

FINCA International, Inc.

Consolidated Financial Statements as of and for the
Years Ended December 31, 2014 and 2013, and
Independent Auditors' Report

FINCA INTERNATIONAL, INC.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
FINCA International, Inc.
Washington, DC

We have audited the accompanying consolidated financial statements of FINCA International, Inc. (the "Company") and its subsidiaries, which comprise the consolidated statements of financial position as of December 31, 2014 and 2013, and the related consolidated statements of profit or loss, statements of other comprehensive income or loss, statements of changes in equity, and statements of cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and in accordance with International Standards on Auditing as established by the International Auditing and Assurance Standards Board. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and its subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for the years then ended in accordance with IFRS as issued by the International Accounting Standards Board.

Deloitte + Touche LLP

June 8, 2015

FINCA INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31, 2014 AND 2013

| | 2014 | 2013 |
|---|------------------------|------------------------|
| ASSETS | | |
| CASH AND CASH EQUIVALENTS | \$ 149,154,910 | \$ 155,060,628 |
| RESTRICTED CASH AND CASH EQUIVALENTS (Note 12) | 23,856,725 | 25,054,057 |
| AVAILABLE FOR SALE FINANCIAL ASSETS (Note 13) | 30,553,509 | 18,883,123 |
| FINANCIAL ASSETS HELD-TO-MATURITY | 1,382,889 | - |
| FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS (Note 14) | 13,179,462 | 3,628,524 |
| LOANS RECEIVABLE—Net (Note 15) | 949,333,168 | 828,793,935 |
| GRANTS RECEIVABLE | 3,099,507 | 3,817,764 |
| OTHER RECEIVABLES, PREPAID AND OTHER ASSETS (Note 16) | 23,792,506 | 16,127,756 |
| PROPERTY AND EQUIPMENT (Note 17) | 33,508,041 | 29,135,224 |
| INTANGIBLE ASSETS (Note 18) | 12,962,360 | 14,961,450 |
| GOODWILL (Note 25) | 1,108,117 | 1,108,117 |
| DEFERRED TAX ASSETS (Note 11) | <u>9,713,658</u> | <u>8,081,528</u> |
| TOTAL | <u>\$1,251,644,852</u> | <u>\$1,104,652,106</u> |
| LIABILITIES AND EQUITY | | |
| LIABILITIES: | | |
| Accounts payable and other accrued liabilities (Note 19) | \$ 33,659,985 | \$ 34,189,189 |
| Financial liability at fair value through profit and loss (Note 14) | 2,346,959 | 1,650,749 |
| Client deposits (Note 20) | 130,213,635 | 78,354,279 |
| Bank deposits | 2,642,270 | - |
| Notes payable (Note 21) | 740,825,686 | 644,350,196 |
| Subordinated debt (Note 22) | 23,646,518 | 22,558,246 |
| Deferred revenue (Note 23) | 10,615,425 | 7,702,074 |
| Employee benefits (Note 24) | 4,618,476 | 3,504,764 |
| Current income tax liability | 4,333,561 | 2,043,254 |
| Deferred tax liabilities (Note 11) | <u>1,327,827</u> | <u>1,245,419</u> |
| Total liabilities | <u>954,230,342</u> | <u>795,598,170</u> |
| EQUITY: | | |
| Reserves | 17,706,184 | 15,211,848 |
| Retained earnings | 188,448,532 | 186,172,023 |
| Currency translation reserve | <u>(28,299,651)</u> | <u>(16,126,565)</u> |
| Equity attributable to owners of the parent company | 177,855,065 | 185,257,306 |
| NON-CONTROLLING INTEREST | <u>119,559,445</u> | <u>123,796,630</u> |
| Total equity | <u>297,414,510</u> | <u>309,053,936</u> |
| TOTAL | <u>\$1,251,644,852</u> | <u>\$1,104,652,106</u> |

See notes to consolidated financial statements.

FINCA INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF PROFIT OR LOSS FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

| | 2014 | 2013 |
|---|----------------------|----------------------|
| INTEREST INCOME | \$ 368,723,713 | \$ 307,025,050 |
| INTEREST EXPENSE | <u>(86,983,253)</u> | <u>(63,538,860)</u> |
| NET INTEREST INCOME (Note 7) | 281,740,460 | 243,486,190 |
| IMPAIRMENT LOSSES ON LOANS (Note 15) | <u>(24,894,600)</u> | <u>(15,554,212)</u> |
| NET INTEREST INCOME AFTER PROVISION FOR IMPAIRMENT LOSSES ON LOANS | 256,845,860 | 227,931,978 |
| OTHER OPERATING INCOME (Note 8) | <u>14,395,528</u> | <u>16,377,246</u> |
| NET OPERATING INCOME | <u>271,241,388</u> | <u>244,309,224</u> |
| PERSONNEL EXPENSES (Note 9) | (164,139,979) | (149,714,540) |
| OTHER OPERATING EXPENSES (Note 10) | (104,331,151) | (93,965,464) |
| DEPRECIATION AND AMORTIZATION (Notes 17 and 18) | <u>(13,302,508)</u> | <u>(9,892,099)</u> |
| TOTAL EXPENSES | <u>(281,773,638)</u> | <u>(253,572,103)</u> |
| (LOSS) BEFORE OTHER INCOME (EXPENSES) | (10,532,250) | (9,262,879) |
| OTHER INCOME (EXPENSES): | | |
| Grants and Donations | 30,631,023 | 31,434,250 |
| Foreign exchange gains (losses) | (2,543,788) | 18,342 |
| Non-operating income (expenses) | <u>(781,990)</u> | <u>962,706</u> |
| PROFIT BEFORE INCOME TAX | 16,772,995 | 23,152,419 |
| TAX (Note 11) | <u>(9,160,312)</u> | <u>(9,100,297)</u> |
| PROFIT FOR THE YEAR | <u>\$ 7,612,683</u> | <u>\$ 14,052,122</u> |
| PROFIT FOR THE YEAR ATTRIBUTABLE TO: | | |
| The parent | \$ 6,258,312 | \$ 12,445,614 |
| Non-controlling interest | <u>1,354,371</u> | <u>1,606,508</u> |
| | <u>\$ 7,612,683</u> | <u>\$ 14,052,122</u> |

See notes to consolidated financial statements.

FINCA INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE INCOME OR LOSS FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

| | 2014 | 2013 |
|---|-------------------------------|-----------------------------|
| PROFIT FOR THE YEAR | <u>\$ 7,612,683</u> | <u>\$ 14,052,122</u> |
| OTHER COMPREHENSIVE INCOME: | | |
| Foreign currency movement during the year (Note 5) | (19,466,455) | (4,487,453) |
| Benefit plan fair value adjustment (Note 24) | <u>(1,489,634)</u> | <u>1,656,266</u> |
| Total other comprehensive income | <u>(20,956,089)</u> | <u>(2,831,187)</u> |
| TOTAL COMPREHENSIVE INCOME OR LOSS FOR THE YEAR | <u><u>\$ (13,343,406)</u></u> | <u><u>\$ 11,220,935</u></u> |
| TOTAL COMPREHENSIVE INCOME OR LOSS FOR THE YEAR ATTRIBUTABLE TO: | | |
| The parent | \$ (7,404,408) | \$ 11,174,650 |
| Non-controlling interest | <u>(5,938,998)</u> | <u>46,285</u> |
| | <u><u>\$ (13,343,406)</u></u> | <u><u>\$ 11,220,935</u></u> |

See notes to consolidated financial statements.

FINCA INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

| | Reserves | Retained Earnings | Currency Translation Reserve | Total | Non-controlling Interest | Total Equity |
|---|---------------|-------------------|------------------------------|----------------|--------------------------|----------------|
| BALANCE—January 1, 2013 | \$ 15,019,357 | \$ 172,254,276 | \$ (13,199,335) | \$ 174,074,298 | \$ 71,783,593 | \$ 245,857,891 |
| Comprehensive income: | | | | | | |
| Profit for the year | - | 12,445,614 | - | 12,445,614 | 1,606,508 | 14,052,122 |
| Foreign currency movement during the year | - | - | (2,927,230) | (2,927,230) | (1,560,223) | (4,487,453) |
| Benefit plan fair value adjustment | - | 1,656,266 | - | 1,656,266 | - | 1,656,266 |
| Total comprehensive income | - | 14,101,880 | (2,927,230) | 11,174,650 | 46,285 | 11,220,935 |
| Issue of ordinary shares by subsidiary | - | - | - | - | 49,999,511 | 49,999,511 |
| Non-controlling interest on acquisition of subsidiary | - | - | - | - | 1,967,241 | 1,967,241 |
| Fair value revaluation reserve | - | 8,358 | - | 8,358 | - | 8,358 |
| Transfer to reserve | 192,491 | (192,491) | - | - | - | - |
| BALANCE—December 31, 2013 | \$ 15,211,848 | \$ 186,172,023 | \$ (16,126,565) | \$ 185,257,306 | \$ 123,796,630 | \$ 309,053,936 |
| Comprehensive income or loss: | | | | | | |
| Profit for the year | - | 6,258,312 | - | 6,258,312 | 1,354,371 | 7,612,683 |
| Foreign currency movement during the year | - | - | (12,173,086) | (12,173,086) | (7,293,369) | (19,466,455) |
| Benefit plan fair value adjustment | - | (1,489,634) | - | (1,489,634) | - | (1,489,634) |
| Total comprehensive income or loss | - | 4,768,678 | (12,173,086) | (7,404,408) | (5,938,998) | (13,343,406) |
| Issue of ordinary shares by subsidiary | - | - | - | - | 1,700,489 | 1,700,489 |
| Non-controlling interest on acquisition of subsidiary | - | - | - | - | - | - |
| Fair value revaluation reserve | - | 2,167 | - | 2,167 | 1,324 | 3,491 |
| Transfer to reserve | 2,494,336 | (2,494,336) | - | - | - | - |
| BALANCE—December 31, 2014 | \$ 17,706,184 | \$ 188,448,532 | \$ (28,299,651) | \$ 177,855,065 | \$ 119,559,445 | \$ 297,414,510 |

See notes to consolidated financial statements.

FINCA INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

| | 2014 | 2013 |
|--|----------------------|----------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net profit for the period after tax | \$ 7,612,683 | \$ 14,052,122 |
| Adjustments to reconcile net profit for the period after tax to net cash used in operating activities: | | |
| Depreciation and amortization (Notes 17 and 18) | 13,302,508 | 9,892,099 |
| Loss on disposal of fixed assets and intangibles (Notes 17 and 18) | 229,912 | 559,059 |
| Impairment on loan losses and other financial assets (Note 15) | 24,894,600 | 15,554,212 |
| Impairment of other assets | 525,408 | 229,084 |
| Foreign exchange losses (gains) (Note 5) | 2,543,788 | (18,342) |
| Changes in deferred tax assets and liabilities | (1,549,722) | (3,277,578) |
| Other non-cash adjustments | 9,530,394 | 3,049,860 |
| (Decrease) increase of assets and liabilities from operating activities after non-cash items: | | |
| Change in loans receivable | (209,915,672) | (213,939,490) |
| Change in grants receivable | 718,257 | (1,746,504) |
| Change in other receivables and other assets | (7,664,750) | (2,840,336) |
| Change in other liabilities | 1,913,133 | 9,513,610 |
| Change in client deposits | 53,501,496 | 15,248,989 |
| Change in bank deposits | 2,797,599 | - |
| Change in deferred revenue | 2,913,351 | (3,912,055) |
| Change in employee benefits | 1,113,712 | (666,613) |
| Change in current income tax liability | 2,290,307 | (123,873) |
| Net cash used in operating activities | <u>(95,242,996)</u> | <u>(158,425,756)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds (purchases) from financial assets | (20,710,671) | 5,419,444 |
| Purchase of property and equipment (Note 17) | (15,589,897) | (15,137,214) |
| Purchase of intangible assets (Note 18) | (3,959,179) | (6,929,751) |
| Proceeds from sales/disposal of fixed assets (Note 17) | 328,338 | 342,075 |
| Net cash on acquisition of subsidiary (Note 25) | <u>-</u> | <u>1,247,257</u> |
| Net cash used in investing activities | <u>(39,931,409)</u> | <u>(15,058,189)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Issue of shares | 1,700,489 | 49,999,511 |
| Proceeds from lenders | 431,798,297 | 408,735,208 |
| Repayment of loans and borrowings to lenders | <u>(297,213,058)</u> | <u>(242,766,445)</u> |
| Net cash provided by financing activities | <u>136,285,728</u> | <u>215,968,274</u> |

(Continued)

FINCA INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

| | 2014 | 2013 |
|---|------------------------|------------------------|
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | \$ 1,111,323 | \$ 42,484,329 |
| CASH AND CASH EQUIVALENTS—Beginning of the year | 155,060,628 | 114,632,334 |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS | <u>(7,017,041)</u> | <u>(2,056,035)</u> |
| CASH AND CASH EQUIVALENTS—End of the year | <u>\$ 149,154,910</u> | <u>\$ 155,060,628</u> |
| SUPPLEMENTAL DISCLOSURES TO CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Interest received | <u>\$ 352,685,012</u> | <u>\$ 285,721,156</u> |
| Interest paid | <u>\$ (77,486,305)</u> | <u>\$ (56,793,284)</u> |
| Income taxes paid | <u>\$ (9,498,855)</u> | <u>\$ (11,152,826)</u> |
| See notes to consolidated financial statements. | | (Concluded) |

FINCA INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

1. NATURE OF ACTIVITIES

FINCA International, Inc. (FINCA or “FINCA International” or the “Company”) is a not-for-profit corporation, incorporated in New York, United States of America (USA), that has received a determination letter from the United States Internal Revenue Service classifying it as a tax-exempt public charity described in Section 501(c)(3) of the United States Internal Revenue Code of 1986, as amended. Founded in 1984, FINCA provides financial services to the world’s lowest-income entrepreneurs so they can create jobs, build assets, and improve their standard of living. FINCA’s headquarters is located in Washington, D.C., USA.

In December 2011, FINCA completed the reorganization of its organizational structure by forming a 100%-owned subsidiary in October 2010, FINCA Microfinance Holding Company LLC (FMH), a holding company incorporated in the USA, through which it could obtain additional capital for expansion of FINCA’s mission. FMH is a limited liability company formed under the laws of the State of Delaware. FINCA International is the substantial majority shareholder, with minority positions held by social and development institutions. In exchange for its majority ownership in FMH, FINCA contributed the ownership of all of its microfinance operating subsidiaries to FMH, in which all operating subsidiaries became wholly owned subsidiaries of FMH. Upon completion of this group reorganization, FINCA obtained equity funding of approximately \$70.3 million. In 2013, FINCA completed its second capital raise for FMH. FMH received \$50 million in additional equity primarily from its existing shareholders. In 2014, one of the existing members contributed additional \$1.7 million in equity of FMH.

The proceeds are used by FINCA to expand outreach, enter additional countries, and provide a greater range of needed products, including savings accounts. FINCA operates FMH with existing FINCA employees and provides stewardship services that include management, accounting, administrative, personnel, and legal functions. FMH follows FINCA’s mission of poverty alleviation, and no changes may be made to the corporate purpose without the consent of FINCA. In order to ensure complete alignment of interests with the microentrepreneur clients that it serves, no FINCA employee, board member, or officer may hold any equity interest in FINCA or any of the subsidiaries. FINCA, as the controlling entity remains a not-for-profit corporation and maintains its designation as a Section 501(c)(3) charitable entity.

At present, FINCA through FMH operates in 23 developing countries in Latin America (Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, and Nicaragua), Africa (Democratic Republic of the Congo, Malawi, Nigeria, Tanzania, Uganda, and Zambia), Eurasia (Armenia, Azerbaijan, Georgia, Kosovo, Kyrgyzstan, Russia, and Tajikistan), and the Middle East (Afghanistan, Jordan, and Pakistan). FINCA operates through local entities (“subsidiaries”) that are owned and/or controlled by FINCA through FMH, including predominantly corporations and, in some cases, nongovernmental organizations, or as branches of FINCA International.

In 2013, through FINCA's wholly owned subsidiary of FMH, FINCA Microfinance Cooperatief U.A. (FMC) in the Netherlands completed the acquisition of FINCA Microfinance Bank Limited with its headquarters in Lahore, Pakistan (formerly Kashf Microfinance Bank Limited) (see Note 25). FMH is the majority shareholder (82.78%) of FINCA Microfinance Bank Limited, Pakistan. In November 2014, FINCA Microfinance Bank in Nigeria, Africa obtained the state banking licenses and started its banking operations.

Subsidiaries principally provide small loans to individuals and to groups of individuals that lack access to traditional financial institutions. In most cases, FINCA loans are made to groups of individuals referred to as "Village Banks." These groups, consisting of individuals that know each other, guarantee each other's loans and provide a network of support for the group members. Individual loans, typically larger in size, are made where individual small businesses demonstrate adequate need and creditworthiness.

In addition to loans, FINCA, through a growing number of its subsidiaries, provides other financial services needed by the working poor, including savings deposits, remittances, and micro insurance.

The majority of FINCA's clients worldwide are generally women (by number of clients) who often lack the ability to secure employment and who, in many cultures, are the primary providers for a family. FINCA's loans are a renewable resource that can improve the economy of an entire community. FINCA operates on a twin bottom line approach of sustainability and social outreach.

2. BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and Interpretations issued by the IFRS Interpretations Committee (IFRIC) (together, IFRS) and stated in U.S. dollars (USD), the currency of the United States, where FINCA is located.

The consolidated financial statements were approved by the board of directors on June 5, 2015.

Basis of Measurement—The consolidated financial statements have been prepared on the historical cost basis, except for the following:

- Financial instruments at fair value through profit or loss are measured at fair value.
- Available for sale financial assets are measured at fair value.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, FINCA takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis, except for share-based payment transactions that are within the scope of IFRS 2, *Share-based Payment*, leasing transactions that are within the scope of International Accounting Standards (IAS) 17, *Leases*, and measurements that have some similarities to fair value but are not fair value, such as net realizable value in IAS 2, *Inventories*, or value in use in IAS 36, *Impairment of Assets*.

In addition, for financial reporting purposes, fair value measurements are categorized into Levels 1, 2, or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- *Level 1*—Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
- *Level 2*—Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly.
- *Level 3*—Level 3 inputs are unobservable inputs for the asset or liability.

