

FUND FLAG EAD
PREVIOUS NAME:
FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN
BULGARIA – FLAG EAD

CONSOLIDATED ANNUAL DIRECTORS' REPORT AND
CONSOLIDATED FINANCIAL STATEMENTS

31 December 2019

**FUND FLAG EAD
(PREVIOUS: FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD)**

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Independent Auditor's Report to the sole shareholder of FUND FLAG EAD (PREVIOUS: FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD)	

**FUND FLAG EAD
(PREVIOUS: FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD)**

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 Tsolova–Ilieva – member

Registered address

1 Sixth September Street, Third Floor, Sofia

Business address

1 Sixth September Street, Third Floor, Sofia

Legal advisors

Law Firm „Lozanova and Groysman”
Lawyer Lora Ivaylova Cankova

Servicing banks

Unicredit Bulbank AD
UBB AD
DSK Bank EAD (incl. the merged Expressbank AD)

Auditor

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

CONSOLIDATED REPORT
on the principal activities of
Fund FLAG EAD
(Previous: Fund for Local Authorities and Governments in Bulgaria – FLAG EAD)
in 2019

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

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.

The name of the company was changed from “Fund for Local Authorities and Governments in Bulgaria – FLAG” EAD to “Fund FLAG” EAD. The change was registered in the Commercial Register on 02.06.2020 and was approved in Protocol № 196 from 25.03.2020 of the Board of Directors of FLAG.

“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 № 147 of the Board of Directors of FLAG, the name of “Fund for Sustainable Urban Development of Sofia” EAD (FSUDS) was changed to “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 FLAG is BGN 90 million. As of 31.12.2019 the total equity of the Group including share capital and reserves altogether amounts to BGN 104 million.

Total agreed long-term credit resource as at 31.12.2019 amounts to BGN 233 million.

Total borrowed capital as at 31.12.2019 amounts to BGN 146 million.

1.2. Management

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

In 2019 eighteen board meetings were held.

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As at 31 December 2019 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 2019 nineteen meetings of the Managing Board and ten of the Supervisory Board were held.

As at 31 December 2019, 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 2019 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 2019 the Group has a core staff with appropriate qualifications and experience to meet the needs of the Group.

The approved number of personnel for 2019 is 21 employees. As of 31.12.2019 there are 3 vacant places for employees. The Group does not plan any significant changes to its human resources in 2020.

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

1.4. External auditor for 2019

By decision of September 24, 2019, Protocol № 185 the Board of Directors approved the results of a public tender for the selection of an external auditor by approving Baker Tilly Klitou and Partners OOD as a contractor for 2019. Subsequently, this election was approved by Protocol T3-62 / 02.10.2019 of the Minister of Regional Development and Public Works, in his capacity as a representative of the state as the sole owner of the capital.

1.5. Borrowed capital

The total contracted long-term credit resource as at 31.12.2019 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 39 116 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

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- UBB AD, revolving loan from 12.10.2018 - BGN 40 000 thousand
- Expressbank AD, revolving loan from 01.11.2018 – BGN 20 000 thousand
- FMFIB - through OPRD under the JESSICA instrument, conditional loan from 30.05.2012 - BGN 23 685 thousand

As at 31.12.2019 the current exposure on loans is as follows:

- UniCredit Bulbank AD - BGN 22 857 thousand
- UBB AD /2016/ - BGN 39 116 thousand /EUR 20 000 thousand/
- DSK Bank EAD - BGN 21 218 thousand
- UniCredit Bulbank AD /2018/ – BGN 30 000 thousand
- UBB AD /2018/ - BGN 10 481 thousand
- Expressbank AD – no balance
- FMFIB - through OPRD under the JESSICA instrument – BGN 22 615 thousand

The total current exposure of the Group's borrowed capital as at 31.12.2019 amounts to BGN 146 million.

1.6. Main results from lending activities in 2019

1.6.1. FLAG

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

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

The average interest rate in 2019 is 2.897%, with a 6-month EURIBOR of 0% and a FLAG margin of 1.083%.

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

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

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The following two tables present the structure of the lending operations of FLAG for 2019 on the basis of credits approved during the year by type of project, operational program and source of repayment of the principal.

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

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

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

In 2019, a total of 207 annexes were signed. The requests for annexes are mainly with the aim of extending the term for utilization - 55, the requests for extension of the term for repayment are 85, those that change both terms are 22. The number of annexes falling into the category "Other" is 34, the reasons are due to a change in accounts, a change in the repayment schedule due to a partial early repayment, reduction of the risk premium (12). In 2019, 11 annexes were signed for restructuring of the residual debt on bridge loans to municipalities into loans repaid with own budget funds.

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

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

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1.6.2. FSUD

In 2019, a total of 10 disbursements amounting to BGN 5,183 thousand were made, of which BGN 1,545 thousand from the OPRD 2007-2014 funds and BGN 3,638 thousand from FSUD's funds. The disbursements represent "recycled" funds and are mainly under the project funding agreements with Hospital "Pirogov" EAD – nine and one utilization from "Prosperitas Building" EOOD.

Since the beginning of the FSUD activity and until 31 December 2019, total disbursements made amount to BGN 55,547 thousand.

The breakdown of utilization per sectors for the period 2013 - 2019 in thousands of BGN is as follows:

Sector/Year	2013	2014	2015	2016	2017	2018	2019	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	5 183	27 174
4. Integrated urban transport	-	-	-	-	-	526	-	526
Total:	1 806	11 508	27 900	8 384	500	5 449	5 183	60 730

As at 31 December 2019, the Fund's portfolio amounted to BGN 48,781 thousand (principal receivables on loans granted), distributed as follows: BGN 26,040 thousand provided by FSUD/sub-loan Co-financing/ and BGN 22,356 thousand provided by FMFIB (OPRD 2007-2014) and BGN 385 thousand co-financing from FUGR for projects implemented under Fund for Urban Development 2014-2020.

As of 31 December 2019, FSUD was able to invest 74% of the funds available for reinvestment in eligible projects.

2. Participation of FLAG in financial instruments

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

As at 31 December 2019, 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.

