JSC VTB Bank (Georgia)

Consolidated financial statements

For the year ended 31 December 2012
Together with independent auditors' report

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Independent auditors' report

To the Shareholders and Supervisory Board of JSC VTB Bank (Georgia) -

We have audited the accompanying consolidated financial statements of JSC VTB Bank (Georgia) and its subsidiaries ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2012, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group 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.

ERNST & YOUNG LLC

11 March 2013

Consolidated statement of financial position

As of 31 December 2012

(Thousands of Georgian Lari)

	Notes	2012	2011
Assets			
Cash and cash equivalents	6	90,668	49,307
Amounts due from banks and international financial institutions	7	33,655	29,879
Loans and advances to customers	8	345,188	267,606
Investment securities:			
- Available-for-sale	9	11,551	3,037
- Held-to-maturity		-	8,486
Property and equipment	10	34,405	37,161
Investment property	11	20,723	18,182
Current income tax assets		83	76
Deferred income tax assets	12	6,181	6,531
Other assets	13	2,629	3,462
Total assets		545,083	423,727
Liabilities			
Amounts due to banks and international financial institutions	14	59,502	40,689
Amounts due to customers	15	293,139	181,868
Other borrowed funds	16	92,885	100,807
Current income tax liabilities		98	-
Deferred income tax liabilities	12	-	7
Other liabilities	13	8,512	8,614
Subordinated loan	25	20,127	20,295
Total liabilities		474,263	352,280
Equity			
Share capital	17	148,043	148,043
Land and buildings revaluation reserve		984	1,572
Unrealised gains / (losses) on investment securities available-for-sale		27	-
Accumulated losses		(78,234)	(78,168)
Total equity		70,820	71,447
Total liabilities and equity		545,083	423,727

Signed and authorised for release on behalf of the Management Board of the Bank on 11 March 2013:

Archil Kontselidze
Chief Executive Officer

Mamuka Menteshashvili
Chief Financial Officer

The accompanying notes on pages 6 to 41 are an integral part of these consolidated financial statements.

Consolidated income statement

For the year ended 31 December 2012

(Thousands of Georgian Lari)

	Notes	*2012*	*2011*
Interest income			
Loans and advances to customers		50,642	39,904
Investment securities:			
- Available-for-sale		831	289
- Held-to-maturity		566	2,584
Cash and cash equivalents		782	1,122
Amounts due from banks and international financial institutions		23	46
		52,844	43,945
Interest expense			
Amounts due to customers		(12,785)	(9,153)
Amounts due to banks, international financial institutions and other borrowed funds		(8,248)	(4,334)
Subordinated loan		(1,394)	(1,371)
		(22,427)	(14,858)
Net interest income		**30,417**	**29,087**
Net recovery of provision for loan impairment	8	1,328	655
Net interest income after recovery of provision for loan impairment		**31,745**	**29,742**
Net fee and commission income	19	4,609	3,715
Net gains/(losses) from foreign currencies:			
- dealing		5,567	4,116
- translation differences		(1,020)	1,970
Net gains from disposal of investment property		190	288
Net gains/(losses) on investment property revaluation	11	417	(1,091)
Other income	20	5,386	3,266
Non-interest income		**15,149**	**12,264**
Personnel expenses	21	(23,572)	(20,177)
Depreciation	10	(2,796)	(2,268)
Other operating expenses	21	(11,489)	(8,864)
Other impairment and provisions charge		(95)	(654)
Non-interest expenses		**(37,952)**	**(31,963)**
Profit before income tax expense		**8,942**	**10,043**
Income tax expense	12	(525)	(733)
Profit for the year		**8,417**	**9,310**

The accompanying notes on pages 6 to 41 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December 2012

(Thousands of Georgian Lari)

	Note	*2012*	*2011*
Profit for the year		8,417	9,310
Other comprehensive income:			
Unrealised gains on investment securities available-for-sale		32	-
Revaluation of land and buildings	10	(594)	-
Income tax relating to components of other comprehensive income	12	84	-
Other comprehensive loss for the year, net of tax		(478)	-
Total comprehensive income for the year		7,939	9,310

The accompanying notes on pages 6 to 41 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2012

(Thousands of Georgian Lari)

	Note	*Share capital*	*Land and buildings revaluation reserve*	*Unrealized gains on investment securities available-for-sale*	*Accumulated losses*	*Total equity*
As of 31 December 2010		148,043	1,609	-	(87,515)	62,137
Total comprehensive income for the year		-	-	-	9,310	9,310
Depreciation of revaluation reserve, net of tax		-	(37)	-	37	-
As of 31 December 2011		148,043	1,572	-	(78,168)	71,447
Total comprehensive income for the year		-	(505)	27	8,417	7,939
Depreciation of revaluation reserve, net of tax		-	(35)	-	35	-
Transfer of property revaluation reserve upon disposal		-	(48)	-	48	-
Dividends declared	17	-	-	-	(8,566)	(8,566)
As of 31 December 2012		148,043	984	27	(78,234)	70,820

The accompanying notes on pages 6 to 41 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2012

(Thousands of Georgian Lari)

	Notes	*2012*	*2011*
Cash flows from operating activities			
Interest received		55,970	49,680
Interest paid		(23,950)	(14,561)
Fees and commissions received		6,821	4,933
Fees and commissions paid		(1,847)	(1,206)
Realised net gains from dealing in foreign currencies		4,238	4,687
Other income received		2,801	2,569
Personnel expenses paid		(22,302)	(19,071)
Other operating expenses paid		(9,861)	(9,468)
Cash flows from operating activities before changes in operating assets and liabilities		**11,870**	**17,563**
Net (increase)/decrease in operating assets			
Amounts due from banks and international financial institutions		1,164	(23,295)
Loans and advances to customers		(80,663)	(81,688)
Other assets		765	97
Net increase/(decrease) in operating liabilities		-	-
Amounts due to banks and international financial institutions		14,139	40,020
Amounts due to customers		113,613	6,178
Other liabilities		(1,384)	(96)
Net cash flows from/(used in) operating activities before income tax		**59,504**	**(41,221)**
Income tax paid		-	-
Net cash from/(used in) operating activities		**59,504**	**(41,221)**
Cash flows from investing activities			
Purchase of investment securities available-for-sale		(26,773)	(8,255)
Proceeds from sale and redemption of investment securities available-for-sale		18,416	5,369
Purchase of investment securities held-to-maturity		-	(21,071)
Proceeds from redemption of investment securities- Held-to-maturity		8,048	43,715
Purchase of property, equipment and intangible assets		(4,382)	(9,370)
Proceeds from sale of property and equipment		3,687	56
Proceeds from disposal of investment property		1,180	5,029
Purchases of investment property		(2,026)	(3,893)
Net cash (used in)/from investing activities		**(1,850)**	**11,580**
Cash flows from financing activities			
Other borrowed funds received		69,093	115,578
Redemption of other borrowed funds		(76,864)	(74,552)
Dividends paid	17	(8,457)	-
Net cash (used in)/from financing activities		**(16,228)**	**41,026**
Effect of exchange rates changes on cash and cash equivalents		(65)	(66)
Net increase in cash and cash equivalents		**41,361**	**11,319**
Cash and cash equivalents, beginning	6	**49,307**	**37,988**
Cash and cash equivalents, ending	6	**90,668**	**49,307**

The accompanying notes on pages 6 to 41 are an integral part of these consolidated financial statements.

(Thousands of Georgian Lari)

1. Introduction

JSC VTB Bank (Georgia) (the "Bank" hereafter) was formed as a joint stock company on 7 April 1995 under the laws of Georgia under the name of United Georgian Bank. The Bank changed its name to VTB Bank (Georgia) on 7 December 2006. The Bank operates under a general banking licence issued by the National Bank of Georgia (the "NBG") on 19 May 1995.

