JSC PASHA Bank Georgia

Financial Statements

Year ended 31 December 2014
together with independent auditor's report

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Independent auditors' 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 2014, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year 2014, 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 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 2014, and its financial performance and cash flows for the year 2014 in accordance with International Financial Reporting Standards.

EY Georgia LLC

16 February 2015

STATEMENT OF FINANCIAL POSITION

As at 31 December 2014

(Amounts in tables are in thousands of Georgian lari)

	Notes	2014	2013
Assets			
Cash and cash equivalents	5	7,100	4,425
Amounts due from credit institutions	6	13,700	14,135
Loans to customers	7	51,836	5,139
Investment securities available-for-sale	8	76,219	12,220
Property and equipment	9	4,047	5,481
Intangible assets	10	1,097	1,035
Other assets	11	1,208	504
Total assets		**155,207**	**42,939**
Liabilities			
Amounts due to credit institutions	12	52,982	10,054
Amounts due to customers	13	5,197	434
Deferred income tax liabilities	14	98	98
Other liabilities	11	386	344
Provisions for guarantees and letters of credit		59	–
Total liabilities		**58,722**	**10,930**
Equity			
Share capital	15	103,000	35,000
Accumulated deficit		(6,789)	(2,991)
Other reserves		274	–
Total equity		**96,485**	**32,009**
Total equity and liabilities		**155,207**	**42,939**

Shahin Mammadov Chairman of the Board of Directors

Chingiz Abdullayev Head of Financial Management Department

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JSC PASHA BANK GEORGIA
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16 February 2015

The accompanying selected explanatory notes on pages 6 to 40 are an integral part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2014

(Amounts in tables are in thousands of Georgian lari)

	Notes	2014	2013
Interest income			
Investment securities available-for-sale		3,539	298
Loans to customers		2,837	205
Amounts due from credit institutions		1,376	1,206
		7,752	**1,709**
Interest expense			
Amounts due to credit institutions		(808)	(62)
Amounts due to customers		(92)	(12)
		(900)	**(74)**
Net interest income		**6,852**	**1,635**
Provision for impairment losses on interest bearing assets	7	(295)	(104)
Net interest income after impairment losses		**6,557**	**1,531**
Net gains from foreign currencies:			
- dealing		104	61
- translation differences		(116)	17
Other operating income		303	–
Non-interest income		**291**	**78**
Net fee and commission expense	17	(11)	(93)
Personnel expenses	18	(2,273)	(1,712)
General and administrative expenses	18	(2,891)	(1,707)
Depreciation and amortisation	9,10	(1,707)	(1,023)
Other operating expenses		(505)	–
Provision for impairment losses on guarantees and letters of credit		(59)	–
Loss on initial recognition of financial assets at fair value	7	(3,206)	–
Non-interest expenses		**(10,652)**	**(4,535)**
Loss before income tax expense		**(3,804)**	**(2,926)**
Income tax benefit/(expense)	14	6	(98)
Net loss for the period		**(3,798)**	**(3,024)**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Net unrealized gain on investments securities available for sale		280	–
Income tax effect on net gain on investments available for sale	14	(6)	–
Total comprehensive loss for the year		**(3,524)**	**(3,024)**

The accompanying selected explanatory notes on pages 6 to 40 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2014

(Amounts in tables are in thousands of Georgian lari)

	Share capital	*Retained earnings/ (Accumulated deficit)*	*Other Reserves*	*Total Equity*
1 January 2013	**35,000**	**33**	**–**	**35,033**
Loss for the year	–	(3,024)	–	(3,024)
31 December 2013	**35,000**	**(2,991)**		**32,009**
Loss for the year	–	(3,798)	–	(3,798)
Other comprehensive loss for the year	–	–	274	274
Total comprehensive loss for the year	**–**	**(3,798)**	**274**	**(3,524)**
Issue of share capital (Note 15)	68,000	–	–	68,000
31 December 2014	**103,000**	**(6,789)**	**274**	**96,485**

The accompanying selected explanatory notes on pages 6 to 40 are an integral part of these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2014

(Amounts in tables are in thousands of Georgian lari)

