# JSC TAOPRIVATBANK

## International Financial Reporting Standards Consolidated Financial Statements and Independent Auditor's Report

## 31 December 2009

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## INDEPENDENT AUDITORS' REPORT

To the Shareholders and Management of JSC TaoPrivatBank:

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

*Management's Responsibility for the Financial Statements*

2 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 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.

*Auditor's Responsibility*

3 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 financial statements are free from material misstatements.

4 An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's 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 controls 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.

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

*Opinion*

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

14 June 2010
Tbilisi, Georgia

| *In thousands of Georgian Lari* | Note | 31 December 2009 | 31 December 2008 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 7 | 67,635 | 66,166 |
| Mandatory cash balances with NBG | | 2,768 | 4,378 |
| Due from other banks | 8 | 16 | 24 |
| Loans and advances to customers | 9 | 90,418 | 150,888 |
| Premises, equipment and intangible assets | 10 | 21,996 | 26,651 |
| Other financial assets | 11 | 9,717 | 1,861 |
| Other assets | 12 | 2,413 | 2,799 |
| **Total assets** | | **194,963** | **252,767** |
| **Liabilities** | | | |
| Due to other banks | 13 | 24,067 | 101,059 |
| Customer accounts | 14 | 89,402 | 108,208 |
| Provisions for liabilities and charges | 15 | 292 | 212 |
| Other financial liabilities | 16 | 3,983 | 2,435 |
| Other liabilities | 17 | 6,036 | 1,526 |
| Deferred income tax liability | 24 | 3,453 | 1,183 |
| Subordinated debt | 18 | 21,517 | - |
| **Total liabilities** | | **148,750** | **214,623** |
| **EQUITY** | | | |
| Share capital | 19 | 58,000 | 48,000 |
| Share premium | | 4,308 | 4,308 |
| Additional paid-in capital | | 10,016 | - |
| Revaluation reserve | | 2,096 | 3,816 |
| Accumulated deficit | | (28,207) | (17,980) |
| **Total equity** | | **46,213** | **38,144** |
| **Total liabilities and equity** | | **194,963** | **252,767** |

Approved for issue and signed on behalf of the Board of Directors on 14 June 2010.

______________ ______________

Bogdan Lesuk
Chief Executive Officer

Vera Dzneladze
Chief Accountant

| *In thousands of Georgian Lari* | Note | 31 December 2009 | 31 December 2008 |
|---|---|---|---|
| Interest income | 20 | 33,727 | 53,756 |
| Interest expense | 20 | (10,419) | (12,604) |
| **Net interest income** | | **23,308** | **41,152** |
| Provision for loan impairment | 9 | (15,548) | (24,752) |
| Recovery of provision against credit card portfolio | 9 | 12,139 | - |
| **Net interest income after provision for loan impairment** | | **19,899** | **16,400** |
| Fee and commission income | 21 | 6,416 | 1,987 |
| Fee and commission expense | 21 | (1,694) | (704) |
| Gains less losses from trading in foreign currencies | | 1,177 | 828 |
| Foreign exchange translation (losses less gains) / gains net of losses | | (3,492) | 971 |
| Provision for credit related commitments | | (890) | (49) |
| Other operating income | 22 | 4,911 | 1,863 |
| Administrative and other operating expenses | 23 | (35,748) | (37,833) |
| **Loss before tax** | | **(9,421)** | **(16,537)** |
| Income tax expense | 24 | (806) | (716) |
| **Loss for the year** | | **(10,227)** | **(17,253)** |
| **Other comprehensive income:** | | | |
| Revaluation of premises | | (2,024) | (444) |
| Deferred income tax recorded in equity | | 304 | 67 |
| **Other comprehensive loss for the year** | | **(1,720)** | **(377)** |
| **Total comprehensive loss for the year** | | **(11,947)** | **(17,630)** |

| *In thousands of Georgian Lari* | Note | Share capital | Share premium | Additional paid-in capital | Revaluation reserve for premises | Accumulated deficit | Total |
|---|---|---|---|---|---|---|---|
| **At 31 December 2007** | | **48,000** | **4,308** | **-** | **4,193** | **(727)** | **55,774** |
| Total other comprehensive loss | | **-** | **-** | | **(377)** | **(17,253)** | **(17,630)** |
| **Balance at 31 December 2008** | | **48,000** | **4,308** | **-** | **3,816** | **(17,980)** | **38,144** |
| **Total comprehensive loss** | | **-** | **-** | **-** | **(1,720)** | **(10,227)** | **(11,947)** |
| **Transactions with owners, recorded directly in equity** | | | | | | | |
| Share issue | 19 | 10,000 | - | - | - | - | **10,000** |
| Additional paid-in capital | 18 | - | - | 11,784 | - | - | **11,784** |
| Income tax recorded in equity | 24 | - | - | (1,768) | - | - | **(1,768)** |
| **Total transactions with owners, recorded directly in equity** | | **10,000** | **-** | **10,016** | **-** | **-** | **20,016** |
| **Balance at 31 December 2009** | | **58,000** | **4,308** | **10,016** | **2,096** | **(28,207)** | **46,213** |

| *In thousands of Georgian Lari* | Note | 31 December 2009 | 31 December 2008 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Interest received | | 33,733 | 40,681 |
| Interest paid | | (8,330) | (10,303) |
| Fees and commissions received | | 6,416 | 1,987 |
| Fees and commissions paid | | (1,683) | (704) |
| Income received from trading in foreign currencies | | 1,177 | 828 |
| Other operating income received | | 4,019 | 1,854 |
| Staff costs paid | | (14,499) | (15,726) |
| Administrative and other operating expenses paid | | (20,902) | (18,363) |
| Income tax paid | | (1,015) | - |
| **Cash flows (used in)/from operating activities before changes in operating assets and liabilities** | | **(1,084)** | **254** |
| Net decrease/(increase) in mandatory balances with NBG | | 1,610 | (898) |
| Net (increase)/decrease in due from other banks | | (16) | 95 |
| Net decrease/(increase) in loans and advances to customers | | 57,014 | (84,981) |
| Net (increase) in other financial assets | | (1,144) | (1,358) |
| Net (increase) in other assets | | (7,947) | (109) |
| Net (decrease)/increase in due to other banks | | (79,287) | 80,069 |
| Net (decreae)/increase in customer accounts | | (21,006) | 56,592 |
| Net increase in other financial liabilities | | 1,046 | 1,274 |
| Net increase in other liabilities | | 6,009 | 860 |
| **Net cash (used in)/from operating activities** | | **(43,721)** | **51,544** |
| **Cash flows from investing activities** | | | |
| Acquisition of investment securities available for sale | | (97) | - |
| Disposal/(acquisition) of premises and equipment and intangible assets | | 2,867 | (13,357) |
| **Net cash from/(used in) investing activities** | | **2,770** | **(13,357)** |
| **Cash flows from financing activities** | | | |
| Issue of ordinary shares | 19 | 10,000 | - |
| Proceeds from subordinated debt | | 33,301 | - |
| **Net cash from financing activities** | | **43,301** | **-** |
| **Effect of exchange rate changes on cash and cash equivalents** | | **203** | **294** |
| **Net increase in cash and cash equivalents** | | **1,469** | **38,735** |
| Cash and cash equivalents at the beginning of the year | | **66,166** | **27,431** |
| **Cash and cash equivalents at the end of the year** | 7 | **67,635** | **66,166** |

## 1 Introduction

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2009 for JSC TaoPrivatBank (the "Bank") and its subsidiary (together referred to as the "Group" or "Bank"). The Bank holds 100% ownership in its subsidiary "TAOGUARD" LTD and "Insurance Company TAO" LTD domiciled in Georgia. "Insurance Company TAO" provides non-life insurance services. "TAOGUARD" provides private security services.

JSC TaoPrivatBank was incorporated in 1992 and is domiciled in the Republic of Georgia. As of 31 December 2009 the Bank's immediate shareholder were PrivatBank (the "Parent Bank"), owning 100% of shares (2008: 75% of shares and AQ ZURIFIN AG, owning 25% of shares). The Parent Bank domiciled in Ukraine is an ultimate controlling party.

***Principal activity.*** The Bank's principal business activity is commercial and retail banking operations within the Republic of Georgia. The Bank has operated under a full banking licence issued by the National Bank of Georgia ("NBG") in 1992. As of 31 December 2009 the Bank has 59 outlets within Georgia (2008: 71).

***Registered address and place of business.*** The registered address of the Bank's head office is 114 Tsereteli Avenue, Tbilisi 0119, Georgia

***Presentation currency.*** These consolidated financial statements are presented in thousands of Georgian Lari ("GEL thousands"). At 31 December 2009, the closing rate of exchange used for translating foreign currency monetary balances was USD 1 = GEL 1.6858 (2008: USD 1 = GEL 1.6670).

## 2 Operating Environment of the Bank

***Political and economic conditions in Georgia.*** Georgia displays certain characteristics of an emerging market, including the existence of a currency that is not freely convertible in most countries outside of the Republic of Georgia, relatively high inflation and economic growth. The banking sector in Georgia is sensitive to adverse fluctuations in confidence and economic conditions. The Georgian economy occasionally experiences falls in confidence in the banking sector accompanied by reductions in liquidity. The tax, currency and customs legislation within Georgia is subject to varying interpretations, and changes, which can occur frequently. Furthermore, the need for further developments in the bankruptcy laws, the absence of formalised procedures for the registration and enforcement of collateral, and other legal and fiscal impediments contribute to the difficulties experienced by banks currently operating in the Republic of Georgia.

At the beginning of the latter half of 2008, both real and financial sectors of national economy of Georgia faced major problems. The military aggression that took place in August 2008 caused a serious damage to the economy of the country. A significant damage of the infrastructure was accompanied with worsening of confidence of the population in the banks and national currency of Georgia.

However it should be noted that notwithstanding a difficult internal and international standing, the situation in the banking system of the country has improved during the year of 2009. Sovereign credit risk rating of Government of Georgia re-confirmed by Fitch rating agency during 2009 was short term "B" and long-term "B+" (2008: short term "B" and long-term "B+").

***Recent volatility in global financial markets.*** The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, at times much higher than normal lending rates, and lower liquidity levels across the Georgian banking sector resulting in a significant reduction in the new number of new loans and advances made to customers, and higher funding costs where its remains possible to obtain debt finance from International Institutions or other local banks. The uncertainties in the global financial market, has also led to bank failures and bank rescues in the United States of America, Western Europe and in Russia. Such circumstances could affect the ability of the Group to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions. The borrowers of the Group may also be affected by the lower liquidity situation, which could in turn impact their ability to repay their outstanding loans.

## 2 Operating Environment of the Bank (Continued)

Deteriorating operating conditions for borrowers may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, management has reflected revised estimates of expected future cash flows in their impairment assessments.

The amount of provision for impaired loans is based on management's appraisals of these assets at the balance sheet date after taking into consideration the cash flows that may result from foreclosure less costs for obtaining and selling the collateral. The market in Georgia for many types of collateral, especially real estate, has been severely affected by the recent volatility in global financial markets resulting in there being a low level of liquidity for certain types of assets. As a result, the actual realisable value on foreclosure may differ from the value ascribed in estimating allowances for impairment.

Management believes that it is impracticable to reliably determine the effects on the Group's future financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and growth of the Group's business in the current circumstances.

## 3 Summary of Significant Accounting Policies

***Basis of preparation.*** These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the revaluation of premises, and the initial recognition of financial instruments based on fair value. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied throughout presented period.

***Going concern.*** The Group has a net loss for the year ended 31 December 2009 of GEL 10,227 thousand (2008: GEL 17,253 thousand). During 2009 the Bank obtained additional investment from the Parent Bank in the form of increased share capital in the amount of GEL 10,000 thousand (refer to Note 19) and subordinated debt in the amount of GEL 21,517 thousand at reduced interest rates (refer to Note 18).

While global events have had a significant impact on the ability to obtain new or extended term borrowings from other financial institutions, and where available, the cost of funding has typically increased, management are actively managing this position and believe that the Group will have access to sufficient resources from its Parent Bank in order to continue to meet all of its current liabilities as they fall due.

***Consolidated financial statements.*** Subsidiaries are those companies and other entities (including special purpose entities) in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain benefits. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date that control ceases.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date, irrespective of the extent of any minority interest.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Bank and all of its subsidiaries use uniform accounting policies consistent with the Bank's policies.

***Investment securities available for sale.*** This classification includes investment securities which the Group intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. The Group classifies investments as available for sale at the time of purchase.

Investment securities available for sale are carried at fair value. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit or loss. Dividends on available-for-sale equity instruments are recognised in profit or loss when the Group's right to receive payment is established and it is probable that the dividends will be collected. All other elements of changes in the fair value are deferred in equity until the investment is derecognised or impaired, at which time the cumulative gain or loss is removed from equity to profit or loss.

## 3 Summary of Significant Accounting Policies (Continued)

Impairment losses are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of investment securities available for sale. A significant or prolonged decline in the fair value of an equity security below its cost is an indicator that it is impaired. The cumulative impairment loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss. Impairment losses on equity instruments are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through current period's profit or loss.

***Financial instruments - key measurement terms.*** Depending on their classification financial instruments are carried at fair value or amortised cost as described below.

*Fair value* is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair value is the current bid price for financial assets and current asking price for financial liabilities which are quoted in an active market. For assets and liabilities with offsetting market risks, the Bank may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange or other institution and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques such as discounted cash flows models or models based on recent arm's length transactions or consideration of financial data of the investees are used to fair value certain financial instruments for which external market pricing information is not available. Valuation techniques may require assumptions not supported by observable market data. Disclosures are made in these financial statements if changing any such assumptions to a reasonably possible alternative would result in significantly different profit, income, total assets or total liabilities.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes transaction costs. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

*Amortised cost* is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method.

Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related balance sheet items.

The effective interest method is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate (refer to income and expense recognition policy).

