

FINCA International, Inc.

Consolidated Financial Statements as of and
for the Years Ended December 31, 2017 and 2016,
and Independent Auditors' Report

FINCA INTERNATIONAL, INC.

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1-2
CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016:	
Statements of Financial Position	3
Statements of Profit or Loss	4
Statements of Other Comprehensive Income or Loss	5
Statements of Changes in Equity	6
Statements of Cash Flows	7-8
Notes to Consolidated Financial Statements	9-52

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Members of the Audit Committee
FINCA International, Inc.
Washington, D.C.

We have audited the accompanying consolidated financial statements of FINCA International, Inc. and its subsidiaries (the "Company"), which comprise the consolidated statements of financial position as of December 31, 2017 and 2016, and the related consolidated statements of profit or loss, other comprehensive income or loss, changes in equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements 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 Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of FINCA International, Inc. and its subsidiaries as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Deloitte + Touche LLP

June 21, 2018

FINCA INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31, 2017 AND 2016

	2017	2016
ASSETS		
Cash and cash equivalents	\$ 153,912,034	\$ 140,797,035
Restricted cash and cash equivalents (Note 12)	37,713,356	26,428,949
Available for sale financial assets (Note 13)	6,232,990	7,670,352
Financial assets held-to-maturity (Note 14)	42,032,786	25,360,625
Financial assets at fair value through profit or loss (Note 15)	31,266,196	19,491,195
Loans receivable-net of allowance (Note 16)	777,645,735	741,756,202
Due from banks	377,904	7,610,297
Other receivables, prepaid, and other assets (Note 17)	23,537,572	28,905,042
Property and equipment (Note 18)	32,057,081	30,556,863
Intangible assets (Note 19)	9,018,960	8,058,153
Goodwill	989,143	1,042,135
Current income tax assets	923,351	3,400,776
Deferred tax assets (Note 11)	<u>5,725,698</u>	<u>2,469,769</u>
TOTAL	<u>\$ 1,121,432,806</u>	<u>\$ 1,043,547,393</u>
LIABILITIES AND EQUITY		
LIABILITIES:		
Accounts payable and other accrued liabilities (Note 20)	\$ 33,829,712	\$ 27,869,722
Financial liability at fair value through profit and loss (Note 15)	11,213,302	8,259,574
Client deposits (Note 21)	372,744,174	262,340,157
Bank deposits	62,546,969	38,341,223
Notes payable (Note 22)	376,330,996	455,536,704
Subordinated debt (Note 23)	5,651,052	5,598,931
Deferred revenue (Note 24)	3,884,371	5,593,390
Employee benefits (Note 25)	3,398,290	3,707,898
Current income tax liability	4,320,467	9,154,377
Deferred tax liabilities (Note 11)	<u>2,138,352</u>	<u>2,119,289</u>
Total liabilities	<u>876,057,685</u>	<u>818,521,265</u>
EQUITY:		
Reserves	18,458,417	18,458,417
Retained earnings	188,891,831	176,281,639
Currency translation reserve	<u>(56,406,825)</u>	<u>(58,472,480)</u>
Equity attributable to owners of the parent company	150,943,423	136,267,576
Noncontrolling interest	<u>94,431,698</u>	<u>88,758,552</u>
Total equity	<u>245,375,121</u>	<u>225,026,128</u>
TOTAL	<u>\$ 1,121,432,806</u>	<u>\$ 1,043,547,393</u>

See notes to consolidated financial statements.

FINCA INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF PROFIT OR LOSS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
CONTINUING OPERATIONS		
Interest income	\$ 283,750,994	\$ 285,226,552
Interest expense	<u>(69,545,445)</u>	<u>(70,435,830)</u>
Net interest income (Note 7)	214,205,549	214,790,722
IMPAIRMENT LOSSES ON LOANS (Note 16)	<u>(28,550,245)</u>	<u>(57,253,878)</u>
Net interest income after provision for impairment losses on loans	185,655,304	157,536,844
OTHER OPERATING INCOME (Note 8)	<u>33,435,308</u>	<u>29,131,799</u>
NET OPERATING INCOME	<u>219,090,612</u>	<u>186,668,643</u>
LOSS ON FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS	<u>(3,027,546)</u>	<u>(5,785,999)</u>
PERSONNEL EXPENSES (Note 9)	(112,402,125)	(110,686,414)
OTHER OPERATING EXPENSES (Note 10)	(83,954,996)	(86,125,776)
DEPRECIATION AND AMORTIZATION (Notes 18 and 19)	<u>(10,380,611)</u>	<u>(10,704,724)</u>
Total expenses	<u>(206,737,732)</u>	<u>(207,516,914)</u>
INCOME (LOSS) BEFORE OTHER INCOME (EXPENSES)	9,325,334	(26,634,270)
OTHER INCOME (EXPENSES):		
Grants and donations	22,431,162	22,497,497
Foreign exchange gains	2,774,555	3,242,776
Nonoperating expenses	<u>1,154,710</u>	<u>(2,022,193)</u>
PROFIT (LOSS) BEFORE INCOME TAX	35,685,761	(2,916,190)
INCOME TAX EXPENSE (Note 11)	<u>(13,230,591)</u>	<u>(17,562,140)</u>
PROFIT (LOSS) FOR THE YEAR FROM CONTINUING OPERATIONS	<u>\$ 22,455,170</u>	<u>\$ (20,478,330)</u>
DISCONTINUED OPERATIONS		
Loss for the year from discontinued operations (Note 27)	<u>\$ (5,046,945)</u>	<u>\$ (1,115,740)</u>
PROFIT (LOSS) FOR THE YEAR ATTRIBUTABLE TO:		
The parent	12,668,346	(13,043,454)
Noncontrolling interest	<u>4,739,879</u>	<u>(8,550,616)</u>
TOTAL PROFIT (LOSS) FOR THE YEAR	<u>\$ 17,408,225</u>	<u>\$ (21,594,070)</u>

See notes to consolidated financial statements.

FINCA INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE INCOME OR LOSS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
PROFIT (LOSS) FOR THE YEAR	<u>\$ 17,408,225</u>	<u>\$ (21,594,070)</u>
OTHER COMPREHENSIVE INCOME (LOSS)		
OTHER COMPREHENSIVE INCOME TO BE RECLASSIFIED TO PROFIT OR LOSS IN SUBSEQUENT PERIODS (NET OF TAX):		
Foreign currency movement during the year	3,014,154	2,103,521
Fair value revaluation reserve	<u>(41,805)</u>	<u>141,448</u>
Net other comprehensive income to be reclassified to profits or loss in subsequent periods (net of tax)	<u>2,972,349</u>	<u>2,244,969</u>
OTHER COMPREHENSIVE LOSS NOT TO BE RECLASSIFIED TO PROFIT OR LOSS IN SUBSEQUENT PERIODS (NET OF TAX):		
Benefit plan fair value adjustment (Note 25)	<u>(31,581)</u>	<u>(13,792)</u>
Other comprehensive loss not to be reclassified to profit or loss in subsequent periods (net of tax)	<u>(31,581)</u>	<u>(13,792)</u>
OTHER COMPREHENSIVE INCOME, NET OF TAX	<u>2,940,768</u>	<u>2,231,177</u>
TOTAL COMPREHENSIVE INCOME (LOSS) FOR THE YEAR, NET OF TAX	<u>\$ 20,348,993</u>	<u>\$ (19,362,893)</u>
TOTAL COMPREHENSIVE INCOME (LOSS), NET OF TAX, FOR THE YEAR ATTRIBUTABLE TO:		
The parent	\$ 14,675,847	\$ (11,646,246)
Noncontrolling interest	<u>5,673,146</u>	<u>(7,716,647)</u>
	<u>\$ 20,348,993</u>	<u>\$ (19,362,893)</u>

See notes to consolidated financial statements.

FINCA INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	Reserves	Retained Earnings	Currency Translation Reserve	Total	Noncontrolling Interest	Total Equity
BALANCE—December 31, 2015	\$ 16,837,266	\$ 190,871,939	\$ (59,795,383)	\$ 147,913,822	\$ 96,636,199	\$ 244,550,021
Comprehensive income or loss:						
Loss for the year	-	(13,043,454)	-	(13,043,454)	(8,550,616)	(21,594,070)
Foreign currency movement during the year	-	-	1,322,903	1,322,903	780,618	2,103,521
Fair value revaluation reserve	-	88,097	-	88,097	53,351	141,448
Benefit plan fair value adjustment	-	(13,792)	-	(13,792)	-	(13,792)
Total comprehensive income or loss	-	(12,969,149)	1,322,903	(11,646,246)	(7,716,647)	(19,362,893)
Dividends to noncontrolling interest	-	-	-	-	(161,000)	(161,000)
Transfer to reserve	1,621,151	(1,621,151)	-	-	-	-
BALANCE—December 31, 2016	18,458,417	176,281,639	(58,472,480)	136,267,576	88,758,552	225,026,128
Comprehensive income or loss:						
Profit for the year	-	12,668,346	-	12,668,346	4,739,879	17,408,225
Foreign currency movement during the year	-	-	2,065,655	2,065,655	948,499	3,014,154
Fair value revaluation reserve	-	(26,573)	-	(26,573)	(15,232)	(41,805)
Benefit plan fair value adjustment	-	(31,581)	-	(31,581)	-	(31,581)
Total comprehensive income or loss	-	12,610,192	2,065,655	14,675,847	5,673,146	20,348,993
BALANCE—December 31, 2017	<u>\$ 18,458,417</u>	<u>\$ 188,891,831</u>	<u>\$ (56,406,825)</u>	<u>\$ 150,943,423</u>	<u>\$ 94,431,698</u>	<u>\$ 245,375,121</u>

See notes to consolidated financial statements.

FINCA INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss) for the year	\$ 17,408,225	\$ (21,594,070)
Adjustments to reconcile net income (loss) for the year to net cash used in operating activities:		
Depreciation and amortization	10,427,186	12,824,660
(Gain) loss on disposal of fixed assets and intangibles	(79,523)	828,419
Impairment on loan losses and other financial assets	27,730,738	60,649,024
Impairment on other assets	881,011	2,449,501
Foreign exchange losses	6,557,271	7,824,262
Changes in deferred tax assets and liabilities	(3,500,797)	3,344,210
(Gain) loss on disposal of subsidiaries before tax and translation adjustments	570,761	(9,032,489)
Other noncash adjustments	(12,745,167)	(2,024,274)
(Decrease) increase of assets and liabilities from operating activities after noncash items:		
Change in loans receivable, including interest receivables	(64,480,114)	(39,974,826)
Change in due from banks	7,218,551	(3,727,694)
Change in other receivables and other assets	(24,990,205)	4,582,318
Change in other liabilities	3,550,214	(65,702)
Change in client deposits	120,619,706	99,747,105
Change in bank deposits	24,326,580	19,215,624
Change in deferred revenue	(2,337,796)	(1,505,981)
Change in employee benefits	(826,291)	261,807
	<u>110,330,350</u>	<u>133,801,894</u>
Net cash provided by operating activities		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of financial assets	(18,178,695)	(15,180,110)
Purchase of property and equipment	(9,848,269)	(11,156,347)
Purchase of intangible assets	(4,414,406)	(2,890,808)
Proceeds from sales/disposal of fixed assets	1,012,352	501,006
Net cash inflow on disposal of subsidiaries	238,367	14,944,775
Principal collection from note receivable	-	5,320,662
	<u>(31,190,651)</u>	<u>(8,460,822)</u>
Net cash used in investing activities		
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issue of shares	-	-
Proceeds from lenders	325,753,615	232,092,248
Repayment of loans and borrowings to lenders	(390,655,273)	(347,440,683)
	<u>(64,901,658)</u>	<u>(115,348,435)</u>
Net cash used in financing activities		

(Continued)

FINCA INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
NET INCREASE IN CASH AND CASH EQUIVALENTS	<u>\$ 14,238,041</u>	<u>\$ 9,992,637</u>
CASH AND CASH EQUIVALENTS—Beginning of the year	140,797,035	137,325,636
CASH HELD FOR SALE—Beginning of the year	<u>-</u>	<u>892,988</u>
Total cash and cash equivalents—beginning of the year	<u>140,797,035</u>	<u>138,218,624</u>
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(1,123,042)	(7,414,226)
CASH HELD FOR SALE (Note 27)	<u>-</u>	<u>-</u>
CASH AND CASH EQUIVALENTS—End of the year	<u>\$ 153,912,034</u>	<u>\$ 140,797,035</u>
SUPPLEMENTAL DISCLOSURES TO CASH FLOWS FROM OPERATING ACTIVITIES:		
Interest received	<u>\$ 328,699,304</u>	<u>\$ 267,329,591</u>
Interest paid	<u>\$ (85,882,421)</u>	<u>\$ (73,426,243)</u>
Income taxes paid	<u>\$ (12,167,277)</u>	<u>\$ (4,244,371)</u>
See notes to consolidated financial statements.		(Concluded)

FINCA INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

1. NATURE OF ACTIVITIES

FINCA International, Inc. (FINCA or “FINCA International” or the “Company”) is a not-for-profit corporation, incorporated in the state of New York, United States of America (USA), that has received a determination letter from the United States Internal Revenue Service classifying it as a tax-exempt public charity described in Section 501(c)(3) of the United States Internal Revenue Code of 1986, as amended. Founded in 1984, FINCA’s mission is to alleviate poverty through lasting solutions that help people build assets, create jobs, and raise their standard of living. FINCA’s headquarters is located in Washington, D.C., USA.

As the majority shareholder of FINCA Microfinance Holding Company, LLC (“FMH”), FINCA engages in microfinance operations in 20 developing countries in Latin America (Ecuador, Guatemala, Haiti, Honduras, and Nicaragua), Africa (Democratic Republic of the Congo, Malawi, Nigeria, Tanzania, Uganda, and Zambia), Eurasia (Armenia, Azerbaijan, Georgia, Kosovo, Kyrgyzstan, and Tajikistan), and the Middle East and South Asia (Afghanistan, Jordan, and Pakistan). FMH operates through local for-profit corporate or non-governmental entities or branches (“subsidiaries”) that are 100% or majority owned and/or controlled by FMH.

