

JSC BTA Bank

Financial statements

Year ended 31 December 2012

Together with independent auditors' report

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Independent auditors' report

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Independent auditors' report

To the Shareholders and Board of Directors of JSC BTA Bank

We were engaged to audit the accompanying financial statements of JSC BTA Bank (the "Bank"), which comprise the statement of financial position as at 31 December 2012, and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

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.

Auditors' 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 auditors' 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 the Bank 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.

Emphasis of matter - material uncertainty

Without qualifying our opinion, we draw attention to Note 3 to the financial statements which indicate that the Bank incurred a total comprehensive loss of GEL 5,281 for the year ended 31 December 2012 and, as of that date, had accumulated losses of GEL 2,170. These conditions, along with other matters as set forth in Note 3, indicate the existence of a material uncertainty which may cast significant doubt about the Bank's ability to continue as a going concern.

Emphasis of matter - related party transactions

Without qualifying our opinion, we draw attention to Note 29 to the financial statements which disclose a significant concentration of the Bank's financing activities with related parties.

Ernst & Young LLC

17 July 2013

Statement of financial position
As at 31 December 2012

(Thousands of Georgian Lari)

| | Notes | 2012 | 2011 As restated (Note 2) | 2010 As restated (Note 2) |
|--|-------|----------------|---------------------------------|---------------------------------|
| Assets | | | | |
| Cash and cash equivalents | 6 | 8,305 | 6,491 | 12,843 |
| Amounts due from credit institutions | 7 | 9,770 | 5,774 | 8,185 |
| Loans to customers | 8 | 75,409 | 71,564 | 48,221 |
| Investments securities: | | | | |
| - available-for-sale | 9 | 20 | - | 40 |
| - held-to-maturity | 9 | 2,873 | 3,533 | 4,371 |
| Property and equipment | 10 | 17,335 | 20,799 | 22,509 |
| Investment property | 11 | 10,478 | 11,822 | 11,245 |
| Intangible assets | 12 | 415 | 592 | 593 |
| Current income tax assets | 13 | 199 | 198 | 198 |
| Other assets | 14 | 1,923 | 2,108 | 1,738 |
| Total assets | | 126,727 | 122,881 | 109,943 |
| Liabilities | | | | |
| Amounts due to credit institutions | 15 | 6,273 | 8,598 | 4,009 |
| Amounts due to customers | 16 | 35,228 | 27,236 | 19,947 |
| Other borrowed funds | 17 | 49,802 | 45,452 | 44,935 |
| Subordinated loan | 18 | 2,507 | 2,528 | 2,683 |
| Deferred income tax liabilities | 13 | 959 | 1,717 | 1,908 |
| Provisions | 19 | 30 | 100 | 218 |
| Other liabilities | 14 | 821 | 862 | 421 |
| Total liabilities | | 95,620 | 86,493 | 74,121 |
| Equity | | | | |
| Share capital | 20 | 30,000 | 30,000 | 30,000 |
| Land and buildings revaluation reserve | | 3,302 | 5,207 | 5,579 |
| (Accumulated losses)/retained earnings | | (2,195) | 1,181 | 243 |
| Total equity | | 31,107 | 36,388 | 35,822 |
| Total liabilities and equity | | 126,727 | 122,881 | 109,943 |

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


Kairat Kenzhogatina
General Director




Natalia Modrekidze
Chief Accountant

17 July 2013

The accompanying notes on pages 6 to 43 are an integral part of these financial statements.

Income statement
For the year ended 31 December 2012

(Thousands of Georgian Lari)

| | Notes | 2012 | 2011 As restated (Note 2) |
|--|--------|-----------------|---------------------------------|
| Interest income | | | |
| Loans to customers | | 14,733 | 11,086 |
| Investment securities - Held-to-maturity | | 384 | 445 |
| Amounts due from credit institutions | | 308 | 483 |
| | | <u>15,425</u> | <u>12,014</u> |
| Interest expense | | | |
| Other borrowed funds | | (4,773) | (3,449) |
| Amounts due to customers | | (2,573) | (1,086) |
| Amounts due to credit institutions | | (500) | (505) |
| Subordinated loan | | (223) | (228) |
| | | <u>(8,069)</u> | <u>(5,268)</u> |
| Net interest income | | 7,356 | 6,746 |
| Loan impairment (charge)/reversal | 8 | (1,982) | 2,636 |
| Net interest income after loan impairment charge | | <u>5,374</u> | <u>9,382</u> |
| Net fee and commission income | 22 | 1,051 | 1,062 |
| Net gains/(losses) from foreign currencies: | | | |
| - dealing | | 1,218 | 1,330 |
| - translation differences | | (168) | (55) |
| Net losses on investment property revaluation | 11 | (156) | (748) |
| Net losses on property revaluation | 10 | (121) | - |
| Net losses from disposal of investment property | | (78) | (70) |
| Other income | 23 | 777 | 973 |
| Non-interest income | | <u>2,523</u> | <u>2,492</u> |
| Personnel expenses | 24 | (5,420) | (4,706) |
| Other operating expenses | 24 | (4,437) | (4,772) |
| Depreciation and amortisation | 10, 11 | (1,558) | (1,727) |
| Other impairment and provisions (charge)/reversal | 25 | (564) | 11 |
| Non-interest expenses | | <u>(11,979)</u> | <u>(11,194)</u> |
| (Loss)/profit before income tax benefit | | (4,082) | 680 |
| Income tax benefit/(expense) | 13 | 464 | 145 |
| (Loss)/profit for the year | | <u>(3,618)</u> | <u>825</u> |

The accompanying notes on pages 6 to 43 are an integral part of these financial statements.

Statement of comprehensive income
For the year ended 31 December 2012

(Thousands of Georgian Lari)

| | <i>Notes</i> | <i>2012</i> | <i>2011 As restated (Note 2)</i> |
|---|--------------|----------------|--|
| (Loss)/profit for the year | | (3,618) | 825 |
| Other comprehensive income/(loss) | | | |
| Revaluation loss of land and buildings | 10 | (1,957) | (305) |
| Income tax relating to components of other comprehensive income | 13 | 294 | 46 |
| Other comprehensive loss for the year, net of tax | | (1,663) | (259) |
| Total comprehensive (loss)/income for the year | | <u>(5,281)</u> | <u>566</u> |

The accompanying notes on pages 6 to 43 are an integral part of these financial statements.

Statement of cash flows
For the year ended 31 December 2012

(Thousands of Georgian Lari)

| | <i>Share capital</i> | <i>Revaluation reserve for property and equipment</i> | <i>Retained earnings/ (accumulated losses)</i> | <i>Total equity</i> |
|--|--------------------------|---|--|-------------------------|
| 31 December 2010 (as previously reported) | 30,000 | 5,579 | (1,017) | 34,562 |
| Correction of errors (Note 2) | - | - | 1,260 | 1,260 |
| 31 December 2010 (as restated) | 30,000 | 5,579 | 243 | 35,822 |
| Total comprehensive income/(loss) for the year (as restated) | - | (259) | 825 | 566 |
| Transfer of revaluation reserve, net of tax | - | (113) | 113 | - |
| 31 December 2011 (as restated) | 30,000 | 5,207 | 1,181 | 36,388 |
| Total comprehensive (loss)/income for the year | - | (1,663) | (3,618) | (5,281) |
| Transfer of revaluation reserve, net of tax | - | (242) | 242 | - |
| 31 December 2012 | <u>30,000</u> | <u>3,302</u> | <u>(2,195)</u> | <u>31,107</u> |

The accompanying notes on pages 6 to 43 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2012

(Thousands of Georgian Lari)

| | Notes | 2012 | 2011 As restated (note 2) |
|--|-------|----------------|---------------------------------|
| Cash flows from operating activities | | | |
| Interest received | | 14,612 | 12,117 |
| Interest paid | | (3,001) | (1,557) |
| Fees and commissions received | | 1,377 | 1,252 |
| Fees and commissions paid | | (327) | (190) |
| Net realised gains from dealing in foreign currencies | | 1,218 | 1,330 |
| Other income received | | 778 | 950 |
| Personnel expenses paid | | (5,415) | (4,468) |
| Other operating expenses paid | | (4,429) | (4,775) |
| Cash flows from operating activities before changes in operating assets and liabilities | | 4,813 | 4,659 |
| <i>Net (increase) decrease in operating assets</i> | | | |
| Amounts due from credit institutions | | (4,058) | 2,082 |
| Loans to customers | | (7,486) | (26,706) |
| Other assets | | (45) | (677) |
| <i>Net increase (decrease) in operating liabilities</i> | | | |
| Amounts due to credit institutions | | (2,302) | 4,643 |
| Amounts due to customers | | 8,039 | 7,131 |
| Other liabilities | | (38) | 214 |
| Net cash flows from/(used in) operating activities before income tax | | (1,077) | (8,654) |
| Income tax paid | | - | - |
| Net cash from/(used in) operating activities | | (1,077) | (8,654) |
| Cash flows from investing activities | | | |
| Purchase of investment securities | | (20) | - |
| Proceeds from sale and redemption of investment securities | | 675 | 946 |
| Purchase of investment property | 11 | - | - |
| Proceeds from sales of investment property | | 2,441 | 1,796 |
| Purchase of property and equipment | | (334) | (914) |
| Proceeds from sale of property and equipment | | 180 | 786 |
| Net cash from/(used in) investing activities | | 2,942 | 2,614 |
| Net cash from/(used in) financing activities | | | |
| Effect of exchange rates changes on cash and cash equivalents | | (51) | (312) |
| Net increase/(decrease) in cash and cash equivalents | | 1,814 | (6,352) |
| Cash and cash equivalents, beginning | 6 | 6,491 | 12,843 |
| Cash and cash equivalents, ending | 6 | 8,305 | 6,491 |

The accompanying notes on pages 6 to 43 are an integral part of these financial statements.

(Thousands of Georgian Lari)

1. Principal activities

JSC BTA Bank (the "Bank") was established on 27 January 2000 as a joint stock company (JSC) following the merger of two Georgian banks: JSC Export-Import Bank and JSC Discount Bank. The Bank was established under the name of the JSC Silk Road Bank. The Bank was registered on 31 January 2000 with the Didube-Chugureti Regional Court of Tbilisi, registration number 2/5-98.

On 30 May 2003 the Bank acquired the assets and liabilities of JSC EA Bank.

On 23 September 2005 based on resolution number 2/5-98 of the Didube-Chugureti Regional Court, the shareholders of the Bank changed, and it was renamed JSC BTA Silk Road Bank. In 2008 based on order number 176-r of Large Payer Tax Inspection the Bank has changed its name to JSC BTA Bank.

As at 31 December 2012 the Bank has a head office and seven service centres located in Tbilisi, one service centre in Poti, one service centre in Kobuleti and one branch and service centre in Batumi.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its corporate and retail customers. The Bank's registered legal address is 2 Zaarbrukeni Square Tbilisi, Georgia. The Bank is regulated by the National Bank of Georgia (the "NBG"; the central bank of Georgia) and conducts the business under license number 238.

The number of Bank's employees as at 31 December 2012 was 250 (2011: 215; 2010: 192).

The Bank's registered legal address is 2 Saarbrucken Square, 0102 Tbilisi, Georgia.

As of 31 December 2012, the shareholders of the Bank are as follows:

| <i>Shareholder</i> | 2012 % | 2011 % | 2010 % |
|-----------------------------------|-----------|-----------|-----------|
| Silk Road Finance Group (Georgia) | 50.99 | 50.99 | 50.99 |
| JSC BTA Bank (Kazakhstan) | 49.00 | 49.00 | 49.00 |
| Individuals | 0.01 | 0.01 | 0.01 |
| Total | 100.00 | 100.00 | 100.00 |

The Bank is ultimately controlled by Giorgi Ramishvili, a Georgian national.

2. Basis of preparation

General

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention except for land and buildings, investment property and investment securities available-for-sale, which are carried at fair value.

