JSC VTB Bank (Georgia)

Consolidated financial statements

For the year ended 31 December 2016
together with independent auditor's report

Contents

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Independent auditor's report

To the shareholders and Board of Directors of JSC VTB Bank (Georgia) -

Opinion

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

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

Basis for opinion

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

Responsibilities of management and supervisory board for the consolidated financial statements

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

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

Supervisory board is responsible for overseeing the Group's financial reporting process.

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Auditor's responsibilities for the audit of the consolidated financial statements

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

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

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

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

Ruslan Khoroshvili

On behalf of EY Georgia LLC

Tbilisi, Georgia

20 March 2017

Consolidated statement of financial position

As of 31 December

(Thousands of Georgian lari)

	Notes	*2016*	*2015*
Assets			
Cash and cash equivalents	6	316,336	267,776
Amounts due from banks and international financial institutions	7	142,175	85,235
Loans and advances to customers	8	933,764	746,392
Investment securities available-for-sale	9	80,513	55,587
Property and equipment	10	35,434	36,185
Investment property	11	20,336	26,678
Current income tax assets		-	104
Deferred income tax assets	12	1,219	-
Other assets	13	16,237	6,092
Total assets		**1,546,014**	**1,224,049**
Liabilities			
Amounts due to banks and international financial institutions	14	286,175	225,012
Amounts due to customers	15	831,274	669,605
Debt securities issued	16	31,690	5,242
Other borrowed funds	17	139,022	114,735
Current income tax liabilities		1,940	-
Deferred income tax liabilities	12	-	1,574
Other liabilities	13	21,726	13,040
Subordinated loan	26	37,759	33,329
Total liabilities		**1,349,586**	**1,062,537**
Equity			
Share capital	18	191,293	191,293
Land and buildings revaluation reserve		3,160	2,758
Perpetual subordinated loan	18	12,900	-
Unrealised gains/(losses) on investment securities available-for-sale	9	1,550	(607)
Accumulated losses		(12,475)	(31,932)
Total equity		**196,428**	**161,512**
Total liabilities and equity		**1,546,014**	**1,224,049**

Signed and authorised for issue on behalf of the Management Board of the Bank on 20 March 2017:

Archil Kontselidze
Chief Executive Officer

Mamuka Menteshashvili
Chief Financial Officer

The accompanying notes on pages 9 to 53 are an integral part of these consolidated financial statements.

Consolidated income statement

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	*2016*	*2015*
Interest income			
Loans and advances to customers		107,594	94,657
Investment securities available-for-sale		5,195	4,236
Cash and cash equivalents		4,012	2,005
Amounts due from banks and international financial institutions		15	-
		116,816	100,898
Interest expense			
Amounts due to customers		(40,869)	(32,196)
Amounts due to banks, international financial institutions and other borrowed funds		(8,903)	(10,827)
Interest expenses on debt securities issued		(1,155)	(63)
Subordinated loan		(2,584)	(2,365)
		(53,511)	(45,451)
Expense due to assets with negative interest rates (NIR)		(66)	-
Net interest income		63,239	55,447
Allowance for loan impairment	8	(660)	(5,992)
Net interest income after allowance for loan impairment		62,579	49,455
Net fee and commission income	20	5,125	5,020
Net gains/(losses) from foreign currencies:			
- Dealing		7,687	3,727
- Translation differences		(3,649)	1,474
Net gains/(losses) from investment securities available-for-sale		66	-
Net gains from disposal of investment property	11	2,449	908
Net gains on investment property revaluation	11	526	515
Other income	21	7,767	7,992
Non-interest income		19,971	19,636
Personnel expenses	22	(36,751)	(33,159)
Depreciation	10	(3,726)	(3,351)
Other operating expenses	22	(14,360)	(14,769)
Other impairment and provision (charge)		(560)	(497)
Non-interest expenses		(55,397)	(51,776)
Profit before income tax expense		27,153	17,315
Income tax benefit/(expense)	12	291	(2,335)
Profit for the year		27,444	14,980

The accompanying notes on pages 9 to 53 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	*2016*	*2015*
Profit for the year		27,444	14,980
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Unrealised gains/(losses) on investment securities available-for-sale	9	2,223	(607)
Realised gains/(losses) on investment securities available-for-sale reclassified to the statement ofprofit or loss	9	(66)	-
Net other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods		**2,157**	**(607)**
Other comprehensive income not to be reclassified to profit or loss in subsequent periods			
Revaluation of land and buildings	10	-	2,159
Income tax effect	12	457	(324)
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods		**457**	**1,835**
Other comprehensive income for the year, net of tax		**2,614**	**1,228**
Total comprehensive income for the year		**30,058**	**16,208**

The accompanying notes on pages 9 to 53 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	*Share capital*	*Land and buildings revaluation reserve*	*Unrealized gains/ (losses) on investment securities available-for-sale*	*Perpetual subordinated loan*	*Accumu-lated losses*	*Total equity*
As of 31 December 2014		**171,293**	**943**	**-**	**-**	**(46,932)**	**125,304**
Total comprehensive income for the year		-	1,835	(607)	-	14,980	**16,208**
Issuance of share capital	18	20,000			-		**20,000**
Depreciation of revaluation reserve, net of tax		-	(20)	-	-	20	-
As of 31 December 2015		**191,293**	**2,758**	**(607)**	**-**	**(31,932)**	**161,512**
Total comprehensive income for the year		-	457	2,157	-	27,444	**30,058**
Issuance of perpetual subordinated loan	18	-	-	-	13,089	-	**13,089**
Foreign exchange translation on perpetual subordinated loan	18	-	-	-	(189)	189	-
Dividends declared	18					(8,231)	**(8,231)**
Depreciation of revaluation reserve, net of tax		-	(55)	-	-	55	-
As of 31 December 2016		**191,293**	**3,160**	**1,550**	**12,900**	**(12,475)**	**196,428**

The accompanying notes on pages 9 to 53 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December

(Thousands of Georgian lari)

	Notes	*2016*	*2015*
Cash flows from operating activities			
Interest received		112,558	98,859
Interest paid		(53,045)	(42,248)
Fees and commissions received		15,042	12,566
Fees and commissions paid		(9,023)	(7,772)
Realised net gains from dealing in foreign currencies		6,361	6,664
Other income received		7,339	7,057
Personnel expenses paid		(35,008)	(33,417)
Other operating expenses paid		(12,856)	(14,231)
Cash flows from operating activities before changes in operating assets and liabilities		**31,368**	**27,478**
Net (increase)/decrease in operating assets			
Amounts due from banks and international financial institutions		(55,471)	(20,444)
Loans and advances to customers		(131,420)	(31,814)
Other assets		(3,199)	424
Net increase/(decrease) in operating liabilities			
Amounts due to banks and international financial institutions		41,917	152,044
Amounts due to customers		138,267	(109,710)
Debt securities issued		25,729	5,174
Other liabilities		4,146	1,522
Net cash flows from operating activities before income tax		**51,337**	**24,674**
Income tax paid		-	-
Net cash received from operating activities		**51,337**	**24,674**
Cash flows from investing activities			
Acquisition of investment securities available-for-sale		(75,153)	(148,885)
Proceeds from sale and redemption of investment securities available-for-sale		54,754	167,407
Purchase of property, equipment and intangible assets		(9,767)	(5,495)
Proceeds from sale of property and equipment		7	-
Proceeds from disposal of investment property		11,795	5,667
Purchases of investment property		(2,179)	(3,147)
Net cash (used in) / received from investing activities		**(20,543)**	**15,547**
Cash flows from financing activities			
Proceeds from issuance of share capital	18	-	20,000
Other borrowed funds received		280,457	322,108
Repayments of other borrowed funds		(271,087)	(328,715)
Dividends paid	18	(8,013)	(1)
Proceeds from perpetual subordinated loan	18	13,089	-
Net cash received from financing activities		**14,446**	**13,392**
Effect of exchange rates changes on cash and cash equivalents		3,320	1,542
Net increase in cash and cash equivalents		**48,560**	**55,155**
Cash and cash equivalents, beginning	6	267,776	212,621
Cash and cash equivalents, ending	6	**316,336**	**267,776**

The accompanying notes on pages 9 to 53 are an integral part of these consolidated financial statements.

(Thousands of Georgian lari)

1. Introduction

JSC VTB Bank (Georgia) (hereafter the "Bank") 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 2016, the Bank has 20 branches (10 of them in Tbilisi) and 16 service centres. As of 31 December 2015, the Bank had 20 branches (10 of them in Tbilisi) and 15 service centres.

