JSC PASHA Bank Georgia

Financial statements

Year ended 31 December 2016
together with independent auditor's report

Contents

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Independent auditor's report

To the Shareholders and Board of Directors of JSC Pasha Bank Georgia

Opinion

We have audited the financial statements of JSC Pasha Bank Georgia (the "Bank"), which comprise the statement of financial position as at 31 December 2016, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2016 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants (IESBA Code)*, and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of management and the audit committee for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, 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.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

The audit committee is responsible for overseeing the Bank's financial reporting process.

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Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

Ruslan Khoroshvili
On behalf of EY Georgia LLC
10 March 2017

STATEMENT OF FINANCIAL POSITION

As at 31 December 2016

(Amounts in tables are in thousands of Georgian lari)

	Notes	2016	2015
Assets			
Cash and cash equivalents	5	7,599	22,282
Amounts due from credit institutions	6	83,261	21,152
Loans to customers	7	95,090	108,602
Investment securities	8	91,880	123,320
Property and equipment	9	1,108	2,689
Intangible assets	10	2,060	2,024
Deferred income tax assets	14	924	1,522
Other assets	11	563	719
Total assets		**282,485**	**282,310**
Liabilities			
Amounts due to credit institutions	12	131,681	161,929
Amounts due to customers	13	46,024	21,288
Provisions for guarantees and letters of credit		85	–
Other liabilities	11	1,411	912
Total liabilities		**179,201**	**184,129**
Equity			
Share capital	15	103,000	103,000
Retained earnings/(accumulated deficit)		354	(4,527)
Other reserves		(70)	(292)
Total equity		**103,284**	**98,181**
Total equity and liabilities		**282,485**	**282,310**

Signed on behalf of the Board of Directors of the Bank on 10 March 2017:

Shahin Mammadov — Chairman of the Board of Directors

Chingiz Abdullayev — Chief Financial Officer, Member of the Board of Directors

The accompanying selected explanatory notes on pages 7 to 42 are an integral part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2016

(Amounts in tables are in thousands of Georgian lari)

	Notes	2016	2015
Interest income			
Loans to customers		12,785	9,864
Investment securities		8,382	7,859
Amounts due from credit institutions		2,153	1,322
		23,320	**19,045**
Interest expense			
Amounts due to credit institutions		(5,949)	(5,741)
Amounts due to customers		(784)	(168)
		(6,733)	**(5,909)**
Net interest income		**16,587**	**13,136**
Provision for impairment losses on interest bearing assets	7, 8	(1,010)	(3,541)
Net interest income after impairment losses		**15,577**	**9,595**
Net gains/(losses) from foreign currencies			
- dealing		1,146	294
- translation differences		(199)	300
Net fee and commission income	17	244	307
Other operating income		387	117
Non-interest income		**1,578**	**1,018**
Personnel expenses	18	(5,183)	(4,489)
General and administrative expenses	18	(4,309)	(3,721)
Depreciation and amortisation	9, 10	(2,098)	(1,824)
(Provision)/reversal of provision for impairment losses on guarantees and letters of credit	16	(85)	59
Non-interest expenses		**(11,675)**	**(9,975)**
Profit before income tax		**5,480**	**638**
Income tax (expense)/benefit	14	(599)	1,624
Net profit for the period		**4,881**	**2,262**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Net unrealized gain/(loss) on investments securities available for sale		221	(562)
Income tax effect on net gain/(loss) on investments available for sale	14	1	(4)
Total comprehensive profit for the year		**5,103**	**1,696**

The accompanying selected explanatory notes on pages 7 to 42 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2016

(Amounts in tables are in thousands of Georgian lari)

	Share capital	Retained earnings/ (accumulated deficit)	Other reserves	Total equity
1 January 2015	**103,000**	**(6,789)**	**274**	**96,485**
Profit for the year	–	2,262	–	2,262
Other comprehensive loss for the year	–	–	(566)	(566)
Total comprehensive income for the year	**–**	**2,262**	**(566)**	**1,696**
31 December 2015	**103,000**	**(4,527)**	**(292)**	**98,181**
Profit for the year	–	4,881	–	**4,881**
Other comprehensive income for the year	–	–	222	**222**
Total comprehensive income for the year	**–**	**4,881**	**222**	**5,103**
31 December 2016	**103,000**	**354**	**(70)**	**103,284**

The accompanying selected explanatory notes on pages 7 to 42 are an integral part of these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2016

(Amounts in tables are in thousands of Georgian lari)