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. Its main office is in Tbilisi, Georgia. As of 31 December 2012 the Bank has 15 branches (7 of them in Tbilisi) and 1 service centre. As of 31 December 2011 the Bank had 12 branches (4 of them in Tbilisi) and 1 service centre.

The Bank's registered legal address is 14 Chanturia str. Tbilisi, Georgia.

As of 31 December 2012 and 2011, the following shareholders owned more than 1% of the outstanding shares:

Shareholder	*2012* %	*2011* %
VTB Bank OJSC	96.31	96.31
Lacarpa Enterprises Limited	2.08	2.08
Other	1.61	1.61
Total	**100.0**	**100.0**

VTB Bank OJSC ("the Parent bank") is the immediate parent of the Bank. The ultimate controlling party for the Group is the State of the Russian Federation ("RF"), acting through the Federal Property Agency, which holds 75.5% of issued and outstanding shares of the Parent bank as of 31 December 2012 (2011: 75.5%)

As of 31 December 2012 and 2011 none of the Supervisory Council and Management Board members owned shares of the Bank.

As of 31 December 2012 the Bank had 830 employees (2011: 687).

These consolidated financial statements have been prepared for JSC VTB Bank (Georgia) and its subsidiaries (together referred to as "the Group").

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

Name	Country of incorporation	The Group ownership interest 2012	2011	Date of Incorporation	Activities
Georgian Fund Company LLC	Georgia	100%	100%	24 June 1999	Financial services (Dormant)
GT+ LLC	Georgia	100%	100%	4 November 2008	Trading and commerce (Dormant)

2. Basis of preparation and significant accounting policies

Basis of preparation

These consolidated 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, investment securities available-for-sale and financial instruments at fair value through profit or loss, which are carried at fair value.

These consolidated 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 Group'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 consolidated financial statements are set out below.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Subsidiaries

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

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 Group 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 Group 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 consolidated 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 Group has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held-to-maturity investments are subsequently measured at amortized cost. Gains and losses are recognized in the consolidated 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 consolidated income statement. However, interest calculated using the effective interest method is recognised in the consolidated income statement.

If the Group 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.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Financial assets (continued)

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 and other relevant valuation models.

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 banks that mature within ninety days of the date of origination and are free from contractual encumbrances.

Derivative financial instruments

In the normal course of business, the Group enters into certain derivative financial instruments contracts primarily including foreign exchange forwards and swaps. Such financial instruments are recorded at fair value. The fair values are estimated based on pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in net gains/ (losses) from foreign currency dealing in consolidated income statement.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to banks and international financial institutions, amounts due to customers, other borrowed funds and subordinated loans. These are initially recognized at fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are measured at amortised cost using the effective interest method. Gains and losses are recognised in the consolidated income statement when the borrowings are derecognised as well as through the amortisation process.

Amounts due to banks and international financial institutions represent funds attracted to manage the Group's liquidity, while other borrowed funds comprises funds received for general capital working purposes and under basic agreements with international credit institutions to finance activities of the Group's customers.

Operating lease – Group as lessee

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

Impairment of financial assets

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

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Impairment of financial assets (continued)

Loans and advances to customers, investment securities held-to-maturity, amounts due from banks and international financial institutions

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

If there is 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 consolidated income statement. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. 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.

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

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

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

Available-for-sale financial investments

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

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

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Restructuring of financial assets

The Group from time to time restructures some of its financial assets. This mostly relates to loans and receivables. The accounting treatment of such restructuring is conducted in 3 basic scenarios:

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

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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 Group 's continuing involvement is the amount of the transferred asset that the Group 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 Group 's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Non-performing loans

According to the Group's policy, non-performing loans are derecognized as follows:

- Individually significant loans are being written off based on respective decision of the Bank's Credit committee;
- Other loans are being written off individually when become overdue for 150 days.

In case the Group receives any amounts from the borrower subsequently to the loan write off, respective amounts are recognized within allowance for loan impairment as recoveries.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

Financial liabilities

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

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

Offsetting

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

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, primarily consisting of letters of credit and guarantees. Financial guarantees are initially recognised in the consolidated financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required settling any financial obligation arising as a result of the guarantee.

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

Taxation

The current income tax expense is calculated in accordance with the regulations of Georgia.

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

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

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

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

Property and equipment

Property and equipment, except for land and buildings, are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met. Buildings are measured at fair value less depreciation and impairment charged subsequent to the date of the revaluation. Land is measured at fair value and not depreciated. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Property and equipment (continued)

Any revaluation surplus is credited to the revaluation reserve for land and buildings included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in the consolidated income statement, in which case the increase is recognised in the consolidated income statement. A revaluation deficit is recognised in the consolidated 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.

Construction in progress is carried at cost, less provision for impairment where required. Upon completion, assets are transferred to office premises or other premises at their carrying amount. Construction in progress is not depreciated until the asset is available for use.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

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

	Years
Buildings	35-50
Utility systems and related features	10-40
Computers and communication equipment	4
Furniture, fixtures and office equipment	6
Motor vehicles	5
Leasehold improvements	Over the term of the underlying lease

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.

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 Group or held for sale in the ordinary course of business.

Investment property is initially recognized at cost, including transaction costs, and subsequently remeasured at fair value which reflects current market value and represents potential price between knowledgeable, willing parties in an arm's length transaction. Revaluation of investment property is held on each reporting date and recognised in consolidated income statement as gains/losses on investment property revaluation. Earned rental income is recorded in consolidated 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. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 5 to 20 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Provisions

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

Retirement and other employee benefit obligations

The Group does not have any pension arrangements separate from the State pension system of the Republic of Georgia.

Share capital

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.

Dividends

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

Contingencies

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

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured.

Interest income and expense

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

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

Fee and commission income

Commission income on settlements and cash operations are recognized when the service is delivered to the customer.

Loan commitment fees for loans that are likely to be drawn down and other credit related fees, including fee on guarantees and letters of credit issued, are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

Dividend income

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

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Foreign currency translation

The consolidated financial statements are presented in Georgian Lari, which is the Group'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 consolidated 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 of 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 National Bank 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 and 2011 were 1.6567 GEL and 1.6703 GEL to 1 USD, respectively. The official NBG rate as of 11 March 2013 is 1.6595 GEL to 1 USD.

3. Critical accounting estimates and judgements in applying accounting policies

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

Going concern

The Group's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources and the financial support of the Parent bank to continue in business for the foreseeable future. Furthermore, the Management is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

Allowance for loan impairment

The Group regularly reviews its loans and receivables to assess impairment. The Group 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 Group 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 Group uses its judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

Revaluation of property

The Group regularly reviews the value of its property (land, office buildings and investment property) for compliance with fair value and performs revaluation to ensure that the current carrying amount of property does not materially differ from its fair value. The Group performs revaluation using special valuation techniques and information about real estate transactions entered into in the local market. The results received from the application of the above valuation methods, however, may not always correspond to the market value of property.

As of 31 December 2012, an independent appraiser determined the fair value of the Group's land and buildings. The market value of the property was determined based on the active market data. Refer to Note 10 and Note 11.

(Thousands of Georgian Lari)

3. Critical accounting estimates and judgements in applying accounting policies (continued)

Taxation

Georgian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently, unexpectedly and with retrospective effect. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant tax authorities. Trends within Georgia suggest that the tax authorities are taking a more assertive position in their 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, the effect of which cannot be practicably estimated, but could be significant to the financial condition of the Group. Fiscal periods remain open to review by the authorities in respect of taxes for six calendar years preceding the year of review.

