JSC VTB Bank (Georgia)

Consolidated Financial Statements

Year ended 31 December 2009
Together with Independent Auditors' Report

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INDEPENDENT AUDITORS' REPORT

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

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

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

ERNST & YOUNG LLC

26 April 2010

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As of 31 December 2009

(Thousands of Georgian Lari)

	Notes	*2009*	*2008*
Assets			
Cash and cash equivalents	5	60,972	46,730
Amounts due from credit institutions	6	5,557	7,207
Loans to customers	7	255,431	325,770
Investment securities:	8		
Available-for-sale		113	1,389
Held-to-maturity		9,445	-
Property and equipment	9	30,043	31,645
Intangible assets	10	509	256
Investment property	11	13,925	1,540
Current income tax assets	12	286	603
Deferred income tax assets	12	6,139	4,771
Other assets	14	1,191	623
Total assets		**383,611**	**420,534**
Liabilities			
Amounts due to credit institutions	15	87,555	114,595
Amounts due to customers	16	153,052	153,263
Other borrowed funds	17	81,338	99,084
Subordinated loan	18	20,494	20,254
Deferred income tax liabilities	12	2	-
Other liabilities	14	5,409	5,292
Total liabilities		**347,850**	**392,488**
Equity			
Share capital	19	104,543	86,356
Property revaluation reserve	19	1,969	5,692
Accumulated losses		(70,751)	(64,002)
Total equity		35,761	**28,046**
Total liabilities and equity		**383,611**	**420,534**

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

Archil Kontselidze
General Director

Irakli Chakhnashvili
Deputy Chief Accountant

26 April 2010

The accompanying notes on pages 6 to 44 are an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2009

(Thousands of Georgian Lari)

	Notes	2009	2008
Interest income			
Loans to customers		57,312	57,640
Cash and cash equivalents		147	2,718
Amounts due from credit institutions		104	151
Investment securities available for sale		32	823
		57,595	**61,332**
Interest expense			
Amounts due to credit institutions		(20,800)	(20,921)
Amounts due to customers		(11,232)	(12,843)
Amounts due to the National Bank of Georgia		(6)	(24)
		(32,038)	**(33,788)**
Net interest income		25,557	27,544
Loan impairment charge	7	(13,290)	(72,748)
Net interest income/ (expense) after loan impairment charge		**12,267**	**(45,204)**
Net fee and commission income	21	2,691	3,482
Net gains/ (losses) from foreign currencies:			
- dealing		3,637	4,356
- translation differences		(23)	776
Gain arising from sale of investment securities available-for-sale		14	-
Impairment of investment securities available-for-sale	8	(1,076)	-
Gain arising from sale of financial assets at fair value through profit or loss	22	-	38,342
Other income	23	3,303	1,652
Non-interest income		8,546	48,608
Personnel expenses	24	(16,711)	(17,108)
Depreciation and amortisation	9, 10	(2,357)	(2,514)
Other operating expenses	24	(9,154)	(10,708)
Other impairment and provisions	13	(745)	(3,326)
Non-interest expenses/losses		**(28,967)**	**(33,656)**
Loss before income tax expense		(8,154)	(30,252)
Income tax benefit	12	815	1,825
Loss for the year		**(7,339)**	**(28,427)**

The accompanying notes on pages 6 to 44 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2009

(Thousands of Georgian Lari)

	Note	*2009*	*2008*
Loss for the year		(7,339)	(28,427)
Other comprehensive income:			
Revaluation of buildings	9	(3,686)	-
Income tax relating to components of other comprehensive income	12	553	-
Other comprehensive loss for the year, net of tax		**(3,133)**	**-**
Total comprehensive loss for the year		**(10,472)**	**(28,427)**

The accompanying notes on pages 6 to 44 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2009

(Thousands of Georgian Lari)

	Share capital	*Property revaluation reserve*	*Accumulated losses*	*Total equity*
As of 31 December 2007	**65,082**	**5,824**	**(35,707)**	**35,199**
Total comprehensive loss for the year			(28,427)	(28,427)
Depreciation of revaluation reserve, net of tax		(126)	126	-
Transfer of property revaluation reserve upon disposal, net of tax		(6)	6	-
Issuance of share capital (Note 19)	21,274			21,274
As of 31 December 2008	**86,356**	**5,692**	**(64,002)**	**28,046**
Total comprehensive loss for the year		(3,133)	(7,339)	(10,472)
Depreciation of revaluation reserve, net of tax		(124)	124	-
Transfer of property revaluation reserve upon disposal, net of tax		(466)	466	-
Issuance of share capital (Note 19)	18,187			18,187
As of 31 December 2009	**104,543**	**1,969**	**(70,751)**	**35,761**