These financial statements are presented in thousands of Georgian Lari ("GEL"), unless otherwise indicated. GEL is utilised as the functional currency as the majority of the Bank's transactions are denominated or funded in GEL. Transactions in other currencies are treated as transactions in foreign currencies.

The principal accounting policies applied in the preparation of these financial statements are set out below.

Restatements and reclassifications

When preparing the financial statements as of and for the year ended 31 December 2012, certain items of the financial statements as of and for the year ended 31 December 2011 and as at 31 December 2010 were corrected and reclassified, and accordingly restated.

The following restatements and reclassifications have been made to the statement of financial position as at 31 December 2011:

(Thousands of Georgian Lari)

2. Basis of preparation (continued)**Restatements and reclassifications (continued)**

The following restatements and reclassifications have been made to the statement of financial position as at 31 December 2011:

| | <i>As previously reported (2011)</i> | <i>Restatements (2011)</i> | <i>Reclassifi- cations (2011)</i> | <i>As adjusted (2011)</i> | <i>Notes</i> |
|--|--|--------------------------------|---------------------------------------|-------------------------------|--------------|
| Statement of financial position | | | | | |
| Cash and cash equivalents | 7,266 | (775) | - | 6,491 | a), b) |
| Amounts due from credit institutions | 5,024 | 775 | (25) | 5,774 | a), b), c) |
| Loans to customers | 71,804 | (240) | - | 71,564 | d) |
| Property and equipment | 20,876 | (77) | - | 20,799 | e), f) |
| Investment property | 2,645 | 9,177 | - | 11,822 | g), h) |
| Other assets | 10,150 | (8,067) | 25 | 2,108 | c), g) |
| Amounts due to credit institutions | 6,420 | - | 2,178 | 8,598 | j) |
| Other borrowed funds | 49,044 | (1,414) | (2,178) | 45,452 | j), k) |
| Deferred income tax liabilities | 1,615 | 102 | - | 1,717 | l), m) |
| Provisions | - | - | 100 | 100 | n) |
| | | | | | d), n), |
| Other liabilities | 908 | 54 | (100) | 862 | o), p), q) |
| Land and buildings revaluation reserve | 4,757 | 450 | - | 5,207 | l) |
| (Accumulated losses)/retained earnings | (422) | 1,603 | - | 1,181 | g), m) |

The following restatements have been made to the income statement for the year ended 31 December 2011 to conform to 2012 presentation:

| | <i>As previously reported (2011)</i> | <i>Restatements (2011)</i> | <i>As adjusted (2011)</i> | <i>Notes</i> |
|--|--|--------------------------------|-------------------------------|--------------|
| Income statement | | | | |
| Interest income on loans to customers | 11,216 | (130) | 11,086 | r) |
| Interest expense on other borrowed funds | (4,574) | 1,125 | (3,449) | k) |
| Loan impairment (charge)/reversal | 2,606 | 30 | 2,636 | d) |
| Net gains/(losses) from foreign currencies translation differences | (344) | 289 | (55) | k) |
| Net gains/(losses) on investment property revaluation | - | (748) | (748) | g) |
| Net losses from disposal of investment property | - | (70) | (70) | g) |
| Other income | 1,639 | (666) | 973 | g), l), r) |
| Personnel expenses | (4,366) | (340) | (4,706) | o), q) |
| Depreciation and amortization | (1,663) | (64) | (1,727) | e) |
| Other operating expenses | (5,478) | 706 | (4,772) | g), f), q) |
| Other impairment and provisions (charge)/reversal | - | 11 | 11 | g), p), |
| Income tax benefit/(expense) | (53) | 198 | 145 | m) |
| (Loss)/profit for the year | 471 | 354 | 825 | |

The following restatements have been made to the statement of comprehensive income for the year ended 31 December 2011:

| | <i>As previously reported (2011)</i> | <i>Restatements (2011)</i> | <i>As adjusted (2011)</i> | <i>Notes</i> |
|---|--|--------------------------------|-------------------------------|--------------|
| Statement of comprehensive income | | | | |
| (Loss)/profit for the year | 481 | 344 | 825 | s) |
| Other comprehensive income/(loss) | | | | |
| Revaluation loss of land and buildings | (834) | 529 | (305) | l) |
| Income tax relating to components of other comprehensive income | 125 | (79) | 46 | l) |
| Other comprehensive (loss)/income for the year, net of tax | (709) | 450 | (259) | l) |
| Total comprehensive (loss)/ income for the year | (228) | 794 | 566 | s) |

(Thousands of Georgian Lari)

2. Basis of preparation (continued)**Restatements and reclassifications (continued)**

The following restatements and reclassifications have been made to the statement of financial position as at 31 December 2010 to conform to 2012 presentation:

| | <i>As previously reported (2010)</i> | <i>Restatements (2010)</i> | <i>Reclassifi- cations (2010)</i> | <i>As adjusted (2010)</i> | <i>Notes</i> |
|--|--|--------------------------------|---------------------------------------|-------------------------------|--------------|
| Statement of financial position | | | | | |
| Cash and cash equivalents | 5,826 | 7,017 | - | 12,843 | a), b) |
| Amounts due from credit institutions | 15,230 | (7,017) | (28) | 8,185 | a), b), c) |
| Investment property | 2,034 | 9,211 | - | 11,245 | g) |
| Other assets | 9,439 | (7,729) | 28 | 1,738 | c), g) i) |
| Amounts due to credit institutions | 906 | - | 3,103 | 4,009 | j) |
| Other borrowed funds | 48,038 | - | (3,103) | 44,935 | j) |
| Deferred income tax liabilities | 1,686 | 222 | - | 1,908 | m) |
| Provisions | - | - | 218 | 218 | n) |
| Other liabilities | 639 | - | (218) | 421 | n) |
| (Accumulated losses)/retained earnings | (1,016) | 1,259 | - | 243 | g), i), m) |

- a) Amounts held as obligatory reserve with NBG (National Bank of Georgia) equal to GEL 2,938 (2010: GEL 2,836) that did not meet definition of cash and cash equivalents were erroneously classified in prior periods as Cash and cash equivalents. To correct the error they were reclassified to Amounts due from credit institutions.
- b) Current accounts with resident and non-resident credit institutions equal to GEL 2,163 (2010: GEL 9,853) that met definition of cash and cash equivalents were erroneously classified in prior periods as Amounts due from credit institutions. To correct the error they were reclassified to Cash and cash equivalents.
- c) Amounts blocked by international financial organizations Western/Visa equal to GEL 25 (2010: GEL 28) that were classified in prior periods as Amounts due from credit institutions were reclassified to Other assets.
- d) In 2011 the deferral of loan origination fee was not taken into account for the amortized cost calculation of loans to customers. Respectively unearned income was included in other liabilities. To correct the error deferred commission income amounting to GEL 270 (2010: nil) were reclassified from Other liabilities to Loans to customers to achieve proper application of effective interest method. Adjustment for the amortized cost also caused decrease of allowance for impairment in amount of 30 GEL in 2011 (2010: nil).
- e) Certain items of other property and equipment in amount of GEL 517 (2010: GEL nil) were erroneously classified in prior period as construction in progress and were not depreciated. To correct the error they were reclassified within the property and equipment into category "other" and depreciation expense for 2011 amounting to GEL 64 (2010: nil) was recognized in the income statement.
- f) Effect of disposal of property and equipment amounting to GEL 13 (2010: nil) related to reporting year ended 31 December 2011 were not recognized in prior year's financial statements. The effect of correction has been reflected in Other operating expense and resulted in decrease of property, plant and equipment as at 31 December 2011 by GEL 13 (2010: nil).
- g) The Company identified that in prior years certain repossessed properties that should be accounted for as investment property at fair value in accordance with IAS 40 was erroneously classified as Assets held for sale and accounted for in accordance with IFRS 5 while criteria for such classification were not met as at 31 December 2011 and 2010. Changes in their fair value less cost to sale were presented within other operating expenses or other income. As result of correction of these errors as at 31 December 2011 investment property increased by GEL 8,620 (2010: GEL 9,211), Other assets decreased by GEL 8,067 (2010: GEL 7,895).

(Thousands of Georgian Lari)

2. Basis of preparation (continued)

Restatements and reclassifications (continued)

- h) In 2011 certain repossessed investment property erroneously was not reflected in the statement of financial position. As result of correction of this error investment property as at 31 December 2011 increased by GEL 557. In addition to that in prior years gains and losses related to investment property disposals and revaluations as well as assets held for sale impairment and reversals of impairment were recognized in Other operating expense and Other income rather than in separate line items Net gains/(losses) on investment property revaluation and Net gains/(losses) from disposal of investment property. The overall effect of these corrections and reclassifications as well those described in g) above was increase of losses presented within Net gains/(losses) on investment property revaluation for 2011 by GEL 748, increase of losses from investment property disposal presented within Net losses from disposal of investment property for 2011 by GEL 70, decrease of other operating expenses by GEL 822 and decrease in other income by GEL 267. At the same time reversal of impairment presented within Other impairment and provisions (charge)/reversal was decreased by GEL 108.
- i) Certain repossessed motor vehicles were erroneously recognized as at 31 December 2010 as assets held for sale and accounted for in accordance with IFRS 5 while they did not meet criteria for such classification. To correct the error their carrying amount presented within Other assets were increased by GEL 166 which represents estimated costs to sell deducted in accordance with IFRS 5 (2011: nil).
- j) Term deposit from BTA Bank (Kazakhstan) amounting to GEL 2,178 (2010: GEL 3,103) that was presented in prior periods as Other borrowed funds was reclassified to Amounts due to credit institutions.
- k) The Company identified that certain Other borrowed funds erroneously were not presented at amortised cost. To correct this error Other borrowed funds decreased by GEL 1,414 (2010: nil). The effect on income statement is represented by decrease of Interest expense and Net gains/(losses) from foreign currencies translation differences in amounts of GEL 1,125 and GEL 289, respectively.
- l) The Company identified that in 2011 effect of revaluation of certain property and equipment was erroneously recognized in other income within profit or loss instead of being recognized in other comprehensive income. In addition to that respective deferred tax effect was not recognized in financial statements for 2011. To correct this error gain on property revaluation amounting to GEL 529 (2010: nil) less respective deferred tax liability amounting to GEL 79 (2010: nil) were recognized in other comprehensive income with respective deferred tax liability. The effect of restatement on Other income is decrease amounted to GEL 529.
- m) The company recognized additional Deferred income tax liability in total amount of GEL 23 (2010: 222) resulted from all adjustments made. The effect of correction to Income tax expense amounted to GEL 198.
- n) Provision for guarantees amounting to GEL 100 (2010: GEL 218) that was included in prior periods in Other liabilities is now presented separately.
- o) In prior periods the Company did not recognize accrual for unused vacation amounting to GEL 213 (2010: nil) and liabilities related to Management and other personnel bonuses amounting to GEL 114 (2010: nil). This error was corrected by increasing amount of respective liabilities as well as increase of Personnel expenses amounted to GEL 327.
- p) The Company identified that amount of GEL 119 (2010: nil) related to guarantee matured in 2011 was erroneously included in other liabilities as at 31 December 2011. To correct this error the Company derecognized the liability presented in the statement of financial position and accordingly adjusted Other impairment and provisions (charge)/reversal line item in the income statement.
- q) The Company identified that certain other liabilities existed as at 31 December 2011 erroneously were not recognised in the financial statements for 2011. To correct this error Other liabilities as at 31 December 2011 were increased by GEL 116 (2010: nil) and other operating expenses were increased by GEL 103 and personnel expenses were increased by GEL 13.
- r) The Company identified that in 2011 penalties accrued on Loans to customers amounting to GEL 130 were erroneously classified as Interest income. To correct this error this amount was reclassified to Other income.
- s) As a result of the restatements the profit for the year increased by GEL 354. The total comprehensive income for the year increased by GEL 794 comprised of the GEL 354 increase of profit for the year and GEL 450 and increase of other comprehensive (loss)/income for the year, net of tax of GEL 450.

(Thousands of Georgian Lari)

3. Going concern

The Bank incurred total comprehensive loss of GEL 5,281 for the year ended 31 December 2012 and as of that date had accumulated losses of GEL 2,170.