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

As of 31 December 2016 and 2015, the following shareholders owned more than 1% of the outstanding shares*:*

Shareholder	*2016* *%*	*2015* *%*
VTB Bank OJSC	97.14	97.14
Lacarpa Enterprises Limited	1.61	1.61
Other	1.25	1.25
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 Government of the Russian Federation ("RF"), acting through the Federal Property Agency, which holds 60.9% of issued and outstanding shares of the Parent bank as of 31 December 2016 (2015: 60.9%).

As of 31 December 2016 and 2015, none of the Supervisory Council and Management Board members owned shares of the Bank.

As of 31 December 2016, the Bank had 1,160 employees (2015: 1,194).

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

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

		The Group ownership interest			
Name	*Country of incorporation*	*2016*	*2015*	*Date of Incorporation*	*Activities*
Georgian Fund Company LLC	Georgia	100%	100%	24 June 1999	Financial services (Dormant)

GT+ LLC wholly owned dormant subsidiary of the Group as at 31 December 2015 was liquidated on 29 January 2016.

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, derivative financial instruments, 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.

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.

Determination of fair value

When financial instruments are recognized initially, they are measured at fair value, adjusted, in the case of instruments not at fair value through profit or loss, for directly attributable fees and costs.

(Thousands of Georgian lari)

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

Financial assets (continued)

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Group determines that the fair value at initial recognition differs from the transaction price, then:

- If the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets, the Group recognises the difference between the fair value at initial recognition and the transaction price as a gain or loss;
- In all other cases, the initial measurement of the financial instrument is adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the Group recognises that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

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.

Operating lease – Group as lessor

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

(Thousands of Georgian lari)

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

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.

Loans and advances to customers, 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.

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

Impairment of financial assets (continued)

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in the consolidated 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.

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.

(Thousands of Georgian lari)

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

Derecognition of financial assets and liabilities (continued)

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;
- Uncollectible loans are written-off against the related allowance for impairment after all necessary procedures to recover the loans have been completed and the amount of the irretrievable loss has been determined.

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.

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 (applicable to distributable profits) and tax laws that have been enacted or substantively enacted at the reporting date.

(Thousands of Georgian lari)

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

Taxation (continued)

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.

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	2-8
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.

(Thousands of Georgian lari)

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

Investment property

Investment property is land or building or a part of a building held to earn rental income or for capital appreciation and which is not used by the 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 reflecting market conditions at the end of the reporting period. Fair value of the Group's investment property is determined on the base of various sources including reports of independent appraisers, who hold a recognized and relevant professional qualification and who have recent experience in valuation of property of similar location and category.

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.

Repossessed assets

Repossessed collateral represents non-financial assets acquired by the Group in settlement of overdue loans. The assets are initially recognised at fair value when acquired and included in premises and equipment, investment property or inventories within other assets depending on their nature and the Group's intention in respect of recovery of these assets and are subsequently re-measured and accounted for in accordance with the accounting policies for these categories of assets. Inventories of repossessed collateral are recorded at the lower of cost or net realisable value.

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 2 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.

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.

Equity

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.

(Thousands of Georgian lari)

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

Equity (continued)

Perpetual subordinated loan

Due to undefined maturity and an option for non-cumulative cancellation of coupon payments, the Group accounts the Perpetual Subordinated Loan as an equity instrument and as a Tier I eligible instrument for the purpose of capital adequacy ratio calculation. The Group accounts for the Perpetual Subordinated Loan denominated in the RUB in the amount equivalent of GEL, using the foreign exchange rate at the reporting date with foreign exchange translation effects recorded in Retained earnings.

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.

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.

(Thousands of Georgian lari)

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

Foreign currency translation (continued)

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 2016 and 2015 were 2.6468 GEL and 2.3949 GEL to 1 USD, respectively.

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.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 24.

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.

According to the current methodology, the Loss Rate is calculated with consideration of the recovery rate, which is based on statistics, indicating recoverability of losses after credits reach more than 90 overdue days.

Revaluation of property

The Group regularly reviews the value of its property (land, office buildings, leasehold improvements 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.

Land and buildings have been revalued to market value at 31 December 2015. Revalued buildings are depreciated in accordance with their remaining useful life since 1 January 2016. The Group's management believes that carrying value of land and buildings does not differ materially from that which would be determined using fair value as of 31 December 2016.

(Thousands of Georgian lari)

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

Going concern (continued)

As of 31 December 2016, an independent appraiser determined the fair value of the Group's investment property. The market value of the property was determined based on the active market data. Refer to Note 10 and Note 11.

Taxation

The current income tax expense is calculated in accordance with the regulations in force in Georgia where the Bank and its Subsidiaries operate.

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. Refer to Note 12.

Changes in presentation

Reclassifications

Starting from 2016 Group changed the presentation of some expenses by using new analytical approach.

Accordingly, the presentation of the comparative figures has been adjusted to the consistent with the new presentation. The reclassification and its impact on comparative period information for the year ended 31 December 2015 on consolidated statement of comprehensive income is as follows:

	As previously reported	*Reclassification*	*As reclassified*
Loan impairment charge	(5,628)	(364)	(5,992)
Other operating expenses:			
Other operating expenses on plastic cards operation	(1,969)	1,520	(449)
Legal and consultancy	(1,765)	499	(1,266)
Expenses on money collection services	(947)	947	-
Other	(407)	(82)	(489)
Net fee and commission income:			
Commission expense on settlements operations	(3,690)	(1,573)	(5,263)
Commission expense on cash operations	(1,041)	(947)	(1,988)

The effect of changes on the consolidated statement of cash flows for the year ended 31 December 2015 is as follows:

Cash flows from operating activities:			
Fees and commissions paid	(5,252)	(2,520)	(7,772)
Other operating expenses paid	(17,115)	2,884	(14,231)
Net (increase)/decrease in operating assets:			
Loans to customers	(31,450)	(364)	(31,814)

(Thousands of Georgian lari)

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 which are effective for annual periods beginning on or after 1 January 2016:

Amendments to IAS 1 Disclosure Initiative

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

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

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

Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exception

The amendments address issues that have arisen in applying the investment entities exception under IFRS 10 *Consolidated Financial Statements*. The amendments to IFRS 10 clarify that the exemption from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures all of its subsidiaries at fair value.

Furthermore, the amendments to IFRS 10 clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value. The amendments to IAS 28 *Investments in Associates and Joint Ventures* allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries.

These amendments must be applied retrospectively and are effective for annual periods beginning on or after 1 January 2016. These amendments do not have any impact on the Group.

Annual improvements 2012-2014 cycle

These improvements are effective for annual periods beginning on or after 1 January 2016. They include, in particular:

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Assets (or disposal groups) are generally disposed of either through sale or distribution to owners. The amendment clarifies that changing from one of these disposal methods to the other would not be considered a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in IFRS 5. This amendment must be applied prospectively. These amendments do not have any impact on the Group.

IFRS 7 Financial Instruments: Disclosures

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

(Thousands of Georgian lari)

5. New accounting pronouncements

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's consolidated financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting.

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

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

IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but restatement of comparative information is not required; the effect on the transition date – 1 January 2018 – would be recorded in retained earnings. The adoption of IFRS 9 is expected to have an effect on the classification and measurement of the Group's financial assets, but no impact on the classification and measurement of the Group's financial liabilities. The Group expects a significant impact on its equity due to adoption of IFRS 9 impairment requirements, but it will need to perform a more detailed analysis, which considers all reasonable and supportable information, including forward-looking elements to determine the extent of the impact.

IFRS 15 Revenue from Contracts with Customers

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

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

The Group does not anticipate early adopting IFRS 15 and is currently evaluating its impact.

(Thousands of Georgian lari)

5. New accounting pronouncements (continued)

IFRS 16 Leases

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

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

The Group does not anticipate early adopting IFRS 16 and is currently evaluating its impact.

Amendments to IAS 12 Income Taxes

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

Amendments to IAS 7 Statement of Cash Flows

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

Amendments to IFRS 2

The IASB issued amendments to IFRS 2 *Share-based Payment* in relation to the classification and measurement of share-based payment transactions. The amendments are intended to eliminate diversity in practice, but are narrow in scope and address specific areas of classification and measurement. The amendments address three main areas:

- The effects of vesting conditions on the measurement of a cash-settled share-based payment transaction;
- The classification of a share-based payment transaction with net settlement features for withholding tax obligations;
- The accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash-settled to equity-settled.

The amendment is effective for annual periods beginning on or after 1 January 2018. On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and other criteria are met. Early application is permitted. The amendments are not expected to have any impact on the Group.

Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts – Amendments to IFRS 4

The amendments address concerns arising from implementing the new financial instruments Standard, IFRS 9, before implementing the new insurance contracts standard that the Board is developing to replace IFRS 4. The amendments introduce two options for entities issuing insurance contracts: a temporary exemption from applying IFRS 9 and an overlay approach. The optional temporary exemption from IFRS 9 is available to entities whose activities are predominantly connected with insurance. The temporary exemption permits such entities to continue to apply IAS *39 Financial Instruments: Recognition and Measurement* while they defer the application of IFRS 9 until 1 January 2021 at the latest. The overlay approach requires an entity to remove from profit or loss additional volatility that may arise if IFRS 9 is applied with IFRS 4.

