JSC VTB Bank (Georgia)

Consolidated Financial Statements

Year ended 31 December 2008
Together with Independent Auditors' Report

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INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of JSC VTB Bank (Georgia) –

We have audited the accompanying consolidated financial statements of JSC VTB Bank Georgia and subsidiaries, which comprise the consolidated balance sheet as at 31 December 2008, and the consolidated statement of operations, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of JSC VTB Bank (Georgia) as at 31 December 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ERNST & YOUNG LLC

30 April 2009

CONSOLIDATED BALANCE SHEET

As of 31 December 2008

(Thousands of Georgian Lari)

	Notes	2008	2007
Assets			
Cash and cash equivalents	5	46,730	79,130
Amounts due from credit institutions	6	7,207	20,433
Loans to customers	7	325,770	344,071
Investment securities available-for-sale	8	1,389	1,335
Property and equipment	9	31,645	32,095
Intangible assets	10	256	294
Current income tax assets	11	603	2,044
Deferred income tax assets	11	4,771	2,935
Other assets	13	2,163	1,223
Total assets		**420,534**	**483,560**
Liabilities			
Amounts due to credit institutions	14	114,595	151,950
Amounts due to customers	15	153,263	229,199
Other borrowed funds	16	99,084	46,022
Subordinated loan	17	20,254	19,395
Other liabilities	14	5,292	1,795
Total liabilities		**392,488**	**448,361**
Equity			
Share capital	18	86,356	65,082
Property revaluation reserve	18	5,692	5,824
Accumulated losses		(64,002)	(35,707)
Total equity		**28,046**	**35,199**
Total liabilities and equity		**420,534**	**483,560**

Signed and authorised for release on behalf of the Management Board of the Bank

Nikoloz Shurgaia

Mamuka Jijavadze

General Director

Chief Accountant

30 April 2009

The accompanying notes on pages 5 to 39 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF OPERATIONS

For the year ended 31 December 2008

(Thousands of Georgian Lari)

	Notes	2008	2007
Interest income			
Loans to customers		57,640	63,629
Amounts due from credit institutions		2,869	1,847
Investment securities available for sale		823	331
		61,332	**65,807**
Interest expense			
Amounts due to credit institutions		(20,920)	(25,816)
Amounts due to customers		(12,868)	(14,817)
		(33,788)	**(40,633)**
Net interest income		**27,544**	**25,174**
Loan impairment charge	7	(72,748)	(15,517)
Net interest income/ (expense) after loan impairment charge		**(45,204)**	**9,657**
Net fee and commission income	20	3,482	4,301
Net gains/(losses) from foreign currencies:			
- dealing		4,356	4,589
- translation differences		776	(536)
Gain arising from sale of financial assets at fair value through profit or loss	21	38,342	–
Other income	21	1,652	1,103
Non-interest income		**48,608**	**9,457**
Personnel expenses	22	(17,108)	(13,493)
Depreciation and amortisation	9, 10	(2,514)	(2,106)
Other operating expenses	22	(10,708)	(8,221)
Other impairment and provision charge	12	(3,326)	(112)
Non-interest expenses		**(33,656)**	**(23,932)**
Loss before income tax expense		**(30,252)**	**(4,818)**
Income tax benefit / (expense)	11	1,825	(670)
Loss for the year		**(28,427)**	**(5,488)**

The accompanying notes on pages 5 to 39 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2008

(Thousands of Georgian Lari)

	Share capital	*Property revaluation reserve*	*Retained earnings/ (accumulated losses)*	*Total equity*
As of 31 December 2006	**40,968**	**174**	**(30,227)**	**10,915**
Revaluation of property, net of tax	–	5,647	–	5,647
Decrease in deferred tax liability related to revaluation of property due to change in tax rates		11		11
Depreciation of revaluation reserve, net of tax	–	(5)	5	–
Transfer of property revaluation reserve upon disposal, net of tax	–	(3)	3	–
Total income and expense for the year recognised directly in equity	–	5,650	8	5,658
Loss for the year	–	–	(5,488)	(5,488)
Total income and expense for the year	–	5,650	(5,480)	170
Issuance of share capital (Note 18)	24,114	–	–	24,114
As of 31 December 2007	**65,082**	**5,824**	**(35,707)**	**35,199**
Depreciation of revaluation reserve, net of tax		(126)	126	–
Transfer of property revaluation reserve upon disposal, net of tax		(6)	6	–
Total income and expense for the year recognised directly in equity		(132)	132	–
Loss for the year	–	–	(28,427)	(28,427)
Total income and expense for the year	–	(132)	(28,295)	(28,427)
Issuance of share capital (Note 18)	21,274	–	–	21,274
31 December 2008	**86,356**	**5,692**	**(64,002)**	**28,046**

The accompanying notes on pages 5 to 39 are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2008

(Thousands of Georgian Lari)

	Notes	2008	2007
Cash flows from operating activities			
Interest received		60,863	60,563
Interest paid		(39,614)	(40,450)
Fees and commissions received		4,637	6,875
Fees and commissions paid		(1,190)	(1,528)
Realised gains less losses from dealing in foreign currencies		4,393	4,576
Other income received		39,918	1,239
Personnel expenses paid		(16,542)	(13,493)
Other operating expenses paid		(11,405)	(8,314)
Cash flows from operating activities before changes in operating assets and liabilities		**41,060**	**9,468**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		13,221	(1,651)
Loans to customers		(53,433)	91
Other assets		(1,554)	98
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		(36,957)	(31,979)
Amounts due to customers		(68,881)	53,692
Other liabilities		(100)	(344)
Net cash flows from/(used in) operating activities before income tax		**(106,644)**	**29,375**
Income tax paid		1,202	(3,516)
Net cash from/(used in) operating activities		**(105,442)**	**25,859**
Cash flows from investing activities			
Purchase of investment securities		(54)	–
Proceeds from sale and redemption of investment securities		–	10,278
Purchase of property, equipment and intangible assets	9, 10	(2,289)	(4,106)
Proceeds from sale of property and equipment		63	195
Net cash from/(used in) investing activities		**(2,280)**	**6,367**
Cash flows from financing activities			
Proceeds from issuance of share capital	19	21,274	24,114
Proceeds from other borrowed funds		61,707	6,101
Repayments of other borrowed funds		(7,711)	(27,836)
Dividends paid to shareholders of the Bank		–	(1)
Net cash from financing activities		**75,270**	**2,378**
Effect of exchange rates changes on cash and cash equivalents		52	(24)
Net increase in cash and cash equivalents		**(32,400)**	**34,580**
Cash and cash equivalents, beginning	5	**79,130**	**44,550**
Cash and cash equivalents, ending	5	**46,730**	**79,130**

The accompanying notes on pages 5 to 39 are an integral part of these consolidated financial statements.

(Thousands of Georgian Lari)

1. Principal activities

JSC VTB Bank (Georgia) (the "Bank") the parent company of the Group of VTB Bank (Georgia) (the "Group" hereafter). It was formed as joint stock company on 7 April 1995 under the laws of Georgia under the name of United Georgian Bank. The Bank changed its name to VTB Bank (Georgia) on 7 December 2006. The Bank operates under a general banking licence issued by the National Bank of Georgia ("NBG", the Central Bank of Georgia) on 19 May 1995. The majority shareholder of the Bank is VTB Bank OJSC. VTB Bank and its subsidiaries collectively form the VTB Group (the "VTB Group").

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its commercial and retail customers. Its main office is in Tbilisi, Georgia. As at 31 December 2008 the Bank has 14 branches (5 of them in Tbilisi) and 12 service centres. The Bank's registered legal address is 14 Chanturia str, Tbilisi, Georgia.

Subsidiaries

"Georgian Fund Company" Ltd is a wholly-owned subsidiary of the Bank registered and operating in Georgia. Its paid-in share capital amounts to GEL 11 thousand. The company operates as a brokerage agent.

"GT+" LTD is a wholly-owned subsidiary of the Bank registered and operating in Georgia. Its paid in share capital amounts to GEL 0.2 thousands. The company operates as real estate agent.

Shareholders

As of 31 December 2008, the following shareholders owned more than 3% of the outstanding shares. Other shareholders individually owned less than 3% of the outstanding shares:

Shareholder	*2008* %	*2007* %
VTB Bank OJSC	77.57	70.52
European Bank of Reconstruction and Development (EBRD)	8.95	11.88
Anton Ingorokva	3.57	4.73
Zaza Sioridze	3.56	4.73
Lacarpa Enterprises Limited	3.56	4.73
Other	2.79	3.41
Total	**100.0**	**100.0**

VTB Bank OJSC is the immediate parent of the Bank. The VTB Bank OJSC majority shareholder and ultimate controlling party for the VTB Group is the State of Russian Federation ("RF"), acting through the Federal Property Agency, which holds 77.5% of VTB's issued and outstanding shares as of 31 December 2008 (2007 – 77.5%).