***Initial recognition of financial instruments***. Trading securities, derivatives and other financial instruments at fair value through profit or loss are initially recorded at fair value. All other financial instruments are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

## 3 Summary of Significant Accounting Policies (Continued)

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date that the Bank commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

***Derecognition of financial assets.*** The Bank derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Bank has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

***Cash and cash equivalents.*** Cash and cash equivalents are items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents include cash balances with NBG (other than mandatory reserve deposits) and all interbank placements with original maturities of less than three months. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

***Mandatory reserve deposits with the NBG.*** Mandatory reserve deposits with the NBG are carried at amortised cost and represent non-interest bearing mandatory reserve deposits which are not available to finance the Bank's day to day operations.

***Due from other banks.*** Amounts due from other banks with maturity over three months are recorded when the Group advances money to counterparty banks with no intention of trading the resulting unquoted non-derivative receivable due on fixed or determinable dates. Amounts due from other banks are carried at amortised cost.

***Loans and advances to customers***. Loans and advances to customers are recorded when the Bank advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates and has no intention of trading the receivable. Loans and advances to customers are carried at amortised cost.

The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

***Impairment of financial assets carried at amortised cost.*** Impairment losses are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the

Bank determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Bank considers in determining whether a financial asset is impaired are its overdue status and realisability of related collateral, if any.

The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

- any instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the borrower experiences a significant financial difficulty as evidenced by the borrower's financial information that the Bank obtains;
- the borrower considers bankruptcy or a financial reorganisation;
- there is an adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrower; or
- the value of collateral significantly decreases as a result of deteriorating market conditions.

**3 Summary of Significant Accounting Policies (Continued)**

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

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

If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. 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.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to impairment loss account in the statement of operations.

***Insurance contracts – classification.*** The Group issues contracts that transfer insurance risks. Insurance contracts are those that transfer significant insurance risk. As a general guideline, the Group defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event that are at least 10% more than the benefits payable if the insured event did not occur.

***Insurance receivables.*** Insurance receivables are initially recognized at nominal value and represent the total amount of insurance premiums to be received from the policyholder over the term of the policy coverage. Insurance receivables are treated in accordance with IFRS 4, "Insurance contracts".

A provision for impairment of insurance receivables is established if there is objective evidence that the Group will not be able to collect the premiums due according to the original terms of insurance policy. The amount of the provision is the difference between the carrying amount and estimated recoverable amount.

***Premiums.*** Upon inception of the contract, the total premiums to be received over the term of the policy coverage are recorded as written and are earned primarily on a pro-rata basis over the term of the related policy coverage. The reserve for unearned premiums represents the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated on a time apportionment basis.

***Losses.*** Losses including loss adjustment expenses are charged to the statement of income as incurred. Reserves for losses represent the accumulation of estimates for incurred losses and include two types of reserves: reserve for reported but not settled losses ("RBNS") and reserve for incurred but not reported losses ("IBNR"). RBNS reserve is calculated for each unsettled claim. The estimation is made on the basis of information received by the Group during investigation of insurance cases to be settled after the balance sheet date. If the amount of loss is not determined, the maximum possible amount of losses not exceeding the insurance limit, stated in the insurance policy, is accepted as RBNS. IBNR is established based on actuarial methods used to determine loss development patterns based on historic information, implied expected ultimate loss ratios and implied reported claims development factors. IBNR is calculated by the Group for each line of business; the calculation includes assumptions based on prior years' claims and claims handling experience.

## 3 Summary of Significant Accounting Policies (Continued)

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. The methods of determining such estimates and establishing the resulting provisions are continually reviewed and updated. Resulting adjustments are reflected in the statement of income as they arise. Loss provision reserve is estimated on an undiscounted basis due to the relatively quick pattern of claims notification and payment.

***Reinsurance.*** The Group assumes and cedes reinsurance in the normal course of business. Ceded reinsurance contracts do not relieve the Group from its obligations to policyholders. Reinsurance receivables include balances due from reinsurance companies for paid claims, including claims handling expenses and premiums receivable ceded to the Group. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance payables are obligations of the Group for the transfer of reinsurance premiums to reinsurers.

***Credit related commitments.*** The Bank enters into credit related commitments, including letters of credit and financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At each balance sheet date, the commitments are measured at the higher of (i) the remaining unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the balance sheet date.

***Premises and equipment.*** Premises and equipment, except for buildings are carried at cost, less accumulated depreciation and provision for impairment, where required. Premises and equipment acquired in business combination are initially recorded at fair value. Construction in progress is carried at cost less provision for impairment where required. Upon completion, assets are transferred to premises and equipment at their carrying amount. Construction in progress is not depreciated until the asset is available for use.

Buildings are subject to revaluation with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. Increases in the carrying amount arising on revaluation are credited to revaluation reserve in equity. Decreases that offset previous increases of the same asset are charged against revaluation reserve directly in equity; all other decreases are charged to the statement of operations. The revaluation reserve for buildings included in equity is transferred directly to accumulated deficit when the surplus is realised on the retirement or disposal of the asset.

Costs of minor repairs and maintenance are expensed when incurred. Costs of replacing major parts or components of premises and equipment items are capitalised and the replaced part is retired.

At each reporting date management assesses whether there is any indication of impairment of premises and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the statement of operations. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount for premises and equipment at cost are recognised in profit or loss.

***Depreciation.*** Land is not depreciated. Depreciation on other items of premises and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

| | Useful lives in years |
|---|---|
| Premises | 50 |
| Office and computer equipment | 3-10 |
| Furniture, fixtures and other equipment | 3-10 |
| Motor vehicles | 10 |
| Leasehold improvements | over the term of the underlying lease |

## 3 Summary of Significant Accounting Policies (Continued)

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

***Intangible assets.*** All of the Group's intangible assets have definite useful life and primarily include capitalised computer software.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred. Capitalised computer software is amortised on a straight line basis over expected useful lives of three to five years.

***Operating leases.*** Where the Bank is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Bank, the total lease payments are charged to profit or loss on a straight-line basis over the period of the lease.

Leases embedded in other agreements are separated if (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets and (b) the arrangement conveys a right to use the asset.

When assets are leased out under an operating lease, the lease payments receivable are recognised as rental income on a straight-line basis over the lease term.

***Due to other banks.*** Amounts due to other banks are recorded when money or other assets are advanced to the Bank by counterparty banks. The non-derivative liability is carried at amortised cost. If the Bank purchases its own debt, the liability is removed from the consolidated balance sheet and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from retirement of debt.

***Customer accounts.*** Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at amortised cost.

***Income taxes.*** Income taxes have been provided for in the consolidated financial statements in accordance with legislation enacted or substantively enacted by the balance sheet date. The income tax charge comprises current tax and deferred tax and is recognised in the consolidated statement of operations except if it is recognised directly in equity because it relates to transactions that are also recognised, in the same or a different period, directly in equity.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit.

Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

***Provisions for liabilities and charges.*** Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when the Bank has a present legal or constructive obligation as a result of past events, 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 the obligation can be made.

***Trade and other payables.*** Trade payables are accrued when the counterparty has performed its obligations under the contract and are carried at amortised cost.

***Share capital.*** Ordinary shares with discretionary dividends are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

## 3 Summary of Significant Accounting Policies (Continued)

***Dividends.*** Dividends are recorded in equity in the period in which they are declared. Any dividends declared after the balance sheet date and before the financial statements are authorised for issue are disclosed in the subsequent events note. The statutory accounting reports of the Bank are the basis for profit distribution and other appropriations. Georgian legislation identifies the basis of distribution as the current year net profit.

***Income and expense recognition.*** Interest income and expense are recorded in the consolidated statement of operations for all debt instruments on an accrual basis using the effective interest method. This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Bank to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Bank does not designate loan commitments as financial liabilities at fair value through profit or loss.

When loans and other debt instruments become doubtful of collection, they are written down to the present value of expected cash inflows and interest income is thereafter recorded for the unwinding of the present value discount based on the asset's effective interest rate which was used to measure the impairment loss.All other fees, commissions and other income and expense items are generally recorded on an accrual basis by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

***Foreign currency translation.*** The functional currency of each of the Bank's consolidated entities is the currency of the primary economic environment in which the entity operates. The functional currency of the Bank and its subsidiaries, and the Bank's presentation currency, is the Georgian Lari.

Monetary assets and liabilities are translated into each entity's functional currency at the official exchange rate of the NBG at the respective balance sheet dates. Foreign exchange gains and losses resulting from the settlement of transactions and from the translation of monetary assets and liabilities into each entity's functional currency at year-end official exchange rates of the NBG are recognised in profit or loss. Translation at year-end rates does not apply to non-monetary items, including equity investments. Effects of exchange rate changes on the fair value of equity securities are recorded as part of the fair value gain or loss.

***Offsetting.*** Financial assets and liabilities are offset and the net amount reported in the consolidated balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

***Staff costs and related contributions.*** Wages, salaries, contributions, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Bank.

## 4 Critical Accounting Estimates, and Judgments in Applying Accounting Policies

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

***Going concern***. Management prepared these financial statements on a going concern basis. In making this judgement management primarily considered ability of the Parent Bank to continue providing financial support to the Bank, including assessment of the Parent Bank's financial position.

## 4 Critical Accounting Estimates, and Judgments in Applying Accounting Policies (Continued)

***Impairment losses on loans and advances.*** The Group regularly reviews its loan portfolios to assess impairment. In determining whether an impairment loss should be recorded in the statement of operations, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. A 5% increase or decrease between actual loss experience and the loss estimates used will result in an additional or lower charge for loan loss impairment of GEL 1,111 thousand (2008: GEL 1,321 thousand). If the projected insurance loss development term had been longer in such a way that 10% of the insurance losses were paid one year later, all other variables held constant, loss before tax would have been GEL 98 thousand (2008:nil) higher on gross basis.

***Initial recognition of related party transactions.*** In the normal course of business the Bank enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. Terms and conditions of related party balances are disclosed in Note 30.

***Liability adequacy test.*** At each balance sheet date, liability adequacy tests are performed to ensure the adequacy of the contract liabilities. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to profit or loss and by subsequently establishing a provision for losses arising from liability adequacy tests (the unexpired risk provision).

Long-term insurance contracts with fixed terms are measured based on assumptions set out at the inception of the contract. When the liability adequacy test requires the adoption of new best estimate assumptions, such assumptions (without margins for adverse deviation) are used for the subsequent measurement of these liabilities.

## 5 Adoption of New or Revised Standards and Interpretations

Certain new standards and interpretations became effective for the Group from 1 January 2009:

***IFRS 8, Operating Segments.*** The standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments, with segment information presented on a similar basis to that used for internal reporting purposes. The Group is not required to report operating segments.

***IAS 23, Borrowing Costs, revised in March 2007.*** The main change is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale (a qualifying asset) form part of the cost of that asset, if the commencement date for capitalisation is on or after 1 January 2009. Other borrowing costs are recognised as an expense using the effective interest method.

## 5 Adoption of New or Revised Standards and Interpretations (Continued)

***IAS 1, Presentation of Financial Statements, revised in September 2007.*** The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which includes all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities are allowed to present two statements: a separate income statement and a statement of comprehensive income. The Group has elected to present a separate income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The revised IAS 1 had an impact on the presentation of the Group's financial statements but had no impact on the recognition or measurement of specific transactions and balances.

***Improvements to International Financial Reporting Standards*** (issued in May 2008). In 2008, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting.

***Puttable Financial Instruments and Obligations Arising on Liquidation—IAS 32 and IAS 1 Amendment.*** The amendment requires classification as equity of some financial instruments that meet the definition of financial liabilities.

***Vesting Conditions and Cancellations—Amendment to IFRS 2, Share-based Payment.*** The amendment clarified that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment.

***IFRIC 13, Customer Loyalty Programmes.*** IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values.

***IFRIC 15, Agreements for the Construction of Real Estate.*** The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions.

***Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate—IFRS 1 and IAS 27 Amendment, issued in May 2008.*** The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying value as deemed cost in the separate financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss for the year rather than as a recovery of the investment.

## 5 Adoption of New or Revised Standards and Interpretations (Continued)

***Improving Disclosures about Financial Instruments - Amendment to IFRS 7, Financial Instruments: Disclosures, issued in March 2009.*** The amendment requires enhanced disclosures about fair value measurements and liquidity risk. The entity is required to disclose an analysis of financial instruments using a three-level fair value measurement hierarchy. The amendment (a) clarifies that the maturity analysis of liabilities should include issued financial guarantee contracts at the maximum amount of the guarantee in the earliest period in which the guarantee could be called; and (b) requires disclosure of remaining contractual maturities of financial derivatives if the contractual maturities are essential for an understanding of the timing of the cash flows. An entity will further have to disclose a maturity analysis of financial assets it holds for managing liquidity risk, if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk. The enhanced disclosures are included in these financial statements.

***Embedded Derivatives - Amendments to IFRIC 9 and IAS 39, issued in March 2009***. The amendments clarify that on reclassification of a financial asset out of the 'at fair value through profit or loss' category, all embedded derivatives have to be assessed and, if necessary, separately accounted for.

***IFRIC 16, Hedges of a Net Investment in a Foreign Operation***. The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied. The IFRIC allows the hedging instrument to be held by any entity or entities within a group except the foreign operation that itself is being hedged. The interpretation also clarifies how the currency translation gain or loss reclassified from other comprehensive income to profit or loss is calculated on disposal of the hedged foreign operation. Reporting entities apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16.

***The International Financial Reporting Standard for Small and Medium-sized Entities (issued in July 2009) is a self-contained standard, tailored to the needs and capabilities of smaller businesses.*** Many of the principles of full IFRS for recognising and measuring assets, liabilities, income and expense have been simplified, and the number of required disclosures have been simplified and significantly reduced. The IFRS for SMEs may be applied by entities which publish general purpose financial statements for external users and do not have public accountability. The Group is not eligible to apply the IFRS for SMEs due to the public accountability of its banking business.

Unless otherwise stated above, the amendments and interpretations did not have any significant effect on the Group's consolidated financial statements.

## 6 New Accounting Pronouncements

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2010 or later periods and which the Group has not early adopted:

***IFRIC 17, Distributions of Non-Cash Assets to Owners*** (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss for the year when the entity settles the dividend payable.

***IFRIC 18, Transfers of Assets from Customers*** (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers.

***Classification of Rights Issues - Amendment to IAS 32*** (issued 8 October 2009; effective for annual periods beginning on or after 1 February 2010). The amendment exempts certain rights issues of shares with proceeds denominated in foreign currencies from classification as financial derivatives.