However, based upon Management's understanding of the tax regulations and Management analysis of the results of inspection conducted by tax authorities, Management believes that its interpretation of the relevant tax legislation is reasonable and will be sustainable. Moreover Management believes that the Group has accrued all applicable taxes.

Deferred tax assets

The recognised deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded in the statement of financial position. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are probable in the future are based on management expectations that are believed to be reasonable under the circumstances.

Changes in presentation

For the purposes of more detailed presentation of credit risk charge and related translation differences the presentation of the comparative consolidated statement of comprehensive income has been adjusted to be consistent with the new presentation. The effect of changes on the consolidated statement of comprehensive income for the year ended 31 December 2011 is as follows:

The effect of changes on the consolidated statement of comprehensive income for the year ended 31December 2011 is as follows:

	As previously reported	*Reclassification*	*As reclassified*
Net recovery provision for loan impairment	2,389	(1,734)	655
Net gains/(losses) from foreign currencies:			
Translation differences	236	1,734	1,970

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

Adoption of new or revised standards and interpretations

The Group 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 Group's financial statements to evaluate the risk exposures relating to those assets. The amendment has no impact on the Group'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 Group:

- 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)

5. New accounting pronouncements

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2013 or later periods and which the Group 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 Group 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.

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.

(Thousands of Georgian Lari)

5. New accounting pronouncements (continued)

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)

5. 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.

6. Cash and cash equivalents

	2012	*2011*
Cash on hand	28,470	15,932
Overnight deposit with the NBG	21,960	11,672
Current accounts with other credit institutions	20,836	10,404
Time deposits with credit institutions	18,391	3,292
Current accounts with the NBG	1,011	8,007
Cash and cash equivalents	**90,668**	**49,307**

As of 31 December 2012, 88% of total current accounts with credit institutions are placed with 2 non-resident credit institutions (2011: 72%).

As of 31 December 2012 overnight deposit with the NBG bears interest rate of 3.75% (2011: 5%).

As of 31 December 2012 and 2011 the Bank's cash and cash equivalents were of high credit grade, were not either past due, or individually impaired, or renegotiated.

7. Amounts due from banks and international financial institutions

	2012	*2011*
Obligatory reserve with the NBG	32,317	27,654
Time deposits	1,338	2,225
Amounts due from banks and international financial institutions	**33,655**	**29,879**

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

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

(Thousands of Georgian Lari)

7. Amounts due from banks and international financial institutions (continued)

As of 31 December 2012, GEL 1,338 (2011: GEL 2,225) included in time deposits was placed on long term deposits and pledged as security for settlement operations to the international financial institutions.

8. Loans and advances to customers

	2012	*2011*
Corporate lending	171,087	159,183
Consumer lending	125,840	81,265
Small business lending	75,247	57,761
Loans to individuals secured by deposits	5,236	6,579
Gross loans and advances to customers	**377,410**	**304,788**
Less – Allowance for impairment	(32,222)	(37,182)
Loans and advances to customers, net	**345,188**	**267,606**

Allowance for impairment of loans and advances to customers

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

	Corporate lending 2012	*Consumer lending 2012*	*Small business lending 2012*	*Total 2012*
At 1 January 2012	33,275	861	3,046	**37,182**
Net (reversal)/charge for the year	(3,899)	2,260	311	**(1,328)**
Foreign currencies translation	(250)	(4)	(22)	**(276)**
Recoveries of previously written off loans and advances	1,644	411	641	**2,696**
Amounts written off	(4,986)	(662)	(404)	**(6,052)**
At 31 December 2012	**25,784**	**2,866**	**3,572**	**32,222**
Individual impairment	18,780	739	628	**20,147**
Collective impairment	7,004	2,127	2,944	**12,075**
	25,784	**2,866**	**3,572**	**32,222**
Gross amount of loans and advances, individually determined to be impaired, before deducting any individually assessed impairment allowance	**30,414**	**1,018**	**1,151**	**32,583**

	Corporate lending 2011	*Consumer lending 2011*	*Small business lending 2011*	*Total 2011*
At 1 January 2011	25,948	1,747	6,111	**33,806**
Net charge/(reversal) for the year	5,288	(1,557)	(4,386)	**(655)**
Foreign currencies translation	(1,554)	(9)	(171)	**(1,734)**
Recoveries of previously written off loans and advances	3,759	870	1,503	**6,132**
Amounts written off	(166)	(190)	(11)	**(367)**
At 31 December 2011	**33,275**	**861**	**3,046**	**37,182**
Individual impairment	26,924	129	224	**27,277**
Collective impairment	6,351	732	2,822	**9,905**
	33,275	**861**	**3,046**	**37,182**
Gross amount of loans and advances, individually determined to be impaired, before deducting any individually assessed impairment allowance	**39,766**	**259**	**642**	**40,667**

(Thousands of Georgian Lari)

8. Loans and advances customers (continued)

Individually impaired loans

Interest income accrued on loans and advances, for which individual impairment allowances have been recognized, as at 31 December 2012, comprised GEL 2,093 (2011: GEL 2,574).

Collateral and other credit enhancements

The amount and type of required collateral depends on the counterparty Credit Risk assessment, for which the Bank has implemented guidelines and policies defining valuation parameters and acceptability of the collateral.

Accepted collateral types are as follows:

- For commercial lending: Real estate properties, inventories, bank deposits, trade receivables and bank guarantees.
- For Retail lending: bank deposits, mortgages over residential properties, inventories, household assets and third party personal guarantees.

The group also accepts guarantees from customer's parent companies issued to insure the loans to their subsidiaries.

The value of the collateral is the subject of monitoring. The Group may request the additional collateral from the borrower in accordance to the loan agreement. For the measurements against the impairment losses, market value of the collateral is reviewed and assessed according to the number of products with a reference to the liquidity and maturity date of given collateral.

As of 31 December 2012 the Group holds collateral (land and buildings) repossessed during the year with cost as of repossession date of GEL 3,113 (2011: GEL 6,117), which were classified as investment property. Refer to Note 11.

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for business use.

Concentration of loans and advances to customers

As of 31 December 2012, the Bank had a concentration of loans represented by GEL 81,208 due from the ten largest third party borrowers (21.5% of gross loan portfolio) (2011 – GEL 90,695 or 29.2%). An allowance of GEL 16,863 (2011:GEL 22,917) was recognised against these loans.

As of 31 December 2012 included in total loans and advances to customers is an exposure to a single greatest borrower of GEL 9,919 or 2.6% of total loan portfolio (2011: GEL 8,421 or 2.8%).

Loans have been extended to the following types of customers:

	2012	*2011*
Commercial legal entities	232,276	207,910
Individuals	145,134	96,878
Gross loans and advances to customers	**377,410**	**304,788**

As of 31 December 2012 and 2011 loans and advances to customers are principally issued within Georgia and their distribution by industry sectors is as follows:

	2012	*2011*
Individuals	145,134	96,878
Trading and service enterprises	121,215	85,452
Real estate construction	48,304	38,750
Manufacturing	20,437	42,654
Financial	14,883	18,114
Energy	9,862	9,422
Telecommunication and transportation	3,540	7,321
Agriculture and food processing	2,113	543
Other	11,922	5,654
Gross loans and advances to customers	**377,410**	**304,788**

(Thousands of Georgian Lari)

9. Investment securities available-for-sale

As of 31 December 2012 investment securities available-for-sale comprised of securities of Ministry of Finance of Georgia with total carrying value of GEL 1,027 (2011: GEL 1,017), securities of National Bank of Georgia with total carrying value of GEL 10,470 (2011: GEL 1,966) classified into level 2, and ordinary shares of legal entity GEL 54 (2011: GEL 54) classified into level 3 of fair value hierarchy.