The accompanying notes on pages 6 to 44 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2009

(Thousands of Georgian Lari)

	Notes	2009	2008
Cash flows from operating activities			
Interest received		55,682	60,863
Interest paid		(31,822)	(39,614)
Fees and commissions received		3,652	4,637
Fees and commissions paid		(1,237)	(1,190)
Realised gains less losses from dealing in foreign currencies		3,637	4,393
Other income received		3,320	39,918
Personnel expenses paid		(16,224)	(16,542)
Other operating expenses paid		(7,576)	(11,405)
Cash flows from operating activities before changes in operating assets and liabilities		**9,432**	**41,060**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		1,650	13,221
Loans to customers		47,129	(53,433)
Other assets		(74)	(1,554)
Net increase/(decrease) in operating liabilities		-	
Amounts due to credit institutions		(26,382)	(36,957)
Amounts due to customers		(1,209)	(68,881)
Other liabilities		(1,334)	(100)
Net cash flows from/(used in) operating activities before income tax		**29,212**	**(106,644)**
Income tax paid		-	1,202
Net cash from/(used in) operating activities		**29,212**	**(105,442)**
Cash flows from investing activities			
Purchase of investment securities		(9,428)	(54)
Proceeds from sale and redemption of investment securities		214	-
Purchase of property, equipment and intangible assets	9, 10	(6,105)	(2,289)
Proceeds from sale of property and equipment		603	-
Proceeds from disposal of investment property		50	-
Purchases of investment property		(1,098)	63
Net cash used in investing activities		**(15,764)**	**(2,280)**
Cash flows from financing activities			
Proceeds from issuance of share capital	19	18,187	21,274
Proceeds from other borrowed funds		9,272	61,707
Repayments of other borrowed funds		(26,676)	(7,711)
Net cash from financing activities		**783**	**75,270**
Effect of exchange rates changes on cash and cash equivalents		11	52
Net increase / (decrease) in cash and cash equivalents		**14,242**	**(32,400)**
Cash and cash equivalents, beginning	5	**46,730**	**79,130**
Cash and cash equivalents, ending	5	**60,972**	**46,730**

The accompanying notes on pages 6 to 44 are an integral part of these consolidated financial statements.

(Thousands of Georgian Lari)

1. Principal activities

JSC VTB Bank (Georgia) (the "Bank") is 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 of 31 December 2009 the Bank has 15 branches (6 of them in Tbilisi) and 3 service centres. As of 31 December 2008 the Bank had 14 branches (5 of them in Tbilisi) and 12 service centers. 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-up 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 up share capital amounts to GEL 0.2 thousands. The company owns and operates tennis courts in Tbilisi.

Shareholders

As of 31 December 2009, the following shareholders owned more than 2% of the outstanding shares. Other shareholders individually owned less than 2% of the outstanding shares:

Shareholder	*2009* %	*2008* %
VTB Bank OJSC	87.38	77.57
European Bank of Reconstruction and Development (EBRD)	7.39	8.95
Lacarpa Enterprises Limited	2.94	3.56
Anton Ingorokva	-	3.57
Zaza Sioridze	-	3.56
Other	2.29	2.79
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 the Russian Federation ("RF"), acting through the Federal Property Agency, which holds 85.5% of VTB's issued and outstanding shares as of 31 December 2009 (2008 – 77.5%).

As of 31 December 2009 none of the Supervisory Council and Management Board owned shares of the Bank. As of 31 December 2008, 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 2009 the Bank had 739 employees (2008: 796).

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.

(Thousands of Georgian Lari)

2. Basis of preparation (continued)

General (continued)

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.

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

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

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

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

The Bank has elected to present comprehensive income in two separate statements: consolidated income statement and consolidated statement of comprehensive income. The Bank has not provided a restated comparative consolidated statement of financial position for the earliest comparative period, as it has not adopted any new accounting policies retrospectively, or has made a retrospective restatement or retrospectively reclassified items in the consolidated financial statements.