The temporary exemption is first applied for reporting periods beginning on or after 1 January 2018. An entity may elect the overlay approach when it first applies IFRS 9 and apply that approach retrospectively to financial assets designated on transition to IFRS 9. The amendments are not expected to have any impact on the Group.

(Thousands of Georgian lari)

6. Cash and cash equivalents

	2016	*2015*
Current accounts with other credit institutions	210,489	105,896
Current accounts with the NBG	51,705	44,979
Cash on hand	49,426	60,670
Time deposits with credit institutions	4,716	56,231
Cash and cash equivalents	316,336	267,776

As of 31 December 2016, 90.42% of total current accounts with credit institutions are placed with 2 non-resident credit institutions (2015: 85.4%).

As of 31 December 2016, GEL 4,716 was placed on two time deposits with credit institutions that had maturity period in January 2017 (As of 31 December 2015: GEL 56,231 time deposits with credit institutions consist from two time deposit with maturity period in January 2016) and bear annual interest rates from 0.01% to 1.5%. (2015: annual interest rates from 0.01% to 8.6%).

As of 31 December 2016 and 2015, the Bank's cash and cash equivalents were of high and standard credit grade, were not either past due, or individually impaired, or renegotiated.

7. Amounts due from banks and international financial institutions

	2016	*2015*
Obligatory reserve with the NBG	141,920	84,937
Time deposits with credit institutions	255	298
Amounts due from banks and international financial institutions	142,175	85,235

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 2016 the obligatory reserve on USD account bears interest at the rate of U.S. Federal Reserve System of less 0.5% (2015 – the rate of U.S. Federal Reserve System of less 0.5%) and on EUR account – the rate of the European Central Bank (2015 – the rate of the European Central Bank of less 0.5%).

As of 31 December 2016, amount of GEL 255 (2015: GEL 298) 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

	2016	*2015*
Corporate lending	422,386	346,933
Consumer lending	333,381	274,463
Small business lending	203,531	153,853
Loans to individuals secured by deposits	5,612	6,871
Gross loans and advances to customers	**964,910**	**782,120**
Less – allowance for impairment	(31,146)	(35,728)
Loans and advances to customers, net	933,764	746,392

(Thousands of Georgian lari)

8. Loans and advances to customers (continued)

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 2016	*Consumer lending 2016*	*Small business lending 2016*	*Total 2016*
At 1 January 2016	**24,778**	**9,381**	**1,569**	**35,728**
Net (reversal)/charge for the year	(5,135)	5,559	236	**660**
Foreign currencies translation	1,896	277	97	**2,270**
Recoveries of previously written off loans and advances	2,558	581	418	**3,557**
Amounts written off	(300)	(9,757)	(1,012)	**(11,069)**
At 31 December 2016	**23,797**	**6,041**	**1,308**	**31,146**
Individual impairment	16,196	93	100	**16,389**
Collective impairment	7,601	5,948	1,208	**14,757**
	23,797	**6,041**	**1,308**	**31,146**
Gross amount of loans and advances, individually determined to be impaired, before deducting any individually assessed impairment allowance	**19,931**	**371**	**401**	**20,703**

	Corporate lending 2015	*Consumer lending 2015*	*Small business lending 2015*	*Total 2015*
At 1 January 2015	**16,980**	**5,896**	**2,594**	**25,470**
Net charge/(reversal) for the year	2,185	5,248	(1,441)	**5,992**
Foreign currencies translation	4,757	419	480	**5,656**
Recoveries of previously written off loans and advances	856	942	550	**2,348**
Amounts written off	-	(3,124)	(614)	**(3,738)**
At 31 December 2015	**24,778**	**9,381**	**1,569**	**35,728**
Individual impairment	19,143	34	663	**19,840**
Collective impairment	5,635	9,347	906	**15,888**
	24,778	**9,381**	**1,569**	**35,728**
Gross amount of loans and advances, individually determined to be impaired, before deducting any individually assessed impairment allowance	**20,025**	**377**	**1,073**	**21,475**

Individually impaired loans

Interest income of loans and advances, for which individual impairment allowances have been recognized, as at 31 December 2016, comprised GEL 541 (2015: GEL 440).

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.

(Thousands of Georgian lari)

8. Loans and advances to customers (continued)

Collateral and other credit enhancements (continued)

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

As of 31 December 2016, the Group repossessed collateral (land and buildings) during the year with cost as of repossession date of GEL 3,098 (2015: GEL 3,701), which were classified as investment property and inventories with the amount of GEL 2,478 and GEL 620 of repossessed collateral, respectively. Refer to Note 11 and 13.

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 2016, the Bank had a concentration of loans represented by GEL 221,507 due from the ten largest third party borrowers 22.96% of gross loan portfolio (2015 – GEL 183,023 or 23.4%) An allowance of GEL 2,525 (2015: GEL 15,221) was recognised against these loans.

Included in total loans to customers is an exposure to a single borrower of GEL 34,532 or 3.58% of total loan portfolio (2015 – GEL 32,506 or 4.16 %), that bears an annual interest rate of 7.5% p.a. and matures in April 2029.

Loans have been extended to the following types of customers:

	2016	*2015*
Commercial legal entities	585,865	474,353
Individuals	375,022	307,767
State-owned companies	4,023	–
Gross loans and advances to customers	**964,910**	**782,120**

As of 31 December 2016 and 2015, loans and advances to customers are principally issued within Georgia and their allocation by industry sectors is as follows:

	2016	*2015*
Individuals	375,022	307,767
Trading and service enterprises	334,637	257,945
Real estate construction	55,702	57,818
Manufacturing	55,512	58,292
Agriculture and food processing	51,859	41,167
Energy	27,900	9,291
Financial	21,173	18,094
Telecommunication and transportation	11,131	9,044
Other	31,974	22,702
Gross loans and advances to customers	**964,910**	**782,120**

9. Investment securities available-for-sale

As of 31 December 2016 investment securities available-for-sale comprised of securities of Ministry of Finance of Georgia with total carrying value of GEL 68,494 (2015: GEL 8,669), securities of National Bank of Georgia with total carrying value of GEL 11,965 (2015: GEL 46,864) and corporate shares of one Georgian company engaged in clearance of utility payments with total carrying value of GEL 54 (2015: GEL 54).

During the year unrealized gain recognized in other comprehensive income on all investment securities were GEL 2,223 (2015: loss GEL 607) and realized loss GEL 66 (2015: GEL 0).

(Thousands of Georgian lari)

10. Property and equipment

The movements in property and equipment during 2016 and 2015 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*	*Construction in progress*	*Total*
Cost or revalued amount								
31 December 2014	**23,909**	**8,695**	**8,608**	**1,938**	**1,606**	**2,598**	**-**	**47,354**
Additions	-	2,347	778	-	184	-	684	**3,993**
Transfer	196	-	-	-	-	488	(684)	**-**
Disposals	-	(198)	(40)	-	-	-	-	**(238)**
Effect of revaluation	930	-	-	-	-	(934)	-	**(4)**
31 December 2015	**25,035**	**10,844**	**9,346**	**1,938**	**1,790**	**2,152**	**-**	**51,105**
Additions	-	1,056	754	-	38	-	1,182	**3,030**
Transfer	979	-	-	-	-	203	(1,182)	**-**
Disposals	-	(428)	(202)	-	(17)	(12)	-	**(659)**
31 December 2016	**26,014**	**11,472**	**9,898**	**1,938**	**1,811**	**2,343**	**-**	**53,476**
Accumulated depreciation and impairment								
31 December 2014	**(987)**	**(6,660)**	**(4,890)**	**(228)**	**(863)**	**(584)**	**-**	**(14,212)**
Depreciation charge	(509)	(988)	(1,207)	(68)	(229)	(350)	-	**(3,351)**
Disposals	-	177	36	-	-	-	-	**213**
Effect of revaluation	1,496	-	-	-	-	934	-	**2,430**
31 December 2015	**-**	**(7,471)**	**(6,061)**	**(296)**	**(1,092)**	**-**	**-**	**(14,920)**
Depreciation charge	(532)	(1,294)	(1,214)	(68)	(234)	(384)	-	**(3,726)**
Disposals	-	405	181	-	17	1	-	**604**
31 December 2016	**(532)**	**(8,360)**	**(7,094)**	**(364)**	**(1,309)**	**(383)**	**-**	**(18,042)**
Net book value								
31 December 2014	22,922	2,035	3,718	1,710	743	2,014	-	33,142
31 December 2015	25,035	3,373	3,285	1,642	698	2,152	-	36,185
31 December 2016	25,482	3,112	2,804	1,574	502	1,960	-	35,434

As of 31 December 2015, 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 increased by GEL 2,426, from which GEL 2,159, GEL 245, GEL 512 were recognized as a gain in other comprehensive income, loss in other operating expenses and reversal of negative revaluation of property and equipment in other income, respectively.