As of 31 December 2008 and 2007, none of the members of the Supervisory Council and Management Board owned shares of the Bank, except for Mr. Z Sioridze (Chairman of Supervisory Council) and Mr. A Ingorkva (Deputy Chairman of Supervisory Council.

As of 31 December 2008 there were 796 number of total Bank personnel (2007: 862 number).

2. Basis of preparation

General

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), which comprise standards and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"), and International Accounting Standards ("IAS") and Standing Interpretations Committee interpretations ("SIC") approved by the International Accounting Standards Committee that remain in effect.

The Bank is required to maintain its records and prepare its consolidated financial statements for regulatory purposes in Georgian Lari in accordance with Georgian accounting and banking legislation and related instructions ("GAL"). These consolidated financial statements are based on the Bank's GAL books and records, as adjusted and reclassified in order to comply with IFRS.

(Thousands of Georgian Lari)

2. Basis of preparation (continued)

General (continued)

These consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. For example, available-for-sale securities and land and buildings have been measured at fair value.

These consolidated financial statements are presented in thousands of Georgian Lari ("GEL"), unless otherwise indicated. GEL is utilised as the majority of the Bank's transactions are denominated or funded in GEL. Transactions in other currencies are treated as transactions in foreign currencies.

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated and except the changes in accounting policies described in Note 3.

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect reported amounts. These estimates are based on information available as of the date of the consolidated financial statements. Actual results, therefore, could differ from these estimates.

3. Summary of significant accounting policies

Changes in accounting policies

During the year, the Bank has adopted the following new and amended IFRS and new IFRIC Interpretations during the year. Adoption of these standards did not have any effect on the financial performance or position of the Bank. The principal effects of these changes are as follows:

IFRIC 11 "IFRS 2 - Group and Treasury Share Transactions"
IFRIC Interpretation 11 became effective for annual periods beginning on or after 1 March 2007 and requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the shareholders provide the equity instruments needed. This Interpretation has no impact on the Bank.

IFRIC 14 "IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction"
IFRIC Interpretation 14 was issued in July 2007 and became effective for annual periods beginning on or after 1 January 2008. This Interpretation provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognized as an asset under IAS 19 Employee Benefits. This Interpretation has no impact on the financial position or performance of the Bank.

Reclassification of Financial Assets – Amendments to IAS 39 "Financial instruments: Recognition and measurement" and IFRS 7 "Financial instruments: Disclosures"
Amendments to IAS 39 and IFRS 7 were issued on 13 October 2008 and allow reclassification of non-derivative financial assets out of the held for trading category in particular circumstances. The amendments also allow transfer of certain financial assets from the available for sale category to loans and receivables category. The effective date of those amendments is 1 July 2008. Any reclassification made in periods beginning on or after 1 November 2008 shall take effect only from the date when the reclassification is made. The Bank did not reclassify any financial assets from held for trading or available for sale categories and hence these amendments did not have any impact on the financial position or performance of the Bank.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Subsidiaries

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

Acquisition of subsidiaries

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

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

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

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

Financial assets

Initial recognition

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

Date of recognition

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

'Day 1' profit

Where the transaction price in a non-active market is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets, the Bank immediately recognises the difference between the transaction price and fair value (a 'Day 1' profit) in the consolidated statement of operations. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognised in the consolidated statement of operations when the inputs become observable, or when the instrument is derecognised.

Loans and receivables

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Financial assets (continued)

Available-for-sale financial assets

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

Determination of fair value

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

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

Offsetting

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

Cash and cash equivalents

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

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to credit institutions and amounts due to customers. These are initially recognized at fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the consolidated statement of operations when the borrowings are derecognised as well as through the amortisation process.

If the Bank purchases its own debt, it is removed from the consolidated balance sheet and the difference between the carrying amount of the liability and the consideration paid is recognised in the consolidated statement of operations.

Leases

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Impairment of financial assets

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

Amounts due from credit institutions and loans to customers

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

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

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

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

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

Available-for-sale financial investments

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

3. Summary of significant accounting policies (continued)

Impairment of financial assets (continued)

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

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

Renegotiated loans

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

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Financial liabilities

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

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Financial guarantees

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

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

Taxation

The current income tax expense is calculated in accordance with the regulations of Georgia.

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

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

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

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

Property and equipment

Property and equipment are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met. Buildings are measured at fair value less depreciation and impairment charged subsequent to the date of the revaluation. Land is measured at fair value and not depreciated.

Construction-in-progress comprises costs directly related to construction of property and equipment. Depreciation of these assets, on the same basis as similar property assets, commences when the assets are put into operation.

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

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

Any revaluation surplus is credited to the revaluation reserve for property and equipment included in equity, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in the consolidated statement of operations, in which case the increase is recognised in the consolidated statement of operations. A revaluation deficit is recognised in the consolidated statement of operations, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

An annual transfer from the revaluation reserve for property and equipment to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original cost. Additionally, accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Property and equipment (continued)

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	50
Computers and communication equipment	4
Furniture, fixtures and office equipment	6
Motor vehicles	5
Leasehold improvements	Over the term of the underlying lease

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

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

Intangible assets

Intangible assets include computer software and licences.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 5 to 20 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end.

Provisions

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

Retirement and other employee benefit obligations

The Bank does not have any pension arrangements separate from the State pension system of the Republic of Georgia, which requires current contributions by the employer calculated as a percentage of current gross salary payments; For the periods before 1 January 2008 such expense was charged in the period the related salaries were earned. Starting from 2008 Georgian Government has abolished social security tax used for State pension arrangements and related obligations are not charged by Bank respectively. In addition, the Bank has no post-retirement benefits.

Share capital

Share capital

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

Treasury shares

Where the Bank or its subsidiaries purchases the Bank's shares, the consideration paid, including any attributable transaction costs, net of income taxes, is deducted from total equity as treasury shares until they are cancelled or reissued. Where such shares are subsequently sold or reissued, any consideration received is included in equity. Treasury shares are stated at weighted average cost. The Bank does not have treasury shares as at 31 December 2008 and 2007.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Share capital (continued)

Dividends

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

Contingencies

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

Recognition of income and expenses

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

Interest and similar income and expense

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

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

Fee and commission income

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

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

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

- *Fee income from providing transaction services*

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

Dividend income

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Foreign currency translation

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

Differences between the contractual exchange rate of a transaction in a foreign currency and the National Bank exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official NBG exchange rates at 31 December 2008 and 31 December 2007 were 1.6670 GEL and 1.5916 GEL to 1 USD, respectively. The official NBG rate as at 30 April 2009 is 1.6501 GEL to 1 USD.

Future changes in accounting policies

Standards and interpretations issued but not yet effective

Improvements to IFRS
In May 2008, the IASB issued amendments to IFRS, which resulted from the IASB's annual improvements project. They comprise amendments that result in accounting changes for presentation, recognition or measurement purposes as well as terminology or editorial amendments related to a variety of individual IFRS standards. Most of the amendments are effective for annual periods beginning on or after 1 January 2009, with earlier application permitted. The Bank is currently evaluating the potential impact that the adoption of the amendments will have on its consolidated financial statements.

IAS 1 Presentation of Financial Statements (Revised)
A revised IAS 1 was issued in September 2007, and becomes effective for annual periods beginning on or after 1 January 2009. This revised Standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income: it presents all items of recognised income and expense, either in one single statement, or in two linked statements. The Bank is still evaluating whether it will have one or two statements.

IAS 23 "Borrowing Costs"(Revised)
A revised IAS 23 Borrowing costs was issued in March 2007, and becomes effective for financial years beginning on or after 1 January 2009. The standard has been revised to require capitalization of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements in the Standard, the Bank will adopt this as a prospective change. Accordingly, borrowing costs will be capitalized on qualifying assets with a commencement date after 1 January 2009. No changes will be made for borrowing costs incurred to this date that have been expensed.

Amendments to IAS 32 "Financial Instruments: Presentation" and IAS 1 "Presentation of Financial Statements" – Puttable Financial Instruments and Obligations Arising on Liquidation
These amendments were issued in February 2008, and become effective for annual periods beginning on or after 1 January 2009. The amendments require puttable instruments that represent a residual interest in an entity to be classified as equity, provided they satisfy certain conditions. These amendments will have no impact on the Bank.

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Future changes in accounting policies (continued)

Amendments to IFRS 1 "First-time Adoption of IFRSs" and IAS 27 "Consolidated and Separate Financial Statements" - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate

These amendments were issued in May 2008, and become effective for annual periods beginning on or after 1 January 2009. The revision to IAS 27 will have to be applied prospectively. The amendments to IFRS 1 allow an entity to determine the cost of investments in a subsidiary, jointly controlled entity or associate in its opening IFRS financial statements in accordance with IAS 27 or using a deemed cost. The amendment to IAS 27 requires all dividends from a subsidiary, jointly controlled entity or associate to be recognized in the income statement in the separate financial statements. The new requirements affect only the parent's separate financial statements and do not have an impact on the consolidated financial statements.