	Notes	*2014*	*2013*
Cash flows from operating activities			
Interest received		4,830	1,496
Interest paid		(716)	(20)
Fees and commissions received		83	76
Fees and commissions paid		(109)	(141)
Realised gains less losses from dealing in foreign currencies		104	61
Personnel expenses paid		(2,432)	(1,489)
General and administrative expenses paid		(2,987)	(1,961)
Other income received		303	–
Cash flows used in operating activities before changes in operating assets and liabilities		**(924)**	**(1,978)**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		300	(14,027)
Loans to customers		(47,999)	(5,211)
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		40,570	10,009
Amounts due to customers		4,684	434
Derivative liabilities		204	
Net cash used in operating activities		**(3,165)**	**(10,773)**
Cash flows from investing activities			
Purchase of investment securities available-for-sale		(83,272)	(27,333)
Proceeds from redemption of investment securities available-for-sale		22,585	15,189
Purchase of property and equipment	9	(137)	(6,431)
Purchase of intangible assets	10,11	(1,300)	(1,264)
Net cash used in investing activities		**(62,124)**	**(19,839)**
Cash flows from financing activities			
Share capital contribution	15	68,000	–
Net cash from financing activities		**68,000**	–
Effect of exchange rates changes on cash and cash equivalents		(36)	4
Net increase/(decrease) in cash and cash equivalents		**2,675**	**(30,608)**
Cash and cash equivalents, beginning	5	**4,425**	**35,033**
Cash and cash equivalents, ending	5	**7,100**	**4,425**

The accompanying selected explanatory notes on pages 6 to 40 are an integral part of these financial statements.

(Amounts 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 2014. The Bank's registered legal address is 15 Rustaveli Avenue, Tbilisi, 0108, Georgia.

As at 31 December 2014, the Bank's 100% owner was OJSC PASHA Bank (the "Parent"), the 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 Georgian Lari ("GEL"), unless otherwise indicated.

Reclassification

The following reclassifications were made to 2013 balances to conform to the 2014 presentation requirements:

Caption	*As previously reported*	*As reclassified*	*Comment*
Other operating expenses	1,537	–	Reclassification from other operating expenses to a separate category, General and administrative expenses
Net fee and commission expenses	263	93	Reclassification of communication expenses and professional fees from fees and commission expenses to General and administrative expenses
General and Administrative expenses	–	1,707	Reclassification from other operating expenses and communication expenses and professions fees from fees and commission expenses to General and administrative expenses

3. Summary of accounting policies

Changes in accounting policies

The Bank has adopted the following amended IFRS and IFRIC which are effective for annual periods beginning on or after 1 January 2014:

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

These amendments 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. This amendment is not relevant to the Bank, since the Bank does not qualify to be 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 amendments had no impact on the Bank's financial position.

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. This IFRIC had no impact on the Bank's financial statements as it has applied the recognition principles under IAS 37 Provisions, Contingent Liabilities and Contingent Assets consistent with the requirements of IFRIC 21 in prior years.

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. This amendment is not relevant to the Bank, since the Bank has not novated its derivatives during the current period.

Recoverable Amount Disclosures for Non-Financial Assets – Amendments to IAS 36

These amendments remove the unintended consequences of IFRS 13 Fair Value Measurement on the disclosures required under IAS 36 Impairment of Assets. In addition, these amendments require disclosure of the recoverable amounts for the assets or cash-generating units (CGUs) for which an impairment loss has been recognised or reversed during the period. These amendments had no impact on the Bank's financial position or performance.

3. Summary of accounting policies (continued)

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.

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.

3. Summary of accounting policies (continued)

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.

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.

Measurement of loans and receivables originated through acquisition

In the case of loans and receivables originated through acquisition the fair value at initial recognition is measured using discounting of future cash flows expected from the financial asset. The difference between the acquisition price and the fair value is recognized in the statement of comprehensive income as gain/(loss) on initial recognition. This policy is applied equally to transactions with third parties, related parties, entities under common control and shareholders.

These loans and receivables are also measured at amortized cost using the effective interest method. Any gain resulting from revision of estimates of the future cash flows is accounted in the statement of comprehensive income within interest income from loans to customers. Any loss resulting from impairment is accounted within the loan loss provision in the statement of comprehensive income.

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.

3. Summary of accounting policies (continued)

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.

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. The right of set-off must not be contingent on a future event and must be legally enforceable in all of the following circumstances:

- the normal course of business;
- the event of default; and
- the event of insolvency or bankruptcy of the entity and all of the counterparties.

These conditions are not generally met in 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.

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

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.Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of industrial average of historical loss experience for assets with credit risk characteristics similar to those in the group, due to the reason that the Bank does not have sufficient statistical data.

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.

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

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

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.