After the functions of the Jessica initiative fund were transferred from the Managing authority of OPRD 2007-2013 to the Fund Manager of Financial Instruments in Bulgaria EAD at the end of 2017, under a Financial agreement signed between the parties on 14.02.2018, a Transfer and substitution agreement was signed between FMFIB, FLAG and FSUD to the Operational Agreement from 30 May 2012. In line with this agreement, all rights, claims, obligations and liabilities of MRDPW under the Operational Agreement are transferred to FMFIB.

2.2 Participation in the financial instrument "Urban Development Fund" under OPRD 2014-2020

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

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

2.3 New investment projects

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

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 7,323 thousand, and are presented split by types below:

Revenue in BGN '000	2019	Share
Interest	6 412	88%
Fees on loans and other income	911	12%
Total	7 323	100%

- ✓ From loans granted - Revenues are formed from lending activity and include interest, management fee and commitment fee.

REVENUES in BGN '000		
1	Interest income on loans	6 405
2	Penalty interest on loans	7
3	Fees on loans granted	899
4	Other income	12

3.1.2 Consolidated expenses

Group of expenses	Amount in BGN thousand	Share in total expenses in %
Maintenance costs	95	3%
Hired services	143	4%
Depreciation expense	73	2%
Remunerations - staff, BoD (including social securities)	1 210	34%
Managing bank fees, other bank fees	871	25%
Interest expenses	823	23%
Impairment / provisions	299	9%
	3 514	100%

3.1.3 Results

Profit before tax of the Group for 2019 is BGN 3,809 thousand and net profit is BGN 3,428 thousand.

3.2 Dividends and distribution of profit

In 2019, by a decision of the Board of Directors, the Group formed a reserve fund of 10% of the net profit for 2018 in the amount of BGN 346 thousand, after which it distributed a dividend to the state in the amount of BGN 1,558 thousand, which was paid during this year.

3.3 Subsidiary companies. Branches.

As of 31 December 2019, Fund FLAG EAD (previous: Fund for local authorities and governments in Bulgaria – 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 December 31, 2019, the Group has 45% share in the jointly controlled company DZZD “Fund for Sustainable Cities”.

As of 31.12.2019 the companies within the group have no branches.

4. Business plan of the Group for 2020

4.1. FLAG

The main goals set by the company's management for 2020 are:

- to continue successfully fulfilling its mission to be a reliable and sustainable partner of Bulgarian municipalities in the implementation of their investment projects and programs, received funding through European programs, offering flexible financial solutions and the necessary technical assistance;
- to complete the structuring and launch of the Bulgarian Investment and Coordination Platform for Urban Development with the partnership of the European Investment Bank.

The assessment of the demand for credit resource for 2020 amounts to BGN 145 million.

4.2. FSUD

The main goals set by the management of the company for 2020 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 under 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. Fulfillment of the undertaken commitments in relation to the objectives for negotiating and investing the funds, as well as achieving the indicators.
- FSUD as a JESSICA Urban Development Fund - monitoring and control of active loans to minimize the risk of non-payment or default by final recipients. Successful completion of the projects in process of implementation within the agreed deadlines. Structuring new projects to invest the free funds and fulfill the set goals for 2020.

4.3. Financial income and result

Based on the assumptions made in the business plan of **FLAG**, the analysis of the activity and the estimates of revenues and expenses in 2019, a forecasted result from operations for 2020 before impairment and taxation in the amount of BGN 3,116 thousand has been determined.

Based on the assumptions made in the business plan of **FSUD**, the analysis of the activity and the revenues and expenses for 2019, a forecasted result from operations for 2020 before impairment and taxation in the amount of BGN 530 thousand has been determined.

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

In 2019 no own shares of the companies in the Group were acquired or transferred.

Remuneration of key management personnel in 2019 amounts to BGN 418 thousand.

As of 31.12.2019 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:

- Dobromir Simidchiev – executive director and member of the Board of Directors of "HIDROLIA" AD, shareholder in "TYUBOR" OOD with 50% share;
- Plamen Ivanov Dermendzhiev – "D Commere Bank" AD – 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.

6. Research and development activity

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

7. Financial risk management and financial instruments

The main 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 2019, as in previous years, the Group does not own or trade in 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.

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 customers / counterparties will not be able to repay in full the amounts due to the Group within the stipulated / agreed term. At the end of 2019, the balance of receivables on loans granted by the Group amounted to BGN 220,878 thousand, and at the end of 2018 it was BGN 210,226 thousand.

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

The credit 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 2019 is based on the Funds' Credit loss impairment policy, developed in accordance with IFRS 9 Financial Instruments.

8. Significant events after the reporting period

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

On January 17, 2020, a Memorandum of Understanding was signed between the European Investment Bank, the Fund Manager of Financial Instruments in Bulgaria EAD and Fund FLAG EAD (previous: Fund for local authorities and governments in Bulgaria – FLAG EAD).

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

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

- Considering the specifics of the client base – disruption of the regularity of borrowers' revenues resulting in difficulty paying the regular loan installments;
- Increase of the extraordinary expenses of the municipalities and healthcare entities related to urgent actions for implementation of the measures for protection of the health of the population, coping with the unusually large number of infectious patients, disinfection, social problems, etc.;
- Delayed implementation of projects approved for funding and extension of utilization deadlines.

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On May 14, 2020 by decision of the government the state of emergency was replaced by a state of epidemic emergency. A gradual relaxation of the restrictions over movement of people and work of trade and cultural sites is expected, while maintaining strict sanitary and hygienic requirements.

Based on the publicly available information at the date of the consolidated financial statements, management has considered possible adverse scenarios regarding the anticipated development of the COVID-19 pandemic and the impact on the Group and the economic environment in which it operates.

