JSC Liberty Bank (formerly JSC People's Bank of Georgia) and Subsidiaries

Consolidated Financial Statements

Year ended 31 December 2009
Together with Independent Auditors' Report

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Independent auditors' report

To the Shareholders and Board of Directors of JSC Liberty Bank –

We have audited the accompanying consolidated financial statements of JSC Liberty Bank and its subsidiaries, which comprise the consolidated statement of financial position as at 31 December 2009, and the consolidated income statement, consolidated statements of comprehensive income, of changes in equity and of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining 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; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects the financial position of JSC Liberty Bank and its subsidiaries as at 31 December 2009, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

ERNST & YOUNG LLC

30 June 2010

Consolidated statement of financial position

As at 31 December 2009

(Thousands of Georgian Lari)

	Notes	2009	2008 (Restated)	2007 (Restated)
Assets				
Cash and cash equivalents	6	98,818	51,160	33,988
Amounts due from credit institutions	7	14,423	9,638	18,246
Loans to customers	8	82,752	109,286	113,592
Investment securities:				
- available-for-sale	9	2,260	7,902	881
- held-to-maturity		1,995	–	–
Investments in associates	10	788	893	789
Investment properties	11	20,184	–	–
Property and equipment	12	80,145	101,283	93,484
Intangible assets	13	4,560	3,540	2,762
Current income tax assets	14	630	630	636
Deferred income tax assets	14	1,313	1,240	–
Prepayments		6,275	17,201	3,969
Other assets	15	6,897	16,282	14,345
Total assets		**321,040**	**319,055**	**282,692**
Liabilities				
Amounts due to credit institutions	16	54,606	82,161	2,977
Amounts due to customers	17	246,638	181,540	200,887
Current income tax liabilities	14	82	1,439	1,294
Deferred income tax liabilities	14	–	–	8,042
Other liabilities	15	10,490	39,407	9,152
Total liabilities		**311,816**	**304,547**	**222,352**
Equity	18			
Share capital		15,721	15,721	15,521
Additional paid-in capital		8,529	8,437	8,200
Treasury shares		(347)	(355)	(500)
Accumulated losses		(38,036)	(45,347)	(560)
Other reserves		23,357	36,078	37,499
Total equity attributable to shareholders of the Bank		**9,224**	**14,534**	**60,160**
Minority interest		–	(26)	180
Total equity		**9,224**	**14,508**	**60,340**
Total liabilities and equity		**321,040**	**319,055**	**282,692**

Signed and authorized for release on behalf of the Management Board of the Group:

Vladimer Gurgenidze Executive Chairman and Chief Executive Officer

Zurab Tsulaia Chief Financial Officer

30 June 2010

The accompanying notes on pages 6 to 50 are an integral part of these consolidated financial statements.

Consolidated income statement

For the year ended 31 December 2009

(Thousands of Georgian Lari)

	Notes	*2009*	*2008 (Restated)*
Interest income			
Loans to customers		23,826	31,642
Amounts due from credit institutions		275	480
Investment securities		4	7
		24,105	**32,129**
Interest expense			
Amounts due to customers		(10,750)	(9,870)
Amounts due to credit institutions		(9,065)	(6,798)
Other		(104)	–
		(19,919)	**(16,668)**
Net interest income		**4,186**	**15,461**
Net impairment charge on interest-bearing assets	7, 8	(16,766)	(27,864)
Net interest expense after impairment charge on interest-bearing assets		**(12,580)**	**(12,403)**
Net fee and commission income	20	29,774	28,279
Net gains from available-for-sale securities		–	176
Net gains from disposal of subsidiaries	21	14,124	–
Net gains from foreign currencies:			
- dealing		3,324	3,517
- translation differences		110	(3,067)
Share of (loss)/profit of associates	10	(105)	104
Other income	22	3,850	11,991
Non-interest income		**51,077**	**41,000**
Salaries and other employee benefits	23	(20,206)	(35,151)
General and administrative expenses	23	(14,822)	(16,955)
Depreciation, amortization and impairment	12, 13	(6,906)	(4,945)
Other operating expenses	23	(615)	(20,738)
Other impairment and provisions	15	(2,295)	(5,256)
Non-interest expenses		**(44,844)**	**(83,045)**
Loss before income tax benefit		**(6,347)**	**(54,448)**
Income tax benefit	14	899	8,705
Loss for the year		**(5,448)**	**(45,743)**
Attributable to:			
- shareholders of the Group		(5,448)	(45,537)
- minority interest		–	(206)
		(5,448)	**(45,743)**
Loss per share:			
- basic loss per share	18	(0.004)	(0.030)

The accompanying notes on pages 6 to 50 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December 2009

(Thousands of Georgian Lari)

	Note	*2009*	*2008 (Restated)*
Loss for the year		**(5,448)**	**(45,743)**
Other comprehensive income/(loss)			
Unrealised gains on investment securities available-for-sale		178	317
Realised losses on investment securities available-for-sale reclassified to the income statement		–	(176)
Revaluation of buildings		(113)	(930)
Income tax relating to components of other comprehensive income	14	(27)	118
Other comprehensive income /(loss) for the year, net of tax		**38**	**(671)**
Total comprehensive loss for the year		**(5,410)**	**(46,414)**
Attributable to:			
- shareholders of the Group		**(5,410)**	**(46,208)**
- minority interest		–	**(206)**
		(5,410)	**(46,414)**

The accompanying notes on pages 6 to 50 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2009

(Thousands of Georgian Lari)

	Attributable to shareholders of the Group							
	Share capital	***Additional paid-in capital***	***Treasury shares***	***Accumulated losses***	***Other reserves***	***Total***	***Minority interest***	***Total equity***
31 December 2007 (as previously reported)	**15,521**	**8,200**	**(500)**	**(234)**	**37,499**	**60,486**	**180**	**60,666**
Restatements (Note 2)	–	–	–	**(326)**	–	**(326)**	–	**(326)**
31 December 2007 (restated)	**15,521**	**8,200**	**(500)**	**(560)**	**37,499**	**60,160**	**180**	**60,340**
Loss for the year	–	–	–	(45,537)	–	(45,537)	(206)	(45,743)
Other comprehensive loss for the year	–	–	–	–	(671)	(671)	–	(671)
Total comprehensive loss for the year (restated)	–	–	–	(45,537)	(671)	(46,208)	(206)	(46,414)
Depreciation of revaluation reserve (Note 18)	–	–	–	750	(750)	–	–	–
Issue of share capital through capitalization of additional-paid-in capital (Note 18)	200	(200)	–	–	–	–	–	–
Sale of treasury shares (Note 18)	–	437	145	–	–	582	–	582
31 December 2008 (restated)	**15,721**	**8,437**	**(355)**	**(45,347)**	**36,078**	**14,534**	**(26)**	**14,508**
Total comprehensive loss for the year	–	–	–	(5,448)	38	(5,410)	–	(5,410)
Depreciation of revaluation reserve (Note 18)	–	–	–	483	(483)	–	–	–
Transfer of revaluation reserve of investment property (Note 18)	–	–	–	12,276	(12,276)	–	–	–
Minority interest disposal, arising from disposal of subsidiary	–	–	–	–	–	–	26	26
Sale of treasury shares (Note 18)	–	92	8	–	–	100	–	100
31 December 2009	**15,721**	**8,529**	**(347)**	**(38,036)**	**23,357**	**9,224**	**–**	**9,224**

The accompanying notes on pages 6 to 50 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2009

(Thousands of Georgian Lari)

	Notes	*2009*	*2008 (Restated)*
Cash flows from operating activities			
Interest received		24,898	29,667
Interest paid		(21,772)	(15,151)
Fees and commissions received		31,278	29,419
Fees and commissions paid		(1,978)	(1,340)
Realized gains from foreign currencies		3,324	3,517
Recoveries of assets previously written off	8,15	1,235	11
Other operating income received		3,850	9,731
Salaries and other employee benefits paid		(20,041)	(35,836)
General and administrative and other operating expenses paid		(10,848)	(15,300)
Cash flows from operating activities before changes in operating assets and liabilities		**9,946**	**4,718**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		(10,955)	(2,027)
Loans to customers		10,315	(8,752)
Other assets		(2,240)	(15,027)
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		(26,834)	78,128
Amounts due to customers		66,230	(21,470)
Other liabilities		2,312	18,581
Net cash flows from operating activities before income tax		**48,774**	**54,151**
Income tax paid		–	(292)
Net cash from operating activities		**48,774**	**53,859**
Cash flows from investing activities			
Purchase of property and equipment and intangible assets		(11,049)	(27,168)
Proceeds from disposal of property and equipment and intangible assets		384	647
Proceeds from disposal of subsidiaries		10,201	–
Purchase of investments available-for-sale		(862)	(7,681)
Net cash used in investing activities		**(1,326)**	**(34,202)**
Cash flows from financing activities			
Sale of treasury shares		8	145
Increase in share premium		92	437
Net cash from financing activities		**100**	**582**
Effect of exchange rates changes on cash and cash equivalents		110	(3,067)
Net increase in cash and cash equivalents		**47,658**	**17,172**
Cash and cash equivalents, beginning	6	**51,160**	**33,988**
Cash and cash equivalents, ending	6	**98,818**	**51,160**

The accompanying notes on pages 6 to 50 are an integral part of these consolidated financial statements.

(Thousands of Georgian Lari)

1. Principal activities

JSC Liberty Bank (the "Bank"), formerly known as JSC People's Bank of Georgia, is a joint stock company, formed on the basis of the former State Bank AgromretsvBank. By the Decree of the Cabinet of Ministers of Georgia number 288, dated 14 April 1993, and the Ordinance of the President of Georgia number 178, dated 29 May 1994 the organizational forms of state owned banks and enterprises were transformed into Joint Stock Companies. The Bank operates under a general banking license issued by the National Bank of Georgia ("NBG"), the central bank of Georgia, on 10 February 1993, as well as licenses for foreign currency operations.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides commercial and broker-dealer services to its commercial and retail customers. Its main office is in Tbilisi, Georgia and it has 184 (2008: 182) branches, outlets and centers operating in Georgia. The Group's registered legal address is 74 Chavchavadze Avenue, 0162 Tbilisi, Georgia.

As of 31 December 2009 and 2008, the following shareholders owned more than 1% of the outstanding shares. Other shareholders owned less than 1% individually of the outstanding shares.

	2009	*2008*
Shareholder	***Ownership interest, %***	***Ownership interest, %***
Liberty Capital LLC	91%	–
Jincharadze Irina	–	25%
Starcode Resources LLC (United Kingdom)	–	20%
Kovalenko Elena	–	20%
Agureva Anna	–	7%
Marshania Tamar	–	6%
Marshania Gaioz	–	1%
Other shareholders (individually holding less than 1%)	9%	21%
Total	**100%**	**100%**

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

		The Group ownership interest			
Name	**Country of incorporation**	**2009**	**2008**	**Date of incorporation**	**Type of operation**
LLC Liberty Securities	Georgia	100%	–	2 September 2009	Securities brokerage/dealer
LLC People's Post of Georgia	Georgia	100%	–	5 January 2009	Postal services
LLC Real Management Company	Georgia	100%	–	27 April 2009	Real estate
LLC Bus Stop	Georgia	100%	–	27 August 2009	Advertising
LLC Sakkalakmshenproekti	Georgia	100%	–	4 September 2009	Real estate
LLC Rustavi Central Cash Desk	Georgia	100%	100%	2004	Inactive
LLC Real Estate Development	Georgia	(a)	100%		Real estate
LLC People's Post	Georgia	(a)	100%		Postal services
LLC Public Investment Management	Georgia	(a)	100%		Brokerage
JSC Sakkalakmshenproekti	Georgia	(a)	98%		Architectural design services and renting
LLC Social House	Georgia	(a)	100%		Medical services
JSC People's Insurance Company	Georgia	(a)	100%		Insurance

(a) No longer Group subsidiary due to sale in 2009.

The Group is ultimately controlled by a Romanian citizen, Dinu Patriciu.

(Thousands of Georgian Lari)

2. Basis of preparation

General

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

The Group and its subsidiaries maintain their accounting records in accordance with IFRS. These consolidated financial statements have been prepared based on accounting records of the Group and its subsidiaries.

