# JSC Liberty Bank and Subsidiaries

## Consolidated financial statements

*Year ended 31 December 2013*
*together with independent auditor's report*

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# Independent auditor's report

To the shareholders and Supervisory Board of JSC Liberty Bank -

We have audited the accompanying consolidated financial statements of JSC Liberty Bank and its subsidiaries ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2013, and the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Management's responsibility for the consolidated financial statements*

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

*Auditor's responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing audit procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The audit procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management of the audited entity, as well as evaluating the overall presentation of the consolidated financial statements.

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

*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group and its subsidiaries as at 31 December 2013, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

EY Georgia LLC

3 April 2014

A member firm of Ernst & Young Global Limited

## Consolidated statement of financial position

## As of 31 December 2013

*(thousands of Georgian Lari)*

| | Notes | 2013 | 2012 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 6 | 355,089 | 232,954 |
| Amounts due from credit institutions | 7 | 40,451 | 2,673 |
| Loans to customers | 8 | 600,080 | 378,118 |
| Investment securities held-to-maturity | 9 | 133,441 | 59,159 |
| Property and equipment | 10 | 128,325 | 126,095 |
| Intangible assets | 11 | 9,660 | 9,280 |
| Prepayments | 13 | 9,927 | 9,586 |
| Other assets | 13 | 16,641 | 21,067 |
| **Total assets** | | 1,293,614 | 838,932 |
| **Liabilities** | | | |
| Amounts due to credit institutions | 14 | 2,342 | 28,173 |
| Amounts due to customers | 15 | 1,158,671 | 696,417 |
| Deferred income tax liabilities | 12 | 7,314 | 3,746 |
| Other liabilities | 13 | 11,179 | 11,934 |
| **Total liabilities** | | 1,179,506 | 740,270 |
| **Equity** | 16 | | |
| Share capital | | 53,284 | 53,284 |
| Additional paid-in capital | | 42,559 | 42,559 |
| Preferred shares | | 5,179 | 893 |
| Accumulated losses | | (7,196) | (18,839) |
| Other reserves | | 20,282 | 20,765 |
| **Total equity** | | 114,108 | 98,662 |
| **Total liabilities and equity** | | 1,293,614 | 838,932 |

Signed and authorised for release on behalf of the Management Board of the Bank:

George Arveladze Chief Executive Officer

Zurab Tsulaia Chief Financial Officer

3 April 2014

*The accompanying notes on pages 6 to 47 are an integral part of these consolidated financial statements.*

## Consolidated statement of profit or loss

## For the year ended 31 December 2013

*(thousands of Georgian Lari)*

| | Notes | 2013 | 2012 |
|---|---|---|---|
| **Interest income** | | | |
| Loans to customers | | 142,930 | 109,892 |
| Investment securities | | 8,592 | 11,380 |
| Amounts due from credit institutions | | 3,622 | 2,937 |
| | | **155,144** | **124,209** |
| **Interest expense** | | | |
| Amounts due to customers | | (97,411) | (66,617) |
| Amounts due to credit institutions | | (1,441) | (3,283) |
| Contingent capital participation notes | | – | (2,264) |
| Other | | (206) | (110) |
| | | **(99,058)** | **(72,274)** |
| **Net interest income** | | **56,086** | **51,935** |
| Loan impairment reversal/(charge) | 8 | 3,733 | (12,504) |
| **Net interest income after loan impairment reversal/(charge)** | | **59,819** | **39,431** |
| Net fee and commission income | 18 | 19,974 | 28,855 |
| *Net gains/(losses) from foreign currencies:* | | | |
| - Dealing | | 6,959 | 6,056 |
| - Translation differences | | (139) | (77) |
| Other income | 19 | 6,224 | 4,817 |
| **Non-interest income** | | **33,018** | **39,651** |
| Personnel expenses | 20 | (41,866) | (37,605) |
| General and administrative expenses | 20 | (20,391) | (18,900) |
| Depreciation, amortisation and impairment | | (11,780) | (10,005) |
| Other operating expenses | | (2,237) | (1,902) |
| Other impairment and provisions | 13 | (1,118) | (885) |
| **Non-interest expense** | | **(77,392)** | **(69,297)** |
| **Profit before income tax expense** | | **15,445** | **9,785** |
| Income tax benefit/(expense) | 12 | 2,620 | (4,601) |
| **Profit for the year** | | **18,065** | **5,184** |
| **Earnings per share:** | 16 | | |
| - Basic and diluted earnings per share (in full amount) | | 0.00315 | 0.00111 |

*The accompanying notes on pages 6 to 47 are an integral part of these consolidated financial statements.*

## Consolidated statement of comprehensive income

## For the year ended 31 December 2013

*(thousands of Georgian Lari)*

| | Notes | 2013 | 2012 |
|---|---|---|---|
| **Profit for the year** | | **18,065** | **5,184** |
| **Other comprehensive income** | | | |
| *Other comprehensive income not to be reclassified to profit or loss in subsequent periods:* | | | |
| Impairment of the building due to fire loss | 10 | – | (608) |
| Income tax relating to components of other comprehensive income | 12, 16 | – | 91 |
| **Net other comprehensive income not to be reclassified to profit or loss in subsequent periods** | | **–** | **(517)** |
| **Other comprehensive income for the year, net of tax** | | **–** | **(517)** |
| **Total comprehensive income for the year** | | **18,065** | **4,667** |

*The accompanying notes on pages 6 to 47 are an integral part of these consolidated financial statements.*

## Consolidated statement of changes in equity

## For the year ended 31 December 2013

*(thousands of Georgian Lari)*

| | *Attributable to shareholders of the Bank* | | | | | | |
|---|---|---|---|---|---|---|---|
| | ***Share capital*** | ***Additional paid-in capital*** | ***Preferred shares*** | ***Treasury shares*** | ***Accumulated losses*** | ***Other reserves*** | ***Total*** |
| **31 December 2011** | **42,708** | **32,809** | **–** | **–** | **(24,504)** | **21,763** | **72,776** |
| Total comprehensive income/(loss) for the year | – | – | – | – | 5,184 | (517) | **4,667** |
| Depreciation of revaluation reserve (Note 16) | – | – | – | – | 481 | (481) | **–** |
| Share based payments (Note 16) | – | 1,712 | – | – | – | – | **1,712** |
| Issue of share capital (Note 16) | 10,576 | 8,038 | – | – | – | – | **18,614** |
| Issue of preferred shares (Note 16) | – | – | 893 | – | – | – | **893** |
| **31 December 2012** | **53,284** | **42,559** | **893** | **–** | **(18,839)** | **20,765** | **98,662** |
| Total comprehensive income/(loss) for the year | – | – | – | – | 18,065 | – | **18,065** |
| Depreciation of revaluation reserve (Note 16) | – | – | – | – | 483 | (483) | **–** |
| Deferred tax (change in valuation estimate) | – | – | – | – | (6,188) | – | **(6,188)** |
| Dividends paid on preferred shares (Note 16) | – | – | – | – | (717) | – | **(717)** |
| Issue of preferred shares (Note 16) | – | – | 4,286 | – | – | – | **4,286** |
| **31 December 2013** | **53,284** | **42,559** | **5,179** | **–** | **(7,196)** | **20,282** | **114,108** |

*The accompanying notes on pages 6 to 47 are an integral part of these consolidated financial statements.*

## Consolidated statement of cash flows

## For the year ended 31 December 2013

*(thousands of Georgian Lari)*

| | Notes | 2013 | 2012 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Interest received | | 175,475 | 129,929 |
| Interest paid | | (89,468) | (70,512) |
| Fees and commissions received | | 24,642 | 33,147 |
| Fees and commissions paid | | (4,463) | (4,503) |
| Net realised gains from dealing in foreign currencies | | 6,690 | 6,183 |
| Recoveries of assets previously written off | 8, 13 | 9,818 | 163 |
| Other income received | | 6,030 | 4,388 |
| Personnel expenses paid | | (41,130) | (36,711) |
| General, administrative and other operating expenses paid | | (21,552) | (20,664) |
| **Cash flows from operating activities before changes in operating assets and liabilities** | | **66,042** | **41,420** |
| *Net (increase)/decrease in operating assets* | | | |
| Amounts due from credit institutions | | (64,322) | 20,711 |
| Loans to customers | | (249,187) | (75,058) |
| Other assets | | 3,593 | (10,304) |
| *Net increase/(decrease) in operating liabilities* | | | |
| Amounts due to credit institutions | | 1,095 | 6,724 |
| Amounts due to customers | | 444,074 | 89,999 |
| Other liabilities | | (3,065) | (1,416) |
| **Net cash flows from operating activities before income tax** | | **198,230** | **72,076** |
| Income tax paid | | – | – |
| **Net cash from operating activities** | | **198,230** | **72,076** |
| **Cash flows from investing activities** | | | |
| Proceeds from redemption of investment available-for-sale | | 200 | – |
| Purchase of investment securities | | (341,170) | (121,730) |
| Proceeds from redemption of investment securities | | 270,063 | 165,598 |
| Purchase of intangibles, property and equipment | | (15,132) | (20,373) |
| Proceeds from sale of property and equipment | | 53 | – |
| **Net cash used in investing activities** | | **(85,986)** | **23,495** |
| **Cash flows from financing activities** | | | |
| Proceeds from issue of preferred shares | | 4,286 | 893 |
| Dividends paid to shareholders of preferred shares | | (717) | – |
| **Net cash from financing activities** | | **3,569** | **893** |
| Effect of exchange rates changes on cash and cash equivalents | | 6,322 | (225) |
| **Net increase/(decrease) in cash and cash equivalents** | | **122,135** | **96,239** |
| **Cash and cash equivalents, beginning** | 6 | **232,954** | **136,715** |
| **Cash and cash equivalents, ending** | 6 | **355,089** | **232,954** |

*The accompanying notes on pages 6 to 47 are an integral part of these consolidated financial statements.*

*(thousands of Georgian Lari)*

## 1. Principal activities

JSC Liberty Bank (the "Bank") is a joint stock company, formed in accordance with legislation of Georgia in 1993. The Bank operates under a general banking license N 3500/10 issued by the National Bank of Georgia (the "NBG"), the central bank of Georgia, on 10 February 1993.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its commercial and retail customers. Its main office is in Tbilisi, Georgia and it had as of 31 December 2013, 603 (31 December 2012: 434) branches, service centers, distribution outlets and mobile banking units operating in Georgia. The Bank's registered legal address is Liberty Tower, 74 I. Chavchavadze Avenue, 0162 Tbilisi, Georgia.

As of 31 December 2013 and 2012, the following shareholders owned more than 1% of the outstanding ordinary shares. Other shareholders owned less than 1% individually of the outstanding ordinary shares.

| *Shareholder* | *2013*<br>*Ownership interest, %* | *2012*<br>*Ownership interest, %* |
|---|---|---|
| Liberty Holdings Georgia LLC (former Liberty Capital LLC) | 70.83% | 72.44% |
| BNY Limited (Nominees) | 11.71% | 11.71% |
| JSC Liberty Capital | 7.36% | 8.05% |
| Stichting Liberty ESOP* | 3.16% | 3.16% |
| Other shareholders (individually holding less than 1%) | 6.94% | 4.64% |
| **Total** | **100.00%** | **100.00%** |

* *Ordinary shares sold on a deferred payment basis to Stichting Liberty ESOP as the trustee for the share based compensation programme Note 16.*

The Bank is a publicly traded company and its ordinary shares are traded on the Georgian Stock Exchange. Free float amounted to 21.8% as of 31 December 2013 (31 December 2012: 19.5%).

The Bank is the parent company of the group (the "Group") which consists of the following entities consolidated in the financial statements:

| Name | Country of incorporation | The Group ownership interest<br>31 December 2013 | The Group ownership interest<br>31 December 2012 | Date of incorporation | Activities |
|---|---|---|---|---|---|
| Bus Stop LLC | Georgia | 100.00% | 100.00% | 27 August 2009 | Outdoor advertising |
| JSC Smartex* | Georgia | 21.26% | 21.47% | 5 January 2009 | Courier services/ Startup incubator and angel investor |

* 21.26% is held by the Bank and 78.74% is held by JSC Liberty Capital, of which Lado Gurgenidze is a 96.52% shareholder. It is accounted for in the Group's financial statements under the equity method

The majority equity interest of the Group is ultimately beneficially owned and controlled by Mr. Dan Costache Patriciu.

As of 31 December 2013 3,201,321,628 ordinary shares held by Liberty Holdings Georgia LLC (58.18% of the ordinary shares outstanding) were encumbered by the order of Tbilisi City Court in connection with civil litigation. For details please refer to Note 26.

## 2. Basis of preparation

### General

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

The Bank and its subsidiaries maintain their accounting records in accordance with IFRS.

## 2. Basis of preparation (continued)

### General (continued)

The consolidated financial statements have been prepared under the historical cost convention except for derivative financial instruments, investment property, buildings and available-for-sale securities as disclosed in the accounting policies below.