Derivative financial instruments

In the normal course of business, the Bank enters into derivative financial instruments such as currency swaps. These financial instruments are recorded at fair value and the fair values are estimated based on sport market prices, due to short term maturities of the financial instruments. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of comprehensive income as net gains/(losses) from foreign currencies dealing.

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.

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.

3. Summary of accounting policies (continued)

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

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.

3. Summary of accounting policies (continued)

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.

Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognised as additional paid-in capital.

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.

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.

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

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 2014 and 2013 were 1.8636 GEL and 1.7363 GEL to 1 USD, respectively, 2.265 GEL and 2.389 GEL to 1 EUR, respectively and 2.3758 GEL and 2.2133 GEL to 1 AZN, respectively.

3. Summary of accounting policies (continued)

Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements which may have impact on the Bank's financial statements are disclosed below. The Bank intends to adopt this standard, when it becomes effective. Management does not expect application of other new standards and interpretations to have significant impact on financial statements.

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments which reflects all phases of the financial instruments project and replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before 1 February 2015. The adoption of IFRS 9 will have an effect on the classification and measurement of the Bank's financial assets, but no impact on the classification and measurement of the Bank's financial liabilities.

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.

(Amounts in tables are in thousands of Georgian lari)

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2014	*2013*
Cash on hand	487	229
Current accounts with the NBG	68	73
Current accounts with other credit institutions	666	4,123
Time deposits with credit institutions up to 90 days	5,879	–
Cash and cash equivalents	**7,100**	**4,425**

As at 31 December 2014, current accounts and time deposit accounts with credit institutions denominated in GEL represent 26.98% of total current and time deposit accounts (31 December 2013: 98.88%). The outstanding balance of current accounts and time deposits accounts, consist of interest bearing correspondent account balances with resident banks in the amount of GEL 129 thousands and GEL 5,879 thousands respectively (31 December 2013: GEL 4,079 thousands on current accounts) and non-interest bearing correspondent account balances with resident and non-resident banks in the amounts of GEL 150 thousands and GEL 387 thousands, respectively (31 December 2013: GEL 16 thousands and GEL 28 thousands, respectively).

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2014	*2013*
Time deposits for more than 90 days	11,105	12,766
Mandatory reserve with the NBG	2,595	1,369
Amounts due from credit institutions	**13,700**	**14,135**

Time deposits comprise of deposits in GEL and EUR placed with two local commercial banks with maturities ranging from April 2015 to June 2015 and interest rates ranging from 5.50% p.a. to 10.00% p.a. (31 December 2013: 4.25% p.a. to 11.00% p.a.).

Credit institutions are required to maintain a mandatory interest earning cash deposit with the NBG at the level of 10.00% and 15.00% by the legislation of the average of funds attracted from customers by the credit institution for the appropriate two-week period in GEL and foreign currencies, respectively. The Bank's ability to withdraw such deposit is significantly restricted by the statutory legislation.

(Amounts in tables are in thousands of Georgian lari)

7. Loans to customers

Loans to customers comprise:

	2014	*2013*
Legal entities:		
Private entities	32,968	5,243
State controlled entities	19,267	–
Loans to customers	**52,235**	**5,243**
Less – Allowance for impairment	(399)	(104)
Loans to customers	**51,836**	**5,139**

Included in loans to customers is a syndicated loan acquired from the Parent on 5 June 2014. GEL 15,731 thousands was the consideration paid to the Parent at the time of acquisition. The loan was initially recognized at fair value estimated to equal GEL 12,525 thousands. The loss on initial recognition of financial assets of GEL 3,206 thousands was recognized in the statement of comprehensive income for the year ended 31 December 2014.

The movement in allowance for impairment losses for loans to customers was as follows:

	2014		
	Private legal entities	*State controlled entities*	*Total*
At 1 January 2014	**104**	–	**104**
Charge for the year	295	–	295
At 31 December 2014	**399**	–	**399**
Collective impairment	399	–	399

	2013		
	Private legal entities	*State controlled entities*	*Total*
At 1 January 2013	–	–	–
Charge for the year	104	–	104
At 31 December 2013	**104**	–	**104**
Collective impairment	104	–	104

Concentration of loans to customers

As At 31 December 2014, the Bank had a concentration of loans due from three major group of borrowers in the total exposure of GEL 39,116 thousands that represented 74.88% of the total gross loan portfolio (31 December 2013: three loans of GEL 3,693 thousands with 70.44% of the gross loan portfolio). An allowance of GEL 136 thousands was recognized against these loans (31 December 2013: GEL 74 thousands).