Subsidiaries principally provide small loans to individuals and to groups of individuals that lack access to traditional financial institutions. In most cases, FINCA loans are made to either groups, individuals, or small and medium-sized enterprises (“SME”). Other loans consist of agricultural loans, education loans, and other microfinance loans. Group and village loans consist of individuals that know each other, guarantee each other’s loans, and provide a network of support for the group members. Individual loans, typically larger in size, are made where individual small businesses demonstrate adequate need and creditworthiness. In addition to loans, FINCA provides other financial services needed by the working poor through a growing number of its subsidiaries, including savings deposits, remittances, and microinsurance.

Approximately half of FINCA’s clients worldwide are women who often lack the ability to secure adequate formal employment and in many cultures, are the primary providers for a family. FINCA’s loans are a renewable resource that can improve the economy of an entire community. FINCA operates on a twin bottom line approach of sustainability and social outreach.

FMH follows FINCA’s mission of poverty alleviation, and no changes may be made to the corporate purpose without the consent of FINCA. In order to ensure complete alignment of interests with the microentrepreneur clients that it serves, no FINCA employee, board member, or officer may hold any equity interest in FMH or any of the subsidiaries.

Additionally, FINCA operates two programs aimed at entrepreneurial solutions to poverty that aim to bring basic services to low-income families and their communities. One program is in the areas of distribution and financing of energy products to the bottom of the pyramid (BOP) customers in Uganda. The second program based in the US and Uganda provides patient early-stage capital, and pre- and post-investment support to

launch and scale high-impact for-profit social enterprises and promote affordable, high-quality, life-improving products and services for people at the BOP.

2. BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and Interpretations issued by the IFRS Interpretations Committee (IFRIC) together (IFRS) and stated in U.S. dollars (USD), the functional currency of FINCA.

The consolidated financial statements were approved by the board of directors on June 19, 2018.

Basis of Measurement—The consolidated financial statements have been prepared on the historical cost basis, except certain financial assets. Financial instruments at fair value through profit or loss (FVTPL) and available-for-sale (AFS) financial assets are measured at fair value. Held-for-sale assets are measured at fair value, less cost of sale.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

To conform our current period presentation to the IFRS standards, we have reclassified certain amounts reported in our prior year's consolidated financial statements. "Current income tax assets" have been broken out from the "Other Receivables, Prepaid and Other Assets" line item to its own line item in our consolidated financial statements for the year ended December 31, 2017 and 2016. Such reclassifications had no impact on profit or loss or equity. Management considers the current presentation of a separate line item to be more informative.

3. SIGNIFICANT ACCOUNTING POLICIES

Management has discussed with the FINCA's audit committee the development, selection, and disclosure of FINCA's significant accounting estimates and judgments and the application of these policies and estimates.

Principles of Consolidation—The consolidated financial statements consolidate the financial statements of FINCA and entities controlled by FINCA and its subsidiaries. Control is achieved when FINCA has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee, and has the ability to use its power to affect its returns.

FINCA reassesses whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

Consolidation of a subsidiary begins when FINCA obtains control over the subsidiary and ceases when FINCA loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statements of profit or loss and other comprehensive income or loss from the date FINCA gains control until the date when FINCA ceases to control the subsidiary.

Noncontrolling Interests—Noncontrolling interests represent the portion of profit or loss and net assets of subsidiaries not owned, directly or indirectly, by FINCA. Noncontrolling interests are presented separately in the consolidated statements of profit or loss and

other comprehensive income and within equity in the consolidated statements of financial position.

Transactions Eliminated on Consolidation—Intra-group balances and transactions and any unrealized income and expenses arising from intra-group transactions are eliminated in the consolidated financial statements. Unrealized gains arising from transactions with equity-accounted investees are eliminated against the investment to the extent of investor's interest in the subsidiary. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

Estimates and Assumptions—Preparing consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Actual results and outcomes may differ from management's estimates and assumptions.

Goodwill—Goodwill arising on an acquisition of a business is carried at cost as established at the date of acquisition of the business, less accumulated impairment losses, if any.

A cash-generating unit to which goodwill has been allocated is tested for impairment annually or more frequently when there is evidence that the unit may be impaired. Any impairment loss for goodwill is recognized directly in profit or loss. An impairment loss recognized for goodwill is not reversed in subsequent periods.

On disposal of the relevant cash-generating unit, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

FINCA performed its annual impairment testing of goodwill arising from the acquisition of FINCA Microfinance Bank Ltd. (Pakistan) in December 2017 by comparing the recoverable amount of the cash-generating unit with its carrying value. The recoverable amount of the cash-generating unit exceeds its carrying value and, therefore, management concluded that goodwill was not impaired.

Discontinued Operations—In the consolidated statements of profit or loss of the reporting period and other comparable period of the previous year, income and expenses from discontinued operations are reported separately from income and expenses from continuing operations. The resulting profit or loss (after taxes) is reported separately in the statements of profit or loss.

Net Interest Income—Interest income from a financial asset is recognized when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Interest income and expense are recognized on an accrual basis using the effective interest method. The effective interest rate is the rate that discounts estimated future cash receipts (including all fees paid or received that form an integral part of the effective interest rate, transaction costs, and other premiums or discounts) through the expected life of the financial asset or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Other Operating Income—Other operating income includes fees and commission income that is recognized on an accrual basis when the service has been provided. Loan origination fees are deferred and recognized as an adjustment to the effective interest rate on the loan. Loan servicing fees are recognized as revenue as the services are provided.

Grant and Donations—Grant revenue is recognized when there is reasonable assurance that FINCA has complied with the terms and conditions associated with the grant and that

grants will be received. Grants are recognized in profit or loss over the periods in which the underlying grant expense is recognized.

Donations received are recorded as revenue when the amount can be reliably measured and there is reasonable assurance that it will be received.

Deferred Revenue- FINCA receives awards from U.S. government and other agencies for various purposes. Awards not yet received are accrued to the extent unreimbursed expenses have been incurred for the purposes specified by an approved award. FINCA defers award revenue received under approved awards, to the extent they exceed expenses incurred for the purposes specified under the awards' restrictions.

Foreign Currency Transactions and Balances—In preparing the financial statements of each individual subsidiary, transactions in currencies other than FINCA's functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Nonmonetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Nonmonetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Exchange differences on monetary items are recognized in profit or loss in the period in which they arise.

Income Tax Expense—FINCA is exempt from federal income tax under Section 501(c)(3) of the United States Internal Revenue Code of 1986, as amended; however, income from certain activities not directly related to the tax-exempt purpose is subject to taxation as unrelated business taxable income. Accordingly, no provision for income taxes is made in the consolidated financial statements. However, some of the domestic and foreign operations of the subsidiaries are subject to local income tax in the jurisdictions where they operate, and certain cross-border payments are subject to foreign withholding taxes.

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the consolidated statements of profit or loss, except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity. The current tax is calculated using tax rates that have been enacted, or substantively enacted, by the end of the reporting period in the respective jurisdictions.

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax basis used. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities are generally recognized for all taxable temporary differences. However, deferred tax liabilities are not recognized for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that

FINCA is able to control the reversal of temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

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

The measurement of deferred tax liabilities and assets reflects the tax consequences that FINCA would expect to occur if it were to recover or settle the carrying amount of its assets and liabilities at the end of the reporting period.

Financial Assets at FVTPL—Financial assets are classified as at FVTPL when the financial asset is either held for trading or it is designated as FVTPL and:

- it has been acquired principally for the purpose of selling it in the near term or
- it is a derivative that is not designated nor effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise;
- the financial asset forms part of a group of financial assets or financial liabilities or both, which is managed, and its performance is evaluated on a fair value basis, in accordance with FINCA's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives and International Accounting Standards (IAS) 39, Financial Instruments: Recognition and Measurement, which permits the entire combined contract to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with remeasurement gains or losses recognized in profit or loss. The net gain or loss recognized in profit or loss incorporates any dividend or interest earned on the financial asset and is included in the (loss) gain on financial assets and liabilities at FVTPL. Fair value is determined in the manner described in Note 6.

HTM Investments—HTM investments are nonderivative financial assets with fixed or determinable payments and fixed maturities that the Company has positive intent and ability to hold to maturity. Subsequent to initial recognition, HTM investments are measured at amortized cost using the effective interest method, less any impairment.

AFS Financial Assets—AFS are nonderivatives that are either designated as AFS or are not classified as (a) loans and receivables, (b) HTM investments, or (c) financial assets as at FVTPL. AFS are stated at fair value at the end of each reporting period. Changes in the carrying amount of AFS monetary financial assets relating to changes in foreign currency rates, interest income calculated using the effective interest method, and dividends on AFS equity investments are recognized in the profit or loss. Other changes in the carrying amount of AFS are recognized in the other comprehensive income and accumulated under

the investment valuation reserve. When the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the revaluation reserve is reclassified to profit or loss.

Loans Receivable—Net of Allowance—Loans receivable are nonderivative financial assets with fixed or determinable payments and that FINCA does not intend to sell immediately or in the near term.

Loans receivable are initially measured at fair value, plus directly attributable transaction costs, and subsequently measured at their amortized cost using the effective interest method, less any impairment.

While not all products require collateral, and collateral requirements vary by country, FINCA utilizes several methods for clients to collateralize their loans, including mandatory savings, real estate, fixed assets, or an additional guarantor.

Two forms of collateral may be applied against impairment losses - cash and marketable precious metals. Compulsory cash collateral is required from the clients in some subsidiaries. The use of precious metals is mainly presented in the Pakistan subsidiary. Where local law allows, voluntary client deposits are also considered collateral for the purposes of provisioning.

Impairment of Loans—FINCA assesses at each balance sheet date whether there is objective evidence that its loans receivable are impaired. If there is objective evidence of impairment of a credit exposure or a portfolio of credit exposures has occurred that influences the future cash flow of the financial assets, the respective losses are immediately measured and recognized.

Depending on the size or type of the credit exposure, such losses are either calculated on an individual credit exposure basis or are collectively assessed for a portfolio of credit exposures. The carrying amount of the loan is reduced through the use of an allowance account and the amount of the loss is recognized in the consolidated statements of profit or loss through impairment losses on loans. FINCA does not recognize losses from expected but not incurred credit losses.

Individually Assessed Loans—Credit exposures are considered individually significant if they have a certain size, partly depending on the individual subsidiary. As a FINCA-wide rule, all credit exposures over a country-specific threshold are individually assessed for impairment. For such credit exposures, it is assessed whether objective evidence of impairment exists, i.e., any factors that might influence the client's ability to fulfill his contractual payment obligations towards the individual subsidiary.

Additionally, the aggregate exposure to the client and the realizable value of collateral held are taken into account when deciding on the allowance for loan losses. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of its estimated future cash flows discounted at the financial asset's original effective interest rate (specific impairment). If a credit exposure has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. The calculation of the present value of the estimated future cash flow of a collateralized financial asset reflects the cash flow that may result from foreclosure, less costs for obtaining and selling the collateral.

If FINCA determines that no objective evidence of impairment exists for an individually assessed loans receivable whether individually significant or not, it includes the loans receivable asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment (impairment for collectively assessed credit exposures).

Collectively Assessed Loans—There are two cases in which credit exposures are collectively assessed for impairment: individually insignificant credit exposures that show objective evidence of impairment, or credit exposures that do not show signs of impairment, in order to cover all losses that have already been incurred, but not yet detected on an individual credit exposure basis

For the purpose of the evaluation of impairment of individually insignificant credit exposures, the credit exposures are grouped on the basis of similar credit risk characteristics, i.e., according to the number of days they are in arrears. Arrears of more than 30 days are considered to be a sign of impairment. This characteristic is relevant for the estimation of future cash flows for the defined groups of such assets, based on historical loss experiences with loans that showed similar characteristics. The collective assessment of impairment for individually insignificant credit exposures and for unimpaired credit exposures belonging to a group of financial assets is based on a quantitative analysis of historical default rates for loan portfolios with similar risk characteristics in the individual subsidiary (migration analysis), grouped into geographical segments with a comparable risk profile. After a qualitative analysis of this statistical data, FINCA management approves appropriate rates as the basis for their portfolio-based impairment allowances. Deviations from this guideline are allowed at the discretion of FINCA management.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by FINCA to reduce any differences between loss estimates and actual loss experience.

Writing off Loans—When a loan is determined uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the consolidated statements of profit or loss.

FINCA writes off a loan (and any related provision for impairment losses) when FINCA's credit committees and a subsidiary's audit committee determines that the loans are uncollectible. This determination is reached after considering information, such as the occurrence of significant changes in a client's financial position, such that the client can no longer pay the obligation, or that proceeds from collateral, if any, will not be sufficient to pay back the entire exposure. For smaller balance standardized loans, charge-off decisions are generally based on a product-specific past due status.

Derecognition of Financial Assets—FINCA derecognizes a financial asset when the contractual rights to the cash flow for the asset expire or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another party. On derecognition of the financial asset, the difference between the asset's carrying

amount and the sum of consideration received and receivable as well as the cumulative gain or loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit or loss.

FINCA also derecognizes certain assets when it charges off balances pertaining to the assets deemed to be uncollectible (see Note 5). Any interest in transferred financial assets that is created or retained by FINCA is recognized as a separate asset or liability.

Impairment of Financial Assets—At each balance sheet date, FINCA assesses whether there is objective evidence that financial assets not carried at FVTPL are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset and that the loss event has an impact on the future cash flows of the asset that can be reliably estimated.

For AFS equity investments, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

Impairment losses on assets carried at amortized cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognized in the consolidated statements of profit or loss and reflected in an allowance account against the financial assets.

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit or loss.

Fair value changes on other financial assets and liabilities carried at FVTPL are presented within the "nonoperating income" line in the consolidated statements of profit or loss.

Financial Liabilities at FVTPL—Financial liabilities are classified as 'at FVTPL' when the financial liability is held for trading or it is designated as 'at FVTPL.' FINCA did not have any financial liabilities held for trading at December 31, 2017 and 2016.

A financial liability other than a financial liability held for trading may be designated at FVTPL upon initial recognition if it meets certain conditions.

Financial liabilities at FVTPL are stated at fair value with remeasurement gains or losses recognized in consolidated statements of profit or loss in (loss) gain on financial assets at FVTPL. The net gain or loss recognized in profit or loss incorporates any interest paid on the financial liability and is included in the "other gains or losses" line item.