IFRS 3 "Business Combinations" (revised in January 2008) and IAS 27 "Consolidated and Separate Financial Statements" (revised in January 2008).

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

Amendments to IFRS 7 "Improving Disclosures about Financial Instruments"

Amendments to IFRS 7 "Improving Disclosures about Financial Instruments" were issued in March 2009 and become effective for periods beginning on or after 1 January 2009 with early application permitted. These Amendments introduce a three-level fair value disclosure hierarchy that distinguishes fair value measurements by the significance of the inputs used. In addition, the amendments enhance disclosure requirements on the nature and extent of liquidity risk arising from financial instruments to which an entity is exposed. These amendments will have no impact on the financial position or performance of the Bank but will result in more detailed disclosures regarding measurement of the fair value of financial instruments.

IFRIC 16 "Hedges of a Net Investment in a Foreign Operation"

IFRIC Interpretation 16 was issued in July 2008 and is applicable for annual periods beginning on or after 1 October 2008. This Interpretation provides guidance on identifying the foreign currency risks that qualify for hedge accounting in the hedge of net investment, where within the group the hedging instrument can be held and how an entity should determine the amount of foreign currency gain or loss, relating to both the net investment and the hedging instrument, to be recycled on disposal of the net investment. The Bank expects that this interpretation will have no impact on the Bank's financial statements. The Bank has not yet fully analysed the likely impact of the interpretation on its consolidated financial statements.

IFRIC 17 "Distribution of Non-Cash Assets to Owners"

IFRIC 17 was issued in November 2008 and becomes effective for financial years beginning on or after 1 July 2009 with early application permitted. This interpretation should be applied prospectively. IFRIC 17 provides guidance on accounting for distributions of non-cash assets to owners. As such it provides guidance on when to recognise a liability, how to measure it and the associated assets, and when to derecognise the asset and liability and the consequences of doing so. IFRIC 17 will have no impact on the financial position or performance of the Bank, as the Bank does not distribute non-cash assets to its owners.

IFRIC 18 Transfers of Assets from Customers

IFRIC 18 was issued in January 2009 and becomes effective for financial years beginning on or after 1 July 2009 with early application permitted, provided valuations were obtained at the date those transfers occurred. This interpretation should be applied prospectively. IFRIC 18 provides guidance on accounting for agreements in which an entity receives from a customer an item of property, plant and equipment that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services or to do both. The interpretation clarifies the circumstances in which the definition of an asset is met, the recognition of the asset and its measurement on initial recognition, the identification of the separately identifiable services, the recognition of revenue and the accounting for transfers of cash from customers. IFRIC 18 will have no impact on the financial position or performance of the Bank, as the Bank does not receive assets from customers.

(Thousands of Georgian Lari)

4. Significant accounting judgements and estimates

Estimation uncertainty

In the process of applying the Bank's accounting policies, management has used its judgements and made estimates in determining the amounts recognised in the consolidated financial statements. The most significant use of judgements and estimates are as follows:

Going concern

The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources and the financial support of the parent – OJSC VTB Bank to continue in business for the foreseeable future. Furthermore, the Management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

Impairment of available-for-sale investments

The Bank records impairment charges on investment securities available-for-sale when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is 'significant' or 'prolonged' requires judgment. In making this judgment, the Bank evaluates, among other factors, historical share price movements and the duration and extent to which the fair value of an investment is less than its cost.

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its judgement to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

Revaluation of property and equipment

The Bank regularly reviews the value of its property and equipment for compliance with fair value and performs revaluation to ensure that the current carrying amount of property and equipment does not materially differ from its fair value. The Bank performs revaluation using special valuation techniques and information about real estate transactions entered into in the local market. The results received from the application of the above valuation methods, however, may not always correspond to the market value of property and equipment.

Taxation

Georgian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently, unexpectedly and with retroactive effect. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant tax authorities. Trends within Georgia suggest that the tax authorities are taking a more assertive position in their interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for six calendar years preceding the year of review.

The interpretations of the relevant authorities could differ and if the authorities were successful in enforcing their interpretation, additional taxes and related fines and penalties may be assessed, the effect of which cannot be practicably estimated, but could be significant to the financial condition of the Bank. However, based upon Management's understanding of the tax regulations and Management analysis of the results of inspection conducted by tax authorities, Management believes that its interpretation of the relevant tax legislation is reasonable and will be sustainable. Moreover Management believes that the Bank has accrued all applicable taxes.

Deferred tax assets

Deferred tax assets are recognised in respect of tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax planning strategies.

(Thousands of Georgian Lari)

5. Cash and cash equivalents

	2008	*2007*
Cash on hand	14,977	15,531
Current accounts with the NBG	9,259	31,314
Current accounts with other credit institutions	22,494	8,255
Time deposits with credit institutions up to 90 days	–	24,030
Cash and cash equivalents	**46,730**	**79,130**

As of 31 December 2008, 83% of total current accounts with credit institutions are placed with 2 non-resident credit institutions (2007 – 69%).

As of 31 December 2007, 63% of total time deposits with credit institutions with maturity up to 90 days are placed with one Georgian bank.

6. Amounts due from credit institutions

	2008	*2007*
Obligatory reserve with the NBG	5,466	17,444
Time deposits with credit institutions	1,426	1,696
Restricted nostro account in Deutsche Bank, AG (Germany)	315	308
Other amounts	–	985
Amounts due from credit institutions	**7,207**	**20,433**

Credit institutions are required to maintain an interest earning cash deposit (obligatory reserve) with the NBG, the amount of which depends on the level of funds attracted by the credit institution. The Bank's ability to withdraw such deposit is restricted by the statutory legislation. The Bank earns 0.5% annual interest on obligatory reserve with NBG (2007: 2%).

As of 31 December 2008, GEL 1,061 (2007 – GEL 944) included in time deposits with credit institutions was placed on long term deposits and pledged as security for settlement operations to the counterparty bank. Of these amounts GEL 894 was placed in two Georgian banks (2007 – GEL 784) and GEL 167 was with 2 US banks (2007 – GEL 159).

7. Loans to customers

	2008	*2007*
Corporate lending	214,910	257,832
Small business lending	83,188	64,946
Consumer lending	59,751	32,658
Loans secured by deposits	178	4,623
Other loans to individuals	7,210	27,005
Gross loans to customers	**365,237**	**387,064**
Less – Allowance for impairment	(39,467)	(42,993)
Loans to customers, net	**325,770**	**344,071**

(Thousands of Georgian Lari)

7. Loans to customers (continued)

Allowance for impairment of loans to customers

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

	Corporate lending 2008	*Small business lending 2008*	*Consumer lending 2008*	*Loans secured by deposits 2008*	*Other loans to individuals 2008*	*Total 2008*
At 1 January 2008	32,024	441	194	–	10,334	42,993
Charge for the year	52,022	3,924	2,011	–	14,790	72,748
Recoveries of previously written off loans	819	221	86	–	121	1,247
Amounts written off	(54,418)	(722)	(676)	–	(21,705)	(77,521)
At 31 December 2008	**30,447**	**3,864**	**1,615**	**–**	**3,540**	**39,467**
Individual impairment	28,456	231	–	–	3,122	31,809
Collective impairment	1,991	3,633	1,615	–	418	7,658
	30,447	**3,864**	**1,615**	**–**	**3,540**	**39,467**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**49,816**	**826**	**–**	**–**	**5,571**	**56,213**

	Corporate lending 2007	*Small business lending 2007*	*Consumer lending 2007*	*Loans secured by deposits 2007*	*Other loans to individuals 2007*	*Total 2007*
At 1 January 2007	28,542	196	667	282	5,201	34,888
Charge for the year	3,476	5,519	(356)	577	6,301	15,517
Recoveries of previously written off loans	6	203	44	–	–	253
Amounts written off	–	(5,477)	(161)	(859)	(1,168)	(7,665)
At 31 December 2007	**32,024**	**441**	**194**	**–**	**10,334**	**42,993**
Individual impairment	29,950	–	–	–	9,304	39,254
Collective impairment	2,074	441	194	–	1,030	3,739
	32,024	**441**	**194**	–	**10,334**	**42,993**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**55,058**	–	**–**	–	**9,745**	**64,803**

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized, as at 31 December 2008, comprised GEL 5,833 (2007 – GEL 7,394).

Collateral and other credit enhancements

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

(Thousands of Georgian Lari)

7. Loans to customers (continued)

The main types of collateral obtained are as follows:

- For commercial lending, charges over real estate properties, inventory, trade receivables and bank guarantees;
- For retail lending, mortgages over residential properties, inventory, household assets and guarantees of the third persons.