Investment securities available-for-sale are valued using valuation technique. These securities are valued using models which incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

10. Property and equipment

The movements in property and equipment during 2012 and 2011 were as follows:

	Land and buildings	*Computers and communi-cation equipment*	*Furniture, fixtures and office equipment*	*Utility systems and related features*	*Motor vehicles*	*Leasehold improve-ments*	*Construc-tion in progress*	*Total*
Cost or revalued amount								
31 December 2010	**26,758**	**6,193**	**3,975**	**-**	**2,419**	**292**	**1,364**	**41,001**
Additions	180	1,114	1,884	-	145	-	6,318	9,641
Transfer	2,766	-	781	1,938	-	347	(5,832)	-
Disposals	-	(616)	(167)	-	(1,279)	-	-	(2,062)
31 December 2011	**29,704**	**6,691**	**6,473**	**1,938**	**1,285**	**639**	**1,850**	**48,580**
Additions	-	881	1,194	-	375	-	1,622	4,072
Transfer	575	-	412	-	-	1,682	(2,669)	-
Disposals	(2,485)	(431)	(528)	-	(460)	-	(452)	(4,356)
Effect of revaluation	(4,817)	-	-	-	-	(310)	-	(5,127)
31 December 2012	**22,977**	**7,141**	**7,551**	**1,938**	**1,200**	**2,011**	**351**	**43,169**
Accumulated depreciation and impairment								
31 December 2010	**(2,760)**	**(4,415)**	**(2,009)**	**-**	**(1,481)**	**(86)**	**-**	**(10,751)**
Depreciation charge	(493)	(757)	(596)	(24)	(358)	(40)	-	(2,268)
Disposals	-	613	132	-	855	-	-	1,600
31 December 2011	**(3,253)**	**(4,559)**	**(2,473)**	**(24)**	**(984)**	**(126)**	**-**	**(11,419)**
Depreciation charge	(572)	(850)	(974)	(68)	(148)	(184)	-	(2,796)
Disposals	113	425	448	-	443	-	-	1,429
Effect of revaluation	3,712	-	-	-	-	310	-	4,022
31 December 2012	**-**	**(4,984)**	**(2,999)**	**(92)**	**(689)**	**-**	**-**	**(8,764)**
Net book value:								
31 December 2010	**23,998**	**1,778**	**1,966**	**-**	**938**	**206**	**1,364**	**30,250**
31 December 2011	**26,451**	**2,132**	**3,952**	**1,962**	**301**	**513**	**1,850**	**37,161**
31 December 2012	**22,977**	**2,157**	**4,552**	**1,846**	**511**	**2,011**	**351**	**34,405**

As of 31 December 2012, an independent appraiser determined the fair value of the Group'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 building, their value decreased by GEL 1,105, from which GEL 594 is unrealized loss on revaluation of land and building recognized in other comprehensive income, GEL 556 is loss recognized in other operating expenses and GEL 45 is reversal of negative revaluation of property and equipment recognized in other income.

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 have

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10. Property and equipment (continued)

amounted to GEL 24,802 (2011 – GEL 26,663) and accumulated depreciation would have amounted to GEL 3,625 (2011 – GEL 3,089).

The total value of fully depreciated property and equipment in use as of 31 December 2012 and 2011 amounted to GEL 5,110 and GEL 4,679, respectively.

11. Investment property

	2012	*2011*
Opening balance at 1 January	18,182	17,897
Additions (Note 8)	3,113	6,117
Disposals	(989)	(4,741)
Unrealized gain/(loss) on revaluation	417	(1,091)
Closing balance at 31 December	20,723	18,182

Investment property is a real estate property comprised of land and buildings which was obtained by the Group through repossession of collateral on defaulted loans. Refer to Note 8.

As of 31 December 2012, an independent appraiser determined the fair value of the Group's investment properties. The appraiser is an industry specialist in valuing these types of investment properties. The fair value represents the amount at which the asset could be exchanged between knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards Committee standards.

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.

12. Taxation

The corporate income tax expense comprises:

	2012	*2011*
Current tax expense	(98)	-
Deferred expense – origination and reversal of temporary differences	(511)	(733)
Less: deferred tax recognised in other comprehensive income	84	-
income tax expense	**(525)**	**(733)**

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:

	2012	*2011*
Income before income tax expense	**8,942**	**10,043**
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	**(1,341)**	**(1,506)**
Change in unrecognized deferred tax assets	1,372	1,181
Non-deductible expenses	(534)	(393)
Tax exempt income less income recognized for tax purposes only	(22)	(15)
Income tax expense	**(525)**	**(733)**

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12. Taxation (continued)

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

		Origination and reversal of temporary differences				
	2010	*In the income statement*	*2011*	*In the income statement*	*Directly in Other comprehensive income*	*2012*
Tax effect of deductible temporary differences:						
Allowance for loan impairment	506	(206)	300	(300)	-	-
Tax losses carried forward	13,512	(2,429)	11,083	(1,918)	-	9,165
Financial instruments adjustment for effective interest rates	19	571	590	401	-	991
Accrued expenses	591	115	706	194	-	900
Securities available-for-sale	162	–	162	5	(5)	162
Investment property	54	153	207	(53)	-	154
Other	31	278	309	92	-	401
Gross deferred tax assets	**14,875**	**(1,518)**	**13,357**	**(1,579)**	**(5)**	**11,773**
Unrecognized deferred tax asset	(6,860)	1,181	(5,679)	1,372	-	(4,307)
Deferred tax assets	**8,015**	**(337)**	**7,678**	**(207)**	**(5)**	**7,466**
Tax effect of taxable temporary differences:						
Allowance for loan impairment	-	-	-	(240)	-	(240)
Property and equipment	(318)	(262)	(580)	(38)	-	(618)
Property revaluation	(396)	–	(396)	-	89	(307)
Allowances for impairment and provision for other losses	(44)	(134)	(178)	63	-	(115)
Financial instruments adjustment for effective interest rate	–	–	–	(5)	-	(5)
Deferred tax liabilities	**(758)**	**(396)**	**(1,154)**	**(220)**	**89**	**(1,285)**
Net deferred tax assets	**7,257**	**(733)**	**6,524**	**(427)**	**84**	**6,181**

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

The Bank and its subsidiaries have available GEL 32,121 of tax losses carried forward which begins to expire in 2013, GEL 8,587 of tax losses carried forward which will expire in 2014, GEL 20,391 of tax losses carried forward which will expire in 2015 if not utilised.

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13. Other assets and liabilities

Other assets comprise:

	2012	*2011*
Financial assets		
Derivative financial assets	460	-
Accrued commission receivable on guarantees and letters of credit	77	31
Unsettled transactions on money transfers	57	784
Total financial assets	**594**	**815**
Non-financial assets		
Intangible assets	1,152	1,073
Prepaid expenses	533	1,268
Advances paid	182	42
Inventories in stock	98	32
Repossessed collateral (equipment)	40	196
Prepaid operational taxes	30	6
Other	-	30
Total non-financial assets	**2,035**	**2,647**
Other assets	**2,629**	**3,462**

Other liabilities comprise:

	2012	*2011*
Financial liabilities		
Accrued bonuses	5,084	3,926
Settlements on plastic cards	804	424
Payables for unused vacations	721	616
Accrued expenses	577	494
Unsettled transactions on money transfers	235	1,821
Settlements on acquisition of property and equipment and inventory	133	246
Derivative financial liabilities	-	661
Total financial liabilities	**7,554**	**8,188**
Non-financial liabilities		
Advances received	518	42
Dividends payable to shareholders of the Bank	341	232
Provision for legal claims	63	-
Operational taxes payable	36	152
Total non-financial liabilities	**958**	**426**
Other liabilities	**8,512**	**8,614**

As of 31 December 2012 the Group's derivative financial instruments comprised of foreign exchange forwards, (2011: foreign exchange forwards and depo swaps) and were attributable to the Level 2 of fair value hierarchy.

