TBC Bank Audit Committee Report 2014

Approved on 3 March 2014

Committee Membership and Qualifications

I am pleased to have taken over the chairmanship of the Audit Committee in March 2014 following the retirement of Emile Groot from the Board. I was first appointed as a member of the Committee in 2013. Emile helped to establish the Bank's Audit Committee, chairing it in the years since 2011, leading up to the Bank's successful IPO in June 2014. I would like to express our deep appreciation of Emile's contribution. In addition to Emile, the Audit Committee also saw the resignations in December 2014, again following the Bank's IPO, of its remaining members who were not on the Supervisory Board of the Bank, Givi Lemonjava and Levan Zuroshvili. They had originally joined the Committee in the context of Georgia's Banking Law which stipulates that audit committees should include only independent members who are not on a bank's board; TBC subsequently obtained a derogation from the National Bank of Georgia to allow inclusion of Supervisory Board committee members in line with international norms. The Committee is very appreciative of their good work over many years and I am pleased to report that Givi has agreed to stay on as adviser to the Committee.

The Committee now comprises in total four non-executive directors of whom two are INEDs, Nikoloz Enukidze (joined the Committee in 2013) and Stefano Marsaglia (joined in June 2014); both nominations were considered and approved by the Board's Corporate Governance and Nomination Committee. The other two, Eric Rajendra (appointed to the Committee in 2012) and myself, were originally nominated to the Supervisory Board by two of the Bank's equity investing IFIs, IFC and EBRD respectively. Nikoloz has in the past been Chairman of Bank of Georgia and Stefano is Executive Chairman of Corporate and Investment Banking at Mediobanca having been Chairman of the Global Financial Institutions Group at Barclays Corporate and Investment Bank.

All current members of the Committee (see biographies on page x of the Annual Report) possess a detailed understanding of the financial sector, with backgrounds primarily in banking, and most serve or have served on (or chaired) other banks' audit committees. The Committee therefore has sufficient recent and relevant expertise to operate effectively and calls upon other expert internal and external resources where required.

Committee Role and Meetings

The Audit Committee, with delegated authority from the Supervisory Board, has multiple areas of responsibility and focus. Its first priority is to ensure the integrity (accuracy and full disclosure) of the Bank's financial reporting, looking hardest at areas of reporting risk and supervising the proper interpretation of accounting rules. Secondly, the Committee oversees the Bank's systems of internal control in relation to financial reporting, fraud, and compliance with prevailing laws and regulations, also evaluating management's competence in this task. The Committee relies heavily on Internal Audit to provide an objective and professionally sceptical view of how the Bank is handling a number of key reporting and record-keeping risks. The Committee also makes recommendations on the appointment and remuneration of external auditors and seeks to maximise the value of the external audit relationship.

In relation to risk, the Bank has a separate Risk committee (on which I sit) and, while there are areas of overlap (mostly in relation to operational risk) with the jurisdiction of the Audit Committee, the two committees each have clearly defined responsibilities and cooperate extensively to minimise duplication and ensure nothing is overlooked.

The Audit Committee has joined other Supervisory Board committees of the Bank in building an active direct dialogue with the National Bank of Georgia as we regard providing ongoing comfort to and obtaining feedback from the regulatory authorities as part of our role of supervising the best interests of all stakeholders in the Bank.

The Committee is fully conscious of the Bank's new status as a listed company on the London Stock Exchange – the heightened investor and regulatory scrutiny that this rightfully brings as well as pressures on management to show performance – and has stepped up its oversight function. The Bank is continuing to grow at a fast pace and this growth is likely to be sustained so long as the Georgian economy continues to prosper. This growth brings challenges to the accounting and control infrastructure of the Bank at the same time as TBC continues to reweight its business towards its retail, micro and SME divisions. The Audit Committee remains vigilant about the implications of these changes and works to ensure that the Bank's systems keep pace. Likewise, financial reporting disclosure requirements have been steadily increasing for a number of years, in tandem with the complexity of accounting standards.

The Committee met formally in person in each quarter of 2014 (February, June, September, December), in accordance with the Bank's quarterly financial reporting cycle and the cycle of Supervisory Board meetings. There were regular interim telephone meetings, mostly around planned releases of financial data, and also ad hoc communications between members and with Internal Audit, External Auditors and management.