Functional and Presentation Currency—The consolidated financial statements are presented in USD, which is FINCA’s functional currency.

3. SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies are set out below:

Management discussed with the FINCA audit committee, the development, selection, and disclosure of FINCA’s critical accounting estimates and judgments and the application of these policies and estimates.

The interest received, interest paid, and income taxes paid have been disclosed as supplemental disclosures to cash flows from operating activities in the consolidated statements of cash flows for the years ended December 31, 2014 and 2013.

The consolidated financial statements incorporate the financial statements of FINCA and entities controlled by FINCA and its subsidiaries. Control is achieved when FINCA:

- has power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect its returns.

FINCA reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

Consolidation of a subsidiary begins when FINCA obtains control over the subsidiary and ceases when FINCA loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statements of profit or loss and other comprehensive income or loss from the date FINCA gains control until the date when FINCA ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income are attributed to the owners of FINCA and to the non-controlling interests. Total comprehensive income of subsidiaries is attributed to the members of FINCA and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of Subsidiaries to bring their accounting policies in line with the Company’s accounting policies. All intragroup assets and liabilities, equity, income, expenses, and cash flows relating to transactions between members of the Company are eliminated in full upon consolidation.

Non-controlling Interests—Non-controlling interests represent the portion of profit or loss and net assets of subsidiaries not owned, directly or indirectly, by FINCA. Non-controlling interests are presented separately in the consolidated statements of profit or loss and within equity in the consolidated statements of financial position, separately from parent shareholders' equity.

All intragroup transactions and balances are eliminated in full upon consolidation. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

Business Combinations—FINCA uses the acquisition method to account for the acquisition of businesses. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Company, liabilities incurred by the Company to the former owners of the acquiree, and the equity interests issued by the Company in exchange for control of the acquiree. Acquisition-related costs are recognized in profit or loss as incurred.

At the acquisition date, the identifiable assets acquired and liabilities assumed are recognized at their fair value except for:

- Deferred tax assets or liabilities and assets or liabilities related to employee benefit arrangements are recognized and measured in accordance with IAS 12, *Income Taxes*, and IAS 19, *Employee Benefits* (as revised in 2011), respectively;
- Liabilities or equity instruments related to share-based payment arrangements of the Company entered to replace the share-based payment arrangements of the acquiree are measured in accordance with IFRS 2 at the acquisition date; and
- Assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, are measured in accordance with the standard.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed. If, after reassessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree, and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognized immediately in profit or loss as a bargain purchase gain.

Non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured at fair value or at the non-controlling interests' proportionate share of the recognized amounts of the acquiree's identifiable net assets. On the acquisition date, FINCA had elected to measure the non-controlling interest in the FINCA Microfinance Bank Limited, Pakistan at fair value.

When the consideration transferred by the Company in a business combination includes assets or liabilities resulting from a contingent consideration, the contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Changes in the fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during

the measurement period that cannot exceed one year from the acquisition date and relate to facts and circumstances that existed at the acquisition date. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates, and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or liability is remeasured at subsequent reporting dates in accordance with IAS 39, *Financial Instruments: Recognition and Measurement*, or IAS 37, *Provision, Contingent Liabilities and Contingent Assets*, as appropriate, with the corresponding gain or loss recognized in profit or loss.

When a business combination is achieved in stages, the Company's previously held equity interest in the acquiree is remeasured at its acquisition-date fair value and the resulting gain or loss, if any, is recognized in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognized in other comprehensive income are reclassified to profit or loss. Prior to the acquisition date of May 7, 2013, FINCA did not hold any equity interests in FINCA Microfinance Bank Limited, Pakistan.

Items for which accounting is not complete by the end of the reporting period in which the combination occurs are reported at provisional amounts. These items are further adjusted during the remeasurement period or additional assets or liabilities are recognized to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognized at that date.

Goodwill—Goodwill arising on an acquisition of a business is carried at cost as established at the date of acquisition of the business less accumulated impairment losses, if any.

For the purposes of impairment testing, goodwill is allocated to the Company's cash-generating unit that is expected to benefit from the synergies of the combination.

A cash-generating unit to which goodwill has been allocated is tested for impairment annually, or more frequently when there is evidence that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than its carrying amount, the impairment loss is allocated first to reduce the goodwill allocated to the cash generating unit and then to the other assets of the unit pro rata based on the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognized directly in profit or loss. An impairment loss recognized for goodwill is not reversed in subsequent periods.

On disposal of the relevant cash-generating unit, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill and fair value adjustments to identifiable assets acquired and liabilities assumed through acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the exchange rate prevailing at the end of each reporting period. Exchange differences are recognized in other comprehensive income.

Revenue Recognition

Net Interest Income—Interest income from a financial asset is recognized when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Interest income and expense are recognized on an accrual basis using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees paid or received that form an integral part of the effective interest rate, transaction costs, and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Once a financial asset or a group of similar financial assets has been written down (or partly written down) as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest income and expense presented in the consolidated statements of profit or loss include:

- Interest on financial assets and liabilities at amortized cost on an effective interest rate basis
- Interest on available for sale investment securities on an effective interest rate basis

Fair value changes on other financial assets and liabilities carried at fair value through profit or loss are presented in net income on other financial instruments carried at fair value within the “non-operating income” line in the consolidated statements of profit or loss.

Fee and Commission Income and Other Operating Income—Fee and commission income are recognized on an accrual basis when the service has been provided. Loan origination fees are deferred and recognized as an adjustment to the effective interest rate on the loan. Loan servicing fees are recognized as revenue as the services are provided.

Other Income—Grant revenue is recognized when there is reasonable assurance that FINCA has complied with the terms and conditions associated with the grant and that grants will be received. Grants are recognized in profit or loss on a systematic basis over the periods in which FINCA recognizes as expenses the related costs for which the grants are intended to compensate.

Donations received are recorded as revenue when the amount can be reliably measured and there is reasonable assurance that it will be received.

Foreign Currency

Foreign Currency Transactions and Balances—In preparing the financial statements of each individual subsidiary, transactions in currencies other than the entity’s functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Nonmonetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Nonmonetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences on monetary items are recognized in profit or loss in the period in which they arise except for:

- exchange differences on foreign currency borrowings relating to assets under construction for future productive use, which are included in the cost of those assets when they are regarded as an adjustment to interest costs on those foreign currency borrowings;
- exchange differences on transactions entered into in order to hedge certain foreign currency risks; and
- exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur (therefore forming part of the net investment in the foreign operation), which are recognized initially in other comprehensive income and reclassified from equity to profit or loss on repayment of the monetary items.

For the purposes of presenting the consolidated financial statements, the assets and liabilities of FINCA's foreign operations are translated into USD using exchange rates prevailing at the end of each reporting period. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during that period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are recognized in other comprehensive income and accumulated in equity (and attributed to non-controlling interests as appropriate).

Dividends—Dividends are recognized in equity in the period in which they are approved by the Company's members.

Income Tax Expense—FINCA is exempt from federal income tax under Section 501(c)(3) of the United States Internal Revenue Code of 1986, as amended; however, income from certain activities not directly related to the tax-exempt purpose is subject to taxation as unrelated business taxable income. Accordingly, no provision for income taxes is made in the consolidated financial statements. However, some of the foreign operations of the subsidiaries are subject to local income tax in the jurisdictions where they operate, and certain cross-border payments are subject to foreign withholding taxes.

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the consolidated statements of profit or loss, except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity. The current tax is calculated using tax rates that have been enacted, or substantively enacted, by the end of the reporting period in the respective jurisdictions.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax basis used. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities are generally recognized for all taxable temporary differences. However, deferred tax liabilities are not recognized for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that FINCA is able to control the reversal of temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax liabilities and assets are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which FINCA expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Financial Assets and Liabilities—FINCA recognizes financial assets and liabilities on its consolidated financial statements when it becomes a party to the contractual obligations of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair

value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

Financial Assets—FINCA recognizes its financial assets within the following specified categories: at fair value through profit or loss (“FVTPL”), available for sale (“AFS”), and loans and receivables. The classification depends on the nature and purpose for which the financial assets were acquired and is determined at the time of initial recognition.

Financial Assets at FVTPL—Financial assets are classified as at FVTPL when the financial asset is either held for trading or it is designated as at FVTPL and:

- it has been acquired principally for the purpose of selling it in the near term or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise or
- the financial asset forms part of a group of financial assets, financial liabilities, or both that is managed and its performance is evaluated on a fair value basis, in accordance with FINCA’s documented risk management or investment strategy, and information about the grouping is provided internally on that basis or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 permits the entire combined contract to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with remeasurement gains or losses recognized in profit or loss. The net gain or loss recognized in profit or loss incorporates any dividend or interest earned on the financial asset and is included in the “other gains and losses” line item. Fair value is determined in the manner described in Note 6.

Held-to-Maturity Investments—Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company has positive intent and ability to hold to maturity. Subsequent to initial recognition, held-to-maturity investments are measured at amortized cost using the effective interest method less any impairment.

AFS Financial Assets—AFS financial assets are non-derivatives that are either designated as AFS or are not classified as (a) loans and receivables, (b) held-to-maturity investments, or (c) financial assets at fair value through profit or loss. AFS financial assets are stated at fair value at the end of reporting period. Changes in the carrying amount of AFS monetary financial assets relating to changes in foreign currency rates, interest income calculated using the effective interest method, and dividends on AFS equity investments are recognized in profit or loss. Other changes in the carrying amount of AFS financial assets are recognized in other comprehensive income and accumulated under the investment valuation reserve. When the investment is disposed of or is determined to be impaired, the cumulative gain or loss, previously accumulated in the revaluation reserve, is reclassified to profit or loss.

Loans Receivable—Loans receivable are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that FINCA does not intend to sell immediately or in the near term.

Loans receivable are initially measured at fair value plus directly attributable transaction costs and subsequently measured at their amortized cost using the effective interest method, less any impairment.

Allowance for Losses on Loans

Impairment of Loans—FINCA assesses at each balance sheet date whether there is objective evidence that a group of financial assets is impaired. If there is objective evidence that impairment of a credit exposure or a portfolio of credit exposures has occurred that influences the future cash flow of the financial assets, the respective losses are immediately recognized. Depending on the size or type of the credit exposure, such losses are either calculated on an individual credit exposure basis or are collectively assessed for a portfolio of credit exposures. The carrying amount of the loan is reduced through the use of an allowance account and the amount of the loss is recognized in the consolidated statements of profit or loss. FINCA does not recognize losses from expected future events.

Individually Assessed Loans—Credit exposures are considered individually significant if they have a certain size, partly depending on the individual subsidiary. As a FINCA-wide rule, all credit exposures over a country-specific threshold are individually assessed for impairment. For such credit exposures, it is assessed whether objective evidence of impairment exists (i.e., any factors that might influence the client's ability to fulfill its contractual payment obligations towards the individual subsidiary):

- Delinquencies in contractual payments of interest or principal
- Breach of covenants or conditions
- Initiation of bankruptcy proceedings
- Any specific information on the client's business (e. g., reflected by cash flow difficulties experienced by the client)
- Changes in the client's market environment
- The general economic situation

Additionally, the aggregate exposure to the client and the realizable value of collateral held are taken into account when deciding on the allowance for impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of its estimated future cash flows discounted at the financial asset's original effective interest rate (specific impairment). If a credit exposure has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. The calculation of the present value of the estimated future cash flow of a collateralized financial asset reflects the cash flow that may result from foreclosure less costs for obtaining and selling the collateral.

If FINCA determines that no objective evidence of impairment exists for an individually assessed financial asset, whether individually significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment (impairment for collectively assessed credit exposures).

Collectively Assessed Loans—There are two cases in which credit exposures are collectively assessed for impairment:

- Individually insignificant credit exposures that show objective evidence of impairment
- The group of credit exposures that do not show signs of impairment in order to cover all losses that have already been incurred but not detected on an individual credit exposure basis

For the purpose of the evaluation of impairment of individually insignificant credit exposures, the credit exposures are grouped on the basis of similar credit risk characteristics (i.e., according to the number of days they are in arrears). Arrears of more than 30 days are considered to be a sign of impairment. This characteristic is relevant for the estimation of future cash flows for the defined groups of such assets, based on historical loss experiences with loans that showed similar characteristics. The collective assessment of impairment for individually insignificant credit exposures and for unimpaired credit exposures belonging to a group of financial assets is based on a quantitative analysis of historical default rates for loan portfolios with similar risk characteristics in the individual subsidiary (migration analysis), grouped into geographical segments with a comparable risk profile. After a qualitative analysis of this statistical data, FINCA management approves appropriate rates as the basis for its portfolio-based impairment allowances. Deviations from this guideline were allowed if necessitated by the specific situation of the subsidiary.

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 in the group and 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 period in which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by FINCA to reduce any differences between loss estimates and actual loss experience.

Writing Off Loans—When a loan is determined uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the allowance for loan impairment in the consolidated statements of profit or loss.

Investments—Investments are initially measured at fair value plus incremental direct transaction costs and subsequently accounted for depending on their classification as either held to maturity, fair value through profit or loss, or AFS.

Derecognition of Financial Assets—FINCA derecognizes a financial asset when the contractual rights to the cash flow for the asset expire or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another party. On derecognition of the financial asset, the difference between the asset's carrying amount and the sum of consideration received and receivable as well as the cumulative gain or loss that had been recognized in other comprehensive income, and accumulated in equity, is recognized in profit or loss.

FINCA also derecognizes certain assets when it charges off balances pertaining to the assets deemed to be uncollectible (see Note 5). Any interest in transferred financial assets that is created or retained by FINCA is recognized as a separate asset or liability.

Impairment of Financial Assets—At each balance sheet date, FINCA assesses whether there is objective evidence that financial assets not carried at FVTPL are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset and that the loss event has an impact on the future cash flows of the asset that can be reliably estimated.

For AFS equity investments, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

For all other financial assets, objective evidence of impairment could include:

- Significant financial difficulty of the issuer or counterparty
- Breach of contract, such as default or delinquency in interest or principal payments
- Probability that the borrower will enter bankruptcy or financial reorganization
- Disappearance of an active market for that financial asset because of financial difficulties

FINCA considers evidence of impairment at both a specific and collective asset level. All individually significant financial assets are assessed for specific impairment. All significant assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets (carried at amortized cost) with similar risk characteristics.

Objective evidence that financial assets are impaired can include default or delinquency by a client, restructuring of a loan or advance by FINCA on terms that FINCA would not otherwise consider, indications that a client or issuer will enter bankruptcy, or other observable data relating to a group of assets, such as adverse changes in the payment status of clients or issuers in the group or economic conditions that correlate with defaults in the group.

Impairment losses on assets carried at amortized cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognized in the consolidated statements of profit or loss and reflected in an allowance account against loans and advances.

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit or loss.

Financial Liabilities—Financial liabilities are classified as either financial liabilities at FVTPL or other financial liabilities.

Financial Liabilities at FVTPL—Financial liabilities are classified as at FVTPL when the financial liability is held for trading or it is designated as at FVTPL. FINCA did not have any financial liabilities held for trading at December 31, 2014.

A financial liability other than a financial liability held for trading may be designated at FVTPL upon initial recognition if:

- it has been incurred principally for the purpose of repurchasing it in the near term; or
- on initial recognition it is part of a portfolio of identified financial instruments that FINCA manages together and has a recent actual pattern of short-term profit taking; or
- it is a derivative that is not designated and effective as a hedging instrument (such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise); or

- the financial asset forms part of a group of financial assets, financial liabilities, or both that is managed and its performance is evaluated on a fair value basis, in accordance with FINCA’s documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives and IAS 39 permits the entire combined contract to be designated as at FVTPL.

Financial liabilities at FVTPL are stated at fair value with remeasurement gains or losses recognized in profit or loss. The net gain or loss recognized in profit or loss incorporates any interest paid on the financial liability and is included in the “other gains or losses” line item.

Other Financial Liabilities—Other financial liabilities (including borrowings, trade, and other payables) are measured at amortized cost using the effective interest method.

FINCA initially recognizes loans and advances and other financial liabilities (including depository instruments with the central banks of subsidiaries’ countries of operation, deposits by banks and customers, debt securities issued, other borrowed funds, subordinated debt, and other financial liabilities) at fair value, net of transaction costs.

Notes Payable—Notes payable are recognized initially at fair value, net of transaction costs incurred. Notes payable are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the consolidated statements of profit or loss over the period of the borrowings using the effective interest method. Fees paid on the establishment of loan facilities are recognized as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred until the draw-down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalized as a prepayment for liquidity services and amortized over the period of the facility to which it relates.

Subordinated Debt—Subordinated debt consists mainly of liabilities to other international financial institutions which in the event of insolvency or liquidation are not repaid until all nonsubordinated creditors have been satisfied. There is no obligation to repay early. Following initial recognition at acquisition cost, the subordinated debt is recognized at amortized cost. Premiums and discounts are accounted for over the respective terms in the consolidated statements of profit or loss under “net interest income.”

Client Deposits—Client deposits are recognized initially at fair value net of transaction costs incurred. Changes to client deposits are subsequently stated at amortized cost; any difference between proceeds net of transaction costs and the redemption value is recognized in the consolidated statements of profit or loss over the period of the borrowings using the effective interest rate method.

Other fair value changes are recognized in other comprehensive income, a component of equity, until the investment is sold or impaired and the balance in equity is recognized in the consolidated statements of profit or loss.

Financial Guarantee Contracts—Financial guarantee contracts issued by FINCA are initially measured at their fair value and, if not designated as at FVTPL, are subsequently measured at the higher of:

- The amount of obligation under the contract, as determined in accordance with IAS 37

- The amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies

Derecognition of Financial Liabilities—Financial liabilities are derecognized when they have been redeemed or otherwise extinguished. All financial liabilities are derecognized when they are extinguished, that is when the obligation is discharged, canceled, or expires. The difference between the carrying amount of financial liability derecognized and consideration paid is recognized in the consolidated statements of profit or loss.

Derivatives—The Company enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign exchange risk, including foreign exchange forward contracts and interest rate and cross-currency swaps.

Derivative instruments are initially recognized at fair value at the date the derivative contracts are entered into and are subsequently remeasured to their fair value at the end of each reporting period. The resulting gain or loss is recognized in profit or loss immediately unless the derivative is designated and effective as hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship. FINCA, in alignment with its risk management objectives, resources, and its strategy for undertaking various hedge transactions, assesses the relationship between the hedging instrument and the hedged item. Based on this assessment, the Company did not designate any of the hedging instruments as derivatives used for hedging purposes that qualify for hedge accounting. At December 31, 2014, the resulting gains or losses from “mark-to-market” valuation of the derivative instruments are recognized in the consolidated statements of profit or loss.