	Notes	2016	2015
Cash flows from operating activities			
Interest received		21,074	18,975
Interest paid		(6,522)	(5,680)
Fees and commissions received		591	561
Fees and commissions paid		(342)	(134)
Realised gains less losses from dealing in foreign currencies		1,146	294
Personnel expenses paid		(4,813)	(3,782)
General and administrative expenses paid		(4,205)	(4,037)
Other income received		387	117
Cash flows from operating activities before changes in operating assets and liabilities		**7,316**	**6,314**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		(49,840)	(2,470)
Loans to customers		16,233	(48,635)
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		(46,506)	94,544
Amounts due to customers		22,243	14,837
Other liabilities		–	(204)
Net cash (used in)/from operating activities		**(50,554)**	**64,386**
Cash flows from investing activities			
Purchase of investment securities		(40,151)	(139,946)
Proceeds from redemption of investment securities		74,994	90,432
Purchase of property and equipment		(118)	(280)
Purchase of intangible assets		(308)	(466)
Net cash from/(used in) investing activities		**34,417**	**(50,260)**
Effect of exchange rates changes on cash and cash equivalents		1,454	1,056
Net (decrease)/increase in cash and cash equivalents		**(14,683)**	**15,182**
Cash and cash equivalents, beginning	5	**22,282**	**7,100**
Cash and cash equivalents, ending	5	**7,599**	**22,282**

(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 2016. The Bank's registered legal address is 15 Rustaveli Avenue, Tbilisi, 0108, Georgia.

As at 31 December 2016 and 2015, 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.

These financial statements have not yet been approved by the Parent on the General Meeting of Shareholders of the Bank. The shareholders have the power and authority to amend the financial statements after the issuance.

2. Basis of preparation

General

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

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 2016:

Amendments to IAS 1 Disclosure Initiative

The amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify:

- The materiality requirements in IAS 1;
- That specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated;
- That entities have flexibility as to the order in which they present the notes to financial statements;
- That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and OCI. These amendments are effective for annual periods beginning on or after 1 January 2016. These amendments do not have any impact on the Bank.

IFRS 7 Financial Instruments: Disclosures

The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7 in order to assess whether the disclosures are required. The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendments.

Fair value measurement

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.

(Amounts in tables are in thousands of Georgian lari)

3. Summary of accounting policies (continued)

Fair value measurement (continued)

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.

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. Loans and receivables include investment securities and loans to customers.

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.

3. Summary of accounting policies (continued)

Financial assets (continued)

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.

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 if 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, investment securities: loans and receivables and loans to customers

For amounts due from credit institutions, investment securities: loans and receivables 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.

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

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. 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.

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.

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 (applicable to undistributed profits) and tax laws, that have been enacted or substantively enacted by the end of the reporting period.

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
Furniture and fixtures	4
Computers and equipment	4
Motor vehicles	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 NBG 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 2016 and 2015 were 2.6468 GEL and 2.3949 GEL to 1 USD, respectively, 2.7940 GEL and 2.6169 GEL to 1 EUR, respectively and 1.4678 GEL and 1.5374 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.

From a classification and measurement perspective, the new standard will require all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics. The IAS 39 measurement categories will be replaced by: fair value through profit or loss (FVPL), fair value through other comprehensive income (FVOCI), and amortised cost categories. IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortised cost or FVOCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement. The accounting for financial liabilities will largely be the same as the requirements of IAS 39.

IFRS 9 will also fundamentally change the approach to loan impairment. The standard will replace IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. The Bank will be required to record an allowance for expected losses for all loans and other debt financial assets not carried at FVPL, as well as for loan commitments and financial guarantee contracts. The allowance is based on the expected credit losses associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case the allowance would be based on the probability of default over the life of the asset.

IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but restatement of comparative information is not required; the effect on the transition date – 1 January 2018 – would be recorded in retained earnings. The adoption of IFRS 9 is expected to 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. The Bank does not expect a significant impact on its equity due to adoption of IFRS 9 impairment requirements, but it will need to perform a more detailed analysis which considers all reasonable and supportable information, including forward-looking elements to determine the extent of the impact.

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

IFRS 15 Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*, effective for periods beginning on 1 January 2018 with early adoption permitted. IFRS 15 defines principles for recognising revenue and will be applicable to all contracts with customers. However, interest and fee income integral to financial instruments and leases will continue to fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (e.g., IFRS 9, and IFRS 16 *Leases*).

Revenue under IFRS 15 will need to be recognised as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard will also specify a comprehensive set of disclosure requirements regarding the nature, extent and timing as well as any uncertainty of revenue and corresponding cash flows with customers.

The Bank does not anticipate early adopting IFRS 15.

IFRS 16 Leases

The IASB issued the new standard for accounting for leases – IFRS 16 *Leases* in January 2016. The new standard does not significantly change the accounting for leases for lessors. However, it does require lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right of-use assets. Lessees must apply a single model for all recognised leases, but will have the option not to recognise 'short-term' leases and leases of 'low-value' assets. Generally, the profit or loss recognition pattern for recognised leases will be similar to today's finance lease accounting, with interest and depreciation expense recognised separately in the statement of profit or loss.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted provided the new revenue standard, IFRS 15, is applied on the same date.

Amendments to IAS 12 Income Taxes

In January 2016, through issuing amendments to IAS 12, the IASB clarified the accounting treatment of deferred tax assets of debt instruments measured at fair value for accounting, but measured at cost for tax purposes. The Bank does not anticipate that adopting the amendments would have a material impact on its financial statements.

Amendments to IAS 7 Statement of Cash Flows

In January 2016, the IASB issued amendments to IAS 7 *Statement of Cash Flows* with the intention to improve disclosures of financing activities and help users to better understand the reporting entities' liquidity positions. Under the new requirements, entities will need to disclose changes in their financial liabilities as a result of financing activities such as changes from cash flows and non-cash items (e.g., gains and losses due to foreign currency movements). The amendment is effective from 1 January 2017. The Bank is currently evaluating the impact.