The measures taken by the state and the government's actions are taken into account and in response to the expected ones, the management of the Group has taken actions aimed at limiting the risks, which include:

- Actions aimed at the staff of the Group (ensuring the highest levels of disinfection in the office, securing a workplace that prevents the possibility of contamination, providing opportunities for working remotely - "work from home")
- Actions aimed at ensuring the continuity of the work of the suppliers (the administration/document processing is ensured through the use of forwarding companies, as well as the supply of the necessary materials for normal functioning)
- Actions aimed at borrowers (maintaining constant communication, discussing options for extending the repayment period when needed, responding quickly to other indications related to decisions and changes in loan terms - extending the utilization period)
- Measures to inform the contracting authority under Jessica initiative, i.e. the FMFIB, of possible delay in meeting deadlines, schedules and indicators. Actions to expand the scope of activities and sectors eligible for FUD funding, considering current needs and available resources, to be used in the most appropriate and beneficial way for the public.
- Actions to ensure the adequate capital and liquidity position of the Group in order to fulfil as much as possible the strategic and business plans for the coming quarters.

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

The name of the parent-company was changed from “Fund for Local Authorities and Governments in Bulgaria – FLAG” EAD to “Fund FLAG” EAD. The change was registered in the Commercial Register on 02.06.2020 and was approved in Protocol № 196 from 25.03.2020 of the Board of Directors of FLAG.

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

Prepared by: Nadya Dankinova – Executive director

09 June 2020



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

INDEPENDENT AUDITOR'S REPORT

To the sole shareholder of FUND FLAG EAD

(PREVIOUS: FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD)

Opinion

We have audited the consolidated financial statements of *FUND FLAG EAD (PREVIOUS: FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD)* („the Group“), which comprise the consolidated statement of financial position as at 31 December 2019, 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 the 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 2019, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs), as adopted by European Union.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group within the meaning of the *International Code of Ethics for Professional Accountants (including International Independence Standards)* issued by International Ethics Standards Board for Accountants (IESBA Code) and the Independent Financial Audit Act (IFAA) applicable to our audit of the 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 the 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.

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

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

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

- a) The information, included in the Annual 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 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 or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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



Ivaylo Yanchev
Registered auditor

9 June 2020
Sofia



Krassimira Radeva – Managing Director
Baker Tilly Klitou and Partners OOD

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

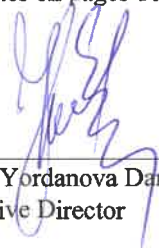
**FUND FLAG EAD (PREVIOUS: FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD)
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**

For the year ended 31 December 2019

	Notes	2019 <i>BGN'000</i>	2018 <i>BGN'000</i>
Interest income	3.1	6,412	5,977
Interest expenses and charges	3.2	(1,694)	(1,694)
Other operating income	3.3	911	748
Net operating income		5,629	5,031
(Expenses for) / Reintegrated impairment of loans granted	9	(299)	105
Payroll expenses	3.4	(1,210)	(1,001)
Depreciation expenses	7	(73)	(28)
Other operating expenses	3.5	(238)	(302)
Profit before tax		3,809	3,805
Income tax expense	4	(381)	(343)
Profit for the year		3,428	3,462
Other comprehensive income for the year, net of taxes		-	-
Total comprehensive income for the year, net of taxes		3,428	3,462

These consolidated financial statements were authorized for issue by the Board of Directors on 9 June 2020.

The notes on pages 16 to 46 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:



Ivaylo Yanchev
Registered auditor
09 June 2020





Krassimira Radeva
Managing director
Baker Tilly Klitou and Partners OOD

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

As at 31 December 2019

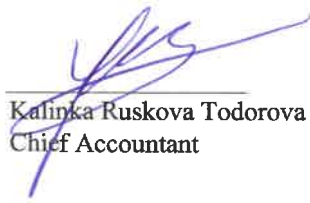
	Notes	31 December	
		2019	2018
		BGN'000	BGN'000
ASSETS			
Cash and cash equivalents	5	29,614	25,007
Receivables and prepayments	6	150	173
Loans granted	9	220,878	210,226
Deferred tax assets	4	2	2
Plant and equipment	7	15	36
Right of use assets	7	93	-
Software	7	3	6
Investment in joint venture	8.2	20	-
TOTAL ASSETS		250,775	235,450
LIABILITIES AND EQUITY			
Liabilities			
Payroll and social security payables	11	164	143
Tax liabilities	12	117	56
Other liabilities	13	332	265
Loans payable	10	145,967	132,661
Total liabilities		146,580	133,125
Equity			
Share capital	14.1	90,000	90,000
Statutory reserves	14.2	3,142	2,796
Retained earnings		11,053	9,529
Total equity		104,195	102,325
TOTAL LIABILITIES AND EQUITY		250,775	235,450

These consolidated financial statements were authorized for issue by the Board of Directors on 9 June 2020.


The notes on pages 16 to 46 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:


Ivaylo Yanchev
Registered auditor
09 June 2020




Krassimira Radeva
Managing director
Baker Tilly Klitou and Partners OOD

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

For the year ended 31 December 2019

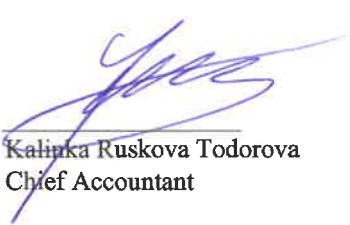
	Note	Share capital	Retained earnings	Statutory reserves	Total
		<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>
As at 31 December 2017		90,000	8,029	2,507	100,536
<i>Effects from the application of IFRS 9 on 1 January 2018</i>		-	(374)	-	(374)
As at 1 January 2018		90,000	7,655	2,507	100,162
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		90,000	9,529	2,796	102,325
As at 1 January 2019		90,000	9,529	2,796	102,325
Profit for the year		-	3,428	-	3,428
Total comprehensive income		-	3,428	-	3,428
Dividend distribution		-	(1,558)	-	(1,558)
Transfer to reserves		-	(346)	346	-
As at 31 December 2019	14	90,000	11,053	3,142	104,195

These consolidated financial statements were authorized for issue by the Board of Directors on 9 June 2020.

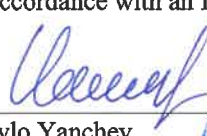
The notes on pages 16 to 46 are an integral part of these consolidated financial statements.