**6 New Accounting Pronouncements (Continued)**

***IAS 27, Consolidated and Separate Financial Statements*** (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value.

***IFRS 3, Business Combinations*** (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer will have to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss for the year. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone.

***Eligible Hedged Items—Amendment to IAS 39, Financial Instruments: Recognition and Measurement*** (effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations.

***IFRS 1, First-time Adoption of International Financial Reporting Standards*** (following an amendment in December 2008, effective for the first IFRS financial statements for a period beginning on or after 1 July 2009). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The Group concluded that the revised standard does not have any effect on its financial statements.

***IAS 27, Consolidated and Separate Financial Statements*** (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value.

***IFRS 3, Business Combinations*** (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer will have to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss for the year. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone.

## 6 New Accounting Pronouncements (Continued)

***Eligible Hedged Items—Amendment to IAS 39, Financial Instruments: Recognition and Measurement*** (effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations.

***IFRS 1, First-time Adoption of International Financial Reporting Standards*** (following an amendment in December 2008, effective for the first IFRS financial statements for a period beginning on or after 1 July 2009). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The Group concluded that the revised standard does not have any effect on its financial statements.

***Group Cash-settled Share-based Payment Transactions - Amendments to IFRS 2, Share-based Payment (effective for annual periods beginning on or after 1 January 2010).*** The amendments provide a clear basis to determine the classification of share-based payment awards in both consolidated and separate financial statements. The amendments incorporate into the standard the guidance in IFRIC 8 and IFRIC 11, which are withdrawn. The amendments expand on the guidance given in IFRIC 11 to address plans that were previously not considered in the interpretation. The amendments also clarify the defined terms in the Appendix to the standard.

***Additional Exemptions for First-time Adopters - Amendments to IFRS 1, First-time Adoption of IFRS*** (effective for annual periods beginning on or after 1 January 2010). The amendments exempt entities using the full cost method from retrospective application of IFRSs for oil and gas assets and also exempt entities with existing leasing contracts from reassessing the classification of those contracts in accordance with IFRIC 4, 'Determining Whether an Arrangement Contains a Lease' when the application of their national accounting requirements produced the same result. The amendments will not have any impact on the Group's financial statements.

***Improvements to International Financial Reporting Standards (issued in April 2009; amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010).*** The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss for the year and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged.

***Amendment to IAS 24, Related Party Disclosures*** (issued in November 2009 and effective for annual periods beginning on or after 1 January 2011). IAS 24 was revised in 2009 by: (a) simplifying the definition of a related party, clarifying its intended meaning and eliminating inconsistencies; and by (b) providing a partial exemption from the disclosure requirements for government-related entities.

***IFRS 9, Financial Instruments Part 1: Classification and Measurement.*** IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets. Key features are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

## 6 New Accounting Pronouncements (Continued)

- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
- While adoption of IFRS 9 is mandatory from 1 January 2013, earlier adoption is permitted.

The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Group's financial statements.

## 7 Cash and Cash Equivalents

| *In thousands of Georgian Lari* | **31 December 2009** | **31 December 2008** |
|---|---|---|
| Cash on hand | 9,949 | 20,300 |
| Cash balances with the NBG (other than mandatory reserve deposits) | 6,675 | 39,046 |
| Correspondent accounts and overnight placements with other banks | 51,011 | 6,820 |
| **Total cash and cash equivalents** | **67,635** | **66,166** |

At 31 December 2009 included in cash balances with NBG (other than mandatory reserve deposits) GEL 6,675 thousand (2008: GEL 36,082 thousand). Interest rate analysis of cash and cash equivalents is disclosed in Note 25. Information on related party balances is disclosed in Note 30.

The credit quality of cash and cash equivalents balances may be summarised as follows at 31 December 2009:

| *In thousands of Georgian Lari* | **Cash on hand** | **Cash balances with the NBG, excluding mandatory reserves** | **Correspondent accounts and overnight placements** | **Total** |
|---|---|---|---|---|
| *Neither past due nor impaired* | | | | |
| - Cash on hand | 9,949 | - | - | **9,949** |
| - Cash balances with Central Banks | - | 6,675 | - | **6,675** |
| - AA rated | - | - | 1,146 | **1,146** |
| - BB+ rated | - | - | 373 | **373** |
| - B+ rated | - | - | 31,793 | **31,793** |
| - B rated | - | - | 12,218 | **12,218** |
| - Unrated | - | - | 5,481 | **5,481** |
| **Total cash and cash equivalents** | **9,949** | **6,675** | **51,011** | **67,635** |

## 7 Cash and Cash Equivalents (Continued)

The credit quality of cash and cash equivalents balances at 31 December 2008 is as follows:

| *In thousands of Georgian Lari* | **Cash on hand** | **Cash balances with the NBG, excluding mandatory reserves** | **Correspondent accounts and overnight placements** | **Total** |
|---|---|---|---|---|
| *Neither past due nor impaired* | | | | |
| - Cash on hand | 20,300 | - | - | **20,300** |
| - Cash balances with Central Banks | - | 39,046 | - | **39,046** |
| - AA- rated | - | - | 153 | **153** |
| - BB rated | - | - | 779 | **779** |
| - B+ rated | - | - | 5,213 | **5,213** |
| - B rated | - | - | 118 | **118** |
| - B- rated | - | - | 377 | **377** |
| - Unrated | - | - | 180 | **180** |
| **Total cash and cash equivalents** | **20,300** | **39,046** | **6,820** | **66,166** |

## 8 Due from Other Banks

| *In thousands of Georgian Lari* | **31 December 2009** | **31 December 2008** |
|---|---|---|
| Short-term placements with other banks with original maturities of more than three months | 16 | 24 |
| **Total due from other banks** | **16** | **24** |

Amounts due from other banks are not collateralised. Analysis by credit quality of amounts due from other banks outstanding at 31 December 2009 and 31 December 2008 is as follows:

| *In thousands of Georgian Lari* | **31 December 2009** | **31 December 2008** |
|---|---|---|
| *Neither past due nor impaired* | | |
| - Largest ten Georgian banks | 16 | 24 |
| **Total due from other banks** | **16** | **24** |

## 9 Loans and Advances to Customers

| *In thousands of Georgian Lari* | **31 December 2009** | **31 December 2008** |
|---|---|---|
| Corporate loans | 29,109 | 40,748 |
| Mortgage loans | 2,970 | 3,532 |
| Loans to individuals – auto | 10,263 | 12,357 |
| Loans to individuals - consumer loans | 12,403 | 27,983 |
| Loans to individuals – cards | 35,642 | 51,970 |
| Loans to individuals – others | 676 | 414 |
| Loans to small and medium enterprises | 21,577 | 40,302 |
| Less: Provision for loan impairment | (22,222) | (26,418) |
| **Total loans and advances to customers** | **90,418** | **150,888** |

## 9 Loans and Advances to Customers (Continued)

Movements in the provision for loan impairment during 2009 are as follows:

| *In thousands of Georgian Lari* | Corpo-rate loans | Mortg-age loans | Loans to indivi-duals - auto | Loans to indivi-duals - consumer loans | Loans to indivi-duals – cards | Loans to indivi-duals - others | Loans to small and medium enter-prises | Total |
|---|---|---|---|---|---|---|---|---|
| **Provision for loan impairment at 1 January 2009** | **3,891** | **36** | **631** | **9,541** | **10,961** | **-** | **1,358** | **26,418** |
| Provision for impairment during the year | 610 | 237 | 816 | 773 | 11,440 | 31 | 1,641 | **15,548** |
| Recovery of provision against credit card portfolio | - | - | - | - | (12,139) | - | - | **(12,139)** |
| Amounts written off during the year as uncollectible | (2,220) | - | - | (4,333) | (1,052) | - | - | **(7,605)** |
| **Provision for loan impairment at 31 December 2009** | **2,281** | **273** | **1,447** | **5,981** | **9,210** | **31** | **2,999** | **22,222** |

On 25 December 2009, the Group entered into an agreement with a non-related non-resident company ("the Purchaser") to irrevocably sell its loan portfolio in the amount of GEL 12,139 thousand which mainly consisted of credit card loans. As such loan portfolio was fully provided for impairment in previous years, the resulting gain of GEL 12,139 thousand on de-recognition of these loans was credited to provision for loan impairment in the consolidated statement of comprehensive income. On 25 December 2009, the Parent Bank signed another put option agreement with the purchaser whereby the Parent Bank agreed to acquire the aforementioned credit card portfolio from the purchaser for a cash consideration of USD 3,600 thousand. The expiry date for the put option was set at 25 December 2011. As of the date of these consolidated financial statements, the Purchaser of the credit card portfolio has not exercised its option. The management of the Group believes that due to the irrevocable nature of the agreement signed between the Group and the Purchaser on 25 December 2009 and related transfer of the entire credit risks associated with the aforementioned loan portfolio from the Group to the Parent Bank, no provision should be made against the credit card loan portfolio in the consolidated financial statements of the Group for the year ended 31 December 2009.

Movements in the provision for loan impairment during 2008 are as follows:

| *In thousands of Georgian Lari* | Corpo-rate loans | Mortgage loans | Loans to indivi-duals - auto | Loans to indivi-duals - consumer loans | Loans to indivi-duals – cards | Loans to indivi-duals - others | Loans to small and medium enter-prises | Total |
|---|---|---|---|---|---|---|---|---|
| **Provision for loan impairment at 1 January 2008** | **403** | **15** | **13** | **597** | **401** | **-** | **237** | **1,666** |
| Provision for impairment during the year | 3,488 | 21 | 618 | 8,944 | 10,560 | - | 1,121 | **24,752** |
| **Provision for loan impairment at 31 December 2008** | **3,891** | **36** | **631** | **9,541** | **10,961** | **-** | **1,358** | **26,418** |

## 9 Loans and Advances to Customers (Continued)

Economic sector risk concentrations within the customer loan portfolio are as follows:

| | 31 December 2009 | | 31 December 2008 | |
|---|---|---|---|---|
| *In thousands of Georgian Lari* | **Amount** | **%** | **Amount** | **%** |
| Individuals | 63,190 | 56% | 130,986 | 74% |
| Retail | 23,554 | 21% | 21,092 | 12% |
| Trade | 16,357 | 15% | 16,825 | 10% |
| Manufacturing | - | 0% | 5,651 | 3% |
| Metallurgy and mining | 665 | 1% | - | 0% |
| Agricultural | 123 | 0% | 179 | 0% |
| Other | 8,751 | 8% | 2,573 | 1% |
| **Total loans and advances to customers (before impairment)** | **112,640** | **100%** | **177,306** | **100%** |

At 31 December 2009 the Group had 1 borrower (2008: 1 borrower) with aggregated loan amounts above GEL 4,000 thousand. The total aggregate amount of these loans was GEL 4,420 thousand (2008: GEL 8,002 thousand) or 4% of the gross loan portfolio (2008: 5%).

Information about collateral at 31 December 2009, is as follows:

| *In thousands of Georgian Lari* | **Corporate loans** | **Mortgage loans** | **Loans to individuals - auto** | **Loans to individuals - consumer loans** | **Loans to individuals – cards** | **Loans to individuals - others** | **Loans to small and medium enterprises** | **Total** |
|---|---|---|---|---|---|---|---|---|
| Unsecured loans | 171 | - | - | 247 | 35,642 | 103 | - | **36,163** |
| Loans collateralised by: | | | | | | | | |
| - cash deposits | 11,245 | - | - | - | - | 4 | 829 | **12,078** |
| - shares of companies | 328 | - | - | - | - | - | 1,091 | **1,419** |
| - transportation means | 157 | - | 10,263 | - | - | 7 | 120 | **10,547** |
| - residential real estate | 2,896 | 2,652 | - | - | - | 66 | 2,888 | **8,502** |
| - other real estate | 13,554 | 189 | - | - | - | 286 | 2,760 | **16,789** |
| - equipment | 51 | 6 | - | 12,123 | - | 27 | 525 | **12,732** |
| - guarantees | 701 | - | - | 33 | - | 43 | 12,688 | **13,465** |
| - other assets | 6 | 123 | - | - | - | 140 | 676 | **945** |
| **Total loans and advances to customers** | **29,109** | **2,970** | **10,263** | **12,403** | **35,642** | **676** | **21,577** | **112,640** |

Information about collateral at 31 December 2008, is as follows:

| *In thousands of Georgian Lari* | **Corporate loans** | **Mortgage loans** | **Loans to individuals - auto** | **Loans to individuals - consumer loans** | **Loans to individuals – cards** | **Loans to individuals - others** | **Loans to small and medium enterprises** | **Total** |
|---|---|---|---|---|---|---|---|---|
| Unsecured loans | 3,044 | - | - | - | 51,970 | - | 1,104 | **56,118** |
| Loans collateralised by: | | | | | | | | |
| - cash deposits | 20,172 | - | 13 | 533 | - | 1 | 816 | **21,535** |
| - shares of companies | 1,303 | - | - | 259 | - | 3 | 1,321 | **2,886** |
| - transportation means | 40 | - | 12,344 | 19 | - | 159 | 200 | **12,762** |
| - residential real estate | 1,834 | 3,114 | - | - | - | 182 | 4,800 | **9,930** |
| - other real estate | 11,453 | 418 | - | 207 | - | 58 | 3,837 | **15,973** |
| - equipment | 266 | - | - | 26,721 | - | - | 1,508 | **28,495** |
| - guarantees | 972 | - | - | 14 | - | - | 24,023 | **25,009** |
| - other assets | 1,664 | - | - | 230 | - | 11 | 2,693 | **4,598** |
| **Total loans and advances to customers** | **40,748** | **3,532** | **12,357** | **27,983** | **51,970** | **414** | **40,302** | **177,306** |