The table below describes the committee composition and formal meeting attendance for 2014:

Audit Committee Composition						
Name	**Position**	**Year of Appointment**	**Scheduled Meetings Eligible To Attend**	**Scheduled Meetings Attended**	**Additional Meetings Eligible to Attend**	**Additional Meetings Attended**
Emile Groot	Previous Chairman *	2011	1	1	-	-
Nicholas Dominic Haag	Chairman	2013	4	4	2	2
Givi Lemonjava	Previous Member**	2002	4	4	2	2
Eric J. Rajendra	Member	2012	4	3	2	2
Levan Zuroshvili	Previous Member***	2002	4	4	2	2
Nikoloz Enukidze	Member	2014	3	3	2	2
Stefano Marsaglia	Member	2014	2	1	2	2

*Resigned from March 2014

** Resigned from December 2014

***Resigned from December 2014

The Bank's CEO, CFO and other management board members plus the Chief Compliance Officer were on occasion invited to participate in Audit Committee meetings together routinely with the Head of Internal Audit. Minuted meetings generally took place on the day prior to Supervisory Board meetings and the Audit Committee made a formal report as a separate agenda item in the latter. In addition, Audit Committee members attended a number of conferences and education programmes including a tailored IFRS workshop and training on internal audit best practices (both provided by PWC) to allow Committee members to stay ahead of evolving international accounting regulations and control improvements. Further training is expected in 2015 to prepare myself and colleagues for the continuing high velocity in changes to accounting, reporting and governance standards.

The Audit Committee Policy of the Bank is set out on TBC's investor relations web site.

This Policy document was last reviewed, amended and agreed by the Committee in December 2014 and approved by the Board in March 2015.

Assessment of Effectiveness

The Audit Committee Effectiveness Review is conducted every year by the Board and the individual Committee members in order to assess the Audit Committee's performance, as per international best practice standards.

The review conducted for the year 2014 was completed in March 2015 and concluded that the Committee operates effectively and carries out all its responsibilities as laid out in its Charter.

Planning and Release of Financial Statements

Starting from second half of 2014, as one of the initiatives for further improving the financial reporting process, the Audit Committee assumed the role of comprehensively pre-vetting all audited and auditor-reviewed financial releases. Accordingly, the Audit Committee reviewed during the year the releases of half-year and full-year financial statements, making recommendations to the Supervisory Board to approve these. The Committee also had pre-release sight of the third quarter results and held discussions with management about these. In respect of 2014, the Audit Committee has reviewed all data and narrative comment and concluded that the Annual Report and financial statements are complete, clear, balanced and consistent with the Committee's understanding of the facts. Likewise, we considered and are satisfied with transparency on the Bank's liquidity and capital adequacy.

To meet the new IPO related best practice requirements regarding the speed and level of disclosure of the financial results, we are pleased that we have been able to accelerate reporting of our 2014 quarterly, semi-annual and annual statements as well as to increase the depth of these reports.

The Audit Committee held multiple 2014 audit planning meetings with PWC during the course of the year, commencing formal audit planning in June. The Audit Committee had the opportunity, without management present, to highlight areas it wished the external audit to focus on, flagging relevant issues and trends. The Committee has evolved towards a policy of regular quarterly status discussions with PWC prior to each Supervisory Board meeting, proactively and mutually addressing any material audit or control issues. PWC has started to attend parts of Supervisory Board, Audit Committee as well as Management Board meetings of the Bank. In addition, as Chairman of the Committee, I also have regular, candid and free-form private sessions with PWC between Committee and Board meetings.

Areas of Audit Committee Focus

We have assessed the reasonableness and appropriateness of critical accounting policies. The main areas of accounting judgement involved the valuation of loans issued and related impairment charges and loan loss provisions. PWC reviewed portfolio-based provisioning of individually-significant loans on a sample basis and also collectively-assessed provisions in respect of individually non-significant loans. The Audit Committee has reviewed assumptions around these provisions and been provided with regular updates on problem and watch list loans as well as related collateral assumptions. We have taken comfort by back-testing the actual sale prices achieved on certain realised collateral assets. We have also reviewed changes to the aggregate proportion of over- and under-collateralised loans within the Bank's total portfolio.