As of 31 December 2012 the Bank's financing arrangements with BTA Bank (Kazakhstan) comprised of GEL 49,802 classified as Other borrowed funds maturing in the period from February 2014 till October 2014 (Note 17), GEL 2,507 classified as Subordinated loan maturing in March 2013 (Note 18) and GEL 1,415 classified as Amounts due to credit institutions maturing in November 2014 (Note 15). Moreover the Bank has negative liquidity gap of GEL 7,322 for within one year (Note 28). Notwithstanding these facts management assesses that the Bank will have the ability to meet all of its liabilities as they come due for the following reasons:

- ▶ The Bank's capability to discharge its liabilities relies on its ability to realize an equivalent amount of assets within the same period of time. The undiscounted financial liability gap does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables disclosed in Notes 26 and 28. These balances are included in amounts due in less than one year in the Maturity Analysis of assets and liabilities (Note 28).
- ▶ The Bank's management is currently in the process of negotiating the restructuring of the total indebtedness towards BTA Bank (Kazakhstan). BTA Bank Kazakhstan agreed to initiate the restructure of the total indebtedness if the Silk Road Finance Group (Georgia) will pledge as collateral 24% of its shares, transfer voting rights for these shares to BTA Bank (Kazakhstan), repay the subordinated debt that matured in March 2013 and was not repaid by the Bank, and increase the number of supervisory board members. Majority shareholder and the Bank have the ability to meet the requested conditions of BTA Bank (Kazakhstan) however they intend to further negotiate the details. The management of the Bank estimates that the process of negotiations and further approval of restructure of indebtedness will be completed by 30 September 2013.
- ▶ The Bank's management is estimating that the reduced cost of debt after the restructure of the indebtedness will enable it to attract more borrowers and thus increase its loan portfolio.

The aggregate of these actions will result into reduced negative liquidity gap.

The management estimates that the Bank will violate the liquidity prudential ratio of the National Bank of Georgia in August 2013 as Other borrowed funds maturing in February 2014 (Note 17) will become current liabilities for the purposes of calculation of the prudential liquidity ratio. As a result there is a risk of sanctions from NBG towards the Bank. The management intends to obtain a waiver letter from NBG as it will be able to demonstrate that liquidity prudential ratio will be met in September 2013 after indebtedness restructure and as a result no sanctions will be applied to the Bank by NBG.

For the reasons described above the financial statements of the Bank are prepared on the going concern basis. However the conditions described above indicate the existence of material uncertainty that may cast significant doubt about the Bank's ability to continue as a going concern.

4. Summary of significant accounting policies

Changes in accounting policies and adoption of new or revised standards and interpretations

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

Amendments to IFRS 7 Financial Instruments: Disclosures

The Amendments were issued in October 2010 and are effective for annual periods beginning on or after 1 July 2011. The amendment requires additional disclosure about financial assets that have been transferred to enable the users of the Bank's financial statements to evaluate the risk exposures relating to those assets. The amendment has no impact on the Bank's financial position or performance.

Other amendments resulting from Improvements to the following standards did not have any impact on the accounting policies, financial position or performance of the Bank:

- ▶ IAS 12 *Income Taxes (Amendment) - Deferred Taxes: Recovery of Underlying Assets*;
- ▶ IFRS 1 *First-Time Adoption of International Financial Reporting Standards (Amendment) - Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopter*.

(Thousands of Georgian Lari)

4. Summary of significant accounting policies (continued)

New accounting pronouncements

Certain new standards and interpretations have been published that are mandatory for the Bank's accounting periods beginning on or after 1 January 2013 or later periods and which the Bank has not early adopted:

IFRS 9 Financial Instruments

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

IFRS 10 Consolidated Financial Statements

IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in IAS 27. In addition IFRS 10 introduces specific application guidance for agency relationships. IFRS 10 replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also includes the issues raised in SIC-12 *Consolidation – Special Purpose Entities*. It is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. Currently the Group evaluates possible effect of the adoption of IFRS 10 on its financial position and performance.

IFRS 11 Joint Arrangements

IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Non-monetary Contributions by Venturers* and is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The Group expects that adoption of IFRS 11 will have no effect on its financial position and performance.

IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 is effective for annual periods beginning on or after 1 January 2013. IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. In particular, the Group will need to disclose more information about the consolidated and unconsolidated structured entities with which it is involved or which it has sponsored. However, the standard will have no impact on Group's financial position or performance.

IFRS 13 Fair Value Measurement

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. IFRS 13 is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The adoption of the IFRS 13 may have effect on the measurement of the Group's assets and liabilities accounted for at fair value. Currently the Group evaluates possible effect of the adoption of IFRS 13 on its financial position and performance.

IAS 27 Separate Financial Statements (as revised in 2011)

As a consequence of the new IFRS 10 and IFRS 12, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The amendment becomes effective for annual periods beginning on or after 1 January 2013. Currently the Group evaluates possible effect of the adoption of IAS 27 on its financial position and performance.

(Thousands of Georgian Lari)

4. Summary of significant accounting policies (continued)

New accounting pronouncements (continued)

IAS 28 Investments in Associates and Joint Ventures (as revised in 2011)

As a consequence of the new IFRS 11 and IFRS 12, IAS 28 has been renamed *IAS 28 Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The amendment becomes effective for annual periods beginning on or after 1 January 2013. Currently the Group evaluates possible effect of the adoption of IAS 28 on its financial position and performance.

Amendments to IAS 19 Employee Benefits

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

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

The amendments to IAS 1 change the grouping of items presented in other comprehensive income. Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, net losses or gains on available-for-sale financial assets) would be presented separately from items that will never be reclassified (for example, revaluation of buildings). The amendment affects presentation only and has no impact on the Group's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

Amendments to IFRS 7 Disclosures - Offsetting Financial assets and Financial Liabilities

These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognized financial instruments that are set off in accordance with IAS 32 *Financial Instruments: Presentation*. The disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreements, irrespective of whether they are set off in accordance with IAS 32. These amendments will not impact the Banks' financial position or performance and will become effective for annual periods beginning on or after 1 January 2013.

Amendments to IAS 32 - Offsetting Financial Assets and Financial Liabilities

These amendments clarify the meaning of "currently has a legally enforceable right to set-off". It will be necessary to assess the impact to the Group by reviewing settlement procedures and legal documentation to ensure that offsetting is still possible in cases where it has been achieved in the past. In certain cases, offsetting may no longer be achieved. In other cases, contracts may have to be renegotiated. The requirement that the right of set-off be available for all counterparties to the netting agreement may prove to be a challenge for contracts where only one party has the right to offset in the event of default.

The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. While many settlement systems are expected to meet the new criteria, some may not. As the impact of the adoption depends on the Group's examination of the operational procedures applied by the central clearing houses and settlement systems it deals with to determine if they meet the new criteria, it is not practical to quantify the effects.

These amendments become effective for annual periods beginning on or after 1 January 2014.

Amendment to IFRS 1 - Government loans

These amendments require first-time adopters to apply the requirements of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, prospectively to government loans existing at the date of transition to IFRS. The amendment will have no impact on the Group.

(Thousands of Georgian Lari)

4. Summary of significant accounting policies (continued)

New accounting pronouncements (continued)

Improvements to IFRS

The amendments are effective for annual periods beginning on or after 1 January 2013. They will not have an impact on the Group.

- ▶ *IFRS 1 First-time Adoption of International Financial Reporting Standards:* This improvement clarifies that an entity that stopped applying IFRS in the past and chooses, or is required, to apply IFRS, has the option to re-apply IFRS 1. If IFRS 1 is not re-applied, an entity must retrospectively restate its financial statements as if it had never stopped applying IFRS.
- ▶ *IAS 1 Presentation of Financial Statements:* This improvement clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative information is the previous period.
- ▶ *IAS 16 Property Plant and Equipment:* This improvement clarifies that major spare parts and servicing equipment that meet the definition of property, plant and equipment are not inventory.
- ▶ *IAS 32 Financial Instruments, Presentation:* This improvement clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12 *Income Taxes*.
- ▶ *IAS 34 Interim Financial Reporting:* The amendment aligns the disclosure requirements for total segment assets with total segment liabilities in interim financial statements. This clarification also ensures that interim disclosures are aligned with annual disclosures.

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial assets upon initial recognition and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

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

Loans and receivables

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

Held-to-maturity investments

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

Available-for-sale financial assets

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

(Thousands of Georgian Lari)

4. Summary of significant accounting policies (continued)

Financial assets (continued)

If the Bank has both the intention and ability to hold investment securities available-for-sale to maturity, they may be reclassified as investment securities held-to-maturity. In this case the fair value of securities, as of the date of reclassification, becomes their new amortised cost. For instruments with a fixed maturity the revaluation reserve as of the date of reclassification is amortised to profit or loss during the period until maturity using the effective interest rate method.

Determination of fair value

The fair value for financial instruments traded in active market at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

Offsetting

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

Reclassification of financial assets

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

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

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

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

Cash and cash equivalents

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

Borrowings

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

(Thousands of Georgian Lari)

4. Summary of significant accounting policies (continued)

Leases

Operating - Bank as lessee

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

Operating - Bank as lessor

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

Impairment of financial assets

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

Amounts due from credit institutions and loans to customers

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

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

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

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

(Thousands of Georgian Lari)

4. Summary of significant accounting policies (continued)

Amounts due from credit institutions and loans to customers (continued)

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

Held-to-maturity financial investments

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

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

Available-for-sale financial investments

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

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

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Future interest income is based on the reduced carrying amount and is

accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in the income statement. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.

The accounting treatment of such restructuring is as follows:

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

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

(Thousands of Georgian Lari)

4. Summary of significant accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Financial liabilities

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

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

Credit related commitments

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

Any increase in the liability relating to financial guarantees is taken to the income statement. The amount of fee received is recognised in the income statement on a straight-line basis over the life of the guarantee.

Taxation

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.

*(Thousands of Georgian Lari)***4. Summary of significant accounting policies (continued)****Taxation (continued)**

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 Group. 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.

Deferred income tax is provided on post acquisition retained earnings and other post acquisition movements in reserves of subsidiaries, except where the Group controls the subsidiary's dividend policy and it is probable that the difference will not reverse through dividends or otherwise in the foreseeable future.

Property and equipment

Equipment is carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met. The carrying values of equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

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

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

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

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

| | <u>Years</u> |
|--------------------------------|--------------|
| Buildings | 50 |
| Furniture and fixtures | 4-10 |
| Computers and office equipment | 4 |
| Motor vehicles | 5 |
| Other | 4-10 |

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

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

(Thousands of Georgian Lari)

4. Summary of significant accounting policies (continued)

Investment property

Investment property is land or building or a part of a building held to earn rental income or for capital appreciation and which is not used by the Bank or held for sale in the ordinary course of business.

Investment properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the reporting date. Gains or losses arising from changes in the fair values of investment properties are included in the income statement in the period in which they arise. Fair values are determined based on an annual evaluation performed by an accredited external, independent valuer, applying a valuation model recommended by the International Valuation Standards Committee.

Transfers are made to or from investment property only when there is a change in use. For a transfer from investment property to owner-occupied property, the deemed cost for subsequent accounting is the fair value at the date of change in use. If owner-occupied property becomes an investment property, the Bank accounts for such property in accordance with the policy stated under property and equipment up to the date of change in use.

Investment properties are derecognised either when they have been disposed of or when they are permanently withdrawn from use and no future economic benefit is expected from their disposal. The difference between the net disposal proceeds and the carrying amount of the asset is recognised in the income statement in the period of derecognition.

Earned rental income is recorded in income statement within other operating income.

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The Bank's intangible assets have definite useful life. Intangible assets are amortised over the useful economic lives of 2 to 7 years (computer software: 6-7 years, licenses: 2-7 years) and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Provisions

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

Share capital

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

Contingencies

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

(Thousands of Georgian Lari)

4. Summary of significant accounting policies (continued)

Recognition of income and expenses

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

Interest and similar income and expense

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

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

Fee and commission income

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income agency fees and other fees. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

Foreign currency translation

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

Differences between the contractual exchange rate of a transaction in a foreign currency and the NBG exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official NBG exchange rates at 31 December 2012, 31 December 2011 and 31 December 2010 were 1.6567, 1.6703 and 1.7728 GEL to 1 USD, respectively.