(Amounts in tables are in thousands of Georgian lari)

7. Loans to customers (continued)

Loans are made in the following industry sectors:

	2014	*2013*
Trade and services	17,431	3,354
Energy	16,510	–
Transport and telecommunications	13,000	–
Non-banking credit organizations	3,093	–
Manufacturing	333	348
Agriculture and food processing	–	1,541
Other	1,868	–
	52,235	**5,243**

8. Investment securities available-for-sale

As at 31 December 2014, investment securities available-for-sale mainly comprised of debt securities of Ministry of Finance of Georgia, debt securities of National Bank of Georgia and debt securities of Georgian and Azerbaijanian commercial banks and certain unrated Azerbaijanian corporations.

Investment securities available-for-sale comprise:

	2014	*2013*
Treasury bills of the Ministry of Finance of Georgia	53,392	–
Treasury bonds of the Ministry of Finance of Georgia	8,163	–
Bonds of financial institutions	6,197	–
Corporate bonds	4,652	–
Certificates of deposits of financial institutions	3,815	–
Certificates of deposit of the NBG	–	12,220
Investment securities available-for-sale	**76,219**	**12,220**

(Amounts 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 equipment*	*Motor vehicles*	*Other equipment*	*Leasehold improve-ments*	*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**
Additions	51	70	–	16	–	137
31 December 2014	**1,818**	**2,279**	**116**	**447**	**1,908**	**6,568**
Accumulated depreciation:						
31 December 2012	–	–	–	–	–	–
Depreciation charge	(269)	(324)	(20)	(54)	(283)	(950)
31 December 2013	**(269)**	**(324)**	**(20)**	**(54)**	**(283)**	**(950)**
Depreciation charge	(449)	(548)	(29)	(87)	(458)	(1,571)
31 December 2014	**(718)**	**(872)**	**(49)**	**(141)**	**(741)**	**(2,521)**
Net book value:						
31 December 2012	–	–	–	–	–	–
31 December 2013	**1,498**	**1,885**	**96**	**377**	**1,625**	**5,481**
31 December 2014	**1,100**	**1,407**	**67**	**306**	**1,167**	**4,047**

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**
Additions	152	551	703
Disposals and write offs	(592)	(15)	(607)
31 December 2014	**436**	**768**	**1,204**
Accumulated amortization			
31 December 2012	–	–	–
Amortization charge	(58)	(15)	(73)
31 December 2013	**(58)**	**(15)**	**(73)**
Amortisation charge	(101)	(35)	(136)
Disposal and write offs	100	2	102
31 December 2014	**(59)**	**(48)**	**(107)**
Net book value:			
31 December 2012	–	–	–
31 December 2013	**818**	**217**	**1,035**
31 December 2014	**377**	**720**	**1,097**

(Amounts in tables are in thousands of Georgian lari)

11. Other assets and liabilities

Other assets comprise:

	2014	*2013*
Other non-financial assets		
Prepayments for acquisition of intangible assets	752	155
Prepaid expenses	284	198
Prepayments for operating lease	150	150
Prepaid taxes other than on income tax	15	1
Other	7	–
Other assets	**1,208**	**504**

Other liabilities comprise:

	2014	*2013*
Other financial liabilities		
Derivative liabilities	204	–
Other financial liabilities	65	64
	269	**64**
Other non-financial liabilities		
Payable to employees	73	200
Deferred income	24	28
Taxes other than income tax	20	52
	117	**280**
Other liabilities	**386**	**344**

The table below shows the fair values of derivative financial instruments, recorded as liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset or liability and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of the credit risk. There are no derivatives as of 31 December 2013.

	2014	
	Notional amount	*Fair Value liability*
Foreign exchange contracts		
SWAPS – domestic	22,927	204
Total derivative liabilities	**22,927**	**204**

(Amounts in tables are in thousands of Georgian lari)

12. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2014	*2013*
Time deposits of the Parent	43,222	10,054
Time deposits of resident commercial banks	9,318	–
Current accounts of the Parent	442	–
Amounts due to credit institutions	**52,982**	**10,054**

As at 31 December 2014, time deposits placed by four resident commercial banks are denominated in USD and mature in January 2015.

Time deposits placed by the Parent are denominated in EUR and USD and mature in first half of 2015.