The Audit Committee has additionally sought clarification on a range of other significant topics including the valuation of investment properties, the accounting treatment post-IPO for share based payments under the Bank's management compensation plan, the amortisation and useful life of tangible and also intangible (e.g. software licenses) assets and the proper accounting for repo (sale and repurchase) agreements. Other areas of focus and discussion with management and internal and external auditors have included the classification of interest income on impaired loans as well as the nature and extent of off balance sheet commitments and related party transactions including the comprehensive identification of the latter. We have looked at the impact of changing tax legislation across the Bank's relevant geographies and the accounting treatment for the Bank's fast-growing financial leasing business.

As noted, the Audit Committee has challenged underlying assumptions and in all cases PWC and management have satisfactorily explained their methodologies used and there were no material disagreements arising. We have also found it useful to discuss materiality thresholds with the external auditors and with management.

Control Environment

We have reviewed the approach and extent of internal control testing by management and internal and external auditors. The Committee spent considerable time in 2014 seeking to ensure that the Bank's internal controls are sufficiently robust, working with Internal Audit to track closely any identified shortcomings and scrutinising remediation follow-up with vintage analyses being carefully maintained. KPIs in respect of the reduction of identified audit deficiencies, however minor, have been cascaded down to branch and departmental level and also included in KPIs for members of the management board. We note that in the second half of 2014 there was evidence of a resulting improvement in the prompt resolution of any such issues.

At our request, PWC has advised us that, consistent with prior years, their audit work included testing of the Bank's information technology systems controls and, in particular, testing of IT security, programme maintenance and operational controls as well as selected application controls over interest, commissions and treasury cycles with related balance sheet items. For avoidance of doubt, the scope of this testing was limited to that necessary for the audit of the financial statements rather than as a separate engagement. PWC also advised us that the audit work additionally included a review of the Bank's fraud risk assessment procedures, again evaluating controls and introducing an element of unpredictability in their audit procedures.

One area we continue to monitor is management compensation, confirming an appropriate balance of incentives which, whilst motivating, do not create potential risks for exaggerated financial reporting. TBC operates an overlapping committee structure of members and it is helpful that Nikoloz Enukidze and I both sit on the Bank's Remuneration Committee.

As noted, we scrutinised relevant related party transactions to ensure that they were carried out on an arm's length basis and did not impact normal financial reporting metrics of the Bank. We are comfortable that management and the Supervisory Board have an adequate process in place to identify and record related parties.

Another area we have paid attention to is the integrity of financial information obtained from borrowers at loan application and monitoring stages, validating appropriate controls implemented by management.

Under TBC's committee structure, ethical standards are supervised by the Risk, Ethics and Compliance Committee. However, the Audit Committee liaises closely with it, there is substantial cross-committee membership (including myself) and I am satisfied that the prevailing ethical climate and safeguards of the Bank are generally supportive of the control environment, in terms of prevailing rules, 'tone at the top' and equally important 'message in the middle'.

Constanta/Subsidiaries

Plans were made for the full integration of Constanta Bank, upon merger, into the audit and control framework of the Bank, combining operations and standardising controls. Following completion of the merger with Constanta, Internal Audit is now performing its roles in respect of this bank with integration of relevant personnel nearly complete. In addition, during the year greater emphasis was placed by Audit Committee and Internal Audit on monitoring controls within other subsidiaries of the Bank, particularly TBC Kredit. The merger with Constanta leads to certain changes in this bank's traditional systems of business process and record-keeping and the Audit Committee will continue to keep a close eye on this evolution.

External Auditor Independence and Reappointment

The Audit Committee is responsible for the assessment of the performance, objectivity and independence of the external auditor and the delivery of a quality audit. Each year the Audit Committee is required to consider the reappointment of the auditors, the suitability of the lead engagement partner as well as the wider audit team and the remuneration and terms of engagement for the chosen auditor. 2014 has been the seventh year in which PWC have audited the Bank. The fact that we have a substantially new Audit Committee with a new Committee chairman has allowed us to take a fresh look at the PWC relationship with new people challenging PWC's and management's interpretation of accounting and control features of the Bank. We remain satisfied that PWC continues to offer an independent, professional and cost-effective service. We reached this decision on the basis of their openness to challenge, our perception of their proper independence from management, the very low level of prior year financial restatements and PWC’s proven ability to meet our tight reporting deadlines. The Committee also noted that the PWC team working onsite, including the audit manager and the audit partner, have been changed during the firm’s period of incumbency. 2014 is the first year for the current audit manager and the fourth year for the audit partner on TBC. The multi-country location of key members of the PWC team is not ideal in terms of accessibility but we do not consider that this impacts the overall quality of the audit, note that several members of the PWC team are based in Tbilisi and do not see another firm providing any significantly better geographic footprint. It is the Committee's current intention, subject to suitable contract terms, to recommend that we proceed with PWC for the year 2015 audit.

