JSC Pasha Bank Georgia

Financial statements

Year ended 31 December 2013
together with independent auditors' report

Contents

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Independent auditor's report

To the shareholders and Board of Directors of JSC PASHA Bank Georgia

We have audited the accompanying financial statements of JSC PASHA Bank Georgia, which comprise the statement of financial position as at 31 December 2013, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Audited entity's responsibility for the financial statements

Management of the audited entity is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on the fairness of these financial statements based on our audit.

We conducted our audit in accordance with the Federal Standards on Auditing effective in Georgia and International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing audit procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The audit procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation and fair presentation of the 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management of the audited entity, as well as evaluating the overall presentation of the 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 financial statements present fairly, in all material respects, the financial position of JSC PASHA Bank Georgia as at 31 December 2013, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

EY Georgia LLC

10 February 2014

Statement of financial position

As at 31 December 2013

(Figures in tables are in thousands of Georgian Lari)

	Notes	2013	2012
Assets			
Cash and cash equivalents	5	4,425	35,033
Amounts due from credit institutions	6	14,135	–
Loans to customers	7	5,139	–
Investment securities available-for-sale	8	12,220	–
Property and equipment	9	5,481	–
Intangible assets	10	1,035	–
Other assets	12	504	–
Total assets		**42,939**	**35,033**
Liabilities			
Amounts due to credit institutions	13	10,054	–
Amounts due to customers	14	434	–
Deferred income tax liabilities	11	98	–
Other liabilities	12	344	–
Total liabilities		**10,930**	**–**
Equity	15		
Share capital		35,000	35,000
(Accumulated deficit)/ Retained earnings		(2,991)	33
Total equity		**32,009**	**35,033**
Total equity and liabilities		**42,939**	**35,033**

Signed and authorised for release on behalf of the Board of Directors of the Bank

Anar Ismayilov Chairman of the Board of Directors

Margarita Svanidze Chief Accountant

10 February 2014

The accompanying notes on pages 6 to 34 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December 2013

(Figures in tables are in thousands of Georgian Lari)

	Notes	2013	For the period from 17 December 2012 (inception date) to 31 December 2012
Interest income			
Amounts due from credit institutions		1,206	33
Investment securities available-for-sale		298	–
Loans to customers		205	–
		1,709	**33**
Interest expense			
Amounts due to customers		(12)	–
Amounts due to credit institutions		(62)	–
		(74)	**–**
Net interest income		1,635	33
Allowance for loan impairment	7	(104)	–
Net interest income after allowance for loan impairment		**1,531**	**33**
Net fee and commission income	17	(263)	–
Net gains from foreign currencies:			
- dealing		61	–
- translation differences		17	–
Non-interest income		**(185)**	**–**
Personnel expenses	18	(1,712)	–
Depreciation and amortisation	9, 10	(1,023)	–
Other operating expenses	18	(1,537)	–
Non-interest expense		**(4,272)**	**–**
(Loss)/Profit before income tax		**(2,926)**	**33**
Income tax expense	11	(98)	–
Loss for the year		**(3,024)**	**33**
Other comprehensive income		–	–
Total comprehensive (loss)/income		**(3,024)**	**33**

The accompanying notes on pages 6 to 34 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December 2013

(Figures in tables are in thousands of Georgian Lari)

	Share capital	Retained earnings/ (Accumulated deficit)	Total equity
17 December 2012 (inception date)	–	–	–
Total comprehensive income for period from 17 December to 31 December 2012 (Note 15)	–	33	**33**
Total comprehensive income for the year	–	**33**	**33**
Issue of share capital (Note 15)	35,000	–	**35,000**
31 December 2012	**35,000**	**33**	**35,033**
Total comprehensive loss for the year	–	(3,024)	**(3,024)**
31 December 2013	**35,000**	**(2,991)**	**32,009**

The accompanying notes on pages 6 to 34 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2013

(Figures in tables are in thousands of Georgian Lari)

	Notes	2013	For the period from 17 December 2012 (inception date) to 31 December 2012
Cash flows from operating activities			
Interest received		1,496	33
Interest paid		(20)	–
Fees and commissions received		76	–
Fees and commissions paid		(311)	–
Realised gains less losses from dealing in foreign currencies		61	–
Personnel expenses paid		(1,489)	–
Other operating expenses paid		(1,791)	–
Cash flows from operating activities before changes in operating assets and liabilities		**(1,978)**	**33**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		(14,027)	–
Loans to customers		(5,211)	–
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		10,009	–
Amounts due to customers		434	–
Net cash flows(used in)/ from operating activities		**(10,773)**	**33**
Cash flows from investing activities			
Purchase of investment securities available-for-sale		(27,333)	–
Proceeds from redemption of investment securities available-for-sale		15,189	–
Purchase of property and equipment	9	(6,431)	–
Purchase of intangible assets		(1,264)	–
Net cash used in investing activities		**(19,839)**	**–**
Cash flows from financing activities			
Proceeds from issue of share capital		–	35,000
Net cash from financing activities		**–**	**35,000**
Effect of exchange rates changes on cash and cash equivalents		4	–
Net increase/(decrease) in cash and cash equivalents		**(30,608)**	**35,033**
Cash and cash equivalents, beginning		**35,033**	**–**
Cash and cash equivalents, ending	5	**4,425**	**35,033**

The accompanying notes on pages 6 to 34 are an integral part of these financial statements.