Nadya Yordanova Dankinova
Executive Director





Kalinka Ruskova Todorova
Chief Accountant

In accordance with an Independent Auditor's Report:


Ivaylo Yanchev
Registered auditor
09 June 2020




Krassimira Radeva
Managing director
Baker Tilly Klitou and Partners OOD

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

For the year ended 31 December 2019

	Notes	2019 BGN'000	2018 BGN'000
Cash flows from operating activities			
Proceeds from interest on bank deposits		-	2
Loans granted		(100,689)	(89,440)
Loans repaid		89,756	60,794
Interest received on loans granted		6,429	5,977
Payments to suppliers		(765)	(777)
Payments to personnel and for social security		(1,196)	(964)
Other proceeds/(payments), net		738	527
Income tax paid		(319)	(335)
Net cash flows used in operating activities		(6,046)	(24,216)
Cash flows from investing activities			
Purchase of equipment and other fixed assets		(4)	(27)
Investment in joint venture		(20)	-
Net cash flows used in investing activities		(24)	(27)
Cash flows from financing activities			
Loans received		35,624	47,946
Repayment of loans		(22,144)	(23,386)
Dividends paid		(1,558)	(1,299)
Interest paid		(815)	(877)
Fees and commissions paid		(382)	(316)
Payments under lease agreements		(48)	-
Net cash flows from financing activities		10,677	22,068
Net increase/(decrease) in cash and cash equivalents		4,607	(2,175)
Cash and cash equivalents at the beginning of the period	5	25,007	27,182
Cash and cash equivalents at the end of the period	5	29,614	25,007

These consolidated financial statements were authorized for issue by the Board of Directors on 9 June 2020.

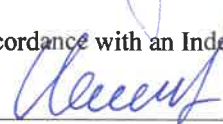
The notes on pages 16 to 46 are an integral part of these consolidated financial statements.


Nadya Yordanova Dankinova
Executive Director




Kalinka Ruskova Todorova
Chief Accountant

In accordance with an Independent Auditor's Report:


Ivaylo Yanchev
Registered auditor
09 June 2020




Krassimira Radeva
Managing director
Baker Tilly Klitou and Partners OOD

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

For the year ended 31 December 2019

1. Corporate information

The consolidated financial statements of Fund FLAG EAD (previous: Fund for local authorities and governments in Bulgaria – FLAG EAD) and its subsidiary FSUD (“the Group”) for the year ended 31 December 2019 were authorized for issue by a decision of the Board of Directors dated 9 June 2020.

Fund FLAG EAD (previous: Fund for local authorities and governments in Bulgaria – 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 Group 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 2019, the shareholders of Fund FLAG EAD (previous: Fund for local authorities and governments in Bulgaria – FLAG EAD) 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 2019.

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 are not yet effective. Some of them are 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:

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

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

For the year ended 31 December 2019

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

- Amendments to IFRS 9, IAS 39 and IFRS 7: Interest Rate Benchmark Reform (in force for annual periods beginning on or after 1 January 2020) - The management does not expect the adoption of these amendments to have a significant effect on the financial statements of the Group.
- Amendments to IFRS 3 Business Combinations (in force for annual periods beginning on or after 01.01.2020) - The management does not expect the adoption of these amendments to have a significant effect on the financial statements of the Group.

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

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

- IFRS 17 "Insurance Contracts" (in force for annual periods beginning on or after 1 January 2021);
- Amendments to IAS 1 "Presentation of Financial Statements: Classification of Liabilities as Current and Non-current" (in force for annual periods beginning on or after 01.01.2022);
- Amendments to IFRS 3 "Business Combinations", IAS 16 "Property, Plant and Equipment", IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" as well as Annual Improvements (in force for annual periods beginning on or after 01.01.2022);
- Amendment to IFRS 16 Leases Covid 19-Related Rent Concessions (in force for annual periods beginning on or after 01.06.2020).

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

2.2 Summary of significant accounting policies

a) Foreign currency conversion

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

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).

(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 of: interest expense on borrowings, interest expense on leases, bank fees on loans and guarantees, net loss from exchange differences.

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

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

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.

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

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

e) Financial instruments – initial recognition and subsequent measurement

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

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

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

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

For the year ended 31 December 2019

2.2 Summary of significant accounting policies (continued)

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

The 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 over 90 days past due, unless there are circumstances that render this claim rebuttable for certain financial instruments. Meanwhile, other events, based on internal and external information, are also monitored for indication that the debtor is not able to repay all outstanding contractual amounts, incl. after taking into account all credit reliefs provided by the 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.

- **Financial liabilities**

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.

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 Group intends either to settle on a net basis or to realize the assets and settle the liabilities simultaneously.

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2.2 Summary of significant accounting policies (continued)

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

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.

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

f) IFRS 13 Fair value measurement

At each reporting date the Group applies IFRS 13 Fair value measurement to the financial instruments and non-financial assets measured at fair value. The fair value is the price, 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 value measurement is based on the assumption that the sale of the asset or the transfer of the liability takes place on:

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

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

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2.2 Summary of significant accounting policies (continued)

f) IFRS 13 Fair value measurement (continued)

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.

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.

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2.2 Summary of significant accounting policies (continued)

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

Accounting policy applicable from 01.01.2019

Group as a lessee

Identifying a lease

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

Initial recognition and measurement

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

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

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

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

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

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

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

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

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

Subsequent measurement

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

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2.2 Summary of significant accounting policies (continued)

k) Leases (continued)

The Group subsequently measures the lease liability by:

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

Accounting for lease reassessments and lease modifications

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

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

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

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

Group as a lessor

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

Accounting policy applicable until 31.12.2018

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

l) Investments and consolidation

• Investments in subsidiaries and consolidation

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

Subsidiaries are all 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.

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2.2 Summary of significant accounting policies (continued)

l) Investments and consolidation (continued)

• **Investments in joint ventures**

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

Investments in joint ventures are accounted for under the equity method. The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the Group's share of the investee's net assets. The Group's profit or loss includes its share of the investee's profit or loss.

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

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

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:

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).

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2.2 Summary of significant accounting policies (continued)

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

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.

If the financial condition and performance of the borrowers deteriorate (above expectations), the value of receivables that should be impaired/written off in subsequent reporting periods may be higher than expected at the date of the statement of financial position.

