing the impact of the amendments on its financial statements.

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

**Statement of compliance**

The consolidated financial statements of FLAG JSC have been prepared in accordance with International Financial Reporting Standards, as adopted by the European Union (IFRS, adopted by EU).

**2.2 Summary of significant accounting policies**

**a) Foreign currency conversion**

The financial statements are presented in Bulgarian Levas (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**

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Group and the revenue can be reliably measured regardless of when the payment is being made.

Revenue is measured at the fair value of the consideration received or due based on the agreed payment terms, net of discounts, rebates, and other sales taxes or customs duties. The Group analyses its selling arrangements against specific criteria to determine whether it acts as a principal or as an agent. It has concluded that it acts as principal in all such arrangements. The following specific recognition criteria must also be met before revenue is recognised:

*Interest income*
Interest income is recognised 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 to/from the parties to the contract that are an integral part of the effective interest rate, transaction costs and any other premiums or discounts.
Interest income is included in finance income in the statement of comprehensive income.

*Service delivery*
The income from service delivery is recognised in the period in which the services were delivered.

**c) 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.

*Deferred income tax*
Deferred income tax is provided using the liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.
Deferred income tax liabilities are recognised for all taxable temporary differences, except:

- when the deferred tax liability arises from the initial recognition of goodwill or 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 can be controlled by the Group and it is probable that the temporary differences will not reverse in the foreseeable future.

**2.2 Summary of significant accounting policies (continued)**

**c) Taxes (continued)**

*Deferred income tax (continued)*
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 utilised.

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 utilised.

Unrecognised deferred income tax assets are reassessed at each reporting date and are recognised 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 realised 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 recognised outside profit or loss is recognised outside profit or loss. Deferred tax items are recognised 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.

**d) Financial instruments – initial recognition and subsequent measurement**

- **Financial assets**

**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 recognised 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 recognised on the trade (transaction) date, which is the date that the Group commits 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 method (EIR), less any allowance for impairment. Amortised cost is calculated taking into account 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.

**2.2 Summary of significant accounting policies (continued)**

**d) Financial instruments – initial recognition and subsequent measurement (continued)**

- **Financial assets (continued)**

**Derecognition**

A financial asset (or, where applicable a part of a financial asset or a part of a group of similar financial assets) is derecognised 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 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.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset or transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. In that case the Group also recognises the associated liability. The transferred asset and the related liability are recognised on a basis that reflects the rights and obligations that the Group has retained.

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, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has incurred, 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 estimated 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, the probability that they will enter bankruptcy or other financial reorganisation, and where observable data indicate that there is a measurable decrease in the estimated 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.

**2.2 Summary of significant accounting policies (continued)**

**d) Financial instruments – initial recognition and subsequent measurement (continued)**

- **Financial assets (continued)**

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised 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 realised 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 recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is recognised in the statement of comprehensive income.

- **Financial liabilities**

**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 recognised 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 recognised in the statement of comprehensive income for the period when the liabilities are derecognised as well as through the amortisation process.

Amortised cost is calculated by taking into account 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 derecognised 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 recognised in the statement of comprehensive income.

**e) Offsetting of financial instruments**

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and the Group intends to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

**2.2 Summary of significant accounting policies (continued)**

**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.

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 of 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 favourable 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.

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 on the basis of the hypotheses underlying 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, which do not allow fair value techniques to be observed directly or indirectly.

As at each balance sheet date the Management carries out an analysis of the changes to the fair market value of the assets and liabilities and monitors their impact on the financial reports 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 valuation techniques. With the assistance of certified valuers the management compares each change in the fair value of assets or 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 on the basis of their nature, risk and level in the hierarchy as noted above.

**g) Equity and reserves**

The share capital is presented at the par value of shares issued and paid. The Group is obliged to set aside a ***Reserves 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 Reserves 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 of the General Meeting.

