# JSC Bank Constanta

## International Financial Reporting Standards Financial Statements and Independent Auditor's Report

## 31 December 2012

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INDEPENDENT AUDITOR'S REPORT

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## *Independent Auditor's Report*

To the Shareholders and Management of JSC Bank Constanta:

We have audited the accompanying financial statements of JSC Bank Constanta which comprise the statement of financial position as at 31 December 2012 and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

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

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

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

### Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of JSC Bank Constanta as at 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers Central Asia & Caucasus B.V. Georgia Branch.

29 March 2013
Tbilisi, Georgia

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| *In thousands of GEL* | Note | 31 December 2012 | 31 December 2011 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 7 | 22,175 | 12,734 |
| Mandatory minimum reserve with National Bank of Georgia | 8 | 9,708 | 6,886 |
| Loans and advances to customers | 9 | 191,904 | 118,124 |
| Prepaid income tax | | 126 | - |
| Intangible assets | 11 | 1,576 | 879 |
| Premises and equipment | 11 | 16,596 | 10,858 |
| Other financial assets | 10 | 1,070 | 729 |
| Other assets | 12 | 1,275 | 949 |
| **Total assets** | | **244,430** | **151,159** |
| **Liabilities** | | | |
| Due to other banks | | 76 | 66 |
| Customer accounts | 13 | 55,926 | 13,798 |
| Other borrowed funds | 16 | 145,559 | 107,881 |
| Current income tax liability | | - | 96 |
| Deferred income tax liability | 24 | 1,346 | 509 |
| Other financial liabilities | 14 | 675 | 377 |
| Other liabilities | 15 | 1,109 | 586 |
| Subordinated debt | 17 | 5,006 | 5,006 |
| **Total liabilities** | | **209,697** | **128,319** |
| **EQUITY** | | | |
| Share capital | 18 | 27,423 | 20,906 |
| Share premium | 18 | 983 | - |
| Retained earnings | | 5,775 | 1,382 |
| Revaluation reserve for premises | | 552 | 552 |
| **Total equity** | | **34,733** | **22,840** |
| **Total liabilities and equity** | | **244,430** | **151,159** |

Approved for issue and signed on behalf of the Board of Directors on 29 March 2013.

Levan Lebanidze
General Director

Zviad Mirianashvili
Finance Director

| *In thousands of GEL* | Note | 2012 | 2011 |
|---|---|---|---|
| Interest income | 19 | 52,447 | 29,369 |
| Interest expense | 19 | (15,748) | (8,336) |
| **Net interest income** | | **36,699** | **21,033** |
| Provision for loan impairment | 9 | (5,959) | (760) |
| **Net interest income after provision for loan impairment** | | **30,740** | **20,273** |
| Fee and commission income | 20 | 1,667 | 724 |
| Fee and commission expense | 20 | (433) | (168) |
| Gains less losses from trading in foreign currencies | | 876 | 422 |
| Foreign exchange translation losses net of gains | | (31) | (60) |
| Other operating income | 21 | 922 | 1,053 |
| Administrative and other operating expenses | 23 | (28,618) | (18,676) |
| Revenue from grants | 22 | 147 | - |
| **Profit before tax** | | **5,270** | **3,568** |
| Income tax expense | 24 | (877) | (519) |
| **Profit for the year** | | **4,393** | **3,049** |
| **Other comprehensive income :** | | | |
| Revaluation of premises | 11 | - | 649 |
| Income tax recorded directly in other comprehensive income | 24 | - | (97) |
| **Other comprehensive income for the year** | | **-** | **552** |
| **Total comprehensive income for the year** | | **4,393** | **3,601** |

| *In thousands of GEL* | Share capital | Share premium | Revaluation reserve for premises | Retained earnings | Total |
|---|---|---|---|---|---|
| **At 1 January 2011** | **17,406** | **-** | **-** | **(1,667)** | **15,739** |
| Profit for the year | - | - | - | 3,049 | **3,049** |
| Other comprehensive income | - | - | 552 | - | **552** |
| **Total comprehensive income for the year** | **-** | **-** | **552** | **3,049** | **3,601** |
| Share capital increase | 3,500 | - | - | - | **3,500** |
| **Balance at 31 December 2011** | **20,906** | **-** | **552** | **1,382** | **22,840** |
| Profit for the year | - | - | - | 4,393 | **4,393** |
| **Total comprehensive income for the year** | **-** | **-** | **-** | **4,393** | **4,393** |
| Share capital increase | 6,517 | 983 | - | - | **7,500** |
| **Balance at 31 December 2012** | **27,423** | **983** | **552** | **5,775** | **34,733** |

| *In thousands of GEL* | Note | 2012 | 2011 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Interest received | | 49,686 | 27,767 |
| Interest paid | | (15,336) | (7,456) |
| Fees and commissions received | | 1,667 | 1,095 |
| Fees and commissions paid | | (433) | (313) |
| Income received from trading in foreign currencies | | 876 | 422 |
| Other operating income received | | 922 | 1,053 |
| Grants received | | 8 | - |
| Staff costs paid | | (13,380) | (9,176) |
| Administrative and other operating expenses paid | | (11,547) | (6,875) |
| Income tax paid | | (262) | - |
| **Cash flows from operating activities before changes in operating assets and liabilities** | | **12,201** | **6,517** |
| Net increase in mandatory minimum reserve with National Bank of Georgia | | (2,790) | (3,870) |
| Net increase in loans and advances to customers | | (76,409) | (49,232) |
| Net increase in other financial assets | | (341) | (104) |
| Net increase in other assets | | (865) | (582) |
| Net increase in customer accounts | | 42,094 | 11,892 |
| **Net cash used in operating activities** | | **(26,110)** | **(35,379)** |
| **Cash flows from investing activities** | | | |
| Acquisition of intangible assets | | (938) | (248) |
| Acquisition of premises and equipment | | (7,745) | (4,531) |
| Proceeds from disposal of premises and equipment | | 56 | 51 |
| **Net cash used in investing activities** | | **(8,627)** | **(4,728)** |
| **Cash flows from financing activities** | | | |
| Proceeds from due to banks | | 10 | 66 |
| Proceeds from other borrowed funds | | 74,307 | 71,010 |
| Repayment of other borrowed funds | | (37,612) | (31,243) |
| Proceeds from subordinated debt | | - | 5,000 |
| Issue of ordinary shares | 18 | 7,500 | 3,500 |
| **Net cash from financing activities** | | **44,205** | **48,333** |
| **Effect of exchange rate changes on cash and cash equivalents** | | **(27)** | **(49)** |
| **Net increase in cash and cash equivalents** | | **9,441** | **8,177** |
| Cash and cash equivalents at the beginning of the period | 7 | **12,734** | **4,557** |
| **Cash and cash equivalents at the end of the year** | | **22,175** | **12,734** |

## 1 Introduction

These financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2012 for JSC Bank Constanta (the “Bank”).

The Bank was incorporated on 8 November 2007 and is domiciled in Georgia. The Bank is a closed joint stock company limited by shares issued and was set up in accordance with Georgian regulations.

As at 31 December 2012, the Bank’s immediate and ultimate parent company was JSC TBC Bank with ownership interest of 84.56%. (2011: 83.26%)

***Principal activity.*** The Bank’s principal business activity is microfinance banking operations within Georgia. The Bank has operated under a general banking licence issued by National Bank of Georgia (“NBG”) since 3 July 2008. The Bank has 47 service centres within Georgia (2011: 25). As at 31 December 2012, the Bank had 983 employees (2011: 556).

***Registered address and place of business.*** The Bank’s registered address is: 115 Tsinamdzgvrishvili Street, Tbilisi 0164, Georgia. Head office location: 117 Tsereteli ave, Tbilisi 0119, Georgia.

***Presentation currency.*** These financial statements are presented in thousands of Georgian Lari ("GEL"), unless otherwise stated.

## 2 Operating Environment of the Bank

The Bank’s principal business activities are within Georgia. Georgia continues to display certain characteristics of an emerging market. Tax, currency and customs legislation is subject to varying interpretations and contributes to the challenges faced by companies operating in the Georgia. In addition, the international sovereign debt crisis and stock market volatility may affect the ability of the Bank to achieve the performance targets.

Management is unable to predict all developments which could have an impact on banking sector and the wider economy and consequently what effect, if any, they could have on the future financial position of the Bank.

The future economic direction of Georgia is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory and political developments.

Management believes it is taking all the necessary measures to support the sustainability and development of the Bank’s business.

## 3 Summary of Significant Accounting Policies

***Basis of preparation.*** These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value, and by the revaluation of premises; available-for-sale financial assets, and financial instruments categorised at fair value through profit or loss. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

***Financial instruments - key measurement terms.*** Depending on their classification financial instruments are carried at fair value, cost, or amortised cost as described below.

*Fair value* is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction. Fair value is the current bid price for financial assets and current asking price for financial liabilities which are quoted in an active market. For assets and liabilities with offsetting market risks, the Bank may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange or other institution and those prices represent actual and regularly occurring market transactions on an arm’s length basis.

## 3 Summary of Significant Accounting Policies (Continued)

Valuation techniques such as discounted cash flow models or models based on recent arm's length transactions or consideration of financial data of the investees are used to fair value certain financial instruments for which external market pricing information is not available. Valuation techniques may require assumptions not supported by observable market data. Disclosures are made in these financial statements if changing any such assumptions to a reasonably possible alternative would result in significantly different profit, income, total assets or total liabilities.

*Cost* is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes *transaction costs*. Measurement at cost is only applicable to investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments.

*Transaction costs* are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

*Amortised cost* is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including fees deferred at origination, if any, are not presented separately and are included in the carrying values of related items in the statement of financial position.

*The effective interest method* is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

***Initial recognition of financial instruments***. Non-derivative financial instruments are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date that the Bank commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

***Derecognition of financial assets.*** The Bank derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Bank has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

**3 Summary of Significant Accounting Policies (Continued)**

***Cash and cash equivalents.*** Cash and cash equivalents are items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents include all interbank placements with original maturities of less than three months. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

***Mandatory cash balances with the NBG.*** Mandatory cash balances with NBG are carried at amortised cost and represent interest bearing and non-interest bearing mandatory reserve deposits which are not available to finance the Bank's day to day operations and hence are not considered as part of cash and cash equivalents for the purposes of the statement of cash flows.

***Loans and advances to customers.*** Loans and advances to customers are recorded when the Bank advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates and has no intention of trading the receivable. Loans and advances to customers are carried at amortised cost.

***Impairment of financial assets carried at amortised cost.*** Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Bank determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Bank considers in determining whether a financial asset is impaired are its overdue status and realisability of related collateral, if any.

The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

- any instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the borrower experiences a significant financial difficulty as evidenced by the borrower's financial information that the Bank obtains;
- the borrower considers bankruptcy or a financial reorganisation;
- there is an adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrower; or
- the value of collateral significantly decreases as a result of deteriorating market conditions.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms.

## 3 Summary of Significant Accounting Policies (Continued)

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. 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.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss for the year.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to other operating income in profit or loss for the year.

***Repossessed collateral***. Repossessed collateral represents financial and non-financial assets acquired by the Bank in settlement of overdue loans. The assets are initially recognised at fair value plus relevant incremental costs when acquired and are subsequently remeasured at lower of cost or net realizable value.

***Credit related commitments.*** The Bank enters into credit related commitments, including letters of credit and financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At the end of each reporting period, the commitments are measured at the higher of (i) the remaining unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the end of each reporting period.

***Investment securities available for sale.*** This classification includes investment securities which the Bank intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Investment securities available for sale are carried at fair value. Dividends on available-for-sale equity instruments are recognised in profit or loss for the year when the Bank's right to receive payment is established and it is probable that the dividends will be collected. All other elements of changes in the fair value are recognised in other comprehensive income until the investment is derecognised or impaired, at which time the cumulative gain or loss is reclassified from other comprehensive income to profit or loss for the year.

Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of investment securities available for sale. A significant or prolonged decline in the fair value of an equity security below its cost is an indicator that it is impaired. The cumulative impairment loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised in profit or loss – is reclassified from other comprehensive income to profit or loss for the year. Impairment losses on equity instruments are not reversed and any subsequent gains are recognised in other comprehensive income. If, in a subsequent period, the fair value of a debt instrument classified as available for sale 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 profit or loss for the year.

## 3 Summary of Significant Accounting Policies (Continued)

***Premises and equipment.*** Premises and equipment, except for land and buildings, are stated at cost less accumulated depreciation and provision for impairment, where required.