Corporate income tax

A significant judgement is required to determine the overall tax provision. There are many transactions and calculations, for which the final tax cannot be determined precisely in the normal course of activity. The 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.

2.3 Effects from the initial application of IFRS 16

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

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

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

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

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

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

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

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

CONSOLIDATED STATEMENT OF FINANCIAL POSITION	31.12.2018 As originally accounted for BGN'000	Effect from application of IFRS 16 BGN'000	01.01.2019 restated BGN'000
ASSETS			
Cash and cash equivalents	25,007	-	25,007
Receivables and prepayments	173	-	173
Loans granted	210,226	-	210,226
Deferred tax assets	2	-	2
Plant and equipment	36	-	36
Right of use assets	-	138	138
Software	6	-	6
TOTAL ASSETS	235,450	138	235,588
LIABILITIES AND EQUITY			
Liabilities			
Payroll and social security payables	143	-	143
Tax liabilities	56	-	56
Other liabilities	265	138	403
Loans payable	132,661	-	132,661
Total liabilities	133,125	138	133,263
Equity			
Share capital	90,000	-	90,000
Statutory reserves	2,796	-	2,796
Retained earnings	9,529	-	9,529
Total equity	102,325	-	102,325
TOTAL LIABILITIES AND EQUITY	235,450	138	235,588

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3. Income and expenses

3.1 Income from interest

	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Interest income on deposits and bank accounts	-	2
Income on loans granted and receivables	6,412	5,975
Total interest income	<u>6,412</u>	<u>5,977</u>

3.2 Interest expenses and charges

	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Interest expenses on loans and borrowings	823	877
Expenses on fees, commissions and foreign exchange differences	871	817
Total interest expenses and charges	<u>1,694</u>	<u>1,694</u>

3.3 Other operating income

	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Income from management and commitment fees	899	735
Other	12	13
Total other operating income	<u>911</u>	<u>748</u>

3.4 Payroll costs

	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Salaries and wages	1,080	901
Social securities	130	100
Total payroll costs	<u>1,210</u>	<u>1,001</u>

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3. Income and expenses (continued)

3.5 Other operating expenses

	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Accounting and audit services	15	48
Rent	-	56
Materials	13	18
Legal services	21	18
Communication services	7	8
Hardware maintenance	6	6
Consulting services	43	50
Social expenditure	21	14
Training	28	-
Insurances	2	2
Other	82	82
Total other operating expenses	<u>238</u>	<u>302</u>

4. Income tax

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

	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Current income tax expense	381	344
Deferred income taxes related to occurrence and reversal of temporary differences	-	(1)
Income tax expense	<u>381</u>	<u>343</u>

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

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

	<u>2019</u>	<u>2018</u>
	<i>BGN'000</i>	<i>BGN'000</i>
Accounting profit before taxes	3,809	3,805
Income tax expense at statutory tax rate of 10% for 2019 (2018: 10%)	381	381
Permanent differences	-	(38)
Income tax expense	<u>381</u>	<u>343</u>

As of 31.12.2019 the Group owes corporate income tax amounting to BGN 117 thousand. (31.12.2018: BGN 56 thousand).

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4. Income tax (Continued)

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

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

5. Cash and cash equivalents

	31 December	
	2019	2018
	<i>BGN'000</i>	<i>BGN'000</i>
Cash in hand and in current accounts	29,357	24,703
Funds in a special account	-	69
Funds in a reserve account	257	235
Total cash and cash equivalents	29,614	25,007

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 are pledged as collateral under bank loan agreements concluded with Unicredit Bulbank AD, UBB AD, DSK Bank EAD and Expressbank (Note 10). There is a pledge on the funds in the special and reserve account in favor of the FMFIB.

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 31 December 2018 and 31 December 2019.

6. Receivables and prepayments

	31 December	
	2019	2018
	<i>BGN'000</i>	<i>BGN'000</i>
Receivables under management fee – FMFIB	87	110
Advances to suppliers	18	21
Other receivables	45	42
Total receivables and prepayments	150	173

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

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

	Hardware <i>BGN'000</i>	Fixtures and equipment <i>BGN'000</i>	Plant and equipment <i>BGN'000</i>	Vehicles <i>BGN'000</i>	Software <i>BGN'000</i>	Other Fixed Assets <i>BGN'000</i>	Right of use assets <i>BGN'000</i>	Total <i>BGN'000</i>
Book value:								
As of 1 January 2018	41	10	22	49	29	6	-	157
Additions	21	-	-	-	6	-	-	27
As of 31 December 2018	62	10	22	49	35	6	-	184
Recognized on 01.01.2019 in accordance with IFRS 16	-	-	-	-	-	-	138	138
Additions	4	-	-	-	-	-	-	4
As of 31 December 2019	66	10	22	49	35	6	138	326
Depreciation:								
As of 1 January 2018	(37)	(9)	(20)	(22)	(21)	(5)	-	(114)
Depreciation charge	(4)	(1)	(2)	(12)	(8)	(1)	-	(28)
As of 31 December 2018	(41)	(10)	(22)	(34)	(29)	(6)	-	(142)
Depreciation charge	(12)	-	-	(13)	(3)	-	(45)	(73)
As of 31 December 2019	(53)	(10)	(22)	(47)	(32)	(6)	(45)	(215)
Carrying amount								
As of 1 January 2018	4	1	2	27	8	1	-	43
As of 31 December 2018	21	-	-	15	6	-	-	42
As of 31 December 2019	13	-	-	2	3	-	93	111

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

8.1. Subsidiary company

By a decision of the sole owner of Fund FLAG EAD (previous: Fund for local authorities and governments in Bulgaria – FLAG EAD), the Ministry of Regional Development and Public Works, from 03.04.2012, and after a meeting of the Board of Directors of the Fund, a new company was incorporated – “Fund for Sustainable Urban Development of Sofia” EAD, with share capital of BGN 500 thousand. The company was registered on 23 April 2012 with the Registry Agency and the share capital was paid in full by Fund FLAG EAD (previous: Fund for local authorities and governments in Bulgaria – 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, Fund FLAG EAD (previous: Fund for local authorities and governments in Bulgaria – FLAG EAD) and FSUDS EAD.