These consolidated financial statements are presented in thousands of Georgian Lari ("GEL"), except per share amounts and unless otherwise indicated.

## 3. Summary of accounting policies

### Changes in accounting policies

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

*IAS 1 Presentation of Items of Other Comprehensive Income – Amendments to IAS 1*

The amendments to IAS 1 introduce a grouping of items presented in other comprehensive income. Items that could be reclassified to profit or loss at a future point in time now have to be presented separately from items that will never be reclassified. The amendment had no impact on the Group's financial position, performance or presentation as the Group has no other comprehensive income in 2013 and 2012

*IAS 32 Tax Effects of Distributions to Holders of Equity Instruments (Amendment)*

The amendment to IAS 32 *Financial Instruments: Presentation* clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12 *Income Taxes*. The amendment removes existing income tax requirements from IAS 32 and requires entities to apply the requirements in IAS 12 to any income tax arising from distributions to equity holders. The amendment did not have an impact on the consolidated financial statements for the Group, as, in accordance with local tax code, there are no tax consequences attached to cash or non-cash distribution.

*IAS 19 Employee Benefits (Revised 2011) (IAS 19R)*

IAS 19R includes a number of amendments to the accounting for defined benefit plans, including actuarial gains and losses that are now recognised in other comprehensive income and permanently excluded from profit and loss; expected returns on plan assets that are no longer recognised in profit or loss, instead, there is a requirement to recognise interest on the net defined benefit liability (asset) in profit or loss, calculated using the discount rate used to measure the defined benefit obligation, and; unvested past service costs are now recognised in profit or loss at the earlier of when the amendment occurs or when the related restructuring or termination costs are recognised. Other amendments include new disclosures, such as, quantitative sensitivity disclosures. The amendments had no impact on the Group's financial position or performance since the Group does not operate a defined benefit plan.

*IFRS 7 Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities – Amendments to IFRS 7*

The amendment requires an entity to disclose information about rights to set-off financial instruments and related arrangements. The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with IAS 32. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether the financial instruments are set off in accordance with IAS 32. The Group does not offset financial instruments in accordance with IAS 32 and does not have relevant offsetting arrangements thus the amendment has no impact on the Group.

*IFRS 10 Consolidated Financial Statements and IAS 27 Separate Financial Statements*

IFRS 10 establishes a single control model that applies to all entities including special purpose entities. IFRS 10 replaces the parts of previously existing IAS 27 *Consolidated and Separate Financial Statements* that dealt with consolidated financial statements and SIC-12 *Consolidation – Special Purpose Entities*. IFRS 10 changes the definition of control such that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. To meet the definition of control in IFRS 10, all three criteria must be met, including: (a) an investor has power over an investee; (b) the investor has exposure, or rights, to variable returns from its involvement with the investee; and (c) the investor has the ability to use its power over the investee to affect the amount of the investor's returns. IFRS 10 had no impact on the consolidation of investments held by the Group.

*(thousands of Georgian Lari)*

## 3. Summary of accounting policies (continued)

### Changes in accounting policies (continued)

*IFRS 11 Joint Arrangements and IAS 28 Investment in Associates and Joint Ventures*

IFRS 11 replaces IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly-controlled Entities – Non-monetary Contributions by Venturers*. IFRS 11 removes the option to account for jointly controlled entities ("JCEs") using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture under IFRS 11 must be accounted for using the equity method. The application of IFRS 11 has not impacted the reported financial position or performance of the Group as it has no JCEs and investments in associates

*IFRS 12 Disclosure of Interests in Other Entities*

IFRS 12 sets out the requirements for disclosures relating to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. None of these disclosure requirements are applicable for the Group.

*IFRS 13 Fair Value Measurement*

IFRS 13 establishes a single source of guidance for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Group has considered the specific requirements relating to highest and best use, valuation premise, and principal (or most advantageous) market. The methods, assumptions, processes and procedures for determining fair value were revisited and adjusted where applicable. The resulting calculations under IFRS 13 affected the principles that the Group uses to assess the fair value, but the assessment of fair value under IFRS 13 has not materially changed the fair values recognised or disclosed.

IFRS 13 mainly impacts the disclosures of the Group. It requires specific disclosures about fair value measurements and disclosures of fair values, some of which replace existing disclosure requirements in other standards. IFRS 13 disclosures are provided in notes 10, 13 and 22.

The disclosure requirements of IFRS 13 apply prospectively and need not be provided for comparative periods before initial application. Consequently, comparatives of these disclosures have not been provided.

In addition to the above-mentioned amendments and new standards, IFRS 1 *First-time Adoption of International Financial Reporting Standards* was amended with effect for reporting periods starting on or after 1 January 2013. The Group is not a first-time adopter of IFRS, therefore, this amendment is not relevant to the Group. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

### Basis of consolidation

Subsidiaries, which are those entities in which the Group has an interest of more than one half of the voting rights, or otherwise has power to exercise control over their operations, are consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All intra-group transactions, balances and unrealised gains on transactions between group companies are eliminated in full; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses are attributed to the non-controlling interests even if that results in a deficit balance.

If the Group loses control over a subsidiary, it derecognises the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests, the cumulative translation differences, recorded in equity; recognises the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in profit or loss and reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss.

*(thousands of Georgian Lari)*

## 3. Summary of accounting policies (continued)

**Investments in associates**

Associates are entities in which the Group generally has between 20% and 50% of the voting rights, or is otherwise able to exercise significant influence, but which it does not control or jointly control. Investments in associates are accounted for under the equity method and are initially recognised at cost, including goodwill. Subsequent changes in the carrying value reflect the post-acquisition changes in the Group's share of net assets of the associate. The Group's share of its associates' profits or losses is recognised in profit or loss, and its share of movements in reserves is recognised in other comprehensive income. However, when the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses, unless the Group is obliged to make further payments to, or on behalf of, the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

**Fair value measurement**

The Group measures financial instruments, such as trading and available-for-sale securities, derivatives and non-financial assets such as investment property, at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortised cost are disclosed in Note 22.

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

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

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

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group 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 Group determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

*(thousands of Georgian Lari)*

## 3. Summary of accounting policies (continued)

### Financial assets (continued)

*Date of recognition*

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Group 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.

*Held-to-maturity investments*

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

*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.

### Cash and cash equivalents

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

### Amounts due from credit institutions

In the normal course of business, the Group maintains advances or deposits for various periods of time with other banks. Amounts due from credit institutions are initially recognised at fair value and are subsequently measured at amortised cost using the effective interest method. Amounts due from credit institutions are carried net of any allowance for impairment losses.

### Derivative financial instruments

In the normal course of business, the Group enters into various derivative financial instruments including forwards and swaps in the foreign exchange and capital markets. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the consolidated statement of profit or loss as net gains/(losses) from trading securities or net gains/(losses) from foreign currencies dealing, depending on the nature of the instrument.

### Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to credit institutions, amounts due to customers and debt securities issued. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the consolidated statement of profit or loss when the borrowings are derecognised as well as through the amortisation process.

If the Group purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is recognised in the consolidated statement of profit or loss.

## 3. Summary of accounting policies (continued)

### Leases

#### *i. Finance – Group as lessee*

The Group recognises finance leases as assets and liabilities in the consolidated statement of financial position at the date of commencement of the lease term at amounts equal to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. In calculating the present value of the minimum lease payments the discount factor used is the interest rate implicit in the lease, when it is practicable to determine; otherwise, the Group's incremental borrowing rate is used. Initial direct costs incurred are included as part of the asset. Lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

The costs identified as directly attributable to activities performed by the lessee for a finance lease, are included as part of the amount recognised as an asset under the lease.

#### *ii. Operating – Group 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.

#### *iii. Operating – Group as lessor*

The Group presents assets subject to operating leases in the consolidated statement of financial position according to the nature of the asset. Lease income from operating leases is recognised in profit or loss on a straight-line basis over the lease term as other income. The aggregate cost of incentives provided to lessees is recognised as a reduction of rental income over the lease term on a straight-line basis. Initial direct costs incurred specifically to earn revenues from an operating lease are added to the carrying amount of the leased asset.

### 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 Group 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 Group 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 Group recognises that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

### Offsetting of financial instruments

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

### Impairment of financial assets

The Group 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.

## 3. Summary of accounting policies (continued)

### Impairment of financial assets (continued)

*Amounts due from credit institutions and loans to customers*

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

If there is 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 Group. 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 consolidated 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.

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

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

*Held-to-maturity financial investments*

For held-to-maturity investments the Group assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognised in profit or loss.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, any amounts formerly charged are credited to the consolidated statement of profit or loss.

*Available-for-sale financial investments*

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

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in profit or loss – is reclassified from other comprehensive income to the consolidated statement of profit or loss. Impairment losses on equity investments are not reversed through the consolidated statement of profit or loss; increases in their fair value after impairment are recognised in other comprehensive income.

## 3. Summary of accounting policies (continued)

### Impairment of financial assets (continued)

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

*Renegotiated loans*

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements, agreement of new loan conditions and improvement of collateral. Once the terms have been renegotiated, the loan is no longer considered past due.

The accounting treatment of such restructuring is conducted in 2 basic scenarios:

- If the loan restructuring is not caused by the financial difficulties of the borrower but the cash flows were renegotiated, the loan is not recognized as impaired. The new effective interest rate is determined based on the remaining cash flows under the loan agreement till maturity. If the new effective interest rate is below the market rate at the date of restructuring, the new carrying amount is calculated as the fair value of the loan after restructuring, being the present value of the future cash flows discounted using the market rate at the date of restructuring. In this case, the difference between the carrying amount before restructuring and the fair value of the loan after restructuring is recognized as a loss on loans restructuring.
- If the loan is impaired after restructuring, the Group uses the original effective interest rate in respect of new cash flows to estimate the recoverable amount of the loan. The difference between the recalculated present value of the new cash flows taking into account collateral and the carrying amount before restructuring is included in loan impairment charge for the period.

Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

### 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 Group 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 Group 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 Group 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 Group'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 Group could be required to repay.

*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.

*(thousands of Georgian Lari)*

## 3. Summary of accounting policies (continued)

**Financial guarantees**

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the consolidated financial statements at fair value, in "Other liabilities", being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of the expenditure that is 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 consolidated statement of profit or loss. The premium received is recognised in profit or loss on a straight-line basis over the life of the guarantee.

**Taxation**

The current income tax expense is calculated in accordance with the regulations of Georgia. It represents the sum of the current and deferred tax expenses.

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

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

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

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

**Property and equipment**

Property and equipment, except for buildings, is 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.

Following initial recognition at cost, buildings are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Any revaluation surplus is credited to the revaluation reserve for property and equipment included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss, in which case the increase is recognised in profit or loss. A revaluation deficit is recognised in profit or loss, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

An annual transfer from the revaluation reserve for property and equipment to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original cost. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

## 3. Summary of accounting policies (continued)

### Property and equipment (continued)

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis at the following annual prescribed rates:

| | |
|---|---|
| Land and buildings | 2%-5% |
| Furniture and fixtures | 10%-20% |
| Computer and office equipment | 20%-25% |
| Motor vehicles | 20%-25% |
| Leasehold improvements | 10%-25% |

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 capitalisation.

Land is not amortized and carried at fair value. Leasehold improvements are amortized over the life of the related leased assets.

Assets under construction comprise costs directly related to construction of property and equipment including an appropriate allocation of directly attributable variable and fixed overheads that are incurred in construction. Depreciation of these assets, on the same basis as similar property assets, commences when the assets are put into operation.

Compensation from third parties for items of property and equipment that were impaired, lost or given up is included in other income when the compensation becomes receivable.

### Investment property

The Group holds certain properties as investments to earn rental income, generate capital appreciation or both and which are not used or held for the sale in the ordinary course of business. Investment property is initially recognized at cost, including transaction costs, and subsequently remeasured at fair value reflecting market conditions at the end of the reporting period. Fair value of the Group's investment property is determined on the base of various sources including reports of independent appraisers, who hold a recognized and relevant professional qualification and who have recent experience in valuation of property of similar location and category. Earned rental income is recorded in the profit or loss within income arising from non-banking activities. Gains and losses resulting from changes in the fair value of investment property are recorded in consolidated statement of profit or loss and presented within other income or other operating expenses lines.

### Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. 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 finite. Intangible assets with finite lives are amortised over the useful economic lives of 5 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Costs associated with maintaining computer software programs are recorded as an expense as incurred.

### Assets classified as held-for-sale

The Group classifies a non-current asset as held-for-sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the non-current asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable.

The sale qualifies as highly probable if the Bank's management is committed to a plan to sell the non-current asset (or disposal group) and an active program to locate a buyer and complete the plan must have been initiated. Further, the non-current asset (or disposal group) must have been actively marketed for a sale at price that is reasonable in relation to its current fair value and in addition the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification of the non-current asset (or disposal group) as held for sale.

*(thousands of Georgian Lari)*

## 3. Summary of accounting policies (continued)

**Assets classified as held-for-sale (continued)**

The Group measures an asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell. The Group recognises an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell if events or changes in circumstance indicate that their carrying amount may be impaired.