Derivatives are valued using a valuation technique with market observable inputs. The applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves. Derivatives comprise:

	2012			*2011*		
	Notional amount	*Fair values Asset*	*Fair values Liability*	*Notional amount*	*Fair values Asset*	*Fair values Liability*
Foreign exchange contracts						
Forwards and Swaps – foreign	19,642	460	-	18,384	-	661
Total derivative assets / liabilities		460	-		-	661

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14. Amounts due to banks and international financial institutions

	2012	2011
Loans received from the Parent bank	58,428	40,382
Current accounts	1,074	307
Amounts due to banks and international financial institutions	**59,502**	**40,689**

As of 31 December 2012 loans received from the Parent bank had maturities ranging from January 2013 till December 2015 (2011: January 2012 till March 2012) and bear annual interest rates from 4.11% to 8.14% (2011:0.9% to 3.72%).

15. Amounts due to customers

	2012	*2011*
Individuals:		
- Current/demand accounts	37,997	24,154
- Term deposits	71,117	50,270
Total due to individuals	**109,114**	**74,424**
State and budgetary organisations:		
- Current/settlement accounts	11,481	15,417
- Term deposits	67	-
Total due to state and budgetary organisations	**11,548**	**15,417**
Commercial legal entities:		
- Current/settlement accounts	140,705	76,897
- Term deposits	31,772	15,130
Total due to commercial legal entities	**172,477**	**92,027**
Total due to legal entities	**184,025**	**107,444**
Total amounts due to customers	**293,139**	**181,868**
Held as security against undrawn loan facilities	**900**	-
Held as security against guarantees issued	**3,090**	**1,224**
Held as security against letters of credit issued	**22,415**	**648**
Held as security against settlement operations	**10**	**2**

At 31 December 2012 the Group had ten largest customers with aggregate balance due of GEL 124,235 or 42% of total amounts due to customers (2011: GEL 51,863 or 29%).

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.

An analysis of customer accounts by industry follows:

	2012	*2011*
Individuals	109,114	74,424
Trade and service	49,825	24,280
Finance	41,808	11,526
Transport and communication	37,058	24,183
Energy	19,090	14,687
Real estate constructions	12,794	6,201
Government	11,548	15,417
Education	5,266	5,132
Manufacturing	4,080	3,971
Agriculture	273	158
Other	2,283	1,889
Amounts due to customers	**293,139**	**181,868**

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16. Other borrowed funds

	2012	*2011*
Borrowings from the Parent bank	53,032	58,823
Borrowings from international financial institutions	37,446	39,354
Borrowings from government organizations	2,407	-
Borrowings from commercial banks	-	2,630
Other borrowed funds	92,885	100,807

As of 31 December 2012 maturities of borrowings from the Parent bank were ranging from January 2013 till September 2015 (2011: from January 2012 till October 2014), annual interest rates from 5.75% to 8.95% (2011 from 3.29% to 7.96%). Refer to Note 25.

Borrowings from international financial institutions as of 31 December 2012 contained facilities in U.S. dollars and Euro with maturities ranging from January 2013 to December 2032 (2011: January 2012 to December 2032) and interest rates from 3% to Libor+5.5% and one loan bearing annual interest at 0.75% (2011: from Libor+3% to Libor+5.5%; 0.75%).

Borrowings from government organizations as of 31 December 2012 contained facilities received from Municipal Development Fund of Georgia to finance energy sector companies. The borrowings are denominated in EUR, bear annual interest at 3% and mature in May 2018.

17. Equity

Share capital

Movements in ordinary shares authorized and fully paid were as follows:

	Number of shares authorized	*Number of shares fully paid*	*Nominal amount, GEL*
31 December 2010	148,075,002	148,042,701	148,043
Cancellation	(32,301)	-	-
31 December 2011	148,042,701	148,042,701	148,043
31 December 2012	148,042,701	148,042,701	148,043

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.

On 11 February 2011 the Bank's registrar recorded the cancellation of 32,301 unpaid common shares of the Bank, following the respective decision of the Parent bank.

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.

On 3 May 2012, the annual general meeting of shareholders of the Bank declared 2012 dividends comprising GEL 8,566 or Georgian Lari 0.06 per share, based on 2011 separate financial statements prepared in accordance with the NBG requirements. The declaration is effective from 30 May 2012. Dividends in the amount of GEL 8,457 were paid to shareholders in 2012. No dividends were declared by the Bank during 2011.

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18. Commitments and contingencies

Operating environment

Georgia continues economic reforms and development of its legal, tax and regulatory frameworks, improvement of institutional policies and market structures, as required by market economy. The combination of dynamic economic growth and development of strong pro-business legal framework is the foundation of stabilization for Georgian economy.

Georgia is influenced by global economic processes, so 2008-2010 global economic crisis, had impact on Georgian economy. In 2011-2012 the country followed global tendency of anaemic economic growth, however, there is uncertainty regarding further growth, which could negatively affect the Group's future financial position, results of operations and business prospects.

While the management of the Group believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances, unexpected deterioration in the global and local economy could negatively affect the Group's results and financial position in a manner not currently determinable.

Legal

From time to time and in the normal course of business, claims against the Group are received. At the reporting date the Group had several unresolved legal claims. Management is of the opinion that there would be no material outflow of resources and accordingly no material provision has been made in these consolidated financial statements.

Financial commitments and contingencies

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

	2012	*2011*
Credit related commitments		
Undrawn loan facilities	26,363	27,096
Guarantees issued	24,492	23,252
Letters of credit	27,060	3,653
Financial commitments and contingencies (before deducting collateral)	**77,915**	**54,001**
Less – cash held as security against letters of credit and guarantees issued (Note 15)	(26,405)	(1,872)
Financial commitments and contingencies	**51,510**	**52,129**

Insurance

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

19. Net fee and commission income

	2012	*2011*
Commission on settlements operations	3,635	3,200
Commission on guarantees and letters of credit issued	1,671	874
Commission on cash operations	832	753
Other	214	128
Fee and commission income	**6,352**	**4,955**
Commission on settlements operations	(1,053)	(1,068)
Commission on cash operations	(230)	(83)
Commission on guarantees and letters of credit issued	(436)	(78)
Other	(24)	(11)
Fee and commission expense	**(1,743)**	**(1,240)**
Net fee and commission income	**4,609**	**3,715**

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20. Other income

	2012	*2011*
Penalties earned from lending operations	2,308	1,801
Income from disposal of property	1,773	230
Gain from loan restructuring	528	-
Reimbursement of legal fees	189	418
Income from operating lease	189	69
Penalties received for deposit redemption before maturity	129	382
Reversal of negative revaluation of property and equipment	45	-
Dividends received on equity investments	-	54
Other	225	312
Other income	5,386	3,266

21. Personnel and other operating expenses

	2012	*2011*
Salaries	16,995	15,429
Bonuses and premiums	6,577	4,748
Personnel expenses	23,572	20,177

Marketing and advertising	1,604	1,429
Legal and consultancy	1,184	862
Occupancy and rent	1,135	631
Repairs and maintenance of property and equipment	757	766
Expenses on money collection services	720	-
Office supplies	711	854
Computer software maintenance	678	614
Utilities	602	468
Communications	569	543
Loss on revaluation of property and equipment	556	-
Operating taxes	403	333
Representation expenses	391	340
Security	350	349
Business travel and related expenses	303	366
Insurance	239	242
Impairment of non-financial assets	238	25
Amortisation of intangible assets	236	198
Charity	77	66
Loss on disposal of property and equipment	-	119
Penalties incurred	-	9
Other	736	650
Other operating expenses	11,489	8,864

22. Risk management

The Group 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 Group'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 to the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's profitability and each individual within the Group 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 Group's strategic planning process.