On December 14, 2015, a transfer and replacement agreement was signed between the EIB, MRDPW, FSUDS EAD and Fund FLAG EAD (previous: Fund for local authorities and governments in Bulgaria – 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.

By Protocol TZ-12 of 22 March 2017 the Minister of Regional Development and Public Works, in its capacity of representative, authorizes FLAG to acquire long-term financial assets in the subsidiary “Fund for Sustainable Urban Development of Sofia” EAD amounting to 4,500,000 BGN, representing 4,500 new, ordinary, available, shares with nominal value of BGN 1,000 each.

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8.1. Subsidiary company (continued)

With this act and following a decision of the Fund's Board of Directors on 28 March 2017, it was proceeded to the registration of the change and the respective increase of the capital of "Fund for Sustainable Urban Development of Sofia" EAD from BGN 500,000 to BGN 5,000,000.

8.2. Investment in joint venture

On December 13, 2017, an agreement was concluded between Fund FLAG EAD (previous: Fund for local authorities and governments in Bulgaria – FLAG EAD), FSUD JSC, Cibank EAD, United Bulgarian Bank AD (UBB) and Bulgarian Consulting Organization EOOD (BCO) for establishment of company incorporated Under the Obligations and Contracts Act "Fund for Sustainable Cities" (FSC). The purpose of the newly established company is to participate in a procurement procedure with the subject "Implementation of a financial instrument Urban Development Fund, financed by funds from the Operational Program "Regions in Growth" 2014-2020. The company is managed jointly by all the founders. According to the founding agreement, the share of the Group in FSC is 45%. In 2019 the Group has invested BGN 20 thousand in FSC.

9. Loans granted

	31 December	
	2019	2018
	<u>BGN'000</u>	<u>BGN'000</u>
Loans granted to municipalities	178,235	169,265
Accrued, but unpaid interest related to loans granted to municipalities	123	107
Impairment of receivables related to loans granted to municipalities	(5,243)	(4,983)
Total loans granted to municipalities, net	173,115	164,389
Loans granted for urban development projects under Jessica initiative	48,396	46,817
Loans granted to FSC	385	-
Accrued, but unpaid interest related to loans granted	25	24
Impairment of receivables related to loans granted	(1,043)	(1,004)
Total loans granted under Jessica initiative and to FSC, net	47,763	45,837
Total loans granted	220,878	210,226

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

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

Loans granted for bridge financing and funding of own activities 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.

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9. Loans granted (Continued)

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

As of 31.12.2019 the Group has concluded 18 contracts under the Jessica program with a total value of 62 million BGN, and each of the loans has two sub-limits:

- EIB / FMFIB sub-limit in the amount of BGN 29,236 thousand, of which BGN 1,545 thousand were utilized in 2019 and BGN 1,781 thousand were repaid;
- Sub-limit "Co-financing" / "FSUD" in the amount of BGN 32,837 thousand, of which BGN 3,638 thousand were utilized in 2019 and BGN 1,823 thousand were repaid.

As of 31.12.2019 the Group has concluded 16 loan agreements as part of the participation of FSUD EAD in Fund for Sustainable Cities. The total value of the contracts is BGN 34,950 thousand. The FSUD's part utilized as of 31.12.2019 is BGN 385 thousand, no repayments have been made (for 2018 there were no contracts / utilizations and repayments).

As of 31.12.2019, a provision for expected credit losses in the amount of BGN 5,243 thousand has been calculated on loans granted for bridge financing and funding of own activities in accordance with IFRS 9. The provision for expected credit losses on loans classified within Stage 1 is in the amount of BGN 2,907 thousand, and the impairment on loans in Stage 2 - BGN 2,336 thousand. As of 31.12.2019, the provision for expected credit losses on loans granted under Jessica initiative is BGN 1,043 thousand. The provision for expected credit losses on loans granted under Jessica initiative classified within Stage 1 is in the amount of BGN 603 thousand, and the impairment on loans in Stage 2 - BGN 440 thousand.

In 2018, a new impairment policy for expected credit losses was adopted in accordance with IFRS 9, according to which as at 31 December 2018 a provision for expected credit losses in the amount of BGN 4,983 thousand has been calculated. The provision for expected credit losses on loans classified within Stage 1 is in the amount of BGN 2,760 thousand, and the impairment on loans in Stage 2 - BGN 2,223 thousand. As of 31.12.2018, the provision for expected credit losses on loans granted under Jessica initiative is BGN 1,004 thousand.

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

	<i>Impairment of receivables on loans granted</i>
As of 31 December 2017 under IAS 39	(5,718)
Amounts recognized in the opening balance of retained earnings upon the first-time adoption of IFRS 9 under the modified retrospective approach	(374)
Opening balance of impairment allowance as of 1 January 2018, calculated under IFRS 9	(6,092)
Reduction in credit loss adjustment, recognized in profit or loss in 2018	105
As of 31 December 2018	(5,987)
Increase in credit loss adjustment, recognized in profit or loss for the year	(299)
As of 31 December 2019	(6,286)

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10. Loans payable

	Maturity	31 December	
		2019	2018
		<i>BGN'000</i>	<i>BGN'000</i>
Revolving loan payable to UniCredit Bulbank	August 2020	30,000	30,000
Revolving loan payable to DSK	May 2024	21,218	21,218
Long-term loan payable to UniCredit Bulbank	November 2023	22,857	28,571
Revolving loan payable to UBB	November 2023	39,116	27,185
Long-term loan payable to Expressbank	October 2025	-	3,047
Revolving loan payable to UBB	October 2025	10,481	-
Deferred fees under loan agreements		(341)	(275)
Accrued interest due		21	17
Total bank loans payable		123,352	109,763
Loans payable to FMFIB	June 2035	22,615	22,898
Total loans payable to FMFIB		22,615	22,898
Total loans payable		145,967	132,661

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

Collateral for bank loans from Unicredit Bulbank AD, UBB AD, DSK Bank EAD and Expressbank AD includes pledge on current and future receivables on bank accounts of FLAG 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 of Sofia" (FSUDS) EAD and "Fund FLAG" EAD (previous: "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.