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

**2.2 Summary of significant accounting policies (continued)**

**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 recognised in the carrying amount of the respective assets as a replacement if the recognition criteria are satisfied. All other repair and maintenance costs are recognised 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 derecognised 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 derecognised.

**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 |

The assets residual values, useful lives and methods of depreciation/amortisation are reviewed at each financial year end, and 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 recognised 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 of ownership 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 entities (including structured entities) controlled by the Group. The Group controls an entity when the Group, has rights over the entity, exposure 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 of impairment of the asset transferred. Where necessary, the accounting policies of the subsidiaries have been changed in order to be consistent with those applied by the Group.

**2.2 Summary of significant accounting policies (continued)**

**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.

**n) Provisions**

Provisions are recognised 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 of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised 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 recognised 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 asset or liability affected in the future.

**Estimates and assumptions**

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

*Impairment of financial receivables*
The Group uses an allowance account to report 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. At 31 December 2016 the best estimate of management for the necessary impairment of receivables amounts to BGN 5,443 thousand (2015: BGN 4,387 thousand). Further details are given in Note 9.

*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.

*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.

## 3. Income and expenses

### 3.1 Income from interest

| | 2016 | 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| Interest income on deposits and bank accounts | 93 | 308 |
| Income on loans granted and receivables | 9,783 | 10,783 |
| **Total interest income** | **9,876** | **11,091** |

### 3.2 Interest expenses and charges

| | 2016 | 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| Interest expenses on loans and borrowings | 2,650 | 3,720 |
| Expenses on fees and commissions and FX differences | 2,429 | 1,150 |
| **Total interest expenses and charges** | **5,079** | **4,870** |

### 3.3 Other operating income

| | 2016 | 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| Management fee and commitment fee | 618 | 912 |
| Other | 16 | 40 |
| **Total other operating income** | **634** | **952** |

### 3.4 Payroll costs

| | 2016 | 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| Salaries and wages | 737 | 723 |
| Social securities | 84 | 84 |
| **Total payroll costs** | **821** | **807** |

### 3. Income and expenses (continued)

#### 3.5 Other operating expenses

| | 2016 | 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| Accounting and audit services | 25 | 25 |
| Rent | 57 | 59 |
| Materials | 20 | 23 |
| Legal services | 17 | 42 |
| Communication services | 7 | 8 |
| Hardware maintenance | 6 | 7 |
| Consulting services | 15 | 70 |
| Social expenditure | 14 | 2 |
| Insurances | 4 | 1 |
| Other | 99 | 74 |
| **Total other operating expenses** | **264** | **311** |

### 4. Income tax

The main components of the income tax expense for the years ended 31 December 2016 and 2015 include:

| | 2016 | 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| Current income tax expense | 325 | 303 |
| Deferred income taxes related to occurrence and reversal of temporary differences | 1 | - |
| **Income tax expense** | **326** | **303** |

In 2016 the applicable statutory tax rate is 10% (2015: 10%).

Reconciliation between income tax expense and the accounting profit multiplied by the statutory tax rate for the years ended 31 December 2016 and 31 December 2015 is presented below:

| | 2016 | 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| Accounting profit before taxes | 3,268 | 3,030 |
| Income tax expense at statutory tax rate of 10% for 2016 (2015: 10%) | 327 | 303 |
| Other | (1) | - |
| **Income tax expense** | **326** | **303** |

As of 31.12.2016 the Group owes corporate income tax amounting to BGN 93 thousand. (31.12.2015: income tax receivable of BGN 83 thousand).