In 2014 the Bank hired PWC for only small audit-related training assignments and for non-audit services directly connected to the IPO, notably running an IPO readiness diagnostic and the provision of relevant comfort letters where there were natural synergies with the audit work performed. Other Big 4 vendors were used to provide other non-audit advisory services, notably Ernst & Young and Deloitte. The Audit Committee and management are in agreement that we should look to these other providers for future non-audit services where they offer an economically and professionally equivalent alternative. The new Audit Committee policy draft formally introduces new rules on the engagement and remuneration of the Bank's external auditor in relation to the performance of non-audit services. Essentially, we will only use PWC for non-audit services where such a contract has been pre-cleared with the Audit Committee and where there is either a clear synergy with PWC's audit role or where PWC offers superior competence or materially better commercial terms. As stated, we remain satisfied that PWC demonstrates a sufficient degree of independence and objectivity in its role as the Bank's external auditor.

Internal Audit

The Committee has taken a fresh look at the role and competences of the Internal Audit department and is satisfied that it is fit for purpose as a "3rd line of defence". Internal Audit currently has sufficient budget and resources to perform its role. The independence from management of the Internal Audit function in its reporting line and direction has been reinforced; Internal Audit now reports solely to the Committee with the latter also determining the former's budget and compensation. The Audit Committee has demonstrated to management its clear empowerment of Internal Audit. The Audit Committee meets regularly with the Head of Internal Audit with no management present, and benefits from the department's objective assurance and insights. As chairman of the Committee, I am in at least monthly contact with the Head of Internal Audit. The Committee routinely reviews Internal Audit's annual and rolling 3 year plan, provides feedback on it and authorises any changes to its scope. We provide targets for and formal assessment of Internal Audit and ensure that it is effective, suitably embedded in the organisation, respected by management and of use to them. The head of Internal Audit now routinely attends monthly Management Board meetings.

Internal Audit has created scales of criticality and a graduated escalation procedure has been put in place to allow it to rapidly alert me and the Committee to any pressing issues that have come to light. The Bank's Internal Audit Charter was updated in December. We have encouraged Internal Audit to take an increasingly 'risk-based' approach to its work, prioritising a hierarchy of higher-risk areas. Sample sizes for its audits have risen significantly in 2014; this has provided extra reassurance to the Committee.

The Bank has recruited a small number of additional Internal Audit staff including a specialist internal IT auditor. It is in the process of acquiring Internal Audit automation software to give it the capability for less manual and more continuous audit testing and tracking. In accordance with international trends, and in anticipation of more automation of areas of its work, Internal Audit has increasingly been assuming responsibilities beyond a pure 'policeman' role. It has, for example, been helping to validate the integrity of the Bank's Basel report generation process as well as assisting in testing internal controls over TBC's financial reporting.

The intention is for Internal Audit's work to become more flexible to respond to changes in the Bank's operational, technological and organisational structures and environment by building in a time 'cushion' allowing it to address any urgent and unexpected developments. In addition to its scheduled audit of head office, service centre and branch units, the intention in 2015 is for Internal Audit to focus further on critical areas including the Bank's provisioning policy, collateral valuation methodology, loan rating model, its financial leasing activities, the quality of its MIS systems, business continuity and cybersecurity as well as the control of outside service providers.

Training was given a high priority in 2014. Almost all managerial staff in Internal Audit have been enrolled in preparing for exams to become at least Level 1 Certified Internal Auditors, an accreditation process run by the international Institute of Internal Auditors. Internal auditors have received training from PWC on emerging global trends in Internal Audit best practice.

It is intended to commission an external assessment of the performance of Internal Audit within the next two years, in accordance with the standards recommended by the Institute of Internal Auditors.

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Nicholas Dominic Haag

Chairman of the Audit Committee