## 9 Loans and Advances to Customers (Continued)

Analysis by credit quality of loans outstanding at 31 December 2009 is as follows:

| *In thousands of Georgian Lari* | **Corporate loans** | **Mortgage loans** | **Loans to individuals - auto** | **Loans to individuals - consumer loans** | **Loans to individuals – cards** | **Loans to individuals - others** | **Loans to small and medium enterprises** | **Total** |
|---|---|---|---|---|---|---|---|---|
| *Neither past due nor impaired* | | | | | | | | |
| 1 to 100 000 | 1,208 | 1,020 | 5,787 | 2,944 | 26,021 | 152 | 7,678 | 44,810 |
| 100 000 to 200 000 | 1,175 | 686 | - | - | - | - | 314 | 2,175 |
| 200 000 to 300 000 | 896 | 473 | - | - | - | - | 733 | 2,102 |
| 300 000 to 500 000 | 2,595 | - | - | - | - | - | - | 2,595 |
| 500 000 to 700 000 | 2,447 | - | - | - | - | - | - | 2,447 |
| 700 000 to 900 000 | 3,165 | - | - | - | - | - | - | 3,165 |
| 1 300 000 to1 400 000 | 1,351 | - | - | - | - | - | - | 1,351 |
| 4 200 000 to 4 300 000 | 4,212 | - | - | - | - | - | - | 4,212 |
| Loans renegotiated in 2009 | 4,360 | - | - | 264 | - | 1 | 6,477 | 11,102 |
| **Total neither past due nor impaired** | **21,409** | **2,179** | **5,787** | **3,208** | **26,021** | **153** | **15,202** | **73,959** |
| *Past due but not impaired* | | | | | | | | |
| - less than 30 days overdue | 748 | 301 | 1,228 | 75 | 2 | 69 | 513 | 2,936 |
| - 30 to 90 days overdue | - | 3 | 524 | 114 | 2,340 | 3 | 62 | 3,046 |
| **Total past due but not impaired** | **748** | **304** | **1,752** | **189** | **2,342** | **72** | **575** | **5,982** |
| *Loans individually and collectively determined to be impaired (gross)* | | | | | | | | |
| - less to 30 days overdue | 3,755 | - | 31 | 18 | 4 | 15 | 44 | 3,867 |
| - 30 to 90 days overdue | - | - | 26 | - | - | - | 17 | 43 |
| - 90 to 180 days overdue | - | 129 | 774 | 101 | 1,875 | 25 | 112 | 3,016 |
| - 180 to 360 days overdue | 1,609 | 244 | 995 | 1,499 | 3,129 | 242 | 3,717 | 11,435 |
| - over 360 days overdue | 1,588 | 114 | 898 | 7,388 | 2,271 | 169 | 1,910 | 14,338 |
| **Total individually and collectively impaired loans (gross)** | **6,952** | **487** | **2,724** | **9,006** | **7,279** | **451** | **5,800** | **32,699** |
| **Less impairment provisions** | **(2,281)** | **(273)** | **(1,447)** | **(5,978)** | **(9,210)** | **(34)** | **(2,999)** | **(22,222)** |
| **Total loans and advances to customers** | **26,828** | **2,697** | **8,816** | **6,425** | **26,432** | **642** | **18,578** | **90,418** |

## 9 Loans and Advances to Customers (Continued)

At 31 December 2009, interest accrual on individually impaired loans was nil (2008: GEL 794 thousand). Analysis by credit quality of loans outstanding at 31 December 2008 is as follows:

| *In thousands of Georgian Lari* | Corporate loans | Mortgage loans | Loans to individuals - auto | Loans to individuals – consumer loans | Loans to individuals – cards | Loans to individuals - others | Loans to small and medium enterprises | Total |
|---|---|---|---|---|---|---|---|---|
| *Neither past due nor impaired* | | | | | | | | |
| 1 to 100,000 | 1,250 | 1,518 | 10,379 | 11,998 | 30,497 | 315 | 32,010 | **87,967** |
| 100 000 to 200 000 | 1,821 | 755 | - | - | - | - | 3,316 | **5,892** |
| 200 000 to 300 000 | 2,553 | 237 | - | - | - | - | 1,151 | **3,941** |
| 300 000 to 400 000 | 2,323 | 304 | - | - | - | - | - | **2,627** |
| 400 000 to 500 000 | 1,267 | - | - | 498 | - | - | - | **1,765** |
| Loans renegotiated in 2008 | 22,187 | - | - | - | - | - | - | **22,187** |
| **Total neither past due nor impaired** | **31,401** | **2,814** | **10,379** | **12,496** | **30,497** | **315** | **36,477** | **124,379** |
| *Past due but not impaired* | | | | | | | | |
| - less than 30 days overdue | 950 | 252 | 857 | 1,110 | 5,684 | 49 | 1,959 | **10,861** |
| - 30 to 90 days overdue | 421 | 332 | 459 | 762 | 2,841 | - | 406 | **5,221** |
| **Total past due but not impaired** | **1,371** | **584** | **1,316** | **1,872** | **8,525** | **49** | **2,365** | **16,082** |
| *Loans individually and collectively determined to be impaired (gross)* | | | | | | | | |
| - No overdue days | 1,523 | - | - | - | - | - | - | **1,523** |
| - 30 to 90 days overdue | 571 | - | - | - | - | - | - | **571** |
| - 90 to 180 days overdue | 624 | 134 | 662 | 3,689 | 6,398 | 2 | 965 | **12,474** |
| - 180 to 360 days overdue | 5,258 | - | - | 6,265 | 5,274 | - | 407 | **17,204** |
| - over 360 days overdue | - | - | - | 3,661 | 1,276 | 48 | 88 | **5,073** |
| **Total individually and collectively impaired loans (gross)** | **7,976** | **134** | **662** | **13,615** | **12,948** | **50** | **1,460** | **36,845** |
| **Less impairment provisions** | **(3,891)** | **(36)** | **(631)** | **(9,538)** | **(10,964)** | **-** | **(1,358)** | **(26,418)** |
| **Total loans and advances to customers** | **36,857** | **3,496** | **11,726** | **18,445** | **41,006** | **414** | **38,944** | **150,888** |

The Bank applied the portfolio provisioning methodology prescribed by IAS 39, *Financial Instruments: Recognition and Measurement*, and created portfolio provisions for impairment losses that were incurred but have not been specifically identified with any individual loan by the balance sheet date. The Group's policy is to classify each loan as 'neither past due nor impaired' until specific objective evidence of impairment of the loan is identified. The impairment provisions may exceed the total gross amount of individually impaired loans as a result of this policy and the portfolio impairment methodology.

The primary factors that the Group considers in determining whether a loan is impaired are its overdue status and realisability of related collateral, if any. As a result, the Group presents above an ageing analysis of loans that are individually determined to be impaired.

## 9 Loans and Advances to Customers (Continued)

The fair value of collateral in respect of loans past due but not impaired and in respect of loans individually determined to be impaired at 31 December 2009 was as follows:

| *In thousands of Georgian Lari* | Corporate loans | Mortgage loans | Loans to individuals – auto | Loans to individuals – consumer loans | Loans to individuals - cards | Loans to individuals - others | Loans to small and medium enterprises | Total |
|---|---|---|---|---|---|---|---|---|
| *Fair value of collateral - loans past due but not impaired* | | | | | | | | |
| - shares of companies | - | - | - | - | - | 1 | - | **1** |
| - transportation means | - | 1,752 | - | - | - | - | - | **1,752** |
| - residential real estate | 278 | - | - | - | 48 | 31 | - | **357** |
| - other real estate | - | - | - | - | - | 136 | - | **136** |
| - equipment | - | - | 182 | - | - | 40 | - | **222** |
| - guarantees | - | - | - | - | 13 | 363 | - | **376** |
| - other assets | - | - | - | - | 6 | 4 | - | **10** |
| *Fair value of collateral - individually impaired loans* | | | | | | | | |
| - cash deposits | - | - | - | - | 3 | - | - | **3** |
| - shares of companies | - | - | - | - | - | 468 | - | **468** |
| - transportation means | - | 2,677 | - | - | 5 | 31 | - | **2,713** |
| - residential real estate | 354 | - | - | - | - | 639 | - | **993** |
| - other real estate | 110 | - | - | - | 222 | 758 | - | **1,090** |
| - equipment | 3 | - | 4,529 | - | 20 | 110 | - | **4,662** |
| - guarantees | - | - | - | - | 22 | 3,600 | - | **3,622** |
| - other assets | - | - | - | - | 125 | 66 | - | **191** |
| **Total** | **745** | **4,429** | **4,711** | **-** | **464** | **6,247** | **-** | **16,596** |

The fair value of collateral in respect of loans past due but not impaired and in respect of loans individually determined to be impaired at 31 December 2008 was as follows:

| *In thousands of Georgian Lari* | Corporate loans | Mortgage loans | Loans to individuals – auto | Loans to individuals – consumer loans | Loans to individuals - cards | Loans to individuals - others | Loans to small and medium enterprises | Total |
|---|---|---|---|---|---|---|---|---|
| *Fair value of collateral - loans past due but not impaired* | | | | | | | | |
| - cash deposits | 10,031 | - | - | 503 | - | 1 | - | **10,535** |
| - shares of companies | 62 | - | - | 238 | - | 3 | 75 | **378** |
| - transportation means | 6 | - | 1,358 | 19 | - | 33 | 20 | **1,436** |
| - residential real estate | 318 | 3,114 | - | - | - | 48 | 333 | **3,813** |
| - other real estate | 4 | 418 | - | - | - | - | 584 | **1,006** |
| - equipment | 176 | - | - | 6,136 | - | - | 75 | **6,387** |
| - guarantees | 180 | - | - | 14 | - | - | 1,611 | **1,805** |
| - other assets | - | - | - | 230 | - | 11 | 67 | **308** |
| *Fair value of collateral - individually impaired loans* | | | | | | | | |
| - cash deposits | 7,052 | - | - | - | - | - | - | **7,052** |
| - shares of companies | 157 | - | - | - | - | - | - | **157** |
| - other real estate | 587 | - | - | - | - | - | - | **587** |
| **Total** | **18,573** | **3,532** | **1,358** | **7,140** | **-** | **96** | **2,765** | **33,464** |

## 9 Loans and Advances to Customers (Continued)

Neither past due nor impaired, but renegotiated loans represent the carrying amount of loans that would otherwise be past due or impaired whose terms have been renegotiated. Past due but not impaired loans primarily include collateralised loans where the fair value of collateral covers the overdue interest and principal repayments. The amount reported as past due but not impaired is the whole balance of such loans, not only the individual instalments that are past due.

Refer to Note 28. Interest rate analysis of loans and advances to customers is disclosed in Note 25. Information on related party balances is disclosed in Note 30.

## 10 Premises, Equipment and Intangible Assets

| *In thousands of Georgian Lari* | Premises | Office and computer equipment | Fixtures and fittings | Vehicles | Leasehold improvements | Total premises and equipment | Computer software licences | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost or valuation** | | | | | | | | |
| **At 1 January 2008** | 9,313 | 6,883 | 1,512 | 425 | 397 | **18,530** | 363 | **18,893** |
| Additions | 34 | 5,827 | 5,098 | 415 | 1,845 | **13,219** | 138 | **13,357** |
| Revaluation | (444) | - | - | - | - | **(444)** | - | **(444)** |
| Reversals of impairment through profit or loss | 9 | - | - | - | - | **9** | - | **9** |
| Elimination of accumulated depreciation and impairment losses | (187) | - | - | - | - | **(187)** | - | **(187)** |
| **At 31 December 2008** | **8,725** | **12,710** | **6,610** | **840** | **2,242** | **31,127** | **501** | **31,628** |
| Additions | - | 471 | 549 | 106 | 141 | **1,267** | - | **1,267** |
| Revaluation | (2,024) | - | - | - | - | **(2,024)** | - | **(2,024)** |
| Elimination of accumulated depreciation and impairment losses | - | (249) | (17) | (139) | - | **(405)** | - | **(405)** |
| **At 31 December 2009** | **6,701** | **12,932** | **7,142** | **807** | **2,383** | **29,965** | **501** | **30,466** |
| **Depreciation, amortisation and impairment losses** | | | | | | | | |
| At 1 January 2008 | - | (915) | (285) | (144) | (58) | **(1,402)** | (203) | **(1,605)** |
| Depreciation and amortisation charge | (187) | (2,344) | (662) | (113) | (159) | **(3,465)** | (94) | **(3,559)** |
| Elimination of accumulated depreciation and impairment losses | 187 | - | - | - | - | **187** | - | **187** |
| **At 31 December 2008** | **-** | **(3,259)** | **(947)** | **(257)** | **(217)** | **(4,680)** | **(297)** | **(4,977)** |
| Depreciation and amortisation charge | (174) | (2,052) | (988) | (72) | (274) | **(3,560)** | (37) | **(3,597)** |
| Elimination of accumulated depreciation and impairment losses | - | 59 | 35 | 14 | (4) | **104** | - | **104** |
| **At 31 December 2009** | **(174)** | **(5,252)** | **(1,900)** | **(315)** | **(495)** | **(8,136)** | **(334)** | **(8,470)** |
| **Carrying amount** | | | | | | | | |
| **At 1 January 2007** | **9,313** | **5,968** | **1,227** | **281** | **339** | **17,128** | **160** | **17,288** |
| **At 31 December 2008** | **8,725** | **9,451** | **5,663** | **583** | **2,025** | **26,447** | **204** | **26,651** |
| **At 31 December 2009** | **6,527** | **7,680** | **5,242** | **492** | **1,888** | **21,829** | **167** | **21,996** |

## 10 Premises, Equipment and Intangible Assets (Continued)

Premises have been revalued to market value at 31 December 2009. The valuation was carried out by a firm of valuators based in Ukraine, LLC PB Consulting, who hold a relevant professional qualification and who have recent experience in valuation of assets of similar category. The basis used for the appraisal was market value. Fair values were estimated using appropriate valuation techniques based upon an analysis of the results of comparable sales of similar premises.

Included in the above carrying amount of premises is a decrease of GEL 2,052 thousand (2008: decrease of GEL 435 thousand) representing revaluation decrease during the year relating to premises of the Group.