**4. Income tax (continued)**

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

| | Temporary difference | Tax | Temporary difference | Tax |
|---|---|---|---|---|
| | 31.12.2016 | 31.12.2016 | 31.12.2015 | 31.12.2015 |
| | BGN '000 | BGN '000 | BGN '000 | BGN '000 |
| Unpaid income to individuals and related social security expense | 15 | 2 | 13 | 1 |

**5. Cash and cash equivalents**

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| Cash in hand and in current accounts | 1,119 | 16,311 |
| Short-term bank deposits | 32,312 | 10,294 |
| Funds in a special account | 776 | 2,653 |
| Funds in a reserve account | 557 | 227 |
| **Total cash and cash equivalents** | **34,764** | **29,485** |

Cash in bank accounts bears floating interest rates based on the daily interest rates on bank deposits. For one of the current accounts is agreed preferential interest rate of 0,65% until the end of April 2016. The term of short-term deposits is one year, but the amounts therein can be changed depending on the liquidity needs of the Group. Contracted interest rate over short term deposits for 2016 varies from 0,05% and 0,45% per annum (2015: 0,62 - 1,30% per annum). The balances of interest receivables on deposits are included in cash and cash equivalents since the amounts accrued are available to the Group on demand. The fair value of cash and short-term deposits equals their carrying amount.

The cash at the special account is designated for financing urban development projects under the JESSICA initiative in line with the requirements set out in the Operational Agreement between the EIB (replaced by MRDPW from 01.01.2016), FLAG and FSUDS.

There is a pledge on the funds in the special and reserve account in favor of the MRDPW.
Current and future claims on bank accounts of FLAG EAD are pledged as collateral per bank loans from UniCredit Bulbank AD, CiBank EAD and DSK Bank EAD (Note 10).

**6. Receivables and prepayments**

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| | *BGN '000* | *BGN '000* |
| Receivables under management fee - MRDPW | 86 | - |
| Deferred expenses | 6 | - |
| Fees receivable on loans granted | - | 1 |
| Other receivables | 25 | 10 |
| **Total receivables and prepayments** | **117** | **11** |

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

## 7. Plant and equipment, software

| | Hardware | Fixtures and fittings | 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 2015 | 40 | 7 | 21 | 36 | 11 | 5 | 120 |
| Additions | 5 | 4 | 1 | - | 3 | 1 | 14 |
| Disposals | (4) | (1) | - | - | - | - | (5) |
| As of 31 December 2015 | 41 | 10 | 22 | 36 | 14 | 6 | 129 |
| Additions | 3 | - | - | 49 | 15 | - | 67 |
| Disposals | (2) | - | - | (36) | - | - | (38) |
| **As of 31 December 2016** | 42 | 10 | 22 | 49 | 29 | 6 | 158 |
| **Depreciation:** | | | | | | | |
| As of 1 January 2015 | (36) | (7) | (8) | (36) | (11) | (2) | (100) |
| Depreciation charge | (4) | - | (4) | - | (1) | (2) | (11) |
| Written-off depreciation | 4 | 1 | - | - | - | - | 5 |
| **As of 31 December 2015** | (36) | (6) | (12) | (36) | (12) | (4) | (106) |
| Depreciation charge | (4) | (2) | (4) | (10) | (1) | (1) | (22) |
| Written-off depreciation | 2 | - | - | 36 | - | - | 38 |
| **As of 31 December 2016** | (38) | (8) | (16) | (10) | (13) | (5) | (90) |
| **Carrying amount** | | | | | | | |
| **As of 1 January 2015** | **4** | **-** | **13** | **-** | **-** | **3** | **20** |
| **As of 31 December 2015** | **5** | **4** | **10** | **-** | **2** | **2** | **23** |
| **As of 31 December 2016** | **4** | **2** | **6** | **39** | **16** | **1** | **68** |

## 8. Subsidiary company

By a decision of the sole owner of FLAG JSC, the Ministry of Regional Development and Public Works, and after a meeting of the Board of Directors of the Fund, a new company was incorporated - Fund for Sustainable Urban Development of Sofia EAD, with share capital of BGN 500 thousand. The company was registered on 23 April 2012 with the Registry Agency and the share capital was paid in full by FLAG JSC. 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 JSC and FSUDS EAD.