5. Significant accounting judgements and estimates

Judgments

In the process of applying the Bank's accounting policies, management has made the following judgements, apart from those involving estimates, which have the most significant effect on the amounts recognised in the financial statements:

- ▶ Classification of investment securities as held to maturity;
- ▶ Useful life periods for the tangible and intangible assets;
- ▶ Tax accruals.

(Thousands of Georgian Lari)

5. Significant accounting judgements and estimates (continued)**Estimation uncertainty**

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

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its judgement to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

Deferred tax assets

Deferred tax assets are recognised in respect of tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax planning strategies.

Determination of collateral value

Management monitors market value of collateral on a regular basis. Management uses its experienced judgment or independent opinion to adjust the fair value to reflect current circumstances. The amount and type of collateral required depends on the assessment of credit risk of the counterparty.

6. Cash and cash equivalents

| | <u>2012</u> | <u>2011 (as restated)</u> | <u>2010 (as restated)</u> |
|--|---------------------|-------------------------------|-------------------------------|
| Cash on hand | 5,234 | 4,187 | 2,183 |
| Current accounts with the National Bank of Georgia | 37 | 141 | 807 |
| Current accounts with other credit institutions | <u>3,034</u> | <u>2,163</u> | <u>9,853</u> |
| Cash and cash equivalents | <u>8,305</u> | <u>6,491</u> | <u>12,843</u> |

As at 31 December 2012 current accounts with other credit institutions consist of non-interest bearing correspondent accounts balances with resident and non-resident banks in the amount of GEL 2,796 (2011: GEL 231, 2010: GEL 7,014) and GEL 238 (2011: GEL 1,932; 2010: GEL 2,839), respectively.

7. Amounts due from credit institutions

| | <u>2012</u> | <u>2011 (as restated)</u> | <u>2010 (as restated)</u> |
|--|---------------------|-------------------------------|-------------------------------|
| Obligatory reserve with the National Bank of Georgia | 6,203 | 2,937 | 2,836 |
| Time deposits for more than 90 days | <u>3,567</u> | <u>2,837</u> | <u>5,349</u> |
| Amounts due from credit institutions | <u>9,770</u> | <u>5,774</u> | <u>8,185</u> |

Credit institutions are required to maintain an interest earning cash deposit (obligatory reserve) with the NBG at 10% and at 15% (2011: 5% until January 2011, 10% until February 2011, 15% until December 2011; 2010: 5%) of the previous month average of funds in GEL and foreign currencies, respectively, attracted from customers by the credit institution. The Bank's ability to withdraw such deposit is restricted by statutory legislation.

In 2012, 2011 and 2010 the obligatory reserve on USD account bears interest at the rate of U.S. Federal Reserve System less 0.5 % p.a.; on EUR account - the rate of the European Central Bank less 0.5 % p.a.

Time deposits for more than 90 days or overdue are placed with 3 resident banks (2011: 2 resident banks, 2010: 2 resident banks).

(Thousands of Georgian Lari)

8. Loans to customers

Loans to customers comprise:

| | 2012 | 2011 (as restated) | 2010 (as restated) |
|---------------------------------|---------------|-----------------------|-----------------------|
| Corporate lending | 42,093 | 42,206 | 25,989 |
| Residential mortgages | 23,514 | 17,588 | 7,308 |
| Small business lending | 6,773 | 6,613 | 6,554 |
| Consumer lending | 4,172 | 3,805 | 3,580 |
| Credit cards | 3,053 | 1,241 | 224 |
| Auto loans | 1,193 | 896 | 1,826 |
| Other | 3,054 | 5,808 | 12,051 |
| Gross loans to customers | 83,852 | 78,157 | 57,532 |
| Less: allowance for impairment | (8,443) | (6,593) | (9,311) |
| Loans to customers | 75,409 | 71,564 | 48,221 |

Allowance for impairment of loans to customers

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

| | Corporate lending 2012 | Residential mortgages 2012 | Small business lending 2012 | Consumer lending 2012 | Credit cards 2012 | Auto loans 2012 | Other 2012 | Total 2012 |
|--|------------------------------|----------------------------------|--------------------------------------|-----------------------------|-------------------------|-----------------------|---------------|---------------|
| At 1 January 2012 | 3,792 | 1,257 | 379 | 523 | 33 | 192 | 417 | 6,593 |
| Net charge/(reversal) for the year | 585 | 735 | (167) | (258) | 166 | (118) | 1,039 | 1,982 |
| Recoveries of previously written off loans and advances | - | 1 | 4 | 216 | - | 18 | 68 | 307 |
| Amounts written off | - | (10) | (22) | (107) | (1) | (36) | (263) | (439) |
| At 31 December 2012 | 4,377 | 1,983 | 194 | 374 | 198 | 56 | 1,261 | 8,443 |
| Individual impairment | 4,044 | 945 | 80 | - | - | - | 344 | 5,413 |
| Collective impairment | 333 | 1,038 | 114 | 374 | 198 | 56 | 917 | 3,030 |
| | 4,377 | 1,983 | 194 | 374 | 198 | 56 | 1,261 | 8,443 |
| Gross amount of loans and advances, individually determined to be impaired, before deducting any individually assessed impairment allowance | 17,142 | 2,878 | 442 | - | - | - | 633 | 21,095 |
| | Corporate lending 2011 | Residential mortgages 2011 | Small business lending 2011 | Consumer lending 2011 | Credit cards 2011 | Auto loans 2011 | Other 2011 | Total 2011 |
| At 1 January 2011 | 4,424 | 723 | 766 | 520 | 21 | 316 | 2,541 | 9,311 |
| Net charge/(reversal) for the year | (653) | 318 | (261) | (181) | 12 | (84) | (1,787) | (2,636) |
| Recoveries of previously written off loans and advances | 149 | 218 | 11 | 196 | - | 16 | 4 | 594 |
| Amounts written off | (128) | (2) | (137) | (12) | - | (56) | (341) | (676) |
| At 31 December 2011 | 3,792 | 1,257 | 379 | 523 | 33 | 192 | 417 | 6,593 |
| Individual impairment | 2,428 | - | - | - | - | - | - | 2,428 |
| Collective impairment | 1,364 | 1,257 | 379 | 523 | 33 | 192 | 417 | 4,165 |
| | 3,792 | 1,257 | 379 | 523 | 33 | 192 | 417 | 6,593 |
| Gross amount of loans and advances, individually determined to be impaired, before deducting any individually assessed impairment allowance | 16,429 | - | - | - | - | - | - | 16,429 |

(Thousands of Georgian Lari)

8. Loans to customers (continued)*Individually impaired loans*

Interest income accrued on loans and advances, for which individual impairment allowances have been recognized, for the year ended 31 December 2012 comprised GEL 2,485 (2011: GEL 1,156; 2010: GEL 1,166).

In accordance with the Georgian legislation, loans may only be written off with the approval of the Board of Directors and, in certain cases, with the respective decision of the Court.

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- ▶ For commercial lending, charges over real estate properties, inventory, and cash held in bank;
- ▶ For retail lending, mortgages over residential properties.

The Bank also obtains guarantees from parent companies for loans to their subsidiaries.

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

It is the Bank's policy to dispose repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Bank does not occupy repossessed properties for business use. The repossessed properties are recorded separately on the face of statement of financial position.

Concentration of loans to customers

As of 31 December 2012, the Bank had a concentration of loans represented by GEL 23,503 due from the ten largest third party borrowers (28% of gross loan portfolio) (2011: GEL 24,548 or 31.4% and 2010: GEL 16,259 or 28%). An allowance of GEL 3,035 (2011: GEL 2,457 and 2010: GEL 3,079) was recognised against these loans. Included in total loans to customers is an exposure to a single greatest borrower of GEL 2,485 or 4.7% of total loan portfolio (2011: GEL 3,659 or 4.7% and 2010: GEL 3,661 or 6.4%), that bears an annual interest rate of 18%.

Loans have been extended to the following types of customers:

| | 2012 | 2011 (as restated) | 2010 (as restated) |
|---------------------------|---------------|-----------------------|-----------------------|
| Commercial legal entities | 48,867 | 48,819 | 32,544 |
| Individuals | 34,985 | 29,338 | 24,988 |
| | <u>83,852</u> | <u>78,157</u> | <u>57,532</u> |

Loans are made within Georgia in the following industry sectors:

| | 2012 | 2011 (as restated) | 2010 (as restated) |
|---------------------------------------|---------------|-----------------------|-----------------------|
| Individuals | 34,985 | 29,338 | 24,988 |
| Construction | 15,572 | 11,207 | 9,329 |
| Retail | 10,548 | 8,984 | 4,568 |
| Financial | 4,880 | 5,147 | 5,064 |
| Food Industry | 4,672 | 6,784 | 3,395 |
| Agriculture | 3,977 | 5,448 | 1,493 |
| Energy | 2,643 | 2,924 | 4,429 |
| Manufacturing | 2,619 | 3,013 | 1,711 |
| Pharmacy | 1,848 | 2,518 | 198 |
| Tourism | 652 | 791 | 562 |
| Transportation and Communication | 212 | 219 | 217 |
| Other | 1,244 | 1,784 | 1,578 |
| Gross loans and advances to customers | <u>83,852</u> | <u>78,157</u> | <u>57,532</u> |

(Thousands of Georgian Lari)

9. Investment securities

Available for sale securities comprise:

| | 2012 | | 2011 | | 2010 | |
|--------------------------------------|---------|------------------|---------|-----------------|---------|------------------|
| | Share % | Carrying value | Share % | Carrying value | Share % | Carrying value |
| JSC Gudauri (JSC Gergeti in 2010) | 2.05% | 260 | 2.05% | 260 | 2.57% | 260 |
| JSC United Clearing Center | 6.25% | 20 | - | - | - | - |
| Tbilisi Interbank Stock Exchange | - | - | - | - | 8.33% | 40 |
| | | <u>280</u> | | <u>260</u> | | <u>300</u> |
| Less: allowance for impairment | | <u>(260)</u> | | <u>(260)</u> | | <u>(260)</u> |
| Available-for-sale securities | | <u><u>20</u></u> | | <u><u>-</u></u> | | <u><u>40</u></u> |

Held-to-maturity securities comprise:

| | 2012 | 2011 | 2010 |
|--|---------------------|---------------------|---------------------|
| Government Treasury bonds of the Ministry of Finance of Georgia | 2,873 | 2,765 | 301 |
| Government Treasury bills of the Ministry of Finance of Georgia | - | 768 | 1,693 |
| Government certificate of deposits of the National Bank of Georgia | - | - | 2,377 |
| Held-to-maturity securities | <u><u>2,873</u></u> | <u><u>3,533</u></u> | <u><u>4,371</u></u> |

| | 2012 | | 2011 | | 2010 | |
|--|------------------------------|-----------|------------------------------|----------------|------------------------------|----------------------|
| | Nominal annual interest rate | Maturity | Nominal annual interest rate | Maturity | Nominal annual interest rate | Maturity |
| Government Treasury bonds of the Ministry of Finance of Georgia | 8.90%- 13.00% | 1-5 years | 9.50%- 13.00% | 5- 7 months | 13.80% | 5 months - 1 year |
| Government Treasury bills of the Ministry of Finance of Georgia | - | - | 9.20%- 9.37% | 1-5 years | 10.07%- 14.00% | 2 years |
| Government certificate of deposits of the National Bank of Georgia | - | - | - | - | 9.05%- 9.75% | 3 months |

(Thousands of Georgian Lari)