Risk management structure

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

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22. Risk management (continued)

Supervisory Council

The Supervisory Council is responsible for the overall risk management approach and for approving the risk strategies and principles.

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Group. 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 (Risk Department) -is responsible for implementing and maintaining risk related procedures to ensure an independent control process. As at the end of 2012 Risk Department consisted of the following sub-divisions:

- Consolidated risk analysis division;
- Entities credit risk division;
- Individuals credit risk division;
- Market and operational risks division;
- Collateral evaluation and monitoring group.

Risk Controlling Unit

The Risk Controlling Unit is responsible for monitoring compliance with risk principles, policies and limits, across the Group. Each business group has a decentralised unit which is responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This unit also ensures the complete capture of the risks in risk measurement and reporting systems.

Bank Treasury

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

Internal Audit

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

Risk measurement and reporting systems

The Bank's risks are measured using a method which reflects both the expected losses likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Group also runs worst case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

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22. Risk management (continued)

Risk measurement and reporting systems (continued)

Information compiled from all the business divisions is examined and processed to analyse, control and identify risks timely. This information is provided to the Management Board, the Asset - liability and Risk management Committee, and the head of each business division. The report includes aggregate credit exposure, credit metric forecasts, hold limit exceptions, liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Risk management department assesses the appropriateness of the allowance for credit losses on a monthly basis.

A daily summary on liquidity utilisation is provided to the Management Board and all other relevant employees of the Group.

Risk mitigation

The Group uses collateral to reduce its credit risks (see below for more detail).

Credit risk

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

Credit-related commitments risks

The Group makes available to its customers guarantees and letters of credit which may require that the Group make payments on their behalf. Such payments are collected from customers based on the terms of the respective agreement. They expose the Group 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 consolidated statement of financial position, including derivatives, before the effect of mitigation through the use of master netting and 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 Group internal credit ratings.

For the purpose of these consolidated financial statements all not past due collectively assessed loans to legal entities (Corporate lending and small business lending) are classified in three quality groups presented in the tables below.

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

For the purpose of these consolidated financial statements all not past due collectively assessed loans to individuals are classified in three quality groups presented in the tables below.

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

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22. Risk management (continued)

Credit risk (continued)

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

	Notes	*Neither past due nor impaired* High grade 2012	Standard grade 2012	Sub-standard grade 2012	*Past due or individually impaired 2012*	*Total 2012*
Amounts due from banks and international financial institutions	7	33,601	54	-	-	33,655
Investment securities available-for-sale	9	11,551	-	-	-	11,551
Loans and advances to customers	8					
Corporate lending		29,076	39,576	60,528	16,123	145,303
Small business lending		56,637	11,655	1,487	1,896	71,675
Consumer lending		119,875	-	875	2,224	122,974
Loans to individuals secured with deposits		5,236	-	-	-	5,236
		210,824	51,231	62,890	20,243	345,188
Total		255,976	51,285	62,890	20,243	390,394

	Notes	*Neither past due nor impaired* High grade 2011	Standard grade 2011	Sub-standard grade 2011	*Past due or individually impaired 2011*	*Total 2011*
Amounts due from banks and international financial institutions	7	28,949	930	-	-	29,879
Investment securities:						
- available-for-sale	9	2,983	-	-	-	2,983
- held-to-maturity		8,486	-	-	-	8,486
Loans and advances to customers	8					
Corporate lending		27,321	73,979	11,175	13,433	125,908
Small business lending		13,904	25,316	14,368	1,127	54,715
Consumer lending		78,753	-	737	914	80,404
Loans to individuals secured with deposits		6,579	-	-	-	6,579
		126,557	99,295	26,280	15,474	267,606
Total		166,975	100,225	26,280	15,474	308,954

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

Overdue but not impaired loans and advances include solely loans and advances that are not individually significant. The tables below show aging analysis of overdue loans.

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22. Risk management (continued)

Credit risk (continued)

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

As of 31 December 2012	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Loans and advances to customers					
Corporate lending	4,350	138	-	-	4,488
Consumer lending	1,113	620	212	-	1,945
Small business lending	1,049	296	27	-	1,372
Total	6,512	1,054	239	-	7,805

As of 31 December 2011	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Loans and advances to customers					
Corporate lending	155	281	155	-	591
Consumer lending	577	156	29	22	784
Small business lending	99	411	199	-	709
Total	831	848	383	22	2,084

For the purpose of these consolidated 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.

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.

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

The table below shows the carrying amount for renegotiated (prolonged or refinanced) financial assets, by class.

	2012	*2011*
Loans and advances to customers		
Corporate lending	10,048	4,846
Small business lending	1,596	2,484
Consumer lending	750	589
Loans secured by deposits	-	835
Total	12,394	8,754

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 Group addresses impairment assessment in two areas- individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Group determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy 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.

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22. Risk management (continued)

Credit risk (continued)

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 Group's overall policy.

The geographical concentration of Group'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	60,372	29,366	930	**90,668**	36,340	12,068	899	**49,307**
Amounts due from banks and international financial institutions	32,371	1,284	-	**33,655**	28,585	1,294	-	**29,879**
Loans and advances to customers	345,188	-	-	**345,188**	267,606	-	-	**267,606**
Investment securities								
- available-for-sale	11,551	-	-	**11,551**	3,037	-	-	**3,037**
- held-to-maturity	-	-	-	-	8,486	-	-	**8,486**
Other assets	134	-	460	**594**	815	-	-	**815**
	449,616	**30,650**	**1,390**	**481,656**	**344,869**	**13,362**	**899**	**359,130**
Liabilities:								
Amounts due to banks and international financial institutions	71	818	58,613	**59,502**	56	63	40,570	**40,689**
Amounts due to customers	241,306	42,703	9,130	**293,139**	164,839	11,753	5,276	**181,868**
Other borrowed funds	-	39,853	53,032	**92,885**	-	42,284	58,523	**100,807**
Subordinated loan	-	-	20,127	**20,127**	-	-	20,295	**20,295**
Other liabilities	7,484	70	-	**7,554**	7,496	68	624	**8,188**
	248,861	**83,444**	**140,902**	**473,207**	**172,391**	**54,168**	**125,288**	**351,847**
Net assets/(liabilities)	**200,755**	**(52,794)**	**(139,512)**	**8,449**	**172,478**	**(40,806)**	**(124,389)**	**7,283**
Net financial commitments	**50,334**	**3,574**	**24,007**	**77,915**	**45,265**	**6,949**	**1,787**	**54,001**

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 in place covering the acceptability and valuation of each type of collateral.

Management monitors the market value of collateral and will request additional collateral in accordance with the underlying agreement.

It is the Group policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim.

(Thousands of Georgian Lari)

22. Risk management (continued)

Credit risk (continued)

The list of acceptable forms of credit support is subject to periodical review. The Group has a set of requirements applicable to each from of credit support. The value of the pledged property is determined by reference to its market value taking into account a liquidity margin.