**Provisions**

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

**Retirement and other benefit obligations**

The Group does not have any pension arrangements separate from the state pension system of Georgia. In addition, the Group has no post-retirement benefits.

**Share-based payment transactions**

Employees (including senior executives) of the bank receive remuneration in the form of share–based payment transactions, whereby employees render services as consideration for equity instruments ("equity–settled transactions").

*Equity-settled transactions*

The cost of equity settled transactions with employees is measured by reference to the fair value at the date on which they are granted.

The cost of equity–settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("the vesting date"). The cumulative expense recognised for equity–settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Bank's best estimate of the number of equity instruments that will ultimately vest. The profit or loss expense or credit for a period is recorded in "Personnel expenses" and represents the movement in cumulative expense recognised as at the beginning and end of that period.

Where the terms of an equity–settled award are modified, the minimum expense recognised in "Personnel expenses" is the expense as if the terms had not been modified. An additional expense is recognised for any modification which increases the total fair value of the share–based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity–settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. This includes any award where non–vesting conditions within the control of either the entity or the counterparty are not met. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of diluted earnings per share (Note 16).

**Share capital**

*Share capital and additional paid in 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.

*(thousands of Georgian Lari)*

## 3. Summary of accounting policies (continued)

### Share capital (continued)

*Treasury shares*

Where the Bank purchase the Bank's shares, the consideration paid, including any attributable transaction costs, net of income taxes, is deducted from total equity as treasury shares until they are cancelled, sold or reissued. Where such shares are subsequently sold or reissued, any consideration received is included in equity. Treasury shares are stated at weighted average cost.

*Dividends*

Dividends are recognised as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the financial statements are authorised for issue.

### Segment reporting

The Group's segment reporting is based on the following operating segments: Retail Banking, Corporate and SME (Small & Medium Size) Banking, Private Banking and Corporate Centre functions.

### Contingencies

Contingent liabilities are not recognised in the consolidated 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 consolidated statement of financial position but disclosed when an inflow of economic benefits is probable.

### Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group 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 Group 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.

*Fee and commission income*

The Group 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. 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.

## 3. Summary of accounting policies (continued)

### Recognition of income and expenses (continued)

*Dividend income*

Revenue is recognised when the Group's right to receive the payment is established.

### Foreign currency translation

The consolidated financial statements are presented in Georgian Lari, which is the Bank's and subsidiaries' 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 consolidated 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 exchange rates used by the Group in the preparation of the consolidated financial statements as of 31 December 2013 and 31 December 2012 are as follows:

| | *2013* | *2012* |
|---|---|---|
| GEL/1 US Dollar | 1.7363 | 1.6567 |
| GEL/1 Euro | 2.3891 | 2.1825 |

### Standards and interpretations issued but not yet effective

*IFRS 9 Financial Instruments*

IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but Amendments to IFRS 9 *Mandatory Effective Date of IFRS 9 and Transition Disclosures*, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the IASB is addressing hedge accounting and impairment of financial assets. The Group will quantify the effect in conjunction with the other phases, when the final standard including all phases is issued.

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

These amendments are effective for annual periods beginning on or after 1 January 2014 provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. It is not expected that this amendment would be relevant to the Group, since none of the entities in the Group qualify to be an investment entity under IFRS 10.

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

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

*IFRIC Interpretation 21 Levies (IFRIC 21)*

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

## 3. Summary of accounting policies (continued)

**Standards and interpretations issued but not yet effective (continued)**

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

These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. These amendments are effective for annual periods beginning on or after 1 January 2014. The Group has not novated its derivatives during the current period. However, these amendments would be considered for future novations.

## 4. Significant accounting judgments and estimates

The preparation of the Group's consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the balance sheet date and the reported amount of income and expenses during the year ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The following estimates and judgments are considered important to the Group's financial condition.

*Allowance for impairment of loans*

The Group regularly reviews its loans to assess for impairment. The Group's loan impairment provisions are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Group considers accounting estimates related to allowance for impairment of loans and receivables a key source of estimation uncertainty because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and receivables are based on recent performance experience, and (ii) any significant difference between the Group's estimated losses and actual losses would require the Group to record provisions which could have a material impact on its consolidated financial statements in future periods.

The Group uses management's judgment to estimate the amount of any impairment loss in cases where a borrower has financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on past performance, past customer behavior and observable data indicating an adverse change in the payment status of borrowers in a group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans. The Group uses management's judgment to adjust observable data for a group of loans to reflect current circumstances not reflected in historical data.

The Group considers the fair value of collateral when estimating the amount of impairment loss for collateralized loans and receivables and finance lease receivables. Management monitors market value of collateral on a regular basis. Management uses its experienced judgment or independent opinion to adjust the fair value to reflect current circumstances. The amount and type of collateral required depends on the assessment of credit risk of the counterparty.

The allowances for impairment of financial assets in the consolidated financial statements have been determined on the basis of existing economic and political conditions. The Group is not in a position to predict what changes in conditions will take place in Georgia and what effect such changes might have on the adequacy of the allowances for impairment of financial assets in future periods.

*Measurement of fair value of investment property and buildings*

Investment property and buildings are stated at fair value. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards Committee standards.

Buildings of the Group are subject to revaluation on a regular basis. The date of latest revaluation was 31 December 2011. As of 31 December 2013 the Group analysed market prices for its premises and concluded that the market price of premises was not materially different from their carrying value. Refer to Note 10.

Fair value of investment property was determined by independent professionally qualified appraisers as of 31 December 2013. Fair value was determined by applying income approach based on discounted cash flow method, supported by the terms of any existing lease and other contracts and, when available, by external evidence such as current market rents for similar properties in a comparable location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows. The estimates of future cash flows include projections of cash outflows for rent or purchase of the land.

The estimates described above are subject to change as new transaction data and market evidence become available.

## 4. Significant accounting judgments and estimates (continued)

*Taxation*

Tax legislation in Georgia is subject to varying interpretations, and changes can occur frequently. Management interpretation of such legislation and changes as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. As such, additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for six years including the year of review. Management believes that as of 31 December 2013 its interpretation of the relevant legislation is appropriate and that the Group's tax position will be sustained.

## 5. Segment information

For management purposes, the Group is organised into the following operating segments based on products and service:

| | |
|---|---|
| Retail Banking | Principally handling individual customers' deposits, and providing consumer loans, overdrafts, credit cards facilities and funds transfer facilities. |
| Corporate and SME Banking | Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers. |
| Private Banking | Principally providing private banking and wealth management services to high net worth individuals. |
| Corporate Centre | Principally providing treasury and back office services to all operating segments of the Bank. |
| Other | Segments not classified above, comprising non-banking operations. |

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance, as explained in the table below, is measured differently from profit or loss in the consolidated financial statements. Income taxes are managed on a group basis and are not allocated to operating segments.

The Group operates in one geographical market – Georgia. Since the Group's assets are located in single geographical area, the Group's external income, total assets and capital expenditure are allocated to a single location.

| **2013** | ***Retail banking*** | ***Corporate & SME banking*** | ***Private banking*** | ***Corporate centre*** | ***Other*** | ***Adjustments and eliminations*** | ***Total*** |
|---|---|---|---|---|---|---|---|
| Net interest income | **45,528** | **2,929** | **722** | **6,897** | **1** | **9** | 56,086 |
| Net fee and commission income | 13,358 | 5,359 | 400 | 901 | (44) | – | 19,974 |
| Net gains from foreign currencies | 4,093 | 1,705 | 341 | 682 | (1) | – | 6,820 |
| Other income | 3,835 | 1,827 | 304 | 122 | 390 | (254) | 6,224 |
| **Total revenue** | **66,814** | **11,820** | **1,767** | **8,602** | **346** | **(245)** | **89,104** |
| Net impairment charge on interest-bearing assets | (5,053) | 9,194 | 29 | – | – | (437) | 3,733 |
| Personnel expenses | (29,854) | (6,554) | (414) | (5,021) | (23) | – | (41,866) |
| Depreciation and amortisation | (8,043) | (1,746) | (116) | (1,748) | (127) | – | (11,780) |
| Other impairment and provisions | (902) | (520) | (36) | (78) | (19) | 437 | (1,118) |
| General and administrative and other operating expenses | (15,593) | (4,379) | (343) | (2,257) | (366) | 310 | (22,628) |
| **Segment results** | **7,369** | **7,815** | **887** | **(502)** | **(189)** | **65** | **15,445** |
| Income tax benefit | – | – | – | – | – | – | 2,620 |
| **Profit for the year** | – | – | – | – | – | – | **18,065** |
| Segment assets | 948,898 | 119,753 | 9,219 | 216,667 | 998 | (1,921) | 1,293,614 |
| Segment liabilities | 480,127 | 499,561 | 63,963 | 135,838 | 307 | (290) | 1,179,506 |
| **Other segment information** | | | | | | | |
| Investments in associates | – | – | – | 304 | – | – | **304** |
| Share of income of associates | – | – | – | 12 | – | – | **12** |

## 5. Segment information (continued)

| 2012 | *Retail banking* | *Corporate & SME banking* | *Private banking* | *Corporate centre* | *Other* | *Adjustments and eliminations* | *Total* |
|---|---|---|---|---|---|---|---|
| Net interest income | 37,692 | 4,634 | 754 | 8,850 | 2 | 3 | 51,935 |
| Net fee and commission income | 17,360 | 7,737 | 72 | 3,730 | (44) | – | 28,855 |
| Net gains from foreign currencies | 1,196 | 896 | 119 | 3,768 | – | – | 5,979 |
| Other income | 400 | 3,660 | 47 | 573 | 443 | (306) | 4,817 |
| **Total revenue** | **56,648** | **16,927** | **992** | **16,921** | **401** | **(303)** | **91,586** |
| Net impairment charge on interest-bearing assets | (2,707) | (5,549) | (55) | (4,691) | – | 498 | (12,504) |
| Personnel expenses | (27,816) | (5,886) | (372) | (3,510) | (21) | – | (37,605) |
| Depreciation, amortisation and impairment | (6,427) | (1,482) | – | (1,976) | (120) | – | (10,005) |
| Other impairment and provisions | (228) | (131) | (9) | (20) | – | (497) | (885) |
| General and administrative and other operating expenses | (12,334) | (4,025) | (315) | (4,072) | (350) | 294 | (20,802) |
| **Segment results** | **7,136** | **(146)** | **241** | **2,652** | **(90)** | **(8)** | **9,785** |
| Income tax expense | – | – | – | – | – | – | (4,601) |
| **Profit for the year** | – | – | – | – | – | – | **5,184** |
| Segment assets | 747,590 | 54,134 | 14,649 | 23,353 | 930 | (1,724) | 838,932 |
| Segment liabilities | 252,360 | 406,558 | 53,692 | 27,638 | 179 | (157) | 740,270 |
| **Other segment information** | | | | | | | |
| Investments in associates | – | – | – | 171 | – | – | **171** |
| Share of income of associates | – | – | – | (63) | – | – | **(63)** |

## 6. Cash and cash equivalents

Cash and cash equivalents comprise:

| | *2013* | *2012* |
|---|---|---|
| Cash on hand | 102,948 | 84,839 |
| Current accounts with the NBG | 124,455 | 46,867 |
| Current accounts with other credit institutions | 27,486 | 17,987 |
| Time deposits with credit institutions up to 90 days | 100,200 | 83,261 |
| **Cash and cash equivalents** | **355,089** | **232,954** |

As of 31 December 2013, GEL 20,367 (31 December 2012: GEL 11,527) was placed on current and time deposit accounts with internationally recognised OECD banks that are the counterparties of the Group in performing international settlements. As of 31 December 2013, GEL 100,200 (31 December 2012: GEL 83,261) was placed on short-term time and overnight deposits with the NBG. The interest rates on time deposits with credit institutions up to 90 days range between 2.0% - 2.5% per annum.

## 7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

| | *2013* | *2012* |
|---|---|---|
| Obligatory reserve with the NBG | 37,847 | – |
| Time deposits for more than 90 days | 2,604 | 2,673 |
| **Amounts due from credit institutions** | **40,451** | **2,673** |

*(thousands of Georgian Lari)*

## 7. Amounts due from credit institutions (continued)

Credit institutions are required to maintain an interest-earning cash deposit (obligatory reserve) with the NBG, the amount of which depends on the level of funds attracted by the credit institution. The Group's ability to withdraw these deposits is restricted by the statutory legislature.

As of 31 December 2013, GEL 2,604 (31 December 2012: GEL 2,593) was placed on current accounts and inter-bank deposits with internationally recognised OECD banks, that are the main counterparties of the Group in performing international settlements. The interest rate on such deposits ranges from 0.05%-0.1% per annum.