10. Property and equipment

The movements in property and equipment were as follows:

| | <i>Land and buildings</i> | <i>Computers and communication equipment</i> | <i>Furniture, fixtures and office equipment</i> | <i>Motor vehicles</i> | <i>Leasehold improvements</i> | <i>Other</i> | <i>Total</i> |
|------------------------------------|---------------------------|--|---|-----------------------|-------------------------------|--------------|---------------|
| Cost | | | | | | | |
| 31 December 2010 | 17,573 | 1,962 | 1,881 | 435 | 2,399 | 1,804 | 26,054 |
| Additions | - | 51 | 71 | 76 | 50 | 666 | 914 |
| Disposals | - | (151) | (289) | (236) | (418) | (529) | (1,623) |
| Effect of revaluation | (1,201) | - | - | - | (687) | - | (1,888) |
| 31 December 2011 | 16,372 | 1,862 | 1,663 | 275 | 1,344 | 1,941 | 23,457 |
| Additions | 15 | 70 | 81 | 122 | - | 46 | 334 |
| Transfers from investment property | 250 | - | - | - | - | - | 250 |
| Disposals | - | - | - | (132) | - | (109) | (241) |
| Write-offs | - | (55) | (85) | - | - | (551) | (691) |
| Effect of revaluation | (2,422) | - | - | - | - | - | (2,422) |
| 31 December 2012 | 14,215 | 1,877 | 1,659 | 265 | 1,344 | 1,327 | 20,687 |
| Accumulated depreciation | | | | | | | |
| 31 December 2010 | - | 910 | 761 | 268 | 1,158 | 448 | 3,545 |
| Depreciation charge | 367 | 250 | 263 | 76 | 393 | 210 | 1,559 |
| Disposals | - | (102) | (164) | (175) | (317) | (105) | (863) |
| Effect of revaluation | (367) | - | - | - | (1,216) | - | (1,583) |
| 31 December 2011 | - | 1,058 | 860 | 169 | 18 | 553 | 2,658 |
| Depreciation charge | 344 | 172 | 235 | 56 | 351 | 214 | 1,372 |
| Disposals | - | - | - | (48) | - | (6) | (54) |
| Write-offs | - | (53) | (78) | - | - | (149) | (280) |
| Effect of revaluation | (344) | - | - | - | - | - | (344) |
| 31 December 2012 | - | 1,177 | 1,017 | 177 | 369 | 612 | 3,352 |
| Net book value | | | | | | | |
| 31 December 2010 | 17,573 | 1,052 | 1,120 | 167 | 1,241 | 1,356 | 22,509 |
| 31 December 2011 | 16,372 | 804 | 803 | 106 | 1,326 | 1,388 | 20,799 |
| 31 December 2012 | 14,215 | 700 | 642 | 88 | 975 | 715 | 17,335 |

As of 31 December 2012, an independent appraiser, Baker Tilly, determined the fair value of the Bank's land and buildings. The appraiser is an industry specialist in valuing these types of property and equipment.

The market value of the property was determined based on the active market data. The market approach was used to determine the fair value, the income approach was used to validate the obtained value estimates, and the cost approach was used to determine the value of real property where no information on recent sales or lease rates for similar properties within the same area was available.

As a result of revaluation of land and buildings, their value decreased by GEL 2,078, from which GEL 1,957 is unrealized loss on revaluation of land and building recognized in other comprehensive income, GEL 121 is loss recognized in income statement of the Bank.

If no revaluation of property and equipment had been performed, the original cost of property and equipment as of 31 December 2012 and 31 December 2011 recorded under the caption "Land and Buildings" would be as follows:

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|----------------------------|---------------|---------------|---------------|
| Cost | 19,955 | 19,690 | 19,690 |
| Accumulated depreciation | (3,498) | (3,153) | (2,785) |
| Net carrying amount | 16,457 | 16,537 | 16,905 |

(Thousands of Georgian Lari)

11. Investment property

| | <u>2012</u> | <u>2011</u> |
|---|---------------|---------------|
| Opening balance at 1 January | 11,822 | 11,245 |
| Additions | 1,581 | 3,170 |
| Disposals | (2,519) | (1,866) |
| Net losses from fair value adjustment | (156) | (748) |
| Transfer to property and equipment, NBV | (250) | - |
| Recoveries | - | 21 |
| 31 December | <u>10,478</u> | <u>11,822</u> |

Investment property is represented by several properties which the Bank took possession in satisfaction of non-performing loans, and holds for long-term appreciation in value.

As of 31 December 2012 the Bank engaged an accredited independent appraiser to determine the fair value of these properties. The appraiser is an industry specialist in valuing these types of investment properties.

The fair value of the property was determined based on the active market data. The market approach was used to determine the fair value, the income approach was used to validate the obtained value estimates, and the cost approach was used to determine the value of real property where no information on recent sales or lease rates for similar properties within the same area was available.

Rental income arising from investment properties comprised GEL 424 (2011: GEL 392).

12. Intangible assets

The movements in intangible assets were as follows:

| | <u>Licences</u> | <u>Computer Software</u> | <u>Total</u> |
|---------------------------------|-----------------|--------------------------|--------------|
| Cost | | | |
| 31 December 2010 | 232 | 735 | 967 |
| Additions | - | 167 | 167 |
| 31 December 2011 | <u>232</u> | <u>902</u> | <u>1,134</u> |
| Additions | 9 | - | 9 |
| 31 December 2012 | <u>241</u> | <u>902</u> | <u>1,143</u> |
| Accumulated amortization | | | |
| 31 December 2010 | (138) | (236) | (374) |
| Amortisation charge | (37) | (131) | (168) |
| 31 December 2011 | <u>(175)</u> | <u>(367)</u> | <u>(542)</u> |
| Amortisation charge | (34) | (152) | (186) |
| 31 December 2012 | <u>(209)</u> | <u>(519)</u> | <u>(728)</u> |
| Net book value | | | |
| 31 December 2010 | <u>94</u> | <u>499</u> | <u>593</u> |
| 31 December 2011 | <u>57</u> | <u>535</u> | <u>592</u> |
| 31 December 2012 | <u>32</u> | <u>383</u> | <u>415</u> |

(Thousands of Georgian Lari)

13. Taxation

The corporate income tax expense comprises:

| | <u>2012</u> | <u>2011</u> |
|--|-------------|-------------|
| Deferred tax expense - origination and reversal of temporary differences | 758 | 191 |
| Less: deferred tax expense recognized directly in other comprehensive income | (294) | (46) |
| Income tax benefit | <u>464</u> | <u>145</u> |

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

| | <u>2012</u> | <u>2011</u> |
|---|-------------|--------------|
| (Loss)/profit before income tax | (4,082) | 680 |
| Statutory tax rate | 15% | 15% |
| Theoretical income tax benefit/(expense) at the statutory rate | <u>612</u> | <u>(102)</u> |
| Non-deductible expenses | 160 | 247 |
| Tax exempt income less income recognized for tax purposes only | (308) | - |
| Income tax benefit | <u>464</u> | <u>145</u> |

In accordance with Georgian tax legislation business and capital losses may be carried forward for up to 5 years.

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

| | <i>Origination and reversal of temporary differences</i> | | | <i>Origination and reversal of temporary differences</i> | | |
|---|--|--------------------------------|--------------------------------------|--|--------------------------------|--------------------------------------|
| | | <i>In the income statement</i> | <i>In other comprehensive income</i> | | <i>In the income statement</i> | <i>In other comprehensive income</i> |
| | <u>2010</u> | | | <u>2011</u> | | |
| Tax effect of deductible temporary differences | | | | | | |
| Allowance for loan impairment | 54 | 14 | - | 68 | (68) | - |
| Tax losses carried forward | 1,422 | (151) | - | 1,271 | 465 | 1,736 |
| Investment property | - | 22 | - | 22 | 252 | 274 |
| Other | 28 | 66 | - | 94 | (44) | 50 |
| Gross deferred tax assets | <u>1,504</u> | <u>(49)</u> | <u>-</u> | <u>1,455</u> | <u>605</u> | <u>2,060</u> |
| Unrecognized deferred tax asset | - | - | - | - | (308) | (308) |
| Net deferred tax assets | <u>1,504</u> | <u>(49)</u> | <u>-</u> | <u>1,455</u> | <u>297</u> | <u>1,752</u> |
| Tax effect of taxable temporary differences | | | | | | |
| Allowance for loan impairment | - | - | - | - | (211) | (211) |
| Investment Property | (81) | 81 | - | - | - | - |
| Property and equipment | (3,306) | 114 | 46 | (3,146) | 352 | 294 |
| Other Assets | (25) | (1) | - | (26) | 26 | - |
| Deferred tax liabilities | <u>(3,412)</u> | <u>194</u> | <u>46</u> | <u>(3,172)</u> | <u>167</u> | <u>294</u> |
| Net deferred tax liabilities | <u>(1,908)</u> | <u>145</u> | <u>46</u> | <u>(1,717)</u> | <u>464</u> | <u>294</u> |

Georgian legal entities must file individual tax declarations. The tax rate for banks for profits was 15% for 2012, 2011 and 2010. The tax rate for companies other than banks was also 15%. According to the Georgian legislation, revenue from state securities is exempted from taxation.

(Thousands of Georgian Lari)

13. Taxation (continued)

As of 31 December 2012, 2011 and 2010 tax assets and liabilities consist of the following:

| | 2012 | 2011 (as restated) | 2010 (as restated) |
|--------------------------------|------------|-----------------------|-----------------------|
| Current income tax assets | 199 | 198 | 198 |
| Income tax assets | 199 | 198 | 198 |
| Current income tax liabilities | 959 | 1,717 | 1,908 |
| Income tax liabilities | 959 | 1,717 | 1,908 |

As of 31 December 2012 the Bank has tax losses carried forward amounting to GEL 7,802, GEL 672 and GEL 3,099 that will expire on 31 December 2014, 31 December 2015 and 31 December 2017 respectively.

14. Other assets and liabilities

Other assets comprise:

| | 2012 | 2011 (as restated) | 2010 (as restated) |
|------------------------------------|--------------|-----------------------|-----------------------|
| Financial assets | | | |
| Repossessed collateral (equipment) | 234 | - | 166 |
| Other | 126 | 371 | 156 |
| Total financial assets | 360 | 371 | 322 |
| Non-financial assets | | | |
| Prepaid expenses | 1,285 | 1,502 | 1,217 |
| Prepaid operational taxes | 278 | 235 | 199 |
| Total non-financial assets | 1,563 | 1,737 | 1,416 |
| Other assets | 1,923 | 2,108 | 1,738 |

Other liabilities comprise:

| | 2012 | 2011 (as restated) | 2010 (as restated) |
|---|------------|-----------------------|-----------------------|
| Financial liabilities | | | |
| Creditors | 415 | 469 | 304 |
| Unsettled transactions on money transfers | 73 | 3 | - |
| Accrued bonuses | 81 | 114 | - |
| Total financial liabilities | 569 | 586 | 304 |
| Non-financial liabilities | | | |
| Unused vacations | 252 | 213 | 89 |
| Operational taxes payable | - | 63 | 12 |
| Other | - | - | 16 |
| Total non-financial liabilities | 252 | 276 | 117 |
| Total other liabilities | 821 | 862 | 421 |

15. Amounts due to credit institutions

Amounts due to credit institutions comprise:

| | 2012 | 2011 (as restated) | 2010 (as restated) |
|---|--------------|-----------------------|-----------------------|
| Term deposits | 6,262 | 8,220 | 4,003 |
| Current accounts | 11 | 378 | 6 |
| Amounts due to credit institutions | 6,273 | 8,598 | 4,009 |

*(Thousands of Georgian Lari)***15. Amounts due to credit institutions (continued)**

Included in term deposits is a deposit from JSC BTA Bank (Kazakhstan) of GEL 1,415 (2011: GEL 2,178; 2010: GEL 3,103) maturing in November 2014 and bearing interest rate of 10% p.a. Remaining term deposits are received from resident banks, mature in January 2013 and are bearing annual interest rates ranging from 2.5% to 6% (2011: maturing in January 2012, interest rates from 6% to 6.75% p.a.; 2010: maturing in June 2011, interest rate of 7.72% p.a.).