Land and buildings of the Bank are subject to revaluation with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. Increases in the carrying amount arising on revaluation are credited to other comprehensive income and increase the revaluation surplus in equity. Decreases that offset previous increases of the same asset are recognised in other comprehensive income and decrease the previously recognised revaluation surplus in equity; all other decreases are charged to profit or loss for the year. The revaluation reserve for premises and equipment included in equity is transferred directly to retained earnings or accumulated deficit when the revaluation surplus is realised on the retirement or disposal of the asset.

Costs of minor repairs and maintenance are expensed when incurred. Costs of replacing major parts or components of premises and equipment items are capitalised and the replaced part is retired.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss for the year (within other operating income or expenses).

***Depreciation.*** Land and construction in progress are not depreciated. Depreciation on other items of premises and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

| | Useful lives in years |
|---|---|
| Premises | 20 to 50 |
| Equipment and motor vehicles | 5 to 10 |
| Leasehold improvements | over the term of the underlying lease |

The residual value of an asset is the estimated amount that the Bank would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

***Intangible assets.*** The Bank's intangible assets other than goodwill have definite useful life and primarily include capitalised computer software. Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring them to use.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Development costs that are directly associated with identifiable and unique software controlled by the Bank are recorded as intangible assets if the inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred. Capitalised computer software is amortised on a straight line basis over expected useful lives of 5 to 20 years.

***Operating leases.*** Where the Bank is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lesser to the Bank, the total lease payments are charged to profit or loss for the year (rental expense) on a straight-line basis over the period of the lease.

Leases embedded in other agreements are separated if (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets and (b) the arrangement conveys a right to use the asset.

***Other borrowed funds.*** Other borrowed funds are recorded when money or other assets are advanced to the Bank by counterparty lenders. The non-derivative liability is carried at amortised cost. If the Bank purchases its own debt, the liability is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from early retirement of debt.

## 3 Summary of Significant Accounting Policies (Continued)

***Subordinated debt.*** Subordinated debt includes long-term non-derivative liabilities and is carried at amortized cost. The repayment of subordinated debt ranks after all other creditors in case of liquidation and is included in Tier 2 Capital of the Bank.

***Customer accounts.*** Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at amortised cost.

***Grants.*** Grants are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Bank will comply with all attached conditions. Grants are included in non-current liabilities as deferred income and are credited to profit or loss when underlying conditions are performed and formal approval obtained from grantor.

***Trade and other payables.*** Trade payables are accrued when the counterparty has performed its obligations under the contract and are carried at amortised cost.

***Derivative financial instruments.*** Derivative financial instruments, mainly foreign exchange contracts, are carried at their fair value. The Bank also enters into offsetting deposits with its counterparty banks to exchange currencies. Such deposits, while legally separate, are aggregated and accounted for as a single derivative financial instrument (currency swap) on a net basis where (i) the deposits are entered into at the same time and in contemplation of one another, (ii) they have the same counterparty, (iii) they relate to the same risk and (iv) there is no apparent business purpose for structuring the transactions separately that could not also have been accomplished in a single transaction.

All derivative instruments are carried as assets when fair value is positive and as liabilities when fair value is negative. Changes in the fair value of derivative instruments are included in profit or loss for the year. The Bank does not apply hedge accounting.

Derivative instruments embedded in other financial instruments are treated as separate derivative instruments when their risks and characteristics are not closely related to those of the host contract.

***Income taxes.*** Income taxes have been provided for in the financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge comprises current tax and deferred tax and is recognised in profit or loss for the year except if it is recognised in other comprehensive income or directly in equity because it relates to transactions that are also recognised, in the same or a different period, in other comprehensive income or directly in equity.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if financial statements are authorised prior to filing relevant tax returns. Taxes other than on income are recorded within administrative and other operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Bank. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

***Uncertain tax positions.*** The Bank's uncertain tax positions are reassessed by management at the end of each reporting period. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the end of the reporting period and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognised based on management's best estimate of the expenditure required to settle the obligations at the end of the reporting period.

## 3 Summary of Significant Accounting Policies (Continued)

***Share capital.*** Ordinary shares with discretionary dividends are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

***Dividends.*** Dividends are recorded in equity in the period in which they are declared. Any dividends declared after the end of the reporting period and before the financial statements are authorised for issue are disclosed in the subsequent events note. Georgian legislation identifies the basis of distribution as the current year net profit.

***Income and expense recognition.*** Interest income and expense are recorded for all debt instruments on an accrual basis using the effective interest method. This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Bank to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Bank does not designate loan commitments as financial liabilities at fair value through profit or loss.

When loans and other debt instruments become doubtful of collection, they are written down to the present value of expected cash inflows and interest income is thereafter recorded for the unwinding of the present value discount based on the asset's effective interest rate which was used to measure the impairment loss.

All other fees, commissions and other income and expense items are generally recorded on an accrual basis by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

***Capitalisation of borrowing costs.*** Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that is not carried at fair value and that necessarily takes a substantial period of time to get ready for its intended use or sale (a qualifying asset) form part of the cost of that asset, if the commencement date for capitalisation is on or after 1 January 2010. Other borrowing costs are recognised as an expense using the effective interest method. The Bank capitalises borrowing costs that would have been avoided if it had not made capital expenditure on qualifying assets. The commencement date for capitalisation is when (a) the Bank incurs expenditures for the qualifying asset; (b) it incurs borrowing costs; and (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale. Capitalisation ceases when all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Interest or other investment income is not deducted in arriving at the amount of borrowing costs available for capitalisation, except where the Bank obtains specific borrowings for the purpose of acquiring a qualifying asset and has investment income on the temporary investment of funds obtained through such specific borrowings.

***Foreign currency translation.*** The functional currency of the Bank is the currency of the primary economic environment in which the entity operates. The Bank's functional and presentation currency is the national currency of Georgia, Lari.

Monetary assets and liabilities are translated into functional currency at the official exchange rate at the respective balance sheet dates. Foreign exchange gains and losses resulting from the settlement of transactions and from the translation of monetary assets and liabilities into functional currency at year-end official exchange rates are recognised in profit or loss. Translation at year-end rates does not apply to non-monetary items, including equity investments. Effects of exchange rate changes on the fair value of equity securities are recorded as part of the fair value gain or loss.

At 31 December 2012, the closing rate of exchange used for translating foreign currency balances was USD 1 = GEL 1.6567 (2011: USD 1 = GEL 1.6703); EUR 1 = GEL 2.1825 (2011: EUR 1 = GEL 2.1614).

## 3 Summary of Significant Accounting Policies (Continued)

***Offsetting.*** Financial assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

***Staff costs and related contributions.*** Wages, salaries, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Bank. The Bank has no legal or constructive obligation to make pension or similar benefit payments and social contributions.

***Presentation of statement of financial position in order of liquidity.*** The Group does not have a clearly identifiable operating cycle and therefore does not present current and non-current assets and liabilities separately in the statement of financial position. Instead, assets and liabilities are presented in order of their liquidity. The following table provides information for each line item in the statement of financial position which combines amounts expected to be recovered or settled before and after twelve months after the reporting period

| | **31 December 2012** | | | **31 December 2011** | | |
|---|---|---|---|---|---|---|
| | **Amounts expected to be recovered or settled** | | | **Amounts expected to be recovered or settled** | | |
| *In thousands of GEL* | **Within 12 months after the reporting period** | **After 12 months after the reporting period** | **Total** | **Within 12 months after the reporting period** | **After 12 months after the reporting period** | **Total** |
| ASSETS | | | | | | |
| Cash and cash equivalents | 22,175 | - | **22,175** | 12,734 | - | **12,734** |
| Mandatory minimum reserve with National Bank of Georgia | - | 9,708 | **9,708** | - | 6,886 | **6,886** |
| Loans and advances to customers | 126,166 | 65,738 | **191,904** | 80,958 | 37,166 | **118,124** |
| Prepaid Income tax | - | 126 | **126** | - | - | **-** |
| Intangible assets | - | 1,576 | **1,576** | - | 879 | **879** |
| Premises and equipment | - | 16,596 | **16,596** | - | 10,858 | **10,858** |
| Other financial assets | 480 | 590 | **1,070** | 461 | 268 | **729** |
| Other assets | - | 1,275 | **1,275** | - | 949 | **949** |
| **TOTAL ASSETS** | **148,821** | **95,609** | **244,430** | **94,153** | **57,006** | **151,159** |
| LIABILITIES | | | | | | |
| Due to other banks | 76 | - | **76** | 66 | - | **66** |
| Customer accounts | 48,179 | 7,747 | **55,926** | 11,998 | 1,800 | **13,798** |
| Other borrowed funds | 43,077 | 102,482 | **145,559** | 37,157 | 70,724 | **107,881** |
| Current income tax liability | - | - | **-** | 96 | - | **96** |
| Deferred income tax liability | - | 1,346 | **1,346** | - | 509 | **509** |
| Other financial liabilities | 675 | - | **675** | 377 | - | **377** |
| Other liabilities | 1,108 | - | **1,108** | 586 | - | **586** |
| Subordinated debt | 6 | 5,000 | **5,006** | 6 | 5,000 | **5,006** |
| **TOTAL LIABILITIES** | **93,122** | **116,635** | **209,697** | **50,286** | **78,033** | **128,319** |

***Changes in presentation.*** Where necessary corresponding figures have been adjusted to conform to the presentation of the current year amounts.

***Amendments of the financial statements after issue.*** The Bank's shareholders and management have the power to amend the financial statements after issue.

## 4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies

The Bank makes estimates and assumptions that affect the amounts recognised in the financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

***Impairment losses on loans and advances.*** The Bank regularly reviews its loan portfolios to assess impairment. In determining whether an impairment loss should be recorded in profit or loss for the year, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. A 10% increase or decrease in actual loss experience compared to the loss estimates used would result in an increase or decrease in loan impairment losses of GEL 110 thousand (2011: GEL 83 thousand), respectively.

***Tax legislation.*** Georgian tax, currency and customs legislation is subject to varying interpretations. Refer to Note 27.

***Initial recognition of related party transactions.*** In the normal course of business the Bank enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. Terms and conditions of related party balances are disclosed in Note 30.

## 5 Adoption of New or Revised Standards and Interpretations

The following new standards and interpretations became effective for the Group from 1 January 2012:

***"Disclosures—Transfers of Financial Assets" – Amendments to IFRS 7 (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011).*** The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party, yet remain on the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognised, but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. The amendment did not have a material impact on these financial statements.

***Other revised standards and interpretations:*** The amendments to IFRS 1 "First-time adoption of IFRS", relating to severe hyperinflation and eliminating references to fixed dates for certain exceptions and exemptions, did not have any impact on these financial statements. The amendment to IAS 12 "Income taxes", which introduced a rebuttable presumption that an investment property carried at fair value is recovered entirely through sale, did not have a material impact on these financial statements.

## 6 New Accounting Pronouncements

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2013 or later, and which the Bank has not early adopted.

## 6 New Accounting Pronouncements (Continued)

***IFRS 9 "Financial Instruments Part 1: Classification and Measurement".*** IFRS 9, issued in November 2010, replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities and in December 2011 to (i) change its effective date to annual periods beginning on or after 1 January 2015 and (ii) add transition disclosures. Key features of the standard are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent payments of principal and interest only (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.

- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

While adoption of IFRS 9 is mandatory from 1 January 2015, earlier adoption is permitted. The Bank is considering the implications of the standard, the impact on the Bank and the timing of its adoption by the Bank.

***IFRS 10 "Consolidated Financial Statements"(issued in May 2011 and effective for annual periods beginning on or after 1 January 2013),*** replaces all of the guidance on control and consolidation in IAS 27 "Consolidated and separate financial statements" and SIC-12 "Consolidation - special purpose entities". IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance. The Bank does not expect the standard to have a material impact on its financial statements.

***IFRS 11 "Joint Arrangements", (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013),*** replaces IAS 31 "Interests in Joint Ventures" and SIC-13 "Jointly Controlled Entities—Non-Monetary Contributions by Venturers". Changes in the definitions have reduced the number of types of joint arrangements to two: joint operations and joint ventures. The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting is mandatory for participants in joint ventures. The Bank does not expect the standard to have a material impact on its financial statements.

## 6 New Accounting Pronouncements (Continued)

***IFRS 12 "Disclosure of Interests in Other Entities", (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013),*** applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It replaces the disclosure requirements currently found in IAS 28 "Investments in associates". IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including significant judgements and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, extended disclosures on share of non-controlling interests in group activities and cash flows, summarised financial information of subsidiaries with material non-controlling interests, and detailed disclosures of interests in unconsolidated structured entities. The Bank does not expect the standard to have a material impact on its financial statements.