Accounts Payable and Other Accrued Liabilities—Accounts payable and other accrued liabilities are measured at amortized cost using the effective interest method.

Notes Payable—Notes payable are recognized initially at fair value, net of transaction costs incurred. Notes payable are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the consolidated statements of profit or loss over the period of the borrowings using the effective interest method. Fees paid on the establishment of loan facilities are recognized as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fees is deferred until the drawdown occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fees is capitalized as a prepayment for liquidity services and amortized over the period of the facility to which it relates.

Subordinated Debt—Subordinated debt consists mainly of liabilities to other international financial institutions, which in the event of insolvency or liquidation are not repaid until all nonsubordinated creditors have been satisfied. Following initial recognition at acquisition cost, the subordinated debt is recognized at amortized cost. Premiums and discounts are amortized over the respective terms in the consolidated statements of profit or loss under “net interest income.”

Client Deposits—Client deposits consist of voluntary saving deposits from clients and collateral deposits required under certain loan products. Client deposits are recognized initially at fair value, net of transaction costs incurred. Changes to client deposits are subsequently stated at amortized cost; any difference between proceeds net of transaction costs and the redemption value is recognized in the consolidated statements of profit or loss over the period of the borrowings using the effective interest rate method.

Financial Guarantee Contracts—Financial guarantee contracts issued by FMH, the intermediary parent company, are initially measured at their fair value. Contracts designated as ‘at FVTPL’ are subsequently measured at the higher of the amount of obligation under the contract, or the amount initially recognized, less cumulative amortization recognized, where appropriate, in accordance with the revenue recognition policies.

Derecognition of Financial Liabilities—Financial liabilities are derecognized when they have been redeemed or otherwise extinguished. All financial liabilities are derecognized when they are extinguished—that is, when the obligation is discharged, canceled, or expires. The difference between the carrying amount of financial liability derecognized and consideration paid is recognized in the consolidated statements of profit or loss.

Derivatives—The Company enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign exchange risk, including foreign exchange forward contracts, interest rate, and foreign exchange swaps.

Derivative instruments are initially recognized at fair value at the date the derivative contracts are entered into and are subsequently remeasured to their fair value at the end of each reporting period. The resulting gain or loss is recognized in profit or loss immediately. FINCA does not designate any of the hedging instruments for the purposes of qualifying for hedge accounting.

Offsetting—Financial assets and liabilities are offset and the net amount is presented in the consolidated statements of financial position when, and only when, FINCA has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards or for gains and losses arising from a group of similar transactions.

Property and Equipment—Items of property and equipment are measured at cost, less accumulated depreciation and recognized impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes all costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

The cost to replace an item of property or equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to FINCA and its cost can be reliably measured.

Depreciation is recognized in the consolidated statements of profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment:

Buildings and offices	20–50 years
Computer equipment	2–5 years
Furniture and office equipment	5–7 years
Vehicles	3–5 years
Other	2–5 years

Leasehold improvements are depreciated over the shorter of the lease term or their useful lives. When necessary, assets are componentized to address different useful lives of the component.

Depreciation methods, useful lives, and residual values are reassessed at each reporting date.

Intangible Assets—Costs associated with maintaining computer software programs are recognized as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by FINCA are recognized as intangible assets when certain criteria are met.

Directly attributable costs that are capitalized as part of the software product include the software development employee costs and an appropriate portion of the overhead costs.

Other development expenditures that do not meet these criteria are recognized as an expense as incurred. Development costs previously recognized as an expense are not recognized as an asset in a subsequent period.

Computer software development costs recognized as assets are amortized over their useful lives, which is three to five years depending on facts and circumstances. Capital work in progress is represented by capitalized costs of information systems implementation in process. Capital work in progress is not amortized.

Impairment of Nonfinancial Assets—The carrying amounts of FINCA's nonfinancial assets are reviewed on an annual basis or whenever a triggering event has been observed to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated to determine the extent of the impairment loss (if any).

An impairment loss is recognized if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that are largely independent from other assets and groups. Impairment losses are recognized in the consolidated statements of profit or loss.

The recoverable amount of an asset or cash-generating unit is the higher of its value in use and its fair value, less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pretax discount rate that reflects

current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. Such impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. Such an impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized in previous years.

Government and Other Grants—Grants are accounted for in accordance with IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, following the gross approach, where the money received and the obligation to use the money for ongoing expenses is not offset. The liability to fulfill the obligation, recognized as deferred revenue in the consolidated statements of financial position, is amortized through the consolidated statements of profit or loss at the same time as funds are spent to cover expenditures. When donor contributions are used to purchase assets, the assets are recognized as property and equipment or intangible assets in the consolidated statements of financial position. Another liability is recognized to reflect the obligation to use the funds for restricted purposes. The liability is amortized through the consolidated statements of profit or loss at which time the expenses are incurred for program activities.

Awards not yet received are accrued to the extent unreimbursed expenses have been incurred for the purposes specified by an approved award. FINCA defers award revenue received under approved awards to the extent they exceed expenses incurred for the purposes specified under the awards' restrictions. Proceeds from monetization of commodities inventory are also reported as refundable advances until proceeds are used for program expenses.

Contingencies—Obligations arising in respect of contingent liabilities that have been disclosed, or those which are not currently recognized or disclosed in the consolidated financial statements, could have a material effect on FINCA's financial position. Application of these accounting principles to legal cases requires FINCA management to make determinations about various factual and legal matters beyond its control.

FINCA makes assessments of the outstanding legal proceedings at each reporting date in order to determine the need for provisions and disclosures in its consolidated financial statements.

Application of New and Revised IFRSs

The following amendments to IFRS became mandatorily effective for the annual period beginning on or after 1 January 2017.

- Amendments to IAS 7, Disclosure requirements
- Amendments to IAS 12, Recognition of deferred tax assets for unrealized losses
- Amendments to IAS 40, Transfers of investment property
- Amendments to IFRS 2, Classification and measurement of share based payment transactions

- Amendments to IFRS 10 and IAS 28, Sale or contribution of assets between an investor and its associate or joint venture
- Amendments to IFRS 12 included in Annual improvements to IFRS Standards 2014-2016 Cycle.

The application of these amendments has had no effect on the Company's financial statements.

FINCA has not applied the following new and revised IFRSs that have been issued, but are not yet effective:

IFRS 9 Financial Instruments (as revised in 2014)

Effective for annual periods beginning on or after January 1, 2018.

In July 2014, the IASB finalized the reform of financial instruments accounting and issued IFRS 9 (as revised in 2014), which contains the requirements for a) the classification and measurement of financial assets and financial liabilities, b) impairment methodology, and c) general hedge accounting. IFRS 9 (as revised in 2014) will supersede IAS 39 upon its effective date.

IFRS 9 (as revised in 2014) is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted. The Company will apply IFRS 9 retrospectively and recognize the cumulative effect of initially applying this standard as an adjustment to the opening balance of retained earnings. The Company continues to evaluate the impact of this guidance on the financial statements. The Company expects that the application of the expected credit loss model of IFRS 9 will result in earlier recognition of credit losses for the respective items and will increase the amount of loss allowance recognized for these items.

IFRS 15 Revenue from Contracts with Customers

Effective for annual periods beginning on or after January 1, 2018.

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. Its core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The recognition and measurement of interest income and dividend income from debt and equity investments are not within the scope of IFRS 15. The Company does not anticipate the application of this standard to have a material effect on the Company's financial statements.

IFRIC 22 Foreign Currency Transactions and Advance Consideration

Effective for annual periods beginning on or after January 1, 2018.

IFRIC 22 clarifies the date of transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense, or income (or part of it). An entity should use the exchange rate on the date on which it initially recognized the non-monetary asset or liability arising from the payment or receipt of the advance

consideration. The Company does not anticipate the impact of the application of IFRIC 22 to be material to its financial statements.

IFRS 16 Leases

Effective for annual periods beginning on or after January 1, 2019

IFRS 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. The standard requires lessees to recognize a “right-to-use asset” and a lease liability reflecting future lease payments for all but short-term leases and leases of low-value assets. The Company is still in the process of evaluating the impact that will result from adopting this standard. The Company is therefore unable to disclose the impact that adopting IFRS 16 will have on its financial statements when such statement is adopted.

IFRS 23 Uncertainty over Income Tax Treatments

Effective for annual periods beginning on or after January 1, 2019.

IFRIC 23 clarifies application of recognition and measurement requirements in IAS 12 *Income Taxes* when there is uncertainty over income tax treatments. IFRIC 23 applies to all aspects of income tax accounting where there is an uncertainty regarding the treatment of an item, including taxable profit or loss, the tax bases of assets and liabilities, tax losses, and credits and tax rates. The Company does not anticipate the impact of the application of IFRIC 23 to be material to its financial statements.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Allowances for Credit Impairment—The specific counterparty component of the total allowances for impairment applies to claims evaluated individually for impairment and is based upon management’s best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgments about a counterparty’s financial situation and the net realizable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by FINCA management.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of claims with similar economic characteristics when there is objective evidence to suggest that they contain impaired claims, but the individual impaired items cannot yet be identified. A component of collectively assessed allowances is for country risks. In assessing the need for collective loan credit loss allowances, management considers factors, such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, assumptions are made to define the way inherent losses are modeled and to determine the required input parameters, based on historical experience and current economic conditions. The accuracy of the allowances depends on how well these estimated future cash flows for specific counterparty allowances are forecast and the model assumptions and parameters used in determining collective allowances.

Income Taxes—FINCA is subject to income tax in several international jurisdictions and significant judgment is required in determining the provision for income taxes. During the ordinary course of business, there are transactions and calculations for which the ultimate

tax determination is uncertain. As a result, FINCA recognizes tax liabilities based on estimates of whether additional taxes and interest will be due. These tax liabilities are recognized when, despite FINCA's belief that its tax return positions are supportable, FINCA believes that certain positions are likely to be challenged and may not be fully sustained upon review by tax authorities. FINCA believes that its accruals for tax liabilities are adequate for all open audit years based on its assessment of many factors, including past experience and interpretations of tax law. This assessment relies on estimates and assumptions and may involve a series of complex judgments about future events. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact income tax expense in the period in which such determination is made.

5. FINANCIAL RISK MANAGEMENT

FINCA believes that effective risk management is of primary importance to its overall operations. Accordingly, FINCA's risk management process has been designed to monitor, evaluate, and manage the principal risks that it assumes in conducting its activities. Specifically, the activities that FINCA engages in, and the risks those activities generate, must be consistent with FINCA's underlying goal of serving the world's lowest income entrepreneurs.

In today's environment, FINCA has placed primary emphasis on solvency, liquidity, anti-money laundering, treasury, budgeting and planning, and capital adequacy. FINCA's financial risks are mitigated through three programs: (i) business management, (ii) independent control functions, and (iii) internal audit.

- **Business Management**—Each of FINCA's subsidiaries, including in-business risk personnel, own and manage the risks, including compliance risks, inherent in or arising from the business, and are responsible for having controls in place to mitigate key risks and promoting a culture of compliance and control.
- **Independent Control Functions**—FINCA's independent control functions, including finance, legal, and risk, set standards according to which FINCA and its businesses are expected to manage and oversee risks, including compliance with applicable laws, regulatory requirements, and policies and standards of ethical conduct. In addition, among other things, the independent control functions provide advice and training to FINCA's businesses and establish tools, methodologies, processes, and oversight of controls used by the businesses to foster a culture of compliance and control and to satisfy those standards.
- **Internal Audit**—FINCA's internal audit function independently reviews activities of the first two lines of defense discussed above based on a risk-based audit plan and methodology approved by the FINCA's board of directors.
- In 2017, the Company adopted a new capital policy based on the Standardized and Basic Indicator approaches stipulated by the Basel framework of Risk Weighted Assets (RWA) and Risk-Weighted Capital Adequacy Ratio (RCAR). All components of Risk Weighted Assets (Credit Risk, Operational and Market Risk) are calculated based on a Subsidiary's balance sheet and income statement. Under the policy, Core RCAR and Total RCAR should not be less than 10% and 12% respectively (Basel limit plus a capital conservation and countercyclical buffer). Core RCAR is equivalent to Core Capital divided by total RWA while Total RCAR is equivalent to Total Capital (Core Capital plus qualifying subordinated debt) divided by total RWA. Core Capital is total

equity less intangible assets. At December 31, 2017 all Subsidiaries (with the exception of FINCA DRC, Malawi and Zambia) were in compliance with this policy.

Credit Risk—Credit risk is the potential for financial loss resulting from the failure of a client or counterparty to honor its financial or contractual obligations. Credit risk arises from FINCA's microfinance activities.

FINCA's loan portfolio is made up entirely of loans made to individuals, groups of individuals, and Small and Mid-Sized Enterprises for a specific purpose and is sufficiently diversified to reduce concentration risk. At December 31, 2017 and 2016, FINCA had 0.8 million and 0.9 million borrowers, respectively.

FINCA's aggregate loan portfolio was \$797.5 million and \$784.6 million as of December 31, 2017 and 2016, respectively (see Note 16). FINCA's total allowance for impairments totaled \$19.9 million, a coverage ratio of 2.5% of total loans, and \$42.9 million, a coverage ratio of 5.5% of total loans, as of December 31, 2017 and 2016, respectively.

Regionally, impairment losses on loans approximate 1.6% to 9.4% and 1.9% to 10.1% of the average total loan portfolio at December 31, 2017 and 2016, respectively. Figures for 2016 include operations that were discontinued in 2017.

	Impairment Losses on Loans		Average Gross Loans to Customers		Impairment Losses as Percentage of Average Gross Loans	
	2017	2016	2017	2016	2017	2016
Eurasia	\$ 4,831,229	\$ 37,392,874	\$ 307,283,717	\$ 363,269,987	1.6 %	10.1 %
Latin America	4,826,635	6,438,828	149,033,762	128,878,059	3.2	5.0
Africa	15,099,363	11,174,980	160,993,629	161,856,200	9.4	6.9
MESA	3,793,018	2,247,196	170,345,059	120,301,645	2.2	1.9

FINCA conducts biannual historical loan loss migration analysis across its subsidiary network in order to determine the probability of default, defined as all loans in arrears in excess of 180 days, as well as an examination of other current observable factors (e.g., macroeconomic, operational, policy and systems changes, political risk) in order to establish subsidiary credit reserves. The loan loss migration data is used to form the statistical base of the credit risk calculation in order to estimate the probability of default over a six-month period.