The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below.

These consolidated financial statements are presented in thousands of Georgian Lari ("GEL"), except per share amounts and unless otherwise indicated. The functional currency of the consolidated financial statements is Georgian Lari.

Restatements and reclassifications

In the course of preparation of the consolidated financial statements for the year ended 31 December 2009, the Group identified certain prior period errors. The Group has corrected these errors by restating the comparative information as at 31 December 2008 and 2007 and for the year ended 31 December 2008.

The following errors were identified:

- In 2008 the Group did not recognize increase in fair value of shares of Visa International. As a result of this error available-for-sale investment securities and revaluation reserve on available-for-sale securities were understated by 141 and 120 GEL, respectively, while deferred tax assets were overstated by 20 GEL as at 31 December 2008.
- The Group did not recognize depreciation expense on computer and office equipment and motor vehicles, which resulted in overstatement of property and equipment as at 31 December 2008 and understatement of depreciation expenses for the year then ended by 270 GEL.
- The Group did not recognize asset received under finance lease in 2008. As a result property and equipment and net liabilities under finance lease agreements within other liabilities were understated by 828 GEL and 548 GEL, respectively, and other assets were overstated by 405 GEL as at 31 December 2008. In addition other operating expenses and translation difference for the year ended 31 December 2008 were understated by 111 GEL and 14 GEL respectively.
- The Group did not recognise interest expense on current account of governmental organization for the year ended 31 December 2008, which lead to understatement of amounts due to customers by 88 GEL as at 31 December 2008.
- Net fee and commission income, salaries and other employees benefits, general and administrative and other operating expenses relating to 2008 in the amount of 129 GEL, 59 GEL, 170 GEL and 98 GEL, respectively, were not recorded in the consolidated income statement for the year ended 31 December 2008, which resulted in understatement of other assets and other liabilities as at 31 December 2008 by 185 GEL and 384 GEL, respectively.
- Salaries and other employee benefits and interest income from amounts due from credit institutions for the year ended 31 December 2008 were overstated by 744 GEL and 450 GEL, respectively, while other operating expense, other impairment and provision, and other income for the year ended 31 December 2008 were understated by 652 GEL, 157 GEL and 1,061 GEL, respectively. As a result, other assets, deferred tax assets and other liabilities as at 31 December 2008 were understated by 539 GEL, 72 GEL and 65 GEL, respectively.
- Other assets, property and equipment and deferred tax liability were overstated by 331 GEL, 40 GEL and 45 GEL, respectively, while accumulated losses were understated by 326 GEL as at 31 December 2007.
- No annual transfer from revaluation reserve for property, plant and equipment to retained earnings was made as prescribed by the accounting policy of the Group. As a result of this error accumulated losses and other reserves were overstated by 750 GEL as at 31 December 2008.

In addition to the correction of the above errors the following reclassifications have been made as at 31 December 2008 and 2007 and for the year ended 31 December 2008 to conform to the 2009 presentation:

- Reclassification of obligatory reserve with NBG from cash and cash equivalents to amounts due from credit institutions.
- Reclassification of amounts settled to vendor for renovation and development works of the Group's property from other assets to property and equipment.
- Reclassification of advances paid to vendors and prepayments for property and equipment from other assets to prepayments.
- Reclassification of income from documentary operations from other operating income to fees and commission income.
- Reclassification of salaries and employee benefits, depreciation, amortization and impairment and general and administrative expenses from other operating expenses.

The cumulative effect of the correction of the above errors and reclassifications is as follows:

(Thousands of Georgian Lari)

2. Basis of preparation (continued)

Restatements and reclassifications (continued)

	As previously reported	*Restatements*	*Reclassifications*	*As adjusted*
Consolidated statement of financial position as at 31 December 2007				
Property and equipment	93,524	(40)	–	93,484
Prepayments	–	–	3,969	3,969
Other assets	18,645	(331)	(3,969)	14,345
Total Assets	**283,063**	**(371)**	–	**282,692**
Deferred tax liabilities	8,087	(45)	–	8,042
Total Liabilities	**222,397**	**(45)**	–	**222,352**
Accumulated losses	(234)	(326)	–	(560)
Total equity attributable to shareholders of the Bank	**60,486**	**(326)**	**–**	**60,160**

	As previously reported	*Restatements*	*Reclassifications*	*As adjusted*
Consolidated statement of financial position as at 31 December 2008				
Cash and cash equivalents	57,069	–	(5,909)	51,160
Amounts due from credit institutions	3,729	–	5,909	9,638
Investment securities available-for-sale	7,761	141	–	7,902
Property and equipment	98,655	539	2,089	101,283
Current income tax assets	630	–	–	630
Deferred income tax assets	1,149	91	–	1,240
Prepayments	–	–	17,201	17,201
Other assets	35,519	53	(19,290)	16,282
Total Assets	**318,231**	**824**	–	**319,055**
Amounts due to customers	181,452	88	–	181,540
Current income tax liabilities	1,451	(12)	–	1,439
Other liabilities	38,408	999	–	39,407
Total Liabilities	**303,472**	**1,075**	–	**304,547**
Accumulated losses	(45,725)	378	-	(45,347)
Other reserves	36,707	(629)	-	36,078
Total equity attributable to shareholders of the Bank	**14,785**	**(251)**	–	**14,534**
Consolidated income statement for the year ended 31 December 2008				
Interest income from amounts due from credit institutions	930	(450)	–	480
Interest expense on amounts due to customers	(9,782)	(88)	–	(9,870)
Net fees and commission income	28,079	129	71	28,279
Net gains from available-for-sale securities	-	-	176	176
Net losses from foreign currency translation	(3,057)	(10)	–	(3,067)
Other income	11,177	1,061	(247)	11,991
Salaries and other employee benefits	–	685	(35,836)	(35,151)
Depreciation, amortization and impairment	–	(248)	(4,697)	(4,945)
General and administrative expenses	–	(170)	(16,785)	(16,955)
Other operating expenses	(77,194)	(862)	57,318	(20,738)
Other impairment and provisions	(5,099)	(157)	–	(5,256)
Loss before income tax benefit	**(54,338)**	**(110)**	–	**(54,448)**
Income tax benefit	8,641	64	–	8,705
Loss for the year	**(45,697)**	**(46)**	–	**(45,743)**

(Thousands of Georgian Lari)

3. Summary of significant accounting policies

Changes in accounting policies

The Group has adopted the following amended IFRS and new IFRIC Interpretations during the year. The principal effects of these changes are as follows:

Improvements to IFRS
In May 2008, the IASB issued amendments to IFRS, which resulted from the IASB's annual improvements project. They comprise amendments that result in accounting changes for presentation, recognition or measurement purposes as well as terminology or editorial amendments related to a variety of individual IFRS standards. Most of the amendments are effective for annual periods beginning on or after 1 January 2009, with earlier application permitted. Amendments included in May 2008 "Improvements to IFRS" did not have any impact on the accounting policies, financial position or performance of the Group.

IAS 1 Presentation of Financial Statements (Revised)
A revised IAS 1 was issued in September 2007, and became effective for annual periods beginning on or after 1 January 2009. This revised Standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income: it presents all items of recognised income and expense, either in one single statement, or in two linked statements. The revised standard also requires that the income tax effect of each component of comprehensive income be disclosed. In addition, it requires entities to present a comparative statement of financial position as at the beginning of the earliest comparative period when the entity has applied an accounting policy retrospectively, makes a retrospective restatement, or reclassifies items in the financial statements.

The Group has elected to present comprehensive income in two separate statements: income statement and statement of comprehensive income. The Group has provided a restated comparative set of financial position for the earliest comparative period, as it has made retrospective restatements and retrospectively reclassified items in the consolidated financial statements.

IFRS 7 "Financial Instruments: Disclosures"
The amendments to IFRS 7 were issued in March 2009, to enhance fair value and liquidity disclosures. With respect to fair value, the amendments require disclosure of a three-level fair value hierarchy, by class, for all financial instruments recognised at fair value and specific disclosures related to the transfers between levels in the hierarchy and detailed disclosures related to level 3 of the fair value hierarchy. In addition, the amendments modify the required liquidity disclosures with respect to derivative transactions and assets used for liquidity management. Comparative information has been provided in the disclosure.

IAS 23 "Borrowing Costs" (Revised)
A revised IAS 23 Borrowing costs was issued in March 2007, and became effective for financial years beginning on or after 1 January 2009. The standard has been revised to require capitalisation of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements in the Standard, the Group adopted this as a prospective change. This interpretation did not have any impact on the Group's financial statements.

IAS 24 "Related party disclosures" (Revised)
The revised IAS 24, issued in November 2009, simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. Previously, an entity controlled or significantly influenced by a government was required to disclose information about all transactions with other entities controlled or significantly influenced by the same government. The revised standard requires disclosure about these transactions only if they are individually or collectively significant. The revised IAS 24 is effective for annual periods beginning on or after 1 January 2011, with earlier application permitted. The Group has decided to early adopt the revised IAS 24 from 1 January 2009.

Amendments to IAS 32 "Financial Instruments: Presentation" and IAS 1 "Presentation of Financial Statements" – Puttable Financial Instruments and Obligations Arising on Liquidation
These amendments were issued in February 2008, and became effective for annual periods beginning on or after 1 January 2009. The amendments require puttable instruments that represent a residual interest in an entity to be classified as equity, provided they satisfy certain conditions. These amendments did not have any impact on Group.

Amendments to IFRS 2 "Share-based Payment"- Vesting Conditions and Cancellations
Amendment to IFRS 2 was issued in January 2008 and became effective for annual periods beginning on or after 1 January 2009. This amendment clarifies the definition of vesting conditions and prescribes the accounting treatment of an award that is effectively cancelled because a non-vesting condition is not satisfied. This amendment did not have any impact on the financial position or performance of the Group.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

IFRS 8 "Operating Segments"
IFRS 8 became effective for annual periods beginning on or after 1 January 2009. This Standard requires disclosure of information about the Group's operating segments and replaces the requirement to determine primary (business) and secondary (geographical) reporting segments of the Group. Adoption of this Standard did not have any impact on the financial position or performance of the Group. The Group determined that the operating segments are the same as the business segments previously identified under *IAS 14 'Segment Reporting"*.

IFRIC 13 "Customer Loyalty Programmes"
IFRIC Interpretation 13 was issued in June 2007 and became effective for annual periods beginning on or after 1 July 2008. This Interpretation requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. This interpretation did not have any impact on the Group's financial statements as no such schemes currently exist.

IFRIC 15 "Agreements for the Construction of Real Estate"
IFRIC Interpretation 15 was issued in July 2008 and is applicable retrospectively for annual periods beginning on or after 1 January 2009. IFRIC 15 clarifies when and how revenue and related expenses from the sale of a real estate unit should be recognized if an agreement between a developer and a buyer is reached before the construction of the real estate is completed. The interpretation also provides guidance on how to determine whether an agreement is within the scope of IAS 11 "Construction Contracts" or IAS 18 "Revenue" and supersedes the current guidance for real estate in the Appendix to IAS 18. This interpretation did not have any impact on the Group's financial statements.

IFRIC 16 "Hedges of a Net Investment in a Foreign Operation"
IFRIC Interpretation 16 was issued in July 2008 and is applicable for annual periods beginning on or after 1 October 2008. This Interpretation provides guidance on identifying the foreign currency risks that qualify for hedge accounting in the hedge of net investment, where within the group the hedging instrument can be held and how an entity should determine the amount of foreign currency gain or loss, relating to both the net investment and the hedging instrument, to be recycled on disposal of the net investment. This interpretation did not have any impact on the Group's financial statements.

Amendments to IFRIC 9 "Reassessment of Embedded Derivatives"
The amendments require entities to assess whether to separate an embedded derivative from a host contract in the case where the entity reclassifies a hybrid financial asset out of the fair value through profit or loss category. This assessment is to be made based on circumstances that existed on the later of the date the entity first became a party to the contract and the date of any contract amendments that significantly change the cash flows of the contract. The amendments are applicable for annual periods ending on or after 30 June 2009. The application of the amendment did not have a significant impact on the Group's financial statements as no reclassifications were made for instruments that contained embedded derivatives.