16. Amounts due to customers

The amounts due to customers include the following:

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|---------------------------------|----------------------|----------------------|----------------------|
| Current accounts | 8,006 | 9,463 | 11,767 |
| Time deposits | 27,222 | 17,773 | 8,180 |
| Amounts due to customers | <u>35,228</u> | <u>27,236</u> | <u>19,947</u> |

At 31 December 2012 amounts due to customers of GEL 12,751 (36%) were due to ten largest third party customers (2011: GEL 11,015 (40%)), 2010: GEL 10,969 (55%). Cash held as security against guarantees amounts GEL 408 (2011: GEL 1,673; 2010: GEL 84).

In accordance with the internal procedures and contractual terms, the Bank is obliged to repay term deposits upon demand of a customer. In case a term deposit is repaid upon demand of the customer prior to maturity, interest on it is paid based on the interest rate for demand deposits, unless a different interest rate is specified in the agreement.

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

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|--|----------------------|----------------------|----------------------|
| Individuals: | | | |
| - Current accounts | 1,515 | 1,400 | 1,913 |
| - Term deposits | 24,311 | 11,650 | 4,271 |
| Total due to individuals | <u>25,826</u> | <u>13,050</u> | <u>6,184</u> |
| Commercial legal entities: | | | |
| - Current/settlement accounts | 6,491 | 8,063 | 9,854 |
| - Term deposits | 2,911 | 6,123 | 3,909 |
| Total due to commercial legal entities | <u>9,402</u> | <u>14,186</u> | <u>13,763</u> |
| Total due to legal entities | <u>9,402</u> | <u>14,186</u> | <u>13,763</u> |
| Total amounts due to customers | <u>35,228</u> | <u>27,236</u> | <u>19,947</u> |
| Held as security against guarantees issued | 408 | 1,673 | 84 |
| Held as security against undrawn loan facilities | 9 | 6 | - |

An analysis of customer accounts by economic sector follows:

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|---------------------------------|----------------------|----------------------|----------------------|
| Individuals | 25,826 | 13,050 | 6,184 |
| Trade and service | 4,338 | 7,828 | 7,639 |
| Real estate | 2,293 | 2115 | 2,548 |
| Finance sector | 1,892 | 117 | - |
| Construction | 312 | 1,207 | 773 |
| Agriculture | 98 | 389 | - |
| Retail | 41 | 1,762 | 1,171 |
| Mining and metallurgy | 21 | 1 | 51 |
| Other | 407 | 767 | 1,581 |
| Amounts due to customers | <u>35,228</u> | <u>27,236</u> | <u>19,947</u> |

(Thousands of Georgian Lari)

17. Other borrowed funds

Other borrowed funds comprise of loans received from JSC BTA Bank (Kazakhstan) with interest rates of 12% p.a. All loans are denominated in USD with initial maturities ranging from January 2010 till March 2011. In March 2010 the loans were restructured and maturity dates were prolonged until 2014:

| | <i>Date of placement</i> | <i>Maturity date</i> | <i>2012</i> | <i>2011 (as restated)</i> | <i>2010 (as restated)</i> |
|-----------------------------|--------------------------|----------------------|---------------|-------------------------------|-------------------------------|
| JSC BTA Bank (Kazakhstan) | 25 January 2010 | 25 October 2014 | 9,478 | 8,668 | 8,562 |
| JSC BTA Bank (Kazakhstan) | 30 November 2009 | 27 August 2014 | 11,456 | 10,463 | 10,408 |
| JSC BTA Bank (Kazakhstan) | 28 September 2010 | 28-May-14 | 10,571 | 9,638 | 9,645 |
| JSC BTA Bank (Kazakhstan) | 5 March 2010 | 4 March 2014 | 4,173 | 3,804 | 3,718 |
| JSC BTA Bank (Kazakhstan) | 5 March 2010 | 4 March 2014 | 440 | 401 | 391 |
| JSC BTA Bank (Kazakhstan) | 18 February 2010 | 18 February 2014 | 10,376 | 9,462 | 9,258 |
| JSC BTA Bank (Kazakhstan) | 18 February 2010 | 18 February 2014 | 1,427 | 1,301 | 1,273 |
| JSC BTA Bank (Kazakhstan) | 11 February 2010 | 11 February 2014 | 1,881 | 1,715 | 1,680 |
| Other borrowed funds | | | 49,802 | 45,452 | 44,935 |

Interest accrued on these loans and the loan principal is repayable at maturity.

18. Subordinated loan

On 14 March 2006, the Bank entered into a subordinated loan agreement with JSC BTA Bank (Kazakhstan) for the total amount of USD 1,500 thousand, with interest rate of 9% p.a. payable quarterly and maturity date of 14 March 2013. Outstanding at 31 December 2012 amounts to GEL 2,507 (2011: GEL 2,528; 2010: GEL 2,683). (Refer to Note 31).

19. Provisions

Provisions comprise:

| | <i>2012</i> | <i>2011 (as restated)</i> | <i>2010 (as restated)</i> |
|--|-------------|-------------------------------|-------------------------------|
| Provision for legal claims | 30 | 100 | 100 |
| Provision for guarantees and other commitments | - | - | 118 |
| Provisions | 30 | 100 | 218 |

20. Equity

Share capital

| | <i>Number of shares authorized</i> | <i>Number of shares fully paid</i> | <i>Nominal amount, GEL</i> |
|------------------------------|------------------------------------|------------------------------------|----------------------------|
| 31 December 2012, 2011, 2010 | 30,000 | 30,000 | 30,000 |

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

Dividends

In accordance with the Georgian legislation, dividends may only be declared to the shareholders of the Bank from the net income as shown in the Bank's separate financial statements prepared in accordance with the NBG requirements. National Bank shall be informed regarding declaration of dividends and also shall be authorized to suspend or restrict payment of dividends, if a commercial bank has violated regulatory requirements of the National Bank. No dividends were declared nor paid in 2012, 2011 and 2010.

(Thousands of Georgian Lari)

21. Commitments and contingencies

Operating environment

As an emerging market, Georgia does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature market economy. Operations in Georgia may involve risks that are not typically associated with those in developed markets (including the risk that the Georgian Lari is not freely convertible outside of the country, and undeveloped debt and equity markets). However over the last few years the Georgian government has made a number of developments that positively affect the overall investment climate of the country, specifically implementing the reforms necessary to create banking, judicial, taxation and regulatory systems. This includes the adoption of a new body of legislation (including new Tax Code and procedural laws). In management's view, these steps contribute to mitigate the risks of doing business in Georgia.

The existing tendency aimed at the overall improvement of the business environment is expected to persist. The future stability of the Georgian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Government. However, the Georgian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world.

While management believes it is taking appropriate measures to support the sustainability of the Bank's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Bank's results and financial position in a manner not currently determinable.

Going concern

As shown in Note 29 the Bank has significant concentration of financing activities with the shareholder, JSC BTA Bank (Kazakhstan), and is highly dependent on its support for funding its daily operations.

Management believe that it will be able to improve liquidity with financial assistance from the shareholders and as such be able to continue to meet its obligations as they become due and payable and therefore, these financial statements were prepared on going concern basis (Note 3).

Legal

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

Taxation

Georgian tax, currency and customs legislation are 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 central authorities. Recent events within Georgia suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for six calendar years proceeding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2012 management of the Bank believes that its interpretation of the relevant legislation is appropriate and that the Bank's tax, currency and customs positions will be sustained.

*(Thousands of Georgian Lari)***21. Commitments and contingencies (continued)****Financial commitments and contingencies**

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

| | <u>2012</u> | <u>2011</u> |
|--|--------------|--------------|
| Credit-related commitments | | |
| Undrawn loan facilities | 2,389 | 3,280 |
| Guarantees issued | 1,054 | 2,272 |
| | <u>3,443</u> | <u>5,552</u> |
| Operating lease commitments | | |
| Not later than 1 year | 113 | 32 |
| Later than 1 year but not later than 5 years | 594 | 1,367 |
| Later than 5 years | 1,175 | 2,462 |
| | <u>1,882</u> | <u>3,861</u> |
| Financial commitments and contingencies (before deducting collateral) | <u>5,325</u> | <u>9,413</u> |
| Less: cash held as security guarantees issued (Note 16) | (408) | (1,673) |
| Less: cash held as security against loans (Note 16) | (9) | (6) |
| Financial commitments and contingencies | <u>4,908</u> | <u>7,734</u> |

Insurance

The Bank has arrangement for employee's medical insurance with insurance company "Ardi Group". According to the agreement, the Bank makes monthly payments of insurance premium to the insurer.

22. Net fee and commission income

Net fee and commission income comprises:

| | <u>2012</u> | <u>2011</u> |
|---------------------------------------|--------------|--------------|
| Commissions on settlements operations | 959 | 849 |
| Commission on cash operations | 262 | 285 |
| Commission on guarantees issued | 130 | 98 |
| Currency conversion operations | 20 | 18 |
| Other | 7 | 2 |
| Fee and commission income | <u>1,378</u> | <u>1,252</u> |
| Commission on settlements operations | (55) | (47) |
| Commission on cash operations | (133) | (31) |
| Commission on plastic card operations | (110) | (96) |
| Other | (29) | (16) |
| Fee and commission expense | <u>(327)</u> | <u>(190)</u> |
| Net fee and commission income | <u>1,051</u> | <u>1,062</u> |

23. Other income

Other income comprises:

| | <u>2012</u> | <u>2011</u> |
|---|-------------|-------------|
| Rental Income (Note 11) | 424 | 392 |
| Refunded court fees | 221 | 365 |
| Income from fines and penalties on loans to customers | 124 | 136 |
| Other | 8 | 54 |
| Net gains from disposal of fixed assets | - | 26 |
| Total other income | <u>777</u> | <u>973</u> |

(Thousands of Georgian Lari)

24. Personnel and other operating expenses

Personnel expenses comprise:

| | 2012 | 2011 |
|----------------------------|--------------|--------------|
| Salaries | 4,927 | 4,449 |
| Bonuses and other benefits | 493 | 257 |
| Personnel expenses | 5,420 | 4,706 |

| | 2012 | 2011 |
|--|--------------|--------------|
| Other operating expenses comprise: | | |
| Occupancy and rent | 1,079 | 1,141 |
| Legal and consultancy | 948 | 865 |
| Office supplies | 665 | 574 |
| Security | 384 | 347 |
| Marketing and advertising | 337 | 325 |
| Operating taxes | 302 | 410 |
| Penalties incurred | 114 | 261 |
| Entertainment | 69 | 105 |
| Business travel and related | 45 | 72 |
| Insurance | 39 | 33 |
| Repair and maintenance of property and equipment | 35 | 55 |
| Loss on disposal of repossessed collateral | 29 | 13 |
| Personnel training | 24 | 54 |
| Other | 360 | 517 |
| Net losses from disposal of fixed assets | 7 | - |
| Other operating expenses | 4,437 | 4,772 |

25. Other impairment allowances and provisions

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

| | <i>Legal cases</i> | <i>Guarantees and commitments</i> | <i>Other assets</i> | <i>Investment property</i> | <i>Property and equipment</i> | <i>Total</i> |
|-------------------|--------------------|---|-------------------------|--------------------------------|-----------------------------------|--------------|
| 31 December 2010 | 100 | 118 | - | - | - | 218 |
| Charge/(reversal) | - | (118) | 128 | (21) | - | (11) |
| Write-offs | - | - | (128) | 21 | - | (107) |
| 31 December 2011 | 100 | - | - | - | - | 100 |
| Charge/(reversal) | (70) | - | 223 | - | 411 | 564 |
| Write-offs | - | - | (223) | - | (411) | (634) |
| 31 December 2012 | 30 | - | - | - | - | 30 |

26. Risk management

The Bank is required to manage financial risks that arise as a consequence of its operations to deliver its policy objectives as well as in the course of managing the Bank's statement of financial position. These risks primarily include credit risk, liquidity risk and funding management, market risk, prepayment risk and operational risk.