13. Amounts due to customers

The amounts due to customers include the following:

	2014	*2013*
Current accounts of customers	1,217	434
Time deposits of customers	3,980	–
Amounts due to customers	**5,197**	**434**

As at 31 December 2014, amounts due to customers included balances with three major customers of GEL 4,819 thousands that constituted 92.72% of the total of customer accounts (31 December 2013: GEL 342 thousands constituting 78.80% of the total amounts due to customers).

An analysis of customer accounts by economic sector follows:

	2014	*2013*
Construction	3,813	–
Trade and services	1,218	257
Other	166	177
Amounts due to customers	**5,197**	**434**

(Amounts in tables are in thousands of Georgian lari)

14. Taxation

The corporate income tax benefit for the year ended 31 December 2014 comprises of deferred tax benefit of GEL 6 thousands (Deferred tax expense year ended 2013: GEL 98 thousands).

The income tax rate applicable to the Bank's income is 15%. The effective income tax rate differs from the statutory income tax rate. A reconciliation of the income tax benefit expense on statutory rates with actual is as follows:

	2014	*2013*
Loss before income tax	(3,804)	(2,926)
Statutory tax rate	15%	15%
Theoretical income tax benefit at the statutory rate	**571**	**439**
Tax exempt income	453	45
Non-deductible expenses	(108)	(21)
Change in unrecognized deferred tax asset	(910)	(561)
Income tax benefit/(expense)	**6**	**(98)**

Deferred tax assets and liabilities as at 31 December 2013 and 31 December 2014 and their movements for the respective period:

	2012	*Through statement of profit and loss*	*2013*	*Through statement of profit and loss*	*Through statement of OCI*	*2014*
Tax effect of deductible temporary differences						
Tax losses carried forward	–	561	561	1,624	–	2,185
Other liabilities	–	19	19	(5)	–	14
Gross deferred tax asset	–	**580**	**580**	**1,619**	–	**2,199**
Unrecognised deferred tax asset	–	(561)	(561)	(910)	–	(1,471)
Deferred tax asset	–	**19**	**19**	**709**	–	**728**
Tax effect of taxable temporary differences						
Property and equipment	–	(100)	(100)	64	–	(36)
Intangible assets	–	(17)	(17)	(5)	–	(22)
Loans to customers	–	–	–	(762)	–	(762)
Investments AFS	–	–	–	–	(6)	(6)
Deferred tax liability	–	**(117)**	**(117)**	**(703)**	**(6)**	**(826)**
Deferred tax liability	–	**(98)**	**(98)**	**6**	**(6)**	**(98)**

The Bank incurred tax losses of GEL 10,830 thousands and GEL 3,737 thousands for 2014 and 2013 which can be carried for 5 years and will expire in 2018 and 2019 respectively if not utilized. Deferred tax assets have not been recognized in respect of part of those losses in amount of GEL 9,807 thousands (2013: GEL 3,737 thousands) as there is uncertainty whether the Bank will be able to generate taxable profit in the future.

(Amounts in tables are in thousands of Georgian lari)

15. Equity

The share capital of the Bank was contributed by the Parent in GEL and they entitle to dividends and any capital distribution in GEL.

On 14 February 2014, the Parent of the Bank on general shareholders meeting decided to increase the Bank's share capital by GEL 68,000 thousands. Increase of capital was paid in on 17 March 2014.

As at 31 December 2014, the Bank's authorized, issued and fully paid capital amounted to GEL 103,000 thousands comprising of 103,000,000 common shares with nominal value of GEL 1.00 (31 December 2013: GEL 35,000 thousands). Each share entitles one vote to the shareholder.

In accordance with Georgian legislation, dividends may only be declared by the Bank's Parent from the net income as shown in the Bank's financial statements prepared in compliance with the NBG requirements. The Bank is obliged to officially inform the NBG of any dividends declared and the NBG reserves the right to suspend or restrict the disbursement of dividends should the Bank be in breach of the NBG regulations.

No dividends were declared or paid during the year ended 31 December 2014 (2013: nil).

Nature and purpose of other reserves

Other reserves record unrealised fair value changes on available-for-sale investments.