IFRIC 18 Transfers of Assets from Customers
IFRIC 18 was issued in January 2009 and becomes effective for transfers of assets from customers received on or after 1 July 2009 with early application permitted, provided valuations were obtained at the date those transfers occurred. This interpretation should be applied prospectively. IFRIC 18 provides guidance on accounting for agreements in which an entity receives from a customer an item of property, plant and equipment that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services or to do both. This interpretation did not have any impact on the financial position or performance of the Group as the Group has no transfers of assets from its customers.

Subsidiaries

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

Acquisition of subsidiaries

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Subsidiaries (continued)

The excess of purchase consideration over the Group's share in the net fair value of the identifiable assets, liabilities and contingent liabilities is recorded as goodwill. If the cost of the acquisition is less than the Group's share in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary acquired the difference is recognised directly in the consolidated income statement.

Minority interest is the interest in subsidiaries not held by the Group. Minority interest at the reporting date represents the minority shareholders' share in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary at the acquisition date and the minorities' share in movements in equity since the acquisition date. Minority interest is presented within equity.

Losses allocated to minority interest do not exceed the minority interest in the equity of the subsidiary unless there is a binding obligation of the minority to fund the losses. All such losses are allocated to the Group.

Increases in ownership interests in subsidiaries

The differences between the carrying values of net assets attributable to interests in subsidiaries acquired and the consideration given for such increases are charged or credited to accumulated losses.

Acquisition of subsidiaries from parties under common control

Acquisitions of subsidiaries from parties under common control are accounted for using the uniting of interests method.

The assets and liabilities of the subsidiary transferred under common control are recorded in these consolidated financial statements at the carrying amounts of the transferring entity (the predecessor) at the date of the transfer. Related goodwill inherent in the predecessor's original acquisition is also recorded in these consolidated financial statements. Any difference between the total book value of net assets, including the Predecessor's goodwill, and the consideration paid is accounted for in these consolidated financial statements as an adjustment to the shareholders' equity.

These consolidated financial statements, including corresponding figures, are presented as if the subsidiary had been acquired by the Group on the date it was originally acquired by the predecessor.

Investments in associates

Associates are entities in which the Group generally has between 20% and 50% of the voting rights, or is otherwise able to exercise significant influence, but which it does not control or jointly control.

Investments in associates are accounted for under the equity method and are initially recognised at cost, including goodwill. Subsequent changes in the carrying value reflect the post-acquisition changes in the Group's share of net assets of the associate. The Group's share of its associates' profits or losses is recognised in the consolidated income statement, and its share of movements in reserves is recognised in other comprehensive income. However, when the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses, unless the Group is obliged to make further payments to, or on behalf of, the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Financial assets

Initial recognition

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

Date of recognition

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Financial assets (continued)

Held-to-maturity investments

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

Loans and receivables

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

Available-for-sale financial assets

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

Determination of fair value

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

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

Offsetting

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

Cash and cash equivalents

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

Amounts due from credit institutions

In the normal course of business, the Group maintains advances or deposits for various periods of time with other banks. Due from credit institutions are initially recognized at fair value. Due from credit institutions are subsequently measured at amortized cost using the effective interest method. Amounts due from credit institutions are carried net of any allowance for impairment losses.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Borrowings

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

If the Group purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is recognised in the consolidated income statement.

Leases

i. Finance - Group as lessee

The Group recognises finance leases as assets and liabilities in the consolidated statement of financial position at the date of commencement of the lease term at amounts equal to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. In calculating the present value of the minimum lease payments the discount factor used is the interest rate implicit in the lease, when it is practicable to determine; otherwise, the Group's incremental borrowing rate is used. Initial direct costs incurred are included as part of the asset. Lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

The costs identified as directly attributable to activities performed by the lessee for a finance lease, are included as part of the amount recognised as an asset under the lease.

ii. Operating - Group as lessee

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

iii. Operating - Group as lessor

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

Impairment of financial assets

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

Amounts due from credit institutions and loans to customers

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Impairment of financial assets (continued)

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

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

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

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

Held-to-maturity financial investments

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

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

Available-for-sale financial investments

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

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

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in the consolidated income statement. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the consolidated income statement, the impairment loss is reversed through the consolidated income statement.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Impairment of financial assets (continued)

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Financial liabilities

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

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

Financial guarantees

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

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

Insurance and reinsurance receivables

Insurance and reinsurance receivables are recognized based upon insurance policy terms and measured at cost. The carrying value of insurance and reinsurance receivables is reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable, with any impairment loss recorded in the consolidated statement of income.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Insurance and reinsurance receivables (continued)

Reinsurance receivables primarily include balances due from both insurance and reinsurance companies for ceded insurance liabilities. Premiums on reinsurance assumed are recognized as revenue in the same manner as they would be if the reinsurance were considered direct business, taking into account the product classification of the reinsured business. Amounts due to reinsurers are estimated in a manner consistent with the associated reinsured policies and in accordance with the reinsurance contract. Premiums ceded and claims reimbursed are presented on a gross basis.

An impairment review is performed on all reinsurance assets when an indication of impairment occurs. Reinsurance receivables are impaired only if there is objective evidence that the Group may not receive all amounts due to it under the terms of the contract that this can be measured reliably.

Insurance liabilities

General insurance liabilities

General insurance contract liabilities are based on the estimated ultimate cost of all claims incurred but not settled at the reporting date, whether reported or not, together with related claims handling costs and reduction for the expected value of salvage and other recoveries. Significant delays can be experienced in the notification and settlement of certain type of general insurance claims, particularly in respect of liability business, environmental and pollution exposures – therefore the ultimate cost of which cannot be known with certainty at the reporting date.

Provision for unearned premiums

The proportion of written premiums, gross of commission payable to intermediaries, attributable to subsequent periods is deferred as unearned premium. The change in the provision for unearned premium is taken to the consolidated income statement in order that revenue is recognized over the period of risk or, for annuities, the amount of expected future benefit payments.

Liability adequacy test

At each reporting date, a liability adequacy test is performed, to ensure the adequacy of unearned premiums net of related deferred acquisition costs. In performing the test, current best estimates of future contractual cash flows, claims handling and policy administration expenses, as well as investment income from assets backing such liabilities, are used. Any inadequacy is immediately charged to the consolidated income statement by establishing an unexpired risk provision.

Taxation

The current income tax expense is calculated in accordance with the regulations of the Georgia. It represents the sum of the current and deferred tax expenses.

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

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

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

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

Property and equipment

Property and equipment is carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Property and equipment (continued)

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

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

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

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

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis at the following annual prescribed rates:

Buildings and other real estate	2%-5%
Furniture and equipment	15%-20%
Computer equipment	20%-25%
Vehicles	20%-25%
Leasehold improvements	15%-25%

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

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

Construction-in-progress comprise costs directly related to construction of property and equipment including an appropriate allocation of directly attributable variable and fixed overheads that are incurred in construction. Depreciation of these assets, on the same basis as similar property assets, commences when the assets are put into operation.

Investment properties

The Group holds certain properties as investments to earn rental income, generate capital appreciation or both. Investment properties are measured initially at cost, including subsequent costs. Subsequent to initial recognition, Investment properties is stated to fair value. Gains or losses arising from changes in fair values of investment properties are included in the consolidated income statement.

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 5 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

Provisions

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Share capital

Share capital

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

Treasury shares

Where the Group or its subsidiaries purchases the Group's shares, the consideration paid, including any attributable transaction costs, net of income taxes, is deducted from total equity as treasury shares until they are cancelled or reissued. Where such shares are subsequently sold or reissued, any consideration received is included in equity. Treasury shares are stated at weighted average cost.

Dividends

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

Segment reporting

The Group's segment reporting is based on the following operating segments: Retail Banking, Corporate and Merchant Banking, Private Banking, Corporate Centre and Real Estate Management functions.

Contingencies

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

Retirement and other benefit obligations

In accordance with the requirements of the Georgian legislation, certain percentages of pension payments were withheld from total disbursements to staff to be transferred to the state pension fund till 1 January 2009, such that a portion of salary expense is withheld from the employee and instead paid to the state pension fund on behalf of the employee. This expense was charged in the period in which the related salaries were earned. Upon retirement, all retirement benefit payments are made by the state pension funds. The Group does not have any pension arrangements separate from the state pension system of Georgia. In addition, the Group has no post-retirement benefits or other significant compensated benefits requiring accrual.

Recognition of income and expenses

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

Interest and similar income and expense

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

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Recognition of income and expenses (continued)

Fee and commission income

The Group earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

- *Fee income earned from services that are provided over a certain period of time*

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

- *Fee income from providing transaction services*

Fees arising from negotiating or participating in the negotiation of a transaction for a third party – such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

Dividend income

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

Foreign currency translation

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

Differences between the contractual exchange rate of a transaction in a foreign currency and the NBG exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies

The exchange rates used by the Group in the preparation of the consolidated financial statements as at 31 December 2009 and 2008 are as follows:

	30 June 2010	*31 December 2009*	*31 December 2008*
GEL/1 US Dollar	1.8442	1.6858	1.6670
GEL/1 Euro	2.2484	2.4195	2.3648

Future changes in accounting policies

Standards and interpretations issued but not yet effective

Amendment to IAS 39 "Financial Instruments: recognition and measurement" - Eligible Hedged Items
The amendment to IAS 39 was issued in August 2008, and becomes effective for annual periods beginning on or after 1 July 2009. The amendment addresses the designation of a one-sided risk in a hedged item, and designation of inflation as a hedged risk or portion in particular situations. It clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as hedged item. Management does not expect the amendment to IAS 39 to affect the Group's consolidated financial statements as the Group has not entered into any such hedges.

IFRS 3 "Business Combinations" (revised in January 2008) and IAS 27 "Consolidated and Separate Financial Statements" (revised in January 2008)
The revised standards were issued in January 2008 and become effective for financial years beginning on or after 1 July 2009. Revised IFRS 3 introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. Revised IAS 27 requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give raise to a gain or loss. Furthermore, the revised standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes introduced by the revised Standards must be applied prospectively and will affect only future acquisitions and transactions with minority interests.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Future changes in accounting policies (continued)

IFRS 2 Share-based Payment: Group Cash-settled Share-based Payment Transactions
The amendment to IFRS 2 was issued in June 2009 and become effective for financial years beginning on or after 1 January 2010. The amendment clarifies the scope and the accounting for group cash-settled share-based payment transactions. This amendment also supersedes IFRIC 8 and IFRIC 11. The Group expects that this amendment will have no impact on the Group's consolidated financial statements.

IFRIC 17 "Distribution of Non-Cash Assets to Owners"
IFRIC Interpretation 17 was issued on 27 November 2008 and is effective for annual periods beginning on or after 1 July 2009. IFRIC 17 applies to pro rata distributions of non-cash assets except for common control transactions and requires that a dividend payable should be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity; an entity should measure the dividend payable at the fair value of the net assets to be distributed; an entity should recognise the difference between the dividend paid and the carrying amount of the net assets distributed in profit or loss. The Interpretation also requires an entity to provide additional disclosures if the net assets being held for distribution to owners meet the definition of a discontinued operation. The Group expects that this interpretation will have no impact on the Group's consolidated financial statements.

Improvements to IFRSs
In April 2009 the IASB issued the second omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. Most of the amendments are effective for annual periods beginning on or after 1 January 2010. There are separate transitional provisions for each standard. Amendments included in April 2009 "Improvements to IFRS" will have no impact on the accounting policies, financial position or performance of the Group, except the following amendments resulting in changes to accounting policies, as described below.