## 8. Loans to customers

Loans to customers comprise:

| | *2013* | *2012* |
|---|---|---|
| Loans to retail clients with regular inflows | 365,755 | 260,038 |
| Consumer loans | 81,991 | 38,183 |
| Micro loans | 58,923 | 22,634 |
| Gold pawn loans | 54,012 | 20,215 |
| Corporate and SME loans | 50,319 | 38,446 |
| Residential mortgage loans | 15,902 | 19,428 |
| **Gross loans to customers** | **626,902** | **398,944** |
| Less – allowance for loan impairment | (26,822) | (20,826) |
| **Loans to customers** | **600,080** | **378,118** |

Loans to retail clients with regular inflows are provided to individuals who have a stream of regular (typically monthly) inflows into their accounts at the Bank either in form of a salary, state pension or welfare payment.

**Allowance for impairment of loans to customers**

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

| | ***Loans to retail clients with regular inflows 2013*** | ***Consumer loans 2013*** | ***Micro loans 2013*** | ***Corporate & SME loans 2013*** | ***Residential mortgage loans 2013*** | ***Total 2013*** |
|---|---|---|---|---|---|---|
| **At 1 January 2013** | **10,319** | **5,410** | **447** | **4,185** | **465** | **20,826** |
| Charge for the year | 3,329 | 2,365 | (23) | (9,194) | (210) | **(3,733)** |
| Recoveries | 449 | 237 | – | 9,125 | – | **9,811** |
| Amounts written off | (71) | (5) | (6) | – | – | **(82)** |
| **At 31 December 2013** | **14,026** | **8,007** | **418** | **4,116** | **255** | **26,822** |
| Individual impairment | 10,855 | 6,257 | 267 | 3,350 | 169 | **20,898** |
| Collective impairment | 3,171 | 1,750 | 151 | 766 | 86 | **5,924** |
| | **14,026** | **8,007** | **418** | **4,116** | **255** | **26,822** |
| Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance | 10,934 | 6,295 | 267 | 12,078 | 169 | 29,743 |

*(thousands of Georgian Lari)*

## 8. Loans to customers (continued)

**Allowance for impairment of loans to customers (continued)**

| | *Loans to retail clients with regular inflows 2012* | *Consumer loans 2012* | *Micro loans 2012* | *Corporate & SME loans 2012* | *Residential mortgage loans 2012* | *Total 2012* |
|---|---|---|---|---|---|---|
| **At 1 January 2012** | **9,642** | **8,358** | **291** | **17,562** | **283** | **36,136** |
| Charge for the year | 6,860 | 1,810 | 156 | 3,496 | 182 | **12,504** |
| Recoveries | 126 | 37 | – | – | – | **163** |
| Amounts written-off | (6,309) | (4,795) | – | (16,873) | – | **(27,977)** |
| **At 31 December 2012** | **10,319** | **5,410** | **447** | **4,185** | **465** | **20,826** |
| Individual impairment | 8,358 | 3,328 | 149 | 3,750 | 286 | **15,871** |
| Collective impairment | 1,961 | 2,082 | 298 | 435 | 179 | **4,955** |
| | **10,319** | **5,410** | **447** | **4,185** | **465** | **20,826** |
| Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance | 8,358 | 3,328 | 149 | 5,012 | 286 | 17,133 |

Loan recoveries in 2013 primarily comprise of recovery of one large legacy corporate & SME loan in the amount of GEL 9,125.

**Individually impaired loans**

Interest income accrued on loans, for which individual impairment allowances have been recognised as of 31 December 2013 comprised GEL 6,051 (2012: GEL 2,356). Related allowance charges were recognised both in 2013 and 2012 and are recorded in consolidated statement of profit or loss under net impairment charge on interest-bearing assets.

**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 as follows:

- For lending to legal entities, mortgages over real estate properties, inventory and trade receivables,
- For retail lending, mortgages over residential properties and gold over gold pawns.

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 of 31 December 2013, the concentration of loans granted by the Group to ten largest third party borrowers comprised GEL 33,066 accounting for 5.3% of the gross loan portfolio of the Group (2012: GEL 16,096 and 4.0%, respectively). An allowance of GEL 246 (2012: GEL 2,896) was established against these loans.

## 8. Loans to customers (continued)

**Concentration of loans to customers (continued)**

Loans have been extended to the following types of customers:

| | *2013* | *2012* |
|---|---|---|
| Individuals | 556,651 | 364,445 |
| Private companies | 70,251 | 34,215 |
| State owned companies | – | 284 |
| **Loans to customers, gross** | **626,902** | **398,944** |
| Less - allowance for loan impairment | (26,822) | (20,826) |
| **Loans to customers, net** | **600,080** | **378,118** |

Loans are made principally within Georgia in the following industry sectors:

| | *2013* | *2012* |
|---|---|---|
| Individuals | 556,651 | 364,445 |
| Trade and service | 44,935 | 26,722 |
| Construction | 2,684 | 2,941 |
| Agriculture | 329 | 61 |
| Other | 22,303 | 4,775 |
| **Loans to customers, gross** | **626,902** | **398,944** |
| Less - allowance for loan impairment | (26,822) | (20,826) |
| **Loans to customers, net** | **600,080** | **378,118** |

## 9. Investment securities held-to-maturity

Held-to-maturity securities comprise:

| | *2013* | *2012* |
|---|---|---|
| Treasury bonds of the Ministry of Finance | 66,839 | 52,184 |
| Treasury bills of the Ministry of Finance | 53,546 | 6,975 |
| Certificates of deposit of the NBG | 13,056 | – |
| **Held-to-maturity securities** | **133,441** | **59,159** |

## 10. Property and equipment

The movements in property and equipment were as follows:

| | *Land and buildings* | *Furniture and fixtures* | *Computers and office equipment* | *Motor vehicles* | *Leasehold improve-ments* | *Assets under construction* | *Total* |
|---|---|---|---|---|---|---|---|
| **Cost or revalued amount** | | | | | | | |
| **31 December 2012** | **86,056** | **36,316** | **15,570** | **11,466** | **4,962** | **1,081** | **155,451** |
| Additions | 4,387 | 4,647 | 1,951 | 1,148 | 1,213 | – | 13,346 |
| Write offs | (36) | (4) | (2) | – | – | (649) | (691) |
| Disposals | – | – | – | (476) | – | – | (476) |
| Transfers | 432 | – | – | – | – | (432) | – |
| **31 December 2013** | **90,839** | **40,959** | **17,519** | **12,138** | **6,175** | **–** | **167,630** |
| **Accumulated depreciation and impairment** | | | | | | | |
| **31 December 2012** | **1,522** | **12,783** | **9,669** | **4,894** | **488** | **–** | **29,356** |
| Depreciation charge | 1,880 | 3,929 | 2,351 | 2,139 | 123 | – | **10,422** |
| Write offs | (5) | (3) | (2) | – | – | – | **(10)** |
| Disposals | – | – | – | (463) | – | – | **(463)** |
| **31 December 2013** | **3,397** | **16,709** | **12,018** | **6,570** | **611** | **–** | **39,305** |
| **Net book value** | | | | | | | |
| **31 December 2012** | **84,534** | **23,533** | **5,901** | **6,572** | **4,474** | **1,081** | **126,095** |
| **31 December 2013** | **87,442** | **24,250** | **5,501** | **5,568** | **5,564** | **–** | **128,325** |

| | *Land and buildings* | *Furniture and fixtures* | *Computers and office equipment* | *Motor vehicles* | *Leasehold improve-ments* | *Assets under construction* | *Total* |
|---|---|---|---|---|---|---|---|
| **Cost or revalued amount** | | | | | | | |
| **31 December 2011** | **60,379** | **30,341** | **11,702** | **9,369** | **4,735** | **1,740** | **118,266** |
| Additions | 5,080 | 6,598 | 3,868 | 2,589 | 722 | 437 | **19,294** |
| Write offs | – | (623) | – | (492) | (590) | – | **(1,705)** |
| Transfers | 1,001 | – | – | – | 95 | (1,096) | **–** |
| Reclassification from Investment property | 20,204 | – | – | – | – | – | **20,204** |
| **31 December 2012** | **86,664** | **36,316** | **15,570** | **11,466** | **4,962** | **1,081** | **156,059** |
| **Accumulated depreciation and impairment** | | | | | | | |
| **31 December 2011** | **171** | **9,696** | **7,436** | **3,380** | **382** | **–** | **21,065** |
| Depreciation charge | 1,351 | 3,470 | 2,233 | 1,889 | 106 | – | **9,049** |
| Impairment | 608 | | | | | | **608** |
| Write offs | – | (383) | – | (375) | – | – | **(758)** |
| **31 December 2012** | **2,130** | **12,783** | **9,669** | **4,894** | **488** | **–** | **29,964** |
| **Net book value** | | | | | | | |
| **31 December 2011** | **60,208** | **20,645** | **4,266** | **5,989** | **4,353** | **1,740** | **97,201** |
| **31 December 2012** | **84,534** | **23,533** | **5,901** | **6,572** | **4,474** | **1,081** | **126,095** |

Buildings and land of the Group are subject to revaluation on a regular basis. The date of latest revaluation was 31 December 2011. As of 31 December 2013 the Group analysed market prices for its premises and concluded that the market price of the premises were not materially different from their carrying value.

*(thousands of Georgian Lari)*

## 10. Property and equipment (continued)

The Group's buildings are classified to Level 3 of the fair value hierarchy. There were no transfers among the levels of the fair value hierarchy in 2013.

If the land and buildings were measured using the cost model, the carrying amounts would be as follows:

| | *2013* | *2012* |
|---|---|---|
| Cost | 46,198 | 41,415 |
| Accumulated depreciation and impairment | (5,342) | (4,418) |
| **Net carrying amount** | **40,856** | **36,997** |

## 11. Intangible assets

The movements in intangible assets, which comprised computer software and licenses, were as follows:

| | *Computer software and licenses* |
|---|---|
| **Cost** | |
| **31 December 2012** | **12,769** |
| Additions | 1,739 |
| Disposals | (1) |
| **31 December 2013** | **14,507** |
| | |
| **Accumulated amortisation** | |
| **31 December 2012** | **3,489** |
| Amortisation charge | 1,358 |
| Disposals | – |
| **31 December 2013** | **4,847** |
| | |
| **Net book value:** | |
| **31 December 2012** | **9,280** |
| **31 December 2013** | **9,660** |

| | *Computer software and licenses* |
|---|---|
| **Cost** | |
| **31 December 2011** | **8,689** |
| Additions | 4,099 |
| Disposals | (19) |
| **31 December 2012** | **12,769** |
| | |
| **Accumulated amortization** | |
| **31 December 2011** | **2,534** |
| Amortisation charge | 956 |
| Disposals | (1) |
| **31 December 2012** | **3,489** |
| | |
| **Net book value:** | |
| **31 December 2011** | **6,155** |
| **31 December 2012** | **9,280** |

## 12. Taxation

The corporate income tax (benefit)/expense comprised:

| | *2013* | *2012* |
|---|---|---|
| Current year tax charge | – | – |
| Deferred tax (benefit)/charge – origination and reversal of temporary differences | (2,620) | 4,601 |
| **Income tax (benefit)/expense** | **(2,620)** | **4,601** |

Georgian legal entities must file individual tax declarations. The tax rate for banks for profits other than on state securities was 15% for 2013 and 2012. The tax rate for interest income on state securities and the NBG deposits is 0%.