***IFRS 13 "Fair Value Measurement", (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013),*** aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Bank is currently assessing the impact of the standard on its financial statements.

***IAS 27 "Separate Financial Statements", (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013),*** was changed and its objective is now to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The guidance on control and consolidated financial statements was replaced by IFRS 10 "Consolidated Financial Statements". The Bank does not expect the amendment to have a material impact on its financial statements.

***IAS 28 "Investments in Associates and Joint Ventures", (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013).*** The amendment of IAS 28 resulted from the Board's project on joint ventures. When discussing that project, the Board decided to incorporate the accounting for joint ventures using the equity method into IAS 28 because this method is applicable to both joint ventures and associates. With this exception, other guidance remained unchanged. The Bank does not expect the amendment to have a material impact on its financial statements.

***Amendments to IAS 1 "Presentation of Financial Statements" (issued in June 2011, effective for annual periods beginning on or after 1 July 2012),*** changes the disclosure of items presented in other comprehensive income. The amendments require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be reclassified to profit or loss in the future. The suggested title used by IAS 1 has changed to 'statement of profit or loss and other comprehensive income'. The Bank expects the amended standard to change presentation of its financial statements, but have no impact on measurement of transactions and balances.

***Amended IAS 19 "Employee Benefits" (issued in June 2011, effective for periods beginning on or after 1 January 2013),*** makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The standard requires recognition of all changes in the net defined benefit liability (asset) when they occur, as follows: (i) service cost and net interest in profit or loss; and (ii) remeasurements in other comprehensive income. The Bank does not expect the amendment to have a material impact on its financial statements.

***"Disclosures - Offsetting Financial Assets and Financial Liabilities" - Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013).*** The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

**6 New Accounting Pronouncements (Continued)**

***"Offsetting Financial Assets and Financial Liabilities" - Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014).*** The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. The Bank is considering the implications of the amendment, the impact on the Bank and the timing of its adoption by the Bank.

***Improvements to International Financial Reporting Standards (issued in May 2012 and effective for annual periods beginning 1 January 2013).*** The improvements consist of changes to five standards. IFRS 1 was amended to (i) clarify that an entity that resumes preparing its IFRS financial statements may either repeatedly apply IFRS 1 or apply all IFRSs retrospectively as if it had never stopped applying them, and (ii) to add an exemption from applying IAS 23 "Borrowing costs", retrospectively by first-time adopters. IAS 1 was amended to clarify that explanatory notes are not required to support the third balance sheet presented at the beginning of the preceding period when it is provided because it was materially impacted by a retrospective restatement, changes in accounting policies or reclassifications for presentation purposes, while explanatory notes will be required when an entity voluntarily decides to provide additional comparative statements. IAS 16 was amended to clarify that servicing equipment that is used for more than one period is classified as property, plant and equipment rather than inventory. IAS 32 was amended to clarify that certain tax consequences of distributions to owners should be accounted for in the income statement as was always required by IAS 12. IAS 34 was amended to bring its requirements in line with IFRS 8. IAS 34 will require disclosure of a measure of total assets and liabilities for an operating segment only if such information is regularly provided to chief operating decision maker and there has been a material change in those measures since the last annual financial statements. The Bank is currently assessing the impact of the amendments on its financial statements.

***Transition Guidance Amendments to IFRS 10, IFRS 11 and IFRS 12 (issued in June 2012 and effective for annual periods beginning 1 January 2013).*** The amendments clarify the transition guidance in IFRS 10 "Consolidated Financial Statements". Entities adopting IFRS 10 should assess control at the first day of the annual period in which IFRS 10 is adopted, and if the consolidation conclusion under IFRS 10 differs from IAS 27 and SIC 12, the immediately preceding comparative period (that is, year 2012 for a calendar year-end entity that adopts IFRS 10 in 2013) is restated, unless impracticable. The amendments also provide additional transition relief in IFRS 10, IFRS 11 "Joint Arrangements" and IFRS 12 "Disclosure of Interests in Other Entities", by limiting the requirement to provide adjusted comparative information only for the immediately preceding comparative period. Further, the amendments will remove the requirement to present comparative information for disclosures related to unconsolidated structured entities for periods before IFRS 12 is first applied. The Bank does not expect the amendment to have a material impact on its financial statements.

***Amendments to IFRS 1 "First-time adoption of International Financial Reporting Standards - Government Loans" (issued in March 2012 and effective for annual periods beginning 1 January 2013).*** The amendments, dealing with loans received from governments at a below market rate of interest, give first-time adopters of IFRSs relief from full retrospective application of IFRSs when accounting for these loans on transition. This will give first-time adopters the same relief as existing preparers. The Bank does not expect the amendment to have a material impact on its financial statements.

***Amendments to IFRS 10, IFRS 12 and IAS 27 - Investment entities (issued on 31 October 2012 and effective for annual periods beginning 1 January 2014).*** The amendment introduced a definition of an investment entity as an entity that (i) obtains funds from investors for the purpose of providing them with investment management services, (ii) commits to its investors that its business purpose is to invest funds solely for capital appreciation or investment income and (iii) measures and evaluates its investments on a fair value basis. An investment entity will be required to account for its subsidiaries at fair value through profit or loss, and to consolidate only those subsidiaries that provide services that are related to the entity's investment activities. IFRS 12 was amended to introduce new disclosures, including any significant judgements made in determining whether an entity is an investment entity and information about financial or other support to an unconsolidated subsidiary, whether intended or already provided to the subsidiary. The Bank does not expect the amendment to have a material impact on its financial statements.

## 6 New Accounting Pronouncements (Continued)

***Other revised standards and interpretations:*** IFRIC 20 "Stripping Costs in the Production Phase of a Surface Mine", considers when and how to account for the benefits arising from the stripping activity in mining industry. The interpretation will not have an impact on the Bank's financial statements.

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Bank's financial statements.

## 7 Cash and Cash Equivalents

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| Cash on hand | 7,934 | 4,422 |
| Cash balances with National Bank of Georgia ("NBG") | 3,240 | 1,045 |
| Correspondent accounts and overnight placements with other banks | 11,001 | 7,267 |
| **Total cash and cash equivalents** | **22,175** | **12,734** |

Interest rate analysis of cash and cash equivalents is disclosed in Note 25.

The credit quality of balances with NBG represented by the credit rating of "BB-" assigned by Fitch for the Government of Georgia (2011: "BB-").

The credit quality of correspondent accounts and overnight placements balances may be summarised based on Fitch ratings as follows at 31 December:

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| A+ | 3,082 | 2,815 |
| B+ | 6,061 | 4,450 |
| B- | - | - |
| Not rated | 1,858 | 2 |
| **Total** | **11,001** | **7,267** |

Cash balances with NBG and corresponding accounts and overnight placements with other banks are not collateralised, these balances are current and not impaired.

## 8 Mandatory minimum reserve with National Bank of Georgia

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| Mandatory minimum reserve with National Bank of Georgia | 9,708 | 6,886 |

The credit quality of mandatory minimum reserve with National Bank of Georgia balances is represented by the credit rating of "BB-" assigned by Fitch for the Government of Georgia (2011: "BB-").

Interest rate analysis of mandatory minimum reserve with National Bank of Georgia is disclosed in Note 25.

## 9 Loans and Advances to Customers

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| Trade and service | 104,635 | 67,191 |
| Agriculture | 72,295 | 42,360 |
| Production | 6,410 | 4,815 |
| Consumer loans | 13,643 | 4,794 |
| Less: Provision for loan impairment | (5,079) | (1,036) |
| **Total loans and advances to customers** | **191,904** | **118,124** |

Movements in the provision for loan impairment during 2012 are as follows:

| *In thousands of GEL* | Trade and service | Agriculture | Production | Consumer loans | Total |
|---|---|---|---|---|---|
| **Provision for loan impairment at 1 January 2012** | **697** | **251** | **59** | **29** | **1,036** |
| Provision for impairment during the year | 1,845 | 3,884 | 145 | 85 | 5,959 |
| Amounts written off during the year as uncollectible | (1,103) | (656) | (105) | (52) | (1,916) |
| **Provision for loan impairment at 31 December 2012** | **1,439** | **3,479** | **99** | **62** | **5,079** |

Movements in the provision for loan impairment during 2011 are as follows:

| *In thousands of GEL* | Trade and service | Agriculture | Production | Consumer loans | Total |
|---|---|---|---|---|---|
| **Provision for loan impairment at 1 January 2011** | **609** | **178** | **55** | **5** | **847** |
| Provision for impairment during the year | 509 | 152 | 39 | 60 | 760 |
| Amounts written off during the year as uncollectible | (421) | (79) | (35) | (36) | (571) |
| **Provision for loan impairment at 31 December 2011** | **697** | **251** | **59** | **29** | **1,036** |

## 9 Loans and Advances to Customers (Continued)

Economic sector risk concentrations within the customer loan portfolio are as follows:

| *In thousands of GEL* | 2012 Amount | 2012 % | 2011 Amount | 2011 % |
|---|---|---|---|---|
| Trade and service | 104,635 | 53% | 67,191 | 56% |
| Agriculture | 72,295 | 37% | 42,360 | 36% |
| Production | 6,410 | 3% | 4,815 | 4% |
| Consumer loans | 13,643 | 7% | 4,794 | 4% |
| **Total loans and advances to customers (before impairment)** | **196,983** | **100%** | **119,160** | **100%** |

At 31 December 2012 the Bank had 22 borrowers (2011: 12 borrowers) with aggregated loan amounts above GEL 100 thousand. The total aggregate amount of these loans was 2,861 thousand (2011: GEL 1,983 thousand) or 1.45% of the gross loan portfolio (2011: 1.7%).

Information about collateral at 31 December 2012 is as follows:

| *In thousands of GEL* | Trade and service | Agriculture | Production | Consumer loans | Total |
|---|---|---|---|---|---|
| Unsecured loans | 775 | 1,462 | 48 | 1,309 | **3,594** |
| *Loans collateralised by:* | | | | | |
| Guarantees of individuals | 62,241 | 64,963 | 3,713 | 2,936 | **133,853** |
| Real estate | 41,505 | 5,834 | 2,649 | 2,544 | **52,532** |
| Other assets | 101 | 36 | - | 1 | **138** |
| Precious metals and cash deposits | 13 | - | - | 6,853 | **6,866** |
| **Total loans and advances to customers (before impairment)** | **104,635** | **72,295** | **6,410** | **13,643** | **196,983** |

Information about collateral at 31 December 2011 is as follows:

| *In thousands of GEL* | Trade and service | Agriculture | Production | Consumer loans | Total |
|---|---|---|---|---|---|
| Unsecured loans | 932 | 737 | 58 | 260 | **1,987** |
| *Loans collateralised by:* | | | | | |
| Guarantees of individuals | 42,014 | 39,364 | 2,926 | 275 | **84,579** |
| Real estate | 24,217 | 2,258 | 1,830 | 1,254 | **29,559** |
| Other assets | 26 | - | - | 4 | **30** |
| Precious metals and cash deposits | 2 | 1 | 1 | 3,001 | **3,005** |
| **Total loans and advances to customers (before impairment)** | **67,191** | **42,360** | **4,815** | **4,794** | **119,160** |

Other assets mainly include equipment. The disclosure above represents the lower of the carrying value of the loan or collateral taken; the remaining part is disclosed within the unsecured exposures. The carrying value of loans was allocated based on proportion of the assets taken as collateral.