(Amounts in tables are in thousands of Georgian lari)

4. Significant accounting judgments and estimates

Estimation uncertainty

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:

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. As at 31 December 2015 total loan portfolio was assessed on collective basis (Note 7). Due to inexistence of own historical loss experience for loans to customers, the Bank used industry average loss ratios for collectively assessed loans. During 2016 the Bank adopted new methodology on financial assets impairment, which was applied to calculate allowances for loans to customer and investment securities as at 31 December 2016. The new methodology is based on loan default probability assessments. The amount of allowance for loans to customers and investment securities recognized in statement of financial position at 31 December 2016 was GEL 2,120 thousand (2015: GEL thousand 1,311) and GEL 201 thousand (2015: nil) respectively. The effect on net income from the application of the new methodology has been estimated by the Bank as additional GEL 303 thousand of impairment charge.

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.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2016	2015
Cash on hand	656	406
Current accounts with the NBG	665	922
Current accounts with other credit institutions	3,778	2,159
Time deposits with credit institutions up to 90 days	2,500	18,795
Cash and cash equivalents	**7,599**	**22,282**

As at 31 December 2016, current accounts and time deposit accounts with credit institutions denominated in GEL represent 46.03% of total current and time deposit accounts (31 December 2015: 2.00%). The outstanding balance of current accounts with credit institutions and time deposit accounts, consist of interest bearing correspondent account balances with resident banks in the amount of GEL 447 thousand and GEL 2,500 thousand, respectively (31 December 2015: GEL 987 thousand and GEL 18,795 thousand, respectively) and non-interest bearing correspondent account balances with resident and non-resident banks in the amounts of GEL 896 thousand and GEL 2,435 thousand, respectively (31 December 2015: GEL 1,140 thousand and GEL 32 thousand, respectively).

(Amounts in tables are in thousands of Georgian lari)

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2016	2015
Time deposits for more than 90 days	52,576	8,542
Mandatory reserve with the NBG	30,685	12,610
Amounts due from credit institutions	**83,261**	**21,152**

Credit institutions are required to maintain a mandatory interest earning cash deposit with the NBG at the level of 7% and 20% of the average of funds attracted from customers by a credit institution for the appropriate two-week period in GEL and foreign currencies, respectively, since June 2016 (31 December 2015: 10% and 15% respectively).

Time deposits comprise of deposits in USD and GEL placed with resident and non-resident commercial banks with maturities ranging from February 2017 to December 2017 and interest rates of 4.0%-5.5% on GEL deposits and 6.5%-7.2% on USD deposits (31 December 2015: deposits in USD placed with one local commercial bank with maturities ranging from February 2016 to March 2016 and interest rate of 5.5%).

7. Loans to customers

Loans to customers comprise:

	2016	2015
Private entities	66,767	70,651
Foreign state controlled entities	30,129	36,347
Individuals	314	2,915
Loans to customers	**97,210**	**109,913**
Less – allowance for impairment	(2,120)	(1,311)
Loans to customers	**95,090**	**108,602**

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

	2016		
	Legal entities	**Individuals**	**Total**
At 1 January 2016	**1,253**	**58**	**1,311**
Charge for the year	796	13	809
At 31 December 2016	**2,049**	**71**	**2,120**
Collective impairment	1,204	5	1,209
Individual impairment	845	66	911
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	8,788	66	8,854

(Amounts in tables are in thousands of Georgian lari)

7. Loans to customers (continued)

	2015		
	Legal entities	**Individuals**	**Total**
At 1 January 2015	**399**	**–**	**399**
Charge for the year	3,483	58	3,541
Write-off	(2,629)	–	(2,629)
At 31 December 2015	**1,253**	**58**	**1,311**
Collective impairment	1,253	58	1,311

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters. The main types of collateral obtained are charges over real estate properties and guarantees from the Parent. The Bank also obtains guarantees from parent companies for loans to their subsidiaries.

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

As at 31 December 2016, the Bank had a concentration of loans due from three major group of borrowers in the total exposure of GEL 53,847 thousand that represented 55.39% of the total gross loan portfolio (31 December 2015: three loans of GEL 63,039 thousand with 57.35% of the gross loan portfolio). An allowance of GEL 467 thousand (31 December 2015: 374) was recognised against these loans. Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2016, comprised GEL 846 thousand, (2015: nil).

Loans are made in the following industry sectors:

	2016	**2015**
Trade and services	48,881	61,775
Non-banking credit organizations	20,664	13,214
Energy	14,929	24,833
Construction	8,778	7,176
Mining	3,644	–
Individuals	314	2,915
	97,210	**109,913**

(Amounts in tables are in thousands of Georgian lari)

8. Investment securities

As at 31 December 2016, investment securities comprised of debt securities of the Ministry of Finance of Georgia, debt securities of the National Bank of Georgia and debt securities of companies and commercial banks registered in Georgia and Azerbaijan.