Offsetting—Financial assets and liabilities are offset and the net amount is presented in the consolidated statements of financial position when, and only when, FINCA has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards or for gains and losses arising from a group of similar transactions.

Cash and Cash Equivalents—Cash and cash equivalents include notes and coins on-hand, unrestricted balances held with central banks, and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value and are used by FINCA in the management of its short-term commitments.

Property and Equipment—Items of property and equipment are measured at cost, less accumulated depreciation and recognized impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labor, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

The cost of replacing part of an item of property or equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to FINCA and its cost can be reliably measured. The costs of the day-to-day servicing of property and equipment are recognized in the consolidated statements of profit or loss as incurred.

Depreciation is recognized in the consolidated statements of profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment:

| | |
|--------------------------------|-------------|
| Buildings and offices | 20–50 years |
| Computer equipment | 2–5 years |
| Furniture and office equipment | 5–7 years |
| Vehicles | 3–5 years |
| Other | 2–5 years |

Leasehold improvements are depreciated over the shorter of the lease term or their useful lives. When necessary, assets are componentized to address different useful lives of the component.

Depreciation methods, useful lives, and residual values are reassessed at each reporting date.

Borrowing Costs—FINCA did not incur any interest costs that qualify for capitalization under IAS 23, *Borrowing Costs*.

Intangible Assets—Costs associated with maintaining computer software programs are recognized as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by FINCA are recognized as intangible assets when the following criteria are met:

- It is technically feasible to complete the software product so that it will be available for use;
- Management intends to complete the software product and use it;
- There is an ability to use or sell the software product;
- It can be demonstrated how the software product will generate probable future economic benefits;
- Adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and
- The expenditure attributable to the software product during its development can be reliably measured.

Directly attributable costs that are capitalized as part of the software product include the software development employee costs and an appropriate portion of the overhead costs.

Other development expenditures that do not meet these criteria are recognized as an expense as incurred. Development costs previously recognized as an expense are not recognized as an asset in a subsequent period.

Computer software development costs recognized as assets are amortized over their useful lives, which is three to five years depending on facts and circumstances. Capital work in progress is represented by capitalized costs of information systems implementation in process. Capital work in progress is not amortized.

Impairment of Nonfinancial Assets—The carrying amounts of FINCA’s nonfinancial assets are reviewed on an annual basis or whenever a triggering event has been observed to determine whether there is any indication of impairment. If any such indication exists, the asset’s recoverable amount is estimated to determine the extent of the impairment loss (if any).

An impairment loss is recognized if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that are largely independent from other assets and groups. Impairment losses are recognized in the consolidated statements of profit or loss.

The recoverable amount of an asset or cash-generating unit is the higher of its value in use and its fair value, less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pretax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. Such impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. Such an impairment loss is reversed only to the extent that the asset’s carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized in previous years.

Leased Assets—Where substantially all of the risks and rewards incidental to ownership of a leased asset have been transferred to FINCA (a “finance lease”), the asset is treated as if it had been purchased outright. The amount initially recognized as an asset is the lower of the fair value of the leased property and the present value of the minimum lease payments payable over the term of the lease. The corresponding lease commitment is shown as a liability. Lease payments are analyzed between capital and interest. The interest element is charged to the consolidated statements of profit or loss over the period of the lease and is calculated so that it represents a constant proportion of the lease liability. The capital element reduces the balance owed to the lessor. As of December 31, 2014 and 2013, FINCA had no finance leases.

Where substantially all of the risks and rewards incidental to ownership are not transferred to FINCA (an “operating lease”), the total rentals payable under the lease are charged to the consolidated statements of profit or loss on a straight-line basis over the lease term. The aggregate benefit of lease incentives is recognized as a reduction of the rental expense over the lease term on a straight-line basis. Lease incentives received are recognized as an integral part of the total lease expense over the term of the lease.

Lease payments made under operating leases are recognized in the consolidated statements of profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

Employee Benefits

Deferred Contribution Benefit Plan—FINCA follows statutory and regulatory requirements with regard to establishing employee benefit plans in both the international jurisdictions it operates and in the United States.

FINCA has established an employee contribution plan that allows employees to defer compensation up to a maximum amount as permitted by the Internal Revenue Code. FINCA makes contributions to the plan as a discretionary employer match. Payments to defined contribution retirement benefit plans are recognized as an expense when employees have rendered service entitling them to the contributions.

Employee Benefit Plans—In accordance with IAS 19 (as amended in 2011), for defined benefit retirement plans, FINCA uses the projected unit credit method to calculate the cost of providing benefits, with actuarial valuations being carried out by a qualified actuary at the end of each annual reporting period. Remeasurements, including actuarial gains and losses, the effect of changes to the asset ceiling (if applicable), and the return on plan assets (excluding interest) is reflected immediately in the consolidated statements of financial position with a cost or credit recognized in other comprehensive income in the period in which they occur. Remeasurement recognized in other comprehensive income is reflected immediately in retained earnings and will not be reclassified in to profit or loss. Prior service costs are recognized in profit or loss in the period of plan amendment. Defined benefit costs are categorized as follows:

- Service costs, which include current and past service costs, as well as gains and losses on curtailments and settlements
- Net interest expense or income
- Remeasurements

FINCA presents the first two components of defined benefit costs in profit or loss under the employee benefits expense line item. The retirement benefit obligation recognized in the consolidated statements of financial position represents the actual deficit of FINCA's defined benefit plans.

Short-Term Benefits—Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A provision is recognized for the amount expected to be paid under short-term cash bonus or if FINCA has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be reliably estimated.

Government and Other Grants—Grants are accounted for in accordance with IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, following the gross approach, where the money received and the obligation to use the money for ongoing expenses is not offset. The liability to fulfill the obligation, recognized in the consolidated statements of financial position, is amortized through the consolidated statements of profit or loss at the same time as funds are spent to cover expenditures. When donor contributions are used to purchase assets, the assets are recognized in the consolidated statements of financial position. Another liability is recognized to reflect the obligation to use the funds for restricted purposes. The liability is amortized through the consolidated statements of profit or loss, at which time expenses are incurred for program activities.

Provisions—Provisions are recognized when FINCA has a present obligation (legal or constructive) as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pretax rate that reflects current market assessments of the time value of money and the risks specific to the obligation.

Application of New and Revised IFRSs

New and Revised IFRSs Affecting Amounts Reported and/or Disclosures in the Financial Statements—

In the current year, FINCA has adopted all new and revised Standards and Interpretations that are relevant to its operations and effective for an accounting period that begins on or after January 1, 2014.

Amendments to IFRS 10, IFRS 12 and IAS 27 Investment Entities

FINCA has applied the amendments to IFRS 10, IFRS 12 and IAS 27 *Investment Entities* for the first time in the current year. The amendments to IFRS 10 define an investment entity and require a reporting entity that meets the definition of an investment entity not to consolidate its subsidiaries but instead to measure its subsidiaries at fair value through profit or loss in its consolidated and separate financial statements.

To qualify as an investment entity, a reporting entity is required to:

- obtain funds from one or more investors for the purpose of providing them with investment management services;
- commit to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- measure and evaluate performance of substantially all of its investments on a fair value basis.

Consequential amendments have been made to IFRS 12 and IAS 27 to introduce new disclosure requirements for investment entities.

As FINCA is not an investment entity (assessed based on the criteria set out in IFRS 10 as at 1 January 2014), the application of the amendments has had no impact on the disclosures or the amounts recognized in the FINCA's consolidated financial statements.

Amendments to IAS 32 *Offsetting Financial Assets and Financial Liabilities*

FINCA has applied the amendments to IAS 32 *Offsetting Financial Assets and Financial Liabilities* for the first time in the current year. The amendments to IAS 32 clarify the requirements relating to the offset of financial assets and financial liabilities. Specifically, the amendments clarify the meaning of 'currently has a legally enforceable right of set-off and 'simultaneous realization and settlement'.

The amendments have been applied retrospectively. As FINCA does not have any financial assets and financial liabilities that qualify for offset, the application of the amendments has had no impact on the disclosures or on the amounts recognized in FINCA's consolidated financial statements. FINCA has assessed whether certain of its financial assets and financial liabilities qualify for offset based on the criteria set out in the amendments and concluded that the application of the amendments has had no impact on the amounts recognized in the FINCA's consolidated financial statements.

Amendments to IAS 36 *Recoverable Amount Disclosures for Non-Financial Assets*

FINCA has applied the amendments to IAS 36 *Recoverable Amount Disclosures for Non-Financial Assets* for the first time in the current year. The amendments to IAS 36 remove the requirement to disclose the recoverable amount of a cash-generating unit (CGU) to which goodwill or other intangible assets with indefinite useful lives had been allocated when there has been no impairment or reversal of

impairment of the related CGU. Furthermore, the amendments introduce additional disclosure requirements applicable to when the recoverable amount of an asset or a CGU is measured at fair value less costs of disposal. These new disclosures include the fair value hierarchy, key assumptions and valuation techniques used which are in line with the disclosure required by IFRS 13 Fair Value Measurements.

The application of these amendments has had no material impact on the disclosures in the FINCA's consolidated financial statements.

Amendments to IAS 39 Novation of Derivatives and Continuation of Hedge Accounting

FINCA has applied the amendments to IAS 39 *Novation of Derivatives and Continuation of Hedge Accounting* for the first time in the current year. The amendments to IAS 39 provide relief from the requirement to discontinue hedge accounting when a derivative designated as a hedging instrument is novated under certain circumstances. The amendments also clarify that any change to the fair value of the derivative designated as a hedging instrument arising from the novation should be included in the assessment and measurement of hedge effectiveness. The amendments have been applied retrospectively. As FINCA does not have any derivatives that are subject to novation, the application of these amendments has had no impact on the disclosures or on the amounts recognized in FINCA's consolidated financial statements.

IFRIC 21 Levies

FINCA has applied IFRIC 21 *Levies* for the first time in the current year. IFRIC 21 addresses the issue as to when to recognize a liability to pay a levy imposed by a government. The Interpretation defines a levy, and specifies that the obligating event that gives rise to the liability is the activity that triggers the payment of the levy, as identified by legislation. The Interpretation provides guidance on how different levy arrangements should be accounted for. In particular, it clarifies that neither economic compulsion nor the going concern basis of financial statements preparation implies that an entity has a present obligation to pay a levy that will be triggered by operating in a future period.

IFRIC 21 has been applied retrospectively. The application of this Interpretation has had no material impact on the disclosures or on the amounts recognized in the FINCA's consolidated financial statements.

New and revised IFRSs in issue but not yet effective

FINCA has not applied the following new and revised IFRSs that have been issued but are not yet effective:

- IFRS 9, *Financial Instruments*⁵
- IFRS 15, *Revenue from Contracts with Customers*⁴
- Amendments to IFRS 11—*Accounting for Acquisitions of Interests in Joint Operations*³
- Amendments to IAS 16 and IAS 38—*Clarification of Acceptable Methods of Depreciation and Amortization*³
- Amendments to IAS 16 and IAS 41—*Agriculture: Bearer Plants*³

- Amendments to IAS 19—*Defined Benefit Plans: Employee Contributions*¹
- Amendments to IFRSs—*Annual Improvements to IFRSs 2010-2012 Cycle*²
- Amendments to IFRSs—*Annual Improvements to IFRSs 2011-2013 Cycle*¹

¹ Effective for annual periods beginning on or after 1 July 2014, with earlier application permitted.

² Effective for annual periods beginning on or after 2014, with limited exceptions. Earlier application is permitted.

³ Effective for annual periods beginning on or after 1 January 2016, with earlier application permitted.

⁴ Effective for annual periods beginning on or after 2017, with earlier application permitted.

⁵ Effective for annual periods beginning on or after 2018, with earlier application permitted.

IFRS 9 *Financial Instruments*—IFRS 9, issued in November 2009, introduced new requirements for the classification and measurement of financial assets. IFRS 9 was amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition.

Key Requirements of IFRS 9—All recognized financial assets that are within the scope of IAS 39 are required to be subsequently measured at amortized cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair value at the end of subsequent accounting periods. In addition, under IFRS 9, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, with only dividend income generally recognized in profit or loss.

- For the measurement of financial liabilities designated as at FVTPL, IFRS 9 requires that the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Under IAS 39, the entire amount of the change in the fair value of the financial liability designated as FVTPL is presented in profit or loss.

In March 2013, the IASB issued a revised exposure draft that proposes a more forward-looking impairment model that reflects expected credit losses, as compared to the incurred loss model under IAS 39.

It is not practicable to provide a reasonable estimate of the effect of IFRS 9 until FINCA performs a detailed review.

IFRS 15 Revenue from Contracts with Customers

In May 2014, IFRS 15 was issued which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and the related Interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the Standard introduces a 5-step approach to revenue recognition:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognizes revenue when (or as) a performance obligation is satisfied, i.e. when ‘control’ of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

It is not practicable to provide a reasonable estimate of the effect of IFRS 15 until FINCA performs a detailed review.

Amendments to IFRS 11 Accounting for Acquisitions of Interests in Joint Operations

The amendments to IFRS 11 provide guidance on how to account for the acquisition of a joint operation that constitutes a business as defined in IFRS 3 *Business Combinations*. Specifically, the amendments state that the relevant principles on accounting for business combinations in IFRS 3 and other standards (e.g. IAS 36 *Impairment of Assets* regarding impairment testing of a cash-generating unit to which goodwill on acquisition of a joint operation has been allocated) should be applied. The same requirements should be applied to the formation of a joint operation if and only if one of the parties that participate in the joint operation contributes an existing business to the joint operation.

A joint operator is also required to disclose the relevant information required by IFRS 3 and other standards for business combinations.

The amendments to IFRS 11 apply prospectively for annual periods beginning on or after 1 January 2016. The management of FINCA does not anticipate that the application of these amendments to IFRS 11 will have a material impact on the FINCA’s consolidated financial statements.

Amendments to IAS 16 and IAS 38 Clarification ion of Acceptable Methods of Depreciation and Amortization

The amendments to IAS 16 prohibit entities from using a revenue-based depreciation method for items of property, plant and equipment. The amendments to IAS 38 introduce a rebuttable presumption that revenue is not an appropriate basis for amortization of an intangible asset. This presumption can only be rebutted in the following two limited circumstances:

- a) when the intangible asset is expressed as a measure of revenue; or
- b) when it can be demonstrated that revenue and consumption of the economic benefits of the intangible asset are highly correlated.

The amendments apply prospectively for annual periods beginning on or after 1 January 2016. Currently, FINCA uses the straight-line method for depreciation and amortization for its property, plant and equipment, and intangible assets respectively. The management of FINCA believe that the straight-line method is the most appropriate method to reflect the consumption of economic benefits inherent in the respective assets and accordingly, the management of FINCA does not anticipate that the application of these amendments to IAS 16 and IAS 38 will have a material impact on the FINCA's consolidated financial statements.

Amendments to IAS 16 and IAS 41 Agriculture: Bearer Plants

The amendments to IAS 16 and IAS 41 define a bearer plant and require biological assets that meet the definition of a bearer plant to be accounted for as property, plant and equipment in accordance with IAS 16, instead of IAS 41. The produce growing on bearer plants continues to be accounted for in accordance with IAS 41.

The Management of FINCA does not anticipate that the application of these amendments to IAS 16 and IAS 41 will have a material impact on the FINCA's consolidated financial statements, as FINCA is not engaged in agricultural activities.

Amendments to IAS 19 Defined Benefit Plans: Employee Contributions

The amendments to IAS 19 clarify how an entity should account for contributions made by employees or third parties to defined benefit plans, based on whether those contributions are dependent on the number of years of service provided by the employee.

For contributions that are independent of the number of years of service, the entity may either recognize the contributions as a reduction in the service cost in the period in which the related service is rendered, or to attribute them to the employees' periods of service using the projected unit credit method; whereas for contributions that are dependent on the number of years of service, the entity is required to attribute them to the employees' periods of service.

The management of FINCA does not anticipate that the application of these amendments to IAS 19 will have a significant impact on FINCA's consolidated financial statements.

Annual Improvements to IFRSs 2010-2012 Cycle

The Annual Improvements to IFRSs 2010-2012 Cycle include a number of amendments to various IFRSs, which are summarized below.

The amendments to IFRS 2 (i) change the definitions of ‘vesting condition’ and ‘market condition’; and (ii) add definitions for ‘performance condition’ and ‘service condition’ which were previously included within the definition of ‘vesting condition’. The amendments to IFRS 2 are effective for share-based payment transactions for which the grant date is on or after 1 July 2014.

The amendments to IFRS 3 clarify that contingent consideration that is classified as an asset or a liability should be measured at fair value at each reporting date, irrespective of whether the contingent consideration is a financial instrument within the scope of IFRS 9 or IAS 39 or a non-financial asset or liability. Changes in fair value (other than measurement period adjustments) should be recognized in profit or loss. The amendments to IFRS 3 are effective for business combinations for which the acquisition date is on or after 1 July 2014.

The amendments to IFRS 8 (i) require an entity to disclose the judgments made by management in applying the aggregation criteria to operating segments, including a description of the operating segments aggregated and the economic indicators assessed in determining whether the operating segments have ‘similar economic characteristics’; and (ii) clarify that a reconciliation of the total of the reportable segments’ assets to the entity’s assets should only be provided if the segment assets are regularly provided to the chief operating decision-maker.

The amendments to the basis for conclusions of IFRS 13 clarify that the issue of IFRS 13 and consequential amendments to IAS 39 and IFRS 9 did not remove the ability to measure short-term receivables and payables with no stated interest rate at their invoice amounts without discounting, if the effect of discounting is immaterial. As the amendments do not contain any effective date, they are considered immediately effective.

The amendments to IAS 16 and IAS 38 remove perceived inconsistencies in the accounting for accumulated depreciation/amortization when an item of property, plant and equipment or an intangible asset is revalued. The amended standards clarify that the gross carrying amount is adjusted in a manner consistent with the revaluation of the carrying amount of the asset and that accumulated depreciation/amortization is the difference between the gross carrying amount and the carrying amount after taking into account accumulated impairment losses.