## 9 Loans and Advances to Customers (Continued)

Analysis by credit quality of loans outstanding at 31 December 2012 is as follows:

| *In thousands of GEL* | Trade and service | Agriculture | Production | Consumer loans | Total |
|---|---|---|---|---|---|
| *Neither past due nor impaired* | | | | | |
| - Borrowers with credit history over two years | 1,226 | 13 | 149 | 786 | **2,174** |
| - New borrowers: | | | | | |
| Individual loans up to GEL 50 thousand | 85,821 | 64,592 | 5,609 | 12,488 | **168,510** |
| Individual loans above GEL 50 thousand | 15,525 | 1,415 | 534 | 69 | **17,543** |
| **Total neither past due nor impaired** | **102,572** | **66,020** | **6,292** | **13,343** | **188,227** |
| *Past due but not impaired* | | | | | |
| - less than 30 days overdue | 700 | 486 | 26 | 226 | **1,438** |
| - 30 to 60 days overdue | - | - | - | 5 | **5** |
| **Total past due but not impaired** | **700** | **486** | **26** | **231** | **1,443** |
| *Loans individually determined to be impaired (gross)* | | | | | |
| - less than 30 days overdue | 391 | 1,598 | 19 | 29 | **2,037** |
| - 30 to 90 days overdue | 501 | 1,999 | 56 | 17 | **2,573** |
| - 91 to 180 days overdue | 458 | 2,186 | 16 | 23 | **2,683** |
| -181 to 360 days overdue | 13 | 6 | 1 | - | **20** |
| **Total impaired loans (gross)** | **1,363** | **5,789** | **92** | **69** | **7,313** |
| **Less impairment provisions** | (1,439) | (3,479) | (99) | (62) | **(5,079)** |
| **Total loans and advances to customers** | **103,196** | **68,816** | **6,311** | **13,581** | **191,904** |

Analysis by credit quality of loans outstanding at 31 December 2011 is as follows:

| *In thousands of GEL* | Trade and service | Agriculture | Production | Consumer loans | Total |
|---|---|---|---|---|---|
| *Neither past due nor impaired* | | | | | |
| - Borrowers with credit history over two years | 745 | 35 | 155 | 1,162 | **2,097** |
| - New borrowers: | | | | | |
| Individual loans up to GEL 50 thousand | 59,953 | 41,714 | 4,066 | 2,749 | **108,482** |
| Individual loans above GEL 50 thousand | 5,946 | 461 | 539 | 831 | **7,777** |
| **Total neither past due nor impaired** | **66,644** | **42,210** | **4,760** | **4,742** | **118,356** |
| *Past due but not impaired* | | | | | |
| - less than 30 days overdue | 274 | 60 | 43 | 15 | **392** |
| - 30 to 60 days overdue | 55 | 27 | - | 1 | **83** |
| **Total past due but not impaired** | **329** | **87** | **43** | **16** | **475** |
| *Loans individually determined to be impaired (gross)* | | | | | |
| - less than 30 days overdue | 110 | - | - | 33 | **143** |
| - 30 to 90 days overdue | 41 | 28 | 10 | - | **79** |
| - 91 to 180 days overdue | 67 | 35 | 2 | 3 | **107** |
| **Total impaired loans (gross)** | **218** | **63** | **12** | **36** | **329** |
| **Less impairment provisions** | (697) | (251) | (59) | (29) | **(1,036)** |
| **Total loans and advances to customers** | **66,494** | **42,109** | **4,756** | **4,765** | **118,124** |

## 9 Loans and Advances to Customers (Continued)

The Bank applied the portfolio provisioning methodology prescribed by IAS 39, *Financial Instruments: Recognition and Measurement*, and created portfolio provisions for impairment losses that were incurred but have not been specifically identified with any individual loan by the end of the reporting period. The Bank's policy is to classify each loan as 'neither past due nor impaired' until specific objective evidence of impairment of the loan is identified. The impairment provisions may exceed the total gross amount of individually impaired loans as a result of this policy and the portfolio impairment methodology.

The primary factors that the Bank considers in determining whether a loan is impaired are its overdue status and realisability of related collateral, if any. As a result, the Bank presents above an ageing analysis of loans that are individually determined to be impaired. Because the loans are individually insignificant as at 31 December 2012 and 2011, the individual impairment calculation is performed on a collective basis for efficiency purposes.

The financial effect of collateral is presented by disclosing collateral values separately for (i) those assets where collateral and other credit enhancements are equal to or exceed carrying value of the asset ("over-collateralised assets") and (ii) those assets where collateral and other credit enhancements are less than the carrying value of the asset ("under-collateralised assets"). The effect of collateral at 31 December 2012:

| | **Over-collateralised assets** | | **Under-collateralised assets** | |
|---|---|---|---|---|
| *In thousands of GEL* | Carrying value of the assets | Fair value of collateral | Carrying value of the assets | Fair value of collateral |
| Trade and service | 103,018 | 309,989 | 1,617 | 843 |
| Agriculture | 66,363 | 151,022 | 5,932 | 4,469 |
| Production | 6,342 | 22,052 | 68 | 19 |
| Consumer loans | 7,903 | 19,826 | 5,740 | 4,432 |

The effect of collateral at 31 December 2011:

| | **Over-collateralised assets** | | **Under-collateralised assets** | |
|---|---|---|---|---|
| *In thousands of GEL* | Carrying value of the assets | Fair value of collateral | Carrying value of the assets | Fair value of collateral |
| Trade and service | 34,359 | 87,986 | 32,833 | 41 |
| Agriculture | 2,883 | 5,996 | 39,476 | 8 |
| Production | 2,730 | 6,866 | 2,085 | 3 |
| Consumer loans | 2,820 | 11,832 | 1,974 | 1,424 |

The effect of collateral is determined by comparison of fair value of collateral to gross loans and advances outstanding at the reporting date.

The fair value of real estate at the end of the reporting period was estimated by indexing the values determined by the Bank's internal credit department staff at the time of loan inception for the average increases in real estate prices by city and region. The fair value of other real estate and other assets was determined by the Bank's credit department using the Bank's internal guidelines. It is impracticable to determine the fair values of guarantees of individuals and its effect on credit risk is not considered in the above given tables.

Refer to Note 28 for the estimated fair value of each class of loans and advances to customers. Interest rate analysis of loans and advances to customers is disclosed in Note 25. Information on related party balances is disclosed in Note 30.

## 10 Other Financial Assets

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| Receivables on money transfer services | 464 | 314 |
| Court advances on legal cases | 362 | 214 |
| Investments available for sale | 54 | 54 |
| Other receivables | 190 | 147 |
| **Total other financial assets** | **1,070** | **729** |

Movements in the provision for impairment of other financial assets during 2012 are as follows:

| *thousands of GEL* | Court advances on legal cases | Other receivables | Total |
|---|---|---|---|
| **Provision for loan impairment at 1 January 2012** | **-** | - | **-** |
| Provision for impairment during the year | 158,988 | 193,375 | **352,363** |
| Amounts written off during the year as uncollectible | 158,988 | 193,375 | **352,363** |
| **Provision for loan impairment at 31 December 2012** | **-** | **-** | **-** |

***Court advances on legal cases:*** Court advances are made as part of legal proceedings against defaulted borrowers. These advances are added to borrowers' accounts and are reimbursable by borrowers in case of positive court ruling. During the year the Bank provided for impairment and wrote-off court advances in the amount of GEL 159 thousand (2011: nil).

***Investments available for sale:*** The Bank together with 9 other Georgian banks established JSC United Clearing Centre ("the Company") in October 2008. The Bank owns 6.25% of the Company as at 31 December 2012 (2011: 6.25%). The investee has not published recent financial information about its operations, its shares are not quoted and recent trade prices are not publicly accessible. The Bank's management could not reliably estimate the fair value of these equity investment securities. The Bank does not intend to dispose these shares in the foreseeable future. The investment is carried at cost.

All other financial assets outstanding at 31 December 2012 are current and unimpaired. They are not collateralised. The primary factors that the Bank considers in determining whether a receivable is impaired are its overdue status and realisability of related collateral, if any.

Refer to Note 28 for the disclosure of the fair value of other financial assets.

## 11 Premises, Equipment and Intangible Assets

| *In thousands of GEL* | Note | Premises | Office and computer equipment | Construction in progress | Leasehold improve-ments | Total premises and equipment | Computer software licences | Total |
|---|---|---|---|---|---|---|---|---|
| Cost at 31 December 2010 - restated | | 4,765 | 4,145 | 671 | 2,281 | **11,862** | 968 | **12,830** |
| Accumulated depreciation and amortisation | | (640) | (2,386) | - | (1,313) | **(4,339)** | (195) | **(4,534)** |
| **Carrying amount at 31 December 2010 - Restated** | | **4,125** | **1,759** | **671** | **968** | **7,523** | **773** | **8,296** |
| Additions | | 577 | 1,865 | 2,092 | 15 | **4,549** | 247 | **4,796** |
| Disposals | | (13) | (587) | - | - | **(600)** | (42) | **(642)** |
| Transfers | | 881 | 583 | (1,709) | 245 | - | - | - |
| Depreciation and amortisation charge | 23 | (91) | (913) | - | (326) | **(1,330)** | (141) | **(1,471)** |
| Elimination of accumulated depreciation on disposals | | 9 | 540 | - | - | **549** | 42 | **591** |
| Increase in value on revaluation | | 649 | - | - | - | **649** | - | **649** |
| Decrease in value on revaluation charged to administrative and other operating expenses | 23 | (482) | - | - | - | **(482)** | - | **(482)** |
| Cost or fair value at 31 December 2011 | | 6,377 | 6,006 | 1,054 | 2,541 | **15,978** | 1,173 | **17,151** |
| Accumulated depreciation and amortisation | | (722) | (2,759) | - | (1,639) | **(5,120)** | (294) | **(5,414)** |
| **Carrying amount at 31 December 2011** | | **5,655** | **3,247** | **1,054** | **902** | **10,858** | **879** | **11,737** |
| Cost or fair value at 31 December 2011 | | 6,377 | 6,006 | 1,054 | 2,541 | **15,978** | 1,173 | **17,151** |
| Accumulated depreciation and amortisation | | (722) | (2,759) | - | (1,639) | **(5,120)** | (294) | **(5,414)** |
| **Carrying amount at 31 December 2011** | | **5,655** | **3,247** | **1,054** | **902** | **10,858** | **879** | **11,737** |
| Additions | | 426 | 3,937 | 3,370 | 11 | **7,744** | 937 | **8,681** |
| Disposals | | - | (2,043) | - | (871) | **(2,914)** | (3) | **(2,917)** |
| Transfers | | 2,055 | 357 | (3,996) | 1,584 | - | - | - |
| Depreciation and amortisation charge | 23 | (144) | (1,417) | - | (391) | **(1,952)** | (240) | **(2,192)** |
| Elimination of accumulated depreciation on disposals | | - | 1,990 | - | 870 | **2,860** | 3 | **2,863** |
| Cost or fair value at 31 December 2012 | | 8,858 | 8,257 | 428 | 3,265 | **20,808** | 2,107 | **22,915** |
| Accumulated depreciation and amortisation | | (866) | (2,186) | - | (1,160) | **(4,212)** | (531) | **(4,743)** |
| **Carrying amount at 31 December 2012** | | **7,992** | **6,071** | **428** | **2,105** | **16,596** | **1,576** | **18,172** |

Premises have been revalued to market value as at 21 July 2011 and 27 December 2011. The valuation was carried out by an independent firm of valuators which holds a recognised and relevant professional qualification and who have recent experience in valuation of assets of similar location and category. The

## 11 Premises, Equipment and Intangible Assets (Continued)

basis used for the appraisal was sales comparison method. Fair values were estimated using appropriate valuation techniques, depending on the degree to which the estimates met the following characteristics: reliability and completeness of the information, specifics of the estimated property.

Management considers that the fair value has not changed significantly between the effective dates of valuation and 31 December 2012.

At 31 December 2012 the carrying amount of premises, equipment and intangible assets would have been GEL 18,009 thousand (2011: GEL 11,570) had the premises been carried at cost less depreciation and impairment losses.

## 12 Other Assets

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| Inventory of marketing materials | 529 | 213 |
| Prepayments | 406 | 339 |
| Repossessed collateral | 312 | 282 |
| Tax assets other than income tax | 28 | 115 |
| **Total other assets** | **1,275** | **949** |

Repossessed collateral represents real estate assets acquired by the Bank in settlement of overdue loans. The Bank expects to dispose of the assets in the foreseeable future. The assets do not meet the definition of non-current assets held for sale and are classified as inventories in accordance with IAS 2, *Inventories*.

## 13 Customer Accounts

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| ***State and public organizations*** | | |
| - Current/settlement accounts | 639 | - |
| - Term/demand deposits | 9,372 | - |
| **Other Legal entities** | | |
| - Current/settlement accounts | 763 | 523 |
| - Term/demand deposits | 7,813 | 584 |
| **Individuals** | | |
| - Current/settlement accounts | 3,243 | 1,632 |
| - Term/demand deposits | 34,096 | 11,059 |
| **Total customer accounts** | **55,926** | **13,798** |

Economic sector concentrations within customer accounts are as follows:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| *In thousands of GEL* | Amount | % | Amount | % |
| Individuals | 37,339 | 67% | 12,691 | 92% |
| State and public organizations | 10,011 | 18% | - | - |
| Trade and services | 5,791 | 11% | 916 | 7% |
| Manufacturing | 124 | 0% | 123 | 1% |
| Construction | 41 | 0% | 26 | 0% |
| Communication | 18 | 0% | 7 | 0% |
| Agriculture | 9 | 0% | 3 | 0% |
| Other sectors | 2,593 | 4% | 32 | 0% |
| **Total customer accounts** | **55,926** | **100%** | **13,798** | **100%** |

At 31 December 2012 the Bank had 52 customers (2011: 16) with balances above GEL 100 thousand. The aggregate balance due to these customers was GEL 24,992 thousand (2011: GEL 3,725 thousand) or 44,69% (2011: 27%) of total customer accounts. Refer to Note 28 for the disclosure of the fair value of each class of customer accounts. Interest rate analysis of customer accounts is disclosed in Note 25. Information on related party balances is disclosed in Note 30.