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

## 9. Loans granted

| | 31 December | |
|---|---|---|
| | 2016 | 2015 |
| | *BGN '000* | *BGN '000* |
| Loans granted to municipalities | 136,216 | 263,926 |
| Accrued, but unpaid interest related to loans granted to municipalities | 123 | 259 |
| Impairment of receivables related to loans granted to municipalities | (5,015) | (4,268) |
| **Total loans granted to municipalities, net** | **131,324** | **259,917** |
| Loans granted for urban development projects under Jessica initiative | 46,008 | 39,696 |
| Accrued, but unpaid interest | 28 | 22 |
| Impairment of receivables related to loans granted | (428) | (119) |
| **Total loans granted under Jessica initiative, net** | **45,608** | **39,599** |
| **Total loans granted** | **176,932** | **299,516** |

Loans granted represent loans provided to municipalities and one state-owned company as well as loans granted under Jessica initiative. One part of the loans granted – BGN 21,349 thousand is used as bridge financing under European programmes and BGN 114,867 thousand for financing of municipalities' own activities.
As of 31.12.2015 bridge financing loans amounted to BGN 129,469 thousand and those for financing own activities amounted to BGN 134,457 thousand.
Current and future receivables on loans granted by FLAG EAD are pledged as collateral per bank loans from UniCredit Bulbank AD, CiBank EAD and DSK Bank EAD (Note 10).
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 nine separate municipalities. The assessment is made in accordance with the Fund`s Impairment policy in the case of credit losses.
As of 31.12.2016 the impairment of bridge financing loans amounts to BGN 107 thousand (BGN 647 thousand as of 31.12.2015), and the impairment of loans repaid by own funds as of 31.12.2016 amounts to BGN 4,908 thousand (BGN 3,621 thousand as of 31.12.2015).
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.

As at 31.12.2016 the loans granted under Jessica initiative amount to BGN 46,008 thousand (31.12.2015: BGN 39,696 thousand). As at 31.12.2016 the impairment of loans granted under Jessica initiative amounts to BGN 428 thousand (31.12.2015: BGN 119 thousand).

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.

Impairment of receivables on loans is made in accordance with the adopted by FSUDS policy for impairment and is portfolio based. The specific impairment is imposed after consideration of loans granted to two borrowers.

## 9. Loans granted (continued)

The changes in the accrued impairment on loans granted in 2016 and 2015 are as follows:

| | *Impairment of receivables from loans granted* |
|---|---|
| **As of 1 January 2015 incl.** | **(1,373)** |
| - for bridge financing | *(573)* |
| - for own financing | *(800)* |
| Charged for the year – incl. | (3,014) |
| - for bridge financing | *(74)* |
| - for own financing | *(2,821)* |
| - for loans under Jessica initiative | *(119)* |
| **As of 31 December 2015 incl.** | **(4,387)** |
| - for bridge financing | *(647)* |
| - for own financing | *(3,621)* |
| - for loans under Jessica initiative | *(119)* |
| (Charged)/Reintegrated for the year – incl. | (1,056) |
| - for bridge financing | *540* |
| - for own financing | *(1,287)* |
| - for loans under Jessica initiative | *(309)* |
| **As of 31 December 2016 incl.** | **(5,443)** |
| - for bridge financing | *(107)* |
| - for own financing | *(4,908)* |
| - for loans under Jessica initiative | *(428)* |

As of 31.12.2016 the accrued impairment on portfolio basis is BGN 1,503 thousand (31.12.2015: BGN 2,345 thousand).

As of 31.12.2016 the specific impairment accrued is BGN 3,940 thousand (31.12.2015: BGN 2,042 thousand).