The Bank also obtains guarantees from parent companies for loans to their subsidiaries.

The value of collateral is subject to monitoring. The Bank may request from the borrower additional collateral in accordance with the loan agreement. For the purposes of providing against impairment losses, realizable value of the received collateral is reviewed and assessed against a number of products with a reference to the liquidity of given collateral and its maturity date.

During the year, the Bank took possession of a building with an estimated fair value of GEL 1,540 (2007 – GEL 10), which the Bank is in the process of selling. It is the Bank's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Bank does not occupy repossessed properties for business use.

Concentration of loans to customers

As of 31 December 2008, the Bank had a concentration of loans represented by GEL 177,072 due from the ten largest third party borrowers (48% of gross loan portfolio) (2007 – GEL 187,433 or 48%). An allowance of GEL 11,947 (2007 – GEL 28,763) was recognised against these loans. Included in total loans to customers is an exposure to a single borrower 84,975 or 23% of total loan portfolio (2007 - GEL 112,375; 29%), that bears an annual interest rate of 12.75% p.a. and matures on May 2012. This loan was financed and fully guaranteed by VTB Bank, the Parent Bank (refer to Note 15) on 30 November 2005.

Loans have been extended to the following types of customers:

	2008	*2007*
Private companies	250,260	282,753
Individuals	114,977	104,285
State-owned companies	–	26
	365,237	**387,064**

As of 31 December 2008 and 2007 loans are principally issued within Georgia and their distribution by industry sectors is as follows:

	2008	*2007*
Energy	129,424	113,024
Individuals	114,977	104,285
Trading and service enterprises	67,499	85,450
Real estate construction	37,025	53,631
Manufacturing	9,175	9,084
Telecommunication and transportation	1,570	2,108
Agriculture and food processing	844	7,781
Other	4,723	11,701
	365,237	**387,064**

8. Investment securities available-for-sale

As at 31 December 2008 securities available-for-sale comprised corporate shares of 6 Georgian companies with total carrying value of GEL 1,389. This includes purchase during 2008 of 10% investment in United Clearing Centre, a Georgian company engaged in clearance of utility payments. As at 31 December 2007 the Bank's investments in available-for-sale securities included corporate shares of 5 Georgian Companies with carrying value of GEL 1,335.

(Thousands of Georgian Lari)

9. Property and equipment

The movements in property and equipment during 2008 and 2007 were as follows:

	Land and buildings	*Computers and communication equipment*	*Furniture, fixtures and office equipment*	*Motor vehicles*	*Leasehold improvements*	*Construction in Progress*	*Total*
Cost or revalued amount							
31 December 2006	**19,959**	**4,240**	**2,574**	**2,096**	**461**	**–**	**29,330**
Additions	1,965	763	458	753	12	–	3,951
Disposals	(6)	(487)	(362)	(530)	(52)	–	(1,437)
Effect of revaluation	7,108	–	–	–	–	–	7,108
31 December 2007	**29,026**	**4,516**	**2,670**	**2,319**	**421**	**–**	**38,952**
Additions	157	836	680	272	189	78	2,212
Disposals	(14)	(300)	(212)	(403)	(72)	–	(1,001)
31 December 2008	**29,169**	**5,052**	**3,138**	**2,188**	**538**	**78**	**40,163**
Accumulated depreciation and impairment							
31 December 2006	**(803)**	**(2,544)**	**(1,325)**	**(719)**	**(19)**	–	**(5,410)**
Depreciation charge	(416)	(822)	(386)	(431)	(9)	–	(2,064)
Disposals		476	288	315	3		1,082
Effect of revaluation	(465)	–	–	–	–	–	(465)
31 December 2007	**(1,684)**	**(2,890)**	**(1,423)**	**(835)**	**(25)**	–	**(6,857)**
Depreciation charge	(580)	(777)	(380)	(425)	(296)	–	(2,458)
Disposals	1	295	172	322	7		797
31 December 2008	**(2,263)**	**(3,372)**	**1,631**	**(938)**	**(314)**		**(8,518)**
Net book value:							
31 December 2006	**19,156**	**1,696**	**1,249**	**1,377**	**442**	**–**	**23,920**
31 December 2007	**27,342**	**1,626**	**1,247**	**1,484**	**396**	**–**	**32,095**
31 December 2008	**26,906**	**1,680**	**1,507**	**1,250**	**224**	**78**	**31,645**

On 15 November 2007, an independent appraiser performed the valuation of the fair value of the Bank's land and buildings. The market value of the property was determined based on the active market data. The market approach was used to determine the fair value, the income approach was used to validate the obtained value estimates, and the cost approach was used to determine the value of real property where no information on recent sales or lease rates for similar properties within the same area was available. The net book value of the land and buildings as of 31 December 2007 included GEL 6,852 which represents a revaluation increment of the Bank's land and buildings that was accounted for in correspondence with the revaluation reserve included in the equity section.

As of 31 December 2008 the Bank performed an analysis of the change in the fair value of buildings that occurred during 2008. The analysis showed that as of December 31, 2008 the fair value of buildings did not change materially as compared to 31 December 2007. Therefore, no new revaluation of the property was performed.

As of 31 December 2008, a deferred tax liability for the amount of GEL 1,017 (2007 – GEL 1,028) was calculated in respect of the above fair value revaluation which was recognized in correspondence with the revaluation reserve for property and equipment.

If no revaluation of property and equipment had been performed, the original cost of property and equipment as of 31 December 2008 and 31 December 2007 recorded under the caption "Buildings, structures and leasehold improvements" would have amounted to GEL 21,698 (2007 – GEL 21,555) and accumulated depreciation would have amounted to GEL 1,645 (2007 – GEL 1,066).

The total value of fully depreciated property and equipment in use as of 31 December 2008 and 2007 amounted to GEL 2,569 and GEL 2,071, respectively.

(Thousands of Georgian Lari)

10. Intangible assets

The movements in intangible assets were as follows:

	Licences	*Computer software*	*Total*
Cost			
31 December 2006	**169**	**160**	**329**
Additions	3	222	225
31 December 2007	**172**	**382**	**554**
Additions	0	18	18
31 December 2008	**172**	**400**	**572**
Accumulated amortization and impairment			
31 December 2006	**(130)**	**(88)**	**(218)**
Amortisation charge	(20)	(22)	(42)
31 December 2007	**(150)**	**(110)**	**(260)**
Amortisation charge	(10)	(46)	(56)
31 December 2008	**(160)**	**(156)**	**(316)**
Net book value:			
31 December 2006	**39**	**72**	**111**
31 December 2007	**22**	**272**	**294**
31 December 2008	**12**	**244**	**256**

11. Taxation

The corporate income tax expense comprises:

	2008	*2007*
Current tax expense	–	–
Deferred tax expense/(benefit) – origination and reversal of temporary differences	(1,836)	1,665
Less: deferred tax recognised directly in equity	11	(995)
Income tax expense/ (benefit)	**(1,825)**	**670**

Georgian legal entities must file individual tax declarations. Corporate income tax rate in Georgia was reduced from 20% to 15% effective 1 January 2008. The tax rate for banks for profits before 1 January 2008 was 20%. The tax rate for companies other than banks was also 15%, and 20% for 2008 and 2007, respectively.

	2008	*2007*
Loss before income tax expense	**(30,252)**	**(4,818)**
Statutory tax rate	15%	20%
Theoretical income tax expense/(benefit) at the statutory rate	**(4,538)**	**(964)**
Change in unrecognized deferred tax asset	1,041	–
Non-deductible expenditures:		
- interest	34	66
- charity	334	102
- entertainment expense	12	20
- Other non-deductible expenses	1,292	8
Effect of reduction in tax rate	–	1,438
Income tax expense	**(1,825)**	**670**

(Thousands of Georgian Lari)

11. Taxation (continued)

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

		Origination and reversal of temporary differences			*Origination and reversal of temporary differences*		
	2006	*In the income statement*	*Directly in equity*	*2007*	*In the income statement*	*Directly in equity*	*2008*
Tax effect of deductible temporary differences:							
Allowance for loan impairment	8,989	(5,050)		3,938	(3,058)		880
Tax losses carried forward	–			2,807	5,941		8,748
Accrued interest expense	–			634	(634)		–
Financial instruments adjustment for effective interest rates	227	(103)		124	95		219
Accrued expenses	129	(8)		121	560		681
Other	61	(35)		26	(24)		2
Gross deferred tax asset	**9,406**	**(1,756)**		**7,650**	**2,880**		**10,530**
Unrecognised deferred tax asset	(4,445)	1,111		(3,334)	(1,041)		(4,375)
Deferred tax asset	**4,961**	**(645)**		**4,316**	**1,839**		**6,155**
Tax effect of taxable temporary differences:							
Property and equipment	(328)	25		(353)	–		(353)
Property revaluation	(44)		(984)	(1,028)		11	(1,017)
Other	–			–	(14)		(14)
Deferred tax liability	**(372)**	**25**	**(984)**	**(1,381)**	**(14)**	**11**	**(1,384)**
Net deferred tax assets	**4,589**	**(670)**	**(984)**	**2,935**	**1,825**	**11**	**4,771**

The Bank has available GEL 18,713 of tax losses carried forwards which will expire in 2012 and GEL 39,604 of tax losses carried forward which will expire in 2013, if not utilised.