16. Commitments and contingencies

Taxation

Georgian tax legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant tax authorities. It is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Management believes that its interpretation of the relevant legislation as at 31 December 2014 is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Commitments and contingencies

As at 31 December 2014, the Bank's commitments and contingencies comprised the following:

	2014	*2013*
Credit related commitments		
Guarantees issued	2,902	183
Letters of credit	559	–
Unused credit lines	463	1,537
	3,924	**1,720**
Operating lease commitments		
Not later than 1 year	1,112	989
More than 1 year but less than 5 years	1,633	412
	2,745	**1,401**
Capital commitments	**108**	**512**

(Amounts in tables are in thousands of Georgian lari)

17. Net fee and commission expense

Net fee and commission expense comprise:

	2014	*2013*
Settlements operations	51	28
Currency conversion operations	29	13
Guarantees issued	11	5
Cash operations	3	1
Fee and commission income	**94**	**47**
Settlements operations	(98)	(134)
Cash operations	(7)	(6)
Fee and commission expense	**(105)**	**(140)**
Net fee and commission expense	**(11)**	**(93)**

18. Personnel, general and administrative expenses

Personnel, general and administrative expenses comprise:

	2014	*2013*
Salaries	2,038	1,307
Bonuses and other employee benefits	235	405
Personnel expenses	**2,273**	**1,712**
Operating leases	1,005	854
Professional services	696	322
Advertising costs	337	59
Communication	124	30
Transportation and business trip expenses	120	29
Corporate hospitality and entertainment	105	100
Utilities	99	88
Personnel training	84	9
Security expenses	58	53
Taxes other than income tax	48	27
Other	215	136
General and administrative expenses	**2,891**	**1,707**

19. Risk management

Introduction

The 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.

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.

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 Credit 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

Audit committee functions are undertaken by the relevant audit committee members of the Parent.
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.

19. Risk management (continued)

Introduction (continued)

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.

During 2014 the Bank was in breach of single borrower exposure ratio set by the NBG. In April 2014, the Bank obtained a breach waiver from the NBG until 31 December 2014. In December 2014 Bank received another breach waiver from the NBG for this covenant until 31 December 2015.

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. 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.

Actual exposure per borrower against limits is monitored on loans granted. The Credit Committee may initiate a change in the limits. Where appropriate, the Bank obtains collateral and corporate guarantees. The credit risks are monitored on a continuous basis and are subject to annual or more frequent reviews.

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.

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank internal credit review process.

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.

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.

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.

		Neither past due nor impaired		
	Notes	*High grade 2014*	*Sub-standard grade 2014*	*Total 2014*
Amounts due from credit institutions	6	13,700	–	**13,700**
Loans to customers, gross	7	39,235	13,000	**52,235**
Investment securities available-for-sale	8	76,219	–	**76,219**
Total		**129,154**	**13,000**	**142,154**

		Neither past due nor impaired		
	Notes	*High grade 2013*	*Sub-standard grade 2014*	*Total 2013*
Amounts due from credit institutions	6	14,135	–	**14,135**
Loans to customers, gross	7	5,243	–	**5,243**
Investment securities available-for-sale	8	12,220	–	**12,220**
Total		**31,598**	–	**31,598**

19. Risk management (continued)

Credit risk (continued)

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 30 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.

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. Zero collective assessment rates is applied for the loan exposures towards legal entities owned by high credit rated foreign government.

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 industrial average.

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

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Credit risk (continued)

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

	2014				2013			
	Georgia	*OECD*	*Other Non-OECD*	*Total*	*Georgia*	*OECD*	*Other Non-OECD*	*Total*
Assets								
Cash and cash equivalents	6,713	185	202	7,100	4,397	–	28	4,425
Amounts due from credit institutions	4,636	–	9,064	13,700	14,135	–	–	14,135
Loans to customers	51,836	–	–	51,836	5,139	–	–	5,139
Investment securities available-for-sale	65,369	–	10,850	76,219	12,220	–	–	12,220
	128,554	185	20,116	148,855	35,891	–	28	35,919
Liabilities								
Amounts due to credit institutions	9,318	–	43,664	52,982	–	–	10,054	10,054
Amounts due to customers	5,197	–	–	5,197	434	–	–	434
Other liabilities	266	3	–	269	64	–	–	64
	14,781	3	43,664	58,448	498	–	10,054	10,552
Net assets/(liabilities)	113,773	182	(23,548)	90,407	35,393	–	(10,026)	25,367

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:

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Liquidity risk and funding management (continued)

	2014 %	*2013* %
LK "Average Liquidity Ratio" (Average volume of liquid assets / Average volume of liabilities)	102.66%	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 2014	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to credit institutions	38,215	15,092	–	–	**53,307**
Amounts due to customers	4,864	347	–	–	**5,211**
Other financial liabilities	269	–	–	–	**269**
Total undiscounted financial liabilities	**43,348**	**15,439**	–	–	**58,787**

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	64	–	–	–	**64**
Total undiscounted financial liabilities	**6,009**	**4,635**	–	–	**10,644**

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*
2014	189	1,499	2,236	–	**3,924**

	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.