The regional segmentation by arrears category for gross loans and allowances at December 31, 2017, is as follows:

	Total Gross Loans for Each Portfolio-Aging Segment						Total Gross Loan Portfolio
	Gross Loan Portfolio						
	Current	1-30	31-60	61-90	91-180	180+	
Eurasia	\$ 276,243,830	\$ 4,423,299	\$ 1,490,715	\$ 1,041,819	\$ 1,776,090	\$ 1,689,971	\$ 286,665,724
Latin America	156,720,742	2,896,138	1,349,968	856,781	1,660,496	582,681	164,066,806
Africa	136,615,764	5,188,615	2,288,338	2,006,552	4,161,741	1,988,640	152,249,650
MESA	<u>188,878,842</u>	<u>2,612,980</u>	<u>800,251</u>	<u>567,661</u>	<u>1,674,947</u>	<u>-</u>	<u>194,534,681</u>
Total	<u>\$ 758,459,178</u>	<u>\$ 15,121,032</u>	<u>\$ 5,929,272</u>	<u>\$ 4,472,813</u>	<u>\$ 9,273,274</u>	<u>\$ 4,261,292</u>	<u>\$ 797,516,861</u>

	Aging of Allowance for Impairment						Total Allowance for Impairment
	Current	1-30	31-60	61-90	91-180	180+	
Eurasia	\$ 1,276,285	\$ 383,991	\$ 531,457	\$ 488,553	\$ 1,356,415	\$ 1,772,279	\$ 5,808,980
Latin America	339,818	303,125	432,304	472,625	1,311,696	603,507	3,463,075
Africa	543,201	829,965	848,807	1,072,517	3,185,522	1,890,430	8,370,442
MESA	<u>462,209</u>	<u>232,579</u>	<u>242,189</u>	<u>215,975</u>	<u>1,075,677</u>	<u>-</u>	<u>2,228,629</u>
Total	<u>\$ 2,621,513</u>	<u>\$ 1,749,660</u>	<u>\$ 2,054,757</u>	<u>\$ 2,249,670</u>	<u>\$ 6,929,310</u>	<u>\$ 4,266,216</u>	<u>\$ 19,871,126</u>

The regional segmentation by arrears category for gross loans and allowances at December 31, 2016, is as follows:

	Total Gross Loans for Each Portfolio-Aging Segment						Total Gross Loan Portfolio
	Gross Loan Portfolio						
	Current	1-30	31-60	61-90	91-180	180+	
Eurasia	\$ 269,428,810	\$ 10,738,716	\$ 6,164,643	\$ 5,144,013	\$ 13,081,589	\$ 30,187,421	\$ 334,745,192
Latin America	126,916,142	2,319,243	1,177,709	1,011,717	2,136,172	439,736	134,000,719
Africa	153,867,922	5,329,790	2,524,532	1,647,639	3,368,948	2,998,776	169,737,607
MESA	<u>142,335,309</u>	<u>1,733,524</u>	<u>606,227</u>	<u>431,799</u>	<u>1,048,577</u>	<u>-</u>	<u>146,155,436</u>
Total	<u>\$ 692,548,183</u>	<u>\$ 20,121,273</u>	<u>\$ 10,473,111</u>	<u>\$ 8,235,168</u>	<u>\$ 19,635,286</u>	<u>\$ 33,625,933</u>	<u>\$ 784,638,954</u>

	Aging of Allowance for Impairment						Total Allowance for Impairment
	Current	1-30	31-60	61-90	91-180	180+	
Eurasia	\$ 2,273,357	\$ 2,660,040	\$ 2,287,999	\$ 2,063,864	\$ 5,899,804	\$ 15,027,508	\$ 30,212,572
Latin America	1,460,855	162,162	303,956	471,599	1,031,158	219,615	3,649,345
Africa	1,986,704	617,861	844,839	599,715	1,535,198	1,953,816	7,538,133
MESA	<u>112,928</u>	<u>164,976</u>	<u>195,745</u>	<u>220,082</u>	<u>788,971</u>	<u>-</u>	<u>1,482,702</u>
Total	<u>\$ 5,833,844</u>	<u>\$ 3,605,039</u>	<u>\$ 3,632,539</u>	<u>\$ 3,355,260</u>	<u>\$ 9,255,131</u>	<u>\$ 17,200,939</u>	<u>\$ 42,882,752</u>

Market Risk—Market risk includes price risk, foreign exchange risk, and liquidity risk, which arise in the normal course of FINCA's business. Price risk is the risk to earnings from changes in interest rates. Foreign exchange rate risk arises from the different markets in which FINCA operates.

FINCA's financial performance is subject to some degree of risk due to changes in interest rates; however, FINCA's subsidiaries' balance sheets have significantly less interest rate risk than that of a traditional financial institution as:

- Neither the assets nor the liabilities of the subsidiaries are tied to one specific short-term market index and, therefore, are unlikely to automatically "reprice" during their stated tenor and
- The short-term tenor of subsidiaries' loans to its clients mean that changes in market rates will have little or no impact on prepayment activity.

The consideration of interest rate risk by term of asset and liability as of December 31, 2017, is as follows:

	Up to 3 Months	3–6 Months	7–12 Months	1–3 Years	More than 3 Years	Non-Interest Sensitive Balances	2017 Total
Cash and cash equivalents	\$ 49,638,036	\$ -	\$ -	\$ -	\$ -	\$ 104,273,998	\$ 153,912,034
Restricted cash and cash equivalents	19,792,774	3,526	1,011,411	50,000	27,964	16,827,681	37,713,356
AFS Financial Assets	3,193,730	-	-	11,357	24,000	3,003,903	6,232,990
Financial assets HTM	31,801,112	5,030,502	4,459,331	741,841	-	-	42,032,786
Financial assets at FVTPL	20,710,219	10,260,882	195,929	-	-	99,166	31,266,196
Loans receivable—net	119,068,917	156,397,392	239,550,494	228,213,780	34,415,152	-	777,645,735
Due from banks	377,904	-	-	-	-	-	377,904
Other receivables, prepaid, and other assets	2,051,739	804,294	41,186	55,421	-	20,584,932	23,537,572
Property and equipment—net	-	-	-	-	-	32,057,081	32,057,081
Intangible assets—net	-	-	-	-	-	9,018,960	9,018,960
Goodwill	-	-	-	-	-	989,143	989,143
Current tax assets	-	-	-	-	-	923,351	923,351
Deferred tax assets	-	-	-	-	-	5,725,698	5,725,698
Total assets	\$ 246,634,431	\$ 172,496,596	\$ 245,258,351	\$ 229,072,399	\$ 34,467,116	\$ 193,503,913	\$ 1,121,432,806
Accounts payable and other accrued liabilities	\$ 36,072	\$ -	\$ -	\$ -	\$ -	\$ 33,793,640	\$ 33,829,712
Financial liability at FVTPL	401,138	10,200,840	(123,112)	562,699	-	171,737	11,213,302
Client deposits	122,204,750	44,198,482	58,174,895	53,220,881	19,663,069	75,282,097	372,744,174
Bank deposits	36,878,616	17,028,807	6,722,485	1,805,567	-	111,494	62,546,969
Notes payable	61,765,617	35,294,357	80,605,458	177,106,985	21,558,579	-	376,330,996
Subordinated debt	-	65,741	96,576	2,488,735	3,000,000	-	5,651,052
Deferred revenue	-	-	-	-	-	3,884,371	3,884,371
Employee benefits	-	-	3,398,290	-	-	-	3,398,290
Current income tax liability	-	-	-	-	-	4,320,467	4,320,467
Deferred tax liabilities	-	-	-	-	-	2,138,352	2,138,352
Total liabilities	\$ 221,286,193	\$ 106,788,227	\$ 148,874,592	\$ 235,184,867	\$ 44,221,648	\$ 119,702,158	\$ 876,057,685
Open position	\$ 25,348,238	\$ 65,708,369	\$ 96,383,759	\$ (6,112,468)	\$ (9,754,532)	\$ 73,801,755	\$ 245,375,121

The consideration of interest rate risk by term of asset and liability as of December 31, 2016 is as follows:

	Up to 3 Months	3–6 Months	7–12 Months	1–3 Years	More than 3 Years	Non-Interest Sensitive Balances	2016 Total
Cash and cash equivalents	\$ 28,852,945	\$ -	\$ -	\$ -	\$ -	\$ 111,944,090	\$ 140,797,035
Restricted cash and cash equivalents	16,062,158	3,601	1,160,000	50,000	-	9,153,190	26,428,949
AFS financial assets	5,490,187	-	11,925	-	-	2,168,239	7,670,352
Financial assets HTM	16,855,821	2,248,156	5,530,111	471,513	255,024	-	25,360,625
Financial assets at FVTPL	997,445	9,195,564	1,789,005	828,242	-	6,680,939	19,491,195
Loans receivable, net	125,240,836	154,538,186	232,685,940	212,487,596	16,803,644	-	741,756,202
Due from banks	2,667,265	1,574,133	1,305,821	-	-	2,063,078	7,610,297
Other receivables, prepaid and other assets	12,458,937	279,345	35,317	-	-	19,532,219	32,305,818
Property and equipment, net	-	-	-	-	-	30,556,863	30,556,863
Intangible assets, net	-	-	-	-	-	8,058,153	8,058,153
Goodwill	-	-	-	-	-	1,042,135	1,042,135
Deferred tax assets	-	-	-	-	-	2,469,769	2,469,769
Total assets	\$ 208,625,594	\$ 167,838,985	\$ 242,518,119	\$ 213,837,351	\$ 17,058,668	\$ 193,668,675	\$ 1,043,547,393
Accounts payable and other accrued liabilities	\$ 373,947	\$ -	\$ 29,614	\$ -	\$ -	\$ 27,466,161	\$ 27,869,722
Financial liability at FVTPL	250,379	7,869,650	-	92,257	-	47,288	8,259,574
Client deposits	129,232,050	23,542,847	42,316,305	44,604,042	5,802,484	16,842,429	262,340,157
Bank deposits	17,969,580	9,866,487	10,220,843	256,332	-	27,981	38,341,223
Notes payable	163,125,928	32,395,771	92,467,927	147,699,113	19,847,965	-	455,536,704
Subordinated debt	-	-	94,263	2,437,396	-	3,067,272	5,598,931
Deferred revenue	7,999	-	-	-	-	5,585,391	5,593,390
Employee benefits	-	-	689,563	1,075,720	1,942,615	-	3,707,898
Current income tax liability	-	-	-	-	-	9,154,377	9,154,377
Deferred tax liabilities	68,854	-	-	-	-	2,050,435	2,119,289
Total liabilities	\$ 311,028,737	\$ 73,674,755	\$ 145,818,515	\$ 196,164,860	\$ 27,593,064	\$ 64,241,334	\$ 818,521,265
Open position	\$ (102,403,143)	\$ 94,164,230	\$ 96,699,604	\$ 17,672,491	\$ (10,534,396)	\$ 129,427,341	\$ 225,026,128

FINCA has performed interest rate simulations based on the gap analysis to estimate the effect on net interest margin and on the longer-term economic value of equity for differing levels of immediate and ongoing changes to market interest rates. A gap analysis consists of separating FINCA's consolidated balance sheets into different time frames in which assets or liabilities mature. FINCA can influence certain interest rates, e.g., deposit and lending rates, whereas other interest rates are determined by exogenous factors in the global macroeconomy.

On a group level, the network-wide impacts from simultaneous interest rate shocks of 200 basis points (bps) for USD and EUR and the weighted average of local currency shocks are considered. The effect on net interest income for the year and consolidated net equity from these assumed interest rate shocks are as follows:

	2017
USD/EUR net interest income impact @ 200 bps (in USD millions)	0.30
Local current net interest income impact (in USD millions)	<u>4.88</u>
Total	<u>5.18</u>
Total as a percentage of total capital	<u>2.15</u> %

Since FINCA's interest-sensitive assets reprice more quickly than its interest-sensitive liabilities, increases in market interest rates result in higher net interest income (and the opposite is also true).

Impacts to the economic value of equity of the longer time bands are also estimated according to the guidance set forth by the Basel Committee on Bank Supervision under the Basel Accords recommendations on bank capital adequacy.

As of December 31, 2017	Shock (Average)	Economic Value Impact (in Millions)
USD/EUR	200 bps	(0.12)
Local	734 bps	<u>4.13</u>
Total		<u>4.01</u>
Total as a percentage of total capital		<u>1.66</u> %

Foreign Currency Risk—Foreign currency risk exists at both FINCA and at the subsidiaries level. Subsidiaries are exposed to exchange rate risk when their liabilities or assets are denominated in a currency that differs from their functional currency (the nonfunctional currency is typically the USD). Subsidiaries are not exposed to any exchange rate risk on either assets or liabilities that are denominated in their functional currency. Certain subsidiaries have no foreign currency risk either because all of their assets and liabilities in their statements of financial position are denominated in their functional currency, their functional currency is the USD, or their functional currency is pegged to the USD.

Subsidiaries match their nonfunctional currency assets with their nonfunctional currency liabilities to the fullest possible extent, thereby minimizing or reducing any foreign currency risk. This matching occurs either by converting nonfunctional currency borrowings into functional currency borrowings, by lending in nonfunctional currency, or by maintaining other assets in nonfunctional currency. It is FINCA's policy not to allow speculative open currency positions; rather, each subsidiary's open currency position is maintained within prescribed limits relative to the subsidiary's capital. Currency positions are measured and reported to each subsidiary's Asset and Liability Committees (ALCO) on a monthly basis. At the consolidated level, FINCA experienced transaction gains of

\$2.8 million in 2017 in comparison to transaction losses of \$3.2 million in 2016, representing about 0.3% and 0.3% of average total assets in 2017 and 2016, respectively.