Investment securities comprise:

	2016	2015
Investment securities: loans and receivables		
Treasury bonds of the Ministry of Finance of Georgia	31,028	38,718
Certificates of deposit of financial institutions	26,543	12,204
Bonds of financial institutions	21,541	24,652
Corporate bonds	12,969	8,892
Treasury bills of the Ministry of Finance of Georgia	–	23,528
Certificates of deposit of the NBG	–	15,326
Investment securities: loans and receivables	**92,081**	**123,320**
Less: allowance for impairment (a)	(201)	–
Total investment securities: loans and receivables	**91,880**	**123,320**

(a) The allowance for the impairment relates to the collectively impaired exposures of corporate bonds.

On 1 July 2015 the Bank's Asset and Liability Committee (ALCO) decided to reclassify all of the Bank's investment securities from the available-for-sale category into category of loans and receivables. The Bank assessed that based on the changing market conditions it is not intending to sell the securities in future and will hold them till their contractual maturities. The fair value of available-for-sale securities at the date of reclassification was GEL 94,516 thousand.

As at 31 December 2016 the carrying value and the fair value of the investment securities reclassified from the available-for-sale category into category of loans and receivables on 1 July was GEL 50,866 thousand and GEL 53,324 thousand respectively (31 December 2015: carrying value of GEL 97,121 thousand and fair value of GEL 96,321 thousand).

(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						
1 January 2015	**1,818**	**2,279**	**116**	**447**	**1,908**	**6,568**
Additions	22	111	131	12	4	280
31 December 2015	**1,840**	**2,390**	**247**	**459**	**1,912**	**6,848**
Additions	3	37	66	27	–	133
Disposals	–	(15)	–	–	–	(15)
31 December 2016	**1,843**	**2,412**	**313**	**486**	**1,912**	**6,966**
Accumulated depreciation						
1 January 2015	**(718)**	**(872)**	**(49)**	**(141)**	**(741)**	**(2,521)**
Depreciation charge	(455)	(575)	(59)	(91)	(458)	(1,638)
31 December 2015	**(1,173)**	**(1,447)**	**(108)**	**(232)**	**(1,199)**	**(4,159)**
Depreciation charge	(461)	(616)	(77)	(95)	(461)	(1,710)
Disposal charge	–	11	–	–	–	11
31 December 2016	**(1,634)**	**(2,052)**	**(185)**	**(327)**	**(1,660)**	**(5,858)**
Net book value						
1 January 2015	**1,100**	**1,407**	**67**	**306**	**1,167**	**4,047**
31 December 2015	**667**	**943**	**139**	**227**	**713**	**2,689**
31 December 2016	**209**	**360**	**128**	**159**	**252**	**1,108**

(Amounts in tables are in thousands of Georgian lari)

10. Intangible assets

The movements in intangible assets were as follows:

	Licenses	Computer software	Total
Cost			
1 January 2015	**436**	**768**	**1,204**
Additions	54	1,061	1,115
Disposals and write offs	(2)	–	(2)
31 December 2015	**488**	**1,829**	**2,317**
Additions	425	90	515
Disposals and write offs	(16)	(90)	(106)
31 December 2016	**897**	**1,829**	**2,726**
Accumulated amortization			
1 January 2015	**(59)**	**(48)**	**(107)**
Amortization charge	(49)	(137)	(186)
31 December 2015	**(108)**	**(185)**	**(293)**
Amortisation charge	(214)	(174)	(388)
Disposals and write offs	14	1	15
31 December 2016	**(308)**	**(358)**	**(666)**
Net book value			
1 January 2015	**377**	**720**	**1,097**
31 December 2015	**380**	**1,644**	**2,024**
31 December 2016	**589**	**1,471**	**2,060**

11. Other assets and liabilities

Other assets comprise:

	2016	2015
Other non-financial assets		
Prepaid expenses	365	432
Prepayments for operating lease	170	150
Prepaid taxes other than income tax	16	20
Prepayments for acquisition of intangible assets	4	106
Other	8	11
Other assets	**563**	**719**

Other liabilities comprise:

	2016	2015
Other financial liabilities		
Other financial liabilities	223	95
	223	**95**
Other non-financial liabilities		
Payable to employees	1,150	780
Deferred income	38	35
Taxes other than income tax	–	2
	1,188	**817**
Other liabilities	**1,411**	**912**

(Amounts in tables are in thousands of Georgian lari)

12. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2016	2015
Time deposits of non-resident commercial banks	39,956	4,793
Time deposits of the Parent	37,617	64,086
Short-term loan from the NBG	28,030	69,700
Time deposits of resident commercial banks	14,478	15,706
Current accounts of the Parent	8,597	1,247
Overdraft from the Parent	3,003	6,397
Amounts due to credit institutions	**131,681**	**161,929**

As at 31 December 2016 the time deposits of non-resident commercial banks are comprised of USD denominated deposits of an entity under common control (2015: one USD denominated deposit of a non-resident bank). As at 31 December 2016 time deposits placed by four resident commercial banks are denominated in GEL and USD, bear interest rates ranging from 6.50% to 6.75% in GEL and from 1.60% to 2.50% in USD and mature in January 2017.