(Amounts 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.

Currency	*change in currency rate in % 2014*	*Effect on profit before tax 2014*	*change in currency rate in % 2013*	*Effect on profit before tax 2013*
USD	1%/(1%)	(107)/107	1%/(1%)	1/(1)
AZN	1%/(1%)	108/(108)	–	–

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.

The effect on profit before tax for one year and on equity, 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
2014	589
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.

(Amounts 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			
At 31 December 2014	*Level 1*	*Level 2*	*Level 3*	*Total*
Assets measured at fair value				
Investment securities available-for-sale	10,849	–	65,370	**76,219**
Assets for which fair values are disclosed				
Cash and cash equivalents	7,100	–	–	**7,100**
Amounts due from credit institutions	–	–	13,700	**13,700**
Loans to customers	–	–	51,836	**51,836**

	Fair value measurement using			
At 31 December 2014	*Level 1*	*Level 2*	*Level 3*	*Total*
Liabilities measured at fair value				
Other liabilities - derivative financial liabilities	–	204	–	**204**
Liabilities for which fair values are disclosed				
Amounts due to credit institutions	–	–	52,982	**52,982**
Amounts due to customers	–	–	5,197	**5,197**

	Fair value measurement using			
At 31 December 2013	*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			
At 31 December 2013	*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**

(Amounts in tables are in thousands of Georgian lari)

20. Fair value measurements (continued)

Fair value hierarchy (continued)

Following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Bank's estimate of assumptions that a market participant would make when valuing the instruments.

Derivative financial instruments

Derivative financial instruments valued using a valuation technique with market observable inputs are currency swaps. The fair values of derivative financial instruments are estimated based on sport market prices, due to short term maturities of the financial instruments

Investment securities available-for-sale

Investment securities available-for-sale valued using a valuation technique consist of unquoted debt securities. The fair value of these securities are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

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 2014	*Fair value 2014*	*Unrecognised gain/(loss) 2014*	*Carrying value 2013*	*Fair value 2013*	*Unrecognised gain/(loss) 2013*
Financial assets						
Cash and cash equivalents	7,100	7,100	–	4,425	4,425	–
Amounts due from credit institutions	13,700	13,700	–	14,135	14,135	–
Loans to customers	51,836	51,836	–	5,139	5,139	–
Financial liabilities						
Amounts due to credit institutions	52,982	52,982	–	10,054	10,054	–
Amounts due to customers	5,197	5,197	–	434	434	–
Total unrecognised change in fair value			–			–

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 and amounts due from credit institutions) and financial liabilities (amounts due to customers) are either liquid or are maturing within 3 months from the reporting date.

(Amounts in tables are in thousands of Georgian lari)

20. Fair value measurements (continued)

Valuation techniques and assumptions (continued)

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 2014 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 2014	*Purchases*	*Interest income*	*Gain recorded in OCI*	*Settlements*	*At 31 December 2014*
Assets						
Investment securities available-for-sale	12,220	72,670	3,366	245	(23,131)	65,370
	12,220	**72,670**	**3,366**	**245**	**(23,131)**	**65,370**

	At 1 January 2013	*Purchases*	*Interest income*	*Gain recorded in OCI*	*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 2014	*Carrying amount*	*Valuation techniques*	*Unobservable input*	*Range of discount rate*
Available-for-sale investment securities				
Treasury bills of the Ministry of Finance of Georgia	53,392	Discounted cash flow	Discount rate	4.59% - 5.34%
Government coupon bonds of the Ministry of Finance of Georgia	8,163	Discounted cash flow	Discount rate	6.47%
Corporate deposit certificates	3,815	Discounted cash flow	Discount rate	5.25%

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%. The effect on carrying amount of investment securities available for sale was immaterial.

(Amounts 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.