For assessment of the group foreign exchange risk, a Value-at-Risk (VaR) analysis is performed on a quarterly basis. The VaR measure estimates the potential loss in capital over a given holding period for a specified confidence level. The methodology employed is the variance-covariance, or delta-normal, approach. The holding period is one year, and the look-back period is 3.5 years. A limitation of the variance-covariance approach is the assumption of a standard normal (or Gaussian) distribution of portfolio returns, and therefore the methodology may underestimate the proportion of outliers and hence the VaR.

The results are shown in the following table:

	95% Confidence	99% Confidence
As of December 31, 2017	\$14.0 million	\$19.8 million
	95% Confidence	99% Confidence
As of December 31, 2016	\$16.6 million	\$23.5 million

FINCA's portfolio VaR decreased in 2017 primarily due to a \$9.2 million reduction of net peso assets in Mexico as well as disposal of net ruble assets and their attendant volatility. The reduction in portfolio volatility was 83 basis points. Overall correlation among FINCA's basket of currencies held stable.

Liquidity Risk—Liquidity risk management includes the identification, measurement, and establishment of limits on potential losses arising from the difficulty of renewing liabilities under normal market conditions. FMH's funding and liquidity objective is to fund its existing asset base (and maintain sufficient excess liquidity), so that it can operate under unusual or adverse market conditions. At the aggregate level, FMH's goal is to ensure that there is sufficient funding in amount and tenor so that adequate liquid resources are available for all operating entities. The liquidity framework requires that entities be liquidity self-sufficient or net providers of liquidity. The primary sources of funding are (i) client and bank deposits, (ii) medium- and long-term borrowings, (iii) credit lines from local banks, and (iv) shareholders' equity.

FINCA works to ensure that the structural tenor of these funding sources is sufficiently long in relation to the tenor of its asset base. The goal of FINCA's asset-liability management is to ensure that there is excess tenor in the liability structure to provide excess liquidity to fund all assets. The excess liquidity resulting from a longer-term liability tenor can effectively offset potential downward pressures on liquidity that may occur under market stress. This excess funding is held in the form of bank deposits and, to lesser extent, unencumbered liquid securities.

Total cash and cash equivalents totaled \$153.9 million as of December 31, 2017, compared to \$140.8 million as of December 31, 2016. FINCA has maintained total cash balance equal to 13.7% and 13.5% of total assets as of December 31, 2017 and 2016, respectively.

Liquidity Risk Management—FINCA runs a centralized treasury model where the overall balance sheet is managed by the treasury department through each microfinance

subsidiaries' ALCO. Day-to-day liquidity and funding are managed by subsidiaries' Chief Financial or Finance Officers (CFOs) and treasurers at the country level and are monitored by subsidiary ALCO and FINCA treasury on a monthly basis. Liquidity management is the responsibility of senior management through FINCA's consolidated ALCO and is overseen by the board of directors through its audit and finance committee. Regulated savings deposit taking subsidiaries maintain legal reserve requirements in accordance with local regulations.

The table below is a gap analysis of FINCA's liquidity. Considering the contractual terms of client loans, FINCA has a substantial amount of excess liquidity in the under one-year time frame (gap < one year of \$259.3 million in 2017 and \$180.7 million in 2016). Due to the short-term nature of the loan portfolio (66.2% of which matures within one year), the \$6.3 and \$11.3 million negative liquidity gaps in years one to three and three to five, respectively, will be covered by the normal course of business operations as new loans are disbursed.

At December 31, 2017	Up to 1 Year	1 Year to 3 Years	More than 3 Years	Total
Cash and cash equivalents	\$ 153,912,034	\$ -	\$ -	\$ 153,912,034
Restricted cash and cash equivalents	37,635,392	50,000	27,964	37,713,356
AFS financial assets	5,959,990	35,357	237,643	6,232,990
Financial assets HTM	41,290,945	741,841	-	42,032,786
Financial assets at FVTPL	31,245,538	20,658	-	31,266,196
Loans receivable—net	515,016,803	228,213,780	34,415,152	777,645,735
Due from banks	377,904	-	-	377,904
Other financial assets	<u>27,541,188</u>	<u>361,793</u>	<u>(1)</u>	<u>27,902,980</u>
	<u>812,979,794</u>	<u>229,423,429</u>	<u>34,680,758</u>	<u>1,077,083,981</u>
Other financial liabilities	4,587,094	562,654	1,786,044	6,935,792
Financial liability at FVTPL	10,605,074	608,228	-	11,213,302
Clients deposits	299,860,226	53,220,881	19,663,067	372,744,174
Bank deposits	60,741,402	1,805,567	-	62,546,969
Notes payable	177,744,319	177,028,098	21,558,579	376,330,996
Subordinated debt	<u>162,316</u>	<u>2,488,736</u>	<u>3,000,000</u>	<u>5,651,052</u>
	<u>553,700,431</u>	<u>235,714,164</u>	<u>46,007,690</u>	<u>835,422,285</u>
Liquidity gap	<u>\$ 259,279,363</u>	<u>\$ (6,290,735)</u>	<u>\$ (11,326,932)</u>	<u>\$ 241,661,696</u>

At December 31, 2016	Up to 1 Year	1 Year to 3 Years	More than 3 Years	Total
Cash and cash equivalents	\$ 140,797,035	\$ -	\$ -	\$ 140,797,035
Restricted cash and cash equivalents	26,026,969	377,083	24,897	26,428,949
Available for sale financial assets	7,116,713	-	553,639	7,670,352
Financial assets held-to-maturity	24,634,088	471,513	255,024	25,360,625
Financial assets at fair value through profit and loss	18,662,953	44,151	784,091	19,491,195
Loans receivable—net	512,464,962	212,487,596	16,803,644	741,756,202
Due from banks	7,610,297	-	-	7,610,297
Other financial assets	<u>17,350,161</u>	<u>-</u>	<u>28,787</u>	<u>17,378,948</u>
	<u>754,663,178</u>	<u>213,380,343</u>	<u>18,450,082</u>	<u>986,493,603</u>
Other financial liabilities	27,708,115	504,647	2,045,371	30,258,133
Financial liability at fair value through profit and loss	8,123,166	136,408	-	8,259,574
Clients deposits	211,933,633	44,597,393	5,809,131	262,340,157
Bank deposits	38,084,892	256,331	-	38,341,223
Notes payable	287,989,629	147,699,112	19,847,963	455,536,704
Subordinated debt	<u>94,263</u>	<u>2,437,396</u>	<u>3,067,272</u>	<u>5,598,931</u>
	<u>573,933,698</u>	<u>195,631,287</u>	<u>30,769,737</u>	<u>800,334,722</u>
Liquidity gap	<u>\$ 180,729,480</u>	<u>\$ 17,749,056</u>	<u>\$ (12,319,655)</u>	<u>\$ 186,158,881</u>

The traditional gap analysis may overstate the amount of near-term liquidity since it does not take into consideration the behavioral characteristics of FINCA's client loan portfolio as well as the diversified nature of FINCA's clients deposit base. From a behavioral perspective, FINCA's clients are able to renew their loans for multiple terms, which lessens the amount of short-term liquidity (lowers the positive gap in that time frame). A significant portion of small-scale deposits based on historical behavior may be deemed as a stable source of funding and can be allocated beyond the one-year time frame.

FMH's consolidated statements of financial position remain liquid in all timeframes owing to the diversified nature of customer deposits and short asset tenor as well as to the fact that client loans amortize. FMH's borrowings are predominately two-year tenor with principal repaid at maturity.

Third-Party Risk—New risks emerge as FINCA's business model continues to evolve. In particular, FINCA may engage third-party relationships in the delivery of services to our clients that brings with it a commensurate emphasis on third-party/vendor risk management.

Third-party risk management is conducted to assess the ongoing behavior, performance, and risks that each third-party relationship introduces. This includes corporate and social responsibility compliance; reputational, operational, and regulatory/legal compliance; information security; technology; and financial risks. Each third-party/vendor engagement requires specific due diligence and ongoing monitoring activities depending on the nature of the services being provided. This includes all phases of the vendor relationship, including

review of proposals, implementation, system integration, and performance monitoring of the third-party services.

6. FINANCIAL ASSETS AND LIABILITIES—FAIR VALUE MEASUREMENTS

FINCA applies IFRS 13, *Fair Value Measurement*, guidance on fair value measurement that established a framework for measuring and disclosing fair value. As defined in the guidance, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FINCA utilizes characteristics of the asset or liability and market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique.

Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis, except for leasing transactions that are within the scope of IAS 17, *Leases*, and measurements that have some similarities to fair value, but are not fair value, such as value in use in IAS 36.

FINCA classifies its fair value balances in the fair value hierarchy based on the observability of the inputs used in the fair value calculation as follows:

Level 1—Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2—Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Significant assumptions are observable in the marketplace throughout the full term of the instrument and can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

The fair value of loans receivable, notes payable, deposits from clients, and subordinated debt categorized as Level 2 are based on a blend of quoted prices for the instruments and quoted prices for similar instruments on the measurement date. FINCA adjusted the discount rate on notes payable by using a credit margin that reflects the credit risk rating for companies similar to FINCA.

FVTPL assets, categorized as Level 2, consist of foreign exchange forward and cross-currency interest rate swaps. These financial instruments are categorized as Level 2 assets because they are valued based on the indirectly observable inputs, including forward exchange rates, interest rate yield curves, and counterparty credit risk.

Level 3—Pricing inputs that are significant and generally less observable than those from objective sources. Level 3 includes those financial instruments that are valued using models or other valuation methodologies.

The fair value of notes payable, deposits from clients, and subordinated debt categorized as Level 3 is based on a model which applies credit risk adjusted factors derived from credit margin, quoted prices for similar instruments, and credit risk ratings on similar counterparties.

The following tables set forth, by level within the fair value hierarchy, the fair value of FINCA's financial assets and liabilities as of December 31, 2017 and 2016.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. FINCA's assessment of the significance of a particular input to the fair value measurement requires the exercise of judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

Except as detailed in the following table, management considers that the carrying amounts of financial assets and financial liabilities recognized in the consolidated financial statements approximate their fair values and are categorized as Level 2.

	2017		2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets				
Loans receivable	\$ 777,645,735	\$ 774,852,759	\$ 741,756,202	\$ 763,784,531
AFS financial assets	6,232,990	6,232,990	530,036	553,639
Financial Liabilities				
Financial liabilities held at amortized cost:				
Deposits from clients	\$ 372,744,174	\$ 376,578,972	\$ 262,340,157	\$ 260,875,587
Notes payable	376,330,996	375,580,136	455,536,704	456,177,202
Subordinated debt	5,651,052	5,706,083	5,598,931	5,621,172

Fair value hierarchy at December 31, 2017, is as follows:

	Level 1	Level 2	Level 3	Total
Financial Assets				
Loans receivable	\$ -	\$ 774,852,759	\$ -	\$ 774,852,759
AFS financial assets (Note 13)	2,694,745	3,538,245	-	6,232,990
Financial Liabilities				
Financial liabilities held at amortized cost:				
Deposits from clients	\$ -	\$ 295,684,179	\$ 80,894,793	\$ 376,578,972
Notes payable	12,132,769	240,371,580	123,075,787	375,580,136
Subordinated debt	-	3,129,703	2,576,380	5,706,083

Financial Assets/ Financial Liabilities	Fair Value as at December 31		Fair Value Hierarchy	Valuation Techniques and Key Inputs	Significant Unobservable Inputs	Relationship of Unobservable Inputs to Fair Value
	2017 Asset (Liability)	2016 Asset (Liability)				
1) Foreign currency forward contracts measured at FVTPL (Note 15)	\$ 276,545 (646,346)	\$ 5,733,680 (13,798)	2	Discounted cash flow. Future cash flows are estimated based on forward exchange rates (spot exchange rate at the end of the reporting period) and contract forward rates, discounted at a rate that reflects the credit risk of the counterpart in the contract	N/A	N/A
2) Foreign exchange swaps measured at FVTPL (Note 15)	10,709,417 (10,556,956)	13,757,515 (8,245,776)	2	Discounted cash flow. Future cash flows are estimated based on forward exchange rates (spot exchange rate at the end of the reporting period) and contract forward rates, discounted at a rate that reflects the credit risk of the counterpart in the contract	N/A	N/A
3) AFS financial assets—Treasury bills (Note 13)	2,694,745	2,620,655	1	Quoted bid prices in an active market	N/A	N/A
4) AFS financial assets—time deposits (Note 13)	3,538,245	4,496,058	2	Quoted prices of similar instruments traded in active markets	N/A	N/A

There were no transfers between Levels 1 and 2 or Levels 2 and 3 during the year.

7. NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON LOANS

Net interest income for the years ended December 31, 2017 and 2016, is as follows:

	2017	2016
Interest income:		
Cash and cash equivalents and investments	\$ 6,175,683	\$ 8,065,177
Loans to clients	<u>277,575,311</u>	<u>277,161,375</u>
Total interest income	<u>283,750,994</u>	<u>285,226,552</u>
Interest expense:		
Deposits from clients	30,499,340	20,197,311
Notes payable and subordinated debt	<u>39,046,105</u>	<u>50,238,519</u>
Total interest expense	<u>69,545,445</u>	<u>70,435,830</u>
Net interest income	<u>\$ 214,205,549</u>	<u>\$ 214,790,722</u>

8. OTHER OPERATING INCOME

Total other operating income for the years ended December 31, 2017 and 2016, was \$33.4 million and \$29.1 million, respectively. Included in this amount is \$5.6 million and \$5.8 million of fines and penalties income and \$2.0 million and \$1.3 million of insurance income for the years ended December 31, 2017 and 2016, respectively and includes

principal forgiveness for certain debt obligations of FINCA Azerbaijan totaling \$14.7 million for the year ended December 31, 2017.