As of 31 December 2016 the Group analysed market prices for its premises and concluded that the market price of premises was not materially different from their carrying value. Refer to Note 24 for details on fair value measurements of the Group's premises.

If no revaluation of property and equipment had been performed, the original cost of property and equipment as of 31 December 2016 and 31 December 2015, recorded under the caption Land and Buildings would have amounted to GEL 32,275 (2015 – GEL 31,295) and accumulated depreciation would have amounted to GEL 10,626 (2015 – GEL 9,944).

The total value of fully depreciated property and equipment in use as of 31 December 2016 and 2015, amounted to GEL 8,946 and GEL 7,965 respectively.

(Thousands of Georgian lari)

11. Investment property

	2016	*2015*
Opening balance at 1 January	**26,678**	**24,352**
Additions	2,478	3,701
Disposals	(9,346)	(1,890)
Unrealized gain/(loss) on revaluation	526	515
Closing balance at 31 December	**20,336**	**26,678**

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 2016 net gains from disposal of investment property was GEL 2,449 (2015: GEL 908), the five largest gains comprised GEL 2,155 (88% of net gains from disposal of investment property), (2015: GEL 738 or 81.3%).

As of 31 December 2016, 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

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

The corporate income tax expense comprises:

	2016	*2015*
Current tax expense	(2,045)	-
Deferred expense – origination and reversal of temporary differences	2,793	(2,659)
Less: deferred tax recognised in other comprehensive income	(457)	324
Income tax benefit/(expense)	**291**	**(2,335)**

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:

	2016	*2015*
Income before income tax expense	**27,153**	**17,315**
Statutory tax rate	15%	15%
Theoretical income tax expense at the statutory rate	**(4,073)**	**(2,597)**
Change in unrecognized deferred tax assets (except expired portion)	-	1,286
Tax effect of expired portion of tax losses carried forward	-	(1,670)
Non-deductible expenses	(31)	(132)
Tax exempt income less income recognized for tax purposes only	1,000	778
Effect of change in tax code	3,395	-
Income tax benefit/(expense)	**291**	**(2,335)**

(Thousands of Georgian lari)

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		
	2014	*In the income statement*	*Directly in other compre-hensive income*	*2015*	*In the income statement*	*Directly in other compre-hensive income*	*2016*
Tax effect of deductible temporary differences							
Tax losses carried forward	2,571	(2,571)	-	-	-	-	-
Financial instruments adjustment for effective interest rates	1,391	(264)	-	1,127	341	-	1,468
Accrued expenses	1,176	30	-	1,206	234	-	1,440
Securities available-for-sale	161	-	-	161	(161)	-	
Other	307	(15)	-	292	(280)	-	12
Gross deferred tax assets	**5,606**	**(2,820)**	**-**	**2,786**	**134**	**-**	**2,920**
Unrecognized deferred tax asset	(1,286)	1,286	-	-	-	-	
Deferred tax assets	**4,320**	**(1,534)**	**-**	**2,786**	**134**	**-**	**2,920**
Tax effect of taxable temporary differences							
Allowance for loan impairment	(1,883)	(476)	-	(2,359)	1,230	-	(1,129)
Property and equipment	(1,050)	(139)	(324)	(1,513)	713	457	(343)
Investment property	(52)	(110)	-	(162)	162	-	-
Allowances for impairment and provision for other losses	(246)	(80)	-	(326)	97	-	(229)
Financial instruments adjustment for effective interest rate	(4)	4	-	-	-	-	-
Deferred tax liabilities	**(3,235)**	**(801)**	**(324)**	**(4,360)**	**2,202**	**457**	**(1,701)**
Net deferred tax assets/(liabilities)	**1,085**	**(2,335)**	**(324)**	**(1,574)**	**2,336**	**457**	**1,219**

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

The Group recognized income tax benefit resulting from reversal of deferred tax assets and liabilities in amount of GEL 3,395 in profit or loss, and benefit of GEL 457 in other comprehensive income (to the extent that it related to items previously recognised in other comprehensive income) for the year ended 31 December 2016.

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

(Thousands of Georgian lari)

13. Other assets and liabilities

Other assets comprise:

	2016	*2015*
Financial assets		
Unsettled transactions on money transfers	4,179	687
Derivative financial assets	142	2
Accrued commission receivable on guarantees and letters of credit	65	100
Accrued income for operating lease	3	12
Other	12	3
Total financial assets	**4,401**	**804**
Non-financial assets		
Intangible assets	7,927	2,338
Prepaid expenses	2,230	2,278
Advances paid	688	306
Inventories of repossessed collateral	620	-
Inventories in stock	367	135
Prepaid operational taxes	-	8
Other	4	223
Total non-financial assets	**11,836**	**5,288**
Other assets	**16,237**	**6,092**

The movement in intangible assets during 2016 and 2015 were as follows:

	Intangible assets
At cost	
1 January 2015	**2,769**
Additions	1,425
31 December 2015	**4,194**
Additions	6,158
31 December 2016	**10,352**
Accumulated amortisation and impairment	
1 January 2015	**(1,432)**
Amortization charge for the year	(424)
31 December 2015	**(1,856)**
Amortization charge for the year	(569)
31 December 2016	**(2,425)**
Net book value	
31 December 2015	**2,338**
31 December 2016	**7,927**

During the 2016, the Group has purchased software licenses under Microsoft Enterprise Agreement between VTB Group and Microsoft in the amount of GEL 5,559.

(Thousands of Georgian lari)

13. Other assets and liabilities (continued)

Other liabilities comprise:

	2016	*2015*
Financial liabilities		
Accrued bonuses	8,165	6,465
Unsettled transactions on money transfers	4,621	482
Settlements on plastic cards	2,147	2,257
Accrued expenses	1,506	1,110
Payables for unused vacations	978	933
Derivative financial liabilities	251	217
Settlements on acquisition of property and equipment and inventory	36	99
Other	41	-
Total financial liabilities	**17,745**	**11,563**
Non-financial liabilities		
Advances received	1,354	591
Operational taxes payable	1,048	36
Provisions for off-BS commitments	872	-
Dividends payable to shareholders of the Bank	605	387
Provision for legal claims	102	463
Total non-financial liabilities	**3,981**	**1,477**
Other liabilities	**21,726**	**13,040**

As of 31 December 2016 and 2015, the Group's derivative financial instruments comprised of foreign exchange forwards and swap 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:

	2016				*2015*			
	Notional amount		*Fair values*		*Notional amount*		*Fair values*	
	Asset	*Liability*	*Asset*	*Liability*	*Asset*	*Liability*	*Asset*	*Liability*
Foreign exchange contracts								
Forwards and Swaps – foreign	20,320	20,429	142	251	52,733	52,948	2	217
Total derivative assets/liabilities	**20,320**	**20,429**	**142**	**251**	**52,733**	**52,948**	**2**	**217**

14. Amounts due to banks and international financial institutions

	2016	*2015*
Loans received from the Parent bank	260,738	162,691
Time deposits and loans	25,175	59,329
Current accounts	262	2,992
Amounts due to banks and international financial institutions	**286,175**	**225,012**

As of 31 December 2016, loans received from the Parent bank had maturities ranging from January 2017 till March 2019 (2015: January 2016 till August 2016) and bear annual interest rates from 1.1% to 3.73% (2015: from 1% to 6.23%).

As of 31 December 2016, time deposits and loans had maturities ranging from January 2017 till June 2017 (As of 31 December 2015 time deposits and loans consist from one time deposit with maturity period in January 2016) and bear annual interest rates from 0% to 7% (2015: from 1.9% to 3.50%).

(Thousands of Georgian lari)

15. Amounts due to customers

	2016	*2015*
Individuals		
Current/demand accounts	121,821	104,446
Term deposits	191,156	163,843
Total due to individuals	**312,977**	**268,289**
State and budgetary organisations		
Current/settlement accounts	136,454	53,268
Term deposits	7,147	9,354
Total due to state and budgetary organisations	**143,601**	**62,623**
Commercial legal entities		
Current/settlement accounts	259,220	204,286
Term deposits	115,476	134,406
Total due to commercial legal entities	**374,696**	**338,693**
Total due to legal entities	**518,297**	**401,316**
Total amounts due to customers	**831,274**	**669,605**
Held as security against undrawn loan facilities	1,311	2,618
Held as security against guarantees issued	14,656	17,225
Held as security against letters of credit issued	-	11,964
Total amounts of cash held as security against letters of credit, undrawn loan facility and guarantees issued	**15,967**	**31,807**
Held as security against settlement operations	7,725	509

At 31 December 2016, amounts due to customers of GEL 331,786 (39.91%) were due to the ten largest third party customers (2015 – GEL 209,765 (31.33%).