As of 31 December 2008 current income tax assets amounted to GEL 603 (2007 – asset GEL 2,044) which related to income tax prepayments.

12. Other impairment and provisions

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

	Allowance for impairment on other assets	*Provision for legal claim*	*Total*
31 December 2006	**6**	**–**	**6**
Charge	112		112
31 December 2007	**118**	**–**	**118**
Charge (Note 19)	(8)	3,334	3,326
Written off	(128)	–	(128)
Recoveries	18	–	18
31 December 2008	**–**	**3,334**	**3,334**

Allowance for impairment of assets is deducted from the carrying amounts of the related assets. Provision for legal claim, is recorded in other liabilities.

(Thousands of Georgian Lari)

13. Other assets and liabilities

Other assets comprise:

	2008	*2007*
Repossessed collateral (Note 7)	1,540	21
Unsettled transactions	237	25
Prepayments for purchase of premises and equipment	219	34
Prepaid expenses	128	803
Accrued commission receivable on guarantees	33	161
Other	6	297
Other assets, gross	**2,163**	**1,341**
Less – Allowance for impairment of other assets (Note 12)	–	(118)
Other assets	**2,163**	**1,223**

Other liabilities comprise:

	2008	*2007*
Provision for legal claim (Notes 12 and 19)	3,334	–
Accrued expenses	1,504	1,011
Dividends payable to shareholders of the Bank	233	233
Unsettled transactions	87	226
Settlements on plastic cards	87	28
Settlements on acquisition of property and equipment and inventory	11	70
Operational taxes payable	9	106
Advances paid	9	23
Other	18	98
Other liabilities	**5,292**	**1,795**

14. Amounts due to credit institutions

	2008	*2007*
Current accounts	92,388	113,762
Time deposits and loans	22,207	38,188
Amounts due to credit institutions	**114,595**	**151,950**
Held as security against settlement operations	**–**	**3**

Current account includes the current account of VTB Bank OJSC for total amount of GEL 91,509 or 99% of total current accounts (in 2007 – GEL 112,923 or 99% of total current accounts) for the purpose of financing a long-term project under an agreement dated 16 September 2005 between the Parent bank and the Bank. The interest payable on this current account is 12.25% p.a.

Time deposits and loans include loans from VTB Bank OJSC for total amount of GEL 16,110 or 73% of total term deposits and loans (in 2007 – GEL 33,730 or 88%) with contractual maturities of 3 months. The interest accrued on these loans ranges from 9.50% - 15.00% per annum (2007 – 7.80% - 9.00%).

15. Amounts due to customers

	2008	*2007*
Current accounts	68,402	87,827
Time deposits	84,861	141,372
Amounts due to customers	**153,263**	**229,199**
Held as security against guarantees	**439**	**2,201**
Held as security against settlement operations	**16**	**20**

(Thousands of Georgian Lari)

15. Amounts due to customers (continued)

At 31 December 2008, amounts due to customers of GEL 53,207 (35%) were due to the ten largest third party customers (2007 – GEL 55,071 (24.%)).

Included in time deposits are deposits of individuals in the amount of GEL 62,367 (2007 – GEL 79,601) and legal entities – GEL – 22,494 (2007 - GEL 23,322). The Bank is obliged to repay such deposits upon demand of a depositor. In case a term deposit is repaid upon demand of the depositor prior to maturity, interest on it is paid based on the interest rate for demand deposits, unless a different interest rate is specified in the agreement.

In the event when customers request to withdraw time deposit before maturity, they are subject to penalties for deposit redemption before maturity. Penalties collected on such operations are disclosed in Note 21.

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

	2008	*2007*
State and budgetary organisations	7,629	6,542
Private enterprises	67,881	78,811
Individuals	77,753	143,846
Amounts due to customers	**153,263**	**229,199**

An analysis of customer accounts by industry follows:

	2008	*2007*
Individuals	77,753	143,846
Transport and communication	35,056	28,718
Trade and service	14,367	20,207
Government	5,810	4,015
Manufacturing	5,464	1,925
Real estate constructions	4,323	7,663
Energy	2,958	7,192
Insurance	345	1,939
Fuel	690	140
Other	6,497	13,554
Amounts due to customers	**153,263**	**229,199**

16. Other borrowed funds

	2008	*2007*
Borrowings from commercial banks	72,476	19,204
Borrowings from international financial institutions	26,608	26,815
Other	–	3
Other borrowed funds	**99,084**	**46,022**

Borrowings from commercial banks as of 31 December 2008 contained facilities in U.S. dollars with maturities ranging from July 2010 till September 2012 (2007 - with maturity in September 2012) and interest rate from Libor+2% till 14% (2007 - Libor+2%).

Borrowings from international financial institutions as of 31 December 2008 contained facilities in U.S. dollars and Euro with maturities ranging from July 2009 till December 2032 (2007 - from March 2008 till December 2032) and interest rates from 0.75% till Libor+4.5% (2007 - from 0.75% till Libor+4.25%).

The Bank is subject to restrictive covenants in relation to borrowings from EBRD amounting to GEL 17,297 as of 31 December 2008 (2007 – GEL 16,476). As of 31 December 2008 the Bank did not comply with 5 covenants relating to the EBRD facility in respect to capital adequacy, single party exposure, ratio of loans in arrears over one day to gross loan portfolio, ratio of open foreign currency exchange position to total capital and negative liquidity gap. EBRD has been informed of these non-compliance and agreed currently not to demand the facilities before maturity. Under the agreement terms EBRD has the right to withdraw loans before the contractual termination of the loan agreement in case of default of covenants maintenance.

(Thousands of Georgian Lari)

17. Subordinated loan

On 25 October 2005, the Bank entered into a subordinated loan agreement with the Parent Bank for the total amount of USD 12,000 thousand, with interest rate of Libor+3.5% payable quarterly and maturity on 25 October 2011. As of 31 December 2008 the outstanding amount was equal to GEL 20,254 (2007- GEL 19,395). In the case of a liquidation of the Bank, this loan is only repayable after all the obligations to the Bank senior creditors have been met.

18. Equity

Movements in shares outstanding, issued and fully paid were as follows:

	Number of shares	*Nominal amount*
	Ordinary	*Ordinary*
31 December 2006	**40,967,699**	**40,968**
Increase in share capital	24,114,645	24,114
31 December 2007	**65,082,344**	**65,082**
Increase in share capital	21,273,357	21,274
31 December 2008	**86,355,701**	**86,356**

The number of authorised ordinary shares is 86,388,002 (2007- 86,388,002) (in full number of shares)., with the nominal value per share of 1 GEL All authorised shares have been issued, of which fully paid is 86,355,701. (2007-65,082,344)

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

In December 2007 the shareholders of the Bank approved an additional issuance of 45,388 ordinary shares with nominal value per share of 1 GEL and placed at par value. In accordance with GAL, increase of share capital is registered as the shares are paid. The total consideration received for these shares in 2007 was comprised of cash for the total amount of GEL 24,114. This share issue was registered by the notary on 18 December 2007. The remainder of this share issue for 21,274 shares had been fully paid on 4 March 2008.

In accordance with Georgian legislation and the Bank's Bylaws, dividends may only be declared to the shareholders of the Bank from accumulated undistributed and unreserved earnings as shown in the Bank's consolidated financial statements prepared in accordance with IFRS. The Bank had GEL (64,002) of accumulated losses as at 31 December 2008 (2007 – GEL (35,707)).

The property revaluation reserve is used to record increases in the fair value of land and buildings, and decreases to the extent that such decrease relates to an increase on the same asset previously recognised in equity.

19. Commitments and contingencies

Operating environment

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

The Georgian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. During the year there have been major events that have an effect on the Bank's operations – the military conflict in August 2008 involving Georgia, the Russian Federation and South Ossetia, and the financial crisis which significantly affected global economies from last quarter of 2008. Though no direct damage has been sustained by the Bank during the military conflict, it had caused significant damage to the Georgian economy and the Fitch and S&P country ratings were downgraded. The ongoing global financial crisis has resulted in capital markets instability, significant deterioration of liquidity in the banking sector, and tighter credit conditions within Georgia. There continues to be uncertainty regarding the access to capital and cost of capital for the Bank and its counterparties, which could affect the Bank's financial position, results of operations and business prospects.