**10. Loans payable**

| | Maturity | 31 December 2016 | 31 December 2015 |
|---|---|---|---|
| | | *BGN'000* | *BGN'000* |
| Payables to EBRD under Loan 1 | August 2023 | - | 45,636 |
| Payables to EBRD under Loan 3 T1 | August 2018 | - | 25,054 |
| Payables to EBRD under Loan 3 T2 | August 2023 | - | 26,078 |
| Deferred fees under EBRD loans | | - | (757) |
| Accrued interest due | | | 986 |
| **Total loans payable to EBRD** | | **-** | **96,997** |
| Revolving loan payable to UniCredit Bulbank | January 2018 | - | 20,000 |
| Revolving loan payable to CiBank | June 2018 | 9,385 | 38,918 |
| Revolving loan payable to DSK | June 2019 | - | 38,356 |
| Revolving loan payable to Municipal bank | March 2016 | - | 13,080 |
| Long-term loan payable to UniCredit Bulbank | November 2023 | 40,000 | - |
| Revolving loan payable to CiBank | November 2023 | 39,116 | - |
| Deferred fees per loans agreements | | (342) | (334) |
| Accrued interest due | | 19 | 40 |
| **Total loans payable to banks** | | **88,178** | **110,060** |
| Loan payable to MRDPW/EIB | June 2035 | 24,136 | 24,178 |
| **Total loans payable to MRDPW/ EIB** | | **24,136** | **24,178** |
| **Total loans payable** | | **112,314** | **231,235** |

Loans payable by the Group to the European Bank for Reconstruction and Development (EBRD) as of 31.12.2015 result from the utilisation of funds under two loan agreements.

The first loan with a limit of EUR 35,000 thousand (BGN 68,454 thousand), which amount has two components:

1. Loan "a" – amounting to EUR 18,000 thousand (BGN 35,205 thousand)
2. Loan "b" – amounting to EUR 17,000 thousand (BGN 33,249 thousand).

The contractual interest rate is based on the six-month EURIBOR plus a floating margin based on the amount of bad debts within the Group's loan portfolio.

The second loan has a limit of EUR 35,000 thousand, which has two components:

1. Tranch 1 (Loan 3 T1) – in the amount of EUR 20,000 thousand (BGN 39,117 thousand)
2. Tranch 2 (Loan 3 T2) - in the amount of EUR 15,000 thousand (BGN 29,337 thousand).

The contractual interest rate is based on the six-month EURIBOR plus a floating margin based on the amount of bad debts within the Group's loan portfolio.

The payables under both contracts signed with the European Bank for Reconstruction and Development (EBRD) were repaid in advance in 2016.

The revolving loan, signed on 06.11.2014 with UniCredit Bulbank AD, was repaid and terminated in 2016. As of 31.12.2015 the utilized amount was BGN 20,000 thousand. The agreed interest rate on this loan is based on one-month SOFIBOR plus margin.

From the 3 revolving loans agreements signed in 2015, the loan from Municipal Bank with utilized amount of BGN 13,080 thousand as of 31.12.2015 was fully repaid and terminated in 2016. The agreed interest rate on this loan is based on one-month SOFIBOR plus margin.

The contract with CiBank EAD from 04.06.2015 has a utilized amount of BGN 9,385 thousand as of 31.12.2016 (BGN 38,918 thousand as of 31.12.2015). The agreed interest rate on this loan is based on six-month EURIBOR plus margin.

The contract with DSK Bank EAD is still in force at the end of 2016, but there are no utilised amounts as of 31.12.2016 (as of 31.12.2015 they were BGN 38,356 thousand). The agreed interest rate on this loan is based on one-month SOFIBOR plus margin.

**10. Loans payable (continued)**

In 2016 the Group signed 2 new loan agreements as follows:
- with UniCredit Bulbank AD dated 22.11.2016 for the amount of BGN 40,000 thousand, for a period of 84 months. As of 31.12.2016 the loan is fully utilized. The agreed interest rate on this loan is based on three-month SOFIBOR plus margin.
- with CiBank EAD dated 22.11.2016 for a revolving loan for the amount of EUR 20,000 thousand, for a period of 84 months. As of 31.12.2016 the loan is fully utilized. The agreed interest rate on this loan is based on six-month EURIBOR plus margin.