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:

	2016	*2015*
Individuals	312,977	268,289
Government	143,601	62,623
Transport and communication	112,833	78,882
Energy	71,162	56,662
Trade and service	67,883	86,222
Finance	58,777	42,308
Real estate constructions	39,042	37,262
Manufacturing	13,009	23,434
Education	4,977	5,774
Agriculture	1,238	2,010
Other	5,775	6,139
Amounts due to customers	**831,274**	**669,605**

16. Debt securities issued

From July 2015, Group had started issuance of debt security deposits. As of 31 December 2016, debt securities comprised of discount certificate deposits with amount of 26,006 with maturities ranging from 9 January 2017 till 15 June 2021 (2015: GEL 4,230, from 31 March 2016 till 2 December 2017) and coupon certificate deposits with amount of GEL 5,684 with maturities ranging from 3 January 2017 till 3 April 2021 (2015: GEL 1,012, 9 March 2016 till 12 November 2016). Certificates of deposit may be freely resold or otherwise assigned to any third party without prior notification of the Bank.

(Thousands of Georgian lari)

17. Other borrowed funds

	2016	*2015*
Borrowings from the Parent bank	79,340	31,827
Borrowings from NBG	35,009	47,000
Borrowings from international financial institutions	22,197	32,711
Borrowings from government organizations	2,476	3,197
Other borrowed funds	**139,022**	**114,735**

As of 31 December 2016, maturities of borrowings from the Parent bank were ranging from February 2017 till December 2021 (2015: from February 2016 till September 2019), annual interest rates from 2.07% to 6.28% (2015: from 3.37% to 6.28%). Refer to Note 26.

As of 31 December 2016 borrowings from international financial institutions contained facilities in U.S. dollars and Euro with maturities ranging from January 2017 to December 2032 (2015: from January 2017 to December 2032) and interest rates from Libor + 5% to Libor + 5.25% and one loan bearing annual interest at 0.75% (2015: from Libor + 5% to Libor + 5.25%; 0.75%).

As of 31 December 2016 borrowings from government organizations contained facilities received from Municipal Development Fund of Georgia to finance energy sector companies. The borrowings are denominated in EUR, bear annual interest rate of 3% (2015: 3%) and with maturities ranging from May 2018 to November 2021 (2015: from May 2018 to November 2021).

As of 31 December 2016, GEL 35,009 (2015: GEL 47,000) borrowings from National Bank of Georgia were received under the securities of Ministry of Finance of Georgia with total nominal value of GEL 36,900 pledged as collateral. (2015: securities of Ministry of Finance of Georgia with total nominal value of GEL 9,024, securities of National Bank of Georgia with total nominal value of GEL 37,613 and loans and advances to customers with total nominal value of GEL 4,289). The borrowings were matured in January 2017 (2015: January 2016) and bears annual interest rates from 6.7% to 8% (2015: 9.5%).

18. 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 2014	**171,292,701**	**171,292,701**	**171,293**
Increase in share capital	20,000,000	20,000,000	20,000
31 December 2015	**191,292,701**	**191,292,701**	**191,293**
31 December 2016	**191,292,701**	**191,292,701**	**191,293**

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 13 October 2015 the Shareholders made a decision to increase the number of authorized ordinary shares by 20,000,000. Related share issue prospectus was approved by the National Bank of Georgia on 23 October 2015. The consideration received for these shares comprised of cash for the total amount of GEL 20,000. There was no movement in share capital during 2016.

Perpetual subordinated loan

On 29 December 2016, the Group issued perpetual subordinated loan for RUB 300,000. As at 31 December 2016, the carrying amount of the perpetual subordinated loan is GEL 12,900. The perpetual subordinated loan has an unlimited term and are redeemable at the Group's option. Coupon rate comprises Central Bank of Russia key rate + 2.5%. The Group has, at its sole discretion, an unconditional right to cancel interest payments by giving notice to the issuer before the payment date.

(Thousands of Georgian lari)

18. Equity (continued)

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. The NBG 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 NBG.

On 22 April 2016, the annual general meeting of shareholders of the Bank declared 2016 dividends comprising GEL 8,231 or Georgian lari 0.04 per share, based on 2015 separate financial statements prepared in accordance with the NBG requirements. Dividends in the amount of GEL 8,013 were paid to shareholders in 2016.

19. Commitments and contingencies

Operating environment

As a small-scale and open economy, the Georgian Economy is sensitive to regional and global challenges. Reduced exports to Georgia's main trading partners, combined with falling remittances, cause income and domestic demand to decline, which puts pressure on the exchange rate. The economic growth rate is still low in the region, mainly effected by the global economic situation.

However, over the last few years the Georgian government has made a number of developments that positively affect the overall investment climate of the country, specifically implementing the reforms necessary to create banking, judicial, taxation and regulatory systems. This includes the adoption of a new body of legislation (including new Tax Code and procedural laws).

In year 2016, economic of Georgia experienced growth of 2.2% (2015: 2.8%), and inflation rate ended up at 1.8%.

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 outflow of resources and accordingly provisions have been made in these consolidated financial statements. Refer to Note 13.

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

	2016	*2015*
Credit related commitments		
Guarantees issued	81,197	79,195
Undrawn loan facilities	68,409	67,759
Other credit-related commitments	8,657	3,535
Letters of credit	1,565	19,861
Financial commitments and contingencies (before deducting collateral)	**159,828**	**170,350**
Less – cash held as security against letters of credit, undrawn loan facility and guarantees issued (Note 15)	(15,967)	(31,807)
Financial commitments and contingencies	**143,861**	**138,543**
Operating lease commitments		
Not later than 1 year	1,250	777
Later than 1 year but not later than 5 years	4,246	2,766
Later than 5 years	1,549	901
	7,045	**4,444**

(Thousands of Georgian lari)

20. Net fee and commission income

	2016	*2015*
Commission on settlements operations	8,657	7,606
Commission on guarantees and other credit related commitments	3,324	3,524
Commission on cash operations	2,015	1,620
Other	260	178
Fee and commission income	**14,256**	**12,928**
Commission on settlements operations	(6,301)	(5,263)
Commission on cash operations	(1,955)	(1,988)
Commission on guarantees and other credit related commitments	(824)	(586)
Other	(51)	(71)
Fee and commission expense	**(9,131)**	**(7,908)**
Net fee and commission income	**5,125**	**5,020**

21. Other income

	2016	*2015*
Penalties received from lending operations	6,615	5,958
Income from operating lease	525	652
Penalties received for deposit redemption before maturity	430	418
Reimbursement of integrated marketing communication campaign costs	141	171
Reimbursement of the principal amount of eligible losses on EBRD Sub-loans	30	189
Income from disposal of property	6	-
Reimbursement of legal fees	5	17
Reimbursement of losses from insurance companies	1	6
Reversal of negative revaluation of land and buildings	-	512
Other	14	69
Other income	**7,767**	**7,992**

22. Personnel and other operating expenses

	2016	*2015*
Salaries	25,059	23,695
Bonuses and premiums	11,692	9,464
Personnel expenses	**36,751**	**33,159**
Occupancy and rent	2,852	2,694
Marketing and advertising	1,922	2,218
Computer software maintenance	1,545	1,192
Legal and consultancy	1,017	1,266
Office supplies	961	923
Repairs and maintenance of property and equipment	911	1,314
Utilities	880	771
Communications	732	735
Operating taxes	606	405
Representation expenses	595	636
Amortisation of intangible assets	569	424
Business travel and related expenses	485	435
Other operating expenses on plastic cards operation	200	449
Insurance	169	179
Charity	85	275
Security	99	94
Impairment charge for property and equipment	57	25
Loss on revaluation of property and equipment	-	245
Other	675	489
Other operating expenses	**14,360**	**14,769**

(Thousands of Georgian lari)

23. 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.

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.

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 2016 Risk Department consisted of the following sub-divisions:

- Consolidated risk analysis division;
- Corporate credit risk division;
- Retail credit risk division;
- Market and operational risks division;
- Collateral evaluation and monitoring group;
- Credit deals 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.

(Thousands of Georgian lari)

23. Risk management (continued)

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.

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, 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.

(Thousands of Georgian lari)

23. Risk management (continued)

Credit risk (continued)

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.