(Figures in tables are in thousands of Georgian Lari)

1. Principal activities

JSC PASHA Bank Georgia (the "Bank") was formed on 17 December 2012 as a joint stock company under the laws of Georgia. The Bank operates under a general banking license issued by the National Bank of Georgia (the "NBG") on 17 January 2013.

The Bank accepts deposits and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its commercial customers. The Bank has one service office in Georgia as of 31 December 2013. The Bank's registered legal address is 15 Rustaveli Avenue, Tbilisi, 0108, Georgia.

As at 31 December 2013, the Bank's 100% owner was OJSC Pasha Bank (the "Parent"),Republic of Azerbaijan. The Bank is ultimately owned by Mrs. Leyla Aliyeva and Mrs. Arzu Aliyeva, who exercise joint control over the Bank.

2. Basis of preparation

General

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The Bank is required to maintain its records and prepare its financial statements for regulatory purposes in Georgian Lari in accordance with Georgian banking and accounting legislation and related instructions. These financial statements are based on the Bank's books and records, as adjusted and reclassified in order to comply with IFRS.

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below

These financial statements are presented in thousands of Georgian Lari ("GEL"), unless otherwise indicated.

3. Summary of accounting policies

Changes in accounting policies

The Bank has adopted the following amended IFRS during the year:

IFRS 13 Fair Value Measurement

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The application of IFRS 13 has not materially impacted the fair value measurements carried out by the Bank.

IFRS 13 also requires specific disclosures on fair values, some of which replace existing disclosure requirements in other standards, including IFRS 7 *Financial Instruments: Disclosures.* Some of these disclosures are specifically required for financial instruments by IAS 34.16A(j), thereby affecting the financial statements. The Bank provides these disclosures in Note 23.

Amendments to IAS 19 Employee Benefits

The IASB has published amendments to IAS 19 *Employee Benefits*, effective for annual periods beginning on or after 1 January 2013, which involve major changes to the accounting for employee benefits, including the removal of the option for deferred recognition of changes in pension plan assets and liabilities (known as the "corridor approach"). In addition, these amendments will limit the changes in the net pension asset (liability) recognised in profit or loss to net interest income (expense) and service costs. These amendments had no impact on the Bank's financial position.

(Figures in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

Amendments to IAS 1 Changes to the Presentation of Other Comprehensive Income

The amendments to IAS 1 change the grouping of items presented in other comprehensive income. Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, net losses or gains on available-for-sale financial assets) would be presented separately from items that will never be reclassified (for example, revaluation of buildings). The amendment affects presentation only and has no impact on the Bank's financial position or performance.

IAS 1 Clarification of the Requirement for Comparative Information (amendment)

These amendments clarify the difference between voluntary additional comparative information and the minimum required comparative information. An entity must include comparative information in the related notes to the financial statements when it voluntarily provides comparative information beyond the minimum required comparative period. The amendments clarify that the opening statement of financial position, presented as a result of retrospective restatement or reclassification of items in financial statements does not have to be accompanied by comparative information in the related notes. The amendments affect presentation only and have no impact on the Bank's financial position or performance.

Amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities

These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognized financial instruments that are set off in accordance with IAS 32 *Financial Instruments: Presentation*. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreements, irrespective of whether they are set off in accordance with IAS 32. These amendments had no impact on the Banks' financial position or performance.

Fair value measurement

The Bank measures financial instruments, such as available-for-sale securities at fair value at each reporting date. Fair values of financial instruments measured at amortised cost are disclosed in Note 20.

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. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. Fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

(Figures in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Fair value measurement (continued)

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 – Quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- Level 2 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;
- Level 3 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. The Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Bank commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category "financial assets at fair value through profit or loss". Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognised in profit or loss.

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Bank has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held-to-maturity investments are subsequently measured at amortised cost. Gains and losses are recognised in profit or loss when the investments are impaired, as well as through the amortisation process.