9. PERSONNEL EXPENSES

Personnel expenses for the years ended December 31, 2017 and 2016, consist of the following:

	2017	2016
Wages and salaries	\$ 88,067,860	\$ 87,048,802
Compulsory social security obligations	7,168,897	7,853,870
Allowances, incentives, and other benefits	13,037,362	11,418,108
Health insurance	<u>4,128,006</u>	<u>4,365,634</u>
Total	<u>\$ 112,402,125</u>	<u>\$ 110,686,414</u>

10. OTHER OPERATING EXPENSES

Other operating expenses for the years ended December 31, 2017 and 2016, consist of the following:

	2017	2016
Professional fees	\$ 16,273,956	\$ 20,445,950
Rent/utilities	14,456,890	14,642,091
Travel	10,744,146	10,427,332
Consumables and office supply	4,626,560	3,880,170
Communication	6,843,430	6,076,530
Taxes other than income	4,386,021	2,564,422
Security	4,394,595	4,466,156
License/memberships/meetings	5,960,600	3,732,613
Marketing	4,517,494	4,291,608
Repairs and maintenance	2,643,489	2,276,122
Training and hiring	1,657,370	2,044,897
Bank charges	1,467,738	1,933,131
Motor vehicles expenses	1,767,619	1,435,471
Insurance	1,633,207	1,272,032
Impairment on assets held for use	-	1,024,180
Other expenditures	<u>2,581,881</u>	<u>5,613,071</u>
	<u>\$ 83,954,996</u>	<u>\$ 86,125,776</u>

11. INCOME TAX

Income tax expense for the years ended December 31, 2017 and 2016, were as follows:

	2017	2016
Current tax expense	\$ 16,468,963	\$ 13,743,746
Deferred tax expense	<u>(3,238,372)</u>	<u>3,818,394</u>
Total income tax expense	<u>\$ 13,230,591</u>	<u>\$ 17,562,140</u>

In calculating both the current tax and the deferred tax, the respective country-specific tax rates are applied. The total income tax expense includes the local country income taxes for the subsidiaries and foreign withholding taxes on certain cross-border payments. The average actual income tax rate for the subsidiaries was 26.5% in 2017 and 26.1% in 2016.

FINCA is exempt from taxes on income, except unrelated business taxable income, under provision of Section 501(c)(3) of the United States Internal Revenue Code and the applicable income tax regulations of the District of Columbia.

Reconciliation of income tax expense for the years ended December 31, 2017 and 2016, is as follows:

	2017	2016
Profit/(loss) before income tax expense	\$ 35,685,761	\$ (2,916,190)
Income tax expense	<u>(13,230,591)</u>	<u>(17,562,140)</u>
Profit/(loss) for the year from continuing operations	<u>\$ 22,455,170</u>	<u>\$ (20,478,330)</u>

	2017	2016
Tax rate using domestic tax rate of parent company (exempt on US federal taxes on income)	\$ -	\$ -
Income tax (taxable Subsidiaries) at local statutory rates	10,348,159	(970,002)
Expenses not deductible for tax purposes	1,631,692	3,829,730
Tax-exempt income	(3,568,851)	(155,478)
Recognition of previously unrecognized tax losses	(1,887,515)	(90,055)
Adjustment for under provision in prior periods	2,000,904	871,840
Foreign withholding taxes	3,294,959	3,412,049
Effect of unused tax losses and tax offsets not recognized as deferred tax assets	1,423,000	7,291,838
Other	<u>(11,757)</u>	<u>3,372,218</u>
Total	<u>\$ 13,230,591</u>	<u>\$ 17,562,140</u>

Deferred income taxes are calculated, under the balance sheet method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts, using the applicable tax rate as stipulated by the tax legislation of the respective countries.

The movements in deferred tax assets and liabilities (the balances are offset within the same jurisdiction as permitted by IAS 12, *Income Taxes*, and shown on a net basis by subsidiaries), details of the deferred tax liability, amounts charged or credited directly to profit or loss during the period, and amounts charged or credited directly to equity during the period are shown below.

In 2017, FINCA recorded \$1.3 million of income tax expense on \$18.2 million of temporary differences associated with FINCA's investments in subsidiaries because it was probable that the temporary differences associated with the distribution of retained earnings through payments of dividends will reverse in the foreseeable future. The temporary differences of \$18.2 million include \$17.1 million of expected distributions of retained earnings from 2017 and \$1.1 million for an increase of expected distributions of retained earnings from prior years.

In 2016, FINCA recorded \$2.1 million of income tax expense on \$18.5 million of temporary differences associated with FINCA's investments in subsidiaries because it was probable that the temporary differences associated with the distribution of retained earnings through payments of dividends will reverse in the foreseeable future. The temporary differences of \$18.5 million include \$14.3 million of expected distributions of retained earnings from 2016 and \$4.2 million for an increase of expected distributions of retained earnings from prior years. The deferred tax liability related to the future distributions of retained earnings by subsidiaries is \$1.4 million and \$1.8 million as of December 31, 2017 and 2016, respectively.

Deferred Tax Assets—Deferred tax assets were recognized by the subsidiaries in the following jurisdictions in 2017: Armenia, Azerbaijan, Democratic Republic of Congo (DRC), Kyrgyzstan, Pakistan, Tajikistan, Tanzania, USA, and Zambia (2016—Armenia, DRC, Georgia, Honduras, Pakistan, Tajikistan, and Tanzania).

2017	Assets (Liabilities)	(Charged)		
		Credited to Profit or Loss	Credited to Equity	Credited to Disc Ops
Property and equipment and software	\$ 12,192	\$ 131,083	\$ (4,873)	\$ -
Provision for loan-loss impairment	1,102,734	(847,884)	53,411	-
Cash flow hedges	-	893,922	(87,035)	-
Deferred income/accrued interest	636,927	(119,397)	21,531	-
Tax loss carryforwards	2,828,171	2,707,184	(1,324)	-
Other	<u>1,145,674</u>	<u>511,224</u>	<u>38,495</u>	<u>-</u>
Net tax assets	<u>\$5,725,698</u>	<u>\$3,276,132</u>	<u>\$ 20,205</u>	<u>\$ -</u>

2016	Assets (Liabilities)	(Charged)		
		Credited to Profit or Loss	Credited to Equity	Credited to Disc Ops
Property and equipment and software	\$ (123,763)	\$ 86,816	\$ (23,494)	\$ 14,867
Provision for loan-loss impairment	2,004,029	38,548	(147,986)	(715,361)
Cash flow hedges	(980,957)	720,101	19,414	-
Deferred income/accrued interest	777,855	(552,781)	(26,630)	-
Tax loss carryforwards	119,663	(3,193,018)	(44,295)	-
Other	<u>672,942</u>	<u>161,586</u>	<u>(12,681)</u>	<u>(757,073)</u>
Net tax assets	<u>\$2,469,769</u>	<u>\$(2,738,748)</u>	<u>\$(235,672)</u>	<u>\$(1,457,567)</u>

Deferred Tax Liabilities—Deferred tax liabilities are recorded by Ecuador, FMH, Georgia, Honduras, Malawi, the Netherlands, Nicaragua, USA, and Uganda in 2017 (2016—Ecuador, FMH, Kyrgyzstan, Malawi, the Netherlands, Nicaragua, USA, and Uganda) as follows:

2017	Assets (Liabilities)	(Charged)	
		Credited to Profit or Loss	Credited to Equity
Property and equipment and software	\$ (473,271)	\$(216,414)	\$ 1,766
Provision for loan-loss impairment	(258,928)	(3,573)	5,119
Deferred income/accrued interest	1,963	(10,823)	1,346
Tax loss carryforwards	130,830	61,835	11,215
Future distribution of retained earnings	(1,435,114)	325,759	-
Other	<u>(103,832)</u>	<u>(194,511)</u>	<u>(782)</u>
Net tax (liabilities) assets	<u>\$(2,138,352)</u>	<u>\$(37,727)</u>	<u>\$18,664</u>

2016	Assets (Liabilities)	(Charged)	
		Credited to Profit or Loss	Credited to Equity
Property and equipment and software	\$ (258,623)	\$ (134,165)	\$ (3,170)
Provision for loan-loss impairment	(260,474)	(1,956)	(26,567)
Deferred income/accrued interest	11,440	133,662	388
Tax loss carryforwards	57,780	(6,548)	6,398
Future distribution of retained earnings	(1,760,873)	(1,284,995)	1
Other	<u>91,461</u>	<u>214,356</u>	<u>(19,391)</u>
Net tax (liabilities) assets	<u>\$(2,119,289)</u>	<u>\$(1,079,646)</u>	<u>\$(42,341)</u>

12. RESTRICTED CASH AND CASH EQUIVALENTS

Restricted cash balances of \$37.7 million and \$26.4 million as of December 31, 2017 and 2016, respectively, comprise undisbursed grant funds to be used in lending and operations, cash balances for country-specific regulatory requirements, and pledged collateral related to local borrowings and deposits, substantially all of which can be contractually released within 12 months.

13. AFS FINANCIAL ASSETS

	2017	2016
Certificates of deposit and other (maturity over 3 mos)	<u>\$ 6,232,990</u>	<u>\$ 7,670,352</u>
Total	<u>\$ 6,232,990</u>	<u>\$ 7,670,352</u>

14. FINANCIAL ASSETS HTM

Financial assets HTM in the amount of \$42.0 million and \$25.4 million at December 31, 2017 and 2016, respectively. Assets at December 31 2017 include \$26.9 million of market Treasury bills issued by State Bank of Pakistan, of which \$22.9 million mature within three months of the balance sheet date and \$7.3 million of Georgia Ministry of Finance Treasury Bills, of which \$6.6 million mature within 12 months of the balance sheet date.

Assets at December 31 2016, include \$17.9 million of market Treasury bills issued by State Bank of Pakistan, of which \$16.5 million mature within three months of the balance sheet date and \$7.3 million of Georgia Ministry of Finance Treasury Bills, of which \$6.5 million mature within 12 months of the balance sheet date.

15. FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

The financial assets and liabilities at FVTPL are represented by the following balances:

2017	Notional Amount	Fair Value Assets	Fair Value Liabilities
Fair value from derivatives with third parties:			
Foreign exchange swaps	\$ 23,549,720	\$ 10,709,417	\$ 10,566,956
Foreign exchange forwards	15,473,360	276,545	646,346
Other securities	<u>-</u>	<u>20,280,234</u>	<u>-</u>
Total derivatives with third parties	<u>\$ 39,023,080</u>	<u>\$ 31,266,196</u>	<u>\$ 11,213,302</u>

2016	Notional Amount	Fair Value Assets	Fair Value Liabilities
Fair value from derivatives with third parties:			
Foreign exchange swaps	\$ 60,581,978	\$ 13,757,515	\$ 8,245,776
Foreign exchange forwards	<u>20,094,840</u>	<u>5,733,680</u>	<u>13,798</u>
Total derivatives with third parties	<u>\$ 80,676,818</u>	<u>\$ 19,491,195</u>	<u>\$ 8,259,574</u>

Neither of the above balances related to hedge transactions qualified for hedge accounting.

16. LOANS RECEIVABLE—NET

Loans receivable as at December 31, 2017 and 2016, including operations that were discontinued in 2017, consist of the following:

	2017	2016
Gross loans to clients—current	\$ 532,015,233	\$ 509,130,748
Gross loans to clients—noncurrent	<u>265,501,628</u>	<u>275,508,206</u>
Total gross loans to clients	797,516,861	784,638,954
Less allowances for impairment	<u>(19,871,126)</u>	<u>(42,882,752)</u>
Loans receivable	<u>\$ 777,645,735</u>	<u>\$ 741,756,202</u>
	2017	2016
Allowances for impairments—balance at January 1	\$ 42,882,752	\$ 24,923,718
Discontinued operations	(110,712)	(2,182,559)
Impairment loss for the year:		
Charge for the year	28,550,245	57,253,878
Amounts written off—net of recovery	(52,218,771)	(34,873,929)
Effect of foreign currency movements	<u>767,612</u>	<u>(1,608,356)</u>
Balance at December 31	<u>\$ 19,871,126</u>	<u>\$ 42,882,752</u>

Collateral—Collateral as at December 31, 2017 and 2016, is represented as follows:

Outstanding Amount of Loan	Balance at January 1, 2017	Discontinued Operations	Collateral Accepted	Collateral Released	Effect of Foreign Currency Movements	Balance at December 31, 2017
Up to \$1,000	\$ 10,349,033	\$ -	\$ 7,036,059	\$ (7,420,367)	\$ (587,209)	\$ 9,377,516
\$1,001–\$5,000	14,639,563	-	3,175,055	(12,467,086)	(531,961)	4,815,571
\$5,001–\$10,000	6,634,569	-	227,972	(6,497,471)	(636)	364,434
More than \$10,001	<u>11,010,717</u>	<u>-</u>	<u>255,354</u>	<u>(11,241,873)</u>	<u>91,952</u>	<u>116,150</u>
Total	<u>\$ 42,633,882</u>	<u>\$ -</u>	<u>\$ 10,694,440</u>	<u>\$(37,626,797)</u>	<u>\$(1,027,854)</u>	<u>\$ 14,673,671</u>

Outstanding Amount of Loan	Balance at January 1, 2016	Discontinued Operations	Collateral Accepted	Collateral Released	Effect of Foreign Currency Movements	Balance at December 31, 2016
Up to \$1,000	\$ 17,218,477	\$ (602,312)	\$ 4,283,191	\$(10,616,209)	\$ 65,886	\$ 10,349,033
\$1,001–\$5,000	22,202,829	(2,056)	9,312,641	(19,154,396)	2,280,545	14,639,563
\$5,001–\$10,000	13,267,922	-	3,555,313	(10,236,548)	47,882	6,634,569
More than \$10,001	<u>25,132,211</u>	<u>-</u>	<u>7,286,441</u>	<u>(17,387,095)</u>	<u>(4,020,840)</u>	<u>11,010,717</u>
Total	<u>\$ 77,821,439</u>	<u>\$(604,368)</u>	<u>\$ 24,437,586</u>	<u>\$(57,394,248)</u>	<u>\$(1,626,527)</u>	<u>\$ 42,633,882</u>

17. OTHER RECEIVABLES, PREPAID, AND OTHER ASSETS

The balances represent other receivables, prepaid, and other assets at December 31, 2017 and 2016, as follows:

	2017	2016
Receivables from sale of discontinued operations	\$ 2,482,106	\$ 12,113,000
Grants receivable	2,716,829	-
Prepaid rent	2,581,595	2,485,785
Receivable from money remittance and other agencies	1,339,914	1,863,609
Prepaid office supplies	1,157,803	1,232,698
Prepaid taxes	650,799	1,148,435
Investment property	-	1,080,792
Deposit with Internal Revenue Service and other fiduciary agencies	2,407,512	998,980
Staff advances and loans	719,888	564,389
Receivable commission, rebates, and refunds from banks and agencies	500,511	191,774
Other prepayments and debtors	<u>8,980,615</u>	<u>7,225,580</u>
Total	<u>\$ 23,537,572</u>	<u>\$ 28,905,042</u>

18. PROPERTY AND EQUIPMENT

Depreciation and amortization expense charged for the years ended December 31, 2017 and 2016, were \$7.4 million and \$7.8 million, respectively. Depreciation expense in 2016 includes operations that were discontinued in 2017.