The collaterals per bank loans from UniCredit Bulbank AD, CiBank EAD and DSK Bank EAD include pledge on current and future claims on bank accounts of FLAG EAD and current and future receivables on loans granted (Note 5 and Note 9).

On May 30, 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 of Sofia" (FSUDS) EAD and "Fund for Local Authorities and Governments in Bulgaria - FLAG" EAD, under which EIB provides to FSUDS 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).

FSUDS 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 FSUDS until a payment date to the EIB. On each payment date FSUDS 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.

FSUDS 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 is 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, FSUDS 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 FSUDS 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. 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, FSUDS 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.

**10. Loans payable (continued)**

As at 31.12.2015 the full disbursement date has not yet occurred, and as a result the transfer of the closing balance of the reserve account to the disbursement account has not been made. 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. In addition Amendment agreement № 4 sets out that the amount of BGN 20,7 mil and BGN 21,5 mil should be disbursed to final recipients by 31.12.2015 and 31.03.2016, respectively. As at 31.12.2015 the disbursements to final recipients under the "EIB" sublimit exceeds both of these amounts.

A transfer and substitution agreement was signed between EIB, MRDPW, FSUDS 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 May 30, 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.

**11. Payroll and social securities payables**

Payables to personnel and for social security at 31 December 2016 are allocated as follows:

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| Payables to personnel | 90 | 81 |
| Payables for social security | 16 | 17 |
| **Total payables to personnel and for social security** | **106** | **98** |

**12. Tax receivables (payables)**

The movements in tax receivables/payables for 2016 and 2015 are as follows:

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| **Tax receivable / (payable) as at 1 January** | **83** | **(49)** |
| Tax paid throughout the year | 150 | 435 |
| Tax accrued for the year (Note 4) | (326) | (303) |
| **Tax receivable/(payable) as at 31 December** | **(93)** | **83** |

**13. Other liabilities**

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| Other liabilities | 375 | 488 |
| *incl.Contingent fee for loan applicants* | *18* | *128* |
| *Good performance guarantee* | *353* | *353* |
| *Payables to suppliers* | *2* | *6* |
| *Other* | *2* | *1* |
| **Total other liabilities** | **375** | **488** |

**14. Share capital and reserves**

**14.1 Share capital**

| | 31 December 2016 | 31 December 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| 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 2016 and 31 December 2015 the issued registered share capital was fully paid-in.

**14.2 Statutory reserves**

Statutory reserves are formed by FLAG JCS 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 December 2016 statutory reserves amount to BGN 2,208 thousand (2015: BGN 1,931 thousand).

**15. Dividend distribution**

In accordance with ordinance № 2 of the Council of Ministers dated 18.02.2016 dividends distributed to the sole shareholder in 2016 amount to BGN 1,245 thousand (2015: BGN 1,253 thousand). Dividend per share is BGN 13,83 (2015: BGN 13,93).

**16. Commitments and contingencies**

**Legal claims**

As at 31 December 2016 and 31 December 2015 there were no litigations against the Group.

**Guarantees**

As at 31 December 2016 and 31 December 2015 the Group has not issued any guarantees.

**Loan commitments**

As of 31.12.2016 the Group has loan commitment related to one loan contract with municipality amounting to BGN 1,000 thousand, under which no funds have been utilized at the year end. The loan commitment at the end of the previous year was per 1 contract totalling BGN 153 thousand.

**Commitments related to rents / operating leases**

The Group has a rental contract concluded for the rent of an office for a term of four years, which came into force on 1 March 2013.

**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 of Sofia EAD is a fully-owned subsidiary of FLAG EAD with a share capital of BGN 500 thousand fully paid by FLAG EAD in 2012.