Also, the borrowers of the Bank may have been affected by the deterioration in liquidity, which could in turn impact their ability to repay the amounts due to the Bank. To the extent that information is available, the Bank has reflected revised estimates of expected future cash flows in its impairment assessment.

(Thousands of Georgian Lari)

19. Commitments and contingencies (continued)

Operating environment (continued)

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

Legal

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will have a material adverse effect on the financial condition or the results of future operations of the Bank. A legal case filed by Cypriot based company against the Bank is pending in the London Court of International Arbitration. The company has claimed USD 6,500 thousand. The Bank's Management with support of its legal counsel has estimated that maximal loss as a result of this litigation will not be higher than USD 2,000 thousand (GEL 3,334 as at 31 December 2008). Accordingly, a provision in the amount of GEL 3,334 has been recognised in the consolidated statement of operations. (Note 12) and Other liabilities (Notes 12 and 13).

Financial commitments and contingencies

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

	2008	*2007*
Credit-related commitments		
Undrawn loan facilities	9,095	16,603
Letters of credit	454	2,745
Guarantees issued	7,054	11,759
Financial commitments and contingencies (before deducting collateral)	**16,603**	**31,107**
Less – Cash held as security against letters of credit and guarantees issued	(439)	(2,201)
Financial commitments and contingencies	**16,164**	**28,906**
Operating lease commitments		
Not later than 1 year	91	54
Later than 1 year but not later than 5 years	77	–
	168	**54**

Insurance

The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions. The Bank has arrangement for employee's life insurance with insurance company "IC Group". Agreement requires current employer's monthly contributions.

20. Net fee and commission income

	2008	*2007*
Commission on settlements operations	2,900	2,527
Commission on cash operations	987	1,078
Commission on guarantees and letters of credit issued	646	1,749
Other	98	421
Fee and commission income	**4,631**	**5,775**
Commission on settlements operations	(899)	(777)
Commission on cash operations	(137)	(44)
Commission on guarantees and letters of credit issued	(36)	(598)
Other	(77)	(55)
Fee and commission expense	**(1,149)**	**(1,474)**
Net fee and commission income	**3,482**	**4,301**

(Thousands of Georgian Lari)

21. Gain from sale of financial assets held through profit and loss and Other income

Gain from sale of financial assets held through profit and loss

In January 2008 the Bank acquired 8% shares of JSC Energy Invest from Cimelio Investments LTD for GEL 78 and 34% from Lacarpa Enterprises Limited, a shareholder, for GEL 12,696. These shares were sold to Parentelato Limited for GEL 51,116. The Bank gained profit of GEL 38,342 from this one-time transaction.

Other income

	2008	*2007*
Penalties received from lending operations	975	639
Gain on sale of repossessed collateral	463	–
Penalties received for deposit redemption before maturity	106	388
Other penalties	29	55
Other	79	21
Other income	**1,652**	**1,103**

22. Personnel and other operating expenses

	2008	*2007*
Salaries and bonuses	17,108	11,250
Social security costs	–	2,243
Personnel expenses	**17,108**	**13,493**
Charity	2,227	515
Marketing and advertising	1,093	1,528
Office supplies	1,059	939
Occupancy and rent	861	606
Repairs and maintenance of property and equipment	834	558
Legal and consultancy	801	439
Communications	598	463
Security	586	603
Operating taxes	519	1,184
Business travel and related expenses	363	293
Utilities	343	308
Penalties incurred	262	21
Entertainment	258	216
Insurance	233	191
Other	671	357
Other operating expenses	**10,708**	**8,221**

Starting from 1 January 2008 the Georgian Government has abolished the social security tax that previously has been paid by employer on behalf of employees. Consequently no social security costs had been incurred in 2008.

23. Risk management

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

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

(Thousands of Georgian Lari)

23. Risk management (continued)

Risk management structure

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

Supervisory Council

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

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Bank. The Asset - liability and Risk management Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Risk Management Unit

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

Risk Controlling Unit

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

Bank Treasury

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

Internal Audit

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

Risk measurement and reporting systems

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

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Management Board, the Asset - liability and Risk management Committee, and the head of each business division. The report includes aggregate credit exposure, credit metric forecasts, hold limit exceptions, liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a monthly basis.

A daily briefing is given to the Management Board and all other relevant employees of the Bank on the utilisation liquidity.

Risk mitigation

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

(Thousands of Georgian Lari)

23. Risk management (continued)

Credit risk

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

Credit-related commitments risks

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

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

	Notes	*Gross maximum exposure 2008*	*Gross maximum exposure 2007*
Cash and cash equivalents (excluding cash on hand)	5	31,753	63,599
Amounts due from credit institutions	6	7,207	20,433
Loans to customers	7	325,770	344,071
All other assets (excluding settlements with tax authorities)		34,064	33,612
		398,794	**461,715**
Financial commitments and contingencies	19	16,603	31,107
Total credit risk exposure		**415,397**	**492,822**

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

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank internal credit ratings. The table below shows the credit quality by class of asset for loan-related balance sheet lines.

		Neither past due nor impaired				
	Notes	*High grade 2008*	*Standard grade 2008*	*Sub-standard grade 2008*	*Past due or individually impaired 2008*	*Total 2008*
Amounts due from credit institutions	6	7,207	–	–	–	7,207
Loans to customers						
Corporate lending		95,468	31,528	36,233	51,681	214,910
Small business lending		67,105	697	11,330	4,056	83,188
Consumer lending		20,082	22,820	15,491	1,358	59,751
Loans secured with deposits		69	109	–	–	178
Other loans to individuals		–	142	1,194	5,874	7,210
	7	**182,724**	**55,296**	**64,248**	**62,969**	**365,237**
Total		**189,931**	**55,296**	**64,248**	**62,969**	**372,444**

(Thousands of Georgian Lari)

23. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets (continued)

		Neither past due nor impaired			Past due or individually impaired	
	Notes	High grade 2007	Standard grade 2007	Sub-standard grade 2007	2007	Total 2007
Amounts due from credit institutions	6	20,433	–	–	–	20,433
Loans to customers						
Corporate lending		165,594	756	995	90,487	257,832
Small business lending		63,908	228	286	524	64,946
Consumer lending		31,999	239	81	323	32,642
Loans secured with deposits		3,154	640	–	829	4,623
Other loans to individuals		10,520	1,685	327	14,489	27,021
	7	**275,175**	**3,548**	**1,689**	**106,652**	**387,064**
Total		**295,608**	**3,548**	**1,689**	**106,652**	**407,497**

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

Past due but not impaired loans and advances include solely those loans and advances that are overdue by less than 90 days for loans to individuals and overdue by less than 60 days for corporate customers. In accordance with the Bank's policy those retail loans that are overdue by more than 90 days and corporate loans that are overdue by more than 60 days are considered to be impaired. The tables below show aging analysis of past due loans. Most of the loans that are overdue by less than 90 days are not considered to be impaired.

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

	Less than 30 days 2008	31 to 60 days 2008	61 to 90 days 2008	More than 90 days 2008	Total 2008
Loans to customers					
Corporate lending	531	–	–	1,334	1,865
Small business lending	849	562	1,461	358	3,230
Consumer lending	766	299	136	157	1,358
Other loans to individuals	50	–	–	253	303
Total	**2,196**	**861**	**1,597**	**2,102**	**6,756**

	Less than 30 days 2007	31 to 60 days 2007	61 to 90 days 2007	More than 90 days 2007	Total 2007
Loans to customers					
Corporate lending					
Small business lending	186	616	–	34,627	35,429
Consumer lending	132	101	40	251	524
Loans collateralized with deposits	172	69	24	58	323
Other loans to individuals	615	214	–	–	829
	3,672	**106**	**57**	**909**	**4,744**
Total	**4,777**	**1,106**	**121**	**35,845**	**41,849**

Loans and advances to customers have been assessed for impairment on the collective basis. Details of loan loss allowance of loan portfolio are disclosed in Note 7.

(Thousands of Georgian Lari)

23. Risk management (continued)

Credit risk (continued)

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

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

	2008	*2007*
Loans to customers		
Corporate lending	39,316	34,389
Small business lending	411	–
Consumer lending	–	–
Loans secured by deposits	–	–
Other loans to individuals	224	709
Total	**39,951**	**35,098**

Renegotiated loans in corporate lending include loans to construction sector with net value of GEL 9,749 and energy sector with net value of GEL 23,913. The weighted average interest rate accrued on the restructured loans of construction sector as of the date of restructuring -1 September 2008 - was 14%, reaching 18% after restructuring. If the above restructuring of loans to construction sector had not been performed the amortized cost of construction sector loans as of 31 December 2008 would have been GEL 9,638. The increase of interest rate from 12% to 14% for the loans to energy sector customers occurred on 29 December 2008. If the restructuring of these loans had not been performed the amortized cost of the loan would not differ materially from the net balance value as of 31 December 2008.