- IFRS 5 Non-current Assets Held for Sale and Discontinued Operations: clarifies that the disclosures required in respect of non-current assets and disposal groups classified as held for sale or discontinued operations are only those set out in IFRS 5. The disclosure requirements of other IFRSs only apply if specifically required for such non-current assets or discontinued operations. The Group expects that this amendment will have no impact on the Group's consolidated financial statements.
- IFRS 8 Operating Segment Information: clarifies that segment assets and liabilities need only be reported when those assets and liabilities are included in measures that are used by the chief operating decision maker. As the Group's chief operating decision maker does review segment assets and liabilities, the Group will continue to disclose this information.
- IAS 7 Statement of Cash Flows: Explicitly states that only expenditure that results in recognising an asset can be classified as a cash flow from investing activities.
- IAS 36 Impairment of Assets: The amendment clarifies that the largest unit permitted for allocating goodwill, acquired in a business combination, is the operating segment as defined in IFRS 8 before aggregation for reporting purposes. The amendment will have no impact on the Group as the annual impairment test is performed before aggregation.

Amendments to IAS 32 "Financial instruments: Presentation": Classification of Rights Issues"
In October 2009, the IASB issued amendment to IAS 32. Entities shall apply that amendment for annual periods beginning on or after 1 February 2010. Earlier application is permitted. The amendment alters the definition of a financial liability in IAS 32 to classify rights issues and certain options or warrants as equity instruments. This is applicable if the rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, in order to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. The Group expects that this amendment will have no impact on the Group's consolidated financial statements.

IFRS 9 "Financial Instruments"
In November 2009 the IASB issued the first phase of IFRS 9 Financial instruments. This Standard will eventually replace IAS 39 Financial Instrument: Recognition and Measurement. IFRS 9 becomes effective for financial years beginning on or after 1 January 2013. Entities may adopt the first phase for reporting periods ending on or after 31 December 2009. The first phase of IFRS 9 introduces new requirements on classification and measurement of financial assets. In particular, for subsequent measurement all financial assets are to be classified at amortised cost or at fair value through profit or loss with the irrevocable option for equity instruments not held for trading to be measured at fair value through other comprehensive income. The Group now evaluates the impact of the adoption of new Standard and considers the initial application date.

(Thousands of Georgian Lari)

4. Significant accounting judgments and estimates

The preparation of the Group's consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the balance sheet date and the reported amount of income and expenses during the year ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The following estimates and judgments are considered important to the Group's financial condition.

Allowance for impairment of loans

The Group regularly reviews its loans to assess for impairment. The Group's loan impairment provisions are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Group considers accounting estimates related to allowance for impairment of loans and receivables a key source of estimation uncertainty because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and receivables are based on recent performance experience, and (ii) any significant difference between the Group's estimated losses and actual losses would require the Group to record provisions which could have a material impact on its financial statements in future periods.

The Group uses management's judgment to estimate the amount of any impairment loss in cases where a borrower has financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on past performance, past customer behavior, observable data indicating an adverse change in the payment status of borrowers in a group, and national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans. The Group uses management's judgment to adjust observable data for a group of loans to reflect current circumstances not reflected in historical data.

The allowances for impairment of financial assets in the consolidated financial statements have been determined on the basis of existing economic and political conditions. The Group is not in a position to predict what changes in conditions will take place in Georgia and what effect such changes might have on the adequacy of the allowances for impairment of financial assets in future periods.

Valuation of financial instruments

Financial instruments that are classified as available-for-sale are stated at fair value. The fair value of such financial instruments is the estimated amount at which the instrument could be exchanged between willing parties, other than in a forced or liquidation sale. If a quoted market price is available for an instrument, the fair value is calculated based on the market price. When valuation parameters are not observable in the market or cannot be derived from observable market prices, the fair value is derived through analysis of other observable market data appropriate for each product and pricing models which use a mathematical methodology based on accepted financial theories. Pricing models take into account the contract terms of the securities as well as market-based valuation parameters, such as interest rates, volatility, exchange rates and the credit rating of the counterparty. Where market-based valuation parameters are missed, management will make a judgment as to its best estimate of that parameter in order to determine a reasonable reflection of how the market would be expected to price the instrument. In exercising this judgment, a variety of tools are used including proxy observable data, historical data, and extrapolation techniques. The best evidence of fair value of a financial instrument at initial recognition is the transaction price unless the instrument is evidenced by comparison with data from observable markets. Any difference between the transaction price and the value based on a valuation technique is not recognized in the consolidated statement of operations on initial recognition.

Subsequent gains or losses are only recognized to the extent that it arises from a change in a factor that market participants would consider in setting a price.

The Group considers that the accounting estimate related to valuation of financial instruments where quoted markets prices are not available is a key source of estimation uncertainty because: (i) it is highly susceptible to change from period to period because it requires management to make assumptions about interest rates, volatility, exchange rates, the credit rating of the counterparty, valuation adjustments and specific feature of the transactions and (ii) the impact that recognizing a change in the valuations would have on the assets reported on its balance sheet as well as its profit/loss could be material.

(Thousands of Georgian Lari)

4. Significant accounting judgments and estimates (continued)

Had management used different assumptions regarding the interest rates, volatility, exchange rates, the credit rating of the counterparty and valuation adjustments, a larger or smaller change in the valuation of financial instruments where quoted market prices are not available would have resulted that could have had a material impact on the Group's reported net income.

Insurance contract provisions

For insurance contract provisions estimates have to be made both for the expected ultimate cost of claims reported but not settled at the balance sheet date ("RBNS") and for the expected ultimate cost of claims incurred but not yet reported at the balance sheet date ("IBNR"). It can take a significant period of time before the ultimate claims cost can be established with certainty and for some type of policies, IBNR claims form the majority of the balance sheet liability.

The main assumption underlying techniques used by the Group is that the Group's past claims development experience is used to project future claims development and, hence, ultimate claims costs. As such, these techniques extrapolate the development of paid and incurred losses, average costs per claim and claim numbers based on the observed development of earlier years and expected loss ratios. Historical claims development is mainly analyzed by significant business lines. Large claims are usually separately addressed, either by being reserved at the face value of loss adjustor estimates or separately projected in order to reflect their future development. In most cases, no explicit assumptions are made regarding future rates of claims inflation or loss ratios. Instead, the assumptions used are those implicit in the historic claims development data on which the projections are based. Additional qualitative judgment is used to assess the extent to which past trends may not apply in future, in order to arrive at the estimated ultimate cost of claims that present the likely outcome from the range of possible outcomes, taking account of all the uncertainties involved.

Further judgment is made as to the recoverability of amounts due from reinsurers. Provisions for bad debts are made specifically based on the solvency of the reinsurers, payment experience with them and any discrepancies of which the Group is aware.

Property and equipment

Certain property (land and buildings) is measured at revalued amounts. The date of the latest appraisal was 31 December 2008. The next revaluation is preliminarily determined as at 31 December 2010. Other items of property, plant and equipment are stated at cost less accumulated depreciation and less any accumulated impairment losses. The estimation of the useful life of an item of property, plant and equipment is a matter of management judgment based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any one of these conditions or estimates may result in adjustments to future depreciation rates.

5. Segment information

For management purposes, the Group is organized into the following operating segments based on products and service:

Retail Banking	Principally handling individual customers' deposits, and providing consumer loans, overdrafts, credit cards facilities and funds transfer facilities.
Corporate and Merchant Banking	Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers.
Corporate Center	Principally providing back office services to all operating segments of the Bank.
Private Banking	Principally providing private banking services to VIP customers of the Bank
Real Estate Management	Principally handling the real estate owned by the Group.
Other	Segments not classified above

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance, as explained in the table below, is measured differently from profit or loss in the consolidated financial statements. Income taxes are managed on a group basis and are not allocated to operating segments.

Transfer prices between operating segments are on an arm's length basis in a manner similar to transactions with third parties.

(Thousands of Georgian Lari)

5. Segment information (continued)

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Group's total revenue in 2009 or 2008.

The following tables present income and profit and certain asset and liability information regarding the Group's operating segments.

2009	*Retail banking*	*Corporate banking*	*Private banking*	*Corporate center*	*Other*	*Adjustments and eliminations*	*Total*
Revenue							
Third party							
Interest income	13,922	4,758	631	4,814	-	(20)	24,105
Net fees and commission income	16,958	9,007	87	3,723	-	(1)	29,774
Net gains from foreign currencies	502	377	76	1,556	(1)	924	3,434
Other income	3,324	3,324	82	4,580	1,066	5,598	17,974
Total revenue	**34,706**	**17,466**	**876**	**14,673**	**1,065**	**6,501**	**75,287**
Interest expense	(8,470)	(6,087)	(206)	(5,156)	(20)	20	(19,919)
Net impairment charge on interest-bearing assets	(553)	(19,131)	(17)	2,935	-	-	(16,766)
Salaries and other employee benefits	(14,528)	(3,332)	(203)	(1,732)	(411)	-	(20,206)
Depreciation, amortization and impairment	(2,950)	(737)	-	(1,229)	(52)	(1,938)	(6,906)
Other impairment and provisions	-	-	-	(2,295)	-	-	(2,295)
General and administrative and other operating expenses	(7,269)	(2,485)	(181)	(5,429)	(421)	348	(15,437)
Segment results	**936**	**(14,306)**	**269**	**1,767**	**161**	**4,931**	**(6,242)**
Income tax benefit							899
Loss for the year							**(5,343)**
Segment assets	196,653	64,210	2,552	59,587	6,384	(8,346)	321,040
Segment liabilities	118,283	166,113	15,416	11,965	614	(575)	311,816
Other segment information							
Investments in associates	-	-	-	788	-	-	788
Share of loss of associates	-	-	-	(105)	-	-	(105)

2008 (Restated)	*Retail banking*	*Corporate banking*	*Corporate center*	*Insurance*	*Real estate management*	*Other*	*Adjustments and eliminations*	*Total*
Revenue								
Third party								
Interest income	19,827	10,301	1,437	-	-	9	555	32,129
Net fees and commission income	15,705	8,793	3,821	-	-	(50)	10	28,279
Net gains from foreign currencies	437	328	1,422	-	(225)	(195)	(1,317)	450
Other income	509	509	1,186	5,521	3,616	2,509	(1,683)	12,167
Total revenue	**36,478**	**21,103**	**7,866**	**5,521**	**3,391**	**2,273**	**(2,435)**	**73,025**
Interest expense	(10,544)	(6,229)	(290)	-	(1,621)	(188)	2,204	(16,668)
Net impairment charge on interest-bearing assets	2,470	(18,790)	(11,544)	-	-	-	-	(27,864)
Salaries and other employee benefits	(23,611)	(5,441)	(2,696)	(795)	(1,527)	(1,021)	(60)	(35,151)
Depreciation, amortization and impairment	(2,412)	(603)	(1,005)	(66)	(537)	(51)	(271)	(4,945)
Other impairment and provisions	-	-	(5,256)	-	-	-	-	(5,256)
General and administrative and other operating expenses	(11,999)	(4,311)	(6,999)	(1,511)	(11,015)	(1,959)	101	(37,693)
Segment results	**(9,618)**	**(15,443)**	**(19,924)**	**3,149**	**(11,309)**	**(946)**	**(461)**	**(54,552)**
Income tax benefit								8,705
Loss for the year								**(45,847)**
Segment assets	180,426	104,405	23,654	19,771	9,176	771	(19,148)	319,055
Segment liabilities	162,500	96,387	35,611	14,926	15,312	1,834	(22,023)	304,547
Other segment information								
Investments in associates	-	-	893	-	-	-	-	893
Share of profit of associates	-	-	104	-	-	-	-	104

(Thousands of Georgian Lari)

6. Cash and cash equivalents

Cash and cash equivalents comprise:

	2009	*2008 (Restated)*	*2007 (Restated)*
Cash on hand	44,075	11,652	16,582
Current accounts with the NBG	24,563	16,535	3,881
Current accounts with other credit institutions	19,664	16,646	13,507
Time deposits with credit institutions up to 90 days	10,516	6,327	18
Cash and cash equivalents	**98,818**	**51,160**	**33,988**

As of 31 December 2009 GEL 16,794 (2008: GEL 11,985) was placed on current and time deposit accounts with internationally recognized OECD banks that are the counterparties of the Group in performing international settlements.