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

		Neither past due nor impaired			*Past due or individually impaired*	
	Notes	*High grade 2016*	*Standard grade 2016*	*Sub-standard grade 2016*	*2016*	*Total 2016*
Cash in credit organisations	6	110,128	156,782	-	-	**266,910**
Amounts due from banks and international financial institutions	7	142,053	122	-	-	**142,175**
Investment securities available-for-sale	9	80,459				**80,459**
Loans and advances to customers	8					
Corporate lending		91,032	231,314	49,574	26,668	**398,589**
Small business lending		195,516	-	4,044	2,664	**202,223**
Consumer lending		284,111	25,063	8,499	9,667	**327,340**
Loans to individuals secured with deposits		5,612	-	-	-	**5,612**
		576,271	**256,377**	**62,117**	**38,999**	**933,764**
Other financial assets	13	-	4,401	-	-	**4,401**
Total		**908,911**	**417,682**	**62,117**	**38,999**	**1,427,709**

		Neither past due nor impaired			*Past due or individually impaired*	
	Notes	*High grade 2015*	*Standard grade 2015*	*Sub-standard grade 2015*	*2015*	*Total 2015*
Cash in credit organisations	6	206,891	215	-	-	**207,106**
Amounts due from banks and international financial institutions	7	85,145	90	-	-	**85,235**
Investment securities available-for-sale	9	55,533	-	-	-	**55,533**
Loans and advances to customers	8					
Corporate lending		115,406	107,633	90,864	8,252	**322,155**
Small business lending		147,143	-	2,376	2,765	**152,284**
Consumer lending		218,209	31,299	6,459	9,115	**265,082**
Loans to individuals secured with deposits		6,871	-	-	-	**6,871**
		487,629	**138,932**	**99,699**	**20,132**	**746,392**
Other financial assets	13	-	804	-	-	**804**
Total		**835,198**	**140,041**	**99,699**	**20,132**	**1,095,070**

(Thousands of Georgian lari)

23. Risk management (continued)

Credit risk (continued)

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.

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

As of 31 December 2016	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Loans and advances to customers					
Corporate lending	20,855	494	694	890	**22,933**
Consumer lending	5,482	1,413	1,372	1,121	**9,388**
Small business lending	903	507	708	246	**2,364**
Total	**27,240**	**2,414**	**2,774**	**2,257**	**34,685**

As of 31 December 2015	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Loans and advances to customers					
Corporate lending	4,474	2,124	97	676	**7,371**
Consumer lending	4,835	1,074	551	2,312	**8,772**
Small business lending	1,243	589	384	139	**2,355**
Total	**10,552**	**3,787**	**1,032**	**3,127**	**18,498**

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 (restructured or refinanced) financial assets, by class.

	2016	*2015*
Loans and advances to customers		
Corporate lending	3,920	7,295
Consumer lending	9,338	6,535
Small business lending	4,622	3,140
Total	**17,880**	**16,970**

(Thousands of Georgian lari)

23. Risk management (continued)

Credit risk (continued)

Impairment assessment

Impairment losses are recognized in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Group determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Group considers in determining whether a financial asset is impaired include any known financial difficulties of counterparties, infringement of the original terms of the contract, whether any payments of principal or interest is overdue and the reliability of related collateral if any.

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.

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.

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

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

(Thousands of Georgian lari)

23. Risk management (continued)

Credit risk (continued)

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

	2016				*2015*			
	Georgia	*OECD*	*CIS and other foreign countries*	*Total*	*Georgia*	*OECD*	*CIS and other foreign countries*	*Total*
Assets								
Cash and cash equivalents	106,358	19,530	190,448	**316,336**	134,803	57,189	75,784	**267,776**
Amounts due from banks and international financial institutions	141,921	132	122	**142,175**	84,937	208	90	**85,235**
Loans and advances to customers	922,465	6,192	5,107	**933,764**	738,933	4,146	3,313	**746,392**
Investment securities – available-for-sale	80,513	–	–	**80,513**	55,587	–	–	**55,587**
Other financial assets	4,265	–	136	**4,401**	804	–	–	**804**
	1,255,522	25,854	195,813	1,477,189	1,015,064	61,543	79,187	1,155,794
Liabilities								
Amounts due to banks and international financial institutions	25,247	–	260,927	**286,174**	62,064	–	162,948	**225,012**
Amounts due to customers	693,206	31,470	106,598	**831,274**	578,230	31,216	60,159	**669,605**
Debt securities issued	24,646	1,237	5,807	**31,690**	4,668	243	331	**5,242**
Other borrowed funds	37,486	22,196	79,340	**139,022**	50,197	32,711	31,827	**114,735**
Subordinated loan	–	–	37,759	**37,759**	–	–	33,329	**33,329**
Other financial liabilities	17,509	–	236	**17,745**	11,384	–	179	**11,563**
	798,094	54,903	490,667	1,343,664	706,543	64,170	288,773	1,059,486
Net assets/(liabilities)	457,428	(29,049)	(294,854)	133,525	308,521	(2,627)	(209,586)	96,308
Net financial commitments	157,792	62	1,975	159,829	167,908	84	2,358	170,350

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.

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, a 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.

(Thousands of Georgian lari)

23. Risk management (continued)

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 2016 and 2015 the ratio was as follows:

	2016	*2015*
LK "Average Liquidity Ratio" (Average monthly volume of liquid assets / Average monthly volume of liabilities)	44%	32%

In 2016 minimum limit of average liquidity ratio is 30% (2015: 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 2016 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 2016	*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	175,786	913	7,725	983	110,038	**295,445**
Amounts due to customers	545,355	79,015	48,638	110,713	59,574	**843,295**
Debt securities issued	2,673	4,276	9,197	6,207	11,687	**34,040**
Other borrowed funds	41,543	17,580	13,249	12,605	61,218	**146,195**
Subordinated loan	757	-	740	1,505	44,397	**47,399**
Other liabilities	10,147	2,272	4,302	944	80	**17,745**
Total cash flow payable under non-derivative liabilities	**776,261**	**104,056**	**83,851**	**132,957**	**286,994**	**1,384,119**
Derivative financial instruments-gross settled						
Positive fair value of derivatives						
(Inflow)	(566)	(2,795)	-	-	-	**(3,361)**
Outflow	559	2,660	-	-	-	**3,219**
Derivative financial instruments-gross settled						
Negative fair value of derivatives						
(Inflow)	(11,825)	(5,134)	-	-	-	**(16,959)**
Outflow	11,917	5,293	-	-	-	**17,210**

(Thousands of Georgian lari)

23. Risk management (continued)

Liquidity risk and funding management (continued)

Non-derivative liabilities As of 31 December 2015	*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	134,339	721	846	90,909	-	**226,815**
Amounts due to customers	403,640	84,579	87,582	67,083	37,330	**680,214**
Debt securities issued	–	139	83	4,884	427	**5,533**
Other borrowed funds	52,231	3,334	1,514	9,850	53,870	**120,799**
Subordinated loan	609	-	603	1,212	41,042	**43,466**
Other liabilities	3,377	2,887	3,815	1,418	66	**11,563**
Total cash flow payable under non-derivative liabilities	**594,196**	**91,660**	**94,443**	**175,356**	**132,735**	**1,088,390**
Derivative financial instruments-gross settled						
Positive fair value of derivatives						
(Inflow)	(395)	-	-	-	-	**(395)**
Outflow	393	-	-	-	-	**393**
Derivative financial instruments-gross settled						
Negative fair value of derivatives						
(Inflow)	(39,253)	(13,085)	-	-	-	**(52,338)**
Outflow	39,426	13,129	-	-	-	**52,555**

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*
2016	20,730	17,004	15,866	52,127	54,101	**159,828**
2015	35,104	16,655	24,155	43,783	50,653	**170,350**

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.

(Thousands of Georgian lari)

23. Risk management (continued)

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.

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 2016*	*Sensitivity of pre-tax income 2016*
USD	0.20%	(89)
USD	(0.20%)	89
GEL	1.25%	(47)
GEL	(1.25%)	47

Currency	*Increase in basis points 2015*	*Sensitivity of pre-tax income 2015*
USD	0.17%	(87)
USD	(0.17%)	87
GEL	2.50%	(162)
GEL	(2.50%)	162

Currency risk

The Group is exposed to currency risk. Currency risk arises from open position in foreign currencies and adverse movements of market exchange rates that may have a negative impact on financial performance of the Group. The Management Board has set limits on positions by currency based on the NBG's regulations. Positions are monitored on a daily basis.