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

(Thousands of Georgian Lari)

26. Risk management (continued)

Risk management structure

The Bank's Board of Directors is ultimately responsible for identifying and controlling risks of the Bank; however, there are separate independent bodies responsible for managing and monitoring risks.

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Bank. The Asset - liability and Risk management Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Risk Management Unit

The Risk Management Unit is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Bank Treasury

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

Internal Audit

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

Risk measurement and reporting systems

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risks types and activities.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Management Board, the Risk Committee, and the head of each business division and used to assess and conclude on the risks of the Bank.

Risk mitigation

The Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration

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

In order to avoid excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Credit risk

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

(Thousands of Georgian Lari)

26. Risk management (continued)**Credit risk (continued)**

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

Credit-related commitments risks

The Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies. The maximum exposure to credit risk for the components of the statement of financial position, before the effect of mitigation through the use of collateral agreements, is best represented by their carrying amounts.

Where financial instruments are recorded at fair value, the carrying value represents the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

Credit quality per class of financial assets

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

All neither past due nor impaired loans to customers excluding loans to individuals are classified in three quality Banks presented in the tables below:

- ▶ High grade group includes borrowers with high level of liquidity and profitability. The probability of default is assessed as low.
- ▶ Standard grade includes borrowers with average level of liquidity and profitability. The probability of default is assessed as moderate.
- ▶ Sub-standard grade group includes borrowers with satisfactory level of liquidity and profitability. The probability of breach of default is assessed as above moderate.

All neither past due nor impaired loans to individuals are classified in three quality groups presented in the tables below:

- ▶ High grade group includes borrowers with good debt servicing and excellent financial position, loans secured with deposits, loans secured with gold.
- ▶ Standard grade group includes borrowers with good/average debt servicing and moderate financial position of the borrower.
- ▶ Sub-standard grade group is represented by loans with average debt servicing and moderate financial position of the borrower.

The table below shows the credit quality by class of credit risk bearing assets:

| | Notes | Neither past due nor impaired | | | Past due but not impaired 2012 | Individually impaired 2012 | Total 2012 |
|--------------------------------------|-------|-------------------------------|------------------------|----------------------------|-----------------------------------|-------------------------------|---------------|
| | | High grade 2012 | Standard grade 2012 | Sub-standard grade 2012 | | | |
| Amounts due from credit institutions | 7 | 9,770 | - | - | - | - | 9,770 |
| Loans to customers | 8 | | | | | | |
| Corporate lending | | 10,069 | 9,130 | 1,663 | 4,089 | 17,142 | 42,093 |
| Residential mortgages | | 1,551 | 15,142 | 798 | 3,145 | 2,878 | 23,514 |
| Small business lending | | 2,296 | 3,060 | 167 | 808 | 442 | 6,773 |
| Consumer lending | | 1,022 | 2,436 | 113 | 601 | - | 4,172 |
| Credit cards | | 113 | 2,547 | 15 | 378 | - | 3,053 |
| Auto loans | | 18 | 911 | 74 | 190 | - | 1,193 |
| Other | | 87 | 97 | 816 | 1,421 | 633 | 3,054 |
| | | <u>15,156</u> | <u>33,323</u> | <u>3,646</u> | <u>10,632</u> | <u>21,095</u> | <u>83,852</u> |
| Debt investment securities | 9 | | | | | | |
| Held to maturity | | 2,873 | - | - | - | - | 2,873 |
| Total | | <u>27,799</u> | <u>33,323</u> | <u>3,646</u> | <u>10,632</u> | <u>21,095</u> | <u>96,495</u> |

(Thousands of Georgian Lari)

26. Risk management (continued)**Credit risk (continued)**

| | Notes | Neither past due nor impaired | | | Past due but not impaired 2011 | Individually impaired 2011 | Total 2011 |
|--------------------------------------|-------|-------------------------------|------------------------|----------------------------|-----------------------------------|-------------------------------|---------------|
| | | High grade 2011 | Standard grade 2011 | Sub-standard grade 2011 | | | |
| Amounts due from credit institutions | 7 | 5,774 | - | - | - | - | 5,774 |
| Loans to customers | 8 | | | | | | |
| Corporate lending | | 9,302 | 10,217 | 5,560 | 698 | 16,429 | 42,206 |
| Residential mortgages | | 53 | 15,144 | 111 | 2,280 | - | 17,588 |
| Small business lending | | 302 | 4,218 | 103 | 1,990 | - | 6,613 |
| Consumer lending | | 546 | 2,423 | 61 | 775 | - | 3,805 |
| Credit cards | | 77 | 1,034 | - | 130 | - | 1,241 |
| Auto loans | | 22 | 481 | 52 | 341 | - | 896 |
| Other | | 72 | 1,424 | 681 | 3,631 | - | 5,808 |
| | | <u>10,374</u> | <u>34,941</u> | <u>6,568</u> | <u>9,845</u> | <u>16,429</u> | <u>78,157</u> |
| Debt investment securities | 9 | | | | | | |
| Held to maturity | | 3,533 | - | - | - | - | 3,533 |
| Total | | <u>19,681</u> | <u>34,941</u> | <u>6,568</u> | <u>9,845</u> | <u>16,429</u> | <u>87,464</u> |

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

| | Less than 30 days 2012 | 31 to 60 days 2012 | 61 to 90 days 2012 | More than 90 days 2012 | Total 2012 |
|------------------------|------------------------------|--------------------------|--------------------------|------------------------------|---------------|
| Loans to customers | | | | | |
| Corporate lending | 3,566 | 331 | - | 192 | 4,089 |
| Residential mortgages | 589 | 765 | 352 | 1,439 | 3,145 |
| Small business lending | 411 | 164 | - | 233 | 808 |
| Consumer lending | 170 | 58 | 36 | 337 | 601 |
| Credit cards | 148 | 42 | 28 | 160 | 378 |
| Auto loans | 71 | 38 | 16 | 65 | 190 |
| Other | 300 | 97 | 42 | 982 | 1,421 |
| Total | <u>5,255</u> | <u>1,495</u> | <u>474</u> | <u>3,408</u> | <u>10,632</u> |
| | | | | | |
| | Less than 30 days 2011 | 31 to 60 days 2011 | 61 to 90 days 2011 | More than 90 days 2011 | Total 2011 |
| Loans to customers | | | | | |
| Corporate lending | 442 | - | - | 256 | 698 |
| Residential mortgages | 785 | 125 | 254 | 1,116 | 2,280 |
| Small business lending | 333 | 294 | 459 | 904 | 1,990 |
| Consumer lending | 144 | 36 | 43 | 552 | 775 |
| Credit cards | 48 | 14 | 19 | 49 | 130 |
| Auto loans | 79 | 26 | 38 | 198 | 341 |
| Other | 1,142 | 149 | 41 | 2,299 | 3,631 |
| Total | <u>2,973</u> | <u>644</u> | <u>854</u> | <u>5,374</u> | <u>9,845</u> |

For the purpose of these financial statements a loan is considered overdue when the borrower fails to make any payment due under the loan agreement at the reporting date. In this case the aggregate amount of all amounts due from borrower under the respective loan agreement including accrued interest and commissions is recognised as overdue.

(Thousands of Georgian Lari)

26. Risk management (continued)**Credit risk (continued)**

Loans and advances to customers have been assessed for impairment on the collective basis. Details of loan loss allowance of loan portfolio are disclosed in Note 8 "Impairment assessment".

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days for individuals and 60 days for legal entities or there are any known difficulties in the cash flows of counterparties, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas - individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

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

Collectively assessed allowances

Allowances are assessed collectively for losses on loans and advances to customers that are not individually significant (including consumer lending and small business lending) and for individually significant loans where there is not yet any evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet any evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the appropriate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. Local management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by Risk management department to ensure alignment with the Bank's overall policy.

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

| | 2012 | | | | 2011 | | | |
|--------------------------------------|----------------|--------------|---------------------------------|----------------|----------------|--------------|---------------------------------|----------------|
| | Georgia | OECD | CIS and other foreign countries | Total | Georgia | OECD | CIS and other foreign countries | Total |
| Assets | | | | | | | | |
| Cash and cash equivalents | 8,067 | 6 | 232 | 8,305 | 6,491 | - | - | 6,491 |
| Amounts due from credit institutions | 9,770 | - | - | 9,770 | 3,850 | 1,403 | 521 | 5,774 |
| Loans to customers | 75,409 | - | - | 75,409 | 71,564 | - | - | 71,564 |
| Investment securities: | | | | | | | | |
| - available-for-sale | 20 | - | - | 20 | - | - | - | - |
| - held-to-maturity | 2,873 | - | - | 2,873 | 3,533 | - | - | 3,533 |
| All other assets | 30,342 | 8 | - | 30,350 | 35,386 | 33 | 100 | 35,519 |
| | <u>126,481</u> | <u>14</u> | <u>232</u> | <u>126,727</u> | <u>120,824</u> | <u>1,436</u> | <u>621</u> | <u>122,881</u> |
| Liabilities | | | | | | | | |
| Amounts due to credit institutions | 4,848 | - | 1,425 | 6,273 | 6,409 | - | 2,189 | 8,598 |
| Amounts due to customers | 30,590 | 509 | 4,129 | 35,228 | 22,019 | 1,845 | 3,372 | 27,236 |
| Other borrowed funds | - | - | 49,802 | 49,802 | - | - | 45,452 | 45,452 |
| Subordinated loans | - | - | 2,507 | 2,507 | - | - | 2,528 | 2,528 |
| Provisions | 30 | - | - | 30 | 100 | - | - | 100 |
| All other liabilities | 1,747 | - | 33 | 1,780 | 2,483 | - | 96 | 2,579 |
| | <u>37,215</u> | <u>509</u> | <u>57,896</u> | <u>95,620</u> | <u>31,011</u> | <u>1,845</u> | <u>53,637</u> | <u>86,493</u> |
| Net assets/(liabilities) | <u>89,266</u> | <u>(495)</u> | <u>(57,664)</u> | <u>31,107</u> | <u>89,813</u> | <u>(409)</u> | <u>(53,016)</u> | <u>36,388</u> |

(Thousands of Georgian Lari)

26. Risk management (continued)**Liquidity risk and funding management**

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, the Bank's Management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of state securities that can be pledged to the NBG to obtain financing in the event of demand. The Bank also has committed lines of credit that it can assess to meet liquidity needs.