Collateral is taken to enhance an acceptable credit proposal, rather than being used as the sole rationale for any credit approval. Where facilities are approved against security, full details, including the type, value, and the frequency of review of the security should be detailed in the Application for Credit Facility Form. Where practical, an bank officer conducts inspection the physical existence of collateral offered.

The Group reassesses the fair value of pledged property with frequency stated for each from of pledge and, if necessary, requires additional collateral or acceptable forms of credit support.

Liquidity risk and funding management

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, the Group'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 Group maintains a portfolio of state securities that can be pledged to the NBG to obtain financing in the event of demand. The Group also has committed lines of credit that it can assess to meet liquidity needs.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratio established by National Bank of Georgia. As of 31 December 2012 and 2011 the ratio was as follows:

	2012	*2011*
LK "Average Liquidity Ratio" (Average monthly volume of liquid assets / Average monthly volume of liabilities)	32%	32%

In 2012 minimum limit of average liquidity ratio is 30% (2011: 30%).

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group'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 Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

Non-derivative liabilities As of 31 December 2012	*On demand and less or equal 1 month*	*More than 1 month and less or equal 3 months*	*More than 3 months and less or equal 6 months*	*More than 6 months and less or equal 1 year*	*More than 1 year*	*Total*
Amounts due to banks and international financial institutions	11,265	18,850	5,446	830	27,793	**64,184**
Amounts due to customers	196,570	17,904	41,858	29,731	12,794	**298,857**
Other borrowed funds	13,589	813	2,110	11,289	76,694	**104,495**
Subordinated loan	344	-	337	686	28,093	**29,460**
Other liabilities	1,358	3,122	180	2,877	17	**7,554**
Total cash flow payable under non-derivative liabilities	223,126	40,689	49,931	45,413	145,391	504,550
Derivative financial instruments-gross settled						
Positive fair value of derivatives						
(Inflow)	-	(19,642)	-	-	-	(19,642)
Outflow	-	19,182	-	-	-	19,182

(Thousands of Georgian Lari)

22. Risk management (continued)

Liquidity risk and funding management (continued)

Non-derivative liabilities As of 31 December 2011	*On demand and less or equal 1 month*	*More than 1 month and less or equal 3 months*	*More than 3 months and less or equal 6 months*	*More than 6 months and less or equal 1 year*	*More than 1 year*	*Total*
Amounts due to banks and international financial institutions	24,035	17,061	-	-	-	**41,096**
Amounts due to customers	120,234	17,199	15,575	24,983	7,734	**185,725**
Other borrowed funds	11,494	9,256	18,014	24,749	45,440	**108,953**
Subordinated loan	350	247	346	700	25,344	**26,987**
Other liabilities	2,715	1,899	154	2,759	-	**7,527**
Total cash flow payable under non-derivative liabilities	**158,828**	**45,662**	**34,089**	**53,191**	**78,518**	**370,288**
Derivative financial instruments- gross settled						
Negative fair value derivatives						
(Inflow)	(14,061)	(4,323)	-	-	-	(18,384)
Outflow	14,551	4,494	-	-	-	19,045

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

	On demand and less or equal 1 month	*More than 1 month and less or equal 3 months*	*More than 3 months and less or equal 6 months*	*More than 6 months and less or equal 1 year*	*More than 1 year*	*Total*
2012	6,502	13,982	23,205	24,410	9,816	**77,915**
2011	9,127	5,221	9,605	10,245	19,803	**54,001**

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

Management believes that this level of funding will remain with the Group for the foreseeable future and that in the event of withdrawal of funds, the Group would be given sufficient notice so as to realise its liquid assets to enable repayment.

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 in less or equal one month in the tables above.

Market risk

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

Market risk – Trading

The Management Board has set limits on the level of risk that may be accepted. The Group's activity in market risks area is limited by NBG Deposit certificates, Ministry of Finance of Georgia Treasury Bills, CDs operations, also interbank loans and deposits, and exchange operations. The Group does not perform derivative trading.

(Thousands of Georgian Lari)

22. Risk management (continued)

Market risk (continued)

Market risk – Non - trading

Interest rate risk

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

The sensitivity of the consolidated income statement includes the effect of the reasonably possible changes in interest rates on the net interest income for one year based on the assumption that there are parallel shifts in the yield curve.

Currency	*Increase in basis points 2012*	*Sensitivity of pre-tax income 2012*
USD	0.03%	(14)
USD	(0.03%)	14

Currency	*Increase in basis points 2011*	*Sensitivity of pre-tax income 2011*
USD	0.06%	(36)
USD	(0.06%)	36

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 Group 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 consolidated income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on consolidated statement of comprehensive income does not differ from the effect on the consolidated income statement. A negative amount in the table reflects a potential net reduction in consolidated income statement or consolidated statement of comprehensive income, while a positive amount reflects a net potential increase.

Currency	*Increase in currency rate in % 2012*	*Effect on profit before tax 2012*	*Increase in currency rate in % 2011*	*Effect on profit before tax 2011*
USD	(0.75%)	28	(5.8%)	(167)
EUR	1.34%	(7)	(7.56%)	6

Currency	*Decrease in currency rate in % 2012*	*Effect on profit before tax 2012*	*Decrease in currency rate in % 2011*	*Effect on profit before tax 2011*
USD	0.75%	(28)	5.8%	167
EUR	(1.34%)	7	7.56%	(6)

(Thousands of Georgian Lari)

22. Risk management (continued)

Prepayment risk

Prepayment risk is the risk that the Group will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall.

The effect on profit before tax for one year and on equity, assuming 10% of repayable financial instruments were to prepay at the beginning of the year, with all other variables held constant, is as follows:

	Effect on net interest income
2012	5,748
2011	4,910

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group 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.

As of 31 December 2012 the Group obtained Banker's Blanket Bond and Computer Crime insurance with insurance premium of GEL 828 (2011: GEL 835) from Lloyd's insurance company.

23. Fair value of financial instruments

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

Set out below is a comparison by class of the carrying amounts and fair values of the Group's financial instruments that are not carried at fair value in the consolidated 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).

	Carrying value 2012	*Fair value 2012*	*Unrecognised gain/(loss) 2012*	*Carrying value 2011*	*Fair value 2011*	*Unrecognised gain/(loss) 2011*
Financial assets						
Loans and advances to customers	345,188	345,874	686	267,606	273,075	5,469
Investment securities held-to-maturity	-	-	-	8,486	8,585	99
Financial liabilities						
Amounts due to customers	293,139	293,991	(852)	181,868	182,208	(340)
Other borrowed funds	92,885	90,261	2,624	100,807	98,006	2,801
Total unrecognised change in unrealised fair value			**2,458**			**8,029**

(Thousands of Georgian Lari)

23. Fair value of financial instruments (continued)

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.

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 amortised cost are estimated by comparing market interest rates when they were first recognised 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.

24. Maturity analysis of financial assets and liabilities

The table below shows assets and liabilities at 31 December 2012 by their remaining expected maturity. Refer to Note 22 for the Bank's contractual undiscounted repayment obligations.

Following principles underlying gap analysis presentation and the Group liquidity risk management are based on the mix of National Bank of Georgia approach and the Bank's practice:

- Cash and cash equivalents represent highly liquid assets and are classified as "On demand and less or equal 1 month"
- Investment securities held-to-maturity are classified based on the remaining maturities
- Loans and advances to customers, amounts due from banks and international financial institutions, other assets, amounts due to banks and international financial institutions, other borrowed funds and other liabilities are included into gap analysis table based on remaining contractual maturities
- Diversification of customer deposits of the bank by number and type of depositors and the past experience of the Group indicate that such accounts and deposits provide a long-term and stable source of funding, and as a result they are allocated per expected time of funds outflow in the gap analysis table on the basis of statistical data accumulated by the Group during the previous periods and assumptions regarding the "stable part" of current account balances.