The amendments to IAS 24 clarify that a management entity providing key management personnel services to a reporting entity is a related party of the reporting entity. Consequently, the reporting entity should disclose as related party transactions the amounts incurred for the service paid or payable to the management entity for the provision of key management personnel services. However, disclosure of the components of such compensation is not required.

The management of FINCA does not anticipate that the application of these amendments will have a significant impact on FINCA’s consolidated financial statements.

Annual Improvements to IFRSs 2011-2013 Cycle

The Annual Improvements to IFRSs 2011-2013 Cycle include a number of amendments to various IFRSs, which are summarized below.

The amendments to IFRS 3 clarify that the standard does not apply to the accounting for the formation of all types of joint arrangement in the financial statements of the joint arrangement itself.

The amendments to IFRS 13 clarify that the scope of the portfolio exception for measuring the fair value of a group of financial assets and financial liabilities on a net basis includes all contracts that are within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9, even if those contracts do not meet the definitions of financial assets or financial liabilities within IAS 32.

The amendments to IAS 40 clarify that IAS 40 and IFRS 3 are not mutually exclusive and application of both standards may be required. Consequently, an entity acquiring investment property must determine whether:

- (a) the property meets the definition of investment property in terms of IAS 40; and
- (b) the transaction meets the definition of a business combination under IFRS 3.

The management of FINCA does not anticipate that the application of these amendments will have a significant impact on FINCA's consolidated financial statements.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Allowances for Credit Impairment—The specific counterparty component of the total allowances for impairment applies to claims evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgments about a counterparty's financial situation and the net realizable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by FINCA management.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of claims with similar economic characteristics when there is objective evidence to suggest that they contain impaired claims, but the individual impaired items cannot yet be identified. A component of collectively assessed allowances is for country risks. In assessing the need for collective loan credit loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, assumptions are made to define the way inherent losses are modeled and to determine the required input parameters, based on historical experience and current economic conditions. The accuracy of the allowances depends on how well these estimated future cash flows for specific counterparty allowances are forecast and the model assumptions and parameters used in determining collective allowances.

Income Taxes—FINCA is subject to income tax in several international jurisdictions, and significant judgment is required in determining the provision for income taxes. During the ordinary course of business, there are transactions and calculations for which the ultimate tax determination is uncertain. As a result, FINCA recognizes tax liabilities based on estimates of whether additional taxes and interest will be due. These tax liabilities are recognized when, despite FINCA's belief that its tax return positions are supportable, FINCA believes that certain positions are likely to be challenged and may not be fully sustained upon review by tax authorities. FINCA believes that its accruals for tax liabilities are adequate for all open audit years based on its assessment of many factors including past experience and interpretations of tax law. This assessment relies on estimates and assumptions and may involve a series of complex judgments about future events. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will affect income tax expense in the period in which such determination is made.

Legal Proceedings—In accordance with IFRS, FINCA recognizes a provision where there is a present obligation from a past event, a transfer of economic benefits is probable, and the amount of costs of the transfer can be estimated reliably. In instances where the criteria are not met, a contingent liability may be disclosed in the notes to the consolidated financial statements. Obligations arising in respect of contingent liabilities that have been disclosed or those that are not currently recognized or disclosed in the consolidated financial statements could have a material effect on FINCA’s financial position. Application of these accounting principles to legal cases requires FINCA management to make determinations about various factual and legal matters beyond its control. FINCA has outstanding legal cases, makes assessments of the legal proceedings at each reporting date, and makes a determination as to their status in order to assess the need for provisions and disclosures in its consolidated financial statements. Among the factors considered in making decisions on provisions are the nature of litigation, claim, or assessment, the legal process and potential level of damages in the jurisdiction in which the litigation, claim, or assessment has been brought, the progress of the case (including the progress after the date of the consolidated financial statements, but before those consolidated statements are issued), the opinions or views of legal advisers, experience on similar cases, and any decision of FINCA’s management as to how it will respond to the litigation, claim, or assessment.

5. FINANCIAL RISK MANAGEMENT

FINCA believes that effective risk management is of primary importance to its overall operations. Accordingly, FINCA’s risk management process has been designed to monitor, evaluate and manage the principal risks it assumes in conducting its activities. Specifically, the activities that FINCA engages in, and the risks those activities generate, must be consistent with FINCA’s underlying goal of serving the world’s lowest income entrepreneurs.

FINCA’s risks are generally categorized into:

- Credit risk
- Market risk
- Liquidity risk
- Counterparty risk
- Foreign currency risk

FINCA’s risk programs are based on three lines of defense: (i) business management, (ii) independent control functions and (iii) Internal Audit.

- **Business Management.** Each of FINCA’s subsidiaries, including in-business risk personnel, own and manage the risks, including compliance risks, inherent in or arising from the business, and are responsible for having controls in place to mitigate key risks and promoting a culture of compliance and control.
- **Independent Control Functions.** FINCA’s independent control functions, including Finance, Legal and Risk, set standards according to which FINCA and its businesses are expected to manage and oversee risks, including compliance with applicable laws, regulatory requirements, policies and standards of ethical conduct. In addition, among other things, the independent control functions provide advice and training to FINCA’s businesses and establish tools, methodologies, processes and oversight of controls used by the businesses to foster a culture of compliance and control and to satisfy those standards.

- Internal Audit. FINCA's Internal Audit function independently reviews activities of the first two lines of defense discussed above based on a risk-based audit plan and methodology approved by the FINCA's Board of Directors.

Historically FINCA maintained a minimum Tier I capital policy that required subsidiaries to maintain common tangible equity equal to at least 20 percent of total assets. This level was quite conservative compared with competitors and local regulatory requirements. To better align with lender and regulatory standards, and acknowledging the constraint this relatively high capital requirement placed upon growth, in 2014 certain subsidiaries were granted approval from FINCA's audit committee to lower their minimum tangible equity level to 15 percent (this lowering was coordinated with relevant lenders). In addition, certain subsidiaries are also permitted to include qualifying Tier II equity in their minimum equity ratios. Subsidiaries that have not been permitted a higher leverage limit must remain compliant with the 20 percent tangible equity level. Compliance with this internal policy is monitored as part of the monthly Asset-Liability Committee (ALCO) process. FINCA's Tier I and Tier II capital ratios exceeded this minimum policy level in 2014 and 2013.

| | 2014 | 2013 |
|--|------------------------|------------------------|
| Reserves | \$ 17,706,184 | \$ 15,211,848 |
| Retained earnings | 188,448,532 | 186,172,023 |
| Currency translation reserve | <u>(28,299,651)</u> | <u>(16,126,565)</u> |
| Tier I capital attributable to the parent company | 177,855,065 | 185,257,306 |
| Tier I capital attributable to non-controlling interests | <u>119,559,445</u> | <u>123,796,630</u> |
| Tier I capital | <u>\$ 297,414,510</u> | <u>\$ 309,053,936</u> |
| Total assets | <u>\$1,251,644,852</u> | <u>\$1,104,652,106</u> |
| Tier I capital/assets | <u>23.8 %</u> | <u>28.0 %</u> |
| Qualified Tier II capital | <u>\$ 3,827,200</u> | <u>\$ 7,688,000</u> |
| Total capital | <u>\$ 301,241,710</u> | <u>\$ 316,741,936</u> |
| Total capital/assets | <u>24.1 %</u> | <u>28.7 %</u> |

Credit Risk—Credit risk is the potential for financial loss resulting from the failure of a client or counterparty to honor its financial or contractual obligations. Credit risk arises from FINCA's microfinance activities.

FINCA's loan portfolio is made up entirely of loans made to individuals and groups of individuals for a specific purpose and is sufficiently diversified to reduce concentration risk. At December 31, 2014 and 2013, FINCA had 1.203 million and 1.146 million borrowers, respectively.

FINCA's aggregate loan portfolio was \$966.9 million and \$840.6 million as of December 31, 2014 and 2013, respectively (see Note 15). FINCA's total allowances for impairments totaled \$17.5 million at December 31, 2014, a coverage ratio of 1.8% of total loans. The total allowances for impairments totaled \$11.8 million at December 31 2013, a coverage ratio of 1.4% of total loans.

Regionally, impairment losses on loans approximate 1.7%–6.0% and 0.9%–5.7% of the average total loan portfolio at December 31, 2014 and 2013, respectively, pursuant to the following:

| | Impairment Losses on Loans | | Average Gross Loans to Customers | | Impairment Losses as % of Average Gross Loans | |
|---------------|-------------------------------|-------------|-------------------------------------|---------------|---|-------|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| Eurasia | \$9,437,650 | \$4,258,956 | \$550,395,904 | \$466,152,944 | 1.7 % | 0.9 % |
| Latin America | 9,984,362 | 8,211,725 | 165,740,519 | 145,080,515 | 6.0 | 5.7 |
| Africa | 4,325,874 | 2,692,928 | 127,505,307 | 95,650,862 | 3.4 | 2.8 |
| MESA | 1,146,714 | 390,603 | 60,107,003 | 37,670,664 | 1.9 | 1.0 |

FINCA conducts biannual historical loan-loss migration analysis across its subsidiary network in order to determine the probability of default, defined as all loans in arrears in excess of 180 days, as well as an examination of other current observable factors (e.g., macroeconomic, operational, policy and systems changes, political risk, etc.) in order to establish subsidiary credit reserves. The loan loss migration data is used to form the statistical base of the credit risk calculation in order to estimate the probability of default over a six month period. In addition, FINCA conducts quarterly vintage loan analysis.

Exposure to credit risk at December 31, 2014 is as follows:

Impaired Loans—Impaired loans are loans for which FINCA determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan agreement.

Past Due but not Impaired Loans—Past due but not impaired loans are loans where contractual interest or principal payments are past due, but FINCA believes that impairment is not appropriate on the basis of the level of collateral available and/or the stage of collection of amounts owed to FINCA.

Loans with Renegotiated Terms—Loans with renegotiated terms are loans that have been restructured due to deterioration in the client’s financial position, and where FINCA has made concessions that it would not otherwise consider. Once the loan is restructured, it remains in this category independent of satisfactory performance after restructuring.

Allowances for Impairment—FINCA establishes an allowance for impairment losses that represents an estimate of probably or expected losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loan loss allowance established for groups of homogeneous assets with respect to losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

Write-Off Policy—FINCA writes off a loan (and any related allowances for impairment losses) when FINCA’s Credit Committees and Subsidiaries’ Audit Committees determine that the loans are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in a client’s financial position, such that the client can no longer pay the obligation, or that proceeds from collateral, if any, will not be sufficient to pay back the entire exposure. For smaller balance standardized loans, charge-off decisions are generally based on a product-specific past due status. Exposure to credit risk at December 31, 2014 is as follows:

The regional segmentation by arrears category for gross loans and allowances at December 31, 2014 is as follows:

| Total Gross Loans for Each Portfolio Aging Segment | | | | | | | |
|--|-----------------------|----------------------|---------------------|---------------------|---------------------|---------------------|----------------------------|
| | Current | 1–30 Days | 31–60 Days | 61–90 Days | 91–180 Days | 180+ Days | Total Gross Loan Portfolio |
| Eurasia | \$ 559,192,472 | \$ 7,337,303 | \$ 2,047,506 | \$ 1,414,742 | \$ 3,128,189 | \$ 553,950 | \$ 573,674,162 |
| Latin America | 164,396,196 | 3,815,032 | 1,654,023 | 1,495,233 | 3,442,964 | 651,880 | 175,455,328 |
| Africa | 134,359,073 | 4,602,399 | 656,888 | 469,308 | 923,424 | 1,112,735 | 142,123,827 |
| MESA | 74,223,274 | 569,332 | 279,174 | 180,971 | 360,450 | 282 | 75,613,483 |
| Total | <u>\$ 932,171,015</u> | <u>\$ 16,324,066</u> | <u>\$ 4,637,591</u> | <u>\$ 3,560,254</u> | <u>\$ 7,855,027</u> | <u>\$ 2,318,847</u> | <u>\$ 966,866,800</u> |

| Aging of the Allowances for Impairment | | | | | | | |
|--|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|--------------------------------|
| | Current | 1–30 Days | 31–60 Days | 61–90 Days | 91–180 Days | 180+ Days | Total Allowance for Impairment |
| Eurasia | \$ 2,079,755 | \$ 419,980 | \$ 709,600 | \$ 825,955 | \$ 2,572,912 | \$ 556,075 | \$ 7,164,277 |
| Latin America | 1,314,263 | 496,233 | 643,766 | 906,732 | 2,696,666 | 540,640 | 6,598,300 |
| Africa | 745,501 | 169,887 | 422,717 | 259,853 | 636,109 | 929,815 | 3,163,882 |
| MESA | 80,334 | 51,261 | 89,025 | 88,762 | 297,509 | 282 | 607,173 |
| Total | <u>\$ 4,219,853</u> | <u>\$ 1,137,361</u> | <u>\$ 1,865,108</u> | <u>\$ 2,081,302</u> | <u>\$ 6,203,196</u> | <u>\$ 2,026,812</u> | <u>\$ 17,533,632</u> |

The regional segmentation by arrears category for gross loans and allowances at December 31, 2013 is as follows:

| Total Gross Loans for Each Portfolio Aging Segment | | | | | | | |
|--|-----------------------|----------------------|---------------------|---------------------|---------------------|---------------------|----------------------------|
| | Current | 1–30 Days | 31–60 Days | 61–90 Days | 91–180 Days | 180+ Days | Total Gross Loan Portfolio |
| Eurasia | \$ 511,423,945 | \$ 4,709,591 | \$ 1,145,719 | \$ 870,901 | \$ 1,943,730 | \$ 333,851 | \$ 520,427,737 |
| Latin America | 149,076,624 | 3,323,472 | 1,355,810 | 1,089,507 | 2,261,397 | 604,217 | 157,711,027 |
| Africa | 111,989,097 | 1,933,014 | 757,809 | 458,287 | 882,448 | 387,951 | 116,408,606 |
| MESA | 45,143,628 | 371,412 | 229,778 | 93,142 | 208,147 | 37,190 | 46,083,297 |
| Total | <u>\$ 817,633,294</u> | <u>\$ 10,337,489</u> | <u>\$ 3,489,116</u> | <u>\$ 2,511,837</u> | <u>\$ 5,295,722</u> | <u>\$ 1,363,209</u> | <u>\$ 840,630,667</u> |

| Aging of the Allowances for Impairment | | | | | | | |
|--|---------------------|-------------------|---------------------|---------------------|---------------------|---------------------|--------------------------------|
| | Current | 1–30 Days | 31–60 Days | 61–90 Days | 91–180 Days | 180+ Days | Total Allowance for Impairment |
| Eurasia | \$ 1,738,619 | \$ 297,256 | \$ 435,123 | \$ 505,767 | \$ 1,671,595 | \$ 259,158 | \$ 4,907,518 |
| Latin America | 1,388,475 | 297,222 | 442,968 | 619,823 | 1,704,986 | 359,233 | 4,812,707 |
| Africa | 116,102 | 124,034 | 233,546 | 178,211 | 669,639 | 399,250 | 1,720,782 |
| MESA | 279,321 | 13,992 | 37,791 | 8,816 | 55,101 | 704 | 395,725 |
| Total | <u>\$ 3,522,517</u> | <u>\$ 732,504</u> | <u>\$ 1,149,428</u> | <u>\$ 1,312,617</u> | <u>\$ 4,101,321</u> | <u>\$ 1,018,345</u> | <u>\$ 11,836,732</u> |

Market Risk—Market risk includes price risk, foreign exchange and liquidity risk, which arise in the normal course of FINCA’s business:

- Price risk is the risk to earnings from changes in interest rates
- Foreign exchange rate risk arises from the different markets in which FINCA operates, which are mostly developing countries with so called exotic currencies
- Liquidity risk is the risk that a change in market conditions precludes the ability of FINCA to fund its existing asset base and operational requirements

Market risks are measured in accordance with established standards to ensure consistency across Subsidiaries. Each Subsidiary is required to comply with network-wide risk limits that clearly define approved risk parameters.