13. Amounts due to customers

The amounts due to customers include the following:

	2016	2015
Time deposits	33,492	11,149
Current accounts	12,532	10,139
Amounts due to customers	**46,024**	**21,288**
Held as security against guarantees issued (Note 16)	757	10,497

As at 31 December 2016, amounts due to customers included balances with three major customers of GEL 27,561 thousand that constituted 59.88% of the total of customer accounts (31 December 2015: 13,984 thousand that constituted 65.69% of the total of customer accounts).

An analysis of customer accounts by economic sector follows:

	2016	2015
Construction	21,071	10,893
Individuals	13,356	23
Trade and services	6,499	4,569
Insurance	4,491	–
Pharmacy	314	–
Energy	256	235
Non-banking credit organizations	37	5,511
Other	–	57
Amounts due to customers	**46,024**	**21,288**

(Amounts in tables are in thousands of Georgian lari)

14. Taxation

In June 2016, amendments to the Georgian tax law in respect of corporate income tax became enacted. The amendments become effective from 1 January 2017 for all Georgian companies except the banks, insurance companies and microfinance organization, for which the effective date is 1 January 2019. Under the new regulation, corporate income tax will be levied on profit distributed as dividends, rather than on profit earned as under the current regulation. The amount of tax payable on a dividend distribution will be calculated as 15/85 of the amount of net distribution. The companies will be able to offset corporate income tax liability arising from dividend distributions out of profits earned in 2008-2016 by the amount of corporate income tax paid for the respective period under the current regulation. Dividends distributions between Georgian resident companies will not be subject to corporate income tax.

Following the enactment of the amendments, as at 31 December 2016 the Bank remeasured its deferred tax assets and liabilities at the tax rates that were expected to apply to the period when the asset is realised or the liability is settled. As IAS 12 *Income Taxes* requires, the Bank used 0% tax rate applicable for undistributed profits in respect of assets and liabilities expected to be realized or settled in the periods when the new regulation becomes effective starting from 1 January 2019.

The amendments to the Georgian tax law described above also provide for charging corporate income tax on certain transactions that are considered deemed profit distributions, e.g. some transactions at non-market prices, non-business related expenses or supply of goods and services free of charge. Taxation of such transaction is outside scope of IAS 12 *Income Taxes* and will be accounted similar to operating taxes starting from 1 January 2019. Tax law amendments related to such deemed profit distribution did not have any effect on the Bank's financial statements for the year ended 31 December 2016.

The corporate income tax expense for the year ended 31 December 2016 comprises of deferred tax expense of GEL 599 thousand (31 December 2015: GEL 1,624 thousand deferred tax benefit).

In 2016 and 2015 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:

	2016	**2015**
Profit before income tax	**5,480**	**638**
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	**(822)**	**(96)**
Tax exempt income	243	334
Non-deductible expenses	(20)	(53)
Utilised tax losses carried forward, not recognized previously	–	335
Change in unrecognized deferred tax asset	–	1,104
Income tax (expense)/benefit	**(599)**	**1,624**

(Amounts in tables are in thousands of Georgian lari)

14. Taxation (continued)

Deferred tax assets and liabilities as at 31 December 2016 and 31 December 2015 and their movements for the respective period:

	2014	Through statement of profit and loss	Through statement of OCI	2015	Through statement of profit and loss	Through statement of OCI	2016
Tax effect of deductible temporary differences							
Tax losses carried forward	2,185	(367)	–	1,818	(1,014)	–	804
Other liabilities	14	54	–	68	67	–	135
Gross deferred tax asset	**2,199**	**(313)**	**–**	**1,886**	**(947)**	**–**	**939**
Unrecognised deferred tax asset	(1,471)	1,471	–	–	–	–	–
Deferred tax asset	**728**	**1,158**	**–**	**1,886**	**(947)**	**–**	**939**
Tax effect of taxable temporary differences							
Property and equipment	(36)	109	–	73	153	–	226
Intangible assets	(22)	(27)	–	(49)	(3)	–	(52)
Loans to customers	(762)	368	–	(394)	217	–	(177)
Investment securities	(6)	16	(4)	6	(19)	1	(12)
Deferred tax liability	**(826)**	**466**	**(4)**	**(364)**	**348**	**1**	**(15)**
Deferred tax asset/ (liability)	**(98)**	**1,624**	**(4)**	**1,522**	**(599)**	**1**	**924**

The Bank incurred tax losses of GEL 10,915 thousand and GEL 3,340 thousand for 2014 and 2013 which can be carried for 5 years and, will expire by 1 January 2019, if not utilized. During 2016 the Bank utilized GEL 6,760 thousand of tax losses carried forward (2015: GEL 2,233 thousand). Management evaluated and concluded that it is probable that deferred tax assets on past tax losses will be recovered, since the bank is generating taxable profit since 2015.

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.

As at 31 December 2016 and 2015, the Bank's authorized, issued and fully paid capital amounted to GEL 103,000 thousand comprising of 103,000,000 common shares with nominal value of GEL 1.00 each. 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 2016 (2015: nil).