## 14 Other Financial Liabilities

Other financial liabilities comprise the following:

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| Payables to legal entities | 422 | 223 |
| Payables to individuals | 59 | 97 |
| Debit or credit card payables | 58 | 22 |
| Settlements on money transfer operations | 14 | 26 |
| Other accrued liabilities | 122 | 9 |
| **Total other financial liabilities** | **675** | **377** |

## 15 Other Liabilities

Other liabilities comprise the following:

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| Accrued employee benefit costs | 911 | 323 |
| Taxes payable other than income tax | 91 | 74 |
| Prepayments received | 55 | 47 |
| Unearned grants | 49 | 139 |
| Other liabilities | 3 | 3 |
| **Total other liabilities** | **1,109** | **586** |

## 16 Other Borrowed Funds

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| International financial institutions | 128,282 | 92,262 |
| Loans from commercial banks | 17,277 | 15,619 |
| **Total other borrowed funds** | **145,559** | **107,881** |

The following tables provide a detailed breakdown for other borrowed funds:

| *In thousands of GEL* | Original Currency | Maturity Date | Total Outstanding 2012 | Total Outstanding 2011 |
|---|---|---|---|---|
| ***Loans from international financial institutions:*** | | | | |
| Pettelaar Effectenbewaarbedrijf N.V | USD | 31-Mar-14 | 8,491 | - |
| Global Commercial Microfinance Consortium II B.V | USD | 5-Nov-19 | 8,328 | - |
| SNS Institutional Microfinance Fund II | USD | 30-Jun-14 | 5,949 | 2,457 |
| Microfinance Enhancement Facility | USD | 7-Jul-14 | 5,129 | 5,158 |
| OikoCredit, Ecumenical Development Cooperative Society U.A. | USD | 2-May-15 | 5,003 | - |
| Global Microfinance Facility | USD | 11-Apr-14 | 4,982 | 5,014 |
| Credit Suisse Microfinance Fund Management Company | USD | 26-Oct-15 | 3,783 | - |
| Capital Gestion | USD | 16-Aug-15 | 3,385 | - |
| ASN Novib Fonds | USD | 15-Mar-14 | 3,375 | 3,394 |
| KCD Mikrofinanzfonds (FIS) | USD | 14-Nov-14 | 3,345 | 3,372 |
| KCD Mikrofinanzfonds (FIS) | USD | 15-Nov-14 | 3,344 | 3,372 |
| Selectum Sicav-Sif | USD | 30-Nov-13 | 3,343 | 3,359 |
| ASN Novib Fonds | USD | 15-Apr-15 | 3,338 | - |
| Global Microfinance Facility | USD | 11-Apr-14 | 3,332 | - |

## 16 Other Borrowed Funds (Continued)

| *In thousands of GEL* | Original Currency | Maturity Date | Total Outstanding 2012 | Total Outstanding 2011 |
|---|---|---|---|---|
| Microfinance Enhancement Facility | USD | 26-Oct-15 | 3,330 | - |
| ResponsAbility SICAV (Lux) | USD | 14-Jun-15 | 3,325 | 3,352 |
| KCD Mikrofinanzfonds (FIS) | USD | 17-Dec-13 | 3,323 | 3,350 |
| Microvest I, LP | USD | 24-Aug-14 | 3,322 | - |
| Microvest I, LP | USD | 24-Aug-13 | 2,532 | 3,330 |
| Credit Suisse Microfinance Fund Management Company | USD | 17-Dec-15 | 2,493 | - |
| ResponsAbility SICAV (Lux) | USD | 31-May-13 | 2,084 | 2,101 |
| Credit Suisse Microfinance Fund Management Company | USD | 14-May-13 | 1,884 | 1,899 |
| Impulse Microfinance Investment Fund NV | USD | 23-Feb-13 | 1,712 | 1,713 |
| EMF Mikrofinance Fund AGmvK | USD | 10-Aug-13 | 1,708 | 1,722 |
| ResponsAbility SICAV (Lux) | USD | 13-Aug-15 | 1,707 | - |
| Impulse Microfinance Investment Fund NV | USD | 23-Feb-13 | 1,704 | 1,723 |
| Dual Return Fund S.I.C.A.V | USD | 22-Aug-14 | 1,704 | 1,718 |
| Volksvermogen n.v. | USD | 11-Mar-13 | 1,699 | 1,707 |
| Wallberg Invest S.A | USD | 2-Apr-14 | 1,678 | - |
| ResponsAbility SICAV (Lux) | USD | 9-Nov-13 | 1,676 | 1,690 |
| Dual Return Fund S.I.C.A.V | GEL | 26-Nov-13 | 1,665 | - |
| Credit Suisse Microfinance Fund Management Company | USD | 10-Jun-13 | 1,664 | 1,677 |
| ASN Novib Fonds | GEL | 15-Jun-13 | 1,664 | - |
| Finethic Microfinance | USD | 20-Dec-15 | 1,644 | - |
| OikoCredit, Ecumenical Development Cooperative Society U.A. | USD | 30-Jul-13 | 1,452 | 1,461 |
| ResponsAbility SICAV (Lux) | USD | 13-Aug-15 | 1,280 | - |
| Credit Suisse Microfinance Fund Management Company | USD | 27-Aug-15 | 1,276 | - |
| Finethic Microfinance | USD | 1-Oct-14 | 1,267 | 1,277 |
| Responsability SICAV (lux) | USD | 26-Oct-15 | 1,261 | - |
| SNS Institutional Microfinance Fund II | USD | 15-Apr-13 | 1,258 | 1,265 |
| OikoCredit, Ecumenical Development Cooperative Society U.A. | GEL | 28-Oct-13 | 1,123 | 2,254 |
| EMF Mikrofinance Fund AGmvK | USD | 6-Feb-14 | 882 | - |
| Finethic Microfinance | USD | 3-Jun-13 | 849 | 856 |
| Wallberg Invest S.A | USD | 6-Sep-15 | 841 | - |
| Natixis Impact Nord Sud Development | USD | 30-Dec-13 | 838 | - |
| Credit Suisse Microfinance Fund Management Company | USD | 9-Nov-13 | 838 | 845 |
| Netri Private Foundation | USD | 31-Jul-13 | 838 | 844 |
| Calvert Social Investment Foundation | USD | 31-Jan-13 | 837 | 844 |
| Dual Return Fund S.I.C.A.V | USD | 30-Oct-15 | 831 | - |
| Responsability SICAV (lux) | USD | 17-Dec-15 | 831 | - |
| Responsability SICAV (lux) | USD | 17-Dec-15 | 831 | - |
| Dual Return Fund S.I.C.A.V | USD | 14-Nov-15 | 829 | - |
| ResponsAbility SICAV (Lux) | USD | 27-May-13 | 626 | 631 |
| Dual Return Fund S.I.C.A.V | EUR | 13-Feb-14 | 579 | - |
| Finethic Microfinance | USD | 1-Sep-14 | 425 | 429 |
| Natixis Impact Nord Sud Development | EUR | 30-Dec-13 | 419 | - |
| Credit Suisse Microfinance Fund Management Company | USD | 26-Jan-13 | 213 | 216 |
| ResponsAbility SICAV (Lux) | USD | 26-Jan-13 | 213 | 216 |
| Pettelaar Effectenbewaarbedrijf N.V | USD | 31-May-12 | - | 6,924 |
| BlueOrchard Loans for Development S.A. | USD | 31-May-12 | - | 6,715 |
| Credit Suisse Microfinance Fund Management Company | USD | 10-Feb-12 | - | 2,583 |
| Dual Return Fund S.I.C.A.V | GEL | 24-Jan-12 | - | 2,094 |
| Wallberg Invest S.A | USD | 29-Mar-12 | - | 1,777 |
| KCD Mikrofinanzfonds (FIS) | USD | 13-Nov-12 | - | 1,687 |
| ASN Novib Fonds | GEL | 15-Jun-12 | - | 1,665 |
| ResponsAbility SICAV (Lux) | USD | 10-Feb-12 | - | 861 |
| Wallberg Invest S.A | USD | 27-Aug-12 | - | 859 |

## 16 Other Borrowed Funds (Continued)

| *In thousands of GEL* | Original Currency | Maturity Date | Total Outstanding 2012 | Total Outstanding 2011 |
|---|---|---|---|---|
| Dual Return Fund S.I.C.A.V | USD | 29-Oct-12 | - | 846 |
| Dual Return Fund S.I.C.A.V | USD | 11-Nov-12 | - | 844 |
| Natixis Impact Nord Sud Development | USD | 29-Apr-12 | - | 844 |
| Dual Return Fund S.I.C.A.V | EUR | 11-Feb-12 | - | 445 |
| Credit Suisse Microfinance Fund Management Company | USD | 24-Feb-12 | - | 436 |
| ResponsAbility SICAV (Lux) | USD | 24-Feb-12 | - | 436 |
| **Total loans from international financial institutions** | | | **128,282** | **92,262** |

| *In thousands of Gel* | Original Currency | Maturity Date | Total Outstanding 2012 | Total Outstanding 2011 |
|---|---|---|---|---|
| ***Loans from commercial banks:*** | | | | |
| TBC Bank | GEL | 1-Nov-16 | 12,243 | 12,216 |
| TBC Bank | GEL | 25-May-13 | 3 | - |
| VDK spaarbank n.v. | USD | 24-Aug-15 | 1,684 | 1,716 |
| VDK spaarbank n.v. | USD | 5-Mar-15 | 1,682 | - |
| VDK spaarbank n.v. | USD | 25-Apr-15 | 833 | - |
| VDK spaarbank n.v. | USD | 26-Oct-15 | 832 | - |
| VDK spaarbank n.v. | USD | 25-Oct-12 | - | 1,687 |
| **Total loans *from Commercial Banks*** | | | **17,277** | **15,619** |

At 31 December 2012, the Bank was in compliance with all the financial covenants stipulated in the loan and borrowing agreements.

Refer to Note 28 for the disclosure of fair value of other borrowed funds. Interest rate analysis of other borrowed funds is disclosed in Note 25. Information on related party balances is disclosed in Note 30.

## 17 Subordinated Debt

Subordinated debt of GEL 5,006 thousand, counterparty of which is JSC TBC Bank, the ultimate parent of the Bank, (2011: GEL 5,006) carries a fixed interest rate and matures on 28 June 2021, with the five equal instalments of GEL 1,000 thousand to be repaid annually starting on 28 July 2017. The debt ranks after all other creditors in the case of liquidation.

Refer to Note 28 for the disclosure of fair value of subordinated debt. Interest rate analysis of subordinated debt is disclosed in Note 25. Information on related party balances is disclosed in Note 30.

## 18 Share Capital

| *In thousands of GEL except for number of shares* | Number of outstanding shares (in thousands) | Ordinary shares | Share premium | Total share capital |
|---|---|---|---|---|
| **At 1 January 2010** | **17,983** | **17,406** | **-** | **17,406** |
| New shares issued | 3,500 | 3,500 | - | **3,500** |
| **At 31 December 2011** | **21,483** | **20,906** | | **20,906** |
| New shares issued | 6,517 | 6,517 | **983** | **7,500** |
| **At 31 December 2012** | **28,000** | **27,423** | **983** | **28,406** |

The total authorised number of ordinary Class A shares is 25,692 thousand, and the total authorised number of ordinary Class B shares is 2,308 thousand. (2011: 19,175 thousand Class A ordinary shares; 2,308 thousand Class B ordinary shares) with a par value for Class A ordinary Share of GEL 1 per share and with a par value for Class B ordinary share of GEL 0.75 per share. (2011: GEL 1 per Class A ordinary share and GEL 0.75 per Class B ordinary share). All issued ordinary shares are fully paid. Each ordinary share carries one vote.