Property and equipment at December 31, 2017 and 2016, are as follows:

	Total	Buildings and Offices	Construction in Progress	Leasehold Improvements	Computer Equipment	Furniture and Office Equipment	Vehicles	Other
Cost								
Balance—January 1, 2016	\$ 63,014,723	\$ 6,226,121	\$ 2,881,746	\$ 13,705,258	\$ 19,433,024	\$ 13,687,344	\$ 3,823,106	\$ 3,258,124
Acquisitions	11,255,963	2,756,649	1,748,934	1,814,201	2,172,014	2,138,805	527,710	97,650
Disposals	(5,417,921)	1,185,208	(1,466,592)	(1,835,082)	(1,838,118)	(655,432)	(444,536)	(363,369)
Currency translation	(843,750)	(27,580)	115,522	(315,812)	(212,832)	(288,766)	(96,642)	(17,640)
Disposal related to discontinued operations	<u>(3,797,022)</u>	<u>-</u>	<u>-</u>	<u>(804,938)</u>	<u>(1,117,117)</u>	<u>(781,618)</u>	<u>(688,678)</u>	<u>(404,671)</u>
Balance—December 31, 2016	<u>\$ 64,211,993</u>	<u>\$ 10,140,398</u>	<u>\$ 3,279,610</u>	<u>\$ 12,563,627</u>	<u>\$ 18,436,971</u>	<u>\$ 14,100,333</u>	<u>\$ 3,120,960</u>	<u>\$ 2,570,094</u>
Balance—January 1, 2017	\$ 64,211,993	\$ 10,140,398	\$ 3,279,610	\$ 12,563,627	\$ 18,436,971	\$ 14,100,333	\$ 3,120,960	\$ 2,570,094
Acquisitions	9,843,576	448,035	583,425	2,786,326	2,777,690	2,672,310	506,961	68,829
Disposals	(4,520,847)	(948)	(17,609)	(444,815)	(2,238,693)	(1,114,199)	(330,452)	(374,131)
Currency translation	(810,875)	(110,317)	(85,868)	(234,370)	(165,441)	(275,104)	52,748	7,477
Disposal related to discontinued operations	<u>(250,192)</u>	<u>-</u>	<u>-</u>	<u>(54,560)</u>	<u>(103,177)</u>	<u>(56,923)</u>	<u>-</u>	<u>(35,532)</u>
Balance—December 31, 2017	<u>\$ 68,473,655</u>	<u>\$ 10,477,168</u>	<u>\$ 3,759,558</u>	<u>\$ 14,616,208</u>	<u>\$ 18,707,350</u>	<u>\$ 15,326,417</u>	<u>\$ 3,350,217</u>	<u>\$ 2,236,737</u>
Depreciation and Impairment Losses								
Balance—January 1, 2016	\$ 31,958,220	\$ 1,675,792	\$ -	\$ 5,347,966	\$ 11,554,566	\$ 9,303,871	\$ 2,966,954	\$ 1,109,071
Depreciation and amortization	7,777,515	471,656	-	1,516,537	3,037,111	1,975,804	456,140	320,267
Disposals	(2,642,658)	8,811	-	(499,055)	(847,829)	(614,186)	(423,213)	(267,186)
Currency translation	(510,126)	(2,912)	-	(87,770)	(205,252)	(135,671)	(62,119)	(16,402)
Disposal related to discontinued operations	<u>(2,927,821)</u>	<u>-</u>	<u>-</u>	<u>(549,641)</u>	<u>(1,039,196)</u>	<u>(459,797)</u>	<u>(685,689)</u>	<u>(193,498)</u>
Balance—December 31, 2016	<u>\$ 33,655,130</u>	<u>\$ 2,153,347</u>	<u>\$ -</u>	<u>\$ 5,728,037</u>	<u>\$ 12,499,400</u>	<u>\$ 10,070,021</u>	<u>\$ 2,252,073</u>	<u>\$ 952,252</u>
Balance—January 1, 2017	\$ 33,655,130	\$ 2,153,347	\$ -	\$ 5,728,037	\$ 12,499,400	\$ 10,070,021	\$ 2,252,073	\$ 952,252
Depreciation and amortization	7,413,517	536,704	-	1,619,802	2,483,732	2,120,136	397,168	255,975
Disposals	(4,167,368)	-	-	(358,132)	(2,314,452)	(945,820)	(286,943)	(262,021)
Currency translation	(239,844)	(11,295)	-	(71,370)	(118,575)	(105,048)	64,477	1,967
Disposal related to discontinued operations	<u>(244,861)</u>	<u>-</u>	<u>-</u>	<u>(54,565)</u>	<u>(100,979)</u>	<u>(54,699)</u>	<u>-</u>	<u>(34,618)</u>
Balance—December 31, 2017	<u>\$ 36,416,574</u>	<u>\$ 2,678,756</u>	<u>\$ -</u>	<u>\$ 6,863,772</u>	<u>\$ 12,449,126</u>	<u>\$ 11,084,590</u>	<u>\$ 2,426,775</u>	<u>\$ 913,555</u>
Net Carrying Amounts								
Balance—January 1, 2016	<u>\$ 31,056,503</u>	<u>\$ 4,550,329</u>	<u>\$ 2,881,746</u>	<u>\$ 8,357,292</u>	<u>\$ 7,878,458</u>	<u>\$ 4,383,473</u>	<u>\$ 856,152</u>	<u>\$ 2,149,053</u>
Balance—December 31, 2016	<u>\$ 30,556,863</u>	<u>\$ 7,987,051</u>	<u>\$ 3,279,610</u>	<u>\$ 6,835,590</u>	<u>\$ 5,937,571</u>	<u>\$ 4,030,312</u>	<u>\$ 868,887</u>	<u>\$ 1,617,842</u>
Balance—December 31, 2017	<u>\$ 32,057,081</u>	<u>\$ 7,798,412</u>	<u>\$ 3,759,558</u>	<u>\$ 7,752,436</u>	<u>\$ 6,258,224</u>	<u>\$ 4,241,827</u>	<u>\$ 923,442</u>	<u>\$ 1,323,182</u>

19. INTANGIBLE ASSETS

Amortization expense amounts to \$3.0 million for the years ended December 31, 2017 and 2016. Amortization expense in 2016 includes operations that were discontinued in 2017.

Intangible assets at December 31, 2017 and 2016, consist of the following:

	Total	Capitalized Software	Capital Work-in-Progress	Other
Costs				
Balance—January 1, 2016	\$ 23,307,810	\$ 20,949,340	\$ 1,607,096	\$ 751,374
Acquisition	3,332,292	2,482,377	849,915	-
Disposals	(5,868,396)	(3,920,844)	(1,947,552)	-
Currency translation	(109,505)	(74,857)	(34,648)	-
Disposal related to discontinued operations	<u>(2,627,181)</u>	<u>(2,627,181)</u>	<u>-</u>	<u>-</u>
Balance—December 31, 2016	<u>\$ 18,035,020</u>	<u>\$ 16,808,835</u>	<u>\$ 474,811</u>	<u>\$ 751,374</u>
Balance—January 1, 2017	\$ 18,035,020	\$ 16,808,835	\$ 474,811	\$ 751,374
Acquisition	4,336,857	4,211,012	125,845	-
Disposals	(1,213,319)	(1,198,065)	(15,254)	-
Currency translation	(249,816)	(234,312)	(15,504)	-
Disposal related to discontinued operations	<u>(575,139)</u>	<u>(575,139)</u>	<u>-</u>	<u>-</u>
Balance—December 31, 2017	<u>\$ 20,333,603</u>	<u>\$ 19,012,331</u>	<u>\$ 569,898</u>	<u>\$ 751,374</u>
Amortization and Impairment				
Balance—January 1, 2016	\$ 12,248,973	\$ 11,629,235	\$ -	\$ 619,738
Amortization for the year	2,999,647	2,895,953	49,223	54,471
Disposals	(3,875,269)	(3,867,240)	(8,029)	-
Impairment loss	(254,693)	(254,693)	-	-
Currency translation	20,963	20,963	-	-
Disposal related to discontinued operations	<u>(1,162,754)</u>	<u>(1,162,754)</u>	<u>-</u>	<u>-</u>
Balance—December 31, 2016	<u>\$ 9,976,867</u>	<u>\$ 9,261,464</u>	<u>\$ 41,194</u>	<u>\$ 674,209</u>
Balance—January 1, 2017	\$ 9,976,867	\$ 9,261,464	\$ 41,194	\$ 674,209
Amortization for the year	2,967,094	2,899,382	13,221	54,491
Disposals	(953,369)	(971,705)	18,336	-
Impairment loss	-	-	-	-
Currency translation	(141,891)	(141,891)	-	-
Disposal related to discontinued operations	<u>(534,058)</u>	<u>(534,058)</u>	<u>-</u>	<u>-</u>
Balance—December 31, 2017	<u>\$ 11,314,643</u>	<u>\$ 10,513,192</u>	<u>\$ 72,751</u>	<u>\$ 728,700</u>
Net Carrying Amounts				
Balance—January 1, 2016	<u>\$ 11,058,837</u>	<u>\$ 9,320,105</u>	<u>\$ 1,607,096</u>	<u>\$ 131,636</u>
Balance—December 31, 2016	<u>\$ 8,058,153</u>	<u>\$ 7,547,371</u>	<u>\$ 433,617</u>	<u>\$ 77,165</u>
Balance—December 31, 2017	<u>\$ 9,018,960</u>	<u>\$ 8,499,139</u>	<u>\$ 497,147</u>	<u>\$ 22,674</u>

20. ACCOUNTS PAYABLE AND OTHER ACCRUED LIABILITIES

Accounts payable and other accrued liabilities at December 31, 2017 and 2016, are as follows:

	2017	2016
Personnel	\$ 8,877,389	\$ 7,927,635
Professional services	4,593,178	3,447,568
Office supplies	3,291,943	1,633,775
Other accounts payable and accrued expenses	10,060,942	6,754,085
Non-income taxes	4,286,939	5,346,587
Deferred rent	<u>2,719,315</u>	<u>2,760,072</u>
Total	<u>\$ 33,829,706</u>	<u>\$ 27,869,722</u>

All accounts payable and other accrued liabilities have a maturity of no more than 12 months from the balance sheet date, other than the noncurrent portion of deferred rent of \$2.3 million of which has an amortization term of 7 years. Carrying values approximate fair value at December 31, 2017 and 2016.

21. CLIENT DEPOSITS

	2017	2016
Compulsory savings/cash collateral	<u>\$ 11,417,725</u>	<u>\$ 8,148,912</u>
Voluntary savings:		
Saving accounts	95,758,136	84,416,693
Term deposit accounts	239,176,269	147,252,736
Other voluntary savings	<u>26,392,044</u>	<u>22,521,816</u>
Total voluntary savings	<u>361,326,449</u>	<u>254,191,245</u>
Total client deposits	<u>\$ 372,744,174</u>	<u>\$ 262,340,157</u>

22. NOTES PAYABLE

Interest rates paid by subsidiaries range from six months London InterBank Offered Rate plus 450 basis points up to 21.0% floating and up to 23.1% fixed in local currencies for commercial loans in countries with high perceived risk or with depreciating currencies. In some situations, FMH, as the intermediary parent company, may be directly liable or may offer support for loans provided to subsidiaries without adequate credit standing, which may be in the form of a direct guarantee, letter of credit, comfort letter, or another form of credit enhancement.

As of the balance sheet date, some subsidiaries have breached covenants contained in financing agreements underlying these obligations. Management believes that these breaches are primarily due to recent global economic conditions, which have impacted microfinance, or in some cases due to local political and economic developments. A breach of a loan covenant could permit a lender to accelerate payment of the loan, but would not permit a cross default beyond the particular subsidiary.

As of December 31, 2017 and 2016, subsidiaries in Azerbaijan, DRC, Guatemala, Malawi, and Tanzania were in breach of financial covenants regarding loans from international financial institutions amounting to \$37 million and \$141 million, respectively. As of December 31, 2017 and 2016, FMH and its subsidiaries had obtained formal waivers for these breaches of covenants accounting for \$24.3 million and \$8.4 million, respectively.

All loans for which no formal waivers were obtained or were not obtained before December 31, 2017, are classified as current in the maturity table below. Although management has obtained formal waivers of some of these breaches or assurances from lenders that the covenants will be waived, there is no assurance that these waivers or assurances will be extended indefinitely or that performance can be brought into full compliance.

Notes payable and overdrafts at December 31, 2017 and 2016, are as follows:

	2017	2016
Overdrafts	\$ 493,674	\$ 3,401,292
Notes payable:		
Principal amount	372,936,512	448,983,858
Accrued interest	<u>2,900,810</u>	<u>3,151,554</u>
	<u>\$ 376,330,996</u>	<u>\$ 455,536,704</u>

Maturities of principal amounts on notes payable and overdrafts due in future fiscal years are as follows:

2018	\$ 174,592,489
2019	130,659,062
2020	46,597,654
2021	10,717,463
2022	3,388,004
Thereafter	<u>7,475,514</u>
	<u>\$ 373,430,186</u>

The book value of notes payable and overdrafts at December 31, 2017 and 2016, is as follows:

	2017	2016
Current:		
Overdrafts	\$ 493,674	\$ 3,401,292
Notes payable:		
Secured	27,442,428	38,074,794
Unsecured	147,597,016	246,615,201
Collateralized borrowings	<u>2,211,201</u>	<u>-</u>
	<u>177,744,319</u>	<u>288,091,287</u>
Non-current:		
Notes payable:		
Secured	27,195,043	40,242,686
Unsecured	125,864,708	125,340,585
Collateralized borrowings	<u>45,526,926</u>	<u>1,862,146</u>
	<u>198,586,677</u>	<u>167,445,417</u>
Total notes payable and overdrafts	<u>\$ 376,330,996</u>	<u>\$ 455,536,704</u>

23. SUBORDINATED DEBT

The subordinated debt balance consists of debt from external financial institutions to FINCA Georgia (\$2.6 million and \$2.5 million) and FINCA Nicaragua (\$3.1 million and \$3.1 million) as of December 31, 2017 and 2016, respectively.