**17. Related party disclosure (continued)**

**Remuneration of management staff**

In 2016, the remuneration of management staff amounts to BGN 295 thousand (2015: BGN 263 thousand).

**18. Financial risk management objectives and policies**

The major financial liabilities of the Group comprise interest-bearing loans and borrowings, and trade 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 2016 and 2015, 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 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 and borrowings with floating interest rates) of the Group's profit before tax, with all other variables held constant is presented below.

| | Increase/Decrease in interest rates | Effect on the pre-tax profit |
|---|---|---|
| | | *BGN '000* |
| **2016** | | |
| Loans payable in EUR | +0.5% | (243) |
| Loans payable in BGN | +0.5% | (200) |
| Loans granted in BGN | +0.5% | 796 |
| Loans payable in EUR | -1% | 485 |
| Loans payable in BGN | -1% | 400 |
| Loans granted in BGN | -1% | (1,592) |
| **2015** | | |
| Loans payable in EUR | +0.5% | (678) |
| Loans payable in BGN | +0.5% | (357) |
| Loans granted in BGN | +0.5% | 1,410 |
| Loans payable in EUR | -1% | 1,356 |
| Loans payable in BGN | -1% | 714 |
| Loans granted in BGN | -1% | (2,819) |

*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.

## 18. Financial risk management objectives and policies (continued)

*Liquidity risk (continued)*

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 of 31.12.2016**

| | On demand | < 3 months | 3-12 months | 1-5 years | > 5 years | Total |
|---|---|---|---|---|---|---|
| | *BGN'000* | *BGN'000* | *BGN'000* | *BGN'000* | *BGN'000* | *BGN'000* |
| Interest-bearing loans and borrowings | - | 262 | 6,426 | 35,029 | 75,630 | 117,347 |
| Trade and other payables | - | 21 | 148 | 205 | - | 374 |
| | - | 283 | 6,574 | 35,234 | 75,630 | 117,721 |

**As of 31.12.2015**

| | On demand | < 3 months | 3-12 months | 1-5 years | > 5 years | Total |
|---|---|---|---|---|---|---|
| | *BGN'000* | *BGN'000* | *BGN'000* | *BGN'000* | *BGN'000* | *BGN'000* |
| Interest-bearing loans and borrowings | - | 23,497 | 11,328 | 158,059 | 52,413 | 245,297 |
| Trade and other payables | - | 483 | - | 5 | - | 488 |
| | - | 23,980 | 11,328 | 158,064 | 52,413 | 245,785 |

The maturity structure of the assets and liabilities at 31 December 2016 has been developed based on the expectations of management regarding the recoverability/settlement of amounts:

| **Assets** | *Within 1 year* | *Over 1 year* | ***Total amount*** |
|---|---|---|---|
| Cash and cash equivalents | 34,764 | - | **34,764** |
| Other receivables | 111 | - | **111** |
| Loans granted | 37,755 | 139,177 | **176,932** |
| **Total assets** | **72,630** | **139,177** | **211,807** |

| **Liabilities** | *Within 1 year* | *Over 1 year* | ***Total amount*** |
|---|---|---|---|
| Loans payable | 5,733 | 82,445 | **88,178** |
| Loan payable to MRDPW | - | 24,136 | **24,136** |
| Other liabilities | 169 | 205 | **374** |
| **Total liabilities** | **5,902** | **106,786** | **112,688** |

**18. Financial risk management objectives and policies (continued)**

*Liquidity risk (continued)*

The maturity structure of the assets and liabilities at 31 December 2015 has been developed based on the expectations of management regarding the recoverability/settlement of amounts:

| **Assets** | *Within 1 year* | *Over 1 year* | ***Total amount*** |
|---|---|---|---|
| Cash and cash equivalents | 29,485 | - | **29,485** |
| Other receivables | 11 | - | **11** |
| Loans granted | 183,802 | 115,714 | **299,516** |
| **Total assets** | **213,298** | **115,714** | **329,012** |

| **Liabilities** | *Within 1 year* | *Over 1 year* | ***Total amount*** |
|---|---|---|---|
| Loans payable | 31,444 | 175,613 | **207,057** |
| Loan payable to EIB | - | 24,178 | **24,178** |
| Other liabilities | 483 | 5 | **488** |
| **Total liabilities** | **31,927** | **199,796** | **231,723** |

*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 2016 the remaining liability of municipalities to the Group amounts to BGN 136,339 thousand and at the end of 2015 it was BGN 264,185 thousand.