FINCA’s financial performance is subject to some degree of risk due to changes in interest rates; however, FINCA’s Subsidiary balance sheets have significantly less interest rate risk than that of a traditional financial institution as:

- The tenor mismatch between assets and liabilities is far less
- Neither the assets nor the liabilities of Subsidiaries are tied to any particular market index and therefore do not automatically “reprice” during their stated tenor
- The short-term nature of FINCA’s loans to clients renders the benefit of prepayments to be immaterial—thus, changes in market rates have an immaterial effect on prepayments

The consideration of interest rate risk by term of asset and liability as of December 31, 2014 is as follows:

| | Up to 3 Months | 3-6 Months | 7-12 Months | 1-3 Years | More Than 3 Years | Non-interest Sensitive Balances | 2014 Total |
|---|-----------------------|-----------------------|----------------------|------------------------|-----------------------|---------------------------------------|-----------------------|
| Cash and cash equivalents | \$ 54,661,182 | \$ 2,098,695 | \$ - | \$ - | \$ - | \$ 92,395,033 | \$ 149,154,910 |
| Restricted cash and cash equivalents | 20,595,753 | 850,523 | - | 50,000 | - | 2,360,449 | 23,856,725 |
| Available for sale financial assets | 8,201,007 | 9,454,720 | 4,277,222 | 7,891,731 | - | 728,829 | 30,553,509 |
| Financial assets held-to-maturity | 43,567 | - | - | 669,651 | 669,671 | - | 1,382,889 |
| Financial assets at fair value | - | - | - | - | - | - | - |
| through profit and loss | 2,250,508 | 7,787,282 | 354,192 | 2,787,480 | - | - | 13,179,462 |
| Loans receivable—net | 253,347,641 | 216,317,813 | 283,131,167 | 191,451,026 | 5,085,521 | - | 949,333,168 |
| Grants receivable—net | 112,739 | - | 198,003 | - | - | 2,788,765 | 3,099,507 |
| Other receivables, prepaid and other assets | 944,526 | 108,614 | 62,993 | 62,900 | 23,097 | 22,590,376 | 23,792,506 |
| Property and equipment—net | - | - | 123,129 | - | 814,635 | 32,570,277 | 33,508,041 |
| Intangible assets—net | - | 19,140 | - | 13,098 | 436,708 | 13,601,531 | 14,070,477 |
| Deferred tax assets | 42,390 | - | - | - | - | 9,671,268 | 9,713,658 |
| | - | - | - | - | - | - | - |
| Total assets | 340,199,313 | 236,636,787 | 288,146,706 | 202,925,886 | 7,029,632 | 176,706,528 | 1,251,644,852 |
| Accounts payable and other accrued liabilities | 2,336,726 | - | 81,376 | - | 555,088 | 30,686,795 | 33,659,985 |
| Financial liability at fair value | - | - | - | - | - | - | - |
| through profit and loss | 20,095 | 67,148 | - | 39,711 | - | 2,220,005 | 2,346,959 |
| Client deposits | 75,737,242 | 22,940,500 | 22,420,399 | 5,142,081 | 669,848 | 3,303,565 | 130,213,635 |
| Bank deposits | 1,547,026 | 1,095,244 | - | - | - | - | 2,642,270 |
| Notes payable | 76,500,489 | 108,884,288 | 167,813,050 | 320,381,909 | 67,245,950 | - | 740,825,686 |
| Subordinated debt | 25,988 | 827,212 | 2,731,181 | 18,232,678 | 1,829,459 | - | 23,646,518 |
| Deferred revenue | 320,962 | 9,712 | 17,523 | 10,238 | - | 10,256,990 | 10,615,425 |
| Employee benefits | - | - | - | - | - | 4,618,476 | 4,618,476 |
| Current income tax liability | 177,095 | - | - | - | - | 4,156,466 | 4,333,561 |
| Deferred tax liabilities | - | - | - | - | 385,729 | 942,098 | 1,327,827 |
| | - | - | - | - | - | - | - |
| Total liabilities | 156,665,623 | 133,824,104 | 193,063,529 | 343,806,617 | 70,686,074 | 56,184,395 | 954,230,342 |
| Open position | \$ 183,533,690 | \$ 102,812,683 | \$ 95,083,177 | \$(140,880,731) | \$(63,656,442) | \$ 120,522,133 | \$ 297,414,510 |

The consideration of interest rate risk by term of asset and liability as of December 31, 2013 is as follows:

| | Up to 3 Months | 3-6 Months | 7-12 Months | 1-3 Years | More Than 3 Years | Non-interest Sensitive Balances | 2013 Total |
|--|-----------------------|-----------------------|-----------------------|-------------------------|-----------------------|---------------------------------------|-----------------------|
| Cash and cash equivalents | \$ 81,684,517 | \$ - | \$ - | \$ - | \$ - | \$ 73,376,111 | \$ 155,060,628 |
| Restricted cash and cash equivalents | 15,610,691 | 2,000,000 | 1,000,000 | - | - | 6,443,366 | 25,054,057 |
| Available for sale financial assets | 3,556,446 | 744,287 | 451,892 | 1,327,725 | - | 12,802,773 | 18,883,123 |
| Financial assets at fair value through profit and loss | 791,137 | 524,823 | 2,223,777 | 88,787 | - | - | 3,628,524 |
| Loans receivable—net | 191,056,276 | 159,007,695 | 233,517,584 | 240,409,345 | 4,803,035 | - | 828,793,935 |
| Grants receivable—net | 46,565 | 215,608 | - | 140,408 | - | 3,415,183 | 3,817,764 |
| Other receivables, prepaid and other assets | 357,210 | - | - | - | - | 15,770,546 | 16,127,756 |
| Property and equipment—net | - | - | - | 86,693 | 983,009 | 28,065,522 | 29,135,224 |
| Intangible assets—net | - | - | - | - | 567,346 | 14,394,104 | 14,961,450 |
| Goodwill | - | - | - | - | - | 1,108,117 | 1,108,117 |
| Deferred tax assets | - | - | - | - | - | 8,081,528 | 8,081,528 |
| Total assets | 293,102,842 | 162,492,413 | 237,193,253 | 242,052,958 | 6,353,390 | 163,457,250 | 1,104,652,106 |
| Accounts payable and other accrued liabilities | 3,230,884 | - | 161,367 | 86,569 | - | 30,710,369 | 34,189,189 |
| Financial liability at fair value through profit and loss | 440,011 | 132,204 | - | (183,173) | - | 1,261,707 | 1,650,749 |
| Client deposits | 42,108,780 | 8,129,310 | 16,971,382 | 7,426,683 | 1,401,878 | 2,316,246 | 78,354,279 |
| Notes payable | 96,484,852 | 52,919,084 | 100,912,303 | 384,011,055 | 10,022,902 | - | 644,350,196 |
| Subordinated debt | 55,443 | 747,734 | 4,885,572 | 12,826,116 | 4,043,381 | - | 22,558,246 |
| Deferred revenue | 171,438 | 24,601 | 16,521 | 49,564 | - | 7,439,950 | 7,702,074 |
| Employee benefits | - | - | - | - | - | 3,504,764 | 3,504,764 |
| Current income tax liability | 92,882 | - | - | - | - | 1,950,372 | 2,043,254 |
| Deferred tax liabilities | - | - | - | - | - | 1,245,419 | 1,245,419 |
| Total liabilities | 142,584,290 | 61,952,933 | 122,947,145 | 404,216,814 | 15,468,161 | 48,428,827 | 795,598,170 |
| Open position | \$ 150,518,552 | \$ 100,539,480 | \$ 114,246,108 | \$ (162,163,856) | \$ (9,114,771) | \$ 115,028,423 | \$ 309,053,936 |

FINCA has performed interest rate simulations based on the above GAP analysis to estimate the effect on net interest margin and on the longer-term economic value of equity for differing levels of immediate and ongoing changes to market interest rates. A GAP analysis consists of separating FINCA's consolidated balance sheets into different time frames in which assets or liabilities mature. Note that FINCA can influence certain interest rates (e.g., deposit and lending rates), whereas other interest rates are determined by exogenous factors in the global macroeconomy.

On a group level, the network-wide impacts from simultaneous interest rate shocks of 200 basis points (bps) for USD and EUR and the weighted average of local currency shocks are considered. The effect on net interest income for the year and consolidated net consolidated equity from these assumed interest rate shocks are as follows:

| | 2014 | 2013 |
|--|---------------------|---------------------|
| USD/EUR net interest income impact @ 200 bp (USD MM) | 0.77 | 1.21 |
| Local current net interest income impact (USD MM) | <u>12.73</u> | <u>8.45</u> |
| Total | <u>13.50</u> | <u>9.66</u> |
| Total as a percentage of total capital | <u>4.5 %</u> | <u>3.1 %</u> |

Since FINCA's interest sensitive assets reprice more quickly than its interest-sensitive liabilities, increases in market interest rates result in higher net interest income (and the opposite is also true).

Impacts to the economic value of equity of the longer time bands are also estimated according to the guidance set forth by the Basel Committee on Bank Supervision under the Basel Accords recommendations on bank capital adequacy.

| | Shock (Average) | Economic Value Impact (USD MM) |
|--|----------------------------|---|
| USD/EUR | 200 bp | (7.17) |
| Local | 617 bp | <u>(0.25)</u> |
| Total | | <u>(7.42)</u> |
| Total as a percentage of total capital | | <u>(2.53)%</u> |

The preponderance of USD liabilities in the later time bands (more than one to three years) in comparison to assets is slightly offset by the economic value of positive repricing by local currency assets in the earlier period (to 12 months).

Liquidity Risk—Liquidity risk management includes (at a minimum) the identification, measurement, and establishment of limits on potential losses arising from the difficulty of renewing liabilities under normal market conditions. FINCA’s funding and liquidity objective is to fund its existing asset base (and maintain sufficient excess liquidity) so that it can operate under unusual/adverse market conditions. At the aggregate level, FINCA’s goal is to ensure that there is sufficient funding in amount and tenor so that adequate liquid resources are available for all operating entities. The liquidity framework requires that entities be liquidity self-sufficient or net providers of liquidity. The primary sources of funding are (a) shareholders equity, (b) medium-term borrowings, and (c) local bank lines of credit.

FINCA works to ensure that the structural tenor of these funding sources is sufficiently long in relation to the tenor of its asset base. In fact, the key goal of FINCA’s asset-liability management is to ensure that there is excess tenor in the liability structure so as to provide excess liquidity to fund all assets. The excess liquidity resulting from a longer-term liability tenor can effectively offset potential downward pressures on liquidity that may occur under market stress. This excess funding is held in the form of bank deposits and, to a far lesser extent, in unencumbered liquid securities.

Total cash and cash equivalents totaled \$149.2 million as of December 31, 2014, compared to \$155.1 million as of December 31, 2013. These period-end amounts increase and decrease intraperiod in the ordinary course of business. FINCA has maintained total cash balance equal to about 11.9 % and 14.1% of total assets as of December 31, 2014 and 2013, respectively, which is considered to be a sufficient liquidity cushion.

Liquidity Risk Management—FINCA runs a centralized treasury model where the overall balance sheet is managed by the Treasury department through subsidiaries’ ALCOs. Day-to-day liquidity and funding are managed by subsidiary chief financial officers and treasurers at the country level and are monitored by subsidiary ALCO and FINCA Treasury on a monthly basis.

Liquidity management is the responsibility of senior management through FINCA’s consolidated ALCO and is overseen by the board of directors through its audit and finance committee. ALCOs are established at each of FINCA’s microfinance operating subsidiaries. Regulated savings deposit-taking subsidiaries maintain legal reserve requirements in accordance with local regulations.

FINCA's microfinance operating subsidiaries are required to comply with a liquidity policy that specifies a minimum amount of liquid assets (cash and cash equivalents) that is to be maintained at all times. This minimum liquidity policy requires that approximately 5.0% of total assets be held in cash and cash equivalents. As of December 31, 2014, the ratio of subsidiaries' unrestricted cash and cash equivalents to total subsidiaries' assets was 8.7%, compared with 9.6% as of December 31, 2013.

A traditional view of FINCA's liquidity is provided by a GAP analysis. Considering the contractual terms of client loans, FINCA has a substantial amount of excess liquidity in the under one-year time frame (GAP less than one year of \$464.0 million in 2014 and \$444.5 million in 2013). Due to the short-term nature of the loan portfolio (79.3% of which matures within one year), the negative liquidity in years one to three will be covered by the normal course of business operations as new loans are disbursed.

| At December 31, 2014 | Up to 1 Year | 1 Year to 3 Years | 3 Years to 5 Years | Total |
|--|-------------------------|------------------------------|-------------------------------|-----------------------|
| Cash and cash equivalents | \$ 149,154,910 | \$ - | \$ - | \$ 149,154,910 |
| Restricted cash and cash equivalents | 22,912,811 | 927,523 | 16,391 | 23,856,725 |
| Available for sale financial assets | 26,697,975 | 3,108,557 | 746,977 | 30,553,509 |
| Financial assets held-to-maturity | 43,567 | 669,651 | 669,671 | 1,382,889 |
| Financial assets at fair value through profit and loss | 7,710,303 | 5,469,159 | - | 13,179,462 |
| Loans receivable—net | 752,796,621 | 191,451,026 | 5,085,521 | 949,333,168 |
| Grants receivable | 3,099,507 | - | - | 3,099,507 |
| Other financial assets | 9,954,438 | 8,605,313 | 141,838 | 18,701,589 |
| | <u>972,370,132</u> | <u>210,231,229</u> | <u>6,660,398</u> | <u>1,189,261,759</u> |
| Other financial liabilities | 23,150,831 | 61,707 | - | 23,212,538 |
| Financial liability at fair value through profit and loss | 2,006,479 | 340,480 | - | 2,346,959 |
| Clients deposits | 124,248,007 | 5,277,790 | 687,838 | 130,213,635 |
| Bank deposits | 2,642,270 | - | - | 2,642,270 |
| Notes payable | 353,166,468 | 320,413,269 | 67,245,949 | 740,825,686 |
| Subordinated debt | 3,121,790 | 18,261,776 | 2,262,952 | 23,646,518 |
| | <u>508,335,845</u> | <u>344,355,022</u> | <u>70,196,739</u> | <u>922,887,606</u> |
| Liquidity gap | <u>\$ 464,034,287</u> | <u>\$(134,123,793)</u> | <u>\$(63,536,341)</u> | <u>\$ 266,374,153</u> |

| At December 31, 2013 | Up to 1 Year | 1 Year to 3 Years | 3 Years to 5 Years | Total |
|--|-----------------------|------------------------|-----------------------|-----------------------|
| Cash and cash equivalents | \$ 155,060,628 | \$ - | \$ - | \$ 155,060,628 |
| Restricted cash and cash equivalents | 25,054,057 | - | - | 25,054,057 |
| Available for sale financial assets | 4,752,625 | 1,327,725 | 12,802,773 | 18,883,123 |
| Financial assets at fair value through profit and loss | 3,539,737 | 88,787 | - | 3,628,524 |
| Loans receivable—net | 583,581,555 | 240,409,345 | 4,803,035 | 828,793,935 |
| Grants receivable | 3,677,355 | 140,409 | - | 3,817,764 |
| Other financial assets | <u>3,328,697</u> | <u>737,364</u> | <u>-</u> | <u>4,066,061</u> |
| | <u>778,994,654</u> | <u>242,703,630</u> | <u>17,605,808</u> | <u>1,039,304,092</u> |
| Other financial liabilities | 12,403,240 | 377,975 | - | 12,781,215 |
| Financial liability at fair value through profit and loss | 1,059,215 | 591,534 | - | 1,650,749 |
| Clients deposits | 69,514,256 | 7,438,144 | 1,401,879 | 78,354,279 |
| Notes payable | 250,316,240 | 384,011,056 | 10,022,900 | 644,350,196 |
| Subordinated debt | <u>1,148,744</u> | <u>12,826,116</u> | <u>8,583,386</u> | <u>22,558,246</u> |
| | <u>334,441,695</u> | <u>405,244,825</u> | <u>20,008,165</u> | <u>759,694,685</u> |
| Liquidity gap | <u>\$ 444,552,959</u> | <u>\$(162,541,195)</u> | <u>\$ (2,402,357)</u> | <u>\$ 279,609,407</u> |

The traditional GAP view tends to overstate the amount of near-term liquidity since it does not take into consideration the behavioral nature of FINCA's client loan portfolio. From a behavioral perspective, FINCA's clients are able to renew their loans for multiple terms, which lessen the amount of short-term liquidity (lowers the positive GAP in that time frame). In spite of this, FINCA's consolidated balance sheets remain liquid owing to the short asset tenor and to the fact that client loans amortize. FINCA's borrowings are predominately two-year tenor with principal repaid at maturity.

Counterparty Risk—FINCA's exposure to the financial loss associated with balances held in other financial institutions is managed in accordance with prescribed limits. Given the relatively high level of cash held by FINCA's subsidiaries (in 2014 and 2013 the average amount of total cash to equity for FINCA's Subsidiaries was 40.7% and 41.9%, respectively). Lacking a limit for each counterparty bank, an undue amount of exposure would exist to the failure of a particular counterparty.

Individual subsidiary ALCOs look at counterparty exposure on a monthly basis to monitor compliance with policy. Pursuant to this policy, FINCA's subsidiaries are only able to hold liquid funds with banks of high reputation or to invest in short-term, federally issued government securities. The maximum amount of exposure to another financial institution is typically limited by the amount of a subsidiary's equity (up to 25% of the subsidiary's equity in one bank).

The level of counterparty risk incurred reflects the nature and purpose of the assets held by the group (aside from its loan portfolio and the fixed assets). Such assets are largely transactional in nature (generated by the routine payment of principal and interest by clients). In addition, a minimum amount of cash and liquid securities is held to ensure sufficient liquidity for the group. While the group tries to generate some income from these assets, the overriding objective is to ensure their secure placement and high level of availability (risk considerations predominate). This is particularly visible in the area of bank placements, where the group is able to take active decisions with respect to the selection of counterparties and the maturity of placements.

Foreign Currency Risk—Foreign exchange risk exists at both FINCA and at the Subsidiaries level. Subsidiaries are exposed to exchange rate risk when their liabilities (or assets) are denominated in a currency that differs from their functional currency (the non-functional currency is typically the United

States Dollar, or “USD”). Subsidiaries are not exposed to any exchange rate risk on either assets or liabilities that are denominated in their functional currency. Certain Subsidiaries have no foreign exchange risk either because their entire balance sheet is denominated in their functional currency (i.e. Kosovo), because their functional currency is the USD (DRC, Ecuador and El Salvador) or because their currency is pegged to the USD (i.e. Jordan).

Subsidiaries match their non-functional currency assets with their non-functional currency liabilities to the fullest possible extent, thereby minimizing or reducing any foreign currency risk. This matching occurs either by converting non-functional currency borrowings into functional currency borrowings, by lending in non-functional currency, and by maintaining other assets in non-functional currency. It is FINCA’s policy not to allow speculative open currency positions; rather, each Subsidiary’s open currency position is maintained within prescribed limits relative to the Subsidiary’s capital. Currency positions are measured and reported to each Subsidiary’s ALCO on a monthly basis. A Subsidiary’s net “long” or “short” foreign currency position is measured in relation to their equity, with the objective of maintaining the position within the more restrictive of (a) lender covenants or (b) the internal guideline of 20% of the Subsidiary’s equity or (c) other contractual or local regulatory requirements. Subsidiaries that have a difference between non-functional currency assets and liabilities typically maintain a higher amount of non-functional currency assets (rendering their net position “long” in relation to the USD). At the consolidated level, FINCA experienced transaction losses of \$2.5 million in 2014 in comparison to transaction gains of \$18 thousands in 2013, representing about 0.2 % and 0% of average total assets in 2014 and 2013, respectively. For assessment of the group foreign exchange risk, a Value-at-Risk (VaR) analysis is performed on a quarterly basis. The VaR measure estimates the potential loss in capital over a given holding period for a specified confidence level. The VaR is a statistically defined, probability-based approach that takes into account market volatilities as well as risk diversification by recognizing offsetting positions and correlations between markets. Risks can be measured consistently across all markets, and risk measures can be aggregated to arrive at a single risk number. The methodology employed is the variance-covariance approach, also known as the delta-normal approach. The holding period is one year, and the look-back period is 3.5 years. A limitation of the variance-covariance, or delta-normal, approach is the assumption of a standard normal (or Gaussian) distribution of portfolio returns, and therefore the methodology may underestimate the proportion of outliers and hence the VaR. The results are shown in the following table:

| | 95% Confidence | 99% Confidence |
|-------------------------|-----------------------|-----------------------|
| As of December 31, 2014 | \$15.5 million | \$21.9 million |
| | 95% Confidence | 99% Confidence |
| As of December 31, 2013 | \$11.6 million | \$16.4 million |

FINCA’s portfolio volatility dramatically increased in 2014 with both individual currency volatility and overall correlation among FINCA’s basket of currencies increasing, leading to an increase in overall portfolio volatility. Furthermore, additional FINCA equity was deployed into subsidiary net assets over the year. FINCA’s foreign currency translation reserve increased in 2014 by \$19.5 million along with \$7.3 million allocated to non-controlling interest members, compared to the 2013 increase of \$4.5 million. The largest translation losses were incurred by the following subsidiaries: Kyrgyzstan—\$4.3 million, Russia—\$3.6 million, Mexico—\$3.1 million, Armenia—\$2.0 million, Georgia—\$1.5 million, Uganda—\$1.1 million and Tanzania—\$1.0 million. The actual loss is \$3.1 million greater than the 2013 VaR model’s estimated look-forward amount at the 99% confidence interval, or 2.8 standard deviations of the 2013’s model’s look-forward amount.