24. DEFERRED REVENUE

Deferred revenue from grants from private corporations and foundations at December 31, 2017 and 2016, are \$3,884,371 and \$5,593,390, respectively.

25. EMPLOYEE BENEFITS

Defined Contribution Pension Plan—FINCA has implemented an employee retirement plan (the “Plan”) under Internal Revenue Code Section 403(b). Under the Plan, qualified employees may defer compensation up to the maximum amount permitted by the Internal Revenue Code. The elective deferral limit was \$18,000 for 2017 and 2016. The catch-up contribution was \$6,000 for 2017 and 2016. FINCA may make contributions to the Plan as a discretionary employer match. FINCA’s contributions to the Plan during the years ended December 31, 2017 and 2016, were \$0.4 million and \$0.4 million, respectively.

Defined Benefit Agreement—FINCA also maintains a defined senior executive retirement plan agreement (the “Agreement”) for certain officers and directors, which provides benefits payable upon retirement from FINCA (no sooner than at age 65). In addition, a death benefit is payable to a surviving spouse or named beneficiary in the event of the death of the eligible officer/director. The Agreement is offered at the sole discretion of FINCA’s board of directors. Currently, several key employees are enrolled in the Agreement. No changes were made to the Plan in 2017 and 2016.

The net liability of FINCA's defined benefit plan recognized at December 31, 2017 and 2016, is summarized as follows:

	2017	2016
Benefit obligation—beginning of year	\$ 3,707,898	\$ 3,599,046
Service cost	102,778	99,538
Interest cost	125,108	135,279
Actuarial loss	31,581	13,792
Settlement	-	-
Net employer benefits paid	<u>(569,075)</u>	<u>(139,757)</u>
Benefit obligation—end of year	<u>\$ 3,398,290</u>	<u>\$ 3,707,898</u>

The change in plan assets at December 31, 2017 and 2016, is summarized as follows:

	2017	2016
Fair value of assets—beginning of year	\$ -	\$ -
Employee contributions	-	-
Employer contributions	569,075	139,757
Settlements	-	-
Benefits paid	<u>(569,075)</u>	<u>(139,757)</u>
Fair value of assets—end of year	<u>\$ -</u>	<u>\$ -</u>

The entire balance of the defined benefit obligation at December 31, 2017 and 2016 is unfunded.

The amounts recognized in comprehensive income related to FINCA's defined benefit plan at December 31, 2017 and 2016, are summarized as follows:

	2017	2016
Service costs:		
Current service cost	\$ 102,778	\$ 99,538
Past service cost	-	-
Settlement gain	-	-
Interest cost	<u>125,108</u>	<u>135,279</u>
Defined benefit cost recognized in P/L	<u>227,886</u>	<u>234,817</u>
Remeasurements:		
Actuarial gains (losses) arising from experience adjustments	(14,034)	(22,958)
Actuarial gains (losses) arising from financial adjustments	(152,863)	(49,248)
Other	<u>135,316</u>	<u>58,414</u>
Defined benefit cost recognized in other comprehensive income	<u>(31,581)</u>	<u>(13,792)</u>
Total defined benefit cost recognized in comprehensive income (loss)	<u>\$ 259,467</u>	<u>\$248,609</u>

Weighted-average assumptions used to determine benefit obligations at December 31, 2017 and 2016, are as follows:

	2017	2016
Discount rate	3.3 %	3.7 %
Salary scale	NA	NA

Weighted-average assumptions used to determine net period pension cost for the years ended December 31, 2017 and 2016, are as follows:

	2017	2016
Discount rate	3.7 %	3.8 %
Salary scale	NA	NA

Based upon the assumptions used to measure pension obligations, FINCA expects to make the following benefit payments in aggregate over the next ten years:

**Years Ending
December 31**

2018	\$133,399
2019	166,645
2020	756,208
2021	199,453
2022	193,798
In aggregate for five fiscal years thereafter	921,094

FINCA's defined benefit plan is exposed to actuarial risks, such as investment, interest rate, and life expectancy risks.

Investment Risk—The present value of the defined benefit plan liability is calculated using the December 31, 2017, Citigroup pension discount curve and the expected benefit payments from the Plan. This curve is the published yield curve of high-grade corporate bond rates.

Interest Risk—A decrease in the bond interest rate will increase the Plan liability.

Life Expectancy Risk—The present value of the defined benefit plan liability is calculated using the published mortality tables for Plan participants during and after employment with FINCA. An increase in the life expectancy of the Plan participants will increase the Plan's liability.

Significant actuarial assumptions for the determination of the defined obligation are discount rate and the life expectancy of the Plan participants. The sensitivity analysis below has been determined based on reasonably possible changes of the discount rate assumption occurring at the end of the reporting period, while holding all other assumptions constant.

If the discount rate is a 500 bps higher (lower) the defined benefit obligation would decrease (increase) by \$0.2 million.

26. COMMITMENTS AND CONTINGENCIES

At December 31, 2017, FINCA was obligated under a number of operating leases for premises used primarily for branch operations and office purposes. In a significant portion of the business locations where FINCA operates, the operating lease agreements are negotiated on a month-to-month or year-by-year basis and are in line with general rental market conditions.

Future minimum lease payments under existing lease contracts are due, in dollars, as follows:

	2017	2016
Less than one year	\$ 5,323,017	\$ 6,444,307
Between one and five years	18,759,644	19,270,300
More than five years	<u>4,291,010</u>	<u>7,912,269</u>
	<u>\$28,373,671</u>	<u>\$33,626,876</u>

Rent expense was \$12.2 million and \$12.5 million for the years ended December 31, 2017 and 2016, respectively.

FMH provided a guarantee directly on a line of credit with a total commitment of \$4.8 million (\$4.0 million outstanding) as of December 31, 2017. In March 2017, this agreement was amended to remove FINCA International as a party and guarantor, leaving FMH as the sole guarantor of this line of credit. As such, FINCA International, jointly and severally with FMH, provided a guarantee directly on a line of credit with a total commitment of \$4.9 million (\$3.3 million outstanding) as of December 31, 2016.

27. DISCONTINUED OPERATIONS

In 2017, FINCA sold its interest in Microfinance Company FINCA Joint Stock Company ("FINCA Russia"). In 2016, FINCA sold its interests in two subsidiaries—FINCA S.A. de CV ("FINCA El Salvador") was sold in June 2016 and Financiera Finca S.A de C.V SOFOM ENR Mexico ("SOFOM") was sold in November 2016.

FINCA Russia, FINCA El Salvador and SOFOM represent discontinued operations in accordance with IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*.

Results of the discontinued operations in 2017 and 2016 include the net income or loss for both FINCA Russia, FINCA El Salvador, and SOFOM for the period up to disposition in 2017 and 2016, respectively.

	2017	2016
Net operating income	\$ 1,997,680	\$ 21,487,906
Expenses	(1,813,815)	(20,899,222)
Intercompany expenses eliminated on consolidation	366,534	1,931,234
Other income	<u>(157,028)</u>	<u>519,966</u>
Profit before income tax of discontinued operations	393,371	3,039,884
Income tax expense	<u>(38,738)</u>	<u>(841,225)</u>
Profit after income tax of discontinued operations	354,633	2,198,659
Loss recognized on the remeasurement of assets of disposal group	<u>-</u>	<u>-</u>
Profit after remeasurement of assets of disposal group	354,633	2,198,659
Loss on sale	<u>(5,401,578)</u>	<u>(3,314,400)</u>
Loss from discontinued operations	<u><u>\$ (5,046,945)</u></u>	<u><u>\$ (1,115,741)</u></u>

The loss on sale from assets of the disposal group in the year ended December 31, 2017 and 2016, respectively, is as follows:

	2017	2016
Consideration received	\$ 807,724	\$ 29,049,635
Net assets disposed of	<u>(1,366,584)</u>	<u>(20,017,146)</u>
Gain on sale before income tax expense and reclassification of foreign currency translation reserve	(558,860)	9,032,489
Reclassification of foreign currency translation reserve	(4,842,718)	(11,065,884)
Income tax expense on gain	<u>-</u>	<u>(1,281,005)</u>
Loss on sale	<u><u>\$ (5,401,578)</u></u>	<u><u>\$ (3,314,400)</u></u>

Net cash inflow on sale of assets of the disposal group in the year ended December 31, 2017 and 2016, respectively, is as follows:

	2017	2016
Consideration received in cash and cash equivalents	\$ 807,724	\$ 16,623,734
Less: cash and cash equivalent balances disposed of	<u>(569,357)</u>	<u>(1,678,959)</u>
Net cash consideration received	<u>\$ 238,367</u>	<u>\$ 14,944,775</u>

Cash flows from the activities of assets of the disposal group for the years ended December 31, 2017 and 2016, are as follows:

	2017	2016
From operating activity	\$ 1,042,622	\$ 7,102,999
From investing activity	(79,579)	1,060,562
From financing activity	<u>(760,863)</u>	<u>(14,283,112)</u>
Total cash flows used by disposal group	<u>\$ 202,180</u>	<u>\$ (6,119,551)</u>

28. FINCA ENTITIES

Through its headquarters, foreign representative offices and branches, controlled subsidiaries and affiliates, FINCA operates in 26 countries. All subsidiaries are controlled by FINCA directly or indirectly through FMH. The significant microfinance operating subsidiaries and controlled affiliates of FINCA at the end of the reporting period are listed below:

Americas

Ecuador	Banco para la Asistencia Comunitaria, FINCA S.A. Joint Stock Company
Guatemala	Fundación Internacional para la Asistencia Comunitaria de Guatemala Foundation FINCA Microfinanzas, S.A.
Haiti	FINCA HAITI Non-Governmental Organization FINCA Haiti. S.A.
Honduras	Sociedad Financiera FINCA Honduras, S.A. Joint Stock Company
Nicaragua	Financiera FINCA Nicaragua, S.A. Joint Stock Company Fundación Internacional para la Asistencia Comunitaria de Nicaragua Not-for-profit Foundation

Africa

Congo	FINCA DR CONGO SARL Limited Liability Joint Stock Company
Malawi	FINCA Limited Company Limited by Shares
Nigeria	FINCA Microfinance Bank Limited
Tanzania	FINCA Tanzania Limited Company Limited by Shares
Uganda	Foundation for International Community Assistance Uganda Limited Company Limited by Shares
Zambia	Foundation for International Community Assistance-Zambia Limited Company Limited by Shares

Eurasia

Armenia	FINCA Universal Credit Organization Closed Joint Stock Company
Azerbaijan	FINCA Azerbaijan Limited Liability Company
Georgia	JSC FINCA Bank Georgia Closed Joint Stock Company
Kosovo	FINCA International, Inc. (Branch)
Kyrgyzstan	FINCA Bank Closed Joint Stock Company
Tajikistan	FINCA Micro-Credit Deposit Organization Limited Liability Company

Middle East

Jordan	FINCA Jordan Specialized Micro Loans Company
Afghanistan	FINCA Afghanistan Joint Stock Company Limited by Shares
Pakistan	FINCA Microfinance Bank Ltd.

Nonmicrofinance Subsidiaries

Netherlands	FINCA Network Support Services BV. FINCA Microfinance Cooperatief U.A.
USA	FINCA Microfinance Holdings Company LLC FINCA Services USA LLC FINCA Microfinance Global Services LLC FINCA International LLC FINCA Plus LLC
Mexico	Tenedora SAPI de C.V Fundación Integral Comunitaria, A.C. Civil Association

Charitable Affiliates

United Kingdom	FINCA UK
Canada	FINCA Canada

In 2017, FMH sold its interest in FICA Joint Stock Company (Russia). In 2016, FMH sold its interests in FINCA S.A. de C.V. in El Salvador and in Financiera Finca S.A. de C.V. SOFOM E.N.R Mexico (see Note 27). FMH retained ownership or control in Fundacion Integral Comunitaria A.C. Civil Association and Tenedora SAPI de CV in Mexico.

Noncontrolling members of FMH hold 37.1% of shares and voting rights as of December 31, 2017 and 2016. Assets and liabilities attributable to FMH noncontrolling members are \$411.7 million and \$322.3 million as of December 31, 2017, and \$382.9 million and \$298.6 million as of December 31, 2016, respectively. Net income (loss) is \$3.6 million and (\$9.3) million for the years 2017 and 2016, respectively. Accumulated net loss is \$0.4 million and \$4.0 million as of December 31, 2017 and 2016, respectively.

Non-controlling interest is attributable to non-controlling shareholders of FINCA Microfinance Bank Ltd. (Pakistan), holding 13.6% of shares and voting rights as of December 31, 2017. Assets and liabilities attributable to non-controlling interests are \$30.9 million and \$20.2 million, and \$26.9 million and \$17.1 million, as of December 31, 2017 and 2016, respectively. Net income and accumulated net income for the year is \$1.1 million and \$0.7 million, and \$2.4 million and \$1.3 million, for the years ended December 31, 2017 and 2016, respectively.

29. RELATED PARTIES

Balances and transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and are not disclosed in this note.

Senior Management Compensation—Total compensation paid to the senior management of the Company for the years ended December 31, 2017 and 2016, amounted to:

	2017	2016
Short-term benefits	\$ 1,371,792	\$ 3,943,577
Postemployment benefits	<u>504,908</u>	<u>139,757</u>
	<u>\$ 1,876,700</u>	<u>\$ 4,083,334</u>

30. SUBSEQUENT EVENTS

In April 2017, FINCA Azerbaijan LLC entered into a wind-down agreement with the majority of its lenders under the terms of which FINCA Azerbaijan LLC continues to operate to collect amounts outstanding on its loan portfolio in return for certain forgiveness of debt from the lenders to meet regulatory capital standards. The wind-down period was set to initially expire on June 30, 2018 but under amendments in November 2017 and March 2018, it was extended to January 31, 2019.

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