7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2009	*2008 (Restated)*	*2007 (Restated)*
Obligatory reserve with the NBG	13,356	9,080	7,587
Time deposits with effective maturity of more than 90 days	1,067	11,057	10,659
	14,423	**20,137**	**18,246**
Less – Allowance for impairment	–	(10,499)	–
Amounts due from credit institutions	**14,423**	**9,638**	**18,246**

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

As of 31 December 2009, GEL 1,067 (2008: GEL 558) was placed on current accounts and inter-bank deposits with number of internationally recognized OECD banks, who are the main counterparties of the Group in performing international settlements. Of these amounts, GEL 503 was pledged to the counterparty banks and GEL 565 to Visa Inc., a global payments technology company as security for open commitments.

The movements in allowance for impairment of amounts due from credit institutions were as follows:

	2009	*2008 (Restated)*	*2007 (Restated)*
1 January	**10,499**	**–**	**–**
(Reversal)/charge	(102)	10,499	–
Write-offs	(10,397)	–	–
31 December	**–**	**10,499**	**–**

8. Loans to customers

Loans to customers comprise:

	2009	*2008 (Restated)*
Commercial loans	43,403	45,077
Pension loans	28,468	4,499
Consumer loans	18,512	55,373
Salary loans	16,598	29,719
Residential mortgage loans	561	39
Gross loans to customers	**107,542**	**134,707**
Less – Allowance for impairment	(24,790)	(25,421)
Loans to customers	**82,752**	**109,286**

(Thousands of Georgian Lari)

8. Loans to customers (continued)

Allowance for impairment of loans to customers

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

	Commercial loans 2009	*Consumer loans 2009*	*Residential mortgage loans 2009*	*Salary loans 2009*	*Pension Loans 2009*	*Total 2009*
At 1 January 2009	**11,463**	**10,356**	**5**	**3,596**	**1**	**25,421**
Charge / (reversal) for the year	19,234	208	(5)	(2,935)	366	16,868
Recoveries	1,159	23	–	–	–	1,182
Amounts written off	(14,290)	(3,442)	–	–	(38)	(17,770)
Interest accrued on impaired loans	(620)	(291)	–	–	–	(911)
At 31 December 2009	**16,946**	**6,854**	**–**	**661**	**329**	**24,790**
Individual impairment	16,784	5,873	–	586	288	23,531
Collective impairment	162	981	–	75	41	1,259
	16,946	**6,854**	**–**	**661**	**329**	**24,790**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**35,543**	**5,854**	**–**	**682**	**290**	**42,369**

	Commercial loans 2008	*Consumer loans 2008*	*Residential mortgage loans 2008*	*Salary loans 2008*	*Pension Loans 2008*	*Total 2008*
At 1 January 2008 (Restated)	**1,863**	**7,821**	**1**	**608**	**90**	**10,383**
Charge / (reversal) for the year	11,096	3,364	4	2,990	(89)	17,365
Recoveries	–	11	–	–	–	11
Amounts written off	(1,364)	(781)	–	(2)	–	(2,147)
Interest accrued on impaired loans	(132)	(59)	–	–	–	(191)
At 31 December 2008 (Restated)	**11,463**	**10,356**	**5**	**3,596**	**1**	**25,421**
Individual impairment	11,239	6,431	–	–	–	17,670
Collective impairment	224	3,925	5	3,596	1	7,751
	11,463	**10,356**	**5**	**3,596**	**1**	**25,421**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**40,792**	**11,204**	**–**	**–**	**–**	**51,996**

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized as at 31 December 2009 comprised GEL 3,288 (2008: GEL 1,954).

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

- For commercial lending, charges over real estate properties, inventory and trade receivables,
- For retail lending, mortgages over residential properties.

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

(Thousands of Georgian Lari)

8. Loans to customers (continued)

Concentration of loans to customers

As of 31 December 2009 concentration of loans granted by the Group to ten largest third party borrowers comprised GEL 33,358 accounting for 31.02% of gross loan portfolio of the Group (2008: GEL 29,397 and 21.82%, respectively). An allowance of GEL 13,043 (2008: GEL 8,788) was established against these loans.

Loans have been extended to the following types of customers:

	2009	*2008 (Restated)*
Individuals	64,139	87,284
Private companies	43,353	47,364
State-owned entities	50	59
Loans to customers - Gross	**107,542**	**134,707**
Less - Allowance for loan impairment	(24,790)	(25,421)
Loans to customers, net	**82,752**	**109,286**

Concentration of loans to customers

As of 31 December 2009 loans are principally issued within Georgia, and their distribution by industry sectors is as follows:

	2009	*2008 (Restated)*
Individuals	64,139	87,284
Trade and service	37,686	33,209
Construction	3,909	8,172
Energy	1,129	2,737
Agriculture	2	1,448
Other	677	1,857
	107,542	**134,707**
Less - Allowance for loan impairment	(24,790)	(25,421)
Loans to customers, net	**82,752**	**109,286**

9. Investment securities

Available-for-sale securities comprise:

	2009	*2008 (Restated)*	*2007 (Restated)*
Corporate shares	5,670	8,666	881
Less – Allowance for impairment (Note 15)	(3,410)	(764)	–
Available-for-sale securities	**2,260**	**7,902**	**881**

Corporate shares as of 31 December 2009 are primarily comprised of investments in a Georgian restaurant chain of GEL 5,319 (2008: GEL 7,644; 2007: nil) and global payments technology company Visa Inc. GEL 319 (2008: GEL 141; 2007: nil).

10. Investments in associates

The following major associates are accounted for under the equity method:

2009

Associates	*Ownership / Voting, %*	*Country*	*Date of incorporation*	*Industry*	*Date of acquisition*
United System for Instant Payments JSC	30%	Georgia	10/15/1995	Electronic Payment Services	10/4/2007

2008

Associates	*Ownership / Voting, %*	*Country*	*Date of incorporation*	*Industry*	*Date of acquisition*
United System for Instant Payments JSC	30%	Georgia	10/15/1995	Electronic Payment Services	10/4/2007

(Thousands of Georgian Lari)

10. Investments in associates (continued)

Movement in investments in associates was:

	2009	2008 (Restated)
Balance, beginning of the year	893	789
Share of (loss) /profit	(105)	104
Investments in associates, end of the year	**788**	**893**

The following table illustrates summarised financial information of the associates:

Aggregated assets and liabilities of associates	*2009*	*2008*
Assets	2,209	2,665
Liabilities	2,408	2,515
Net (liabilities)/assets	**(199)**	**150**

Aggregated revenue and profit of associates	*2009*	*2008*
Revenue	6,259	6,099
(Loss)/profit	(349)	340

11. Investment properties

	2009	2008
At 1 January	–	–
Transfers from property and equipment	20,184	–
At 31 December	**20,184**	**–**

Investment properties are stated at fair value, which has been determined based on valuation performed by Georgian Valuation Company, an accredited independent appraiser, as at 31 December 2009. Georgian Valuation Company is an industry specialist in valuing these types of investment property. The fair value represents the amount at which asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards Committee standards.

Rental income and direct operating expenses arising from investment properties comprise:

	2009	2008
Rental income	270	–
Direct operating expenses	53	–

The entire amount of direct operating expenses participated in the generation of rental income during the respective periods.

(Thousands of Georgian Lari)

12. Property and equipment

The movements in property and equipment were as follows:

	Buildings	Furniture and fixtures	Computers and office equipment	Motor vehicles	Leasehold improvements	Assets under construction	Total
Cost or revalued amount							
31 December 2008 (Restated)	**73,772**	**16,811**	**7,805**	**1,906**	**3,798**	**4,676**	**108,768**
Additions	3,914	1,714	525	1,366	281	3	**7,803**
Disposals	(3,946)	(417)	(186)	(122)	–	(91)	**(4,762)**
Transfers	(20,184)	–	–	–	–	–	**(20,184)**
31 December 2009	**53,556**	**18,108**	**8,144**	**3,150**	**4,079**	**4,588**	**91,625**
Accumulated depreciation							
31 December 2008 (Restated)	**112**	**2,911**	**3,405**	**873**	**184**	**–**	**7,485**
Depreciation charge	980	1,616	1,345	485	63	–	**4,489**
Disposals	(314)	(96)	(55)	(29)	–	–	**(494)**
31 December 2009	**778**	**4,431**	**4,695**	**1,329**	**247**	**–**	**11,480**
Net book value:							
31 December 2008 (Restated)	**73,660**	**13,900**	**4,400**	**1,033**	**3,614**	**4,676**	**101,283**
31 December 2009	**52,778**	**13,677**	**3,449**	**1,821**	**3,832**	**4,588**	**80,145**

	Buildings	Furniture and fixtures	Computers and office equipment	Motor vehicles	Leasehold improvements	Assets under construction	Total
Cost or revalued amount							
31 December 2007 (Restated)	**74,691**	**12,193**	**5,333**	**1,735**	**3,012**	**1,664**	**98,628**
Additions	8,133	4,938	2,473	317	883	3,204	**19,948**
Disposals	(69)	(320)	(1)	(146)	(97)	(192)	**(825)**
Effect of revaluation	(8,983)	–	–	–	–	–	**(8,983)**
31 December 2008 (Restated)	**73,772**	**16,811**	**7,805**	**1,906**	**3,798**	**4,676**	**108,768**
Accumulated depreciation							
31 December 2007 (Restated)	**229**	**1,970**	**2,236**	**589**	**120**	**–**	**5,144**
Depreciation charge	1,868	1,077	1,170	423	67	–	**4,605**
Disposals	(60)	(136)	(1)	(139)	(3)	–	**(339)**
Effect of revaluation	(1,925)	–	–	–	–	–	**(1,925)**
31 December 2008 (Restated)	**112**	**2,911**	**3,405**	**873**	**184**	**–**	**7,485**
Net book value:							
31 December 2007 (Restated)	**74,462**	**10,223**	**3,097**	**1,146**	**2,892**	**1,664**	**93,484**
31 December 2008 (Restated)	**73,660**	**13,900**	**4,400**	**1,033**	**3,614**	**4,676**	**101,283**

(Thousands of Georgian Lari)

12. Property and equipment (continued)

	Buildings	*Furniture and fixtures*	*Computers and office equipment*	*Motor vehicles*	*Leasehold improvements*	*Assets under construction*	*Total*
Cost or revalued amount							
31 December 2006	**32,242**	**7,165**	**3,852**	**1,331**	**2,162**	**298**	**47,050**
Additions	17,072	5,028	1,481	420	850	1,366	**26,217**
Disposals	(44)	–	–	(16)	–	–	**(60)**
Effect of revaluation	25,327	–	–	–	–	–	**25,327**
Effect of restatement	94	–	–	–	–	–	**94**
31 December 2007 (Restated)	**74,691**	**12,193**	**5,333**	**1,735**	**3,012**	**1,664**	**98,628**
Accumulated depreciation							
31 December 2006	594	1,103	1,331	389	71	–	**3,488**
Depreciation charge	1,029	867	905	209	49	–	**3,059**
Disposals	(2)	–	–	(9)	–	–	**(11)**
Effect of revaluation	(1,526)	–	–	–	–	–	**(1,526)**
Effect of restatement	134	–	–	–	–	–	**134**
31 December 2007 (Restated)	**229**	**1,970**	**2,236**	**589**	**120**	**–**	**5,144**
Net book value:							
31 December 2006	**31,648**	**6,062**	**2,521**	**942**	**2,091**	**298**	**43,562**
31 December 2007 (Restated)	**74,462**	**10,223**	**3,097**	**1,146**	**2,892**	**1,664**	**93,484**

If the buildings were measured using the cost model, the carrying amounts would be as follows:

	2009	*2008*	*2007*
Cost	57,302	57,334	49,270
Accumulated depreciation and impairment	4,315	3,197	1,824
Net carrying amount	**52,987**	**54,137**	**47,446**

13. Intangible assets

The movements in intangible assets were as follows:

	Computer software	*Total*
Cost		
31 December 2008	4,233	**4,233**
Additions	3,457	**3,457**
Disposals	(27)	**(27)**
31 December 2009	**7,663**	**7,663**
Accumulated amortization and impairment		
31 December 2008	693	**693**
Amortisation charge	469	**469**
Disposals	(7)	**(7)**
Impairment	1,948	**1,948**
31 December 2009	**3,103**	**3,103**
Net book value:		
31 December 2008	**3,540**	**3,540**
31 December 2009	**4,560**	**4,560**

(Thousands of Georgian Lari)

13. Intangible assets (continued)

	Computer software	*Total*
Cost		
31 December 2007	**3,115**	**3,115**
Additions	1,118	1,118
31 December 2008	**4,233**	**4,233**
Accumulated amortization and impairment		
31 December 2007	**353**	**353**
Amortisation charge	340	340
31 December 2008	**693**	**693**
Net book value:		
31 December 2007	**2,762**	**2,762**
31 December 2008	**3,540**	**3,540**

14. Taxation

The corporate income tax expense (benefit) comprises:

	2009	*2008 (Restated)*
Current tax charge	26	458
Deferred tax charge – origination and reversal of temporary differences	(925)	(9,163)
Deferred tax recognised in other comprehensive income	(27)	118
Income tax benefit	**(899)**	**(8,705)**

Deferred tax related to items charged or credited to other comprehensive income during the year is as follows:

	2009	*2008 (Restated)*
Net unrealized gains on investment securities available for sale	178	141
Revaluation of buildings	–	(930)
Income tax charged to other comprehensive income (at 15%)	**27**	**(118)**

Georgian legal entities must file individual tax declarations. The tax rate for banks for profits other than on state securities was 15% for 2009 and 2008. The tax rate for interest income on state securities changed from 10% to 7.5%, effective 1 January 2009 and further from 7.5% to 0%, effective 9 August 2009.