## 11 Other Financial Assets

| *In thousands of Georgian Lari* | **31 December 2009** | **31 December 2008** |
|---|---|---|
| Insurance receivables | 6,603 | - |
| Prepayments on money transfer transactions | 2,694 | - |
| Doubtful debt | 367 | - |
| Receivables on credit card services | 323 | 1,493 |
| Investment securities available for sale | 97 | 97 |
| Settlements on conversion operations | - | 210 |
| Accrued commission on guarantees | - | 61 |
| Less: Provision for impairment | (367) | - |
| **Total other financial assets** | **9,717** | **1,861** |

Analysis by credit quality of other financial receivables outstanding at 31 December 2009 is as follows:

| *In thousands of Georgian Lari* | **Receivables on credit card services** | **Deposits for Guarantee given** | **Investment securities available for sale** | **Doubtful debt** | **Cash with the limited rights** | **Total** |
|---|---|---|---|---|---|---|
| *Neither past due nor impaired* | | | | | | |
| - Collected after the balance sheet date | 323 | - | - | - | 2,694 | 3,017 |
| - Other | - | 6,603 | 97 | 367 | - | 7,067 |
| **Total neither past due nor impaired** | **323** | **6,603** | **97** | **367** | **2,694** | **10,084** |
| Less impairment provision | - | - | - | (367) | - | (367) |
| **Total other financial receivables** | **323** | **6,603** | **97** | **-** | **2,694** | **9,717** |

## 11 Other Financial Assets (Continued)

Analysis by credit quality of other financial receivables outstanding at 31 December 2008 is as follows:

| *In thousands of Georgian Lari* | **Receivables on credit card services** | **Conversion operations** | **Accrued commission on guarantees** | **Investment securities available for sale** | **Total** |
|---|---|---|---|---|---|
| *Neither past due nor impaired* | | | | | |
| - Collected after the balance sheet date | 1,493 | 210 | 61 | - | **1,764** |
| - Other | - | - | - | 97 | **97** |
| **Total neither past due nor impaired** | **1,493** | **210** | **61** | **97** | **1,861** |
| **Total other financial receivables** | **1,493** | **210** | **61** | **97** | **1,861** |

## 12 Other Assets

| *In thousands of Georgian Lari* | **31 December 2009** | **31 December 2008** |
|---|---|---|
| Prepaid expenses | 100 | 1,937 |
| Other tax asset | 975 | 154 |
| Withdrawal collaterals | 39 | - |
| Prepayments for services | 438 | 162 |
| Materials and supplies | 68 | 41 |
| Other | 1,012 | 505 |
| Less: Provision for impairment | (219) | - |
| **Total other assets** | **2,413** | **2,799** |

Information on related party balances is disclosed in Note 30.

## 13 Due to Other Banks

| *In thousands of Georgian Lari* | **31 December 2009** | **31 December 2008** |
|---|---|---|
| Loan from National Bank of Georgia | - | 35,000 |
| Short-term placements of other banks | 14,087 | 60,199 |
| Long term loan from Parent Bank | 1,740 | 2,007 |
| Correspondent accounts and overnight placements of other banks | 8,240 | 3,853 |
| **Total due to other banks** | **24,067** | **101,059** |

As at 31 December 2008 long term loan from Parent Bank represents loan granted at 18 October 2007 for development of ATM network of the Group, bearing annual interest rate of 7.66% for eight years.

At 31 December 2009 the Group had 3 banks (2008: 3 banks) with balances above GEL 3,400 thousand (2008: GEL 1,500 thousand). The aggregate balance of these banks was GEL 5,140 thousand (2008: GEL 80,224 thousand) or 21% (2008: 49%) of total due to other banks.

At 31 December 2009, the estimated fair value of due to other banks was GEL 24,151 thousand (2008: GEL 101,059 thousand). Refer to Note 28. Interest rate analysis of due to other banks is disclosed in Note 13. Information on related party balances is disclosed in Note 30.

## 14 Customer Accounts

| *In thousands of Georgian Lari* | 31 December 2009 | 31 December 2008 |
|---|---|---|
| **State and public organisations** | | |
| - Current/settlement accounts | 1,901 | 671 |
| - Term deposits | 574 | 845 |
| **Other legal entities** | | |
| - Current/settlement accounts | 20,391 | 36,688 |
| - Term deposits | 39,096 | 43,479 |
| **Individuals** | | |
| - Current/demand accounts | 3,758 | 4,454 |
| - Term deposits | 23,682 | 22,071 |
| **Total customer accounts** | **89,402** | **108,208** |

Economic sector concentrations within customer accounts are as follows:

| | 31 December 2009 | | 31 December 2008 | |
|---|---|---|---|---|
| *In thousands of Georgian Lari* | Amount | % | Amount | % |
| Manufacturing | 40,597 | 45% | 70,509 | 65% |
| Individuals | 27,440 | 31% | 26,525 | 25% |
| Trade | 11,606 | 13% | 5,829 | 6% |
| Services | 7,243 | 8% | 3,779 | 3% |
| Transport and communication | 164 | 0% | 17 | 0% |
| Agriculture | 6 | 0% | 33 | 0% |
| Other | 2,346 | 3% | 1,516 | 1% |
| **Total customer accounts** | **89,402** | **100%** | **108,208** | **100%** |

At 31 December 2009 the Group had 1 customer (2008: 1 customer) with balances above GEL 20 000 thousand (2008: GEL 5,000 thousand). The aggregate balance of this customer was GEL 17,038 thousand (2008: GEL 20,391 thousand) or 40% (2008: 19%) of total customer accounts.

As of 31 December 2009, the Bank maintained customer deposit balances of GEL 65 379 thousand (2008: GEL 21,534 thousand) which were blocked by the Bank as collateral for loans and off-balance sheet credit instruments granted by the Bank.

Interest rate analysis of customer accounts is disclosed in Note 25. Information on related party balances is disclosed in Note 30.

At 31 December 2009, the estimated fair value of customer accounts was GEL 89,402 thousand (2008: GEL 108,208 thousand). Refer to Note 28.

## 15 Provisions for Liabilities and Charges

Movements in provisions for liabilities and charges are as follows:

| *In thousands of Georgian Lari* | Guarantees | Total |
|---|---|---|
| **Carrying amount at 1 January 2008** | **163** | **163** |
| Additions charged to profit and loss | 49 | 49 |
| **Carrying amount at 31 December 2008** | **212** | **212** |
| Additions charged to profit and loss | 80 | 80 |
| Unused amounts reversed | - | - |
| **Carrying amount at 31 December 2009** | **292** | **292** |

***Credit related commitments:*** Specific provisions were created for losses incurred on financial guarantees to borrowers whose financial conditions deteriorated.

## 16 Other Financial Liabilities

Other financial liabilities comprise the following:

| *In thousands of Georgian Lari* | **31 December 2009** | **31 December 2008** |
|---|---|---|
| Settlement on money transfer operations | 3,980 | 1,187 |
| Trade payables | - | 987 |
| Other accrued liabilities | 3 | 236 |
| Debit or credit card payables | - | 25 |
| **Total other financial liabilities** | **3,983** | **2,435** |

At 31 December 2009, the estimated fair value of other financial liabilities was GEL 3,481 thousand (2008: GEL 2,435 thousand). Refer to Note 28.

## 17 Other Liabilities

Other liabilities comprise the following:

| *In thousands of Georgian Lari* | **31 December 2009** | **31 December 2008** |
|---|---|---|
| Insurance reserves | 5,657 | 1,014 |
| Taxes payable other than on income | 260 | 309 |
| Accrued employee benefit costs | 84 | 189 |
| Other | 35 | 14 |
| **Total other liabilities** | **6,036** | **1,526** |

Insurance reserves consist of reserve for unearned premiums and insurance loss reserves.

Movements in the reserve for unearned premium are as follows:

| *In thousands of Georgian Lari* | **Gross** | **Reinsurers' share** | **Total** |
|---|---|---|---|
| **Reserve for unearned premiums as at 31 December 2008** | **1,298** | **(403)** | **895** |
| Increase in gross reserve | 3,729 | - | **3,729** |
| Increase in reinsurers' share of reserve | - | 4 | **4** |
| **Reserve for unearned premiums as at 31 December 2009** | **5,027** | **(399)** | **4,628** |

Insurance loss reserves consisted of the following:

| | **31 December 2009** | | |
|---|---|---|---|
| *In thousands of Georgian Lari* | **RBNS** | **IBNR** | **Total** |
| Gross reserves | 441 | 596 | **1,037** |
| Reinsurers' share of reserves | (8) | - | **(8)** |
| **Loss reserves net of reinsurers' share** | **433** | **596** | **1,029** |

## 17 Other Liabilities (Continued)

Movements in the insurance loss reserves are as follows:

| *In thousands of Georgian Lari* | RBNS | IBNR | Total |
|---|---|---|---|
| **Loss reserves, net of reinsurance, as at 1 January 2009** | **43** | **76** | **119** |
| Increase/(decrease) in reserve, gross | 379 | 520 | **899** |
| (Increase)/decrease in reinsurers' share of reserves | 11 | - | **11** |
| **Loss reserves, net of reinsurance, as at 31 December 2009** | **433** | **596** | **1,029** |

## 18 Subordinated debt

Subordinated debt comprised of the following:

| *In thousands of Georgian Lari* | Currency | Due | Amount |
|---|---|---|---|
| Loan 1 | USD | 31-Dec-15 | 2,051 |
| Loan 2 | USD | 31-Dec-15 | 7,691 |
| Loan 3 | USD | 31-Dec-15 | 11,775 |
| **Total** | | | **21,517** |

Subordinated debt represents long term borrowing agreements from the Parent Bank, which, in case of the Group's default, would be secondary to the Group's other obligations, including deposits and other debt instruments.

On 25 December 2009 contractual interest rates on subordinated loans were re-negotiated and reduced to 3% p.a., effective retrospectively starting with the date of issue. As the re-negotiated contractual interest rate on the subordinated loans was lower than market interest rate, fair value adjustment has been recorded by application of the market rate of 13% effective at the loan restructuring date. The fair value gain on restructuring in the amount of GEL 11,784 thousand and related deferred tax liability in the amount of GEL 1,768 thousand were recognized in the consolidated statement of changes in equity for the year ended 31 December 2009. Refer to Note 24.

Refer to Note 28 for the disclosure of the fair value of subordinated debt. Geographical, maturity and interest rate analysis of subordinated debt is disclosed in Note 25. Information on related party balances is disclosed in Note 30.

## 19 Share Capital

| *In thousands of Georgian Lari except for number of shares* | Number of outstanding shares | Ordinary shares | Share premium | Total |
|---|---|---|---|---|
| **At 1 January 2008** | **480,000** | **48,000** | **4,308** | **52,308** |
| **At 31 December 2008** | **480,000** | **48,000** | **4,308** | **52,308** |
| New shares issued | 100,000 | 10,000 | - | **10,000** |
| **At 31 December 2009** | **580,000** | **58,000** | **4,308** | **62,308** |

The total authorised number of ordinary shares is 580 thousand shares (2008: 480 thousand shares) with a par value of GEL 100 per share (2008: GEL 100 per share). All issued ordinary shares are fully paid.

In 2009 the Bank issued an additional 100,000 ordinary shares with nominal amount of GEL 100 per share.

In 2009 the Parent Bank increased its ownership interest from 75% to 100% of ordinary shares.

## 20 Interest Income and Expense

| *In thousands of Georgian Lari* | 31 December 2009 | 31 December 2008 |
|---|---|---|
| **Interest income** | | |
| Loans and advances to customers | 32,405 | 52,199 |
| Correspondent accounts with other banks | - | 1,264 |
| Due from other banks | 1,088 | 293 |
| Other | 234 | - |
| **Total interest income** | **33,727** | **53,756** |
| **Interest expense** | | |
| Term placements of other banks | - | 4,270 |
| Correspondent accounts of other banks | 2,525 | 3,250 |
| Term deposits of legal entities | 3,436 | 2,356 |
| Term deposits of individuals | 2,273 | 1,976 |
| Current/settlement accounts | 287 | 728 |
| Subordinated debt | 1,411 | - |
| Other | 487 | 24 |
| **Total interest expense** | **10,419** | **12,604** |
| **Net interest income** | **23,308** | **41,152** |

## 21 Fee and Commission Income and Expense

| *In thousands of Georgian Lari* | 31 December 2009 | 31 December 2008 |
|---|---|---|
| **Fee and commission income** | | |
| *Fee and commission income in respect of financial instruments not at fair value through profit or loss:* | | |
| - Settlement transactions | 5,730 | 673 |
| - Currency conversion operations | 20 | 661 |
| - Cash transactions and collection | 202 | 381 |
| - Guarantees issued | 464 | 272 |
| **Total fee and commission income** | **6,416** | **1,987** |
| **Fee and commission expense** | | |
| *Fee and commission expense in respect of financial instruments not at fair value through profit or loss* | | |
| - Settlement transactions | 1,461 | 530 |
| - Cash transactions | 3 | 142 |
| - Other | 230 | 32 |
| **Total fee and commission expense** | **1,694** | **704** |
| **Net fee and commission income** | **4,722** | **1,283** |

In 2009 the Bank significantly increased commissions charged on settlement operations, such as ATM service fees which amounted to GEL 2,998 thousand (2008: GEL 282 thousand), and took active measures to increase the number of customers served.