	2012							
	On demand and less or equal 1 month	*More than 1 month and less or equal 3 months*	*More than 3 months and less or equal 6 months*	*More than 6 months and less or equal 1 year*	*More than 1 year*	*Overdue*	*No stated maturity*	*Total*
Financial assets								
Cash and cash equivalents	90,668	-	-	-	-	-	-	**90,668**
Amounts due from banks and international financial institutions	6,082	4,973	6,717	4,882	11,001	-	-	**33,655**
Loans and advances to customers	22,004	43,206	48,744	56,248	171,578	3,408	-	**345,188**
Investment securities available-for-sale	10,470	-	1,027	-	-	-	54	**11,551**
Other assets	95	473	25	1	-	-	-	**594**
Total	129,319	48,652	56,513	61,131	182,579	3,408	54	481,656
Financial liabilities								
Amounts due to banks and international financial institutions	11,205	18,311	4,970	-	25,016	-	-	**59,502**
Amounts due to customers	55,432	27,446	50,785	30,072	129,404	-	-	**293,139**
Other borrowed funds	13,468	317	1,098	8,846	69,156	-	-	**92,885**
Subordinated debt	247	-	-	-	19,880	-	-	**20,127**
Other liabilities	1,358	3,122	180	2,877	17	-	-	**7,554**
Total	81,710	49,196	57,033	41,795	243,473	-	-	473,207
Net	*47,609*	*(544)*	*(520)*	*19,336*	*(60,894)*	*3,408*	*54*	*8,449*
Cumulative gap	*47,609*	*47,065*	*46,545*	*65,881*	*4,987*	*8,395*	*8,449*	-

(Thousands of Georgian Lari)

24. Maturity analysis of financial assets and liabilities (continued)

	2011							
	On demand and less or equal 1 month	More than 1 month and less or equal 3 months	More than 3 months and less or equal 6 months	More than 6 months and less or equal 1 year	More than 1 year	Overdue	No stated maturity	Total
Financial assets								
Cash and cash equivalents	49,307	-	-	-	-	-	-	**49,307**
Amounts due from banks and international financial institutions	6,557	5,536	4,236	6,860	6,690	-	-	**29,879**
Loans and advances to customers	26,916	45,312	32,444	51,185	110,473	1,276	-	**267,606**
Investment securities								
- available-for-sale	-	1,966	-	-	1,017	-	54	**3,037**
- held-to-maturity	1,993	2,460	-	4,033	-	-	-	**8,486**
Other assets	792	7	7	4	5	-	-	**815**
Total	85,565	55,281	36,687	62,082	118,185	1,276	54	359,130
Financial liabilities								
Amounts due to banks and international financial institutions	23,850	16,839	-	-	-	-	-	**40,689**
Amounts due to customers	41,596	20,352	20,103	23,904	75,913	-	-	**181,868**
Other borrowed funds	10,896	8,051	16,963	23,363	41,534	-	-	**100,807**
Subordinated debt	251	-	-	-	20,044	-	-	**20,295**
Other liabilities	3,205	2,070	154	2,759	-	-	-	**8,188**
Total	79,798	47,312	37,220	50,026	137,491	-	-	351,847
Net	*5,767*	*7,969*	*(533)*	*12,056*	*(19,306)*	*1,276*	*54*	*7,283*
Cumulative gap	*5,767*	*13,736*	*13,203*	*25,259*	*5,953*	*7,229*	*7,283*	*-*

As of 31 December 2012 total amount of funding obtained from the Parent bank amounted to GEL 131,770 (2011: GEL 119,685). Management believes that this level of funding will remain with the Group for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment. Refer to note 25.

Long-term loans are generally not available in Georgia. However, in the Georgian marketplace, many short-term credits are granted with the expectation of renewing the loans at maturity. As such, the ultimate maturity of assets may be different from the analysis presented above.

25. Related party disclosures

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

	2012			2011		
	The Parent bank	Entities under common control	Key management personnel	The Parent bank	Entities under common control	Key management personnel
Cash and cash equivalents	351	17,372	-	700	3,828	-
Loans and advances to customers, gross	-	-	54	-	-	26
Less: allowance for impairment	-	-	(1)	-	-	-
Loans and advances to customers, net	-	-	53	-	-	26
Other assets	460	-	-	-	-	-
Amounts due to banks and international financial institutions (Note 14)	58,611	2	-	40,567	2	-
Amounts due to customers	-	15,831	1,089	-	7,067	302
Other borrowed funds (Note 16)	53,032	-	-	58,823	-	-
Subordinated loan	20,127	-	-	20,295	-	-
Other liabilities	-	-	2,052	624	-	1,514

(Thousands of Georgian Lari)

25. Related party disclosures (continued)

Entities under common control 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). In these consolidated financial statements included into entities under common control are the members of VTB Group and other legal entities controlled by the Russian Federation.

On 25 October 2005, the Group entered into a subordinated loan agreement with the Parent bank for the total amount of USD 12,000 thousand, with interest rate of Libor+6% payable quarterly and maturity on 26 October 2019. In the case of a liquidation of the Group, this loan is only repayable after all the obligations to the Group senior creditors have been met.

As of 31 December 2012 other liabilities to key management personnel comprised of accrued bonuses totalling GEL 1,977 (2011: GEL 1,451) and unpaid vacation of GEL 75 (2011: GEL 63).

The income and expense arising from related party transactions are presented in the table below:

	2012			*2011*		
	The Parent bank	*Entities under common control*	*Key management personnel*	*The Parent bank*	*Entities under common control*	*Key management personnel*
Interest income	1	60	6	–	404	4
Interest expense	(7,335)	(611)	(83)	(4,496)	(319)	(48)
Loan impairment charge	–	–	(1)	–	–	–
Fee and commission income	–	12	1	–	34	–
Fee and commission expense	(52)	(63)	–	(1)	(49)	–
Net gains /(losses) from foreign currencies dealing	968	108	2	(565)	127	5

For the year ended 31 December 2012, remuneration of the members of the key management personnel comprised salaries, bonuses and other staff related expenses totalling GEL 3,810 (2011: GEL 3,231).

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

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

26. 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 to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

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.

Capital adequacy ratio

Regulatory capital consists of Tier 1 capital, which comprises common shares, reserve fund and retained earnings excluding current year profit or loss less amount of property revaluation reserve transferred to authorised capital, and intangible assets. The other component of regulatory capital is Tier 2 capital, which includes profit or loss of current year, general reserves (not more than 1.25% of risk weighted assets) and subordinated long-term debt.

The NBG requires banks to maintain a minimum capital adequacy ratio of 12% of risk-weighted assets, computed based on the NBG guidelines. As of 31 December 2012 the Bank's statutory capital adequacy ratio as calculated in accordance with the NBG requirements was 13.48% (2011: 16.19%).

The Bank was in compliance with the capital adequacy ratio calculated based on the NBG requirement as of 31 December 2012 and 2011.

(Thousands of Georgian Lari)

26. Capital adequacy (continued)

Capital adequacy ratio of the Bank in accordance with Basel I as modified by the NBG requirements is as follows:

	2012	*2011*
Tier 1 capital	68,684	59,492
Tier 2 capital	27,991	26,392
Total regulatory capital for ratio calculation	**96,675**	**85,884**
Risk weighted assets	**624,740**	**510,738**
Capital adequacy ratio	**15.47%**	**16.82%**