(Thousands of Georgian Lari)

14. Taxation (continued)

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

	2009	*2008 (Restated)*
Loss before income tax expense	**(6,347)**	**(54,448)**
Statutory tax rate	*15%*	*15%*
Theoretical income tax benefit at the statutory rate	**(952)**	**(8,167)**
- other	53	(538)
Income tax benefit	**(899)**	**(8,705)**

As at 31 December tax assets and liabilities consist of the following:

	2009	*2008 (Restated)*
Current income tax assets	630	630
Deferred income tax assets	1,313	1,240
Income tax assets	**1,943**	**1,870**
Current income tax liabilities	82	1,439
Deferred income tax liabilities	–	–
Income tax liabilities	**82**	**1,439**

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

		Origination and reversal of temporary differences			*Origination and reversal of temporary differences*			
	2007 (Restated)	*In the income statement*	*In other compre-hensive income*	*2008 (Restated)*	*In the income statement*	*In other compre-hensive income*	*Disposal*	*2009*
Tax effect of deductible temporary differences:								
Impairment of goodwill	163	–	–	163	(163)	–	–	–
Property and equipment	875	141	–	1,016	(1,016)	–	–	–
Tax loss carry forward	2,740	5,001	–	7,741	325	–	(626)	7,440
Loan to customers	–	–	–	–	580	–	–	580
Other assets	–	–	–	–	587	–	–	587
Equity investments	–	–	–	–	377	–	–	377
Deferred tax assets	**3,778**	**5,142**	–	**8,920**	**690**	–	(626)	**8,984**
Tax effect of taxable temporary differences:								
Property and equipment/Intangible assets	(11,820)	4,022	139	(7,659)	357	–	(253)	(7,555)
Securities owned	–	–	(21)	(21)	(122)	27	–	(116)
Deferred tax liabilities (assets)	**(11,820)**	**4,022**	**118**	**(7,680)**	**235**	**27**	**(253)**	**(7,671)**
Deferred tax assets (liabilities)	**(8,042)**	**9,164**	**118**	**1,240**	**925**	**27**	**(879)**	**1,313**

The Group has available GEL 7,440 of tax losses carried forwards which begins to expire in 2012, if not utilised.

(Thousands of Georgian Lari)

15. Other assets and liabilities

Other assets comprise:

	2009	*2008 (Restated)*	*2007 (Restated)*
Receivables from money transfers	3,464	2,326	3,817
Assets held-for-sale	2,032	468	468
Receivable from documentary operations	660	186	–
Prepaid taxes other than income tax	611	5,114	3,939
Receivables arising from insurance contracts	–	11,337	1,880
Voucherization income receivable	–	–	3,036
Other	731	2,063	2,124
	7,498	**21,494**	**15,264**
Less – Allowance for impairment of other assets	(601)	(5,212)	(919)
Other assets	**6,897**	**16,282**	**14,345**

Other liabilities comprise:

	2009	*2008 (Restated)*	*2007 (Restated)*
Unsettled funds	3,479	–	–
Sundry creditors	2,361	–	–
Post war state social aid	2,001	16,620	–
State social aid project funds	972	4,579	3,322
Net liabilities under finance lease agreements	457	548	–
Pension funds	210	541	759
Operating taxes payable	158	679	–
Provision for guarantees and other commitments (Note 15)	80	–	146
Insurance contract provision for unearned premiums	–	10,829	2,186
Insurance contract provisions for claims	–	2,566	459
Insurance contract provisions for claims	–	1,604	1,240
Tax penalties and fines	–	28	–
Other	772	1,413	1,040
Other liabilities	**10,490**	**39,407**	**9,152**

Liabilities under finance lease agreements as at 31 December 2009 and 2008 are analyzed as follows:

	2009	*2008 (Restated)*	*2007 (Restated)*
Minimum lease payments:			
Not later than 1 year	412	7	–
Later than 1 year and not later than 5 years	149	333	–
Later than 5 years	–	333	–
	561	**673**	–
Less – Future finance costs	(104)	(125)	–
Net liabilities under finance lease agreements	**457**	**548**	–

(Thousands of Georgian Lari)

15. Other assets and liabilities (continued)

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

	Securities available-for-sales	*Other assets*	*Guarantees and commitments*	*Total*
31 December 2006	**–**	**721**	**–**	**721**
Charge	–	206	146	**352**
Write-offs	–	(8)	–	**(8)**
31 December 2007 (restated)	**–**	**919**	**146**	**1,065**
Charge	764	4,638	(146)	**5,256**
Write-offs	–	(345)	–	**(345)**
31 December 2008 (restated)	**764**	**5,212**	**–**	**5,976**
Charge (reversal)	2,917	(702)	80	**2,295**
Write-offs	(271)	(3,962)	–	**(4,233)**
Recoveries	–	53	–	**53**
31 December 2009	**3,410**	**601**	**80**	**4,091**

16. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2009	*2008 (Restated)*
Time deposits and loans	54,600	52,348
Current accounts	6	7
Borrowings from international credit institutions	–	29,806
Amounts due to credit institutions	**54,606**	**82,161**

During 2009, the Group placed with and received short-term funds from Georgian and OECD banks in different currencies. As of 31 December 2009 the Group had an equivalent of GEL 9,000 (2008: GEL 18,131) received as deposits from Georgian banks. As of 31 December 2008 the borrowings from international credit institutions comprised of a term loan facility agreement with GML Capital LLP for the total amount of USD 25,000.

Time deposits and inter-bank loan, and borrowings from international credit institutions were comprised of:

As of 31 December 2009	*Grant date*	*Contractual maturity*	*Currency*	*Interest rate per annum*	*Facility amount in original currency*	*Balance as of 31 December 2009 in GEL*
National Bank of Georgia	28-Jul-09	28-Jul-14	GEL	13%	45,000	45,000
TBC Bank	31-Dec-09	4-Jan-10	GEL	5%	5,000	5,000
Basis Bank	31-Dec-09	4-Jan-10	GEL	4%	4,000	4,000
Landes Bank	22-Aug-07	14-Aug-12	USD	LIBOR+1.75%	355	600
Total						**54,600**

As of 31 December 2008	*Grant date*	*Contractual maturity*	*Currency*	*Interest rate per annum*	*Facility amount in original currency*	*Balance as of 31 December 2008 in GEL*
National Bank of Georgia	30-Dec-08	29-Jan-09	GEL	13%	20,000	20,014
National Bank of Georgia	31-Dec-08	8-Jan-09	GEL	8.1%	14,200	14,203
InvestBank	24-Dce-08	15-Jan-09	EUR	12%	5,000	11,851
TBC Bank	15-Dec-08	8-Jan-09	GEL	12%	3,800	3,820
TBC Bank	17-Dec-08	5-Jan-09	GEL	12.5%	1,655	1,662
Landes Bank	22-Aug-07	14-Aug-12	USD	LIBOR+1.75%	469	798
Total						**52,348**

(Thousands of Georgian Lari)

17. Amounts due to customers

The amounts due to customers include the following:

	2009	*2008 (Restated)*	*2007 (Restated)*
Current accounts	187,253	109,946	152,699
Time deposits	59,385	71,594	48,188
Amounts due to customers	**246,638**	**181,540**	**200,887**
Held as security against guarantees	**5,342**	**1,371**	**936**

At 31 December 2009, amounts due to customers of GEL 112,630 (46%) were due to the ten largest customers (2008: GEL 30,649 (17%)).

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

	2009	*2008 (Restated)*	*2007 (Restated)*
State and budgetary organizations	102,244	32,682	57,561
Private enterprises	50,656	35,384	36,336
Individuals	93,738	113,474	106,990
Amounts due to customers	**246,638**	**181,540**	**200,887**

An analysis of customer accounts by economic sector follows:

	2009	*2008 (Restated)*	*2007 (Restated)*
Governmental	102,244	32,682	57,561
Individuals	93,738	113,474	106,990
Trade	5,441	5,611	7,871
Real estate constructions	1,293	6,805	2,626
Transport and communication	1,258	1,644	2,941
Energy	674	601	2,219
Agriculture	407	269	118
Mining	46	14	490
Other	41,537	20,440	20,071
Amounts due to customers	**246,638**	**181,540**	**200,887**

18. Equity

Share capital and additional paid-in capital

As of 31 December 2009, authorized share capital comprised 3,000,000,000 common shares of which 1,572,109,700 were fully issued and paid (2008: 1,572,110,000 common shares, of which 1,572,110,000 were issued and fully paid). Each share has nominal value of GEL 0.01.

Shares issued and outstanding, net of treasury shares, and movements are described below:

	Number of shares	*Nominal amount*
	Ordinary	*Ordinary*
31 December 2007 (Restated)	**1,502,053**	**15,021**
Increase in share capital through capitalization of additional paid-in capital	20,000	200
Sale of treasury shares	14,500	145
31 December 2008 (Restated)	**1,536,553**	**15,366**
Sale of treasury shares	841	8
31 December 2009	**1,537,394**	**15,374**

(Thousands of Georgian Lari)

18. Equity (continued)

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

On 2 November 2009 the authorized share capital of the Bank was increased from GEL 15,721 thousand as of 31 December 2008 to GEL 30,000 thousand comprising of 3,000,000 thousand shares. The increase is in anticipation of future increase of free float and attraction of new investors.

Basic loss per share

2009 net loss attributable to ordinary shareholders of the Group comprise GEL 5,448 (2008: net loss GEL 45,743). At 31 December 2009 weighted average number of ordinary shares outstanding during the year was 1,537,238,340 (2008:1,542,098,518), resulting to loss per share of GEL0.004 (full amount) for 2009 (2008: Loss per share of GEL0.030). No dilution effect for 2009 and 2008.

Treasury shares

Treasury shares of GEL 347 as of 31 December 2009 comprise Group's shares owned by the Bank (2008: GEL 355 was owned by Bank's subsidiaries).

Dividends

No dividends were declared and paid during 2009 and 2008.

Other reserves

Movements in other reserves were as follows:

	Revaluation reserve for property and equipment	*Unrealised gains/(losses) on investment securities available-for-sale*	*Total*
At 1 January 2008 (Restated)	**37,499**	**–**	**37,499**
Revaluation of buildings	(930)	–	**(930)**
Tax effect of revaluation of buildings	139	–	**139**
Depreciation of revaluation reserve	(750)	–	**(750)**
Net unrealised gains / (losses) on available-for-sale investments	–	317	**317**
Realised gains/(losses) on investment securities available-for-sale reclassified to the income statement	–	(176)	**(176)**
Tax effect of net gains on investment securities available-for-sale	–	(21)	**(21)**
At 31 December 2008 (Restated)	**35,958**	**120**	**36,078**
Transfer of revaluation to accumulated losses	(12,276)	–	**(12,276)**
Depreciation of revaluation reserve	(483)	–	**(483)**
Net unrealised gains / (losses) on available-for-sale investments	–	178	**178**
Realised gains/(losses) on investment securities available-for-sale reclassified to the income statement	(113)	–	**(113)**
Tax effect of net gains on investment securities available-for-sale	–	(27)	**(27)**
At 31 December 2009	**23,086**	**271**	**23,357**

Nature and purpose of other reserves

Revaluation reserve for property and equipment

The revaluation reserve for property and equipment comprises increases in the fair value of buildings and decreases to the extent that such decrease relates to an increase on the same asset previously recognised in equity.