## 22 Other Operating Income

| *In thousands of Georgian Lari* | 31 December 2009 | 31 December 2008 |
|---|---|---|
| Insurance premiums received less shares of reinsurance agents | 4,626 | 1,611 |
| Sublease income | 17 | - |
| Other | 268 | 252 |
| **Total other operating income** | **4,911** | **1,863** |

## 23 Administrative and Other Operating Expenses

| *In thousands of Georgian Lari* | Note | 31 December 2009 | 31 December 2008 |
|---|---|---|---|
| Staff costs | | 14,065 | 15,914 |
| Operating lease expense for premises | | 7,749 | 5,659 |
| Insurance claims settlements and changes in reserves | | 4,643 | 2,053 |
| Depreciation of premises and equipment | 10 | 3,560 | 3,465 |
| Security services | | 1,879 | 1,269 |
| Communications and information services | | 985 | 1,934 |
| Advertising and marketing services | | 764 | 1,896 |
| Utilities and office supplies | | 505 | 936 |
| Travel expenses | | 367 | 362 |
| Taxes other than on income | | 288 | 253 |
| Professional services | | 270 | 731 |
| Office costs | | 280 | 1,439 |
| Equipment repairs costs | | 43 | 825 |
| Amortisation of software | 10 | 37 | 94 |
| Credit cards production expenses | | - | 421 |
| Other | | 313 | 582 |
| **Total administrative and other operating expenses** | | **35,748** | **37,833** |

## 24 Income Taxes

Income tax expense comprises the following:

| *In thousands of Georgian Lari* | 31 December 2009 | 31 December 2008 |
|---|---|---|
| Current tax | - | - |
| Deferred tax | 806 | 716 |
| **Income tax expense for the year** | **806** | **716** |

The income tax rate applicable to the majority of the Group's 2009 income is 15% (2008: 15%). A reconciliation between the expected and the actual taxation charge is provided below.

| *In thousands of Georgian Lari* | 31 December 2009 | 31 December 2008 |
|---|---|---|
| **Loss before tax** | (9,421) | (16,537) |
| Theoretical tax credit at statutory rate (15%) | (1,413) | (2,481) |
| Tax effect of items which are not deductible or assessable for taxation purposes: | | |
| - Non-deductible expenses | 186 | 647 |
| Unrecognised tax loss carry forwards | 2,033 | 2,549 |
| **Income tax expense for the year** | **806** | **716** |

## 24 Income Taxes (Continued)

The Group has unrecognised potential deferred tax assets in respect of unused tax loss carry forwards of GEL 2,034 thousand (2008: GEL 2,549 thousand). Due to uncertainty in availability and timing of the Group's future taxable profits, the management decided not to recognise any deferred tax asset in respect of the temporary differences on unused tax losses carried forward. The tax loss carry forwards expire in 2014.

A deferred tax asset of GEL 304 thousand (2008: GEL 67 thousand) has been recorded directly in equity in respect of the revaluation of the Group's premises. Refer to Notes 10.

Differences between IFRS and statutory taxation regulations in Georgia give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below and is recorded at the rate of 15% (2008: 15%).

| *In thousands of Georgian Lari* | 31 December 2008 | Credited/ (charged) to profit or loss | Credited/ (charged) directly to equity | 31 December 2009 |
|---|---|---|---|---|
| **Tax effect of deductible/(taxable) temporary differences and tax loss carry forwards** | | | | |
| Premises and equipment: premises | (1,771) | 224 | 304 | (1,243) |
| Loan impairment provision | 540 | (1,160) | - | (620) |
| Subordinated debt | - | - | (1,768) | (1,768) |
| Other financial liabilities | 35 | 351 | - | 386 |
| Other liabilities | 13 | (221) | - | (208) |
| **Net deferred tax asset/(liability)** | **(1,183)** | **(806)** | **(1,464)** | **(3,453)** |
| Recognised deferred tax asset | **588** | **575** | **304** | **386** |
| Recognised deferred tax liability | **(1,771)** | **(1,381)** | **(1,768)** | **(3,839)** |
| **Net deferred tax asset/(liability)** | **(1,183)** | **(806)** | **(1,464)** | **(3,453)** |

| *In thousands of Georgian Lari* | 31 December 2007 | Credited/ (charged) to profit or loss | Credited/ (charged) directly to equity | 31 December 2008 |
|---|---|---|---|---|
| **Tax effect of deductible/(taxable) temporary differences and tax loss carry forwards** | | | | |
| Premises and equipment: premises | (803) | (1,035) | 67 | (1,771) |
| Loan impairment provision | 3 | 537 | - | 540 |
| Other assets | 30 | (30) | - | - |
| Other financial liabilities | - | 35 | - | 35 |
| Other liabilities | 38 | (25) | - | 11 |
| Tax loss carry forwards | 198 | (198) | - | - |
| **Net deferred tax asset/(liability)** | **(534)** | **(716)** | **67** | **(1,183)** |
| Recognised deferred tax asset | **269** | **252** | **67** | **588** |
| Recognised deferred tax liability | **(803)** | **(968)** | - | **(1,771)** |
| **Net deferred tax asset/(liability)** | **(534)** | **(716)** | **67** | **(1,183)** |

## 25 Financial Risk Management

The risk management function within the Bank is carried out in respect of financial risks (credit, market, and liquidity risks), operational risks and legal risks. Financial risk comprises market risk (including currency risk, interest rate risk and other price risk), credit risk and liquidity risk. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimise operational and legal risks.

*Risk Management Bodies.* Risk management policy, monitoring and control are conducted by a number of bodies of the Group under the supervision of the credit committee (the "Credit Committee"). Other bodies responsible for risk management within the Group include the Treasury and the Financial and Risk Management Department. The Group also has a system of internal controls which is supervised and monitored by its Internal Audit Department and Financial Monitoring Department.

*Credit Committee.* The Credit Committee, which is composed of the Chairman of the Bank, its Deputies, the Heads of the Business, the Head of the Finance and Risk Management Department and the Head of the Treasury Department, meets bi-weekly and is responsible for setting credit policy, approving loans over the prescribed lending limits and the limits for counterparty banks, monitoring loan performance and the quality of the Group's loan portfolio and reviewing large loan projects and the lending policies of the Bank's branches. The Credit Committee also monitors the interest rates set for a range of currencies by the Group's main competitors and the overall market situation and determines the Group's pricing policy.

*Treasury.* Day-to-day asset and liability management is done by the Treasury. The Treasury is responsible for overseeing the Group's assets and liabilities and liquidity and interest rate sensitivity analysis based on instructions and guidelines from the Financial and Risk Management Department and its own assessments. The Treasury is responsible for the operational aspects of asset and liability management.

*The Financial and Risk Management Department* calculates and monitors the Bank's compliance with the mandatory ratios set by the NBG, the requirement to maintain mandatory reserves on the Bank's correspondent account with the NBG and its internal liquidity ratios (in accordance with the Bank's internal Methodology for Liquidity Risk Assessment and Control). In carrying out these functions, the Financial and Risk Management Department works with the Treasury, its back office, and depositary and credit service officers of the head office business divisions and the Credit Committee.

*Risk Control Department* analyses the creditworthiness of counterparty banks, calculates provisions for the Group's active operations and limits for counterparty banks, monitors problem assets in the loan portfolio under credit programs, monitors compliance with interbank transaction limits, reviews the lending authority limits of branch and sub-branch heads, analyses lending policies of the branches and sub-branches and provides the Credit Committee with suggestions for improving its policies. It also determines the strategy and basic methodological approaches in the Group's risk management system and oversees its compliance with the requirements established by the NBG as well as the Group's internal guidelines (including, among others, transaction limits and balance sheet structural limits for branches and sub-branches).

***Credit risk.*** The Group takes on exposure to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises as a result of the Group's lending and other transactions with counterparties giving rise to financial assets.

The Group's maximum exposure to credit risk is reflected in the carrying amounts of financial assets on the consolidated balance sheet.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. The Group's maximum exposure to credit risk is reflected in the carrying amounts of financial assets on the consolidated balance sheet. For guarantees, import letters of credit and commitments to extend credit, the maximum exposure to credit risk is the amount of the commitment. Refer to the Note 27. The general principles of the Group's credit policy are outlined in the formal Group's Credit Policy. Formal and unified Group's Credit Manual regulates every significant aspect of the lending operations of the Group and outlines procedures for analysing the financial position of borrowers and the valuation of any proposed collateral and specifies the requirements for loan documentation and the procedures for the monitoring of loans. The Group has collateral policy based on a thorough review and assessment of the value of collateral.

**25 Financial Risk Management (Continued)**

The Group's goal is to ensure that there is sufficient collateral to cover a particular loan if the quality of that loan should deteriorate in value. A substantial portion of the Group's loan portfolio generally include acceleration clauses in case of deterioration of the financial position of the borrower. Credit products are, except in very unusual circumstances, only made available to customers that hold accounts with the Group. This policy provides the dual benefits of additional security for the credit products and additional business for the Group in other areas of corporate banking services.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to a single borrower, or groups of affiliated borrowers, and by close on-going supervision of concentrations in geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal payment obligations and by changing the lending limits where appropriate. Exposure to credit risk is also managed, in part, by obtaining collateral and corporate and personal guarantees. Basic information on the level of credit risk, including reports on the loan portfolio and the volume of problem assets broken down by credit programme and manager, is posted on the Group's internal website. This information is updated weekly and can be viewed both as at the current date and over a period of time. There are specific sections of the Group's website dedicated to problem assets for both corporate and retail clients and the portfolio of corporate loans.

A review of the lending and deposit-taking policy of each branch is presented to the Credit Committee twice per month. The following information on the Bank's branch loan portfolio is considered by the Credit Committee:

- information on the major risks taken (being the ten largest exposures in the portfolio);
- information on the ten largest problem loans.

*Loan Approval Procedure.* The lending policies and credit approval procedures of the Group are based on strict guidelines in accordance with the NBG regulations. The Group also has detailed regulations for collateral assessment, which is conducted by Group's trained specialists on collateral. The Bank sets lending authority limits to limit risks to the Group arising from lending activities. Lending authority limits for senior managers of service centers are set twice per year by the Financial and Risk Department in the head office and approved by an order of the Bank together with proxies authorizing the relevant heads to make lending decisions. The lending authority limit of a branch or sub-branch head depends on the amount of own funds of a branch or sub-branch, overall rating of a branch or sub-branch and its integrated lending activity efficiency rating.

Lending authority limits for junior managers (heads of departments and divisions) are set by the head of the relevant branch or sub-branch and apply to a particular individual.

If the amount of a proposed loan does not exceed the lending authority limit of a head of a branch or sub-branch, the decision on granting the loan is taken by the credit committee of a branch. If the amount exceeds this limit, lending authority is granted from the head office in accordance with the Bank's credit procedures. Loan applications originated by the relevant client relationship managers are passed on to the relevant credit committee for approval of credit limit. Exposure to credit risk is also managed, in part, by obtaining collateral and corporate and personal guarantees.

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract. The Group uses the same credit policies in assuming conditional obligations as it does for on-balance sheet financial instruments, through established credit approvals, risk control limits and monitoring procedures.

*Loan Monitoring.* The Group's IT systems allow the Management monitoring of loans' performance on-line. The Group reassesses the credit risk on each loan on an ongoing basis by (i) monitoring the financial and market position of the borrower and (ii) assessing the sufficiency of collateral for the loan. The financial and market position of the borrower is regularly reviewed. The review is based on the flow of funds into the customer's accounts, its most recent financial statements and other business and financial information submitted by the borrower or otherwise obtained by the Group.

The current market value of collateral is monitored regularly to assess its sufficiency with respect to the loan in question. The review of collateral is performed by independent appraisal companies. The frequency of such reviews depends on the security provided and the degree of volatility of the asset's market price.

## 25 Financial Risk Management (Continued)

Problem loans are identified on a daily basis based on signs of debt servicing deterioration. The Group carries out analyses of problem loans by collecting information about such loans, investigating the causes of problems and working out measures for their early redemption. On the basis of the findings of such analyses, a report is submitted to the Bank's Board regarding the problem loans in the Group's loan portfolio and the level of acceptable credit risk. To improve the quality of the loan portfolio, the Group applies a policy of on-line blocking the ability of a sub-branch or manager responsible for a particular lending programme to grant further loans if the percentage of non-performing loans issued by a particular sub-branch or manager exceeds the maximum permitted level of problem assets until this level decreases.

***Market risk.*** The Group takes on exposure to market risks. Market risks arise from open positions in currency and interest rate, all of which are exposed to general and specific market movements. Management sets limits on the value of risk that may be accepted, which is monitored on a daily basis. However, the use of this approach does not prevent losses outside of these limits in the event of more significant market movements.

***Currency risk.*** The Bank is exposed to effects of fluctuation in the prevailing local/foreign currency exchange rates on its financial position. Currency risk is the risk that movements in foreign exchange rates will affect the Bank's income or the value of its portfolios of financial instruments. The main element in the Bank's risk policy regarding foreign currency risk is that there is no conscious effort to take a trading position in any currency. Limited open positions occur as a natural consequence of business operations only. The Bank uses every effort to match its assets and liabilities by currency.

In respect of currency risk, management sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily.

The table below summarises the Bank's exposure to foreign currency exchange rate risk at the balance sheet date:

| | At 31 December 2009 | | | 31 December 2008 | | |
|---|---|---|---|---|---|---|
| *In thousands of Georgian Lari* | **Monetary financial assets** | **Monetary financial liabilities** | **Net balance sheet position** | **Monetary financial assets** | **Monetary financial liabilities** | **Net balance sheet position** |
| Georgian Lari | 68,588 | 47,191 | 21,397 | 80,937 | 74,163 | 6,774 |
| US Dollars | 85,332 | 75,345 | 9,987 | 129,564 | 125,543 | 4,021 |
| Euros | 16,419 | 16,239 | 180 | 12,179 | 11,968 | 211 |
| Russian Roubles | 47 | 47 | - | 16 | - | 16 |
| Swiss Franc | 146 | 146 | - | 602 | 26 | 576 |
| Ukrainian Hryvnia | 22 | 1 | 21 | 19 | 2 | 17 |
| **Total** | **170,554** | **138,969** | **31,585** | **223,317** | **211,702** | **11,615** |

The above analysis includes only monetary assets and liabilities. Investments in equities and non-monetary assets are not considered to give rise to any material currency risk.

## 25 Financial Risk Management (Continued)

The following table presents sensitivities of profit or loss and equity to reasonably possible changes in exchange rates applied at the balance sheet date relative to the functional currency of the respective Group entities, with all other variables held constant:

| | At 31 December 2009 | | 31 December 2008 | |
|---|---|---|---|---|
| *In thousands of Georgian Lari* | Impact on profit or loss | Impact on equity | Impact on profit or loss | Impact on equity |
| US Dollar strengthening by 10% | 999 | - | 402 | - |
| US Dollar weakening by 10% | (999) | - | (402) | - |
| Euro strengthening by 5% | 9 | - | 11 | - |
| Euro weakening by 5% | (9) | - | (11) | - |
| Russian Rouble strengthening by 5% | - | - | 1 | - |
| Russian Rouble weakening by 5% | - | - | (1) | - |
| Swiss Franc strengthening by 5% | - | - | 29 | - |
| Swiss Franc weakening by 5% | - | - | (29) | - |
| Ukrainian Hryvnia strengthening by 5% | 1 | - | 1 | - |
| Ukrainian Hryvnia weakening by 5% | (1) | - | (1) | - |
| **Total** | **1,009** | **-** | **444** | **-** |

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the respective entity of the Group.