(Figures in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Financial assets (continued)

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for sale financial assets are measured at fair value with gains or losses being recognised in other comprehensive income until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to the statement of profit or loss. However, interest calculated using the effective interest method is recognised in profit or loss.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- a financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity;
- other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Bank has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

Measurement of financial instruments at initial recognition

When financial instruments are recognised initially, they are measured at fair value, adjusted, in the case of instruments not at fair value through profit or loss, for directly attributable fees and costs.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Bank determines that the fair value at initial recognition differs from the transaction price, then:

- if the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets, the Bank recognises the difference between the fair value at initial recognition and the transaction price as a gain or loss;
- in all other cases, the initial measurement of the financial instrument is adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the Bank recognises that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

(Figures in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the statement of financial position.

Impairment of financial assets

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Amounts due from credit institutions and loans to customers

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

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the statement of profit or loss.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

(Figures in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of 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 years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Available-for-sale financial investments

For available-for-sale financial investments, the Bank assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in profit or loss. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the statement of profit or loss.

The accounting treatment of such restructuring is as follows:

- If the currency of the loan has been changed the old loan is derecognised and the new loan is recognised.
- If the loan restructuring is not caused by the financial difficulties of the borrower the Bank uses the same approach as for financial liabilities described below.
- If the loan restructuring is due to the financial difficulties of the borrower and the loan is impaired after restructuring, the Bank recognizes the difference between the present value of the new cash flows discounted using the original effective interest rate and the carrying amount before restructuring in the provision charges for the period. In case loan is not impaired after restructuring the Bank recalculates the effective interest rate.

Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original or current effective interest rate.

(Figures in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

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

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

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank's continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

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

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

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the National Bank of Georgia, excluding mandatory reserves, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Mandatory reserve deposit with the NBG

Mandatory reserve deposits with the NBG are carried at amortised cost and represent interest bearing mandatory reserve deposits which are not available to finance the Bank's day to day operations and hence are not considered as part of cash and cash equivalents for the purposes of the statement of cash flows. Mandatory reserve is included in amounts due from credit institutions.

(Figures in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Leases

Operating – Bank as lessee

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognised as expenses on a straight-line basis over the lease term and included into other operating expenses.

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees. Financial guarantees are initially recognised in the financial statements at fair value, in "Other liabilities", being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the statement of profit or loss. The premium received is recognised in profit or loss on a straight-line basis over the life of the guarantee.

Taxation

The current income tax expense is calculated in accordance with the regulations of Georgia.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting date.

Georgia also has various operating taxes that are assessed on the Bank's activities. These taxes are included as a component of other operating expenses.

Property and equipment

Property and equipment are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Computers and communication equipment	4
Vehicles	4
Furniture and fixtures	4
Other equipment	5
Leasehold improvements	4

(Figures in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Property and equipment (continued)

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

Costs related to repairs and renewals are charged when incurred and included in other operating expenses, unless they qualify for capitalization.

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

Contingencies

Contingent liabilities are not recognised in the statement of financial position but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognised in the statement of financial position but disclosed when an inflow of economic benefits is probable.

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

(Figures in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Fee and commission income

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

- *Fee income earned from services that are provided over a certain period of time*

  Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

- *Fee income from providing transaction services*

  Fees arising from negotiating or participating in the negotiation of a transaction for a third party – such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

Foreign currency translation

The financial statements are presented in Georgian Lari ("GEL"), which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the statement of profit or loss as gains less losses from foreign currencies – translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the Central Bank exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official GEL exchange rates at 31 December 2013 and 2012, were 1.7363 GEL and 1.6567 GEL to 1 USD, respectively.

Standards and interpretations issued but not yet effective

IFRS 9 Financial Instruments

IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but Amendments to IFRS 9 *Mandatory Effective Date of IFRS 9 and Transition Disclosures*, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the IASB is addressing hedge accounting and impairment of financial assets. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Bank's financial assets, but will not have an impact on classification and measurements of the Bank's financial liabilities. The Bank will quantify the effect in conjunction with the other phases, when the final standard including all phases is issued.

(Figures in tables are in thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)

These amendments are effective for annual periods beginning on or after 1 January 2014 provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. It is not expected that this amendment would be relevant to the Bank, since the Bank does not own entities to be qualified as an investment entity under IFRS 10.

IAS 32 Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32

These amendments clarify the meaning of "currently has a legally enforceable right to set-off" and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting. These are effective for annual periods beginning on or after 1 January 2014. These amendments are not expected to be relevant to the Bank.

IFRIC Interpretation 21 Levies (IFRIC 21)

IFRIC 21 clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. IFRIC 21 is effective for annual periods beginning on or after 1 January 2014. The Bank does not expect that IFRIC 21 will have impact on its financial statements.

IAS 39 Novation of Derivatives and Continuation of Hedge Accounting – Amendments to IAS 39

These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. These amendments are effective for annual periods beginning on or after 1 January 2014. The Bank does not expect that this amendment will have impact on its financial statements as it is not involved in derivatives business.

4. Significant accounting judgments and estimates

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgments and estimates are as follows:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 20.