## 19 Interest Income and Expense

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| **Interest income** | | |
| Loans and advances to customers | 52,032 | 29,253 |
| Due from other banks | 415 | 116 |
| **Total interest income** | **52,447** | **29,369** |
| **Interest expense** | | |
| Loans from international financial institutions | (8,817) | (6,752) |
| Term deposits of individuals and legal entities | (4,291) | (511) |
| Loans from other banks | (2,589) | (895) |
| Term placements of other banks | (51) | (178) |
| **Total interest expense** | **(15,748)** | **(8,336)** |
| **Net interest income** | **36,699** | **21,033** |

## 20 Fee and Commission Income and Expense

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| **Fee and commission income** | | |
| - Plastic card operations | 608 | 88 |
| - Administrative fee on customer accounts | 558 | 365 |
| - Settlement transactions | 351 | 185 |
| - Cash transactions | 42 | 21 |
| - Other | 108 | 65 |
| **Total fee and commission income** | **1,667** | **724** |
| **Fee and commission expense** | | |
| - Cash collection and transportation services | (121) | (2) |
| - Plastic card operations | (114) | (13) |
| - Settlement transactions | (72) | (52) |
| - Bloomberg membership fees | (39) | (40) |
| - Cash transactions | (21) | (2) |
| - Other | (66) | (59) |
| **Total fee and commission expense** | **(433)** | **(168)** |
| **Net fee and commission income** | **1,234** | **556** |

## 21 Other Operating Income

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| Income from loans previously written-off | 763 | 934 |
| Other | 159 | 119 |
| **Total other operating income** | **922** | **1,053** |

## 22 Revenue from Grants

| *In thousands of GEL* | **2012** |
|---|---|
| Income from CARE Grant Agreement | 139 |
| Local grantors | 8 |
| **Total revenue from grants** | **147** |

Funds were transferred to the Bank's ownership in 2012 as a result of the Bank meeting performance standards and targets set forth in respective agreements.

## 23 Administrative and Other Operating Expenses

| *In thousands of GEL* | **Note** | **2012** | **2011** |
|---|---|---|---|
| Staff costs | | 14,291 | 9,400 |
| Advertising and marketing services | | 2,831 | 1,703 |
| Depreciation and amortisation | 11 | 2,192 | 1,471 |
| Occupancy and rent | | 2,125 | 1,369 |
| Taxes other than on income | | 1,285 | 791 |
| Stationery | | 744 | 451 |
| Communication services | | 673 | 374 |
| Transportation expenses | | 551 | 392 |
| Impairment of other financial assets | 10 | 352 | - |
| Repair and maintenance of premises and equipment | | 523 | 240 |
| Professional services | | 449 | 475 |
| Business trip expenses | | 401 | 247 |
| Utility services | | 350 | 224 |
| Representative expenses | | 307 | 133 |
| Security services | | 304 | 196 |
| Fuel expenses | | 221 | 179 |
| Impairment of repossessed collateral | | 187 | 91 |
| Insurance services | | 37 | 26 |
| Impairment of premises and equipment | 11 | - | 482 |
| Other | | 795 | 432 |
| **Total administrative and other operating expenses** | | **28,618** | **18,676** |

## 24 Income Taxes

### *(a) Components of income tax expense*

Income tax expense recorded in profit or loss for the year comprises the following:

| *In thousands of GEL* | **2012** | **2011** |
|---|---|---|
| Current tax | - | (97) |
| Deferred tax expense | (837) | (422) |
| **Income tax expense** | **(837)** | **(519)** |

### *(b) Reconciliation between the tax expense and profit or loss multiplied by applicable tax rate*

The income tax rate applicable to the majority of the Bank's 2012 income is 15% (2011: 15%). Reconciliation between the expected and the actual taxation charge is provided below.

## 24 Income Taxes (Continued)

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| **IFRS profit before tax** | **5,270** | **3,568** |
| Theoretical tax charge at statutory rate (2012: 15%; 2011: 15%) | (791) | (535) |
| Tax effect of income which is exempt from taxation | 5 | 41 |
| Tax effect of non-deductible expenses | (51) | (25) |
| **Income tax expense for the year** | **(837)** | **(519)** |

### *(c) Deferred taxes analysed by type of temporary difference*

Differences between IFRS and statutory taxation regulations in Georgia give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below and is recorded at the rate of 15% (2011: 15%).

| *In thousands of GEL* | 1 January 2011 | Credited / (Charged) to profit and loss | Charged directly to equity | 31 December 2011 | Credited / (Charged) to profit and loss | 31 December 2012 |
|---|---|---|---|---|---|---|
| **Tax effect of taxable temporary differences** | | | | | | |
| Tax losses carried forward | 148 | (148) | - | - | - | - |
| Loans and advances to customers | 3 | (18) | - | (15) | (162) | (177) |
| Cash and cash equivalents | - | - | - | - | 764 | 764 |
| Premises equipment and intangible assets | (167) | (284) | - | (451) | (723) | (1,174) |
| Other assets | 29 | 47 | - | 76 | 121 | 197 |
| Due to Other Banks | - | - | - | - | (745) | (745) |
| Other liabilities | 34 | 3 | - | 37 | (81) | (44) |
| Other borrowed funds | (37) | (22) | - | (59) | (11) | (70) |
| Premises revaluation reserve | - | - | (97) | (97) | - | (97) |
| **Net deferred tax asset /(liability)** | **10** | **(422)** | **(97)** | **(509)** | **(837)** | **(1,346)** |

## 25 Financial Risk Management

The risk management function within the Bank is carried out in respect of financial risks, operational risks and legal risks. Financial risk comprises market risk (including currency risk, interest rate risk and other price risk), credit risk and liquidity risk. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimise operational and legal risks.

***Credit risk.*** Credit risk is the risk of financial loss to the Bank if a customer or counterparty fails to meet its contractual obligations when due. The major portion of credit risk arises from the Banks' loans and advances to customers. For risk reporting purposes, the Bank considers and consolidates all elements of credit risk exposures such as individual customer and counterparty default risk and industry risk.

## 25 Financial Risk Management (Continued)

The Bank has established a Credit Committee, which is responsible for approving credit limits for individual borrowers:

- The Bank's supervisory board is required to review and approve all amounts above GEL 370 thousand (equivalent of USD 220 thousand).
- The Bank's board of directors is required to review and approve all amounts above GEL 170 thousand (equivalent of USD 100 thousand) and below GEL 370 thousand (equivalent of USD 220 thousand). It is also responsible for issuing guidance to the Bank's credit committee in relation to all other loans; and
- The Bank's Credit committee reviews and approves all amounts below GEL 170 thousand (equivalent of USD 100 thousand). The Credit Committee meets on a weekly basis.

As at 31 December 2012, the breakdown of the loan portfolio by economic and product sectors is provided in Note 9.

Loan applications originated by the relevant client relationship managers are passed on to the relevant credit committee for approval of credit limit. In order to monitor credit risk exposures, regular reports are produced by the credit department's officers based on a structured analysis focusing on the customer's business and financial performance. Any significant exposures against customers with deteriorating creditworthiness are reported to and reviewed by the Board of Directors. The Bank does not use formalised internal credit ratings to monitor exposures to credit risk. Management monitors and follows up on past due balances. The Bank's procedure for write off of non-performing loans is based on number of days of overdue status. Subsequent recoveries are recorded in profit and loss as other income.

Exposure to credit risk is also assessed and managed, in part, by obtaining, controlling and monitoring collateral in the form of mortgage interests over property, pledge of assets and securities and other collateral including corporate and personal guarantees.

While collateral is an important mitigating factor in assessing the credit risk, it is the Bank's policy to establish that loans are within the customer's capacity to repay rather to rely solely on security. Collateral is considered as a secondary source of repayment. In limited cases, depending on the customer's standing or on the type of product or amounts, the facilities may be unsecured.

***Maximum exposure to credit risk.*** The Bank's maximum exposure to credit risk is generally reflected in the carrying amounts of financial assets on the statement of financial position and commitments to extend credit. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant. For guarantees and commitments to extend credit, the maximum exposure to credit risk is the amount of the commitment Refer to Note 27.

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract. The Bank uses the same credit policies in making conditional obligations as it does for on-balance sheet financial instruments through established credit approvals, risk control limits and monitoring procedures.

***Market risk.*** The Bank takes on exposure to market risks. Market risks arise from open positions in currency and interest rate, all of which are exposed to general and specific market movements. Management sets limits on the value of risk that may be accepted, which is monitored on a monthly basis. However, the use of this approach does not prevent losses outside of these limits in the event of more significant market movements.

***Currency risk.*** In respect of currency risk, management sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily.

## 25 Financial Risk Management (Continued)

Bank's exposure to foreign currency exchange rate risk at 31 December 2012 is as follows:

| *In thousands of GEL* | Monetary financial assets | Monetary financial liabilities | Derivatives | Net position |
|---|---|---|---|---|
| Georgian Lari | 84,020 | 58,071 | (4,971) | 20,978 |
| US Dollars | 139,130 | 147,635 | 4,971 | (3,534) |
| EURO | 1,538 | 1,535 | - | 3 |
| Other | 169 | 1 | - | 168 |
| **Total** | **224,857** | **207,242** | **-** | **17,615** |

Bank's exposure to foreign currency exchange rate risk at 31 December 2011 is as follows:

| *In thousands of GEL* | Monetary financial assets | Monetary financial liabilities | Net position |
|---|---|---|---|
| Georgian Lari | 42,685 | 29,458 | 13,227 |
| US Dollars | 95,004 | 96,844 | (1,840) |
| EURO | 777 | 826 | (49) |
| Other | 7 | - | 7 |
| **Total** | **138,473** | **127,128** | **11,345** |

Monetary financial assets include cash and cash equivalents, mandatory minimum reserve with National Bank of Georgia, loans and advances to customers, other financial assets. Monetary financial liabilities include due to other banks, customer accounts, other borrowed funds, other financial liabilities, and subordinated debt.

The Bank has procedures in place to ensure compliance with the requirements of the National Bank of Georgia. These include:

- Ensuring and monitoring that the open currency positions are below the limit as set by the National Bank of Georgia that is 20% of the fixed supervisory capital;
- Calculating the currency risk limits during the working day as well as at the end of each day; and
- When the open currency positions are misbalanced, the Bank is liable to immediately proceed on operations that will get the open currency positions back to balance. These actions are instigated by Management as required.

The following table presents sensitivities of profit or loss and equity to reasonably possible changes in exchange rates applied at the end of the reporting period relative to the functional currency of the Bank, with all other variables held constant:

| | At 31 December 2012 | | At 31 December 2011 | |
|---|---|---|---|---|
| *In thousands of GEL* | Impact on profit before tax | Impact on net profit | Impact on profit before tax | Impact on net profit |
| US Dollar strengthening by 10% | (353) | (300) | (184) | (156) |
| US Dollar weakening by 10% | 353 | 300 | 184 | 156 |
| Euro strengthening by 10% | - | - | (5) | (4) |
| Euro weakening by 10% | - | - | 5 | 4 |
| Other strengthening by 10 % | 17 | 14 | - | - |
| Other weakening by 10% | (17) | (14) | - | - |

Other than as a result of any impact on the Bank's profit or loss, there is no other impact on the Bank's equity as a result of such changes in exchange rates.

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the Bank.

## 25 Financial Risk Management (Continued)

***Interest rate risk.*** The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. Management monitors on a monthly basis and sets limits on the level of mismatch of interest rate repricing that may be undertaken.

As at 31 December 2012 or 2011 the Bank was not subject to significant interest rate risk since all its financial assets and majority of financial liabilities bear fixed interest rates or are interest free and all such assets and liabilities are accounted for at amortised cost.