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

| | *2013* | *2012* |
|---|---|---|
| **Profit before income tax** | **15,445** | **9,785** |
| Statutory tax rate | 15% | 15% |
| **Theoretical income tax expense at the statutory rate** | **2,317** | **1,468** |
| Change in unrecognised deferred tax asset | (3,633) | 5,072 |
| Income from state securities at 0% | (1,679) | (2,038) |
| Other | 375 | 99 |
| **Income tax (benefit)/expense** | **(2,620)** | **4,601** |

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

| | | *Origination and reversal of temporary differences* | | | *Origination and reversal of temporary differences* | | |
|---|---|---|---|---|---|---|---|
| | *2011* | *In the statement of profit or loss* | *In other compre-hensive income* | *2012* | *In the statement of profit or loss* | *Effect of change in statement of changes in equity* | *2013* |
| **Tax effect of deductible temporary differences** | | | | | | | |
| Property and equipment | 269 | – | – | **269** | (269) | – | **–** |
| Taxable loss carried forward | 7,138 | (1,309) | – | **5,829** | (4,534) | – | **1,295** |
| Loans to customers | 1,286 | 430 | – | **1,716** | 2,933 | – | **4,649** |
| Equity investments | 1,029 | 44 | – | **1,073** | – | – | **1,073** |
| Other assets | 437 | (233) | – | **204** | 149 | – | **353** |
| Other liabilities | 347 | 64 | – | **411** | 64 | – | **475** |
| **Gross deferred tax assets** | **10,506** | **(1,004)** | **–** | **9,502** | **(1,657)** | **–** | **7,845** |
| Unrecognised deferred tax asset | (1,578) | (4,048) | – | **(5,626)** | 4,331 | – | **(1,295)** |
| **Deferred tax asset** | **8,928** | **(5,052)** | **–** | **3,876** | **2,674** | **–** | **6,550** |
| **Tax effect of taxable temporary differences** | | | | | | | |
| Property and equipment and intangible assets | (8,164) | 451 | 91 | **(7,622)** | (54) | (6,188) | **(13,864)** |
| **Deferred tax liabilities** | **(8,164)** | **451** | **91** | **(7,622)** | **(54)** | **(6,188)** | **(13,864)** |
| **Net deferred tax assets/ (liabilities)** | **764** | **(4,601)** | **91** | **(3,746)** | **2,620** | **(6,188)** | **(7,314)** |

## 12. Taxation (continued)

The Group has available GEL 8,632 (2012: GEL 38,858) of taxable losses carried forward which begin to expire in 2014, if not utilised. The Group has fully provisioned this taxable loss carry forward. During the year the Bank utilised a taxable loss carry forward of GEL 27,367 (2012: GEL 1,892) and wrote off the expired portion of GEL 2,859 (2012: GEL 6,831), with the respective tax effect of the utilisation amounting to GEL 4,105 (2011: GEL 285) and tax effect of the write off amounting to GEL 429 (2011: GEL 1,024). The schedule of the available taxable loss carried forward with the respective expiration dates is presented below:

| ***Year of expiration*** | ***2013*** | ***2012*** |
|---|---|---|
| 2013 | – | 30,226 |
| 2014 | 6,310 | 6,310 |
| 2015 | 2,322 | 2,322 |
| **Taxable loss carried forward, gross** | **8,632** | **38,858** |
| Unrecognised taxable loss carried forward | (8,632) | (35,708) |
| **Taxable loss carried forward, net** | **–** | **3,150** |

## 13. Other assets, prepayments and other liabilities

Other assets comprise:

| | ***2013*** | ***2012*** |
|---|---|---|
| Receivables from remittances systems operators | 6,273 | 10,149 |
| Investment property | 4,986 | 4,793 |
| Guarantee deposits placed | 1,403 | 1,388 |
| Receivable from guarantees paid | 764 | 794 |
| Repossessed property | 725 | 712 |
| Current income tax assets | 637 | 637 |
| Prepaid taxes other than income tax | 555 | 577 |
| Investment in associate | 304 | 171 |
| Receivable from documentary operations | 274 | 231 |
| Other | 3,094 | 2,987 |
| | **19,015** | **22,439** |
| Less – allowance for impairment of other assets | (2,374) | (1,372) |
| **Other assets** | **16,641** | **21,067** |

Receivables from remittances in the amount of GEL 6,273 (2012: GEL 10,149) represent money transfers made in advance toward the retail clients at the period end that were subsequently settled by the systems operators within several days in accordance with respective service contracts.

Investment properties primarily comprise of class B office space located in downtown Zugdidi with total rental space of 1,848 square meters and the warehouse building located in an industrial area of Tbilisi with storage space of 7,850 square meters; as well as several other properties located outside of Tbilisi.

Investment properties are stated at fair value. The fair value represents the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The date of latest revaluation is 31 December 2013. The valuation was performed by an accredited independent valuator with a recognised and relevant professional qualification and with recent experience in the locations and categories of the investment property being valued. The valuation models in accordance with those recommended by the International Valuation Standards Committee have been applied and are consistent with the principles in IFRS 13. Refer to Note 22 for details.

There were no other movements in investment property during 2013 except fair value revaluation.

The Group's investment property items are classified to Level 3 of the fair value hierarchy. There were no transfers among the levels of the fair value hierarchy in 2013.

Guarantee deposits placed as of 31 December 2013 primarily represent pledged funds at VISA Inc. and MasterCard Inc. in the amount of GEL 609 and GEL 793, respectively (31 December 2012: VISA Inc. for GEL 579, MasterCard Inc. for GEL 757).

## 13. Other assets, prepayments and other liabilities (continued)

Prepayments comprise:

| | *2013* | *2012* |
|---|---|---|
| Prepayments for fixed and intangible assets | 5,174 | 3,698 |
| Prepayments for security services | 3,297 | 4,401 |
| Prepayments for professional services | 198 | 203 |
| Prepaid insurance | 109 | 107 |
| Prepayments for office supplies | 27 | 115 |
| Other | 1,122 | 1,062 |
| **Total prepayments** | **9,927** | **9,586** |

Advances for security service represent a prepayment made to Legal Entity of Public Law (LEPL) Security Police Department (SPD). On 30 May 2012, the Bank signed a five year service agreement with SPD for 63 months until 1 September 2017 in the amount of GEL 5 million. According to the agreement, SPD provides security services at the Bank's head office, branches and other distribution outlets, as well as for vehicles used for cash transportation. In connection with this agreement, the Bank has recognised an expense in the amount of GEL 1,104 for the year ended 31 December 2013 (2012: GEL 583).

Other liabilities comprise:

| | *2013* | *2012* |
|---|---|---|
| Bonus accrual | 3,069 | 1,884 |
| Funds pending settlements | 2,804 | 4,690 |
| Sundry creditors | 1,647 | 766 |
| Payables for intangible assets | 840 | 1,498 |
| Operating taxes payable | 264 | 703 |
| Provision on guarantees and commitments | 159 | 188 |
| Derivative financial liabilities | – | 272 |
| Other | 2,396 | 1,933 |
| **Other liabilities** | **11,179** | **11,934** |

The movements in other impairment allowances and provisions were as follows:

| | *Other assets* | *Guarantees and commitments* | *Total* |
|---|---|---|---|
| **31 December 2012** | **1,780** | **188** | **1,968** |
| Charge/(reversal) | 1,147 | (29) | **1,118** |
| Write-offs | (560) | – | **(560)** |
| Recoveries | 7 | – | **7** |
| **31 December 2013** | **2,374** | **159** | **2,533** |

| | *Other assets* | *Guarantees and commitments* | *Total* |
|---|---|---|---|
| **31 December 2011** | **1,601** | **99** | **1,700** |
| Charge | 796 | 89 | **885** |
| Write-offs | (617) | – | **(617)** |
| **31 December 2012** | **1,780** | **188** | **1,968** |

Provisions for claims, guarantees and commitments are recorded in other liabilities.

## 14. Amounts due to credit institutions

Amounts due to credit institutions comprise:

| | *2013* | *2012* |
|---|---|---|
| Current accounts | 2,168 | 1,035 |
| Time deposits and loans | 174 | 27,138 |
| **Amounts due to credit institutions** | **2,342** | **28,173** |

## 15. Amounts due to customers

The amounts due to customers include the following:

| | *2013* | *2012* |
|---|---|---|
| Current accounts | 750,699 | 452,766 |
| Time deposits | 407,972 | 243,651 |
| **Amounts due to customers** | **1,158,671** | **696,417** |
| Held as security against guarantees issued | 5,020 | 3,215 |

At 31 December 2013, amounts due to customers of GEL 274,665 (23.7%) were due to the ten largest customers (31 December 2012: GEL 214,250 (30.8%)).

Amounts due to customers include accounts with the following types of customers:

| | *2013* | *2012* |
|---|---|---|
| Individuals | 542,922 | 301,710 |
| State and public sector | 474,457 | 323,963 |
| Private enterprises | 141,292 | 70,744 |
| **Amounts due to customers** | **1,158,671** | **696,417** |

The amounts due customers by economic sector are as follows:

| | *2013* | *2012* |
|---|---|---|
| Individuals | 542,922 | 301,710 |
| State and public sector | 474,457 | 323,963 |
| Trade | 37,321 | 21,961 |
| Transport and communication | 19,136 | 4,119 |
| Energy | 15,678 | 3,054 |
| Real estate constructions | 3,304 | 4,519 |
| Agriculture | 785 | 1,120 |
| Mining | 67 | 116 |
| Other | 65,001 | 35,855 |
| **Amounts due to customers** | **1,158,671** | **696,417** |

## 16. Equity

*Share capital*

As of 31 December 2013, the authorised share capital of the Bank comprised 7,500,000,000 ordinary shares, of which 5,918,670,396 were issued and 5,328,424,855 ordinary shares were fully paid (31 December 2012: 6,000,000,000 ordinary shares, of which 5,918,670,396 were issued and 5,328,424,855 were fully paid). Each share has nominal value of GEL 0.01. Out of total number of ordinary shares issued, 173,829,499 shares are sold on deferred payment basis to Stichting Liberty ESOP and are attributable to the share based compensation programme.

## 16. Equity (continued)

*Share capital (continued)*

Movements in ordinary and preferred, net of treasury shares are described below:

| | Number of shares | | Nominal amount | | |
|---|---|---|---|---|---|
| | *Preferred* | *Ordinary* | *Preferred* | *Ordinary* | *Total* |
| **31 December 2011** | **–** | **4,270,769,547** | **–** | **42,708** | **42,708** |
| Increase in share capital | 892,584 | 1,057,655,308 | 893 | 10,576 | **11,469** |
| **31 December 2012** | **892,584** | **5,328,424,855** | **893** | **53,284** | **54,177** |
| Increase in share capital | 4,286,480 | – | 4,286 | – | **4,286** |
| **31 December 2013** | **5,179,064** | **5,328,424,855** | **5,179** | **53,284** | **58,463** |

The share capital of the Bank was contributed by the shareholders in GEL and they are entitled to dividends and any capital distribution in GEL.

During 2013 no new ordinary shares have been sold.

During the year ended 31 December 2012, the Bank raised GEL 18,614 through the conversion of the Contingent Capital Participation Notes (The "CCPN") into 1,057,655,308 newly issued ordinary shares at the conversion price of GEL 0.0176 (resulting an increase of the nominal capital by GEL 10,576 and additional paid-in capital by GEL 8,038). Liberty Holdings Georgia LLC and JSC Liberty Capital held 95.7% of the CCPN, with the remainder held by certain minority shareholders.

*Convertible preferred shares*

In August 2012, the Bank issued and made available for sale to the general public in a public offer in Georgia 10,000,000 non-redeemable convertible preferred shares at the gross placement price of GEL 1 per convertible preferred share (with the permissible size of the public offer subsequently increased to 30,000,000 convertible preferred shares), of which 5,179,064 convertible preferred shares were outstanding and fully paid-up as of 31 December 2013 (2012: 892,584), and the remainder was available for sale through the public offer expiring on 31 December 2015. The convertible preferred shares issued by the Bank are not listed. The convertible preferred shares are perpetual and can be converted, at the holder's discretion, into ordinary shares of the bank at the conversion price based on 1.05 times the IFRS audited ordinary equity book value of the Bank as of the end of the preceding calendar year.

The dividend rate on the convertible preferred shares is 17% per annum, payable annually, subject to the AGM approval in each given year. The dividends are non-cumulative. The conversion option was classified as equity component as of the initial recognition date and its fair value comprised zero.

The ability to pay dividends is subject to the Bank's financial condition and results of operations and compliance with the prudential capital adequacy requirements and may be restricted by, among other things, applicable laws and regulations, financing arrangements and other agreements and commitments, and by the NBG.

In 2013, 13 senior employees who were collectively awarded a retention bonus of GEL 1,200 purchased 960,000 convertible preferred shares with the gross placement price of GEL 1 per convertible preferred share fully paid up.

*Basic/diluted earnings per share*

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding of the effect of all dilutive potential ordinary shares, which comprise share options granted to employees and preferred shares.

In 2013, net income attributable to ordinary shareholders of the Group comprised GEL 18,065 (2012: GEL 5,184) and the weighted average number of ordinary shares outstanding during the year was 5,502,254,354 (2012: 4,653,621,404), resulting in earnings per share of GEL 0.00315 (full amount) for 2013 (2012: GEL 0.00111).

At 31 December 2013, preferred shares did not have dilutive effect as the conversion price of GEL 0.021 exceeded the quoted weighted average market price for the period of GEL 0.009. Thus, the dilution did not include the potential effect from the conversion of 5,179,064 convertible preferred shares into ordinary shares as of 31 December 2013 (At 31 December 2012 the diluted number of ordinary shares was 4,701,071,753, resulting in diluted earnings per share of GEL 0.00110 (full amount) for 2012. The dilution effect was from the conversion of 892,584 preferred shares into ordinary shares).

## 16. Equity (continued)

*Dividends*

The Bank has not paid any dividends on its ordinary shares for the years 2013 and 2012. The bank paid dividends on the convertible preferred shares in the amount of GEL 717 in 2013 (2012: nil).

*Other reserves*

Movements in other reserves were as follows:

| | ***Revaluation reserve for property and equipment*** | ***Total*** |
|---|---|---|
| **At 31 December 2011** | **21,763** | **21,763** |
| Depreciation of revaluation reserve, net of tax | (481) | **(481)** |
| Impairment loss as a result of fire, net of tax | (517) | **(517)** |
| **At 31 December 2012** | **20,765** | **20,765** |
| Depreciation of revaluation reserve, net of tax | (483) | **(483)** |
| **At 31 December 2013** | **20,282** | **20,282** |

**Nature and purpose of other reserves**

*Revaluation reserve for property and equipment*

The revaluation reserve for property and equipment is used to record increases in the fair value of the buildings and decreases to the extent that such decrease relates to an increase on the same asset previously recognised in equity.