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its experienced judgment to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Due to inexistence of own historical loss experience for loans to customers, the Bank uses industry average loss ratios for collectively assessed loans. The Bank uses its experienced judgment to adjust observable data for a group of loans or receivables to reflect current circumstances.

(Figures in tables are in thousands of Georgian Lari)

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2013	2012
Cash on hand	229	–
Current accounts with the NBG	73	–
Current accounts with other credit institutions	4,123	35,033
Cash and cash equivalents	4,425	**35,033**

As at 31 December 2013 current accounts with other credit institutions, on 99% are denominated in GEL, consist of interest bearing correspondent account balances with two resident banks in the amount of GEL 4,079 thousands and non-interest bearing correspondent account balances with resident and non–resident banks in the amount of GEL 16 thousands and GEL 28 thousands, respectively (31 December 2012: GEL 35,033 thousands interest bearing correspondent account with single resident bank). The interest rate ranges from 0.2% to 3.35% p.a.

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2013	2012
Mandatory reserve with the NBG	1,369	–
Time deposits for more than 90 days	12,766	–
Amounts due from credit institutions	**14,135**	–

Credit institutions are required to maintain a non-interest earning cash deposit with the NBG at the level of 10% and 15% of the average of funds in GEL and foreign currencies, respectively, attracted from customers by the credit institution for the appropriate two-week period. The Bank's ability to withdraw such deposit is significantly restricted by the statutory legislation.

Time deposits comprise of four time deposits placed in GEL with local commercial banks maturing from March to October 2014 and earning interest rate ranging from 4.25% to 11% p.a.

7. Loans to customers

Loans to customers comprise:

	2013	2012
Corporate lending	5,243	–
Gross loans to customers	**5,243**	–
Less: allowance for impairment	(104)	–
Loans to customers	**5,139**	–

Allowance for impairment of loans to customers

A reconciliation of the allowance for impairment of loans to corporate customers is as follows:

	2013
At 17 December 2012 (inception date) and at 1 January 2013	–
Charge for the year	104
At 31 December 2013	**104**
Individual impairment	–
Collective impairment	104
	104

(Figures in tables are in thousands of Georgian Lari)

7. Loans to customers (continued)

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty.

The main types of collateral obtained are as follows:

- Charges over real estate properties, movable properties, inventory and trade receivables;
- Guarantees from the shareholders and affiliates of borrower
- Guarantees from other banks

Two loans with total exposure as at 31 December 2013 of GEL 876 thousands are guaranteed by the Parent.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

Concentration of loans to customers

All loans outstanding as at 31 December 2013 are issued to private companies. As at 31 December 2013, the Bank had a concentration of loans represented by GEL 3,693 thousands due from the three largest borrowers (70% of gross loan portfolio). An allowance of GEL 74 thousands was recognised against these loans.

Loans are to borrowers within Georgia in the following industry sectors:

	2013	2012
Trading enterprises	2,735	–
Agriculture and food processing	1,541	–
Services	619	–
Manufacturing	348	–
	5,243	–

8. Investment securities available-for-sale

Available-for-sale securities comprise:

	2013	2012
Certificates of deposits of the NBG	12,220	–
Available-for-sale securities	**12,220**	–

	2013		2012	
	Nominal Annual Interest Rate	Maturity	Nominal Annual Interest Rate	Maturity
Certificates of deposits of the NBG	3.8% - 4.25%	3-6 Months	–	–

(Figures in tables are in thousands of Georgian Lari)

9. Property and equipment

The movements in property and equipment were as follows:

	Furniture and fixtures	Computers and office equipment	Motor vehicles	Other equipment	Leasehold improvements	Total
Cost						
31 December 2012	–	–	–	–	–	–
Additions	1,767	2,209	116	431	1,908	6,431
31 December 2013	**1,767**	**2,209**	**116**	**431**	**1,908**	**6,431**
Accumulated depreciation						
31 December 2012	–	–	–	–	–	–
Depreciation charge	(269)	(324)	(20)	(54)	(283)	(950)
31 December 2013	**(269)**	**(324)**	**(20)**	**(54)**	**(283)**	**(950)**
Net book value						
31 December 2012	–	–	–	–	–	–
31 December 2013	**1,498**	**1,885**	**96**	**377**	**1,625**	**5,481**

10. Intangible assets

The movements in intangible assets were as follows:

	Licenses	Computer software	Total
Cost			
31 December 2012	–	–	–
Additions	876	232	1,108
31 December 2013	**876**	**232**	**1,108**
Accumulated amortization and impairment			
31 December 2012	–	–	–
Amortisation charge	(58)	(15)	(73)
31 December 2013	**(58)**	**(15)**	**(73)**
Net book value			
31 December 2012	–	–	–
31 December 2013	**818**	**217**	**1,035**

11. Taxation

The corporate income tax expense comprises:

	2013	For the period from 17 December 2012 (inception date) to 31 December 2012
Current tax charge	–	–
Deferred credit – origination and reversal of temporary differences	(98)	–
Income tax expense	**(98)**	–

Georgian legal entities have to file individual corporate income tax declarations. Standard corporate income tax rate comprised 15% for 2013 and 2012. According to the Georgian legislation, revenue from state securities is exempted from taxation.