(Amounts in tables are in thousands of Georgian lari)

15. Equity (continued)

Nature and purpose of other reserves

On 1 July 2015 the Bank reclassified all of the Bank's investment securities from available-for-sale category into category of loans and receivables. The revaluation gain/(loss) on the available-for-sale securities at the date of reclassification is gradually being recycled to profit and loss, as the reclassified securities approach their maturity.

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 2016 is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Commitments and contingencies

As at 31 December 2016 and 2015, the Bank's commitments and contingencies comprised the following:

	2016	2015
Credit related commitments		
Guarantees issued	13,026	22,326
Unused credit lines	5,230	443
Letters of credit	318	359
	18,574	**23,128**
Operating lease commitments		
Not later than 1 year	1,723	1,525
More than 1 year but less than 5 years	8,016	625
Contingency over 5 years	868	–
	10,607	**2,150**
Less: provisions for guarantees and letters of credit	(85)	–
Commitments and contingencies (before deducting collateral)	**29,096**	**25,278**
Less: deposits held as security against guarantees issued (Note 13)	(757)	(10,497)
Commitments and contingencies	**28,339**	**14,781**

(Amounts in tables are in thousands of Georgian lari)

17. Net fee and commission income

Net fee and commission income comprises:

	2016	2015
Guarantees	285	299
Brokerage operations	152	163
Settlements operations	126	72
Cash operations	21	13
Currency conversion operations	2	–
Fee and commission income	**586**	**547**
Settlements operations	(161)	(119)
Plastic cards	(82)	(56)
Guarantees	(82)	(45)
Cash operations	(16)	(19)
Brokerage operations	(1)	(1)
Fee and commission expense	**(342)**	**(240)**
Net fee and commission income	**244**	**307**

18. Personnel, general and administrative expenses

Personnel, general and administrative expenses comprise:

	2016	2015
Salaries	3,658	3,160
Bonuses and other employee benefits	1,525	1,329
Personnel expenses	**5,183**	**4,489**
Operating leases	1,479	1,341
Professional services	1,214	912
Advertising costs	587	412
Personnel training	253	190
Corporate hospitality and entertainment	146	155
Utilities	112	117
Transportation and business trip expenses	84	122
Insurance	77	35
Security expenses	58	69
Maintenance and exploitation	37	38
Membership fees	35	26
Taxes other than income tax	19	34
Communication	3	62
Other	205	208
General and administrative expenses	**4,309**	**3,721**

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.

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.

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Risk management structure (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.

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 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.

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.

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Credit risk (continued)

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 2016	Sub-standard grade 2016	Individually impaired	Total 2016
Amounts due from credit institutions	6	83,261	–	–	**83,261**
Loans to customers	7	88,356	–	8,854	**97,210**
Investment securities	8	89,050	3,031	–	**92,081**
Total		**260,667**	**3,031**	**8,854**	**272,552**

		Neither past due nor impaired			
	Notes	High grade 2015	Standard grade 2015	Individually Impaired	Total 2015
Amounts due from credit institutions	6	21,152	–	–	**21,152**
Loans to customers	7	109,913	–	–	**109,913**
Investment securities	8	117,105	6,215	–	**123,320**
Total		**248,170**	**6,215**	**–**	**254,385**

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 pay out 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.

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Credit risk (continued)

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. Collective assessment is performed by applying the delinquency roll rate model approach, where impairment allowances are estimated based on the percentage of assets with similar characteristics that become increasingly delinquent.

Impairment losses on off balance sheet commitments such as guarantees and letters of credit are estimated by applying the parameters sources from on balance sheet portfolio.

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

	2016			2015			
	Georgia	Other Non-OECD	Total	Georgia	OECD	Other Non-OECD	Total
Assets							
Cash and cash equivalents	5,164	2,435	**7,599**	22,250	3	29	**22,282**
Amounts due from credit institutions	78,236	5,025	**83,261**	21,152	–	–	**21,152**
Loans to customers	95,090	–	**95,090**	108,602	–	–	**108,602**
Investment securities	88,860	3,020	**91,880**	117,105	–	6,215	**123,320**
	267,350	**10,480**	**277,830**	**269,109**	**3**	**6,244**	**275,356**
Liabilities							
Amounts due to credit institutions	3,500	128,181	**131,681**	85,407	2	76,520	**161,929**
Amounts due to customers	8,874	37,150	**46,024**	21,288	–	–	**21,288**
Other liabilities	223	–	**223**	91	4	–	**95**
	12,597	**165,331**	**177,928**	**106,786**	**6**	**76,520**	**183,312**
Net assets/(liabilities)	**254,753**	**(154,851)**	**99,902**	**162,323**	**(3)**	**(70,276)**	**92,044**

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.