## 17. Commitments and contingencies

**Operating environment**

Parliamentary elections of 1 October 2012 and the subsequent peaceful transition of power relieved political uncertainty and strengthened the democratic governance in Georgia, further strengthened by the presidential elections held on 27 October 2013. Subsequent to the parliamentary elections, the credit rating agencies reconfirmed their sovereign ratings of Georgia with stable outlook. Georgia remains under precautionary (non-cash) stand-by arrangement with the IMF which ensures dialogue on all aspects of macro-fiscal and monetary decision-making. All Georgian sovereign and corporate Eurobonds traded on 31 December 2013 above their par value. In the recent years, Georgia implemented far-reaching structural reforms. In 2013 Georgia stepped up from No. 9 to No. 8 in the World Bank Ease of Doing Business global rankings; it is far ahead of any other country in the broader neighbourhood. Supply-side economic reforms have contributed to the resilience and helped to contain Georgia's exposure to exogenous challenges stemming from the global financial and credit market conditions. After the relatively insignificant dip in 2009, the economy rebounded significantly growing by 7.0%, 6.2% and 3.1% in 2011, 2012 and 2013 respectively, with GDP growth projected to exceed 5% in 2014.

Budget deficit in 2013 amounted, on a preliminary basis, to 2.7% of GDP (2012: 2.8%). Proper fiscal-monetary interaction and prudent banking sector supervision allowed to sustain positive development dynamics in the financial sector and to counter exchange rate and credit risks, providing for incremental loan book growth while keeping system-wide NPLs at a relatively low level. The end-of-period inflation rate changed from negative 1.3% as of 31 December 2012 to positive 2.4% as of 31 December 2013. Public debt as a share of GDP comprised 34.5% as of 31 December 2013. The government and the NBG sustain sufficient liquidity – in the form of the government cash deposit at the NBG and in the form of the NBG's international reserves.

Georgia remains a small open economy, which is exposed to exogenous trends and pressures. Fiscal and monetary policies implemented in the recent years helped to create certain shield and policy space, although external capital market sentiment and choppiness of global credit conditions – if these transcend certain scale and depth – might trigger pass-through on the in-country consumer, lender and investment confidence. Relatively high unemployment in Georgia, reduced corporate liquidity and profitability, and corporate and personal insolvencies dating back to 2008-2009 continue to affect the Group's borrowers' ability to repay the amounts due to the Group. Changes in economic conditions are correlated with the value of collateral held against loans and other obligations. To the extent that information is available, the Group has reflected revised estimates of expected future cash flows in its impairment assessment.

## 17. Commitments and contingencies (continued)

### Legal

In the ordinary course of business, the Group is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Group.

The Group's commitments and contingencies comprised the following:

| | *2013* | *2012* |
|---|---|---|
| **Credit related commitments** | | |
| Guarantees | 13,083 | 27,318 |
| Letters of credit | 157 | – |
| Undrawn loan commitments | 53,136 | 23,200 |
| | **66,376** | **50,518** |
| **Operating lease commitments** | | |
| Not later than 1 year | 3,826 | 2,911 |
| Later than 1 year but not later than 5 years | 9,341 | 7,400 |
| Later than 5 years | 4,811 | 4,872 |
| | **17,978** | **15,183** |
| Capital expenditure commitments | 1,279 | 455 |
| Less – provisions (Note 13) | (159) | (188) |
| **Commitments and contingencies (before deducting collateral)** | **85,474** | **65,968** |
| Less – cash held as security against guarantees issued | (5,020) | (3,215) |
| **Commitments and contingencies** | **80,454** | **62,753** |

As of 31 December 2013 and 31 December 2012, the Bank had Bankers Blanket Bond insurance, Directors and Officers liability insurance, Property and Vehicle insurance coverage.

## 18. Net fee and commission income

Net fee and commission income comprised:

| | *2013* | *2012* |
|---|---|---|
| Remittances | 7,084 | 7,781 |
| Settlements operations | 5,599 | 5,098 |
| Plastic card operations | 4,982 | 4,731 |
| Cash operations | 1,614 | 2,044 |
| Fee income received from utility payments | 1,362 | 1,574 |
| Guarantees and letters of credit | 507 | 1,345 |
| Fee income received from the Social Service Agency and other State entities | 8 | 8,738 |
| Other | 3,396 | 1,892 |
| **Fee and commission income** | **24,552** | **33,203** |
| Plastic card operations | (2,450) | (2,058) |
| Settlements operations | (2,057) | (2,053) |
| Cash operations | (45) | (40) |
| Guarantees and letters of credit | (26) | (197) |
| **Fee and commission expense** | **(4,578)** | **(4,348)** |
| **Net fee and commission income** | **19,974** | **28,855** |

## 19. Other income

Other income comprised:

| | *2013* | *2012* |
|---|---|---|
| Income from penalty on late payments on customer loans & advances | 4,583 | 2,634 |
| Income from rent | 670 | 737 |
| Gain from revaluation of investment property | 194 | – |
| Income from advertising | 155 | 144 |
| Gain from sale of assets | 47 | 80 |
| Income from fire loss reimbursement from insurance | – | 595 |
| Other | 575 | 627 |
| **Total other income** | **6,224** | **4,817** |

## 20. Personnel and general and administrative expenses

Personnel and general and administrative expenses comprise:

| | *2013* | *2012* |
|---|---|---|
| Salaries | 34,384 | 33,165 |
| Variable bonuses | 3,780 | 1,868 |
| Performance based discretionary bonus pool | 2,494 | 2,297 |
| Share based payment compensation | 1,208 | 275 |
| **Personnel expenses** | **41,866** | **37,605** |

| | *2013* | *2012* |
|---|---|---|
| Occupancy and rent | 4,035 | 3,337 |
| Marketing and advertising | 2,438 | 2,370 |
| Office supplies | 2,223 | 1,729 |
| Utility expense | 1,714 | 1,726 |
| Legal and other professional services | 1,707 | 1,112 |
| Operating taxes | 1,397 | 1,320 |
| Communications | 1,300 | 983 |
| Security | 1,098 | 1,111 |
| Corporate hospitality and entertainment | 576 | 626 |
| Travel expenses | 550 | 549 |
| Repair and maintenance | 454 | 316 |
| Insurance | 406 | 425 |
| Personnel training and recruitment | 109 | 75 |
| Other | 2,384 | 3,221 |
| **General and administrative expenses** | **20,391** | **18,900** |

## 21. Risk management

### Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. The Group is exposed to credit risk, liquidity risk and market risk. It is also subject to operating risks.

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

*Risk Management Structure*

The Supervisory Board is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

*(thousands of Georgian Lari)*

## 21. Risk management (continued)

### Introduction (continued)

*Management Board*

The Management Board has the responsibility to monitor the overall risk process within the Group.

*Audit Committee*

The Audit Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

*Bank Treasury*

Bank Treasury is responsible for managing the Group's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Group.

*Internal Audit*

Risk management processes throughout the Group are audited annually by the internal audit function, which examines both the adequacy of the procedures and the Group's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

*Risk Measurement and Reporting Systems*

The Group's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment.

Monitoring and controlling risks is primarily performed based on limits established by the Group. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept, with additional emphasis on selected industries.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Management Board, and the head of each business division. The report includes aggregate credit exposure, hold limit exceptions, liquidity ratios and risk profile changes. Senior management assesses the appropriateness of the allowance for credit losses on a monthly basis.

For all levels throughout the Group, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

The Group actively uses collateral to reduce its credit risks.

*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 Group's performance to developments affecting a particular industry or geographical location.

### Credit risk

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

The Group 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.

## 21. Risk management (continued)

### Credit risk (continued)

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 Group makes available to its customers guarantees which may require that the Group make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. 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 Group internal credit policies. The table below shows the credit quality by class of asset for loan-related lines in the statement of financial position, based on the categories specified in the tables.

| *As of 31 December 2013* | *Notes* | *Neither past due nor impaired 2013* | *Past due but not fully impaired 2013* | *Individually impaired 2013* | *Total 2013* |
|---|---|---|---|---|---|
| Amounts due from credit institutions | 7 | 40,451 | – | – | **40,451** |
| **Loans to customers** | 8 | | | | |
| Loans to retail clients with regular inflows | | 347,083 | 7,738 | 10,934 | **365,755** |
| Consumer loans | | 66,691 | 9,005 | 6,295 | **81,991** |
| Micro loans | | 58,188 | 468 | 267 | **58,923** |
| Gold pawn loans | | 52,802 | 1,210 | – | **54,012** |
| Corporate & SME loans | | 33,282 | 4,959 | 12,078 | **50,319** |
| Residential mortgage loans | | 15,420 | 313 | 169 | **15,902** |
| | | **573,466** | **23,693** | **29,743** | **626,902** |
| Investment securities held-to-maturity | 9 | 133,441 | – | – | **133,441** |
| **Total** | | **747,358** | **23,693** | **29,743** | **800,794** |

| *As of 31 December 2012* | *Notes* | *Neither past due nor impaired 2012* | *Past due but not fully impaired 2012* | *Individually impaired 2012* | *Total 2012* |
|---|---|---|---|---|---|
| Amounts due from credit institutions | 7 | 2,673 | – | – | **2,673** |
| **Loans to customers** | 8 | | | | |
| Loans to retail clients with regular inflows | | 246,549 | 5,130 | 8,359 | **260,038** |
| Consumer loans | | 31,793 | 3,062 | 3,328 | **38,183** |
| Micro loans | | 22,382 | 103 | 149 | **22,634** |
| Gold pawn loans | | 19,228 | 987 | – | **20,215** |
| Corporate & SME loans | | 24,349 | 9,086 | 5,011 | **38,446** |
| Residential mortgage loans | | 18,338 | 804 | 286 | **19,428** |
| | | **362,639** | **19,172** | **17,133** | **398,944** |
| Investment securities held-to-maturity | 9 | 59,159 | – | – | **59,159** |
| **Total** | | **424,471** | **19,172** | **17,133** | **460,776** |

## 21. Risk management (continued)

### Credit risk (continued)

An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories. The attributable risk ratings are assessed and updated regularly.

*Aging analysis of past due but not impaired loans per class of financial assets*

| *As of 31 December 2013* | *Notes* | *Less than 30 days 2013* | *31 to 60 days 2013* | *61 to 90 days 2013* | *More than 90 days 2013* | *Total 2013* |
|---|---|---|---|---|---|---|
| **Loans to customers** | 8 | | | | | |
| Loans to retail clients with regular inflows | | 4,551 | 2,380 | 807 | – | **7,738** |
| Consumer loans | | 6,010 | 1,939 | 1,056 | – | **9,005** |
| Micro loans | | 298 | 116 | 54 | – | **468** |
| Gold pawn loans | | 781 | 199 | 79 | 151 | **1,210** |
| Corporate & SME | | 851 | 539 | 69 | 3,500 | **4,959** |
| Residential mortgage loans | | 95 | 190 | 28 | – | **313** |
| **Total** | | **12,586** | **5,363** | **2,093** | **3,651** | **23,693** |

| *As of 31 December 2012* | *Notes* | *Less than 30 days 2012* | *31 to 60 days 2012* | *61 to 90 days 2012* | *More than 90 days 2012* | *Total 2012* |
|---|---|---|---|---|---|---|
| **Loans to customers** | 8 | | | | | |
| Loans to retail clients with regular inflows | | 3,690 | 1,078 | 362 | – | **5,130** |
| Consumer loans | | 1,691 | 768 | 603 | – | **3,062** |
| Micro loans | | 72 | 21 | 10 | – | **103** |
| Gold pawn loans | | 634 | 163 | 68 | 122 | **987** |
| Corporate & SME | | 2,711 | 1,094 | 695 | 4,586 | **9,086** |
| Residential mortgage loans | | 545 | 201 | 58 | – | **804** |
| **Total** | | **9,343** | **3,325** | **1,796** | **4,708** | **19,172** |

See Note 8 for more detailed information with respect to the allowance for impairment of loans to customers.

*Carrying amount per class of financial assets whose terms have been renegotiated*

The table below shows the carrying amount for renegotiated financial assets, by class.

| | *2013* | *2012* |
|---|---|---|
| **Loans to customers** | | |
| Loans to retail clients with regular inflows | 89 | 101 |
| Consumer loans | 21,834 | 8,805 |
| Micro loans | 516 | 239 |
| Corporate & SME loans | 4,735 | 4,488 |
| Residential mortgage loans | 143 | 143 |
| **Total** | **27,317** | **13,776** |

*(thousands of Georgian Lari)*

## 21. Risk management (continued)

### Credit risk (continued)

*Impairment assessment*

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

*Individually assessed allowances*

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

*Collectively assessed allowances*

Allowances are assessed collectively for losses on loans to customers that are not individually significant (including credit cards, residential mortgages, consumer lending and loans to retail clients with regular inflows) 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. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the appropriate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. Management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Group's overall policy.