(Figures in tables are in thousands of Georgian Lari)

11. Taxation (continued)

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2013	For the period from 17 December 2012 (inception date) to 31 December 2012
Loss/income before tax	(2,926)	33
Statutory tax rate	15%	15%
Theoretical income tax benefit/(expense) at the statutory rate	439	(5)
Tax exempt income	45	5
Non-deductible expenditures:		
- representative expenses	(13)	–
- other	(8)	–
Change in unrecognised deferred tax assets	(561)	–
Income tax expense	(98)	–

Deferred tax assets and liabilities as of 31 December and their movements for the respective year comprise:

	2012	In the statement of profit or loss	2013
Tax effect of deductible temporary differences			
Tax losses carried forward	–	561	561
Other liabilities	–	19	19
Gross deferred tax asset	–	580	580
Unrecognised deferred tax asset	–	(561)	(561)
Deferred tax asset	–	19	19
Tax effect of taxable temporary differences			
Property and equipment	–	(100)	(100)
Intangible assets	–	(17)	(17)
Deferred tax liability	–	(117)	(117)
	–		
Deferred tax liability	–	(98)	(98)

The Bank has available GEL 3,737 thousands of taxable losses which can be carried forward for 5 years and will expire in 2018 if not utilized.

(Figures in tables are in thousands of Georgian Lari)

12. Other assets and liabilities

Other assets comprise:

	2013	2012
Other non-financial assets		
Prepaid expenses	198	–
Prepayments for intangible assets	155	–
Prepayments for operating lease	150	–
Prepaid taxes other than income tax	1	–
Other assets	**504**	–

Other liabilities comprise:

	2013	2012
Other financial liabilities		
Payables for professional services	47	–
Accrued expenses	17	–
Operational tax payables	52	–
	116	–
Other non-financial liabilities		
Provision for unused vacation	101	–
Accrued bonuses	99	–
Deferred income	28	–
	228	–
Other liabilities	**344**	–

13. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2013	2012
Time deposits of the Parent in USD	10,054	–
Amounts due to credit institutions	**10,054**	–

Time deposits placed by the Parent are maturing in 2014 and bearing interest rate of 3% p.a.

(Figures in tables are in thousands of Georgian Lari)

14. Amounts due to customers

The amounts due to customers include the following:

	2013	2012
Current accounts	434	–
Amounts due to customers	**434**	**–**

All current accounts outstanding as at 31 December 2013 are amounts due to private enterprises. At 31 December 2013, amounts due to customers of GEL 137 thousands (32%) were due to the single largest customer.

An analysis of customer accounts by economic sector follows:

	2013	2012
Trade	257	–
Agriculture	39	–
Other	138	–
Amounts due to customers	**434**	**–**

15. Equity

The share capital of the Bank was contributed by the Parent in GEL. Each common share owner is entitled to dividends and any capital distribution in GEL.

As at 31 December 2013 and 2012, the Bank's authorized, issued and fully paid capital was GEL 35,000 thousands common shares with nominal value of GEL 1.00 per share. Each share entitles one vote to the shareholder.

In accordance with Georgian legislation, dividends may only be declared by the Parent of the Bank from the net income as shown in the Bank's financial statements prepared in accordance with the NBG requirements. The NBG shall be informed regarding declaration of dividends. The NBG has right to suspend or restrict payment of dividends, if a commercial bank has violated regulatory requirements of the NBG.

No dividends were declared or paid in 2013 and during the period from 17 December 2012 to 31 December 2012.

(Figures in tables are in thousands of Georgian Lari)

16. Commitments and contingencies

Taxation

Applicable taxes in Georgia include corporate income tax (profit tax), individuals' withholding taxes, property tax and value added tax, among others. However, regulations are often unclear or nonexistent and few precedents have been established. This creates tax risks in Georgia, substantially more significant than typically found in countries with more developed tax systems. Management believes that the Bank is in substantial compliance with the tax laws affecting its operations. However, the risk remains that relevant authorities could take differing positions with regard to interpretative issues.