The liquidity position is assessed and managed by the Bank based on certain liquidity ratio established by National Bank of Georgia. The NBG requires banks to maintain liquidity ratio of more than 30%. As of 31 December 2012 and 2011 the ratio was as follows:

| | <u>2012</u> | <u>2011</u> |
|--|-------------|-------------|
| LK "Average Liquidity Ratio" (Average monthly volume of liquid assets / Average monthly volume of liabilities) | 34.70% | 33.87% |

Analysis of financial liabilities by remaining contractual maturities

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

| <i>Financial liabilities As at 31 December 2012</i> | <i>On demand and less than 1 month</i> | <i>1 to 3 months</i> | <i>3 to 12 months</i> | <i>1 to 5 years</i> | <i>Over 5 years</i> | <i>Total</i> |
|---|--|--------------------------|---------------------------|-------------------------|-------------------------|-----------------------|
| Amounts due to credit institutions | 4,862 | - | - | 1,680 | - | 6,542 |
| Amounts due to customers | 17,007 | 3,575 | 9,933 | 5,900 | 617 | 37,032 |
| Other borrowed funds | - | - | - | 62,203 | - | 62,203 |
| Subordinated loan | - | 2,552 | - | - | - | 2,552 |
| Provisions | 30 | - | - | - | - | 30 |
| Other financial liabilities | 385 | 151 | 33 | - | - | 569 |
| Total undiscounted financial liabilities | <u>22,284</u> | <u>6,278</u> | <u>9,966</u> | <u>69,783</u> | <u>617</u> | <u>108,928</u> |

| <i>Financial liabilities As at 31 December 2011</i> | <i>On demand and less than 1 month</i> | <i>1 to 3 months</i> | <i>3 to 12 months</i> | <i>1 to 5 years</i> | <i>Over 5 years</i> | <i>Total</i> |
|---|--|--------------------------|---------------------------|-------------------------|-------------------------|----------------------|
| Amounts due to credit institutions | 6,425 | - | - | 2,178 | - | 8,603 |
| Amounts due to customers | 15,466 | 739 | 9,653 | 2,080 | 657 | 28,595 |
| Other borrowed funds | - | - | - | 57,012 | - | 57,012 |
| Subordinated loan | - | - | - | 2,799 | - | 2,799 |
| Provisions | 100 | - | - | - | - | 100 |
| Other financial liabilities | 293 | 163 | 63 | 67 | - | 586 |
| Total undiscounted financial liabilities | <u>22,284</u> | <u>902</u> | <u>9,716</u> | <u>64,136</u> | <u>657</u> | <u>97,695</u> |

(Thousands of Georgian Lari)

26. Risk management (continued)**Liquidity risk and funding management (continued)**

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies.

| | <i>On demand and less than 1 month</i> | <i>1 to 3 months</i> | <i>3 to 12 months</i> | <i>1 to 5 years</i> | <i>Over 5 years</i> | <i>Total</i> |
|-------------------------|--|--------------------------|---------------------------|-------------------------|-------------------------|--------------|
| 2012 | | | | | | |
| Undrawn loan facilities | 2,389 | - | - | - | - | 2,389 |
| Guarantees issued | 45 | 173 | 415 | 421 | - | 1,054 |
| | <u>2,434</u> | <u>173</u> | <u>415</u> | <u>421</u> | <u>-</u> | <u>3,443</u> |
| 2011 | | | | | | |
| Undrawn loan facilities | 2,272 | - | - | - | - | 2,272 |
| Guarantees issued | 58 | 3 | 1,950 | 1,269 | - | 3,280 |
| | <u>2,330</u> | <u>3</u> | <u>1,950</u> | <u>1,269</u> | <u>-</u> | <u>5,552</u> |

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

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

Included in due to customers are term deposits of individuals. In accordance with the Georgian legislation, the Bank is obliged to repay such deposits upon demand of a depositor.

Market risk

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

Currency risk

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

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2012 and 2011 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Lari, with all other variables held constant on the income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on the income statement. A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase.

| <i>Currency</i> | <i>Change in currency rate in % 2012</i> | <i>Effect on profit before tax 2012</i> | <i>Change in currency rate in % 2011</i> | <i>Effect on profit before tax 2011</i> |
|-----------------|--|---|--|---|
| USD | (0.75%)/0.75% | (18)/18 | (5.80%)/5.80% | (148)/148 |
| EUR | 1.34%/(1.34%) | (19)/19 | (7.56%)/7.56% | 10/(10) |

(Thousands of Georgian Lari)

26. Risk management (continued)**Operational risk**

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

27. Fair values of financial instruments

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

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

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

| <i>At 31 December 2012</i> | <i>Level 1</i> | <i>Level 2</i> | <i>Level 3</i> | <i>Total</i> |
|--|----------------|----------------|----------------|--------------|
| Investment securities available-for-sale | - | 20 | - | 20 |
| <i>At 31 December 2011</i> | <i>Level 1</i> | <i>Level 2</i> | <i>Level 3</i> | <i>Total</i> |
| Investment securities available-for-sale | - | - | - | - |

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

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the statement of financial position, except for assets for which fair value approximates carrying value - those assets that are liquid or have a short term maturity (less than three months or bear floating interest rate).

| | <i>Carrying value 2012</i> | <i>Fair value 2012</i> | <i>Unrecognised gain/(loss) 2012</i> | <i>Carrying value 2011</i> | <i>Fair value 2011</i> | <i>Unrecognised gain/(loss) 2011</i> |
|---|----------------------------|------------------------|--------------------------------------|----------------------------|------------------------|--------------------------------------|
| Financial assets | | | | | | |
| Loans to customers | 75,409 | 75,409 | - | 71,564 | 71,564 | - |
| Investment securities held-to-maturity | 2,873 | 2,984 | 111 | 3,533 | 3,511 | 22 |
| Financial liabilities | | | | | | |
| Amounts due to customers | 35,228 | 35,253 | 25 | 27,236 | 26,093 | 1,143 |
| Other borrowed funds | 49,802 | 49,802 | - | 45,452 | 45,452 | - |
| Total unrecognised change in unrealised fair value | | | <u>136</u> | | | <u>1,165</u> |

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

(Thousands of Georgian Lari)

27. Fair values of financial instruments (continued)*Assets for which fair value approximates carrying value*

For financial assets and financial liabilities that are liquid or have a short term maturity (less than three months) or bear floating interest rate, it is assumed that the carrying amounts approximate to their fair value.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortized cost are estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity.

28. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 26 "Risk management" for the Bank's contractual undiscounted repayment obligations.

| | 2012 | | | 2011 | | |
|--|------------------------|---------------------------|---------------|------------------------|---------------------------|---------------|
| | <i>Within one year</i> | <i>More than one year</i> | <i>Total</i> | <i>Within one year</i> | <i>More than one year</i> | <i>Total</i> |
| Financial assets | | | | | | |
| Cash and cash equivalents | 8,305 | - | 8,305 | 6,491 | - | 6,491 |
| Amounts due from credit institutions | 9,770 | - | 9,770 | 5,774 | - | 5,774 |
| Loans to customers | 10,376 | 65,033 | 75,409 | 11,940 | 59,624 | 71,564 |
| Investment securities | - | - | - | - | - | - |
| available-for-sale | - | 20 | 20 | - | - | - |
| held-to-maturity | 1,950 | 923 | 2,873 | 1,070 | 2,463 | 3,533 |
| Other financial assets | 117 | 243 | 360 | 371 | - | 371 |
| Total | 30,518 | 66,219 | 96,737 | 25,646 | 62,087 | 87,733 |
| Financial liabilities | | | | | | |
| Amounts due to credit financial institutions | 4,858 | 1,415 | 6,273 | 6,420 | 2,178 | 8,598 |
| Amounts due to customers | 29,876 | 5,352 | 35,228 | 25,153 | 2,083 | 27,236 |
| Other borrowed funds | - | 49,802 | 49,802 | - | 45,452 | 45,452 |
| Subordinated debt | 2,507 | - | 2,507 | - | 2,528 | 2,528 |
| Provisions | 30 | - | 30 | 100 | - | 100 |
| Other financial liabilities | 569 | - | 569 | 519 | 67 | 586 |
| Total | 37,840 | 56,569 | 94,409 | 32,192 | 52,308 | 84,500 |
| Net | (7,322) | 9,650 | 2,328 | (6,546) | 9,779 | 3,233 |
| Cumulative gap | (7,322) | 2,328 | 2,328 | (6,546) | 3,233 | 3,233 |

The Bank's capability to discharge its liabilities relies on its ability to realize an equivalent amount of assets within the same period of time. The undiscounted financial liability gap does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than one month in the tables above. Refer to Note 3 for the Bank's management judgment and discussion related to liquidity gap.

29. Related party disclosures

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

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

(Thousands of Georgian Lari)

29. Related party disclosures (continued)

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

As of 31 December 2012 and 2011 outstanding balances on related party transactions are as follows:

| | 2012 | | | 2011 | | |
|---|--------------|-------------------------------|--------------------------|--------------|-------------------------------|--------------------------|
| | Shareholders | Entities under common control | Key management personnel | Shareholders | Entities under common control | Key management personnel |
| Amounts due from Banks | - | - | - | 377 | - | - |
| Loans outstanding at 1 January, gross | - | - | 404 | - | - | 302 |
| Loans issued during the year | - | - | 34 | 11 | - | 274 |
| Loan repayments during the year | - | - | (65) | (11) | - | (172) |
| Loans outstanding at 31 December, gross | - | - | 373 | - | - | 404 |
| Less: allowance for impairment at 31 December | - | - | (152) | - | - | (34) |
| Loans outstanding at 31 December, net | - | - | 221 | - | - | 370 |
| Deposits at 1 January | - | - | 76 | - | - | 29 |
| Deposits received during the year | - | - | 16 | - | - | 52 |
| Deposits repaid during the year | - | - | (51) | - | - | (5) |
| Deposits at 31 December | - | - | 41 | - | - | 76 |
| Current accounts at 31 December | 14 | 160 | 39 | 14 | 235 | 75 |
| Other Assets | - | 775 | - | - | 925 | - |
| Other Liabilities | - | - | 45 | - | - | 94 |
| Amounts due to credit institutions (Note 15) | 1,415 | - | - | 2,178 | - | - |
| Other borrowed funds (Note 17) | 49,802 | - | - | 45,452 | - | - |
| Subordinated loan (Note 18) | 2,507 | - | - | 2,528 | - | - |
| Commitments and guarantees issued | - | - | 10 | - | - | 32 |

Entities under the same group are companies that directly or indirectly through one or more intermediaries control or are controlled by or are under common control with the Bank (this includes holding companies subsidiaries and fellow subsidiaries).

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

| | For the year ended 31 December | | | | | |
|--|--------------------------------|-------------------------------|--------------------------|--------------|-------------------------------|--------------------------|
| | 2012 | | | 2011 | | |
| | Shareholders | Entities under common control | Key management personnel | Shareholders | Entities under common control | Key management personnel |
| Interest income on loans to customers | - | - | 36 | - | - | 58 |
| Loan impairment charge | - | - | 179 | - | - | (51) |
| Interest expense on amounts due to customers | - | - | 5 | - | - | 3 |
| Interest expense on amounts due to credit institutions | 180 | - | - | 260 | - | - |
| Interest expense on other borrowed funds | 4,773 | - | - | 3,449 | - | - |
| Interest expense on subordinated loan | 223 | - | - | 228 | - | - |
| Fee and commission income | 1 | 6 | 2 | 1 | 17 | 2 |
| Fee and commission expense | 2 | - | - | - | 17 | - |
| Other operating expenses | - | 150 | - | - | 125 | - |

(Thousands of Georgian Lari)

29. Related party disclosures (continued)

Compensation of key management personnel was comprised of the following:

| | <u>2012</u> | <u>2011</u> |
|--|-------------|-------------|
| Salaries and other short-term benefits | 900 | 748 |
| Total key management compensation | <u>900</u> | <u>748</u> |

As of 31 December 2012 other liabilities to key management personnel comprised of accrued bonuses totalling GEL 55 in 2011 and unpaid vacation of GEL 45 in 2012 (2011: GEL 39).

Key management personnel as of 31 December 2012 and 2011 comprised 5 members of the Supervisory Board and 6 members of the Management Board of the Bank.

The Bank had no significant transactions with members of the Supervisory Board in 2012 and 2011.

30. Capital adequacy

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

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

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

NBG capital adequacy ratio

The NBG requires banks to maintain a minimum total capital adequacy ratio of 12% (2011 - 12%) of risk-weighted assets and Tier 1 Capital adequacy ratio of 8% (2011 - 8%). As of 31 December 2012 and 2011, the Bank's capital adequacy ratios on this basis were as follows:

| | <u>2012</u> | <u>2011</u> |
|---------------------------------|----------------|----------------|
| Core capital | 20,865 | 26,183 |
| Supplementary capital | 1,164 | 1,711 |
| Total regulatory capital | <u>22,029</u> | <u>27,894</u> |
| Risk-weighted assets | <u>154,038</u> | <u>156,557</u> |
| Capital adequacy ratio | 14.30% | 17.82% |
| Tier 1 Capital adequacy ratio | 13.55% | 16.72% |

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

31. Events after the reporting date

In June 2013 BTA Bank (Kazakhstan) agreed to initiate the restructuring of the total indebtedness of BTA Georgia if Silk Road Finance Group, will pledge as collateral 24% of its shares, transfer voting rights for these shares to BTA Bank (Kazakhstan), repay the subordinated debt that matured in March 2013 and was not repaid by the Bank, and increase the number of supervisory board members. Silk Road Finance Group and the Bank have the ability to meet the requested conditions of BTA Bank (Kazakhstan), however they intend to further negotiate on the details (Note 3).