Financial guarantees and letters of credit are assessed and provisions are made in a similar manner as for loans.

The geographical concentration of the Group's assets and liabilities is set out below:

| | *2013* | | | | *2012* | | | |
|---|---|---|---|---|---|---|---|---|
| | ***Georgia*** | ***OECD*** | ***CIS and other foreign countries*** | ***Total*** | ***Georgia*** | ***OECD*** | ***CIS and other foreign countries*** | ***Total*** |
| **Assets:** | | | | | | | | |
| Cash and cash equivalents | 329,243 | 20,367 | 5,479 | **355,089** | 215,312 | 11,527 | 6,115 | **232,954** |
| Amounts due from credit institutions | 37,847 | 2,604 | – | **40,451** | 80 | 2,593 | – | **2,673** |
| Loans to customers | 600,080 | – | – | **600,080** | 378,118 | – | – | **378,118** |
| Investment securities held-to-maturity | 133,441 | – | – | **133,441** | 59,159 | – | – | **59,159** |
| All other assets | 163,151 | 1,402 | | **164,553** | 164,690 | 1,338 | | **166,028** |
| | **1,263,762** | **24,373** | **5,479** | **1,293,614** | **817,359** | **15,458** | **6,115** | **838,932** |
| **Liabilities:** | | | | | | | | |
| Amounts due to credit institutions | 2,342 | – | – | **2,342** | 28,173 | – | – | **28,173** |
| Derivative financial liabilities | – | – | – | **–** | 232 | 40 | – | **272** |
| Amounts due to customers | 1,117,547 | 13,431 | 27,693 | **1,158,671** | 667,798 | 7,814 | 20,805 | **696,417** |
| All other liabilities | 18,493 | – | – | **18,493** | 15,408 | – | – | **15,408** |
| | **1,138,382** | **13,431** | **27,693** | **1,179,506** | **711,611** | **7,854** | **20,805** | **740,270** |
| **Net assets/(liabilities)** | **125,380** | **10,942** | **(22,214)** | **114,108** | **105,748** | **7,604** | **(14,690)** | **98,662** |

## 21. Risk management (continued)

### Liquidity risk and funding management

The tables below summarise the maturity profile of the Group's financial liabilities at 31 December 2013, 31 December 2012 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

| As of 31 December 2013 | *Less than 3 months* | *3 to 12 months* | *1 to 5 years* | *Over 5 years* | *Total* |
|---|---|---|---|---|---|
| **Financial liabilities** | | | | | |
| Amounts due to credit institutions | 2,168 | 174 | – | – | **2,342** |
| Amounts due to customers | 858,771 | 243,910 | 86,096 | 1,815 | **1,190,592** |
| **Total undiscounted financial liabilities** | **860,939** | **244,084** | **86,096** | **1,815** | **1,192,934** |

| As of 31 December 2012 | *Less than 3 months* | *3 to 12 months* | *1 to 5 years* | *Over 5 years* | *Total* |
|---|---|---|---|---|---|
| **Financial liabilities** | | | | | |
| Amounts due to credit institutions | 1,411 | 26,933 | – | – | **28,344** |
| Amounts due to customers | 497,470 | 187,027 | 31,923 | 1,423 | **717,843** |
| **Total undiscounted financial liabilities** | **498,881** | **213,960** | **31,923** | **1,423** | **746,187** |

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

| | *Less than 3 months* | *3 to 12 months* | *1 to 5 years* | *Over 5 years* | *Total* |
|---|---|---|---|---|---|
| 2013 | 59,616 | 10,294 | 10,032 | 5,691 | **85,633** |
| 2012 | 43,375 | 6,092 | 10,938 | 5,751 | **66,156** |

The Group 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. The Bank has no significant concentration of market risk.

*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 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. Since majority of the interest bearing assets and liabilities of the Group are at fixed rates the Group is not open to interest rate risk fluctuations on the existing interest bearing assets and liabilities.

## 21. Risk management (continued)

### Market risk (continued)

*Currency risk*

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Management Board has set limits on positions by currency based on the NBG regulations. Positions are monitored on a daily basis.

The tables below indicate the currencies to which the Group had significant exposure at 31 December on its non-trading monetary assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the currency rate against the GEL, with all other variables held constant on the statement of profit or loss (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on the statement of profit or loss. A negative amount in the table reflects a potential net reduction in statement of profit or loss or equity, while a positive amount reflects a net potential increase.

| *Currency* | *Appreciation/ (depreciation) of the exchange rate of GEL against the respective currency in % 2013* | *Effect on profit before tax 2013* | *Appreciation/ (depreciation) of the exchange rate of GEL against the respective currency in % 2012* | *Effect on profit before tax 2012* |
|---|---|---|---|---|
| USD | -4.80% | 186 | 0.81% | 30 |
| EUR | -9.47% | (2) | -0.98% | (8) |

### 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 Group 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 include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

## 22. Fair value disclosures

### Fair value measurement procedures

External Valuators are involved for valuation of significant assets, such as properties and available-for-sale securities. Involvement of external Valuators is decided upon annually by the management after discussion with and approval by the Bank's audit committee. Selection criteria include market knowledge, reputation, independence and whether professional standards are maintained. Valuators are normally rotated every three years. The management decides, after discussions with the Group's external Valuators, which valuation techniques and inputs to use for each case.

At each reporting date, the management analyses the movements in the values of assets and liabilities which are required to be re-measured or re-assessed as per the Group's accounting policies. For this analysis, the management verifies the major inputs applied in the latest valuation by agreeing the information in the valuation computation to contracts and other relevant documents. The management, in conjunction with the Group's external Valuators, also compares each the changes in the fair value of each asset and liability with relevant external sources to determine whether the change is reasonable. On an interim basis, the management and the Group's external Valuators present the valuation results to the audit committee and the Group's independent auditors. This includes a discussion of the major assumptions used in the valuations.

### Fair value hierarchy

For the purpose of fair value disclosures, the Group has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

## 22. Fair value disclosures (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 Group's financial instruments that are carried in the consolidated statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

| | *Carrying value 2013* | *Fair value 2013* | *Unrecognised gain/(loss) 2013* | *Carrying value 2012* | *Fair value 2012* | *Unrecognised gain/(loss) 2012* |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Investment securities held-to-maturity | 133,441 | 136,851 | 3,410 | 59,159 | 61,130 | 1,971 |
| **Total unrecognised change in unrealised fair value** | | | **3,410** | | | **1,971** |

**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. This assumption is also applied to demand deposits and savings accounts without a specific maturity.

*Financial assets and financial liabilities carried at amortized cost*

Fair value of the quoted notes and bonds is based on price quotations at the reporting date, as such they fall under level 2 fair value hierarchy. The fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to the NBG and credit institutions and other financial assets and liabilities, is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

*Investment property and buildings*

There are three main approaches to valuation of real property:

*Market Approach*

Establishes limits on the market value for the real estate by examining the prices commonly paid for properties that compete with the subject property for buyers. Sales are investigated to ensure that the parties to the transaction were adequately motivated. Sale prices reflecting motivation other than that of a typical market participant, i.e. transactions of special purchasers who are willing to pay a premium for a particular property, should be eliminated. The method involves analysing units of comparison such as a price per square metre of gross building area. Adjustments are made to the sales/listing for differences in location, size, age and condition, financing and various other factors which may have any influence on the value.

In the analysis of the market value of appraised properties by the sales comparison (market data) approach, it is utilised the sales/listing measured to the best available, most recent and overall similar sales/listing available as of the report date.

Information on the comparable sales and listing is obtained from brokerage companies, agents and brokers, as well as public information, including commercial broker listings on websites and published data. Then such information is further confirmed with owners and/or principles or brokers involved in the listed transactions.

*Cost Approach*

Establishes the value of the real estate by estimating the cost of acquiring the land and building a new property or renovating an old property for equivalent utilisation purposes with no undue cost due to delay. An estimate of entrepreneurial incentive or developer's profit/loss is commonly added to the land and construction costs. For mature properties, the cost approach is used to estimate the depreciation cost, including items of physical deterioration and functional obsolescence.

*(thousands of Georgian Lari)*

## 22. Fair value disclosures (continued)

### Valuation techniques and assumptions (continued)

The main approach of the cost replacement method reflects the idea that one will not pay for the given property more than he/she would pay for the construction of that property.

The cost approach involves the following steps:

- Estimate land value;
- Estimate reproduction or replacement cost of the improvements;
- Estimate accrued depreciation from all sources (physical deterioration, functional obsolescence, external and economic obsolescence);
- Deduct accrued depreciation from the reproduction or replacement cost to arrive at the depreciated improvement cost;
- Estimate equipment cost and deduct depreciation;
- Add the depreciated improvement cost to depreciated equipment cost and to the land value to arrive at a total property value indication.

*Income Capitalisation Approach*

The income generation methodology is based on the hypothetical incomes generated through the use of the property being valued. The estimation of the real estate market value is based on the capitalisation coefficient which is calculated based on the long-term rate of the alternative investment methodology.

*Discount Cash Flow (DCF)*

The fair value of completed investment property is determined using a discounted cash flow (DCF). Based on the actual and projected market demand, types of goods/ services to be produced/provided, pricing policy and expected competitive environment in the market, the strategic financial projections for the business is developed. Using DCF method, a property's fair value is estimated using explicit assumptions regarding the benefits and liabilities of ownership over the asset's life including an exit or terminal value. As an accepted method within the income approach to valuation, the DCF method involves the projection of a series of cash flows on a real property interest. To this projected cash flow series, an appropriate, market-derived discount rate is applied to establish the present value of the cash inflows associated with the real property. The duration of the cash flow and the specific timing of inflows and outflows are determined by events such as rent reviews, lease renewal and related lease up periods, re-letting, redevelopment, or refurbishment. The appropriate duration is typically driven by market behaviour that is a characteristic of the class of real property.

In the case of investment properties, periodic cash flow is typically estimated as gross income less vacancy, non-recoverable expenses, collection losses, lease incentives, maintenance cost, agent and commission costs and other operating and management expenses. The series of periodic net cash inflows, along with an estimate of the terminal value anticipated at the end of the projection period, is then discounted.

## 22. Fair value disclosures (continued)

### Valuation techniques and assumptions (continued)

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

| *As of 31 December 2013* | *Carrying amount* | *Valuation techniques* | *Unobservable input* | *Range (weighted average)* |
|---|---|---|---|---|
| Property and equipment - buildings | 87,442 | - Market approach<br>- Cost approach | - Price volatility adjustment<br>- Replacement cost<br>- Annual depreciation cost (Physical, Functional, Economic)<br>- Land price volatility adjustment | (20%) up to 25% |
| Investment property - commercial building | 1,871 | - Market approach | - Price volatility adjustment | (16%) up to 19% |
| Investment property - commercial building | 332 | - Cost approach | - Replacement cost<br>- Annual depreciation cost (Physical, Functional, Economic)<br>- Land price volatility adjustment | (10%) up to 9% |
| Investment property - commercial building | 950 | - Cost approach | - Replacement cost<br>- Annual depreciation cost (Physical, Functional, Economic)<br>- Land price volatility adjustment | (5%) up to 5% |
| Investment property - commercial building | 1,762 | - Income Capitalisation Approach (DCF) | - Annual average vacancy rate<br>- Rent per Sq.m<br>- Annual Discount rate | (12%) up to 3% |
| Investment property - commercial building | 73 | - Market approach | - Price volatility adjustment | (22%) up to 13% |

## 23. Maturity analysis of assets and liabilities

The table below shows an analysis of monetary assets and liabilities according to when they are expected to be recovered or settled.

| | *2013* | | | *2012* | | |
|---|---|---|---|---|---|---|
| | *Within one year* | *More than one year* | *Total* | *Within one year* | *More than one year* | *Total* |
| Cash and cash equivalents | 355,089 | – | 355,089 | 232,954 | – | **232,954** |
| Amounts due from credit institutions | 40,451 | – | 40,451 | 2,673 | – | **2,673** |
| Loans to customers | 379,610 | 220,470 | 600,080 | 235,044 | 143,074 | **378,118** |
| Investment securities held-to-maturity | 80,495 | 52,946 | 133,441 | 18,412 | 40,747 | **59,159** |
| **Total** | **855,645** | **273,416** | **1,129,061** | **489,083** | **183,821** | **672,904** |
| | | | | | | |
| Amounts due to credit institutions | 2,342 | – | 2,342 | 28,173 | – | **28,173** |
| Amounts due to customers, of which: | 682,766 | 475,905 | 1,158,671 | 402,698 | 293,719 | **696,417** |
| Current accounts | 347,515 | 403,184 | 750,699 | 186,123 | 266,643 | **452,766** |
| Time deposits | 335,251 | 72,721 | 407,972 | 216,575 | 27,076 | **243,651** |
| Other liabilities | 2 | – | 2 | 274 | – | **274** |
| **Total** | **685,110** | **475,905** | **1,161,015** | **431,145** | **293,719** | **724,864** |
| **Net** | **170,535** | **(202,489)** | **(31,954)** | **57,938** | **(109,898)** | **(51,960)** |

## 23. Maturity analysis of assets and liabilities (continued)

Customer deposits diversification by number and type of depositors and the past experience of the Group indicate that such accounts and deposits provide a long term and stable source of funding, and as a result they are allocated per expected time of funds outflow in the gap analysis table on the basis of statistical data accumulated by the Group during the previous periods and assumptions regarding the "permanent" part of current account balances.