***Interest rate risk.*** Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. Management monitors on a daily basis and sets limits on the level of mismatch of interest rate repricing that may be undertaken.

At present, the Bank manages its interest rate risk by matching, where possible, its maturity and/or repricing positions. In addition, the Bank's monthly interest margins are continually reviewed in order to reprice its assets when deemed appropriate. Operational procedures set the acceptable interest rate margin at a minimum of 10%. At present, through the Bank's matching policies and high interest rate margins, potential interest rate risk is not considered to be significant.

The Group is exposed to interest rate risk, principally as a result of lending at fixed interest rates, in amounts and for periods, which differ from those of term borrowings at fixed interest rates. In practice, interest rates are generally fixed on a short-term basis. Also, interest rates that are contractually fixed on both assets and liabilities are usually renegotiated to reflect current market conditions.

The Finance and Risk Division and the Credit Committee are both responsible for interest rate risk management. The Finance and Risk Division establishes the principal policies and approaches to interest rate risk management and the Credit Committee conducts weekly monitoring and revision of interest rates for various currencies within certain time limits and product categories. The Group regularly monitors interest rate risk by means of interest rate gap analysis, which is based on ordering assets and liabilities sensitive to interest rates into a number of time bands. Fixed interest rate assets and liabilities are arranged by the time remaining until maturity

The table below summarises the Bank's exposure to interest rate risks. The table presents the aggregated amounts of the Bank's financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest re-pricing or maturity dates.

## 25 Financial Risk Management (Continued)

| *In thousands of Georgian Lari* | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | More than 1 year | Non-monetary | Total |
|---|---|---|---|---|---|---|
| **31 December 2009** | | | | | | |
| Total financial assets | 80,857 | 1,614 | 24,661 | 62,960 | 462 | **170,554** |
| Total financial liabilities | 81,418 | 3,007 | 22,658 | 30,376 | 1,510 | **138,969** |
| **Net interest sensitivity gap at 31 December 2009** | **(561)** | **(1,393)** | **2,003** | **32,584** | **(1,048)** | **31,585** |
| **31 December 2008** | | | | | | |
| Total financial assets | 43,867 | 102,511 | 29,185 | 47,657 | 97 | **223,317** |
| Total financial liabilities | 118,024 | 36,090 | 54,835 | 2,753 | - | **211,702** |
| **Net interest sensitivity gap at 31 December 2008** | **(74,157)** | **66,421** | **(25,650)** | **44,904** | **97** | **11,615** |

The Group monitors interest rates for its financial instruments. The table below summarises interest rates based on reports reviewed by key management personnel:

| | **At 31 December 2009** | | | **31 December 2008** | | |
|---|---|---|---|---|---|---|
| *In % p.a.* | **GEL** | **USD** | **Euro** | **GEL** | **USD** | **Euro** |
| **Assets** | | | | | | |
| Cash and cash equivalents | 0.07 | 2.62 | 0.65 | 0.07 | 2.62 | 0.65 |
| Due from other banks | 0.00 | 7.00 | 3.00 | 2.00 | 0.00 | 0.00 |
| Loans and advances to customers | | | | | | |
| - Corporate loans | 12.00 | 17.00 | 15.60 | 18.10 | 17.00 | 16.10 |
| - Mortgage loans | 22.80 | 19.20 | 18.70 | 26.70 | 18.10 | 15.90 |
| - Loans to individuals - auto | 23.00 | 19.40 | 0.00 | 23.80 | 15.80 | 0.00 |
| - Loans to individuals - consumer loans | 18.70 | 0.00 | 0.00 | 20.80 | 0.00 | 0.00 |
| - Loans to individuals – cards | 22.10 | 18.50 | 18.00 | 25.30 | 18.50 | 17.20 |
| - Loans to individuals – others | 23.20 | 19.60 | 19.10 | 26.40 | 20.70 | 20.80 |
| - Loans to small and medium enterprises | 20.90 | 17.30 | 16.80 | 24.90 | 20.90 | 17.70 |
| **Liabilities** | | | | | | |
| Due to other banks | 4.00 | 3.00 | 0.00 | 10.15 | 12.62 | 0.00 |
| Customer accounts | | | | | | |
| - current and settlement accounts | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| - term deposits | 8.00 | 9.00 | 7.00 | 12.16 | 10.03 | 12.87 |

The sign "-" in the table above means that the Group does not have the respective assets or liabilities in the corresponding currency.

## 25 Financial Risk Management (Continued)

***Geographical risk concentrations.*** The geographical concentration of the Group's financial assets and liabilities at 31 December 2009 is set out below:

| *In thousands of Georgian Lari* | Georgia | OECD | Non-OECD | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | 27,268 | 13,364 | 27,003 | **67,635** |
| Mandatory cash balances with NBG | 2,768 | - | - | **2,768** |
| Due from other banks | 16 | - | - | **16** |
| Loans and advances to customers | 88,494 | - | 1,924 | **90,418** |
| Other financial assets | 9,657 | 10 | 50 | **9,717** |
| **Total financial assets** | **128,203** | **13,374** | **28,977** | **170,554** |
| **Non-financial assets** | **24,395** | - | **14** | **24,409** |
| **Total assets** | **152,598** | **13,374** | **28,991** | **194,963** |
| **Liabilities** | | | | |
| Due to other banks | 19,227 | 3,380 | 1,460 | **24,067** |
| Customer accounts | 88,639 | - | 763 | **89,402** |
| Subordinated debt | - | - | 21,517 | **21,517** |
| Other financial liabilities | 3,983 | - | - | **3,983** |
| **Total financial liabilities** | **111,849** | **3,380** | **23,740** | **138,969** |
| **Non-financial liabilities** | **9,781** | **-** | **-** | **9,781** |
| **Total liabilities** | **121,630** | **3,380** | **23,740** | **148,750** |
| **Net balance sheet position** | **30,968** | **9,994** | **5,251** | **46,213** |
| **Credit related commitments** | **28,637** | **-** | **-** | **28,637** |

## 25 Financial Risk Management (Continued)

Assets, liabilities and credit related commitments have been based on the country in which the counterparty is located. Balances with Georgian counterparties actually outstanding to/from offshore companies of these Georgian counterparties are allocated to the caption “Georgia”.

The geographical concentration of the Group’s assets and liabilities at 31 December 2008 is set out below:

| *In thousands of Georgian Lari* | Georgia | OECD | Non-OECD | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | 60,571 | 383 | 5,212 | **66,166** |
| Mandatory cash balances with NBG | 4,378 | - | - | **4,378** |
| Due from other banks | 24 | - | - | **24** |
| Loans and advances to customers | 150,888 | - | - | **150,888** |
| Other financial assets | 1,861 | - | - | **1,861** |
| **Total financial assets** | **217,722** | **383** | **5,212** | **223,317** |
| **Non-financial assets** | **29,450** | - | - | **29,450** |
| **Total assets** | **247,172** | **383** | **5,212** | **252,767** |
| **Liabilities** | | | | |
| Due to other banks | 48,521 | - | 52,538 | **101,059** |
| Customer accounts | 108,208 | - | - | **108,208** |
| Other financial liabilities | 2,435 | - | - | **2,435** |
| **Total financial liabilities** | **159,164** | **-** | **52,538** | **211,702** |
| **Non-financial liabilities** | **2,921** | **-** | **-** | **2,921** |
| **Total liabilities** | **162,085** | **-** | **52,538** | **214,623** |
| **Net balance sheet position** | **85,087** | **383** | **(47,326)** | **38,144** |
| **Credit related commitments** | **45,447** | **-** | **-** | **45,447** |

***Other risk concentrations.*** Management monitors and discloses concentrations of credit risk by obtaining reports listing exposures to borrowers with aggregated loan balances in excess of 10 % of net assets. Refer to Notes 8 and 9.

***Liquidity risk.*** Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations arising from its financial obligations. It refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of financial institutions.

In order to manage liquidity risk, the Bank performs daily monitoring of future expected cash flows on clients’ and banking operations, which is part of the assets/liabilities management process. The Management Board and Supervisory Board set limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals under both normal and stressed conditions. They also set parameters for the risk diversification of the liability base.

## 25 Financial Risk Management (Continued)

The National Bank of the Georgia has in place minimum levels of liquidity required.

The Bank's liquidity policy is comprised of the following:

- Projecting cash flows and maintaining the level of liquid assets necessary to ensure liquidity in various time-bands;
- Maintaining a funding plan commensurate with the Bank's strategic goals;
- Maintaining a diverse range of funding sources thereby increasing the Bank's borrowing capacity, domestically as well as from foreign sources;
- Maintaining highly liquid and high-quality assets;
- Adjusting its product base by time bands against available funding sources;
- Daily monitoring of liquidity ratios against regulatory requirements; and
- Constant monitoring of asset and liability structures by time-bands.

Credit committee is responsible for ensuring that Treasury properly manages the Bank's liquidity position. The Risk Management Department is responsible for controlling these activities. Decisions on liquidity positions and management are made by the Management Board.

The table below shows liabilities at 31 December 2009 by their remaining contractual maturity. The amounts disclosed in the maturity table are the contractual undiscounted cash flows, including gross loan commitments. Such undiscounted cash flows differ from the amount included in the balance sheet because the balance sheet amount is based on discounted cash flows. Foreign currency payments are translated using the spot exchange rate at the balance sheet date.

The maturity analysis of financial liabilities at 31 December 2009 is as follows:

| *In thousands of Georgian Lari* | **Demand and less than 1 month** | **From 1 to 3 months** | **From 3 to 12 months** | **From 12 months to 5 years** | **Over 5 years** | **Total** |
|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | |
| Due to other banks | 24,204 | - | - | 1,788 | - | **25,992** |
| Customer accounts – individuals | 66,155 | 3,012 | 25,445 | 4,731 | - | **99,343** |
| Subordinated debt | - | - | 646 | 2,582 | 22,163 | **25,391** |
| Other financial liabilities | 3,983 | - | - | 2,480 | - | **6,463** |
| Gross loan commitments | 28,637 | - | - | - | - | **28,637** |
| **Total potential future payments for financial obligations** | **122,979** | **3,012** | **26,091** | **11,581** | **22,163** | **185,826** |

The maturity analysis of financial liabilities at 31 December 2008 is as follows:

| *In thousands of Georgian Lari* | **Demand and less than 1 month** | **From 1 to 6 months** | **From 6 to 12 months** | **From 12 months to 5 years** | **Over 5 years** | **Total** |
|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | |
| Due to other banks | 53,683 | - | 52,382 | - | 3,224 | **109,289** |
| Customer accounts – individuals | 62,202 | 37,980 | 20,023 | - | - | **120,205** |
| Other financial liabilities | 2,435 | **-** | **-** | **-** | **-** | **2,435** |
| Gross loan commitments | 45,660 | **-** | **-** | **-** | **-** | **45,660** |
| **Total potential future payments for financial obligations** | **163,980** | **37,980** | **72,405** | **-** | **3,224** | **277,589** |

## 25 Financial Risk Management (Continued)

The Group does not use the above undiscounted maturity analysis to manage liquidity. Instead, the Group monitors remaining contractual maturities, which may be summarised as follows at 31 December 2009:

| *In thousands of Georgian Lari* | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | From 12 months to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | 67,635 | - | - | - | - | **67,635** |
| Mandatory cash balances with NBG | 2,768 | - | - | - | - | **2,768** |
| Due from other banks | - | - | 16 | - | - | **16** |
| Loans and advances to customers | 7,814 | 1,614 | 21,570 | 59,420 | - | **90,418** |
| Other financial assets | 2,640 | - | 3,075 | 3,540 | 462 | **9,717** |
| **Total financial assets** | **80,857** | **1,614** | **24,661** | **62,960** | **462** | **170,554** |
| **Liabilities** | | | | | | |
| Due to other banks | 22,411 | - | - | 1,656 | - | **24,067** |
| Customer accounts | 59,014 | 3,007 | 22,658 | 4,723 | - | **89,402** |
| Subordinated debt | - | - | - | - | 21,517 | **21,517** |
| Other financial liabilities | 1,503 | - | - | 2,480 | - | **3,983** |
| **Total financial liabilities** | **82,928** | **3,007** | **22,658** | **8,859** | **21,517** | **138,969** |
| **Net liquidity gap at 31 December 2009** | **(2,071)** | **(1,393)** | **2,003** | **54,101** | **(21,055)** | **31,585** |
| **Cumulative liquidity gap at 31 December 2009** | **(2,071)** | **(3,464)** | **(1,461)** | **52,640** | **31,585** | |

Negative cumulative gap within 12 months of GEL 1,461 thousand represents liquidity risk for the Bank. However, management believes that in spite of a substantial portion of customers accounts being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Bank would indicate that these customer accounts provide a long-term and stable source of funding for the Bank. Further, management believes the Bank will able to obtain necessary funds from Parent Bank for current liquidity management.

The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. It is unusual for banks ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Group and its exposure to changes in interest and exchange rates.