The table below summarises the Bank's exposure to interest rate risks. The table presents the aggregated amounts of the Bank's financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest repricing or maturity dates.

| *In thousands of GEL* | **Demand and less than 1 month** | **From 1 to 3 months** | **From 3 to 12 months** | **More than 1 year** | **Non-interest bearing** | **Total** |
|---|---|---|---|---|---|---|
| **31 December 2012** | | | | | | |
| Total financial assets | 20,380 | 18,182 | 92,826 | 65,738 | 27,731 | **224,857** |
| Total financial liabilities | 9,186 | 9,932 | 76,635 | 103,189 | 8,300 | **207,242** |
| **Net interest sensitivity gap at 31 December 2012** | **11,194** | **8,250** | **16,191** | **(37,451)** | **19,431** | **17,615** |
| **31 December 2011** | | | | | | |
| Total financial assets | 10,497 | 12,136 | 61,417 | 37,161 | 17,262 | **138,473** |
| Total financial liabilities | 9,215 | 7,254 | 43,473 | 64,390 | 2,796 | **127,128** |
| **Net interest sensitivity gap at 31 December 2011** | **1,282** | **4,882** | **17,944** | **(27,229)** | **14,466** | **11,345** |

The Bank monitors interest rates for its financial instruments. The table below summarises effective interest rates based on reports reviewed by key management personnel:

| | **2012** | | | **2011** | | |
|---|---|---|---|---|---|---|
| *In % p.a.* | **GEL** | **USD** | **Other** | **GEL** | **USD** | **Other** |
| **Assets** | | | | | | |
| Cash and cash equivalents | 2.84% | 0.34% | 0.04% | 3.90% | 0.04% | 0.10% |
| Loans and advances to customers | | | | | | |
| - Trade and service | 44.63% | 23.59% | - | 46.29% | 25.41% | - |
| - Agriculture | 40.81% | 34.62% | - | 41.73% | 36.38% | - |
| - Production | 44.19% | 23.90% | - | 44.34% | 25.23% | - |
| - Consumer loans | 35.39% | 24.58% | 10.25% | 39.36% | 21.10% | 11.30% |
| **Liabilities** | | | | | | |
| Due to other banks | 5.98% | - | - | - | - | - |
| Current/settlement accounts | 0% | 0% | 0% | 0% | 0% | 0% |
| Term/demand deposits | 15.47% | 9.57% | 6.40% | 15.40% | 9.60% | 6.60% |
| Other borrowed funds | 11.45% | 8.01% | 8.05% | 13.91% | 8.28% | 7.50% |
| Subordinated debt | 14.00% | - | - | 14.00% | - | - |

The sign "-" in the table above means that the Bank does not have the respective assets or liabilities in the corresponding currency.

## 25 Financial Risk Management (Continued)

***Geographical risk concentrations.*** The geographical concentration of the Bank's financial assets and liabilities at 31 December 2012 is set out below:

| *In thousands of GEL* | Georgia | OECD | Non-OECD | Total |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Cash and cash equivalents | 19,093 | 3,082 | - | 22,175 |
| Mandatory minimum reserve with National Bank of Georgia | 9,708 | | | 9,708 |
| Loans and advances to customers | 191,904 | - | - | 191,904 |
| Other financial assets | 1,069 | 1 | | 1,070 |
| **Total financial assets** | **221,774** | **3,083** | **-** | **224,857** |
| **Financial liabilities** | | | | |
| Due to other banks | 76 | - | - | 76 |
| Customer accounts | 53,827 | 1,730 | 369 | 55,926 |
| Other borrowed funds | 12,246 | 122,412 | 10,901 | 145,559 |
| Other financial liabilities | 675 | - | - | 675 |
| Subordinated debt | 5,006 | - | - | 5,006 |
| **Total financial liabilities** | **71,830** | **124,142** | **11,270** | **207,242** |
| **Net position in on-balance sheet financial instruments** | **149,944** | **(121,059)** | **(11,270)** | **17,615** |
| **Credit related commitments** | **2,397** | **-** | **-** | **2,397** |

Assets and liabilities have generally been based on the country in which the counterparty is located. Balances with Georgian counterparties actually outstanding to/from offshore companies of these Georgian counterparties are allocated to the caption "Georgia".

The geographical concentration of the Bank's assets and liabilities at 31 December 2011 is set out below:

| *In thousands of GEL* | Georgia | OECD | Non-OECD | Total |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Cash and cash equivalents | 9,919 | 2,815 | - | 12,734 |
| Mandatory minimum reserve with National Bank of Georgia | 6,886 | - | - | 6,886 |
| Loans and advances to customers | 118,124 | - | - | 118,124 |
| Other financial assets | 729 | - | - | 729 |
| **Total financial assets** | **135,658** | **2,815** | **-** | **138,473** |
| **Financial liabilities** | | | | |
| Due to other banks | 66 | - | - | 66 |
| Customer accounts | 13,620 | 101 | 77 | 13,798 |
| Other borrowed funds | 12,216 | 88,929 | 6,736 | 107,881 |
| Other financial liabilities | 377 | - | - | 377 |
| Subordinated debt | 5,006 | - | - | 5,006 |
| **Total financial liabilities** | **31,285** | **89,030** | **6,813** | **127,128** |
| **Net position in on-balance sheet financial instruments** | **104,373** | **(86,215)** | **(6,813)** | **11,345** |
| **Credit related commitments** | **655** | **-** | **-** | **655** |

***Other risk concentrations.*** Management monitors and discloses concentrations of credit risk by obtaining various reports relating to borrowings. The Bank did not have any such significant risk concentrations at 31 December 2012 and 2011.

Management determines concentration by assessing the quantitative data about its exposure to the risk at the reporting date. This disclosure is based on the information provided internally to key management personnel of the Bank and includes for example disclosure of concentration of risks such as currency, credit and interest.

***Liquidity risk.*** Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan drawdowns, guarantees and cash-settled derivative instruments. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can

## 25 Financial Risk Management (Continued)

be predicted with a high level of certainty. Liquidity risk is managed by the Asset-Liability Committee and ultimately by the Board of Management of the Bank.

The Bank seeks to maintain a stable funding base primarily consisting of other borrowed funds, and corporate and retail customer deposits. The Bank invests the funds in diversified portfolios of liquid assets, in order to be able to respond quickly and smoothly to unforeseen liquidity requirements.

The liquidity management of the Bank requires considering the level of liquid assets necessary to settle obligations as they fall due; maintaining access to a range of funding sources; maintaining funding contingency plans; and monitoring liquidity ratios against regulatory requirements. The Bank calculates liquidity ratios on a daily basis in accordance with the requirement of the National Bank of Georgia. The ratio that is monitored is liquidity ratio, which is calculated as the ratio of liquid assets to liabilities maturing within 60 calendar days. The ratio was 48.23% at 31 December 2012 (2011: 52.8%).

According to the instruction set by the NBG, the Bank calculates instant liquidity as a ratio of daily average liquid assets to daily average liquid liabilities. This ratio is calculated based on balances derived from statutory financial statements of the Bank. The National Bank of Georgia has in place minimum levels of liquidity required. As at 31 December 2012 and 2011, the Bank complied with this requirement.

The table below shows liabilities by their remaining contractual maturity. The amounts disclosed in the maturity table are the contractual undiscounted cash flows, gross loan commitments and financial guarantees.

When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the reporting date. Foreign currency payments are translated, using the spot exchange rate at the balance sheet date.

The undiscounted maturity analysis of financial liabilities at 31 December 2012 was, as follows:

| *In thousands of GEL* | **Demand and less than 1 month** | **From 1 to 3 months** | **From 3 to 12 months** | **From 12 months to 5 years** | **Over 5 years** | **Total** |
|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | |
| Due to other banks | 77 | - | - | - | - | **77** |
| Customer accounts | 10,056 | 4,779 | 36,332 | 8,405 | 71 | **59,643** |
| Other financial liabilities | 675 | - | - | - | - | **675** |
| Other borrowed funds | 2,271 | 8,504 | 41,107 | 110,062 | 6,735 | **168,679** |
| Subordinated debt | 59 | 113 | 527 | 3,732 | 5,120 | **9,551** |
| Gross settled forwards | 4,973 | - | - | - | - | **4,973** |
| Gross credit related commitments | 2,280 | 16 | 101 | - | - | **2,397** |
| **Total potential future payments for financial obligations** | **20,391** | **13,412** | **78,067** | **122,199** | **11,926** | **245,995** |

The undiscounted maturity analysis of financial liabilities at 31 December 2011 is, as follows:

| *In thousands of GEL* | **Demand and less than 1 month** | **From 1 to 3 months** | **From 3 to 12 months** | **From 12 months to 5 years** | **Over 5 years** | **Total** |
|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | |
| Due to other banks | 66 | - | - | - | - | **66** |
| Customer accounts | 4,614 | 1,050 | 6,828 | 2,609 | - | **15,101** |
| Other financial liabilities | 377 | - | - | - | - | **377** |
| Other borrowed funds | 3,976 | 7,750 | 32,627 | 92,800 | - | **137,153** |
| Subordinated debt | 65 | 115 | 527 | 2,802 | 6,750 | **10,259** |
| Gross credit related commitments | 640 | - | - | - | - | **640** |
| **Total potential future payments for financial obligations** | **9,738** | **8,915** | **39,982** | **98,211** | **6,750** | **163,596** |

## 25 Financial Risk Management (Continued)

The Bank does not use the above undiscounted maturity analysis to manage liquidity. Instead, the Bank monitors expected maturities, which may be summarised, as follows, as at 31 December 2012:

| *In thousands of GEL* | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 12 months to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | 22,175 | - | - | - | - | **22,175** |
| Mandatory minimum reserve with National Bank of Georgia | - | - | - | - | 9,708 | **9,708** |
| Loans and advances to customers | 12,951 | 18,654 | 94,561 | 65,418 | 320 | **191,904** |
| Other financial assets | 479 | - | - | 537 | 54 | **1,070** |
| **Total financial assets** | **35,605** | **18,654** | **94,561** | **65,955** | **10,082** | **224,857** |
| **Liabilities** | | | | | | |
| Due to other banks | 76 | - | - | - | - | **76** |
| Customer accounts | 10,022 | 4,260 | 33,897 | 7,722 | 25 | **55,926** |
| Other financial liabilities | 675 | - | - | - | - | **675** |
| Other borrowed funds | 3,071 | 7,059 | 32,947 | 96,349 | 6,133 | **145,559** |
| Subordinated debt | 6 | - | - | 1,000 | 4,000 | **5,006** |
| **Total financial liabilities** | **13,850** | **11,319** | **66,844** | **105,071** | **10,218** | **207,242** |
| **Liquidity surplus/(gap) at 31 December 2012** | **21,755** | **7,335** | **27,717** | **(39,116)** | **(76)** | **17,615** |
| **Cumulative liquidity surplus at 31 December 2012** | **21,755** | **29,090** | **56,807** | **17,691** | **17,615** | |

The expected maturity analysis of financial instruments at 31 December 2011 is as follows:

| *In thousands of GEL* | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 12 months to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | 12,734 | - | - | - | - | **12,734** |
| Mandatory minimum reserve with National Bank of Georgia | - | - | - | - | 6,886 | **6,886** |
| Loans and advances to customers | 6,227 | 12,306 | 62,425 | 36,857 | 309 | **118,124** |
| Other financial assets | 329 | - | 132 | 214 | 54 | **729** |
| **Total financial assets** | **19,290** | **12,306** | **62,557** | **37,071** | **7,249** | **138,473** |
| **Liabilities** | | | | | | |
| Due to other banks | 66 | - | - | - | - | **66** |
| Customer accounts | 4,577 | 976 | 6,445 | 1,784 | 16 | **13,798** |
| Other financial liabilities | 377 | - | - | - | - | **377** |
| Other borrowed funds | 3,771 | 7,062 | 26,324 | 70,724 | - | **107,881** |
| Subordinated debt | 6 | - | - | - | 5,000 | **5,006** |
| **Total financial liabilities** | **8,797** | **8,038** | **32,769** | **72,508** | **5,016** | **127,128** |
| **Liquidity surplus/(gap) at 31 December 2011** | **10,493** | **4,268** | **29,788** | **(35,437)** | **2,233** | **11,345** |
| **Cumulative liquidity surplus at 31 December 2011** | **10,493** | **14,761** | **44,549** | **9,112** | **11,345** | |

The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is unusual for banks ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially

## 25 Financial Risk Management (Continued)

enhances profitability, but can also increase the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest and exchange rates.

## 26 Management of Capital

The Bank's objectives when managing capital are to (i) comply with the capital requirements set by National Bank of Georgia ("NBG"), (ii) to safeguard the Bank's ability to continue as a going concern and (iii) to comply with financial covenants stipulated by borrowing agreements. Compliance with capital adequacy ratios set by National Bank Georgia is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's General Director and the Chief Accountant and subsequently submitted to the NBG. Compliance with financial covenants stipulated by borrowing agreements is monitored on a monthly basis. Other objectives of capital management are evaluated annually.

Under the current capital requirements set by NBG banks have to: (a) hold the minimum level of regulatory capital of GEL 12,000,000 (b) maintain a ratio of regulatory capital to risk weighted assets ("statutory capital ratio") at or above a prescribed minimum of 12% and (c) maintain a ratio of tier-1 capital to the risk-weighted assets (the 'Tier-1 capital ratio') at or above the prescribed minimum of 8%. The total capital that the Bank manages, which is the same as the amount of capital required for NBG statutory capital adequacy purposes, is GEL 39,836 thousand as at 31 December 2012 (2011: GEL 28,250 thousand).