After the audit period, an extraordinary devaluation event occurred in Azerbaijan, where the currency (manat) was formerly pegged to the USD. As there was no previous history of volatility with the USD, models of estimated translation losses were previously unavailable. Losses from the event (occurring February 21, 2015) are to be considered in addition to any VaR calculated above.

6. FINANCIAL ASSETS AND LIABILITIES—FAIR VALUE MEASUREMENTS

Management considers that the carrying amounts of financial assets and financial liabilities recognized in the consolidated financial statements approximate their fair values other than for loans receivable, deposits from clients and notes payable.

| | 2014 | | 2013 | |
|---|-----------------|----------------|-----------------|----------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial Assets | | | | |
| Loans receivable | \$ 949,333,168 | \$ 962,354,417 | \$ 828,793,935 | \$ 832,136,747 |
| Financial Liabilities | | | | |
| Financial liabilities held at amortized cost: | | | | |
| Deposits from clients | 130,213,635 | 130,180,275 | 78,354,279 | 77,822,366 |
| Notes payable | 740,825,686 | 747,697,354 | 644,350,196 | 645,249,133 |

Fair value hierarchy at December 31, 2014 is as follows:

| Financial Assets | Level 1 | Level 2 | Level 3 | Total |
|---|---------|----------------|---------|----------------|
| Loans receivable | \$ - | \$ 962,354,417 | \$ - | \$ 962,354,417 |
| Financial Liabilities | | | | |
| Financial liabilities held at amortized cost: | | | | |
| Deposits from clients | - | 130,180,275 | - | 130,180,275 |
| Notes payable | - | 747,697,354 | - | 747,697,354 |

Management considers the identification of a proper discount rate and cash flow analysis impractical for its investments in the Class IIIB Notes in the FINCA Microfinance Fund B.V. Incorporated and the investment in membership interests in MFX Solutions LLC, as comparable financial instruments are not available; therefore, the investments AFS are measured and carried at cost. On each balance sheet date, management tests the value of investments for impairment. As of December 31, 2014 and 2013, management has concluded that FINCA's investments held for sale are not impaired.

The group's financial assets and financial liabilities are measured at fair value on a recurring basis.

Some of FINCA's financial assets and financial liabilities are measured at fair value at the end of each reporting period. The following table gives information about how the fair values of these financial assets and financial liabilities are determined (in particular, the valuation technique(s) and inputs used).

| Financial Assets/ Financial Liabilities | Fair Value at | | Fair Value Hierarchy | Valuation Techniques and Key Inputs | Significant Unobservable Inputs | Relationship of Unobservable Inputs to Fair Value |
|---|-------------------------------|-------------------------------|-------------------------|---|---------------------------------------|--|
| | 2014 Asset/ (Liability) | 2013 Asset/ (Liability) | | | | |
| 1) Foreign currency forward contracts measured at FVTPL (Note 14) | \$ 176,896 (2,220,005) | \$ (1,261,707) | 2 | Discounted cash flow. Future cash flows are estimated based on forward exchange rates (spot exchange rate at the end of the reporting period) and contract forward rates, discounted at a rate that reflects the credit risk of the counterparty in the contract. | N/A | N/A |
| 2) Foreign cross currency swaps measured at FVTPL (Note 14) | 13,002,566 (126,954) | 3,628,525 (389,042) | 2 | Discounted cash flow. Future cash flows are estimated based on forward exchange rates (spot exchange rate at the end of the reporting period) and contract forward rates, discounted at a rate that reflects the credit risk of the counterparty in the contract. | N/A | N/A |
| 3) Available for sale financial assets— Treasury bills (Note 13) | 4,456,913 | 3,760,146 | 1 | Quoted bid prices in an active market. | N/A | N/A |
| 4) Available for sale financial assets— Time deposits (Note 13) | 24,076,506 | 13,822,976 | 2 | Quoted prices of similar instruments traded in active markets. | N/A | N/A |

There were no transfers between Levels 1 and 2 in the period.

7. NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON LOANS

Net interest income for the years ended December 31, 2014 and 2013 is as follows:

| | 2014 | 2013 |
|---|-----------------------|-----------------------|
| Interest income: | | |
| Cash and cash equivalents and investments | \$ 7,381,597 | \$ 5,029,723 |
| Loans to clients | <u>361,342,116</u> | <u>301,995,327</u> |
| Total interest income | <u>368,723,713</u> | <u>307,025,050</u> |
| Interest expense: | | |
| Deposits from clients | 6,588,892 | 2,225,426 |
| Notes payable and subordinated debt | <u>80,394,361</u> | <u>61,313,434</u> |
| Total interest expense | <u>86,983,253</u> | <u>63,538,860</u> |
| Net interest income | <u>\$ 281,740,460</u> | <u>\$ 243,486,190</u> |

8. OTHER OPERATING INCOME

Total other operating income for the years ended December 31, 2014 and 2013 was \$14.4 million and \$16.4 million, respectively. Included in this amount is \$3.0 million (2013, \$9.1 million) of fines and penalties income and \$3.3 million (2013, \$2.7 million) of net insurance income.

9. PERSONNEL EXPENSES

Personnel expenses for the years ended December 31, 2014 and 2013 consist of the following:

| | 2014 | 2013 |
|---|-----------------------|-----------------------|
| Wages and salaries | \$ 121,615,688 | \$ 104,502,391 |
| Compulsory social security obligations | 19,436,467 | 19,522,317 |
| Allowances, incentives, and other benefits | 4,086,150 | 18,215,915 |
| Health insurance | 15,566,992 | 3,737,847 |
| Increase in liability for long-term service leave | 2,229,308 | 1,276,249 |
| Increase in liability for employee benefits | <u>1,205,374</u> | <u>2,459,821</u> |
| Total | <u>\$ 164,139,979</u> | <u>\$ 149,714,540</u> |

10. OTHER OPERATING EXPENSES

Other operating expenses for the years ended December 31, 2014 and 2013 consist of the following:

| | 2014 | 2013 |
|--|-----------------------|----------------------|
| Professional fees | \$ 18,352,540 | \$ 23,095,610 |
| Rent | 14,920,609 | 14,446,790 |
| Travel | 12,597,008 | 13,370,072 |
| Consumables and office supply | 6,385,542 | 4,515,744 |
| Communication | 6,300,249 | 5,583,461 |
| Taxes other than income | 6,093,553 | 3,572,251 |
| Security | 5,731,000 | 4,573,055 |
| License/memberships | 4,646,429 | 565,229 |
| Marketing | 4,619,097 | 3,414,021 |
| Repairs and maintenance | 4,179,815 | 4,418,517 |
| Training and hiring | 3,598,597 | 3,135,778 |
| Utilities | 3,388,739 | 2,088,415 |
| Bank charges | 2,905,150 | 3,379,141 |
| Motor vehicles expenses | 2,823,949 | 2,593,347 |
| Subsidiaries start up, integration, and reorganization costs | 1,627,424 | 2,603,483 |
| Insurance | 1,462,741 | 1,407,912 |
| Meetings, conferences, meals & entertainment | 920,170 | 1,020,091 |
| Impairment on assets held for use | 469,186 | - |
| Other expenditures | <u>3,309,353</u> | <u>182,547</u> |
| | <u>\$ 104,331,151</u> | <u>\$ 93,965,464</u> |

In the table above, the prior year line item 'Other' (\$1.8 million) for 2013 has been broken out into the line items 'License/Membership' (\$0.6 million), 'Meetings, Conferences, Meals & Entertainment' (\$1.0 million) and 'Other expenditures' (\$0.2 million) to conform to the current reporting format and the presentation in our consolidated financial statements for the year ended December 31, 2014. Such reclassifications had no impact on profit or loss or equity. Management considered it appropriate to create these two new line items.

11. INCOME TAX EXPENSE

This item includes all taxes on income. Income tax expense for the years ended December 31, 2014 and 2013 were as follows:

| | 2014 | 2013 |
|--------------------------|---------------------|---------------------|
| Current tax expense | \$ 11,515,838 | \$ 11,745,582 |
| Deferred tax benefit | <u>(2,355,526)</u> | <u>(2,645,285)</u> |
| Total income tax expense | <u>\$ 9,160,312</u> | <u>\$ 9,100,297</u> |

In calculating both the current tax and the deferred tax, the respective country-specific tax rates are applied. The total income tax expense includes the local country income taxes for the subsidiaries and foreign withholding taxes on certain cross-border payments. The average actual income tax rate for the subsidiaries increased slightly from 25.5% in 2013 to 26.3% in 2014. FINCA is exempt from taxes on income, except unrelated business taxable income, under provision of Section 501(c)(3) of the United States Internal Revenue Code and the applicable income tax regulations of the District of Columbia. The U.S. federal and state income tax on unrelated business taxable income was \$11 thousands and \$25 thousands in 2014 and 2013, respectively.

Reconciliation of income tax expense for the years ended December 31, 2014 and 2013 is as follows:

| | 2014 | 2013 |
|---|---------------------|----------------------|
| Income before income tax expense | \$ 16,772,995 | \$ 23,152,419 |
| Income tax expense | <u>(9,160,312)</u> | <u>(9,100,297)</u> |
| Profit for the year | <u>\$ 7,612,683</u> | <u>\$ 14,052,122</u> |
| | 2014 | 2013 |
| Tax rate using domestic tax rate of FINCA (exempt on taxes on income) | \$ - | \$ - |
| Foreign income tax (taxable Subsidiaries) at local statutory rates | 5,937,406 | 5,325,049 |
| Expenses not deductible for tax purposes | 4,247,421 | 3,699,463 |
| Tax-exempt income | (5,295,963) | (3,491,171) |
| Recognition of previously unrecognized tax losses | (2,092,098) | - |
| Adjustment for under provision in previous periods | (318,491) | 166,597 |
| Foreign withholding taxes | 3,520,608 | 2,879,979 |
| Effect of unused tax losses and tax offsets not recognized as deferred tax assets | 2,982,647 | 1,381,553 |
| Others | <u>178,782</u> | <u>(861,173)</u> |
| Total income tax expense | <u>\$ 9,160,312</u> | <u>\$ 9,100,297</u> |

Deferred income taxes are calculated, under the balance sheet method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts, using the applicable tax rate as stipulated by the tax legislation of the respective countries.

The movements in deferred tax assets and liabilities (the balances are offset within the same jurisdiction as permitted by IAS 12 and shown on a net basis by subsidiaries), details of the deferred tax liability, amounts charged or credited directly to profit or loss during the period, and amounts charged or credited directly to equity during the period are shown below.

In 2014, FINCA recorded \$0.3 million of income tax expense on \$10.2 million of temporary differences associated with FINCA's investments in subsidiaries because it was probable that the temporary differences associated with the distribution of retained earnings through payments of dividends will reverse in the foreseeable future. In 2013, FINCA recorded \$0.1 million of income tax benefit on \$2.9 million of temporary differences of the same nature. The deferred tax liability related to the future distributions of retained earnings by subsidiaries is \$0.5 million and \$0.3 million as of December 31, 2014 and 2013, respectively.

Deferred Tax Assets—Deferred tax assets were recognized by the subsidiaries in the following jurisdictions in 2014: FINCA SSC US Company, Armenia, Azerbaijan, Georgia, Tajikistan, Honduras, Mexico, Tanzania, Uganda, Zambia, DRC and Pakistan (2013—Armenia, Azerbaijan, Georgia, Russia, Honduras, Mexico, Tanzania, Uganda, Zambia and Pakistan).

| | Assets (Liability) | (Charged) Credited to Profit or Loss | (Charged) Credited to Equity | Business Combination |
|--------------------------------------|-------------------------------|---|---|---------------------------------|
| 2014 | | | | |
| Property and equipment, and software | \$ 99,771 | \$ 42,946 | \$ (95,804) | \$ - |
| Provision for loan loss impairment | 2,178,607 | 445,531 | (634,792) | - |
| Cash flow hedges | 444,001 | 191,638 | 22 | - |
| Deferred income/accrued interest | 1,596,516 | 121,925 | (6,176) | - |
| Tax loss carryforwards | 3,995,563 | 1,825,494 | (67,155) | - |
| Other | <u>1,399,200</u> | <u>(118,502)</u> | <u>(72,995)</u> | <u>-</u> |
| Net tax assets | <u>\$ 9,713,658</u> | <u>\$ 2,509,032</u> | <u>\$ (876,900)</u> | <u>\$ -</u> |
| | | | | |
| | Assets (Liability) | (Charged) Credited to Profit or Loss | (Charged) Credited to Equity | Business Combination |
| 2013 | | | | |
| Property and equipment, and software | \$ 120,053 | \$ 351,905 | \$ (166,307) | \$ - |
| Provision for loan loss impairment | 2,342,736 | 668,366 | (31,128) | - |
| Cash flow hedges | 252,341 | 252,322 | 20 | - |
| Deferred income/accrued interest | 1,414,684 | 19,677 | (65,444) | - |
| Tax loss carryforwards | 2,291,594 | 868,505 | 212,290 | 470,846 |
| Other | <u>1,660,120</u> | <u>(164,592)</u> | <u>182,233</u> | <u>-</u> |
| Net tax assets | <u>\$ 8,081,528</u> | <u>\$ 1,996,183</u> | <u>\$ 131,664</u> | <u>\$ 470,846</u> |

Deferred Tax Liabilities—Deferred tax liabilities are recorded by FMH, FINCA SSC BV company, Dutch Cooperatief, Kyrgyzstan, Ecuador, Nicaragua, and Malawi in 2014 (2013—FMH, FINCA SSC BV company, Kyrgyzstan, Ecuador, Nicaragua, and Malawi) as follows:

| 2014 | Assets (Liability) | (Charged) Credited to Profit or Loss | (Charged) Credited to Equity |
|--|-------------------------------|---|---|
| Property and equipment, and software | \$ (80,652) | \$ 47,434 | \$ 2,239 |
| Provision for loan loss impairment | (579,333) | (112,322) | 85,060 |
| Deferred income/accrued interest | (41,315) | 25,099 | (14,303) |
| Tax loss carryforwards | 186,058 | 175,839 | (18,742) |
| Future distribution of retained earnings | (535,219) | (194,139) | - |
| Other | <u>(277,366)</u> | <u>(95,417)</u> | <u>16,844</u> |
| Net tax (liabilities) assets | <u>\$ (1,327,827)</u> | <u>\$ (153,506)</u> | <u>\$ 71,098</u> |
| 2013 | Assets (Liability) | (Charged) Credited to Profit or Loss | (Charged) Credited to Equity |
| Property and equipment, and software | \$ (130,593) | \$ (80,696) | \$ 40,257 |
| Provision for loan loss impairment | (552,070) | (94,408) | 54,298 |
| Deferred income/accrued interest | (94,278) | 11,782 | (61,538) |
| Tax loss carryforwards | 28,960 | 30,026 | (1,065) |
| Future distribution of retained earnings | (341,080) | 885,590 | - |
| Other | <u>(156,358)</u> | <u>(103,191)</u> | <u>(2,170)</u> |
| Net tax (liabilities) assets | <u>\$ (1,245,419)</u> | <u>\$ 649,103</u> | <u>\$ 29,782</u> |

12. RESTRICTED CASH AND CASH EQUIVALENTS

Restricted cash balances of \$23.9 million and \$25.1 million as of December 31, 2014 and 2013, respectively, comprise undisbursed grant funds to be used in lending and operations, cash balances for country-specific regulatory requirements, and pledged collateral related to local borrowings and deposits, all of which can be contractually released within 12 months.

13. AVAILABLE FOR SALE FINANCIAL ASSETS

| | 2014 | 2013 |
|---------------------------------------|----------------------|----------------------|
| Investment in FINCA Microfinance Fund | \$ 1,100,000 | \$ 1,100,000 |
| Certificates of deposit and other | <u>29,453,509</u> | <u>17,783,123</u> |
| Total | <u>\$ 30,553,509</u> | <u>\$ 18,883,123</u> |

In 2010, FINCA International invested \$1.1 million in the Microfinance Fund in the Netherlands. This \$21.2 million special purpose fund, structured, placed, and managed by Deutsche Bank, provided \$20.6 million in subordinated loans to seven of FINCA International's subsidiaries in Armenia, Azerbaijan, Democratic Republic of Congo, Georgia, Kyrgyzstan, Mexico, and Tajikistan. The subordinated debt is designed as Tier II capital securities to alleviate capital constraints of the respective FINCA's subsidiaries. Investors in the fund are primarily from the private sector. The fund seeks to provide socially motivated investors an exposure to global microfinance through the issuance of subordinated loans.

Certificates of deposit with maturity over three months are qualified and reported as AFS financial assets in the consolidated statements of financial position.

14. FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

The financial assets and liabilities at fair value through profit or loss are represented by the following balances:

| 2014 | Notional Amount | Fair value Assets | Liabilities |
|---|----------------------------|------------------------------|---------------------|
| Fair value from derivatives with third parties: | | | |
| Foreign exchange swaps | \$ 95,385,768 | \$ 13,002,566 | \$ 126,954 |
| Foreign exchange forwards | <u>1,996,286</u> | <u>176,896</u> | <u>2,220,005</u> |
| Total | <u>\$ 97,382,054</u> | <u>\$ 13,179,462</u> | <u>\$ 2,346,959</u> |
| | | | |
| 2013 | Notional Amount | Fair value Assets | Liabilities |
| Fair value from derivatives with third parties: | | | |
| Foreign exchange swaps | \$ 68,080,862 | \$ 3,628,524 | \$ 389,042 |
| Foreign exchange forwards | <u>11,262,000</u> | <u>-</u> | <u>1,261,707</u> |
| Total | <u>\$ 79,342,862</u> | <u>\$ 3,628,524</u> | <u>\$ 1,650,749</u> |

Negative market values of derivatives fall under the position “Financial liabilities at fair value through profit or loss.” This item consists solely of the negative fair values of derivative hedging instruments, primarily currency swaps.