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

## 25 Financial Risk Management (Continued)

The analysis by remaining contractual maturities may be summarised as follows at 31 December 2008:

| *In thousands of Georgian Lari* | **Demand and less than 1 month** | **From 1 to 6 months** | **From 6 to 12 months** | **From 12 months to 5 years** | **Over 5 years** | **Total** |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | 66,166 | - | - | - | - | **66,166** |
| Mandatory cash balances with NBG | 2,510 | 1,460 | 408 | - | - | **4,378** |
| Due from other banks | 24 | - | - | - | - | **24** |
| Loans and advances to customers | 19,294 | 55,161 | 28,777 | 44,361 | 3,295 | **150,888** |
| Other financial assets | 1,764 | - | - | - | 97 | **1,861** |
| **Total financial assets** | **89,758** | **56,621** | **29,185** | **44,361** | **3,392** | **223,317** |
| **Liabilities** | | | | | | |
| Due to other banks | 53,559 | - | 44,746 | - | 2,754 | **101,059** |
| Customer accounts | 62,029 | 36,090 | 10,089 | - | - | **108,208** |
| Other financial liabilities | 2,435 | - | - | - | - | **2,435** |
| **Total financial liabilities** | **118,023** | **36,090** | **54,835** | **-** | **2,754** | **211,702** |
| **Net liquidity gap at 31 December 2008** | **(28,265)** | **20,531** | **(25,650)** | **44,361** | **638** | **11,615** |
| **Cumulative liquidity gap at 31 December 2008** | **(28,265)** | **(7,734)** | **(33,384)** | **10,977** | **11,615** | |

***Insurance risk.*** The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and therefore unpredictable for each individual insurance contract.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Group faces under its insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits are greater than estimated. Insured events are random and the actual number and amount of claims and benefits will vary from year to year from the level established using statistical techniques.

The Group includes the insurance company. A subject of its activity is non-life insurance. The main insurance products of the company:

- Medical insurance
- The default insurance
- Property insurance
- Insurance of cars.

The Group manages insurance risk by means of established internal procedures which include:

- Establishment of underwriting procedures intended for underwriting department to monitor loss performance of the insurance portfolios by lines of business;
- Use of reinsurance to limit the Group's exposure to claims/catastrophes;
- Monitoring by the management of assets and liabilities to try to match the pattern of expected claim payments with the dates of maturity of assets; and,
- Diversification over several classes of insurance business.

The Group's insurance portfolio primarily consists of physical damage to property, equipment and other assets, physical damages to motor vehicles, financial loss, bodily injury and physical damage suffered by the third parties, and medical insurance.

## 26 Management of Capital

The Bank's objectives when managing capital are to comply with the capital requirements set by the National Bank Georgia, to safeguard the Bank's ability to continue as a going concern and to maintain a sufficient capital base to achieve a capital adequacy ratio of at least 12. Compliance with capital adequacy ratios set by the National Bank Georgia is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's General Director and the Chief Accountant and subsequently submitted to the NBG. Other objectives of capital management are evaluated annually.

Under the current capital requirements set by the National Bank of Georgia banks have to: (a) hold the minimum level of share capital of GEL 12,000 thousand (b) maintain a ratio of regulatory capital to risk weighted assets ("statutory capital ratio") at or above a prescribed minimum of 12 and (c) maintain a ratio of tier-1 capital to the risk-weighted assets (the 'Tier-1 capital ratio') at or above the prescribed minimum of 8. The total capital that the Bank manages, which is the same as the amount of capital required for NBG statutory capital adequacy purposes, is GEL 48 268 thousand as of 31 December 2009 (2008: GEL 40,219 thousand). Regulatory capital is based on the Bank's reports prepared under the Georgian accounting standards and comprises:

| *In thousands of Georgian Lari* | **31 December 2009** | **31 December 2008** |
|---|---|---|
| **Tier 1 capital** | | |
| Share capital | 58,000 | 48,000 |
| Share premium | 4,308 | 4,308 |
| Retained earnings | (17,980) | (727) |
| Less: Intangible assets | (239) | (203) |
| **Total qualifying Tier 1 capital** | **44,089** | **51,378** |
| **Tier 2 capital** | | |
| Current year loss | (10,227) | (17,253) |
| Revaluation reserves | 2,096 | 3,816 |
| General reserves, limited to a maximum of 1.25 of the Bank's credit and market risk-weighted assets | 1,544 | 2,278 |
| **Total qualifying Tier 2 capital** | **(6,587)** | **(12,188)** |
| **Total regulatory capital** | **37,502** | **40,219** |
| **Risk-weighted assets:** | | |
| On-balance sheet | 167,881 | 182,204 |
| Off-balance sheet | 26,309 | 10,617 |
| **Total risk-weighted assets** | **194,190** | **192,821** |
| **Basel ratio** | **19** | **21** |

The Group and the Bank have complied with all externally imposed capital requirements as at 31 December 2009 and 2008.

## 27 Contingencies and Commitments

***Legal proceedings.*** From time to time and in the normal course of business, claims against the Bank are received. Based on its own estimates and internal professional advice the Bank's Management is of the opinion that no material losses will be incurred in respect of claims and, accordingly, no provision has been made in this set of financial statements.

***Compliance with the NBG regulations.*** The Bank is subject to certain statutory regulations set by the NBG related primarily to its operations. Non-compliance with such regulations may result in negative consequences for the Bank including penalties imposed by the NBG. The Bank was not in breach of any capital requirement regulations as of 31 December 2009 and 2008. However, two indicators (ratio of unsecured loans to loan portfolio and property investment ratio) exceed established norms. The non-compliance with such indicators may lead to imposition of restriction on distribution of dividends. During 2009 and up to the report issue date no other penalties and fines or other adverse actions were imposed by NBG. Management expects that the breached indicators will be rectified by the end of calendar year 2010.

## 27 Contingencies and Commitments (Continued)

***Tax legislation.*** Georgian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant regional and state authorities. Recent events within Georgia suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar periods proceeding the period of review. Under certain circumstances reviews may cover longer periods. Management believes that its interpretation of the relevant legislation is appropriate and the Bank's tax, currency legislation and customs positions will be sustained. Accordingly, at 31 December 2008 no provision for potential tax liabilities has been recorded.

***Capital expenditure commitments.*** At 31 December 2009, the Bank does not have material contractual capital expenditure commitments.

***Operating lease commitments.*** Where the Group is the lessee, the future minimum lease payments under non-cancellable operating leases are as follows:

| *In thousands of Georgian Lari* | **31 December 2009** | **31 December 2008** |
|---|---|---|
| Not later than 1 year | 16 | 7,922 |
| Later than 1 year and not later than 5 years | 304 | 16,067 |
| Later than 5 years | 183 | 200 |
| **Total operating lease commitments** | **503** | **24,189** |

***Credit related commitments.*** The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate or cash deposits and therefore carry less risk than a direct borrowing.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments, if the unused amounts were to be drawn down. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards and adequate collateral. The Bank monitors the term to maturity of credit related commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments. Outstanding credit related commitments are as follows:

| *In thousands of Georgian Lari* | **Notes** | **31 December 2009** | **31 December 2008** |
|---|---|---|---|
| Undrawn credit lines | 30 | 17,469 | 34,148 |
| Guarantees issued | | 11,395 | 10,617 |
| Import letters of credit | | - | 894 |
| Less: Provision for credit related commitments | 15 | (227) | (212) |
| **Total credit related commitments, net of provision** | | **28,637** | **45,447** |

## 27 Contingencies and Commitments (Continued)

The total outstanding contractual amount of undrawn credit lines and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded. The fair value of credit related commitments was GEL 17,469 thousand at 31 December 2009 (2008: GEL 34,148 thousand).

Credit related commitments are denominated in currencies as follows:

| *In thousands of Georgian Lari* | 31 December 2009 | 31 December 2008 |
|---|---|---|
| Georgian Lari | 9,200 | 16,939 |
| US Dollars | 19,437 | 27,923 |
| Euros | - | 797 |
| **Total** | **28,637** | **45,659** |

***Assets pledged and restricted.*** The Group does not have assets pledged as collateral.

## 28 Fair Value of Financial Instruments

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price.

The estimated fair values of financial instruments have been determined by the Bank using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. Georgia continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may be outdated or reflect distressed sale transactions and therefore not represent fair values of financial instruments. Management has used all available market information in estimating the fair value of financial instruments.

Cash and cash equivalents are carried at amortised cost which approximates current fair value.

***Loans and receivables carried at amortised cost.*** The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on currency, maturity of the instrument and credit risk of the counterparty and average rates used were as follows:

| *In thousands of Georgian Lari* | 31 December 2009 | 31 December 2008 |
|---|---|---|
| *Loans and advances to customers – Note 9* | | |
| Corporate loans | 18.16 | 18.23 |
| Mortgage loans | 22.80 | 22.24 |
| Loans to individuals – auto | 23.00 | 19.14 |
| Loans to individuals – consumer loans | 18.70 | 33.34 |
| Loans to individuals – cards | 22.10 | 28.86 |
| Loans to individuals – others | 23.20 | 24.54 |
| Loans to small and medium enterprises | 20.90 | 19.11 |
| Due to other banks | 7.00 | 13.36 |
| *Customer accounts – Note 14* | | |
| Term deposits | 13.15 | 11.20 |

## 28 Fair value of Financial Instruments (Continued)

Estimated fair values as of 31 December 2009 presented in the following table:

| *In thousands of Georgian Lari* | 31 December 2009 | | 31 December 2008 | |
|---|---|---|---|---|
| | **Carrying value** | **Fair value** | **Carrying value** | **Fair value** |
| Corporate loans | 26,828 | 26,894 | 36,855 | 36,828 |
| Mortgage loans | 2,697 | 2,702 | 4,913 | 4,920 |
| Loans to individuals – auto | 8,816 | 8,819 | 11,727 | 11,631 |
| Loans to individuals - consumer loans | 6,425 | 6,427 | 17,028 | 17,029 |
| Loans to individuals – cards | 26,432 | 27,332 | 41,009 | 41,016 |
| Loans to individuals – others | 642 | 644 | 412 | 414 |
| Loans to small and medium enterprises | 18,578 | 18,528 | 38,944 | 38,903 |
| **Total** | **90,418** | **91,346** | **150,888** | **150,741** |

***Liabilities carried at amortised cost.*** The estimated fair value of fixed interest rate instruments with stated maturity, for which a quoted market price is not available, was estimated based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity. The fair value of liabilities repayable on demand or after a notice period ("demandable liabilities") is estimated as the amount payable on demand, discounted from the first date that the amount could be required to be paid. Refer to Notes 13, 14, and 16 for the estimated fair values of due to other banks, customer accounts, and other financial liabilities respectively.

## 29 Presentation of Financial Instruments by Measurement Category

For the purposes of measurement, IAS 39, *Financial Instruments: Recognition and Measurement*, classifies financial assets into the following categories: (a) loans and receivables; (b) available-for-sale financial assets; (c) financial assets held to maturity and (d) financial assets at fair value through profit or loss ("FVTPL"). Financial assets at fair value through profit or loss have two subcategories: (i) assets designated as such upon initial recognition, and (ii) those classified as held for trading.

All of the Bank's financial assets except investment securities available for sale and financial liabilities are carried at amortised cost.

As at 31 December 2009 and 31 December 2008 other financial assets are presented with their IAS 39 categories in a table below:

| *In thousands of Georgian Lari* | 31 December 2009 | | | 31 December 2008 | | |
|---|---|---|---|---|---|---|
| | **Loans and receiv-ables** | **Available-for-sale assets** | **Total** | **Loans and receiv-ables** | **Available-for-sale assets** | **Total** |
| ***Other financial assets:*** | | | | | | |
| - Credit and debit cards receivables | 323 | - | 323 | 1,493 | - | 1,493 |
| - Settlements on conversion operations | - | - | - | 210 | - | 210 |
| - Accrued interest on other assets | - | - | - | 61 | - | 61 |
| - Investment securities available for sale | - | 97 | 97 | - | 97 | 97 |
| - Cash with the limited rights | 2,694 | - | 2,694 | - | - | - |
| - Other | 6,603 | - | 6,603 | - | - | - |
| **Total other financial assets** | **9,620** | **97** | **9,717** | **1,764** | **97** | **1,861** |

Other financial instruments are presented in the balance sheet in accordance with their IAS 39 categories.

## 30 Related Party Transactions

Parties are generally considered to be related if the parties are under common control or one party has the ability to control the other party or can 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.

At 31 December 2009, the outstanding balances with related parties were as follows:

| *In thousands of Georgian Lari* | **Parent bank** | **Entities under common control** | **Key management personnel** |
|---|---|---|---|
| Cash and cash equivalents (contractual interest rate: 0-2%) | 38,942 | - | - |
| Subordinated debt (contractual interest rate: 3%) (Refer to Note 18) | 21,517 | - | - |
| Customer accounts (contractual interest rate: 3 - 4%) | - | 2,073 | - |
| Due to other banks (contractual interest rate: 0%) | 5,141 | - | - |

At 31 December 2008, the outstanding balances with related parties were as follows:

| *In thousands of Georgian Lari* | **Parent bank** | **Entities under common control** | **Key management personnel** |
|---|---|---|---|
| Cash and cash equivalents (contractual interest rate: 0-2%) | 5,212 | - | - |
| Gross amount of loans and advances to customers (contractual interest rate: 18%) | - | - | 11 |
| Due to other banks (contractual interest rate: 0 - 13.36%) | 49,238 | 3,298 | - |

The income and expense items with related parties for 2009 were as follows:

| *In thousands of Georgian Lari* | **Parent bank** | **Entities under common control** | **Key management personnel** |
|---|---|---|---|
| Interest income | 1,501 | - | - |
| Interest expense | (1,499) | (747) | - |
| Fee and commission income | - | 4 | - |
| Fee and commission expense | - | (4) | - |
| Other operating income | - | 1,000 | - |

The income and expense items with related parties for 2008 were as follows:

| *In thousands of Georgian Lari* | **Parent bank** | **Entities under common control** | **Key management personnel** |
|---|---|---|---|
| Interest income | 304 | - | 5 |
| Interest expense | - | (5,104) | - |
| Gains less losses from trading in foreign currencies | - | 7,684 | - |

Key management compensation is presented below:

| | **31 December 2009** | | **31 December 2008** | |
|---|---|---|---|---|
| *In thousands of Georgian Lari* | **Expense** | **Accrued liability** | **Expense** | **Accrued liability** |
| *Short-term benefits:* | | | | |
| - Salaries | 664 | - | 683 | - |
| - Short-term bonuses | - | - | 19 | - |
| **Total** | 664 | - | 702 | - |

Short-term bonuses fall due wholly within twelve months after the end of the period in which management rendered the related services.

## 31 Events after the end of the reporting period

On 1 June 2010 the Parent Bank made a decision to increase authorized and issued ordinary share capital by the amount equivalent to USD 10,000 thousand based on official NBG spot exchange rate effective on the date of subscription. As of the date of this report the issue has not been subscribed for.