(Thousands of Georgian lari)

23. Risk management (continued)

Market risk (continued)

The tables below indicate the currencies to which the Group had significant exposure at 31 December 2016 and 2015 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% 2016*	*Effect on profit before tax 2016*	*Increase in currency rate in% 2015*	*Effect on profit before tax 2015*
USD	14%	4,206	15%	3,478
EUR	17.5%	30	20%	(6)
RUB	30%	21	20%	139

Currency	*Decrease in currency rate in% 2016*	*Effect on profit before tax 2016*	*Decrease in currency rate in% 2015*	*Effect on profit before tax 2015*
USD	(7%)	(2,103)	(11%)	(2,551)
EUR	(10.5%)	(18)	(16%)	5
RUB	(15%)	(11)	(30%)	(209)

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
2016	12,689
2015	11,685

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 2016, the Group obtained Banker's Blanket Bond and Computer Crime insurance on a total insured sum of GEL 2, 647 (2015: GEL 2,395) from "IC-Group" insurance company. Total sum of insurance was reinsured by "AIG Europe" insurance company.

(Thousands of Georgian lari)

24. Fair value measurements

The Group's Board of directors determines the policies and procedures for recurring fair value measurement, such as investment property and buildings.

External valuers are involved for valuation of significant assets, such as investment property and buildings. Involvement of external valuers is decided upon annually by the Board of directors. Selection criteria include market knowledge, reputation, independence and whether professional standards are maintained. The Board of directors decides, after discussions with the Bank's Group's external valuers, which valuation techniques and inputs to use for each case.

At each reporting date, the Board of directors analyses the movements in the values of assets and liabilities which are required to be re-measured or re-assessed as per the Group's accounting policies. For this analysis, the board of directors in conjunction with Group's external valuers verifies the major inputs applied in the latest valuation by agreeing the information in the valuation computation to contracts and other relevant documents.

Fair value hierarchy

For the purpose of fair value disclosures, the Group's has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability. The following tables show analysis of assets and liabilities measured at fair value or for which fair values are disclosed by level of the fair value hierarchy:

At 31 December 2016	*Level 1*	*Level 2*	*Level 3*	*Total*
Assets measured at fair value				
Investment securities available for sale	-	80,459	54	**80,513**
Total investment property	-	-	20,336	**20,336**
Land	-	-	3,565	**3,565**
Residential properties	-	-	8,478	**8,478**
Non-residential properties	-	-	8,293	**8,293**
Total revalued land and premises	-	-	25,482	**25,482**
Land	-	-	186	**186**
Office buildings	-	-	17,063	**17,063**
Service centers/means of production	-	-	8,233	**8,233**
Derivative financial assets	-	142	-	**142**
Assets for which fair values are disclosed				
Cash and cash equivalents	49,426	266,910	-	**316,336**
Amounts due from banks and international financial institutions	-	142,175	-	**142,175**
Loans to customers	-	-	944,233	**944,233**
Liabilities measured at fair value				
Derivative financial liabilities	-	251	-	**251**
Liabilities for which fair values are disclosed				
Amounts due to banks and international financial institutions	-	286,175	-	**286,175**
Amounts due to customers	-	-	833,861	**833,861**
Debt securities issued	-	-	32,321	**32,321**
Other borrowed funds	-	137,197	-	**137,197**
Subordinated loans	-	37,759	-	**37,759**

(Thousands of Georgian lari)

24. Fair value measurements (continued)

Fair value hierarchy (continued)

At 31 December 2015	*Level 1*	*Level 2*	*Level 3*	*Total*
Assets measured at fair value				
Investment securities available for sale	-	55,533	54	**55,587**
Total investment property	-	-	26,678	**26,678**
Land	-	-	4,098	**4,098**
Residential properties	-	-	7,172	**7,172**
Non-residential properties			15,408	**15,408**
Total revalued land and premises	-	-	25,035	**25,035**
Land	-	-	186	**186**
Office buildings	-	-	16,439	**16,439**
Service centers/means of production	-	-	8,410	**8,410**
Derivative financial assets	-	2	-	**2**
Assets for which fair values are disclosed				
Cash and cash equivalents	60,670	207,106	-	**267,776**
Amounts due from banks and international financial institutions	-	85,235	-	**85,235**
Loans to customers	-	-	756,652	**756,652**
Liabilities measured at fair value				
Derivative financial liabilities	-	217	-	**217**
Liabilities for which fair values are disclosed				
Amounts due to banks and international financial institutions	-	225,012	-	**225,012**
Amounts due to customers	-	-	671,591	**671,591**
Debt securities issued	-	-	5,242	**5,242**
Other borrowed funds	-	112,841	-	**112,841**
Subordinated loan	-	33,329	-	**33,329**

During the years ended 31 December 2016 and 2015, there have been no transfers between levels of fair value hierarchy.

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 2016	*Fair value 2016*	*Unrecognised gain/(loss) 2016*	*Carrying value 2015*	*Fair value 2015*	*Unrecognised gain/(loss) 2015*
Financial assets						
Amounts due from banks and international financial institutions	142,175	142,175	-	85,235	85,235	-
Loans and advances to customers	933,764	944,233	10,469	746,392	756,652	10,260
Financial liabilities						
Amounts due to banks and international financial institutions	286,175	286,175	-	225,012	225,012	-
Amounts due to customers	831,274	833,861	(2,587)	669,605	671,591	(1,986)
Debt securities issued	31,690	32,321	(631)	5,242	5,242	-
Other borrowed funds	139,022	137,197	1,825	114,735	112,841	1,894
Subordinated loan	37,759	37,759	-	33,329	33,329	-
Total unrecognised change in unrealised fair value			**9,076**			**10,168**

(Thousands of Georgian lari)

24. Fair value measurements (continued)

Fair value hierarchy (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.

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are already recorded at fair value in the consolidated financial statements.

Investment securities available-for-sale

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.

Derivatives

Derivatives valued using a valuation technique with market observable inputs are mainly interest rate swaps, currency swaps and forward foreign exchange contracts. The most frequently 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.

Property and equipment (buildings and land) and investment property

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

(Thousands of Georgian lari)

24. Fair value measurements (continued)

Fair value hierarchy (continued)

Description of significant unobservable inputs to valuations of non-financial assets

The following tables show descriptions of significant unobservable inputs to level 3 valuations of investment properties and revalued properties and equipment as of 31 December 2016:

	Amount	*Valuation technique*	*Significant unobservable inputs*	*Range (weighted average) in*	*Other key information*	*Range (weighted average)*	*Sensitivity of the input to fair value*
Investment property	**20,336**						
Land	3,565	Market approach	Price per square metre	0.18-260,69 (40.08) Georgian lari	Square metre	79-22,939 (3,238)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 350
Residential properties	8,478	Market approach	Price per square metre	12–2,520.2 (545.14) Georgian lari	Square metre	21-746 (146)	10 % increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 851
Non-residential properties	**8,293**						
	7,683	Market approach	Price per square metre	3.4-2,520.2 (906.27) Georgian lari	Square metre	8-16,472 (332)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 720
	610	Income approach	Cap. rate	14.5%			10% increase (decrease) in the cap. rate would result in increase (decrease) in fair value by 54
Revaluated land and premises	**25,482**						
Land	186	Market approach	Price per square metre	0.18-260,69 (40.08) Georgian lari	Square metre	79-22,939 (3,238)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 19
Office buildings	17,063	Market approach	Price per square metre	2,380-2,666 (2,475) Georgian lari	Square metre	2,000–2,500 (2,333)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,656
Service centers / means of production	8,233						
	8,066	Market approach	Price per square metre	216-11,965 (2,823) Georgian lari	Square metre	61-1,100 (196)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 420
	167		Cap. rate	13.25%	Square metre		10% increase (decrease) in the cap. rate would result in increase (decrease) in fair value by 12

(Thousands of Georgian lari)

24. Fair value measurements (continued)

Fair value hierarchy (continued)

The following tables show descriptions of significant unobservable inputs to level 3 valuations of investment properties and revalued properties and equipment as of 31 December 2015:

	Amount	*Valuation technique*	*Significant unobservable inputs*	*Range (weighted average) in*	*Other key information*	*Range (weighted average)*	*Sensitivity of the input to fair value*
Investment property	**26,678**						
Land	4,098	Market approach	Price per square metre	0.06-444.44 (43.5) Georgian lari	Square metre	29-22,902 (3,696)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 397
Residential properties	7,172	Market approach	Price per square metre	0.37-2,163.6 (532.2) Georgian lari	Square metre	22-2,702 (176)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 725
Non-residential properties	**15,408**						
	13,908	Market approach	Price per square metre	0.93-3,120.6 (1,028.9) Georgian lari	Square metre	7-30,001 (612)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,321
	1,500	Income approach	Cap. rate	15.29%-15.29% (15.29%)			10% increase (decrease) in the cap rate would result in increase (decrease) in fair value by 151
Revaluated land and premises	**25,035**						
Land	186	Market approach	Price per square metre	0.06-444.44 (43.5) Georgian lari	Square metre	29-22,902 (3,696)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 19
Office buildings	16,439	Market approach	Price per square metre	2,380-2,666 (2,475) Georgian lari	Square metre	2,000-2,500 (2,333)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 1,596
Service centers / means of production	8,410						
	8,240	Market approach	Price per square metre	216-11,965 (2,823) Georgian lari	Square metre	61-1,100 (196)	10% increase (decrease) in the price per square metre would result in increase (decrease) in fair value by 428
	170		Cap. rate	13.25%	Square metre		10% increase (decrease) in the cap.rate would result in increase (decrease) in fair value by 12

(Thousands of Georgian lari)

25. Maturity analysis of financial assets and liabilities

The table below shows assets and liabilities at 31 December 2016 by their remaining expected maturity. Refer to Note 23 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";
- Loans and advances to customers, Investment securities available-for-sale, amounts due from banks and international financial institutions, other assets, amounts due to banks and international financial institutions, debt securities issued, other borrowed funds, Subordinated debt 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.