Neither of the above balances related to hedge transactions qualified for hedge accounting.

15. LOANS RECEIVABLE—NET

Loans receivable as at December 31, 2014 and 2013 consist of the following:

| | 2014 | 2013 |
|------------------------------------|-----------------------|-----------------------|
| Gross loans to clients current | \$ 720,540,441 | \$ 591,916,192 |
| Gross loans to clients non-current | <u>246,326,359</u> | <u>248,714,475</u> |
| Total loans to clients | <u>\$ 966,866,800</u> | <u>\$ 840,630,667</u> |
| | | |
| Gross loans to clients | \$ 966,866,800 | \$ 840,630,667 |
| Less allowances for impairment | <u>(17,533,632)</u> | <u>(11,836,732)</u> |
| Loans receivable | <u>\$ 949,333,168</u> | <u>\$ 828,793,935</u> |

| | 2014 | 2013 |
|--------------------------------------|----------------------|----------------------|
| Allowances for impairments: | | |
| Balance at January 1 | \$ 11,836,732 | \$ 10,136,221 |
| Impairment loss for the year: | | |
| Charge for the year | 24,894,600 | 15,554,212 |
| Amounts written off—net of recovery | (17,587,487) | (13,700,413) |
| Effect of foreign currency movements | <u>(1,610,213)</u> | <u>(153,288)</u> |
| Balance at December 31 | <u>\$ 17,533,632</u> | <u>\$ 11,836,732</u> |

Impairment losses on loans approximate 1.7%–6.0% and 0.9%–5.7% of the total loan portfolio by regions at December 31, 2014 and 2013, respectively. While not all products require collateral, and collateral requirements vary by country, FINCA utilizes several methods for clients to collateralize their loans, including mandatory savings, real estate, fixed assets, or an additional guarantor.

16. OTHER RECEIVABLES, PREPAID AND OTHER ASSETS

The balances represent other receivables, prepaid and other assets at December 31, 2014 and 2013 as follows:

| | 2014 | 2013 |
|--|----------------------|----------------------|
| Receivable from money remittance and other agencies | \$ 615,676 | \$ 624,231 |
| Prepaid/overpaid income tax | 1,682,326 | 1,522,498 |
| Deposit with Internal Revenue Service and other fiduciary agencies | 705,913 | 567,558 |
| Receivable commission, rebates, and refunds from banks and agencies | <u>2,016,797</u> | <u>1,351,774</u> |
| Financial assets other than cash and cash equivalents and loans receivable | 5,020,712 | 4,066,061 |
| Prepaid rent | 3,674,041 | 3,144,013 |
| Taxes | 964,448 | 938,389 |
| Prepayment for fixed assets | 749,905 | 793,626 |
| Office supplies | 838,687 | 631,147 |
| Staff advances and loans | 813,660 | 1,065,816 |
| Prepaid repair and maintenance expenses | 318,395 | 756,349 |
| Prepaid insurance | 369,720 | 481,252 |
| Encumbered account | 8,516,809 | - |
| Other debtors | <u>2,526,129</u> | <u>4,251,103</u> |
| Total | <u>\$ 23,792,506</u> | <u>\$ 16,127,756</u> |

The funds in the line ‘Encumbered account’ relates to a bank account, due to a pending investigation into an international inward transfer. Management believes that access to this account will be restored in due course and is currently undertaking action in this respect. Therefore management considered it appropriate to create a new line item called ‘Encumbered account’. In the consolidated cash flow statements, the encumbered account is included with the change in other receivables and other assets.

17. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2014 and 2013 are as follows:

| Cost | Total | Furniture and Office | | | | | | |
|---|---------------------|-----------------------|--------------------------|------------------------|---------------------|---------------------|--------------------|--------------------|
| | | Buildings and Offices | Construction in Progress | Leasehold Improvements | Computer Equipment | Equipment | Vehicles | Other |
| Balance—January 1, 2013 | \$44,183,995 | \$3,678,264 | \$ 726,874 | \$ 6,969,070 | \$15,411,459 | \$ 9,546,779 | \$5,539,658 | \$2,311,891 |
| Acquisitions | 16,284,858 | 193,350 | 2,707,956 | 4,790,982 | 2,856,199 | 3,626,147 | 789,473 | 1,320,751 |
| Disposals | (3,013,132) | (23,291) | (285,769) | (368,227) | (1,244,134) | (266,732) | (781,451) | (43,528) |
| Currency translation | (709,893) | (77,358) | (40,195) | (157,448) | (143,941) | (213,413) | (39,246) | (38,292) |
| Balance—December 31, 2013 | <u>\$56,745,828</u> | <u>\$3,770,965</u> | <u>\$3,108,866</u> | <u>\$11,234,377</u> | <u>\$16,879,583</u> | <u>\$12,692,781</u> | <u>\$5,508,434</u> | <u>\$3,550,822</u> |
| Balance—January 1, 2014 | \$56,745,828 | \$3,770,965 | \$3,108,866 | \$11,234,377 | \$16,879,583 | \$12,692,781 | \$5,508,434 | \$3,550,822 |
| Acquisitions | 16,301,750 | 1,890,635 | 1,481,933 | 3,203,936 | 3,979,105 | 3,473,863 | 559,840 | 1,712,438 |
| Disposals | (3,673,391) | (436) | (711,853) | (1,036,199) | (521,173) | (283,349) | (801,407) | (318,974) |
| Currency translation | (4,138,276) | (223,979) | (369,430) | (792,890) | (960,323) | (1,086,622) | (452,787) | (252,245) |
| Balance—December 31, 2014 | <u>\$65,235,911</u> | <u>\$5,437,185</u> | <u>\$3,509,516</u> | <u>\$12,609,224</u> | <u>\$19,377,192</u> | <u>\$14,796,673</u> | <u>\$4,814,080</u> | <u>\$4,692,041</u> |
| Depreciation and Impairment Losses | | | | | | | | |
| Balance—January 1, 2013 | \$22,591,099 | \$ 656,072 | \$ - | \$ 3,359,434 | \$ 8,068,155 | \$ 6,600,962 | \$3,499,459 | \$ 407,017 |
| Depreciation and amortization | 7,361,491 | 346,277 | - | 1,644,359 | 2,274,551 | 1,890,965 | 826,094 | 379,245 |
| Disposals | (2,111,999) | (14,090) | - | (344,224) | (820,760) | (316,057) | (601,680) | (15,188) |
| Currency translation | (229,987) | (10,249) | - | (39,420) | (68,274) | (78,269) | (21,972) | (11,803) |
| Balance—December 31, 2013 | <u>\$27,610,604</u> | <u>\$ 978,010</u> | <u>\$ -</u> | <u>\$ 4,620,149</u> | <u>\$ 9,453,672</u> | <u>\$ 8,097,601</u> | <u>\$3,701,901</u> | <u>\$ 759,271</u> |
| Balance—January 1, 2014 | \$27,610,604 | \$ 978,010 | \$ - | \$ 4,620,149 | \$ 9,453,672 | \$ 8,097,601 | \$3,701,901 | \$ 759,271 |
| Depreciation and amortization | 8,774,508 | 397,939 | - | 1,910,410 | 3,053,626 | 2,298,076 | 728,261 | 386,196 |
| Disposals | (2,403,288) | (10,414) | - | (1,037,850) | (367,338) | (241,209) | (670,887) | (75,590) |
| Currency translation | (2,253,954) | (26,701) | - | (424,985) | (716,604) | (633,274) | (352,651) | (99,739) |
| Balance—December 31, 2014 | <u>\$31,727,870</u> | <u>\$1,338,834</u> | <u>\$ -</u> | <u>\$ 5,067,724</u> | <u>\$11,423,356</u> | <u>\$ 9,521,194</u> | <u>\$3,406,624</u> | <u>\$ 970,138</u> |
| Net Carrying Amounts | | | | | | | | |
| Balance—December 31, 2012 | <u>\$21,592,896</u> | <u>\$3,022,192</u> | <u>\$ 726,874</u> | <u>\$ 3,609,636</u> | <u>\$ 7,343,304</u> | <u>\$ 2,945,817</u> | <u>\$2,040,199</u> | <u>\$1,904,874</u> |
| Balance—December 31, 2013 | <u>\$29,135,224</u> | <u>\$2,792,955</u> | <u>\$3,108,866</u> | <u>\$ 6,614,228</u> | <u>\$ 7,425,911</u> | <u>\$ 4,595,180</u> | <u>\$1,806,533</u> | <u>\$2,791,551</u> |
| Balance—December 31, 2014 | <u>\$33,508,041</u> | <u>\$4,098,351</u> | <u>\$3,509,516</u> | <u>\$ 7,541,500</u> | <u>\$ 7,953,836</u> | <u>\$ 5,275,479</u> | <u>\$1,407,456</u> | <u>\$3,721,903</u> |

Depreciation and amortization expense charged for the years ended December 31, 2014 and 2013 were \$8.8 million and \$7.4 million respectively.

18. INTANGIBLE ASSETS

Intangible assets at December 31, 2014 and 2013 consist of the following:

| Costs | Total | Capitalized Software | Capital Work-In-Progress | Other |
|------------------------------------|----------------------|-----------------------------|---------------------------------|-------------------|
| Balance—January 1, 2013 | \$ 14,865,890 | \$ 11,571,554 | \$ 3,294,336 | \$ - |
| Acquisition | 10,137,905 | 6,096,148 | 3,290,383 | 751,374 |
| Disposals | (1,981,961) | (409,237) | (1,572,724) | - |
| Currency translation | <u>(366,674)</u> | <u>(256,094)</u> | <u>(110,580)</u> | <u>-</u> |
| Balance—December 31, 2013 | <u>\$ 22,655,160</u> | <u>\$ 17,002,371</u> | <u>\$ 4,901,415</u> | <u>\$ 751,374</u> |
| Balance—January 1, 2014 | \$ 22,655,160 | \$ 17,002,371 | \$ 4,901,415 | \$ 751,374 |
| Acquisition | 9,921,958 | 7,610,032 | 2,311,926 | - |
| Disposals | (6,594,412) | (420,652) | (6,173,760) | - |
| Currency translation | <u>(1,354,221)</u> | <u>(1,325,945)</u> | <u>(28,276)</u> | <u>-</u> |
| Balance—December 31, 2014 | <u>\$ 24,628,485</u> | <u>\$ 22,865,806</u> | <u>\$ 1,011,305</u> | <u>\$ 751,374</u> |
| Amortization and Impairment | | | | |
| Balance—January 1, 2013 | \$ 5,633,101 | \$ 5,633,101 | \$ - | \$ - |
| Amortization for the year | 2,530,608 | 2,359,136 | - | 171,472 |
| Disposals | (402,355) | (402,355) | - | - |
| Currency translation | <u>(67,644)</u> | <u>(67,644)</u> | <u>-</u> | <u>-</u> |
| Balance—December 31, 2013 | <u>\$ 7,693,710</u> | <u>\$ 7,522,238</u> | <u>\$ -</u> | <u>\$ 171,472</u> |
| Balance—January 1, 2014 | \$ 7,693,710 | \$ 7,522,238 | \$ - | \$ 171,472 |
| Amortization for the year | 4,528,000 | 4,234,000 | - | 294,000 |
| Disposals | (106,225) | (106,225) | - | - |
| Currency translation | <u>(449,360)</u> | <u>(449,360)</u> | <u>-</u> | <u>-</u> |
| Balance—December 31, 2014 | <u>\$ 11,666,125</u> | <u>\$ 11,200,653</u> | <u>\$ -</u> | <u>\$ 465,472</u> |
| Net Carrying Amounts | | | | |
| Balance—January 1, 2012 | <u>\$ 6,525,397</u> | <u>\$ 5,171,640</u> | <u>\$ 1,353,757</u> | <u>\$ -</u> |
| Balance—December 31, 2012 | <u>\$ 9,232,789</u> | <u>\$ 5,938,453</u> | <u>\$ 3,294,336</u> | <u>\$ -</u> |
| Balance—December 31, 2013 | <u>\$ 14,961,450</u> | <u>\$ 9,480,133</u> | <u>\$ 4,901,415</u> | <u>\$ 579,902</u> |
| Balance—December 31, 2014 | <u>\$ 12,962,360</u> | <u>\$ 11,665,153</u> | <u>\$ 1,011,305</u> | <u>\$ 285,902</u> |

Amortization expense for the years ended December 31, 2014 and 2013 amounts to \$4.5 million and \$2.5 million respectively.

19. ACCOUNTS PAYABLE AND OTHER ACCRUED LIABILITIES

Accounts payable and other accrued liabilities at December 31, 2014 and 2013 are as follows:

| | 2014 | 2013 |
|--|----------------------|----------------------|
| Other accounts payable and accrued expenses | \$ 7,915,719 | \$ 7,418,904 |
| Professional services | 2,812,991 | 2,766,755 |
| Interest refundable to clients | 1,421,668 | 1,926,792 |
| Office supplies | 512,482 | 460,263 |
| Insurance | <u>915,441</u> | <u>208,501</u> |
| | | |
| Total financial liabilities, excluding notes payable, classified as financial liabilities measured at amortized cost | 13,578,301 | 12,781,215 |
| | | |
| Personnel | 11,964,884 | 12,589,135 |
| Taxes | 4,698,670 | 6,124,132 |
| Deferred rent | 3,099,049 | 2,191,232 |
| Legal provision | <u>319,081</u> | <u>503,475</u> |
| | | |
| Total | <u>\$ 33,659,985</u> | <u>\$ 34,189,189</u> |

The fair value of accounts payable and other accrued liabilities classified as financial liabilities measured at amortized cost is based on cash flows discounted at rates commensurate within the respective subsidiary country.

All accounts payable and other accrued liabilities have a maturity of no more than 12 months from the balance sheet date, other than the non-current portion of deferred rent of \$2.9 million of which has an amortization term of 11 years. Carrying values approximate fair value at December 31, 2014 and 2013.

20. CLIENT DEPOSITS

FINCA accepts and maintains savings deposits from clients in subsidiary operations. FINCA has been pursuing a strategy to increase client savings in subsidiary operations eligible to accept voluntary deposits, offering clients access to banking services while receiving lower-cost funding in return.

These voluntary deposits represent the majority of FINCA's savings deposits. Additionally, certain loan products are structured to require a deposit at the time the loan is made, representing an additional source of client deposits maintained by FINCA.

| | 2014 | 2013 |
|------------------------------------|-----------------------|----------------------|
| Compulsory savings/cash collateral | \$ 8,646,389 | \$ 9,076,331 |
| Voluntary savings: | | |
| Saving accounts | 54,641,150 | 36,918,648 |
| Term deposit accounts | 64,581,980 | 31,846,411 |
| Other voluntary savings | <u>2,344,116</u> | <u>512,889</u> |
| Total voluntary savings | <u>121,567,246</u> | <u>69,277,948</u> |
| Total deposits from clients | <u>\$ 130,213,635</u> | <u>\$ 78,354,279</u> |

21. NOTES PAYABLE

FINCA and its Subsidiaries have two broad categories of debt: charitable and commercial. The majority of FINCA loans are sourced from international financial institutions supporting microfinance, but FINCA has also borrowed from private sources. Interest rates paid by Subsidiaries range from six-months LIBOR + 375 bps up to 36% floating and up to 32% fixed in local currencies for commercial loans in countries with high perceived risk or with depreciating currencies. In some situations, FINCA, as the parent company, may be directly liable or may offer support for loans provided to Subsidiaries without adequate credit standing, which may be in the form of a direct guarantee, letter of credit, comfort letter, or another form of credit enhancement. As of each balance sheet date, some Subsidiaries have breached covenants contained in financing agreements underlying these obligations. Management believes that these breaches are primarily due to recent global economic conditions which have impacted microfinance, or in some cases due to local political and economic developments. A breach of a loan covenant could permit a lender to accelerate payment of the loan, but would not permit a cross-default beyond the particular Subsidiary. Management has obtained either formal waivers of these breaches or assurances from lenders that the covenants will not be enforced. However, no assurance can be provided that these waivers will be extended indefinitely or that all performance can be brought into full compliance. As of December 31, 2014, subsidiaries in Azerbaijan, Kosovo, Kyrgyzstan, Russia, Ecuador, Mexico, Nicaragua, Tanzania, Zambia and Afghanistan were in breach of financial covenants regarding loans from international financial institutions amounting to USD 50.4 million. Prior to the date of issuance of these financial statements the subsidiaries had obtained formal waivers for these breaches of covenant amounting to USD 27.7 million. All loans for which no formal waivers were obtained or were not obtained before December 31, 2014 are classified as current in the maturity table below.

Notes payable at December 31, 2014 and 2013 are as follows:

| | 2014 | 2013 |
|------------------|-----------------------|-----------------------|
| Overdraft | \$ 282,023 | \$ 395,813 |
| Notes payable: | | |
| Principal amount | 732,411,449 | 632,480,500 |
| Accrued interest | <u>8,132,214</u> | <u>11,473,883</u> |
| | <u>\$ 740,825,686</u> | <u>\$ 644,350,196</u> |

Maturities of principal amounts on notes payable due in future fiscal years is as follows:

| | |
|------------|-----------------------|
| 2015 | \$ 345,065,616 |
| 2016 | 235,558,190 |
| 2017 | 84,823,717 |
| 2018 | 8,164,818 |
| 2019 | 25,333,920 |
| Thereafter | <u>33,747,211</u> |
| | <u>\$ 732,693,472</u> |

The book value of notes payable at December 31, 2014 and 2013 are as follows:

| | 2014 | 2013 |
|---------------------------|-----------------------|-----------------------|
| Non-current: | | |
| Notes payable: | | |
| Secured | \$ 36,235,315 | \$ 30,362,185 |
| Unsecured | 349,768,445 | 363,216,545 |
| Collateralized borrowings | <u>1,624,098</u> | <u>455,225</u> |
| | <u>387,627,858</u> | <u>394,033,955</u> |
| Current: | | |
| Overdrafts | 282,023 | 395,813 |
| Notes payable: | | |
| Secured | 39,810,219 | 35,382,358 |
| Unsecured | 312,850,040 | 213,530,612 |
| Collateralized borrowings | <u>255,546</u> | <u>1,007,458</u> |
| | <u>353,197,828</u> | <u>250,316,241</u> |
| Total notes payable | <u>\$ 740,825,686</u> | <u>\$ 644,350,196</u> |

22. SUBORDINATED DEBT

The balance is mainly represented by subordinated debt, which was received in 2009 by seven subsidiaries from the Microfinance Fund of which \$19.5 million were outstanding at December 31, 2014 and 2013. Maturity of this debt is on September 20, 2016, and an effective interest rate varies in the range of 12.8% to 16.2%. Subordinated debt agreements with subsidiaries contain the following key provisions: no early redemption and the principal of the subordinated debt are junior in right of repayment to holders of senior debt. Each individual subordinated debt agreement includes a number of financial covenants. As agreed with the lender, Tajikistan repaid \$1.4 million during 2013.