Regulatory capital is based on the Bank's reports prepared under the NBG regulations and comprises:

| *In thousands of GEL* | 2012 | 2011 |
|---|---|---|
| **Tier 1 capital** | | |
| Share capital | 27,423 | 20,906 |
| Share premium | 983 | - |
| Retained earnings/(accumulated loss) | 922 | (1,870) |
| Less: intangible assets | (1,543) | (837) |
| **Total tier 1 capital after deductions** | **27,785** | **18,199** |
| **Tier 2 capital** | | |
| Current year profit | 3,700 | 2,801 |
| Reserves | 3,611 | 2,310 |
| Subordinated debt | 4,800 | 5,000 |
| Less: investments specified in regulations | (60) | (60) |
| **Total tier 2 capital** | **12,051** | **10,051** |
| **Total regulatory capital** | **39,836** | **28,250** |
| **Risk-weighted assets:** | | |
| On-balance sheet (A-Can) | 316,164 | 198,580 |
| **Total risk-weighted assets** | **316,164** | **198,580** |
| Core capital adequacy ratio (Tier 1) | 9% | 9% |
| Total capital adequacy ratio (Tier 1 and Tier 2) | 13% | 14% |

The Bank has complied with all externally imposed capital requirements throughout 2012 and 2011.

## 27 Contingencies and Commitments

***Legal proceedings.*** From time to time and in the normal course of business, claims against the Bank may be received. On the basis of its own estimates and internal professional advice management is of the opinion that no material losses will be incurred in respect of claims and accordingly no provision has been made in these financial statements.

***Compliance with covenants.*** The Bank is in compliance with all the covenants related to its borrowings.

## 27 Commitments and Contingencies (Continued)

***Tax legislation.*** Georgian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant regional and state authorities. Recent events within Georgia suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for five calendar periods preceding the period of review. Under certain circumstances, reviews may cover longer periods. Management believes that its interpretation of the relevant legislation is appropriate and the Bank's tax position will be sustained. Accordingly, at 31 December 2012 and 2011 no provision for potential tax liabilities has been recorded.

***Credit related commitments.*** Undrawn credit lines and issued guarantees as at 31 December 2012 amounted to GEL 2,397 thousand and GEL 121 thousand respectively (2011: GEL 655 thousand and nil). The total outstanding contractual amount of undrawn credit lines and guarantees does not necessary represent future cash requirements, as these financial instruments may expire or terminate without being funded. The fair value of credit related commitments was nil at 31 December 2012 (2011: nil).

## 28 Fair Value of Financial Instruments

### *(a) Fair values of financial instruments carried at amortised cost.*

Fair values of financial instruments carried at amortised cost are as follows:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| *In thousands of GEL* | **Carrying amount** | **Fair value** | **Carrying amount** | **Fair value** |
| **Financial Assets** | | | | |
| Cash and cash equivalents | 22,175 | 22,175 | 12,734 | 12,734 |
| Mandatory minimum reserve with National Bank of Georgia | 9,708 | 9,708 | 6,886 | 6,886 |
| ***Loans and advances to customers*** | | | | |
| - Trade and service | 103,196 | 101,319 | 66,494 | 66,039 |
| - Agriculture | 68,816 | 68,459 | 42,109 | 41,822 |
| - Production | 6,311 | 6,178 | 4,756 | 4,676 |
| - Consumer loans | 13,581 | 13,126 | 4,765 | 4,512 |
| Other receivables | 1,016 | 1,016 | 675 | 675 |
| **Total Financial Assets Carried at Amortised Cost** | **224,803** | **221,981** | **138,419** | **137,344** |
| **Financial liabilities** | | | | |
| Due to other banks | 76 | 76 | 66 | 66 |
| ***Customer accounts*** | | | | |
| -current/settlement accounts | 639 | 639 | | |
| - Current/settlement accounts of legal entities | 763 | 763 | 523 | 523 |
| - Term deposits of legal entities | 9,372 | 9,372 | 584 | 584 |
| - Current/demand accounts of individuals | 3,243 | 3,243 | 1,632 | 1,632 |
| - Term deposits of individuals | 33,430 | 33,430 | 11,059 | 11,059 |
| Other borrowed funds | 145,559 | 143,322 | 107,881 | 106,974 |
| Other financial liabilities | 675 | 675 | 377 | 377 |
| Subordinated debt | 5,006 | 5,006 | 5,006 | 5,006 |
| **Total Financial Liabilities Carried at Amortised Cost** | **207,242** | **205,005** | **127,128** | **126,221** |

## 28 Fair Value of Financial Instruments (Continued)

### *(b) The methods and assumptions applied in determining fair values.*

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price. Where quoted market prices are not available, the Bank used valuation techniques. The fair value of floating rate instruments that are not quoted in an active market was estimated to be equal to their carrying amount. The fair value of unquoted fixed interest rate instruments was estimated based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

Discount rates used depend on currency, maturity of the instrument and credit risk of the counterparty and were as follows:

| | **2012** | **2011** |
|---|---|---|
| Cash and cash equivalents | 0.0% to 4.5% p.a | 0.0% to 6.5% p.a. |
| ***Loans and advances to customers*** | | |
| - Trade and service | 23.3% to 44.1% p.a | 26.1% to 48.2% p.a. |
| - Agriculture | 34.6% to 39.4% p.a | 38.4% to 42.6% p.a. |
| - Production | 24.2% to 43.0% p.a | 26.9% to 49.2% p.a. |
| - Consumer loans | 26.6% to 33.3% p.a | 28.0% to 42.0% p.a. |
| ***Customer accounts*** | | |
| Current/settlement accounts | - | - |
| Term/demand deposits | 4.5% to 16.0% p.a | 6.6% to 15.4% p.a. |
| Other borrowed funds | 8% to 15.1% p.a | 7.8% to 17.0% p.a. |
| Subordinated debt | 14% p.a | 14% p.a. |

## 29 Presentation of Financial Instruments by Measurement Category

For the purposes of measurement, IAS 39, *Financial Instruments: Recognition of Measurement*, classifies financial assets into the following categories: (a) loans and receivables; and (b) available for sale financial assets.

The following table provides a reconciliation of classes of financial assets with these measurement categories as at 31 December 2012:

| *In thousands of GEL* | **Loans and receivables** | **Available for sale assets** | **Total** |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 22,175 | - | **22,175** |
| Mandatory minimum reserve with National Bank of Georgia | 9,708 | - | **9,708** |
| Loans and advances to customers: | | | |
| - Trade and service | 103,196 | - | **103,196** |
| - Agriculture | 68,816 | - | **68,816** |
| - Production | 6311 | - | **6,311** |
| - Consumer loans | 13,581 | - | **13,581** |
| Other financial assets: | | | |
| - Other financial receivables | 1,016 | - | **1,016** |
| - Corporate shares | - | 54 | **54** |
| **Total financial assets** | **224,803** | **54** | **224,857** |
| **Non-financial assets** | | | **19,573** |
| **Total assets** | | | **244,430** |

As at 31 December 2012 and 2011 all of the Bank's financial liabilities were carried at amortised cost.

## 29 Presentation of Financial Instruments by Measurement Category (Continued)

The following table provides a reconciliation of classes of financial assets with these measurement categories as at 31 December 2011:

| *In thousands of GEL* | Loans and receivables | Available for sale assets | Total |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | - | - | **12,734** |
| Mandatory minimum reserve with National Bank of Georgia | 6,886 | - | **6,886** |
| Loans and advances to customers: | | | |
| - Trade and service | 66,494 | - | **66,494** |
| - Agriculture | 42,109 | - | **42,109** |
| - Production | 4,756 | - | **4,756** |
| - Consumer loans | 4,765 | - | **4,765** |
| Other financial assets: | | | |
| - Other financial receivables | 675 | - | **675** |
| - Corporate shares | - | 54 | **54** |
| **Total financial assets** | **125,685** | **54** | **138,473** |
| **Non-financial assets** | | | **12,686** |
| **Total assets** | | | **151,159** |

## 30 Derivative financial instruments

Foreign exchange derivative financial instruments entered into by the Bank are generally traded in an over-the-counter market with professional market counterparties on standardised contractual terms and conditions. Derivatives have potentially favourable (assets) or unfavourable (liabilities) conditions as a result of fluctuations in market interest rates, foreign exchange rates or other variables relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time.

The table below sets out fair value, at the balance sheet date, of currencies receivable or payable under gross settled currency swap entered into by the Bank. The table reflects gross positions before the netting of any counterparty positions (and payments) and covers the contracts with settlement dates after the respective balance sheet date. The contracts are short term in nature.

| | 2012 | |
|---|---|---|
| *In thousands of GEL* | Receivable on settlement | Payable on settlement |
| **Gross settled currency swaps: fair values, at the balance sheet date, of** | | |
| - USD receivable on settlement (+) | 4,971 | - |
| - GEL payable on settlement (-) | - | (4,971) |
| **Fair value of foreign exchange forwards** | **4,971** | **(4,971)** |
| **Net fair value of foreign exchange forwards** | **-** | **-** |

The entity was not engaged in similar contracts as at 31 December 2011.

## 31 Related Party Transactions

Parties are generally considered to be related if the parties are under common control or one party has the ability to control the other party or can 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.

At 31 December 2012, the outstanding balances with related parties were as follows:

| *In thousands of GEL* | Parent Company | Key management personnel | Other related parties |
|---|---|---|---|
| Cash and cash equivalents (contractual interest rate: 6.5 %) | 5,480 | - | - |
| Gross amount of loans and advances to customers (contractual interest rate: 13 %-24%) | - | 164 | - |
| Other financial assets | - | - | 69 |
| Other assets | - | - | 39 |
| Customer accounts (contractual interest rate: 0 %-17%) | - | 431 | 104 |
| Due to banks (Contractual Interest Rate: 5.5% ) | 70 | - | - |
| Other borrowed funds (contractual interest rate: 7.75%- 13.14%) | 12,246 | - | 7,579 |
| Other financial liabilities | - | - | 28 |
| Subordinated debt (contractual interest rate: 14 %) | 5,006 | - | - |

Other related parties are mainly non controlling shareholders of the Bank.

The income and expense items with related parties for 2012 were as follows:

| *In thousands of GEL* | Parent Company | Key management personnel | Other related parties |
|---|---|---|---|
| Interest income | 159 | 61 | 6 |
| Interest expense | (2,244) | (95) | - |
| Foreign exchange translation gains less losses | (5) | (35) | (60) |
| Net fee and commission expense | - | - | (7) |
| Administrative and other operating expenses | - | (1,180) | - |

Aggregate amounts lent to and repaid by related parties during 2012 were:

| *In thousands of GEL* | Parent Company | Key management personnel | Other related parties |
|---|---|---|---|
| Amounts lent to related parties during the year | 26,152 | 329 | - |
| Amounts repaid by related parties during the year | 24,158 | 1,049 | - |

At 31 December 2011, the outstanding balances with related parties were as follows:

| *In thousands of GEL* | Parent Company | Key management personnel | Other related parties |
|---|---|---|---|
| Cash and cash equivalents (contractual interest rate: 6.5 %) | 4,342 | - | - |
| Gross amount of loans and advances to customers (contractual interest rate: 13 %-24%) | - | 846 | 14 |
| Customer accounts (contractual interest rate: 0 %-17%) | | 1,716 | 157 |
| Due to banks (Contractual Interest Rate: 5.5% ) | 66 | - | - |
| Other borrowed funds (contractual interest rate: 7.75%- 13.14%) | 12,216 | - | 3,715 |
| Subordinated debt (contractual interest rate: 14 %) | 5,006 | - | - |

Other related parties are mainly non controlling shareholders of the Bank.

## 31 Related Party Transactions (Continued)

The income and expense items with related parties for 2011 were as follows:

| *In thousands of GEL* | Parent Company | Key management personnel | Other related parties |
|---|---|---|---|
| Interest income | 59 | 73 | 1 |
| Interest expense | 756 | 121 | 475 |
| Foreign exchange translation gains less losses | - | (14) | 80 |
| Administrative and other operating expenses | - | 881 | - |

Aggregate amounts lent to and repaid by related parties during 2011 were:

| *In thousands of GEL* | Parent Company | Key management personnel | Other related parties |
|---|---|---|---|
| Amounts lent to related parties during the year | 13,363 | 1,262 | 51 |
| Amounts repaid by related parties during the year | 13,422 | 792 | 36 |

Key management compensation is presented below:

| *In thousands of GEL* | 2012 Expense | 2011 Expense |
|---|---|---|
| Short-term benefits - Salaries | 1,180 | 792 |