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days for individuals and 60 days for legal entities or there are any known difficulties in the cash flows of counterparties, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas- individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

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

Collectively assessed allowances

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

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

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

(Thousands of Georgian Lari)

23. Risk management (continued)

Credit risk (continued)

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

	2008				2007			
	Georgia	*OECD*	*CIS and other foreign banks*	*Total*	*Georgia*	*OECD*	*CIS and other foreign banks*	*Total*
Assets:								
Cash and cash equivalents	25,699	20884	147	46,730	71,276	6,248	1,606	79,130
Amounts due from credit institutions	6,725	482	–	7,207	18,981	467	985	20,433
Loans to customers	325,770	–	–	325,770	339,677	–	4,394	344,071
Investment securities available-for-sale	1,389	–	–	1,389	1,335	–	–	1,335
Other assets	39,438			39,438	38,591	–	–	38,591
	399,021	**21,366**	**147**	**420,534**	**469,860**	**6,715**	**6,985**	**483,560**
Liabilities:								
Due to credit institutions	6,150	212	108,233	114,595	4,578	89	147,283	151,950
Due to customers	137,583	4,094	11,586	153,263	219,060	2,073	8,066	229,199
Other borrowed funds	–	38,237	60,847	99,084	3	46,019	–	46,022
Subordinated loan	–	–	20,254	20,254	–	–	19,395	19,395
Other liabilities	5,292	–	–	5,292	1,795	–	–	1,795
	149,025	**42,543**	**200,920**	**392,488**	**225,436**	**48,181**	**174,744**	**448,361**
Net balance sheet position	**249,996**	**(21,177)**	**(200,773)**	**28,046**	**244,424**	**(41,466)**	**(167,759)**	**35,199**
Net off-balance sheet position	**15,005**	**1,557**	**42**	**16,603**	**22,859**	**7,706**	**541**	**31,106**

Liquidity risk and funding management

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

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can assess to meet liquidity needs. In addition, the Bank maintains a cash deposit (obligatory reserve) with the NBG, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratio established by the Georgian Financial Supervision Agency (GFSA). As at 31 December, the ratio was as follows:

	2008, %	*2007, %*
LK "Average Liquidity Ratio" (Average monthly volume of liquid assets / Average monthly volume of liabilities)	25%	32%

In 2007 and partly in 2008 the minimum limit of average liquidity ratio was 30%. Starting from 28 September 2008 the minimum limit of average liquidity ratio is 20%.

(Thousands of Georgian Lari)

23. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2008 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

Financial liabilities As at 31 December 2008	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to credit institutions	30,501	19,406	64,688	–	114,595
Amounts due to customers	106,869	27,346	18,911	136	153,263
Other borrowed funds	4,009	5,015	84,843	5,217	99,084
Subordinated loan	250	0	20,004	–	20,254
Other liabilities	1,872	3,418	2	–	5,292
Total undiscounted financial liabilities	**143,501**	**55,185**	**188,448**	**5,354**	**392,488**

Financial liabilities As at 31 December 2007	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to credit institutions	46,956	18,528	86,466	–	151,950
Derivative financial instruments:					
- Contractual amounts payable	4,616	–	–	–	4,616
- Contractual amounts receivable	(4,663)	–	–	–	(4,663)
Amounts due to customers	171,171	38,165	19,706	157	229,199
Other borrowed funds	21,987	2,763	15,854	5,418	46,022
Subordinated loan	296	–	–	19,099	19,395
Other liabilities	616	289	890	–	1,795
Total undiscounted financial liabilities	**240,979**	**59,745**	**122,916**	**24,674**	**448,314**

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies.

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
2008	5,823	4,471	6,249	57	16,603
2007	16,386	7,431	7,290	–	31,107

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

Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

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

Included in due to customers are term deposits of individuals.

(Thousands of Georgian Lari)

23. Risk management (continued)

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. Except for the concentrations within foreign currency, the Bank has no significant concentration of market risk.

Market risk – Trading

The Management Board has set limits on the level of risk that may be accepted. Bank's activity in market risks area is limited by NBG Deposit certificates operations, also interbank loans and deposits, and exchange operations. Market financial instruments as derivatives and interest rates are not in use.

Market risk – Non - trading

Interest rate risk

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

The sensitivity of the consolidated statement of operations includes the effect of the reasonably possible changes in interest rates on the net interest income for one year based on the assumption that there are parallel shifts in the yield curve.

Currency	*Increase in basis points 2008*	*Sensitivity of pre-tax income 2008*
USD	0.58%	(293)
USD	(0.58%)	293

Currency	*Increase in basis points 2007*	*Sensitivity of pre-tax income 2007*
USD	0.47%	(269)
USD	(0.47%)	269

Currency risk

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

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2008 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Lari, with all other variables held constant on the consolidated statement of operations (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on the consolidated statement of operations. A negative amount in the table reflects a potential net reduction in consolidated statement of operations or equity, while a positive amount reflects a net potential increase.

Currency	*Increase in currency rate in % 2008*	*Effect on profit before tax 2008*	*Increase in currency rate in % 2007*	*Effect on profit before tax 2007*
USD	11.20%	(1,567)	2.80%	(40)
EUR	19.30%	(207)	6.90%	(973)

Currency	*Decrease in currency rate in % 2008*	*Effect on profit before tax 2008*	*Decrease in currency rate in % 2007*	*Effect on profit before tax 2007*
USD	(11.20%)	1,567	(2.80%)	40
EUR	(19.30%)	207	(6.90%)	973

(Thousands of Georgian Lari)

23. Risk management (continued)

Market risk (continued)

Prepayment risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall.

The effect on profit before tax for one year and on equity, assuming 10% of repayable financial instruments were to prepay at the beginning of the year, with all other variables held constant, is as follows:

	Effect on net interest income	*Effect on equity*
2008	6,471	–
2007	6,448	–

Operational risk

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

As of 31 December 2008 the Bank obtained Banker's Blanket Bond and Computer Crime insurance coverage of GEL 1,250 (2007: GEL 796) from Lloyd's insurance company.

24. Fair values of financial instruments

	Carrying value 2008	*Fair value 2008*	*Unrecognised gain/(loss) 2008*	*Carrying value 2007*	*Fair value 2007*	*Unrecognised gain/(loss) 2007*
Financial assets						
Cash and cash equivalents	46,730	46,730	–	79,130	79,130	–
Amounts due from credit institutions	7,207	7,207	–	20,433	20,433	–
Loans to customers	325,770	314,691	(11,079)	344,071	344,071	–
Investment securities available-for-sale	1,389	1,389	–	1,335	1,335	–
Financial liabilities						
Amounts due to credit institutions	114,595	114,595	–	151,950	151,950	–
Amounts due to customers	153,263	148,524	4,378	229,199	229,199	–
Other borrowed funds	99,084	95,228	3,856	46,022	46,022	–
Subordinated loan	20,254	20,254	–	19,395	19,395	–
Total unrecognised change in unrealised fair value			**(2,845)**			–

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

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or have a short term maturity (less than thee months) it is assumed that the carrying amounts approximate to their fair value.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognised with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. For quoted debt issued the fair values are calculated based on quoted market prices. For those notes issued where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term to maturity.

(Thousands of Georgian Lari)

24. Fair values of financial instruments (continued)

Financial instruments recorded at fair value

Certain financial instruments (investment securities available-for-sale) are recorded at fair value using valuation techniques as observable market data are not available. Their fair value is determined using a valuation model that has been tested against the prices of actual market transactions and using the Bank's best estimate of the most appropriate model inputs. These are adjusted to reflect the spread for bid and ask prices to reflect costs to close out positions, counterparty current spread and limitations in the models. Also, profit calculated when such financial instruments are first recorded ('Day 1' profit) is deferred and recognised only when the inputs become observable or on derecognition of the instrument.

25. Maturity analysis of financial assets and liabilities

The table below shows an analysis of financial assets and liabilities according to when they are expected to be recovered or settled. See Note 23 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2008			*2007*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Financial assets						
Cash and cash equivalents	46,730	–	**46,730**	79,130	–	**79,130**
Amounts due from credit institutions	4,877	2,330	**7,207**	16,361	4,072	**20,433**
Loans to customers	69,735	256,035	**325,770**	83,557	260,512	344,071
Investment securities available-for-sale	–	1,389	**1,389**	–	1,335	**1,335**
Total	**121,342**	**259,754**	**381,096**	**179,048**	**265,921**	**444,969**
Financial liabilities						
Amounts due to credit institutions	49,908	64,687	**114,595**	65,484	86,466	**151,950**
Amounts due to customers	134,215	19,048	**153,263**	209,336	19,863	**229,199**
Other borrowed funds	9,024	90,060	**99,084**	24,750	21,272	**46,022**
Subordinated debt	250	20,004	**20,254**	296	19,099	**19,395**
Total	**193,398**	**193,798**	**387,196**	**299,866**	**146,700**	**446,566**
Net	***(72,056)***	***65,956***	***(6,100)***	***(120,818)***	***119,221***	***(1,597)***

The Bank's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant negative liquidity mismatch in the period less than one year, resulting from a significant concentration of deposits from VTB Bank OJSC.