Commitments and contingencies

As at 31 December the Bank's commitments and contingencies comprised the following:

	2013	2012
Credit related commitments		
Undrawn loan commitments	1,537	–
Guarantees	183	–
	1,720	–
Operating lease commitments		
Not later than 1 year	989	–
Later than 1 year but not later than 5 years	412	–
	1,401	–
Capital commitments	**512**	–

17. Net fee and commission income

Net fee and commission income comprises:

	2013	For the period from 17 December 2012 (inception date) to 31 December 2012
Settlements operations	28	–
Currency conversion operations	13	–
Guarantees issued	5	–
Cash collection	1	–
Fee and commission income	**47**	–
Settlements operations	(304)	–
Cash operations	(6)	–
Fee and commission expense	**(310)**	–
Net fee and commission income	**(263)**	–

(Figures in tables are in thousands of Georgian Lari)

18. Personnel and other operating expenses

Personnel and other operating expenses comprise:

	2013	For the period from 17 December 2012 (inception date) to 31 December 2012
Salaries	1,307	–
Bonuses and other employee benefits	405	–
Personnel expenses	**1,712**	–
Operating leases	854	–
Professional services	177	–
Corporate hospitality and entertainment	100	–
Utility expenses	88	–
Marketing and advertising	59	–
Security	53	–
Office supplies	40	–
Insurance	30	–
Business travel and related	29	–
Operating taxes	27	–
Repair and maintenance	12	–
Penalties incurred	10	–
Other	58	–
Other operating expenses	**1,537**	–

19. Risk management

Introduction

Risk is inherent in the Bank's activities and it is managed through a process of ongoing identification, measurement, treatment and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. Regardless of the sophistication of the measures, bank distinguishes between expected and unexpected losses. Expected losses are typically reserved for as described in credit risk policy. For unexpected losses Bank relies on its capital as a buffer to absorb such losses. The Bank is exposed to financial risk, being subdivided into credit and liquidity risk, operational risk and market risk, being subdivided into trading and non-trading risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Risk management structure

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles. The Board of Directors is ultimately responsible for identifying and controlling risks and different departments and committees which are responsible for managing and monitoring risks.

(Figures in tables are in thousands of Georgian Lari)

19. Risk management (continued)

Risk management

The Risk Management Department is responsible for determining, implementing and maintaining risk management framework to ensure an independent control process which is done through two units:

- Credit Risk Assessment Unit, and
- Systemic and Operational Risk Assessment Unit.

Asset and Liability Committee

Asset and Liability Committee (ALCO) is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding, liquidity, interest rate, and capital adequacy risks of the Bank.

Internal Audit

Risk management processes throughout the Bank are audited by the internal audit function on a constant basis, which examines the adequacy of the procedures, their design and operational effectiveness, and the Bank's compliance both with the regulatory requirements and internal procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Audit Committee

The Audit Committee is responsible for the fundamental risk issues and manages and monitors relevant risk decisions and performance of control functions by other departments in the Bank pertaining to general control environment, manual, IT dependent or application controls, intentional or unintentional misstatement risks, risk of fraud or misappropriation of assets, information security, anti-money laundering, etc.

Risk measurement and reporting systems

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept.
The main body to which the risks are reported is ALCO. The respective meetings are held once a month.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

(Figures in tables are in thousands of Georgian Lari)

19. Risk management (continued)

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Credit-related commitments risks

The Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of guarantee. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies. The Bank uses collateral to reduce its credit risks.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank internal credit ratings which are the same as the ones per the regulation of the National Bank of Georgia.

Loans to customers of High grade are those for which the principal and interest are paid in a timely manner and are supported by the sound capital and paying capability of the borrower. This classification is proper when the borrower is financially strong and has sufficient capital to cushion unforeseen adverse impacts, is within its profit targets and produces cash flows sufficient to satisfy a liability on time, including the subject asset. This grade is same as Standard grade per the regulation of the National Bank of Georgia.

Standard grade is assigned to loans when they are adequately protected but potentially weak because while there was to be stable financial condition and paying capability of the borrower at the time of the loan's origination, some deficiencies or trends are now apparent which, if not corrected, might cause concern about the borrower's ability to continue to serve the loan in a timely manner. This grade is same as Watch grade per the regulation of the National Bank of Georgia.

Loans are classified as Sub-standard if they are inadequately protected by the capital and paying capability of the borrower or by the value of any supporting collateral. Sub-standard loan has such weaknesses or problems which jeopardize payments of the indebtedness or makes full repayment questionable. This grade is same as Sub-standard grade per the regulation of the National Bank of Georgia.

All amounts due from credit institutions, corporate lending and investment securities available-for-sale in amounts of GEL 14,135 thousands, GEL 5,244 thousands, and GEL 12,220 thousands respectively are classified in high grade credit ratings.

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

(Figures in tables are in thousands of Georgian Lari)

19. Risk management (continued)

Credit risk (continued)

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to customers that are not individually significant and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Due to the reason that the Bank does not possess own statistical data impairment losses are calculated based on NBG normatives.

Financial guarantees are assessed and provision made in a similar manner as for loans to customers.