	2014			*2013*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	7,100	–	7,100	4,425	–	4,425
Amounts due from credit institutions	13,700	–	13,700	14,135	–	14,135
Loans to customers	24,883	26,953	51,836	2,456	2,683	5,139
Investment securities available-for-sale	58,394	17,825	76,219	12,220	–	12,220
Property and equipment	–	4,047	4,047	–	5,481	5,481
Intangible assets	–	1,097	1,097	–	1,035	1,035
Other assets	1,189	19	1,208	199	305	504
Total	**105,266**	**49,941**	**155,207**	**33,435**	**9,504**	**42,939**
Amounts due to credit institutions	52,982	–	52,982	10,054	–	10,054
Amounts due to customers	5,197	–	5,197	434	–	434
Deferred income tax liabilities	–	98	98	–	98	98
Other liabilities	364	22	386	335	9	344
Provisions	18	41	59	–	–	–
Total	**58,561**	**161**	**58,722**	**10,823**	**107**	**10,930**
Net	**46,705**	**49,780**	**96,485**	**22,612**	**9,397**	**32,009**

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:

	2014		*2013*	
	The Parent	*Key management personnel*	*The Parent*	*Key management personnel*
Cash and cash equivalents	202	–	28	–
Amounts due to credit institutions	(43,664)	–	(10,054)	–
Other liabilities	(7)	(3)	(4)	(26)

(Amounts 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:

	2014	*2013*
	The Parent	*The Parent*
Fee and commission income	8	5
Fee and commission expense	23	–
Interest expense on amounts due to credit institutions	526	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.

As of 31 December 2014 included in loans to customers is a syndicated loan acquired from the Parent on 5 June 2014. GEL 15,731 thousands was the consideration paid to the Parent at the time of acquisition. The loan was initially recognized at fair value estimated to equal GEL 12,525 thousands. The loss on initial recognition of financial assets of GEL 3,206 thousands was recognized in the statement of comprehensive income for the year ended 31 December 2014

Compensation of key management personnel was comprised of the following:

	2014	*2013*
Salaries and other short-term benefits	407	259

Key management personnel as at 31 December 2014 and 31 December 2013, comprised of 3 members of the Supervisory Board and 3 members of the Board of Directors of the Bank.

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 the 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 the NBG to safeguard the 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 the NBG is monitored monthly with reports outlining their calculation reviewed and signed by the Chief Accountant and 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.

(Amounts 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% of risk-weighted assets and Tier 1 Capital adequacy ratio of 8%. As at 31 December 2014 and as at 31 December 2013, the Bank's capital adequacy ratios on this basis were as follows:

	Notes	*31 December 2014*	*Adjustments*	*31 December 2014 Per the NBG*
Share capital	15	103,000	–	103,000
Prior years accumulated deficit		(2,991)	94	(2,897)
Less: Intangible assets, net	10	(1,097)	–	(1,097)
Main capital		**98,912**	**94**	**99,006**
Current year loss		(3,798)	(5,157)	(8,955)
General reserves		458	394	852
Additional capital		**(3,340)**	**(4,763)**	**(8,103)**
Less: deductions from capital		–	–	–
Total capital		**95,572**	**(4,669)**	**90,903**
Risk weighted assets				**139,366**
Capital adequacy ratio				65.23%
Tier 1 Capital adequacy ratio				71.04%

	Notes	*31 December 2013*	*Adjustments*	*31 December 2013 Per the NBG*
Share capital	15	35,000	–	35,000
Prior years accumulated deficit		33	–	33
Less: Intangible assets, net	10	(1,035)		(1,035)
Main capital		**33,998**	–	**33,998**
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**
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.

(Amounts in tables are in thousands of Georgian lari)

23. Capital adequacy (continued)

NBG capital adequacy ratio (continued)

Starting from 30 June 2014 the NBG requires that all banks comply with Basel II regulations in their capital adequacy assessment. This implies the minimum ratio of 10.50% for total regulatory capital coefficient, minimum 7.00% of the core Tier 1 capital coefficient and minimum 8.50 % for Tier 1 capital coefficient. As at 31 December 2014, the Bank's capital adequacy ratios on the Basel II basis were as follows:

	Notes	*31 December 2014*	*Adjustments*	*31 December 2014 Per the NBG*
Additional tier 1 capital	15	103,000	–	103,000
Prior years accumulated deficit		(2,991)	94	(2,897)
Less: Intangible assets, net	10	(1,097)	–	(1,097)
Current year loss		(3,798)	(5,157)	(8,955)
Core tier 1 capital		**95,114**	**(5,063)**	**90,051**
Tier 1 capital		**95,114**	**(5,063)**	**90,051**
Supplementary capital		458	394	852
Total regulatory capital		**95,572**	**(4,669)**	**90,903**
Risk weighted assets				**127,699**
Capital adequacy ratio				71.19%
Core Tier 1 capital/Tier 1 capital adequacy ratio				70.52%