The Bank has received significant funds from VTB Bank OJSC. Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

The Bank has received significant funds from EBRD. The above table contains an analysis of monetary assets and liabilities based on contractual maturity of EBRD loan grouped on the basis of the remaining period from the balance sheet date to the contractual maturity date: less than 3 months – GEL 2,406; from 3 months to 1 year – GEL 1,852; from 1 year to 5 years - GEL 13,039. The Bank is subject to restrictive covenants in relation to borrowings from EBRD. As of 31 December 2008 the Bank did not comply with covenants relating to the EBRD facility. EBRD has been informed of this non-compliance and agreed currently not to demand the facilities before maturity. Under the agreement terms EBRD has the right to withdraw loans before the contractual termination of the loan agreement in case of default of covenants maintenance.

Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank and its compliance with regulatory liquidity ratios. Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

(Thousands of Georgian Lari)

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

Long-term loans are generally not available in Georgia. However, in the Georgian marketplace, many short-term credits are granted with the expectation of renewing the loans at maturity. As such, the ultimate maturity of assets may be different from the analysis presented above. In addition, the maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due on demand in the tables above.

Included in amounts due to customers are term deposits of individuals.

26. Related party disclosures

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

In accordance with IAS 24 "Related Party Disclosures" the following counterparties are considered to be related:

(a) enterprises that directly or indirectly through one or more intermediaries control or are controlled by or are under common control with the reporting enterprise (this includes holding companies subsidiaries and fellow subsidiaries).

(b) associates – enterprises in which the Company has significant influence and which is neither a subsidiary nor a joint venture of the investor.

(c) individuals owning directly or indirectly an interest in the voting power of the Bank that gives them significant influence over the Bank and anyone expected to influence or be influenced by that person in their dealings with the Bank.

(d) key management personnel that is those persons having authority and responsibility for planning directing and controlling the activities of the Bank including directors and officers of the Bank and close members of the families of such individuals; and

(e) enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the Bank and enterprises that have a member of key management in common with the Bank.

In considering each possible related party relationship attention is directed to the substance of the relationship not merely the legal form.

As of 31 December 2008 and 2007 the Bank was part of the VTB Group and all legal entities included in VTB Group were related parties to the Bank. Commencing 1 January 2005 the revised IAS 24 removed the exemption for state-controlled entities. Since the Bank’s parent is a state-owned entity the Bank introduced a policy in accordance with which it discloses transactions and outstanding balances as well as details of guarantees given or received directly and indirectly from entities owned by the Russian Federation. As of 31 December 2008 and 2007 transactions with related parties were performed on market terms unless otherwise disclosed.

(Thousands of Georgian Lari)

26. Related party disclosures (continued)

As of 31 December 2008 and 2007 outstanding balances on related party transactions are as follows:

	2008				*2007*			
	Shareholders	***Entities under common control***	***Key management personnel***	***Total per balance sheet***	***Shareholders***	***Entities under common control***	***Key management personnel***	***Total per balance sheet***
Cash and cash equivalents	65	8,810	–	**46,730**	489	966	–	**79,130**
Amounts due to credit institutions	–	–	–	**7,207**	–		283	**20,433**
Loans to customers, gross		23,913	40	**365,237**	–	985	181	**387,095**
Less: allowance for impairment	–	–		**(39,467)**	–	(20)	(4)	**(42,993)**
Loans to customers, net	–	–	40	**325,770**	–	965	177	**344,071**
Amounts due to credit institutions	108,229	5	–	**114,595**	147,269	14	–	**151,950**
Amounts due to customers	–	1,690	630	**153,263**	–	110	370	**229,199**
Other borrowed funds	78,144	–	–	**99,084**	16,476	–	–	**46,022**
Subordinated loan	20,254	–	–	**20,254**	19,395	–	–	**19,395**

Related party transactions include the current account of VTB Bank. The Parent bank placed GEL 91,509 (in 2007 – GEL 112,923) with Bank for the purpose of financing long-term project under an agreement dated 16 September 2005 between Parent Bank and the Bank. The interest payable on this current account is 12.25% p.a. Refer to Note 14. Current accounts also include loans from VTB Bank OJSC for total amount of GEL 16,110 (in 2007 – GEL 33,730) with contractual maturities of 3 months and current account of GEL 610 (in 2007 – GEL 616).

Borrowings from Parent bank (other borrowed funds and subordinated loan) include loans of GEL 76,958 thousand (in 2007 – GEL 33,730) which bear interest rates ranging from 9.50% to 15.00% per annum. On 25 October 2005, the Bank entered into a subordinated loan agreement with the Parent Bank. The amount of this loan is GEL 20,254 thousand as of 31 December 2007 (in 2007- GEL 19,395). The loan bears an interest rate of Libor+3.5% which is payable quarterly and matures on 25 October 2011. In the case of a liquidation of the Bank, this loan is only repayable after all the obligations to the Bank senior creditors have been met. Refer to Notes 14, 16 and 17.

Profit and loss on related party transactions are presented in the table below:

	2008				*2007*			
	Shareholders	***Entities under common control***	***Key management personnel***	***Total per statement of operations***	***Shareholders***	***Entities under common control***	***Key management personnel***	***Total per statement of operations***
Interest income	1	1,117	2	**61,332**	1	341	44	**65,807**
Interest expense	17,128	303	11	**(33,788)**	(20,373)	(179)	(42)	**(40,633)**
Allowance for loan impairment	–			**(72,748)**		(3)	2	**(15,517)**
Fee and commission income				**4,631**				**5,775**
Fee and commission expense				**(1,149)**	(72)	(25)		**(1,474)**
Other income				**1,652**		38		**1,103**
Gain arising from sale of financial assets at fair value through profit or loss	28,683			**38,342**				**–**
Other operating expenses				**(10,708)**		(1)	(1,330)	**(8,221)**

Compensation of key management personnel was comprised of the following:

	2008	***2007***
Salaries and other short-term benefits	2,214	1,348
Social security costs	–	270
Total key management compensation	**2,214**	**1,618**

Key management personnel as of 31 December 2008 comprise 15 (2007 –16) members of the Supervisory Board and the Management Board of JSC VTB Bank (Georgia).

(Thousands of Georgian Lari)

27. Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the ratios established by the Financial Supervisory Agency of Georgia (the "FSA") in supervising the Bank.

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

Capital adequacy ratio

Regulatory capital consists of Tier 1 capital, which comprises share, reserve fund and retained earnings excluding current year profit less amount of property revaluation reserve transferred to authorised capital and intangible assets. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the FSA. The other component of regulatory capital is Tier 2 capital, which includes profit of current year, general reserves (not more than 1.25% of risk weighted assets) and subordinated long-term debt.

The FSA requires banks to maintain a minimum capital adequacy ratio of 12% of risk-weighted assets, computed based on the NBG guidelines. Capital adequacy ratios of the Bank calculated based on these financial statements are as follows:

	2008	*2007*
Tier 1 capital	50,524	35,867
Tier 2 capital	(15,095)	15,519
Less: deductions from capital		(1,297)
Total regulatory capital for ratio calculation	**35,429**	**50,089**
Risk weighted assets	**384,197**	**500,511**
Capital adequacy ratio	9.22%	10.01%

The Bank was not in compliance with the capital adequacy ratio calculated based on the NBG requirement as at 31 December 2008, and has accordingly obtained a waiver letter on capital adequacy ratio from the FSA until 31 May 2009. With the planned increase in share capital by the end of May 2009 as described in Note 28, the Bank will return to compliance with the minimum capital adequacy requirement.

28. Events after the balance sheet date

On 6 March 2009 OJSC VTB Bank entered into an agreement with Zaza Sioridze and Anton Ingorokva, minority shareholders of VTB Bank Georgia, for the acquisition of their total 7.13% minority shares, thereby increasing the share ownership of OJSC VTB Bank in VTB Bank Georgia from 77.57% as of 31 December 2008 to 84.7%.

On 14 April 2009, the Supervisory Board of the Bank approved the additional issuance of shares to increase the share capital by 9 million USD. The major shareholder of the Bank, VTB Bank OJSC, intends to exercise its pre-emptive right and will transfer 7.6 million USD, its proportionate share in ownership, by end of May 2009. After the increase in share capital, the Bank will be in compliance with the capital adequacy requirement of NBG (pending from the Bank - filing of application for increase in share capital).