	2016							
	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	316,336	-	-	-	-	-	-	**316,336**
Amounts due from banks and international financial institutions	42,446	9,769	22,268	22,545	45,147	-	-	**142,175**
Loans and advances to customers	43,109	103,487	95,044	153,966	532,425	5,733	-	**933,764**
Investment securities - available-for-sale	37,958	19,686	7,357	9,131	6,327	-	54	**80,513**
Other financial assets	3,859	315	-	131	96	-	-	**4,401**
Total	**443,708**	**133,257**	**124,669**	**185,773**	**583,995**	**5,733**	**54**	**1,477,189**
Financial liabilities								
Amounts due to banks and international financial institutions	174,844	10	6,772	-	104,549	-	-	**286,175**
Amounts due to customers	209,003	82,680	48,408	107,035	384,148	-	-	**831,274**
Debt securities issued	2,666	4,239	9,023	5,966	9,796	-	-	**31,690**
Other borrowed funds	41,491	17,115	12,561	11,424	56,431	-	-	**139,022**
Subordinated debt	563	-	-	-	37,196	-	-	**37,759**
Other financial liabilities	10,147	2,272	4,302	944	80	-	-	**17,745**
Total	**438,714**	**106,316**	**81,066**	**125,369**	**592,200**	**-**	**-**	**1,343,665**
Net	**4,994**	**26,941**	**43,603**	**60,404**	**(8,205)**	**5,733**	**54**	**133,524**
Cumulative gap	**4,994**	**31,935**	**75,538**	**135,942**	**127,737**	**133,470**	**133,524**	**-**

(Thousands of Georgian lari)

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

	2015							
	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	267,776	-	-	-	-	-	-	**267,776**
Amounts due from banks and international financial institutions	19,766	12,094	7,526	22,587	23,262	-	-	**85,235**
Loans and advances to customers	49,608	65,105	85,005	121,193	421,434	4,047	-	**746,392**
Investment securities - available-for-sale	9,983	19,424	18,860	1,385	5,881	-	54	**55,587**
Other financial assets	782	13	-	8	1	-	-	**804**
Total	347,915	96,636	111,391	145,173	450,578	4,047	54	1,155,794
Financial liabilities								
Amounts due to banks and international financial institutions	134,265	157	-	90,590	-	-	-	**225,012**
Amounts due to customers	116,986	105,307	101,890	65,596	279,826	-	-	**669,605**
Debt securities issued	-	138	81	4,643	380	-	-	**5,242**
Other borrowed funds	52,145	3,157	1,112	8,880	49,441	-	-	**114,735**
Subordinated debt	454	-	-	-	32,875	-	-	**33,329**
Other financial liabilities	3,377	2,887	3,815	1,418	66	-	-	**11,563**
Total	307,227	111,646	106,898	171,127	362,588	-	-	1,059,486
Net	40,688	(15,010)	4,493	(25,954)	87,990	4,047	54	96,308
Cumulative gap	40,688	25,678	30,171	4,217	92,207	96,254	96,308	-

As of 31 December 2016, total amount of funding obtained from the Parent bank amounted to GEL 378,022 (2015: GEL 228,100). 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 26.

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.

26. Related party disclosures

As of 31 December 2016 and 2015, outstanding balances on related party transactions are as follows:

	2016			*2015*		
	The Parent bank	*Entities under common control*	*Key management personnel*	*The Parent bank*	*Entities under common control*	*Key management personnel*
Cash and cash equivalents	33,668	167,722	-	75,577	14,920	-
Loans and advances to customers, gross	-	-	149	-	-	440
Less: allowance for impairment	-	-	-	-	-	-
Loans and advances to customers, net	-	-	149	-	-	440
Other assets	135	-	-	-	-	-
Amounts due to banks and international financial institutions	260,923	4	-	162,944	4	-
Amounts due to customers	-	19,488	4,253	-	10,244	4,266
Debt securities issued	-	-	2,903	-	-	-
Other borrowed funds (Note 17)	79,340	-	-	31,827	-	-
Subordinated loan	37,759	-	-	33,329	-	-
Other liabilities	269	-	4,191	230	-	3,621
Commitments and guarantees issued	-	28	88	-	28	95

(Thousands of Georgian lari)

26. 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. On 13 October 2014, the Group entered into a subordinated loan agreement with the Parent bank for the total amount of RUB 126,400, with interest rate of 11% payable quarterly and maturity on 13 October 2021. In the case of a liquidation of the Group, these loans are only repayable after all the obligations to the Group senior creditors have been met.

As of 31 December 2016 other liabilities to key management personnel comprised of accrued bonuses totalling GEL 4,058 (2015: GEL 3,490) and unpaid vacation of GEL 133 (2015: GEL 131).

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

	2016			*2015*		
	The Parent bank	*Entities under common control*	*Key management personnel*	*The Parent bank*	*Entities under common control*	*Key management personnel*
Interest income	7	1,041	25	5	2	49
Interest expense	(8,961)	(956)	(258)	(10,330)	(701)	(203)
Fee and commission income	–	39	3	–	34	7
Fee and commission expense	(137)	(20)	–	(165)	(28)	–
Net gains from foreign currencies dealing	355	439	13	(704)	637	23
Other operating expenses	–	(33)	–	–	(18)	–

For the year ended 31 December 2016, remuneration of the members of the key management personnel comprised salaries, bonuses and other staff related expenses totalling GEL 7,571 (2015: GEL 6,525).

Key management personnel as of 31 December 2016 comprise 5 members of the Supervisory Board and 6 members of the Management Board of the Bank (2015: 7 members of the Supervisory Board and 6 members of the Management Board).

The Group had no significant transactions with members of the Supervisory Board in 2016 and 2015.

27. 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.

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 regulatory capital adequacy ratio of 10.8% (2015: 11.4%) of risk-weighted assets, computed based on the NBG guidelines. As of 31 December 2016 the Bank's statutory regulatory capital adequacy ratio as calculated in accordance with the NBG requirements was 11.69% (2015: 13.31%).

(Thousands of Georgian lari)

27. Capital adequacy (continued)

Capital adequacy ratio (continued)

The NBG also requires banks to maintain a minimum tier one capital adequacy ratio of 7.2% (2015: 7.6%) of risk-weighted assets, computed based on the NBG guidelines. As of 31 December 2016 the Bank's statutory tier one capital adequacy ratio as calculated in accordance with the NBG requirements was 7.64% (2015: 9.96%).

Besides from 30 June 2014 the NBG also requires fulfilment of capital adequacy ratios computed in accordance with Basel II/III with some modifications by the NBG requirements. The requirements for banks are to maintain a minimum common equity tier one capital, total tier one capital and total regulatory capital adequacy ratios of 7%, 8.5% and 10.5% of risk-weighted assets, respectively are computed based on the NBG guidelines. The Bank was in compliance with these capital adequacy ratios as of 31 December 2016 and 2015. The Bank's capital adequacy ratios on this basis were as follows:

	2016	*2015*
Common Equity Tier 1 capital	137,666	133,717
Additional Tier 1 capital	12,900	-
Tier 1 capital	150,566	133,717
Tier 2 capital	34,822	35,648
Total regulatory capital for ratio calculation	**185,388**	**169,365**
Risk weighted assets	**1,703,103**	**1,320,031**
Common Equity Tier 1 capital adequacy ratio	**8.08%**	**10.13%**
Tier 1 capital adequacy ratio	**8.84%**	**10.13%**
Total capital adequacy ratio	**10.89%**	**12.83%**

Capital adequacy ratio of the Bank in accordance with Basel I computed on IFRS-based of the groups consolidated financial statements as modified by the NBG requirements is as follows:

	2016	*2015*
Tier 1 capital	170,892	157,022
Tier 2 capital	44,709	33,567
Total regulatory capital for ratio calculation	215,601	**190,589**
Risk weighted assets	**1,171,090**	**951,418**
Capital adequacy ratio	**18.41%**	**20.03%**