23. DEFERRED REVENUE

FINCA receives awards from U.S. government and other agencies for various purposes. Awards not yet received are accrued to the extent unreimbursed expenses have been incurred for the purposes specified by an approved award. FINCA defers award revenue received under approved awards, to the extent they exceed expenses incurred for the purposes specified under the awards' restrictions. Proceeds from monetization of commodities inventory are also reported as refundable advances until proceeds are used for program expenses.

The balance of deferred revenue at December 31, 2014 and 2013 is as follows:

| | 2014 | 2013 |
|---|----------------------|---------------------|
| United States Department of Agriculture | \$ 4,855,160 | \$ 2,486,548 |
| Others | <u>5,760,265</u> | <u>5,215,526</u> |
| Total | <u>\$ 10,615,425</u> | <u>\$ 7,702,074</u> |

24. EMPLOYEE BENEFITS

Pension Plan Deferred Compensation—FINCA has implemented an employee retirement plan (the “Plan”) under Internal Revenue Code Section 403(b). Under the Plan, qualified employees may defer compensation up to the maximum amount permitted by the Internal Revenue Code. The elective deferral limits were \$17.5 thousands for both 2014 and 2013. The catch-up contribution were \$5.5 thousands for both 2014 and 2013. FINCA may make contributions to the Plan as a discretionary employer match. FINCA’s contributions to the Plan during both years ended December 31, 2014 and 2013, was \$0.4 million.

Defined Benefit Agreement—FINCA also maintains a defined senior executive retirement plan agreement (the “Agreement”) for certain officers and directors, which provides benefits payable upon retirement from FINCA (no sooner than at age 65). In addition, a death benefit is payable to a surviving spouse or named beneficiary in the event of the death of the eligible officer/director. The Agreement is offered at the sole discretion of FINCA’s Board of Directors. Currently, several key employees are enrolled in the Agreement. During 2014, one employee reached the vesting age. No changes were made to the plan in 2014. In 2013, FINCA purchased two non-participating 20-year fixed annuity contracts in a partial settlement of the plan liability of \$0.8 million.

The net liability of FINCA’s defined benefit plan recognized at December 31, 2014 and 2013 is summarized as follows:

| | 2014 | 2013 |
|--------------------------------------|---------------------|---------------------|
| Benefit obligation—beginning of year | \$ 3,504,954 | \$ 4,854,602 |
| Service cost | 88,979 | 141,577 |
| Interest cost | 139,167 | 151,292 |
| Actuarial (gain) loss | 1,489,635 | (683,170) |
| Settlement | - | (796,637) |
| Net employer benefits paid | <u>(604,259)</u> | <u>(162,710)</u> |
| Benefit obligation—end of year | <u>\$ 4,618,476</u> | <u>\$ 3,504,954</u> |

The change in plan assets at December 31, 2014 and 2013 is summarized as follows:

| | 2014 | 2013 |
|--|------------------|------------------|
| Fair value of assets—beginning of year | \$ - | \$ - |
| Employee contributions | - | - |
| Employer contributions | 604,259 | 959,347 |
| Settlements | - | (796,637) |
| Benefits paid | <u>(604,259)</u> | <u>(162,710)</u> |
| Fair value of assets—end of year | <u>\$ -</u> | <u>\$ -</u> |

The amounts recognized in comprehensive income related to FINCA's defined benefit plan at December 31, 2014 and 2013 are summarized as follows:

| | 2014 | 2013 |
|--|-----------------------|-------------------|
| Service costs: | | |
| Current service cost | \$ 88,979 | \$ 141,577 |
| Past service costs | - | 973,096 |
| Interest cost | <u>139,167</u> | <u>151,102</u> |
| Defined benefit costs recognized in profit or loss | <u>228,146</u> | <u>1,265,775</u> |
| Remeasurements: | | |
| Actuarial (losses) gains arising from experience adjustments | (763,135) | (480,000) |
| Actuarial (losses) gains arising from financial assumptions | (403,200) | (203,170) |
| Other | <u>(323,300)</u> | <u>-</u> |
| Defined benefit costs recognized in other comprehensive income | <u>(1,489,635)</u> | <u>(683,170)</u> |
| Total | <u>\$ (1,261,489)</u> | <u>\$ 582,605</u> |

FINCA does not have any plan assets. As a result the entire balances of the defined benefit obligation at December 31, 2014 and 2013 of \$4.6 million and \$3.5 million, respectively, are unfunded.

Weighted-average assumptions used to determine benefit obligations at December 31, 2014 and 2013 are as follows:

| | 2014 | 2013 |
|---------------|-------------|-------------|
| Discount rate | 3.30 % | 4.20 % |
| Salary scale | N/A | N/A |

Weighted-average assumptions used to determine net period pension cost for the years ended December 31, 2014 and 2013 are as follows:

| | 2014 | 2013 |
|---------------|-------------|-------------|
| Discount rate | 4.2 % | 3.3 % |
| Salary scale | N/A | N/A |

Based upon the assumptions used to measure pension obligations, FINCA expects to make the following benefit payments in aggregate during five years:

**Years Ending
December 31**

| | |
|---|------------|
| 2015 | \$ 204,167 |
| 2016 | 204,167 |
| 2017 | 204,167 |
| 2018 | 204,167 |
| 2019 | 204,167 |
| In aggregate for five fiscal years thereafter | 2,291,015 |

FINCA's defined benefit plan is exposed to actuarial risks, such as investment risk, interest rate risk, and life expectancy risks.

Investment Risk—The present value of the defined benefit plan liability is calculated using the December 31, 2014 Citigroup pension discount curve and the expected benefit payments from the plan. This curve is the published yield curve of high-grade corporate bond rates.

Interest Risk—A decrease in the bond interest rate will increase the plan liability.

Life Expectancy Risk—The present value of the defined benefit plan liability is calculated using the published mortality tables for plan participants during and after employment with FINCA. An increase in the life expectancy of the plan participants will increase the plan's liability.

Significant actuarial assumptions for the determination of the defined obligation are discount rate and the life-expectancy of plan participants. The sensitivity analysis below have been determined based on reasonably possible changes of the discount rate assumption occurring at the end of the reporting period, while holding all other assumptions constant.

If the discount rate is a 500 points higher (lower) the defined benefit obligation would decrease by \$0.2 million (increase by \$0.3 million).

25. BUSINESS COMBINATIONS

Subsidiary Acquired—On May 7, 2013, FINCA through its subsidiary, FMH, completed acquisition of 82.78% of voting equity interest of Kashf Microfinance Bank Limited, a microfinance bank organized and existing under the laws of the Islamic Republic of Pakistan for a total cash consideration of \$10.6 million. The acquisition occurred to continue the expansion of FINCA's microfinance activities in the region. Subsequent to acquisition Kashf Microfinance Bank Limited was rebranded under the name FINCA Microfinance Bank Ltd.

Acquisition-related costs amounted to \$0.2 million have been excluded from the consideration transferred and have been recognized as other operating expenses in profit or loss in the prior year.

Assets acquired and liabilities recognized at the date of acquisition:

| | |
|--|--------------------------|
| Cash and cash equivalents | \$ 11,826,223 |
| Restricted cash and cash equivalent | 1,178,131 |
| Available-for-sale financial assets | 1,991,423 |
| Loans receivable | 14,635,351 |
| Other receivables, prepaid, and other assets | 444,718 |
| Property and equipment | 1,147,645 |
| Intangible assets | 877,175 |
| Deferred tax assets | <u>470,846</u> |
| Total assets | <u>\$ 32,571,512</u> |
| Accounts payable and other accrued liabilities | \$ 1,396,683 |
| Client deposits | 20,316,476 |
| Deferred revenue | <u>172,280</u> |
| Total liabilities | 21,885,439 |
| Total equity | <u>10,686,073</u> |
| Total equity and liabilities | <u>\$ 32,571,512</u> |

The receivables acquired (which principally comprised loans receivable) in this transaction with a fair value of \$14.6 million had gross contractual amounts of \$14.8 million. The amount at acquisition date of the contractual cash flows was not expected to be collected is considered to be insignificant.

Non-controlling Interests (NCI)—The NCI (17.22% ownership interest in FINCA Microfinance Bank Ltd.) recognized at the acquisition date was measured by reference to the fair value of the NCI and amounted to \$2.0 million. This fair value was estimated by applying an income approach. The following were the key model inputs used in determining the fair value:

- assumed discount rate of 19.6%;
- assumed cash flows from operations for the period 2014–2016 and an estimated terminal value of 1.25 of the net assets value as at December 31, 2016; and
- assumed adjustments because of the lack of control or lack of marketability that market participants were considered when estimating the fair value of the NCIs in FINCA Microfinance Bank Ltd.

Goodwill Arising on Acquisition

| | |
|---|-------------------------|
| Consideration transferred | \$ 10,578,323 |
| Plus non-controlling interests (17.22%) | 1,967,241 |
| Less fair value of identifiable net assets acquired | (10,686,073) |
| Less customer-based intangible assets | <u>(751,374)</u> |
| Goodwill arising on acquisition | <u>\$ 1,108,117</u> |

Goodwill arose in the acquisition of FINCA Microfinance Bank Ltd. because the consideration paid for the combination effectively included amounts in relation to the benefit of expected synergies, revenue growth, future market development, and the assembled workforce of FINCA Microfinance Bank Ltd.

These benefits are not recognized separately from goodwill because they do not meet the recognition criteria for identifiable intangible assets. In relation to the identifiable net assets acquired, management has used book value as an approximation for fair value, as there were no material differences between the book value and fair value of the identifiable net assets acquired.

As a result of the business combination, intangible assets representing core deposit and loan customer relationships were recognized in the amount of \$0.8 million. The amortization charge for the years 2014 and 2013 is \$0.3 million and \$0.2 million, respectively.

FINCA performed its annual impairment testing of goodwill in December 2014. The recoverable amount of the cash generating unit exceeds its carrying value and therefore management concluded that goodwill was not impaired.

Net Cash Outflow on Acquisition of Subsidiary

| | Year Ended December 31, 2013 |
|---|---|
| Consideration paid to former shareholders | \$ 2,121,468 |
| Consideration paid to Kashf Microfinance Bank Limited | <u>8,456,855</u> |
| | <u>\$ 10,578,323</u> |
| Consideration paid to former shareholders | \$ 2,121,468 |
| Less cash and cash equivalent balances acquired | <u>(3,368,725)</u> |
| | <u>\$ (1,247,257)</u> |

Impact of Acquisition on the Consolidated Results of FINCA—Profit after tax for the year includes \$0.3 million in respect of FINCA Microfinance Bank Ltd.

Had this business combination been effected at January 1, 2013, the net interest income of the FINCA would have been \$245.0 million, and the profit for the year would have been \$13.7 million. Management considers these pro forma numbers to represent an approximate measure of the performance of the combined group on an annualized basis and to provide a reference point for comparison in future periods.

In determining the pro forma net interest income and profit of FINCA had FINCA Microfinance Bank Ltd. been acquired at the beginning of the current year, management has:

- Calculated depreciation of plant and equipment acquired on the basis of the fair values arising in the initial accounting for the business combination rather than the carrying amounts recognized in the preacquisition financial statements and
- Calculated borrowing costs on the funding levels, credit ratings, and debt/equity position of FINCA after the business combination

26. COMMITMENTS AND CONTINGENCIES

At December 31, 2014, FINCA was obligated under a number of operating leases for premises used primarily for branch operations and office purposes. In a significant portion of the business locations where FINCA operates, the operating lease agreements are negotiated on a month-to-month or year-by-year basis and are in line with general rental market conditions.

Future minimum lease payments under existing lease contracts are due, in dollars, as follows:

| | 2014 | 2013 |
|----------------------------|----------------------|----------------------|
| Less than one year | \$ 5,664,107 | \$ 5,465,759 |
| Between one and five years | 22,784,338 | 16,917,875 |
| More than five years | <u>7,955,278</u> | <u>9,181,401</u> |
| | <u>\$ 36,403,723</u> | <u>\$ 31,565,035</u> |

Rent expense was \$14.9 million and \$14.4 million for years ended December 31, 2014 and 2013, respectively.

There are no contingent assets, contingent liabilities, and capital commitments at December 31, 2014 and 2013. As discussed in Note 28, FINCA issued guarantees to the third parties on behalf of its subsidiaries.

27. FINCA ENTITIES

Through its headquarters, foreign representative offices and branches, controlled subsidiaries and affiliates, FINCA operates in 27 countries. All subsidiaries are controlled by FINCA directly or indirectly through FMH. The significant microfinance operating subsidiaries and controlled affiliates of FINCA at the end of the reporting period are listed below:

Americas

| | |
|-------------|---|
| Ecuador | Banco para la Asistencia Comunitaria, FINCA S.A. Joint Stock Company |
| El Salvador | Asociación de Fomento Integral Comunitaria de El Salvador Not-for-profit Association FINCA S.A. de C.V. |
| Guatemala | Fundación Internacional para la Asistencia Comunitaria de Guatemala Foundation FINCA S.A. |
| Haiti | FINCA HAITI Non-Governmental Organization |
| Honduras | Sociedad Financiera FINCA Honduras, S.A. Joint Stock Company |
| Mexico | Fundación Internacional para la Asistencia Comunitaria de Honduras Not-for-profit Organization SOFOM Mexico SAPI |
| Nicaragua | Fundación Integral Comunitaria, A.C. Civil Association Financiera FINCA Nicaragua, S.A. Joint Stock Company Fundación Internacional para la Asistencia Comunitaria de Nicaragua Not-for-profit Foundation |

África

| | |
|----------|--|
| Congo | FINCA DR CONGO SARL Limited Liability Joint Stock Company |
| Malawi | FINCA Limited Company Limited by Shares |
| Nigeria | FINCA Microfinance Bank Limited |
| Tanzania | FINCA Tanzania Limited Company Limited by Shares |
| Uganda | Foundation for International Community Assistance Uganda Limited Company Limited by Shares |
| Zambia | Foundation for International Community Assistance-Zambia Limited Company Limited by Shares |

Eurasia

| | |
|------------|---|
| Armenia | FINCA Universal Credit Organization Closed Joint Stock Company |
| Azerbaijan | FINCA Azerbaijan Limited Liability Company |
| Georgia | JSC FINCA Bank Georgia Closed Joint Stock Company |
| Kosovo | FINCA International, Inc. (Branch) |
| Kyrgyzstan | FINCA Micro-Credit Company Closed Joint Stock Company |
| Russia | FINCA CJSC Closed Joint Stock Company |
| Tajikistan | FINCA Micro-Credit Deposit Organization Limited Liability Company |

Middle East

| | |
|-------------|---|
| Jordan | FINCA Jordan Specialized Micro Loans Company |
| Afghanistan | FINCA Afghanistan Joint Stock Company Limited by Shares |
| Pakistan | FINCA Microfinance Bank Ltd. |

Non-microfinance subsidiaries

| | |
|-------------|-------------------------------------|
| Netherlands | FINCA Network Support Services BV. |
| Netherlands | FINCA Microfinance Cooperatief U.A. |
| USA | FINCA Services USA LLC |

Charitable affiliates

| | |
|----------------|--------------|
| United Kingdom | FINCA UK |
| Canada | FINCA Canada |

Non-controlling interest is attributable to:

- Non-controlling members of FMH holding 37.93% of shares and voting rights. Assets and liabilities attributable to FMH non-controlling members are \$474.7 million and \$361.9 million as of December 31, 2014 and \$431.8 and \$311.0 million as of December 31, 2013, respectively. Net income for the year 2014 is \$1.4 million (2013: \$1.6 million) and accumulated net income is \$9.6 million (2013: \$8.3 million).

- Non-controlling shareholders of FINCA Microfinance Bank Ltd. (Pakistan) holding 17.22% of shares and voting rights. Assets and liabilities attributable to non-controlling shareholders are \$11.0 million (2013: \$6.5 million) and \$8.8 million (2013: \$4.7 million), respectively. Net income and accumulated net income for the year are \$0.3 million (2013: \$50 thousands) and \$0.3 million (2013: \$50 thousands), respectively. No dividends were paid to NCI shareholders in 2014 and 2013.

No dividends were paid to NCI members in 2014.

28. RELATED PARTIES

Balances and transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and are not disclosed in this note.

Management Compensation—Total compensation paid to the management of FINCA for the years ended December 31, 2014 and 2013, amounted to:

| | 2014 | 2013 |
|--------------------------|---------------------|---------------------|
| Short-term benefits | \$ 5,361,435 | \$ 4,700,602 |
| Post employment benefits | <u>65,000</u> | <u>59,792</u> |
| | <u>\$ 5,426,435</u> | <u>\$ 4,760,394</u> |

Guarantees—FINCA International provides guarantees directly on behalf of the subsidiaries of FMH. Total balance of outstanding guarantees from FINCA International was \$6.6 million and \$8.5 million as of December 31, 2014 and 2013, respectively.

29. SUBSEQUENT EVENTS

Subsequent to the balance sheet date, on February 21, 2015, the Central Bank of the Republic of Azerbaijan devalued the Azerbaijani Manat (AZN). As a result, the official exchange rate of AZN to the U.S. dollar fell by approximately 34% from the exchange rate at the balance sheet date. FINCA recorded a currency translation adjustment of \$13.1 million for the first quarter of 2015.

On March 3, 2015, FINCA's subsidiary Closed Joint Stock Company FINCA Micro-Credit Company, Kyrgyzstan, obtained from the National Bank of Kyrgyz Republic a license for banking activities and for performing banking operations in foreign currency.

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