Unrealised gains (losses) on investment securities available-for-sale

This reserve comprises fair value changes on available-for-sale securities.

(Thousands of Georgian Lari)

19. Commitments and contingencies

Operating environment

Georgia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Georgian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Government.

The Georgian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The global financial crisis has resulted in a decline in the gross domestic product, capital markets instability, significant deterioration of liquidity in the banking sector, and tighter credit conditions within Georgia. While the Georgian Government has introduced a range of stabilization measures aimed at providing liquidity to Georgian banks and companies, there continues to be uncertainty regarding the access to capital and cost of capital for the Group and its subsidiaries, which could affect the Group's financial position, results of operations and business prospects.

Also, factors including increased unemployment in Georgia, reduced corporate liquidity and profitability, and increased corporate and personal insolvencies, have affected the Group's borrowers' ability to repay the amounts due to the Group. In addition, changes in economic conditions have resulted in deterioration in the value of collateral held against loans and other obligations. To the extent that information is available, the Group has reflected revised estimates of expected future cash flows in its impairment assessment.

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

As at 31 December 2009 the Group has accumulated losses of Gel 38,036 (2008: accumulated losses of GEL 45,347), incurred net loss of GEL 5,448 for the year ended 31 December 2009 (2008: Net loss of GEL 45,743) and has negative liquidity gap through one year of GEL 75,785 and GEL 101,453 in total as disclosed in Note 26. The Group's management believes that these conditions do not indicate the existence of material uncertainty which may cast significant doubt about the Group's ability to continue as a going concern. Based on its assessment, Management believes that it has adequate resources, is able to improve liquidity, and is taking appropriate measures, to continue as a going concern, and that the preparation of the consolidated financial statements on going concern basis is appropriate.

Legal

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

Financial commitments and contingencies

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

	2009	*2008 (Restated)*	*2007 (Restated)*
Credit related commitments			
Undrawn loan commitments	1,439	2,645	2,508
Guarantees	7,527	15,060	8,102
	8,966	**17,705**	**10,610**
Operating lease commitments			
Not later than 1 year	1,860	1,902	2,469
Later than 1 year but not later than 5 years	4,861	4,692	4,598
Later than 5 years	1,320	706	508
	8,041	**7,300**	**7,575**
Capital expenditure commitments	6,078	6,345	717
Contingent tax liability	250	–	–
Less – Provisions (Note 15)	(80)	–	(146)
Commitments and contingencies (before deducting collateral)	**23,255**	**31,350**	**18,756**
Less – Cash held as security against letters of credit and guarantees	(8,133)	(1,594)	(3,512)
Financial commitments and contingencies, net	**15,122**	**29,756**	**15,244**

(Thousands of Georgian Lari)

20. Net fee and commission income

Net fee and commission income comprises:

	2009	*2008 (Restated)*
Settlements operations	21,522	24,888
Cash operations	1,811	3,236
Guarantees and letters of credit	289	257
Other	8,130	1,295
Fee and commission income	**31,752**	**29,676**
Settlements operations	(865)	(644)
Cash operations	(78)	(379)
Other	(1,035)	(374)
Fee and commission expense	**(1,978)**	**(1,397)**
Net fee and commission income	**29,774**	**28,279**

21. Net gains/(losses) from disposal of subsidiaries

Net gains/(losses) from disposal of subsidiaries during 2009 is mainly comprised gains from the sale of JSC People's Insurance Company, Real Estate Development LLC, JSC Sakkalakmshenproekti and People's Post LLC amounting to GEL 5,263, GEL 6,238, GEL 1,320 and GEL 1,303, respectively.

22. Other income

	2009	*2008 (Restated)*
Insurance income	–	22,767
Change in unearned premium reserve	–	(8,539)
Change in the insurance contract provisions for claims	–	(2,565)
Insurance claims incurred	–	(6,864)
Insurance income, net	**–**	**4,799**
Income from architectural works and rent	408	2,662
Income from postal and courier services	296	2,153
Revenue from fines	2,711	1,081
Gain from sale of land	–	162
Revenue from servicing documentary stamps	–	120
Other	435	1,014
Total other income	**3,850**	**11,991**

23. Salaries and other employee benefits, general and administrative and other operating expenses

	2009	*2008 (Restated)*
Salaries	19,819	29,726
Bonuses	387	5,425
Salaries and other employee benefits	**20,206**	**35,151**

(Thousands of Georgian Lari)

23. Salaries and other employee benefits, general and administrative and other operating expenses

	2009	*2008 (Restated)*
Occupancy and rent	3,011	2,737
Operating taxes	2,923	1,243
Repair and maintenance	1,572	571
Corporate hospitality and entertainment	1,160	1,880
Office supplies	1,049	2,980
Security	1,000	1,050
Communication	994	1,103
Banking services	586	–
Marketing and advertising	527	3,721
Travel expenses	352	684
Insurance	234	–
Cash packing	103	–
Subscription expense	20	–
Personnel training and recruitment	6	–
Other	1,285	986
General and administrative expenses	**14,822**	**16,955**

	2009	*2008 (Restated)*
Land and buildings impairment loss	–	6,126
Bad debts write off	–	2,810
Penalties and fines	–	1,197
Bank forms and documents production	–	140
Other expenses	615	10,465
Other operating expenses	**615**	**20,738**

(Thousands of Georgian Lari)

24. Risk management

Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. The Group is exposed to credit risk, liquidity risk and market risk. It is also subject to operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Group's strategic planning process.

Risk management structure

The Supervisory Board is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Supervisory Board

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

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Group.

Audit Committee

The Audit Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Risk Management

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

Risk Controlling

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

Group Treasury

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

Internal Audit

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

Risk measurement and reporting systems

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

(Thousands of Georgian Lari)

24. Risk management (continued)

Introduction (continued)

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

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Management Board, the Risk Committee, and the head of each business division. The report includes aggregate credit exposure, hold limit exceptions, liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Board of Directors receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Group.

For all levels throughout the Group, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

A daily briefing is given to the Management Board and all other relevant employees of the Group on the utilisation of market limits, proprietary investments and liquidity, plus any other risk developments.

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

Excessive risk concentration

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

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

Credit risk

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

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

Limits on the level of credit risk by borrower are reviewed and approved by the Supervisory Board twice a year. Actual exposure per borrower against limits is monitored on new loans granted. The Credit Committee may initiate a change in the limits; however this must be approved by the Supervisory Board.

Where appropriate, and in the case of most loans, the Group obtains collateral and corporate guarantees. The credit risks are monitored on a continuous basis and are subject to annual or more frequent reviews, especially where no such security can be obtained.

Credit-related commitments risks

The Group makes available to its customers guarantees which may require that the Group make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Group to similar risks to loans and these are mitigated by the same control processes and policies.

(Thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

The table below shows the maximum exposure to credit risk for the components of the consolidated statement of financial position, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	Notes	Maximum exposure 2009	Maximum exposure 2008 (Restated)
Cash and cash equivalents (excluding cash on hand)	6	54,743	39,508
Amounts due from credit institutions	7	14,423	9,638
Loans to customers	8	82,752	109,286
Investment securities			
- Available-for-sale	9	2,260	7,902
- Held-to-maturity		1,995	–
		156,173	**166,334**
Financial commitments and contingencies	19	753	16,111
Total credit risk exposure		**156,926**	**182,445**

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

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 11.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group internal credit ratings. The table below shows the credit quality by class of asset for loan-related lines in the statement of financial position, based on the Group's credit rating system.

	Notes	Neither past due nor impaired 2009	Past due but not impaired 2009	Individually impaired 2009	Total 2009
Amounts due from credit institutions	7	14,423	–	–	**14,423**
Loans to customers:	8				
Commercial loans		6,710	1,150	35,543	**43,403**
Consumer loans		9,669	2,989	5,854	**18,512**
Residential mortgage loans		561	–	–	**561**
Salary loans		14,140	1,776	682	**16,598**
Pension loans		28,178	–	290	**28,468**
		59,258	**5,915**	**42,369**	**107,542**
Investment securities					
Available-for-sale	9	351	–	5,319	**5,670**
Held to maturity		1,995	–	–	**1,995**
		2,346	**–**	**5,319**	**7,665**
Total		**76,027**	**5,915**	**47,688**	**129,630**

(Thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

	Notes	Neither past due nor impaired 2008 (Restated)	Past due but not impaired 2008 (Restated)	Individually impaired 2008 (Restated)	Total 2008 (Restated)
Amounts due from credit institutions	7	9,638	–	10,499	**20,137**
Loans to customers:	8				
Commercial loans		3,336	949	40,792	**45,077**
Consumer loans		41,478	2,690	11,205	**55,373**
Residential mortgage loans		39	–	–	**39**
Salary loans		29,492	227	–	**29,719**
Pension loans		4,345	154	–	**4,499**
		78,690	4,020	51,997	**134,707**
Debt investment securities					
Available-for-sale	9	1,022	–	7,644	**8,666**
		1,022	**–**	**7,644**	**8,666**
Total		**89,350**	**4,020**	**71,312**	**163,510**

Past due loans to customers include those that are only past due by a few days. An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

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

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

	Notes	Less than 30 days 2009	31 to 60 days 2009	61 to 90 days 2009	More than 90 days 2009	Total 2009
Loans to customers:	8					
Commercial loans		346	7	30	767	**1,150**
Consumer loans		1,622	596	547	224	**2,989**
Salary loans		816	197	296	467	**1,776**
Pension loans		–	–	–	–	**–**
Total		**2,784**	**800**	**873**	**1,458**	**5,915**

	Notes	Less than 30 days 2008 (Restated)	31 to 60 days 2008 (Restated)	61 to 90 days 2008 (Restated)	More than 90 days 2008 (Restated)	Total 2008 (Restated)
Loans to customers:	8					
Commercial loans		90	211	0	648	**949**
Consumer loans		415	361	438	1,476	**2,690**
Salary loans		45	16	13	153	**227**
Pension loans		4	3	54	93	**154**
Total		**554**	**591**	**505**	**2,370**	**4,020**

See Note 8 for more detailed information with respect to the allowance for impairment of loans to customers.

(Thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

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

The table below shows the carrying amount for renegotiated financial assets, by class.

	2009	*2008 (Restated)*
Loans to customers:		
Commercial loans	17,701	3,901
Consumer loans	2,027	–
Residential mortgage loans	26	–
Salary loans	1,546	–
Pension loans	–	–
Total	**21,300**	**3,901**

Impairment assessment

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

Individually assessed allowances

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

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to customers that are not individually significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

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

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for loans.

(Thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

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

	2009				*2008 (Restated)*			
	Georgia	*OECD*	*CIS and other foreign banks*	*Total*	*Georgia*	*OECD*	*CIS and other foreign banks*	*Total*
Assets:								
Cash and cash equivalents	79,425	16,794	2,599	98,818	34,144	11,985	5,031	51,160
Amounts due from credit institutions	13,356	1,067	–	14,423	9,080	558	–	9,638
Loans to customers	82,752	–	–	82,752	109,286	–	–	109,286
Investment securities:								
- available-for-sale	1,941	319	–	2,260	7,761	141	–	7,902
- held-to-maturity	1,995	–	–	1,995	–	–	–	–
All other assets	117,651	3,141	–	120,792	137,963	3,106	–	141,069
	297,120	**21,321**	**2,599**	**321,040**	**298,234**	**15,790**	**5,031**	**319,055**
Liabilities:								
Amounts due to credit institutions	54,007	599	–	54,606	51,557	30,604	–	82,161
Amounts due to customers	226,587	20,051	–	246,638	181,540	–	–	181,540
All other liabilities and minority interest	10,572	–	–	10,572	40,846	–	–	40,846
	291,166	**20,650**	**–**	**311,816**	**273,943**	**30,604**	**–**	**304,547**
Net assets / (liabilities)	**5,954**	**671**	**2,599**	**9,224**	**24,291**	**(14,814)**	**5,031**	**14,508**

Liquidity risk and funding management

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

The Group maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. In addition, the Group maintains a cash deposit (obligatory reserve) with the NBG, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Group primarily on a standalone basis, based on certain liquidity ratios established by the NBG.