The geographical concentration of Bank's monetary assets and liabilities is set out below:

	2013				2012			
	Georgia	**OECD**	**Other Non-OECD**	**Total**	**Georgia**	**OECD**	**Other Non-OECD**	**Total**
Assets								
Cash and cash equivalents	4,397	–	28	4,425	35,033	–	–	35,033
Amounts due from credit institutions	14,135	–	–	14,135	–	–	–	–
Loans to customers	5,139	–	–	5,139	–	–	–	–
Investment securities available-for-sale	12,220	–	–	12,220	–	–	–	–
	35,891	**–**	**28**	**35,919**	**35,033**	**–**	**–**	**35,033**
Liabilities								
Amounts due to credit institutions	–	–	10,054	10,054	–	–	–	–
Amounts due to customers	434	–	–	434	–	–	–	–
Other liabilities	116	–	–	116	–	–	–	–
	550	**–**	**10,054**	**10,604**	**–**	**–**	**–**	**–**
Net assets/(liabilities)	**35,341**	**–**	**(10,026)**	**25,315**	**35,033**	**–**	**–**	**35,033**

(Figures in tables are in thousands of Georgian Lari)

19. Risk management (continued)

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. Funds attracted from the Parent provide sufficient sources for the Bank's operations in the foreseeable future. The Bank manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of state securities that can be pledged to the NBG in the event of an unforeseen interruption of cash flow. In addition, the Bank maintains a cash deposit (obligatory reserve) with the NBG, the amount of which depends on the level of customer funds attracted. The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratios established by the NBG. As at 31 December, these ratios were as follows:

	2013, %	2012, %
LK "Average Liquidity Ratio" (Average volume of liquid assets / Average volume of liabilities)	274.52%	–

Analysis of financial liabilities by remaining contractual maturities

The tables below summarize the maturity profile of the Bank's financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

As at 31 December 2013	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	5,511	4,635	–	–	**10,146**
Amounts due to customers	434	–	–	–	**434**
Other financial liabilities	89	27	–	–	**116**
Total undiscounted financial liabilities	**6,034**	**4,662**	–	–	**10,696**

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
2013	1,537	183	–	–	**1,720**

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than three months in the tables above.

(Figures in tables are in thousands of Georgian Lari)

19. Risk management (continued)

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. Except for the concentrations within foreign currency, the Bank has no significant concentration of market risk.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank has set limits on positions by currency based on the NBG regulations. Positions are monitored on a daily basis. The Bank's exposure to currency risk is minimal as the f in USD are almost fully matched by deposit from the Parent in the same currency.

Prepayment risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate long-term loans when interest rates fall.

The effect on profit before tax for one year, assuming 10% of repayable financial instruments were to prepay at the beginning of the year, with all other variables held constant, is as follows:

	Effect on net interest income	Effect on equity
2013	62	–

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but a control framework and monitoring and responding to potential risks could be effective tools to manage the risks. Controls should include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

(Figures in tables are in thousands of Georgian Lari)

20. Fair value measurements

Fair value hierarchy

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

	Fair value measurement using			
	Level 1	Level 2	Level 3	Total
Assets measured at fair value				
Investment securities available-for-sale	–	–	12,220	**12,220**
Assets for which fair values are disclosed				
Cash and cash equivalents	4,425	–	–	**4,425**
Amounts due from credit institutions	14,135	–	–	**14,135**
Loans to customers	–	–	5,139	**5,139**

	Fair value measurement using			
	Level 1	Level 2	Level 3	Total
Liabilities for which fair values are disclosed				
Amounts due to credit institutions	10,054	–	–	**10,054**
Amounts due to customers	434	–	–	**434**

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2013	Fair value 2013	Unrecognised gain/(loss) 2013	Carrying value 2012	Fair value 2012	Unrecognised gain/(loss) 2012
Financial assets						
Cash and cash equivalents	4,425	4,425	–	35,033	35,033	–
Amounts due from credit institutions	14,135	14,135	–	–	–	–
Loans to customers	5,139	5,139	–	–	–	–
Financial liabilities						
Amounts due to credit institutions	10,054	10,054	–	–	–	–
Amounts due to customers	434	434	–	–	–	–
Total unrecognised change in fair value			–			–

(Figures in tables are in thousands of Georgian Lari)

20. Fair value measurements (continued)

Valuation techniques and assumptions

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. All of the Banks financial assets excluding loans to customers (i.e. cash and cash equivalents, amounts due from credit institutions and investment securities available-for-sale) and financial liabilities (amounts due to customers) are either liquid or are maturing within 3 months from the reporting date.

The fair value of fixed rate financial assets carried at amortised cost (i.e. loans to customers) is estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial assets. The loans to customers were issued within 12 months period ended 31 December 2013 at market interest rates and thus their carrying value approximates their fair value.