As at the end of 2016 the the remaining liability of the loan recipients under Jessica program to the Group amounts to BGN 46,036 thousand and at the end of 2015 it was BGN 39,718 thousand.

Credit risk management in FLAG EAD in 2016 is carried out by the "Lending and monitoring" Directorate and is monitored simultaneously by the Executive Director and the Board of Directors. Credit risk management in the subsidiary FSUDS EAD in 2016 is carried out by the "Lending" expert and is supervised both by the Executive Director and the Managing Board of the fund.

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.

## 18. Financial risk management objectives and policies (continued)

*Credit risk (continued)*

The impairment of loans granted as of December 31, 2016 is on a portfolio basis, while there are also impairments of specific exposures.

The maximum exposure of the Group to credit risk as at 31 December 2016 and 31 December 2015 is as follows:

| | *2016* | | *2015* | |
|---|---|---|---|---|
| | *Gross* | *Net* | *Gross* | *Net* |
| **Exposure** | | | | |
| Cash and cash equivalents | 34,764 | 34,764 | 29,485 | 29,485 |
| Loans granted | 182,375 | 176,932 | 303,903 | 299,516 |
| Other receivables | 111 | 111 | 11 | 11 |
| **Total balance sheet items** | **217,250** | **211,807** | **333,399** | **329,012** |

At the end of 2016 there are 3 loans that were overdue with more than 30 days and there are no restructured loans.

At the end of 2015 no loans were overdue and there were no restructured loans.

*Capital management*

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios to support its business and maximise shareholder value.

The Group manages its capital structure and adjusts it, where necessary, depending on the changes in the economic environment. The Group is subject to the rulings of the Council of Ministers on distribution of dividends to the Ministry of Regional Development and Public Works. In 2016 and in 2015 there were no changes in the objectives, policies or processes for the management of capital of the Group.

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

| | 2016 | 2015 |
|---|---|---|
| | *BGN'000* | *BGN'000* |
| **Net profit** | **2,942** | **2,727** |

In connection with the contracts signed with Unicredit Bulbank AD and CiBank EAD for provision of borrowed capital for the refinancing of the Fund's liabilities to EBRD, FLAG has the obligation to comply with the requirements in respect of certain financial ratios which were laid down in the contracts. In this way the Fund will guarantee its financial stability and effective work.

The ratios are as follows:

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

## 19. 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.

## 20. Events after the reporting period

With Protocol T3-12 from 22 March 2017 the Minister of Regional Development and Public Works, as a representative, authorized FLAG to acquire long-term financial assets in the subsidiary "Fund for sustainable urban development of Sofia" EAD worth BGN 4,500,000, representing 4,500 new ordinary, available, registered shares with a nominal value of BGN 1,000 each. With this act and following a decision of the Board of Directors of FLAG EAD from 28 March 2017/Protocol №147 it was proceeded with the registration of the share capital increase from BGN 500,000 to BGN 5,000,000 in the Commercial Register. Meanwhile, changes to the Articles of association of FSUDS related to the scope of its business activity and its name were made. The changes in the Articles of association of FSUDS related to the scope of its business activity, its name and the share capital increase were officially published in the Commercial register on 05.04.2017.

No other events have occurred after 31 December 2016, which require additional adjustments and/or disclosures in the Group's consolidated financial statements for the year ended 31 December 2016.