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Liquidity risk and funding management (continued)

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:

	2016, %	2015, %
LK "Average Liquidity Ratio" (Average volume of liquid assets / Average volume of liabilities)	39.05	34.12

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 2016	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	105,866	26,474	–	–	**132,340**
Amounts due to customers	29,084	15,578	1,714	–	**46,376**
Other financial liabilities	223	–	–	–	**223**
Total undiscounted financial liabilities	**135,173**	**42,052**	**1,714**	**–**	**178,939**

As at 31 December 2015	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	141,430	987	21,214	–	**163,631**
Amounts due to customers	20,636	2,919	–	–	**23,555**
Other financial liabilities	95	–	–	–	**95**
Total undiscounted financial liabilities	**162,161**	**3,906**	**21,214**	**–**	**187,281**

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Liquidity risk and funding management (continued)

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
2016	18,255	–	319	–	**18,574**

	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
2015	22,769	359	–	–	**23,128**

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.

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 2016	Effect on profit before tax 2016	Change in currency rate 2015	Effect on profit before tax 2015
USD	15%/(15%)	1,070/(1,070)	15%/(15%)	105/(105)
AZN	15%/(15%)	75/(75)	15%/(15%)	15/(15)

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.

(Amounts in tables are in thousands of Georgian lari)

19. Risk management (continued)

Market risk (continued)

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:

	Decrease of net interest income
2016	1,159
2015	1,303

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's statement of profit or loss.

The sensitivity of the statement of profit or loss is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2016. The Bank did not hold any floating rate financial assets or liabilities in 2015.

Currency	Increase/(decrease) in basis points 2016	Sensitivity of net interest income 2016
GEL	100/(100)	168/(168)

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 2016	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets for which fair values are disclosed				
Cash and cash equivalents	7,599	–	–	**7,599**
Amounts due from credit institutions	–	–	83,261	**83,261**
Loans to customers	–	–	95,090	**95,090**
Investment securities	–	3,020	88,860	**91,880**

	Fair value measurement using			
At 31 December 2016	**Level 1**	**Level 2**	**Level 3**	**Total**
Liabilities for which fair values are disclosed				
Amounts due to credit institutions	–	–	131,681	**131,681**
Amounts due to customers	–	–	46,024	**46,024**

	Fair value measurement using			
At 31 December 2015	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets for which fair values are disclosed				
Cash and cash equivalents	22,282	–	–	**22,282**
Amounts due from credit institutions	–	–	21,152	**21,152**
Loans to customers	–	–	108,602	**108,602**
Investment securities	–	6,215	117,105	**123,320**

	Fair value measurement using			
At 31 December 2015	**Level 1**	**Level 2**	**Level 3**	**Total**
Liabilities for which fair values are disclosed				
Amounts due to credit institutions	–	–	161,929	**161,929**
Amounts due to customers	–	–	21,288	**21,288**

(Amounts in tables are in thousands of Georgian lari)

20 Fair value measurements (continued)

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 2016	Fair value 2016	Unrecognised gain/(loss) 2016	Carrying value 2015	Fair value 2015	Unrecognised gain/(loss) 2015
Financial assets						
Cash and cash equivalents	7,599	7,599	–	22,282	22,282	–
Amounts due from credit institutions	83,261	83,261	–	21,152	21,152	–
Loans to customers	95,090	95,090	–	108,602	108,602	–
Investment securities	91,880	94,704	2,824	123,320	121,500	(1,820)
Financial liabilities						
Amounts due to credit institutions	131,681	131,681	–	161,929	161,929	–
Amounts due to customers	46,024	46,024	–	21,288	21,288	–
Total unrecognised change in fair value			**2,824**			**(1,820)**

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 Bank's 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.

The fair value of 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 majority of loans to customers outstanding as at 31 December were issued within 12 months period ended 31 December 2016 at market interest rates, while the contractual interest rates of those loans issued in 2015 approximate market interest rates as at 31 December 2016. Hence their carrying value approximates their fair value.

Investment securities

As at 31 December 2016 investment securities represent fixed rated financial assets carried at amortized cost. The fair value for investment securities loans and receivables is derived by discounting the future cash flows using current market rates for similar financial assets.

(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.

	2016			2015		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Cash and cash equivalents	7,599	–	**7,599**	22,282	–	**22,282**
Amounts due from credit institutions	83,261	–	**83,261**	21,152	–	**21,152**
Loans to customers	50,747	44,343	**95,090**	26,130	82,472	**108,602**
Investment securities	63,163	28,717	**91,880**	62,282	61,038	**123,320**
Property and equipment	–	1,108	**1,108**	–	2,689	**2,689**
Intangible assets	–	2,060	**2,060**	–	2,024	**2,024**
Deferred income tax assets	–	924	**924**	–	1,522	**1,522**
Other assets	384	179	**563**	604	115	**719**
Total	**205,154**	**77,331**	**282,485**	**132,450**	**149,860**	**282,310**
Amounts due to credit institutions	131,681	–	**131,681**	142,147	19,782	**161,929**
Amounts due to customers	44,404	1,620	**46,024**	21,288	–	**21,288**
Provisions for guarantees and letters of credit	85	–	**85**	–	–	**–**
Other liabilities	1,411	–	**1,411**	912	–	**912**
Total	**177,581**	**1,620**	**179,201**	**164,347**	**19,782**	**184,129**
Net	**27,573**	**75,711**	**103,284**	**(31,897)**	**130,078**	**98,181**

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.