As of 31 December 2013 total Amounts due to customers amounted to GEL 1,158,671 (2012: GEL 696,417), of which current accounts comprised of GEL 750,699 and GEL 452,766 as of 31 December 2013 and 2012, respectively. The Bank conducts the analysis of the stability of current accounts for the period of the preceding two years on a daily basis. These balances have not fallen below GEL 403,184 (2012: GEL 266,643) for the respective periods of the preceding 24 months. As such, it is reasonable to present these funds in Amounts due to customers in more than one year maturity range in the above schedule. If the contractual maturities of Amounts due to customers were considered, the cumulative liquidity gap within one year as of 31 December 2013 would have been negative GEL 232,649 (31 December 2012: negative GEL 208,705).

As of 31 December 2013, the Bank had sufficient liquid collateral to additionally draw down GEL 126,770 (2012: GEL 54,622) from the NBG at immediate notice.

On 14 June 2013, Fitch Ratings affirmed the Bank's Long-Term Foreign Currency Issuer Default Rating (IDR) of 'B', Short-term IDR of 'B', Individual Rating of 'D/E', Support Rating of '4' and Support Rating Floor of 'B'. The Outlook for the Long-term IDR is Stable. (In 2010 Fitch Ratings assigned the Bank a Long-Term Foreign Currency Issuer Default Rating (IDR) of 'B', Short-term IDR of 'B', Individual Rating of 'D/E', Support Rating of '4' and Support Rating Floor of 'B'. The Outlook for the Long-term IDR is Stable).

## 24. Related party disclosures

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

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

The outstanding balances at the period end of and related income and expense arising from related party transactions are as follows:

| | *2013* | | | | *2012* | | | |
|---|---|---|---|---|---|---|---|---|
| | *Parent* | *Entities with significant influence over the Group* | *Entities under common control* | *Key management personnel* | *Parent* | *Entities with significant influence over the Group* | *Entities under common control* | *Key management personnel* |
| **Loans outstanding at 1 January, gross** | **–** | **–** | **–** | **258** | **–** | **–** | **–** | **208** |
| Loans issued during the year | – | – | – | 208 | – | – | – | 50 |
| Loan repayments during the year | – | – | – | (319) | – | – | – | – |
| **Loans outstanding at 31 December, gross** | **–** | **–** | **–** | **147** | **–** | **–** | **–** | **258** |
| Less: allowance for impairment at 31 December | – | – | – | 3 | – | – | – | 5 |
| **Loans outstanding at 31 December, net** | **–** | **–** | **–** | **144** | **–** | **–** | **–** | **253** |
| Interest income on loans | – | – | – | 22 | – | – | – | 29 |
| Impairment (reversal)/ charge for loans | – | – | – | (2) | – | – | – | – |

*(thousands of Georgian Lari)*

## 24. Related party disclosures (continued)

| | 2013 | | | | 2012 | | | |
|---|---|---|---|---|---|---|---|---|
| | *Parent* | *Entities with significant influence over the Group* | *Entities under common control* | *Key management personnel* | *Parent* | *Entities with significant influence over the Group* | *Entities under common control* | *Key management personnel* |
| **Deposits at 1 January** | **–** | **–** | **–** | **1,718** | **–** | **–** | **–** | **30** |
| Deposits received during the year | 620 | – | 587 | 654 | – | – | – | 1,905 |
| Deposits repaid during the year | – | – | – | (2,012) | – | – | – | (217) |
| **Deposits at 31 December** | **620** | **–** | **587** | **360** | **–** | **–** | **–** | **1,718** |
| Current accounts at 31 December | 48 | 9 | 1,089 | 2,175 | 303 | – | 574 | 631 |
| Interest expense on deposits | 17 | 0 | 90 | 209 | 118 | – | – | 271 |
| Interest expense on the CCPN | – | – | – | – | 2,167 | | | – |
| Commitments and guarantees issued | – | – | 850 | – | – | – | – | – |
| Fee and commission income | – | – | 292 | 5 | – | – | – | 2 |
| Other operating expenses | 36 | – | 478 | 180 | – | – | – | 335 |

Entities under common control comprises of organizations in which shareholders of the Group exercise control which represent related parties to the Group.

The number of key personnel at 31 December 2013 was 11 (2012: 12) and their compensation comprised of the following:

| | *2013* | *2012* |
|---|---|---|
| Salaries and other short term benefits | 3,618 | 2,714 |
| Retention bonus paid in cash for purchase of convertible preferred shares | 1,164 | – |
| Share based payment compensation | – | 211 |
| **Total key personnel compensation** | **4,782** | **2,925** |

## 25. Capital adequacy

The Bank is regulated by the NBG. As such, the Bank submits to the NBG monthly reports of its financial position and operation (the "Monthly Supervision Report"), which, *inter alia*, contains the Bank's Tier I and Total Capital Adequacy Ratios, calculated in accordance with the methodology required by the NBG. The capital adequacy calculation methodology adopted by the NBG differs in certain material respects from the BIS (Basel I) framework, but has historically been more stringent, due, *inter alia*, to the higher market-risk weighting of the assets.

The Bank maintains an actively managed capital base to cover risks inherent in the business and aims at further enhancing its capital base. The adequacy of the Group's capital is monitored using, among other measures, the ratios established by the NBG and the ratios established by the Basel Capital Accord 1988 in supervising the Group.

The minimum Tier I and the Total Capital Adequacy Ratios required by the NBG are 8% and 12%, respectively, of the risk weighted assets. The Bank's Tier I and Total Capital Adequacy Ratios were above the minimum requirements as of 31 December 2013 and 31 December 2012.

## 25. Capital adequacy (continued)

*NBG capital adequacy ratio*

The NBG requires banks to maintain the minimum capital adequacy ratio of 12% of the RWA, as well as the minimum core capital (Tier 1 capital) adequacy ratio of 8% of the RWA, computed based on the Bank's stand-alone financial statements, prepared in accordance with the NBG requirements. As of 31 December 2013 and 31 December 2012, the Bank's capital adequacy ratios were as follows:

| | ***2013*** | ***2012*** |
|---|---|---|
| Core capital | 72,691 | 59,975 |
| Supplementary capital | 48,895 | 17,726 |
| Less: deductions from capital | (1,458) | (1,458) |
| **Total capital** | **120,128** | **76,243** |
| **Risk-weighted assets** | **888,121** | **620,796** |
| Tier I capital adequacy ratio | 8.18% | 9.66% |
| Capital adequacy ratio | 13.53% | 12.28% |

On 23 October 2013, the NBG approved (by its Decree # 100/04) the revised minimum capital adequacy ratio of 10.5% of the RWA, minimum core capital (Tier 1 capital) adequacy ratio of 8.5% of the RWA, as and common equity ratio of 7.0% of the RWA, computed based on the Bank's stand-alone financial statements, prepared in accordance with the NBG requirements. During the transitional period, banks are required to report their capital adequacy ratios under both old and new methods of calculation.As of 31 December 2013 and 31 December 2012, the Bank's capital adequacy ratios per new regulation were as follows:

| | ***2013*** | ***2012*** |
|---|---|---|
| **Total regulatory capital** | **118,030** | **74,941** |
| Tier 1 capital | 107,972 | 67,964 |
| Common equity tier 1 capital | 102,793 | 67,071 |
| **Additional tier 1 capital** | **5,179** | **893** |
| Tier 2 capital | 10,058 | 6,977 |
| Total risk weighted exposures | 950,819 | 676,647 |
| Total regulatory capital ratio | 12.41% | 11.08% |
| Tier 1 capital ratio | 11.36% | 10.04% |
| Common equity tier 1 ratio | 10.81% | 9.91% |

*Capital adequacy ratio under Basel Capital Accord 1988*

The Group's capital adequacy ratios, computed in accordance with the Basel Capital Accord 1988, with subsequent amendments including the amendment to incorporate market risks, as of 31 December 2013 and 31 December 2012, were as follows:

| | ***2013*** | ***2012*** |
|---|---|---|
| Tier 1 capital | 93,827 | 77,897 |
| Tier 2 capital | 29,915 | 27,618 |
| **Total capital** | **123,742** | **105,515** |
| **Risk-weighted assets** | **783,891** | **575,684** |
| Tier 1 capital adequacy ratio | 11.97% | 13.53% |
| Total capital adequacy ratio | 15.79% | 18.33% |

*(thousands of Georgian Lari)*

## 26. Events after the reporting period

On 31 October 2013 former shareholders of JSC Liberty Bank - Irina Jincharadze, Elena Kovalenko and Tamar Marshania (hereinafter the "Original Plaintiffs") - filed a claim at the Tbilisi City Court against the defendants Eurooil LLP, JSC Liberty Bank, Liberty Holdings Georgia LLC, JSC Liberty Capital, Liberty Investments Holding BV (hereinafter the "Respondents"), requesting partial annulment and voidance of the share purchase agreement between Eurooil LLP, on the one hand, and Irina Jincharadze, Elena Kovalenko, Giorgi Goguadze, Tamar Marshania, Gaioz Marshania, Ana Agureeva and Stark Road Resource Limited, on the other hand, dated 29 December 2008 (as amended on 29 December 2008) (hereinafter the "SPA") with respect to the sale and purchase of 1,403,223,900 ordinary shares of the Bank (with the aggregate consideration received by the selling shareholders amounting to 2.76 times the IFRS audited equity book value of the Bank as of 31 December 2008), of which the Original Plaintiffs had sold 801,454,200 ordinary shares of the Bank for the aggregate consideration of GEL 20,835. As injunctive relief, the Original Plaintiffs requested the encumbrance of 50.97% of the Bank's ordinary shares held by one of the defendants - Liberty Holdings Georgia LLC and nine units of real estate property owned by JSC Liberty Bank.

On 1 November 2013 the Tbilisi City Court partially satisfied the injunction application of Irina Jincharadze, Elena Kovalenko and Tamar Marshania and encumbered 50.97% of the ordinary shares outstanding of the Bank held by Liberty Holdings Georgia LLC. On 21 November, 2013 one other former shareholder Ana Gerbiak (the Original Plaintiffs and Ana Gerbiak jointly referred to as "Former Shareholders") filed a claim at the Tbilisi City Court against the defendants Eurooil LLP, JSC Liberty Bank, Liberty Holdings Georgia LLC, JSC Liberty Capital, Liberty Investments Holding BV; requesting partial annulment and voidance of the SPA. As injunctive relief, Ana Gerbiak requested the encumbrance of 7.21% of the Bank's ordinary shares outstanding held by one of the defendants - Liberty Holdings Georgia LLC.

On 25 November 2013 the Tbilisi City Court satisfied the injunction application of Ana Gerbiak and encumbered 7.21% of shares of the Bank held by Liberty Holding Georgia LLC. As a result, as of 31 December 2013, 3,201,321,628 ordinary shares of the Bank owned by Liberty Holdings Georgia LLC (equivalent to the IFRS ordinary equity book value of GEL 63,375) were encumbered by the Tbilisi City Court pending the outcome of the litigation

The Respondents have duly appealed Tbilisi City Court's decisions on both of the cases initiated by the Former Shareholders, requesting the reversal of the court's decisions on the ordinary share encumbrance, however, the Tbilisi Court of Appeals upheld both decisions of the Tbilisi City Court and returned the case back to the Tbilisi City Court for further consideration.

The Tbilisi City Court subsequently joined the claims filed by the Original Plaintiffs and Ana Gerbiak and the case in currently pending as one.

In addition to the above appeals, the Respondents filed a motion, requesting the Tbilisi City Court to oblige the Former Shareholders to post adequate undertaking to secure potential damages inflicted on the Bank as a result of the injunction. The Respondents provided the Tbilisi City Court with three different independent expert opinions which confirm the necessity of such undertaking and the Tbilisi City Court satisfied the claims by the Respondents and ruled, in the hearing held on 14 March 2014, that the Former Shareholders post the undertaking in the amount of USD 2.8 million in cash in the designated escrow account within 7 (seven) calendar days from the date of the ruling. Failure by the Former Shareholders to provide the above undertaking shall automatically revoke the encumbrance on the Bank's shares unless subsequently appealed by the Original Plaintiffs. The Original Plaintiffs did not post the requested undertaking in the amount of USD 2.8 million and the court has issued a ruling on 28 March 2014, ordering removal of the encumbrance on the shares. The Original Plaintiffs have 5 (five) calendar days to appeal the court ruling after receipt of such ruling.

Management strongly believes that the aforementioned lawsuit is frivolous in nature and wholly without merit and anticipates that the litigation will end in favour of the Respondents, including the Bank.