Analysis of financial liabilities by remaining contractual maturities

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

Financial liabilities As at 31 December 2009	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to credit institutions	10,551	31,898	25,132	–	67,581
Amounts due to customers	167,086	58,847	30,953	150	257,036
Other financial liabilities	13	399	149	–	561
Total undiscounted financial liabilities	**177,650**	**91,114**	**56,234**	**150**	**325,178**

(Thousands of Georgian Lari)

24. Risk management (continued)

Liquidity risk and funding management (continued)

Financial liabilities As at 31 December 2008 (Restated)	***Less than 3 months***	***3 to 12 months***	***1 to 5 years***	***Over 5 years***	***Total***
Amounts due to credit institutions	39,951	32,585	–	12,773	85,309
Amounts due to customers	146,891	52,960	40,186	172	240,209
Other financial liabilities	21,747	333	333	–	22,413
Total undiscounted financial liabilities	**208,589**	**85,878**	**40,519**	**12,945**	**347,931**

The table below shows the contractual expiry by maturity of the Group's financial commitments and contingencies. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

	Less than 3 months	***3 to 12 months***	***1 to 5 years***	***Over 5 years***	***Total***
2009	4,125	4,994	11,816	2,399	**23,334**
2008	11,333	6,375	12,936	706	**31,350**

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

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

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. The Group classifies exposures to market risk into either trading or non-trading portfolios. Trading and Non-trading positions are managed and monitored using other sensitivity analysis. Except for the concentrations within foreign currency, the Group has no significant concentration of market risk.

Interest rate risk

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

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve.

Currency	***Increase in basis points 2009***	***Sensitivity of net interest income 2009***	***Sensitivity of equity 2009***
USD	1%	(6)	–

Currency	***Decrease in basis points 2009***	***Sensitivity of net interest income 2009***	***Sensitivity of equity 2009***
USD	-1%	6	–

Currency	***Increase in basis points 2008***	***Sensitivity of net interest income 2008***	***Sensitivity of equity 2008***
USD	1%	(8)	–

Currency	***Decrease in basis points 2008***	***Sensitivity of net interest income 2008***	***Sensitivity of equity 2008***
USD	-1%	8	–

(Thousands of Georgian Lari)

24. Risk management (continued)

Market risk (continued)

Currency risk

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

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

Currency	***Change in currency rate in % 2009***	***Effect on profit before tax 2009***	***Change in currency rate in % 2008***	***Effect on profit before tax 2008***
USD	1.30%	29	9.20%	21
EUR	12.70%	(15)	14.90%	8
GBP	16.10%	3	24.90%	20
RUR	0.30%	1	0.30%	–
UAH	0.30%	–	2.80%	–

Operational risk

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

25. Fair values of financial instruments

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

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

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

At 31 December 2009	***Level 1***	***Level 2***	***Level 3***	***Total***
Financial assets				
Investment securities – available-for-sale	–	2,260	–	2,260
	–	**2,260**	**–**	**2,260**

At 31 December 2008 (Restated)	***Level 1***	***Level 2***	***Level 3***	***Total***
Financial assets				
Investment securities – available-for-sale	–	7,902	–	7,902
	–	**7,902**	**–**	**7,902**

Financial instruments recorded at fair value

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

(Thousands of Georgian Lari)

25. Fair values of financial instruments (continued)

Investment securities available-for-sale

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

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

Set out below is a comparison by class of the carrying amounts and fair values of the Group's financial instruments that are not carried at fair value in the consolidated statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2009	*Fair value 2009*	*Unrecognised gain/(loss) 2009*	*Carrying value 2008 (Restated)*	*Fair value 2008 (Restated)*	*Unrecognised gain/(loss) 2008 (Restated)*
Financial assets						
Cash and cash equivalents	98,818	98,818	–	51,160	51,160	–
Amounts due from credit institutions	14,423	14,423	–	9,638	9,638	–
Loans to customers	82,752	82,693	(59)	109,286	109,286	–
Investment securities:						
- held-to-maturity	1,995	1,995	–	–	–	–
Financial liabilities						
Amounts due to credit institutions	54,606	54,606	–	82,161	82,161	–
Amounts due to customers	246,638	246,638	–	181,570	181,570	–
Total unrecognised change in unrealised fair value			**(59)**			**–**

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

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and savings accounts without a specific maturity.

Fixed and variable rate financial instruments

For quoted debt instruments the fair values are determined based on quoted market prices. The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

(Thousands of Georgian Lari)

26. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled.

	2009			*2008 (Restated)*		
	Within one year	***More than one year***	***Total***	***Within one year***	***More than one year***	***Total***
Cash and cash equivalents	98,818	–	98,818	51,160	–	51,160
Amounts due from credit institutions	13,356	1,067	14,423	5,909	3,729	9,638
Loans to customers	69,872	12,880	82,752	101,714	7,572	109,286
Investment securities:						
- available-for-sale	–	2,260	2,260	–	7,902	7,902
- held-to-maturity	1,995	–	1,995	–	–	–
Total	**184,041**	**16,207**	**200,248**	**158,783**	**19,203**	**177,986**
Amounts due to credit institutions	39,210	15,396	54,606	52,207	29,954	82,161
Amounts due to customers	220,279	26,359	246,638	125,281	56,259	181,540
Other liabilities	337	120	457	322	226	548
Total	**259,826**	**41,875**	**301,701**	**177,810**	**86,439**	**264,249**
Net	**(75,785)**	**(25,668)**	**(101,453)**	**(19,027)**	**(67,236)**	**(86,263)**

See Note 24 "Risk management" for the Group's contractual undiscounted repayment obligations and management's discussion on managing liquidity risk and resolving negative liquidity gaps.

27. Related party disclosures

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

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

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

	2009					*2008 (Restated)*				
	Parent	***Entities with significant influence over the Group***	***Entities under common control***	***Associates (OSMP)***	***Key manage-ment personnel***	***Parent***	***Entities with significant influence over the Group***	***Entities under common control***	***Associates (OSMP)***	***Key manage-ment personnel***
Loans outstanding at 1 January, gross	1,780	–	–	357	302	2,583	–	–	120	323
Loans issued during the year	215	–	–	5	206	1,951	–	–	1,002	1,067
Loan repayments during the year	1,995	–	–	362	269	2,754	–	–	765	1,088
Loans outstanding at 31 December, gross	**–**	**–**	**–**	**–**	**239**	**1,780**	**–**	**–**	**357**	**302**
Less: allowance for impairment at 31 December	–	–	–	–	5	1,780	–	–	7	104
Loans outstanding at 31 December, net	**–**	**–**	**–**	**–**	**234**	**–**	**–**	**–**	**350**	**198**
Interest income on loans	6	–	–	4	26	716	–	–	31	34
Impairment charge for loans	–	–	–	(7)	1	1,729	–	–	5	98
Deposits at 1 January	–	–	–	–	–	–	–	–	–	–
Deposits received during the year	–	–	–	–	–	145	–	–	–	3,833
Deposits repaid during the year	–	–	–	–	–	145	–	–	–	3,833
Deposits at 31 December	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Current accounts at 31 December	790	19,912	–	119	272	81	–	–	6,095	4
Interest expense on deposits	212	169	–	–	5	1	–	–	–	49
Commitments and guarantees issued	–	2,529	–	600	–	–	–	–	–	–
Fee and commission income	–	21	–	14	–	2	–	–	10	2
Other operating expenses	–	–	–	86	2	–	–	–	56	4

(Thousands of Georgian Lari)

26. Related party disclosures (continued)

Compensation of key management personnel was comprised of the following:

	2009	*2008 (Restated)*
Salaries and other benefits	400	1,427
Total key management personnel compensation	**400**	**1,427**

28. Capital adequacy

The Group maintains an actively managed capital base to cover risks inherent in the business and aims at further enhancing its capital base. The adequacy of the Group's capital is monitored using, among other measures, the ratios established by the NBG and the ratios established by the Basel Capital Accord 1988 in supervising the Group.

Prior to 19 September 2009, the Bank had violated established regulatory capital requirements. However, on 19 September 2009, the Bank obtained a waiver letter from the NBG, exempting the Bank from regulatory capital requirements for a three-year period ending 19 September 2012. According to the waiver letter, the Bank's regulatory capital shall be treated as though it were increased from its current level by GEL 108,000. The amount shall be considered as core capital (Tier 1 capital) and shall be included in the calculation of the prudential ratios, including, without limitation, the capital adequacy ratios. In order to enhance the Bank's capital base, Liberty Capital LLC, the new controlling shareholder committed at the time of purchase of 91.218% equity interest in the Bank, to contribute USD 10 million equivalent in GEL in share capital within six months from the acquisition date. In October 2009 these funds were placed on deposit at the Bank and were subsequently converted, in February 2010, into share capital as described in Note 29 - Events after the reporting period.

NBG capital adequacy ratio

The NBG requires banks to maintain the minimum capital adequacy ratio of 12% of risk-weighted assets, as well as the minimum core capital (Tier 1 capital) adequacy ratio of 8% of risk-weighted assets computed based on Bank's stand-alone financial statements, prepared in accordance with NBG requirements. As of 31 December 2009 and 2008, the Bank's capital adequacy ratios calculated on this basis and reflecting the above-mentioned waiver were as follows:

	2009	*2008 (Restated)*
Core capital	(6,001)	30,181
Theoretical additions to capital (Tier 1) in accordance with the waiver obtained as described above	108,000	–
Supplementary capital	(5,814)	(45,629)
Less: deductions from capital	(5,569)	(3,415)
Total capital	**90,616**	**(18,863)**
Risk-weighted assets	**241,967**	**317,935**
Capital adequacy ratio	**37.45%**	**(5.93%)**

(Thousands of Georgian Lari)

28. Capital adequacy (continued)

Capital adequacy ratio under Basel Capital Accord 1988

The Group's capital adequacy ratio, computed in accordance with the Basel Capital Accord 1988, with subsequent amendments including the amendment to incorporate market risks, as of 31 December 2009 and 2008, comprised:

	2009	*2008 (Restated)*
Tier 1 capital	(13,788)	(21,190)
Tier 2 capital *	-	-
Less: Deductions from capital	(347)	(355)
Total capital	**(14,135)**	**(21,545)**
Risk weighted assets	**219,826**	**278,023**
Tier 1 capital ratio	(6.27%)	(7.62%)
Total capital ratio	(6.43%)	(7.75%)
Notional ** Tier 1 capital ratio (including NBG waiver of GEL 108,000 in Tier 1)	42.86%	-
Notional ** Total capital ratio (including NBG waiver of GEL 108,000 in Tier 1)	54.48%	-

* *Since Tier 1 capital was negative, none of the available Tier 2 capital has been taken into account for the purposes of Basel Capital Accord 1988 capital requirement computation*
** *Available Tier 2 capital of GEL 25,894 has been taken into account for the purposes of Notional Basel Capital Accord 1988 capital requirement computation*

29. Events after the reporting period

On 4 February 2010 the Bank's shareholders contributed 10,000 USD equivalent of GEL into the share capital of the Bank.

On 18 May 2010 the Bank repaid 30,000 GEL of its long term loan of GEL 45,000 to the National Bank of Georgia. At the same time the Bank maintained a 3 year GEL 45,000 credit facility at 13% per annum until July 2013.

On 5 July, 2010 the Bank launched the Global Depositary Receipts (GDRs) Programme with Bank of New York Mellon. The Bank's shares in the form of GDRs will be available to the international investors outside the United States.