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10. Loans payable (continued)

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.

On 14.12.2015 an agreement for transfer and replacement was signed between the EIB, the Ministry of Regional Development and Public Works, FSUD EAD and Fund FLAG EAD (previous: Fund for Local Authorities and Governments in Bulgaria – FLAG EAD), according to which, as of 01.01.2016 due to the expiration of the EIB's commitment to the JESSICA initiative, all rights and obligations of the EIB under the Operational Agreement were transferred to the Ministry of Regional Development and Public Works (Managing authority of OPRD).

An Amendment Agreement № 5 to the Operational Agreement of 30 May 2012 was signed on 08.07.2016. Pursuant to this agreement, as of 31 October 2016 the amount of the total "Co-financing" should be at least equal to the amount of the Conditional loan.

In 2017 a procedure for transferring the rights and obligations of the 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. Its purpose is to regulate the relations between FSUD EAD, Fund FLAG EAD (previous: Fund for Local Authorities and Governments in Bulgaria – 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 are allocated as follows:

	31 December	
	2019	2018
	<i>BGN'000</i>	<i>BGN'000</i>
Payables to personnel	142	123
Payables for social security	22	20
Total payables to personnel and for social security	164	143

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12. Income tax payable

The movements in tax payables for 2019 and 2018 are as follows:

	31 December	
	2019	2018
	<i>BGN'000</i>	<i>BGN'000</i>
Tax payable as at 1 January	(56)	(47)
Tax paid throughout the year	320	335
Tax accrued for the year (Note 4)	(381)	(344)
Tax payable as at 31 December	(117)	(56)

13. Other liabilities

	31 December	
	2019	2018
	<i>BGN'000</i>	<i>BGN'000</i>
Other liabilities	332	265
<i>incl. Contingent fee for loan applicants</i>	58	81
<i>Good performance guarantee</i>	131	131
<i>Payables to suppliers</i>	47	49
<i>Lease liabilities</i>	94	-
<i>Other</i>	2	4
Total other liabilities	332	265

14. Share capital and reserves

14.1 Share capital

	31 December	
	2019	2018
	<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 2019 and 31 December 2018 the issued registered share capital was fully paid-in.

14.2 Statutory reserves

Statutory reserves are formed by Fund FLAG EAD (previous: Fund for Local Authorities and Governments in Bulgaria – 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 31.12.2019 statutory reserves amount to BGN 3,142 thousand (2018: BGN 2,796 thousand).

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15. Dividend distribution

According to Order № 1 of the Council of Ministers of 07.06.2019, in 2019 dividends were distributed to the sole shareholder in the amount of BGN 1,558 thousand (2018: BGN 1,299 thousand). The dividend per share is BGN 17.31 (2018: BGN 14.43).

16 Commitments and contingent liabilities

Legal claims

As at 31 December 2019 and 31 December 2018 there were no litigations against the companies within the Group.

Loan commitments

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

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 Fund FLAG EAD (previous: Fund for Local Authorities and Governments in Bulgaria – FLAG EAD).

The Fund for Sustainable Urban Development EAD is a fully owned subsidiary of Fund FLAG EAD (previous: Fund for Local Authorities and Governments in Bulgaria – FLAG EAD) with a share capital of BGN 5,000 thousand fully paid by FLAG.

Fund for Sustainable Cities (FSC) – a jointly controlled entity.

Remuneration of management staff

In 2019 the remuneration of management staff amounts to BGN 418 thousand (2018: BGN 372 thousand).

Related party transactions

In 2019 the Group has provided a loan to Fund for Sustainable Cities in the amount of BGN 385 thousand. As of 31.12.2019 the Group has a receivable from FSC of BGN 385 thousand.

18. Financial risk management objectives and policies

The main 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 2019 and 2018, 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.

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18. Financial risk management objectives and policies (continued)

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.

	<u>Increase/Decrease in interest rates</u>	<u>Effect on the pre- tax profit</u> <i>BGN'000</i>
2019		
Loans payable in EUR	+0.5%	(196)
Loans payable in BGN	+0.5%	(423)
Loans granted in BGN	+0.5%	1,004
Loans payable in EUR	-1%	391
Loans payable in BGN	-1%	846
Loans granted in BGN	-1%	(2,008)
2018		
Loans payable in EUR	+0.5%	(136)
Loans payable in BGN	+0.5%	(399)
Loans granted in BGN	+0.5%	965
Loans payable in EUR	-1%	272
Loans payable in BGN	-1%	798
Loans granted in BGN	-1%	(1,929)

Liquidity risk

The effective management of the 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:

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18. Financial risk management objectives and policies (continued)

Liquidity risk (continued)

Liabilities

As at 31 December 2019

	<u>On demand</u>	<u>< 3 months</u>	<u>3-12</u>	<u>1-5</u>	<u>> 5 years</u>	<u>Total</u>
	<i>BGN'000</i>	<i>BGN'000</i>	<i>months</i>	<i>years</i>	<i>BGN'000</i>	<i>BGN'000</i>
Interest-bearing loans and borrowings	-	289	36,461	80,554	10,582	127,886
Borrowings under loan contract with FMFIB	-	7	1,644	8,264	12,700	22,615
Trade and other payables	-	184	34	114	-	332
	<u>-</u>	<u>480</u>	<u>38,139</u>	<u>88,932</u>	<u>23,282</u>	<u>150,833</u>

As at 31 December 2018

	<u>On demand</u>	<u>< 3 months</u>	<u>3-12</u>	<u>1-5</u>	<u>> 5 years</u>	<u>Total</u>
	<i>BGN'000</i>	<i>BGN'000</i>	<i>months</i>	<i>years</i>	<i>BGN'000</i>	<i>BGN'000</i>
Interest-bearing loans and borrowings	-	238	6,398	82,688	24,781	114,105
Borrowings under loan contract with FMFIB	-	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>

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

Assets	<u>Within 1 year</u>	<u>Over 1 year</u>	<u>Total amount</u>
Cash and cash equivalents	29,614	-	29,614
Other receivables	132	-	132
Loans granted	104,026	116,852	220,878
Total assets	133,772	116,852	250,624
Liabilities	<u>Within 1 year</u>	<u>Over 1 year</u>	<u>Total amount</u>
Loans payable to banks	37,737	87,615	123,352
Loan payable to FMFIB	1,651	20,964	22,615
Other liabilities	218	114	332
Total liabilities	37,606	108,693	146,299

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18. Financial risk management objectives and policies (continued)

Liquidity risk (continued)

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>	<i>Total amount</i>
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>	<i>Total amount</i>
Loans payable to banks	5,732	104,031	109,763
Loan payable to FMFIB	1,072	21,826	22,898
Other liabilities	200	65	265
Total liabilities	7,004	125,922	132,926

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.