Movements in level 3 assets and liabilities at fair value

The following table shows a reconciliation of the opening and closing amount of Level 3 assets which are recorded at fair value:

	At 1 January 2013	Purchases	Interest income	Settlements	At 31 December 2013
Assets					
Investment securities available-for-sale	–	27,333	298	(15,411)	12,220
	–	**27,333**	**298**	**(15,411)**	**12,220**

The following table shows the quantitative information about significant unobservable inputs used in the fair value measurement categorized within Level 3 of the fair value hierarchy:

31 December 2013	Carrying amount	Valuation techniques	Unobservable input	Range of discount rate
Available-for-sale investment securities				
Debt securities	12,220	Discounted cash flow	Discount rate	3.80% - 4.25%

In order to determine reasonably possible alternative assumptions the Bank adjusted the above key unobservable model inputs by increasing and decreasing the discount rate by 10 per cent. The effect on carrying amount of investment securities available for sale was immaterial.

(Figures in tables are in thousands of Georgian Lari)

21. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 19 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2013			2012		
	Within one year	**More than one year**	**Total**	**Within one year**	**More than one year**	**Total**
Cash and cash equivalents	4,425	–	4,425	35,033	–	35,033
Amounts due from credit institutions	14,135	–	14,135	–	–	–
Loans to customers	2,456	2,683	5,139	–	–	–
Investment securities available-for-sale	12,220	–	12,220	–	–	–
Property and equipment	–	5,481	5,481	–	–	–
Intangible assets	–	1,035	1,035	–	–	–
Other assets	199	305	504	–	–	–
Total	**33,435**	**9,504**	**42,939**	**35,033**	**–**	**35,033**
Amounts due to credit institutions	10,054	–	10,054	–	–	–
Amounts due to customers	434	–	434	–	–	–
Deferred income tax liabilities	–	98	98			
Other liabilities	335	9	344	–	–	–
Total	10,823	107	10,930	–	–	–
Net	**22,612**	**9,397**	**32,009**	35,033	–	35,033

22. Related party disclosures

In accordance with IAS 24 *Related Party Disclosures*, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The outstanding balances of related party transactions are as follows:

	2013		2012	
	The Parent	**Key management personnel**	**The Parent**	**Key management personnel**
Cash and cash equivalents	28	–	–	–
Amounts due to credit institutions	10,054	–	–	–
Other liabilities	4	26	–	–

(Figures in tables are in thousands of Georgian Lari)

22. Related party disclosures (continued)

The income and expense arising from related party transactions are as follows:

	For the year ended 31 December	
	2013	2012
	The Parent	The Parent
Fee and commission income	5	–
Interest expense on amounts due to credit institutions	62	–

Other related party transactions carried out during 2013 comprised of purchase of property and equipment and intangible assets from the Parent in the amount of GEL 6,068 thousands and GEL 809 thousands, respectively.

Compensation of key management personnel was comprised of the following:

	2013	2012
Salaries and other short-term benefits	259	–
Total key management personnel compensation	259	–

As at 31 December 2013, other liabilities to key management personnel comprised of accrued bonuses and unpaid vacation of GEL 26 thousand in 2013.

Key management personnel as at 31 December 2013, comprised of 3 members of the Supervisory Board and 3 members of the Management Board of the Bank.

The Bank had no significant transactions with members of the Supervisory Board in 2013.

23. Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the ratios established by NBG in supervising the Bank.

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements set by NBG to safeguard a Bank's ability to continue as a going concern and to maintain sufficient capital base to achieve a capital adequacy ratio of at least 12%. Compliance with capital adequacy ratios set by National Bank of Georgia is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Chairman of the Executive Board and Chief Accountant subsequently submitted to the NBG.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities.

(Figures in tables are in thousands of Georgian Lari)

23. Capital adequacy (continued)

NBG capital adequacy ratio

The NBG requires banks to maintain a capital adequacy ratio of 12% (2012 – 12%) of risk-weighted assets and Tier 1 Capital adequacy ratio of 8% (2012 – 8%). As at 31 December 2013 and 2012, the Bank's capital adequacy ratio on this basis was as follows:

	Notes	2013 Per IFRS	Adjustments	2013 Per NBG
Share capital	15	35,000		
Retained earnings	15	33		
Less: Intangible assets net	10	(1,035)		–
Main capital		**33,998**		**35,000**
Current year loss		(3,024)	94	(2,930)
General reserves	7	104	4	108
Additional capital		**(2,920)**	**98**	**(2,822)**
Less: deductions from capital		–	–	–
Total capital		**31,078**	**98**	**31,176**
Risk weighted assets		**23,949**		**23,949**
Capital adequacy ratio				130%
Tier 1 Capital adequacy ratio				142%

Regulatory capital consists of main capital, which comprises share capital and retained earnings including current year profit. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the NBG. The other component of regulatory capital is Additional capital, which includes subordinated debt and revaluation reserve.