(Amounts in tables are in thousands of Georgian lari)

22. Related party disclosures (continued)

The outstanding balances of related party transactions are as follows:

	2016			2015		
	The Parent	Key management personnel	Entities under common control	The Parent	Key management personnel	Entities under common control
Cash and cash equivalents	2,435	–	–	29	–	–
Property plant and equipment	21	–	–	–	–	–
Amounts due from credit Institutions	–	–	5,025	–	–	–
Amounts due to credit institutions	(49,218)	–	(39,956)	(71,730)	–	–
Amounts due to customers	–	(7,259)	(23,027)	–	(1)	(42)
Other liabilities	(2)	–	–	–	–	–

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

	2016			2015
	The Parent	Key management personnel	Entities under common control	The Parent
Fee and commission income	50	–	–	44
Fee and commission expense	84	–	–	53
Interest income on amounts due from credit institutions	–	–	72	–
Interest expense on amounts due to credit institutions	1,911	–	277	2,178
Interest expense on amounts due to customers	–	105	396	–
Professional fees	–	–	–	5

Compensation of key management personnel was comprised of the following:

	2016	2015
Salaries and other short-term benefits	1,251	1,029

Key management personnel as at 31 December 2016 and 2015, comprised of 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.

(Amounts in tables are in thousands of Georgian lari)

23. Capital adequacy (continued)

The primary objectives of the Bank's capital management are (i) to ensure that the Bank complies with externally imposed capital requirements set by the NBG, (ii) to safeguard the Bank's ability to continue as a going concern and (iii) to maintain sufficient capital base to achieve a capital adequacy ratio of at least 10.80% (2015: 11.4%). Compliance with capital adequacy ratios set by the NBG is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Chief Accountant or Chief Financial Officer and 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.

NBG capital adequacy ratio

The NBG requires banks to maintain a capital adequacy ratio of 10.80% (2015: 11.4%). of risk-weighted assets and Tier 1 Capital adequacy ratio of 7.2%. (2015: 7.6%). As at 31 December 2016 and as at 31 December 2015, the Bank's capital adequacy ratios on this basis were as follows:

	Notes	31 December 2016	Adjustments	31 December 2016 Per the NBG
Share capital	15	103,000	–	103,000
Prior years accumulated deficit		(4,527)	(4,632)	(9,159)
Less: intangible assets, net	10	(2,060)	–	(2,060)
Main capital		**96,413**	**(4,632)**	**91,781**
Current year income		4,881	2,483	7,364
General reserves		2,406	(356)	2,050
Additional capital		**7,287**	**2,127**	**9,414**
Less: deductions from capital		–	–	–
Total capital		**103,700**	**(2,505)**	**101,195**
Risk weighted assets				**218,136**
Capital adequacy ratio				42.08%
Tier 1 capital adequacy ratio				46.39%

	Notes	31 December 2015	Adjustments	31 December 2015 Per the NBG
Share capital	15	103,000	–	103,000
Prior years accumulated deficit		(6,789)	(5,063)	(11,852)
Less: intangible assets, net	10	(2,024)	–	(2,024)
Main capital		**94,187**	**(5,063)**	**89,124**
Current year income		2,262	431	2,693
General reserves	7	1,311	1,131	2,442
Additional capital		**3,573**	**1,562**	**5,135**
Less: deductions from capital		–	–	–
Total capital		**97,760**	**(3,501)**	**94,259**
Risk weighted assets				**215,933**
Capital adequacy ratio				43.65%
Tier 1 capital adequacy ratio				41.27%

(Amounts in tables are in thousands of Georgian lari)

23. Capital adequacy (continued)

NBG capital adequacy ratio (continued)

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.

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 2016, the Bank's capital adequacy ratios on the Basel II basis were as follows:

	Notes	31 December 2016	Adjustments	31 December 2016 Per the NBG
Additional tier 1 capital	15	103,000	–	103,000
Prior years accumulated deficit		(4,527)	(4,632)	(9,159)
Less: intangible assets, net	10	(2,060)	–	(2,060)
Current year income		4,881	2,483	7,364
Core tier 1 capital		**101,294**	**(2,149)**	**99,145**
Tier 1 capital		**101,294**	**(2,149)**	**99,145**
Supplementary capital		2,406	(356)	2,050
Total regulatory capital		**103,700**	**(2,505)**	**101,195**
Risk weighted assets				**296,917**
Capital adequacy ratio				34.08%
Core Tier 1 capital/Tier 1 capital adequacy ratio				33.39%

	Notes	31 December 2015	Adjustments	31 December 2015 Per the NBG
Additional tier 1 capital	15	103,000	–	103,000
Prior years accumulated deficit		(6,789)	(5,063)	(11,852)
Less: intangible assets, net	10	(2,024)	–	(2,024)
Current year income		2,262	431	2,693
Core tier 1 capital		**96,449**	**(4,632)**	**91,817**
Tier 1 capital		**96,449**	**(4,632)**	**91,817**
Supplementary capital		1,311	1,131	2,442
Total regulatory capital		**97,760**	**(3,501)**	**94,259**
Risk weighted assets				**239,946**
Capital adequacy ratio				39.28%
Core Tier 1 capital/Tier 1 capital adequacy ratio				38.27%