At the end of 2019, the balance of the liabilities of the municipalities to the Group amounted to BGN 178,358 thousand, and at the end of 2018 it was BGN 169,372 thousand.

At the end of 2019, the balance of the liabilities of the borrowers under the Jessica program amounted to BGN 48,421 thousand, and at the end of 2018 it was BGN 46,841 thousand.

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

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

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

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

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18. Financial risk management objectives and policies (continued)

Credit risk (continued)

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).

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.

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18. Financial risk management objectives and policies (continued)

Credit risk (continued)

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

31.12.2019	Internal credit risk category	Expected credit loss (IFRS 9)	Gross book value BGN '000	Impairment Loss (adjustment) BGN '000	Book value BGN '000
Loans granted to third parties	Stage 1	<i>12-month period</i>	207,796	(3,510)	204,286
Loans granted to third parties	Stage 2	<i>Lifetime</i>	18,983	(2,776)	16,207
			226,779	(6,286)	220,493

31.12.2018	Internal credit risk category	Expected credit loss (IFRS 9)	Gross book value BGN '000	Impairment Loss (adjustment) BGN '000	Book value BGN '000
Loans granted to third parties	Stage 1	<i>12-month period</i>	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

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

	2019		2018	
	Gross	Net	Gross	Net
Exposure				
Cash and cash equivalents	29,614	29,614	25,007	25,007
Loans granted	227,164	220,878	216,213	210,226
Other receivables	132	132	152	152
Total balance sheet items	256,910	250,624	241,372	235,385

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 2019, as in 2018, there are no changes in the Group's capital management goals, policies or processes.

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18. Financial risk management objectives and policies (continued)

Capital management (continued)

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

	2019	2018
	<u>BGN'000</u>	<u>BGN'000</u>
Net profit	<u>3,428</u>	<u>3,462</u>

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

Reconciliation of the movement of liabilities arising from financing activities

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

	1.1.2019	Dividend distribution	Change in cash flows from financing activities	Interest accrued	Other non- monetary changes	31.12.2019
	BGN'000	BGN'000	BGN'000	BGN'000	BGN'000	BGN'000
Loans payable	132,661	-	12,283	815	208	145,967
Dividend payables	-	1,558	(1,558)	-	-	-
Lease liabilities	-	-	(48)	4	138	94
Total	132,661	1,558	10,677	819	346	146,061

*Lease liabilities are included in Note 13 Other liabilities.

	1.1.2018	Dividend distribution	Change in cash flows from financing activities	Interest accrued	Other non- monetary changes	31.12.2018
	BGN'000	BGN'000	BGN'000	BGN'000	BGN'000	BGN'000
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

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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 Fund FLAG EAD (previous: Fund for Local Authorities and Governments in Bulgaria – 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 and the applicable interest rates change in line with the market conditions.

21. Events after the reporting period

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

On January 17, 2020, a Memorandum of Understanding was signed between the European Investment Bank, the Fund Manager of Financial Instruments in Bulgaria EAD and Fund FLAG EAD (previous: Fund for local authorities and governments in Bulgaria – FLAG EAD).

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

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

- Considering the specifics of the client base – disruption of the regularity of borrowers' revenues resulting in difficulty paying the regular loan installments;
- Increase of the extraordinary expenses of the municipalities and healthcare entities related to urgent actions for implementation of the measures for protection of the health of the population, coping with the unusually large number of infectious patients, disinfection, social problems, etc.;
- Delayed implementation of projects approved for funding and extension of utilization deadlines.

On May 14, 2020 by decision of the government the state of emergency was replaced by a state of epidemic emergency. A gradual relaxation of the restrictions over movement of people and work of trade and cultural sites is expected, while maintaining strict sanitary and hygienic requirements.

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21. Events after the reporting period (continued)

Based on the publicly available information at the date of the consolidated financial statements, management has considered possible adverse scenarios regarding the anticipated development of the COVID-19 pandemic and the impact on the Group and the economic environment in which it operates.

The measures taken by the state and the government's actions are taken into account and in response to the expected ones, the management of the Group has taken actions aimed at limiting the risks, which include:

- Actions aimed at the staff of the Group (ensuring the highest levels of disinfection in the office, securing a workplace that prevents the possibility of contamination, providing opportunities for working remotely - "work from home")
- Actions aimed at ensuring the continuity of the work of the suppliers (the administration/document processing is ensured through the use of forwarding companies, as well as the supply of the necessary materials for normal functioning)
- Actions aimed at borrowers (maintaining constant communication, discussing options for extending the repayment period when needed, responding quickly to other indications related to decisions and changes in loan terms - extending the utilization period)
- Measures to inform the contracting authority under Jessica initiative, i.e. the FMFIB, of possible delay in meeting deadlines, schedules and indicators. Actions to expand the scope of activities and sectors eligible for FUD funding, considering current needs and available resources, to be used in the most appropriate and beneficial way for the public.
- Actions to ensure the adequate capital and liquidity position of the Group in order to fulfil as much as possible the strategic and business plans for the coming quarters.

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

The name of the parent-company was changed from "Fund for Local Authorities and Governments in Bulgaria – FLAG" EAD to "Fund FLAG" EAD. The change was registered in the Commercial Register on 02.06.2020 and was approved in Protocol № 196 from 25.03.2020 of the Board of Directors of FLAG.

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