The amendments to IFRS 7 were issued in March 2009, to enhance fair value and liquidity disclosures. With respect to fair value, the amendments require disclosure of a three-level fair value hierarchy, by class, for all financial instruments recognised at fair value and specific disclosures related to the transfers between levels in the hierarchy and detailed disclosures related to level 3 of the fair value hierarchy. In addition, the amendments modify the required liquidity disclosures with respect to derivative transactions and assets used for liquidity management. Comparative information has not been provided as permitted by the transition provisions of the amendment.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

IFRS 7 "Financial Instruments: Disclosures"

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

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

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

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

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

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

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

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

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

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

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 income statement

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

Losses allocated to minority interest do not exceed the minority interest in the equity of the subsidiary unless there is a binding obligation of the minority to fund the losses. All such losses are allocated to the 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 and subsequently can reclassify financial assets in certain cases as described below.

3. Summary of significant accounting policies (continued)

Financial assets (continued)

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 income statement. 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 income statement when the inputs become observable, or when the instrument is derecognised.

Held-to-maturity investments

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

Loans and receivables

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

Available-for-sale financial assets

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

Determination of fair value

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

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

Offsetting

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Financial assets (continued)

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- a financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity;
- other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Bank has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

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.

Derivative financial instruments

In the normal course of business, the Bank enters into various derivative financial instruments including futures, forwards, swaps and options in the foreign exchange and capital markets. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the consolidated income statement as gains less losses from trading securities or gains less losses from foreign currencies dealing, depending on the nature of the instrument.

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair value on the trading portfolio with changes in fair value recognised in the consolidated income statement.

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, amounts due to customers other borrowed funds and subordinated loans. 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 income statement hen the borrowings are derecognised as well as through the amortisation process.

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

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.

Impairment of financial assets

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

Amounts due from credit institutions and loans to customers

For amounts due from credit institutions and loans to customers carried at amortised cost, the 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 income statement. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the consolidated income statement.

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

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the 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.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Impairment of financial assets continued (continued)

Held-to-maturity financial investments

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

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

Available-for-sale financial investments

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

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

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

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.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

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 income statement.

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 income statement. The premium received is recognised in the consolidated income statement 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 reporting date.

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

Georgia also has various operating taxes 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.

3. Summary of significant accounting policies (continued)

Property and equipment (continued)

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

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

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis 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 of 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;

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.

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Share capital (continued)

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 of 31 December 2009 and 2008.

Dividends

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

Contingencies

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

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 reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the consolidated income statement as gains less losses from foreign currencies - translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as of 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 2009 and 31 December 2008 were 1.6858 GEL and 1.6670 GEL to 1 USD, respectively. The official NBG rate as of 26 April 2010 is 1.7519 GEL to 1 USD.

Future changes in accounting policies

Standards and interpretations issued but not yet effective

Amendment to IAS 39 "Financial Instruments: recognition and measurement" - Eligible Hedged Items

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

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

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

IFRS 2 Share-based Payment: Group Cash-settled Share-based Payment Transactions

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

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

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

(Thousands of Georgian Lari)

3. Summary of significant accounting policies (continued)

Future changes in accounting policies (continued)

Improvements to IFRS

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

- IAS 7 Statement of Cash Flows: Explicitly states that only expenditure that results in recognising an asset can be classified as a cash flow from investing activities.
- IAS 36 Impairment of Assets: The amendment clarifies that the largest unit permitted for allocating goodwill, acquired in a business combination, is the operating segment as defined in IFRS 8 before aggregation for reporting purposes. The amendment will have no impact on the Bank as the annual impairment test is performed before aggregation.

Amendments to IAS 32 "Financial instruments: Presentation": Classification of Rights Issues"

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

IFRS 9 "Financial Instruments"

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

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.

(Thousands of Georgian Lari)

4. Significant accounting judgements and estimates (continued)

Estimation uncertainty (continued)

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

The Bank regularly reviews the value of its property (land, office buildings and investment property) for compliance with fair value and performs revaluation to ensure that the current carrying amount of property 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.

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

	2009	2008
Cash on hand	20,298	14,977
Current accounts with the NBG	33,029	9,259
Current accounts with other credit institutions	7,645	22,494
Cash and cash equivalents	**60,972**	**46,730**

As of 31 December 2009, 76% of total current accounts with credit institutions are placed with 2 non-resident credit institutions (2008 – 83%).

Non-cash transactions performed by the Bank during 2009 are represented by the acquisition of inventory and property and equipment for GEL 85 (2008 – GEL 6).

6. Amounts due from credit institutions

	2009	2008
Obligatory reserve with the NBG	3,801	5,466
Time deposits with credit institutions	1,434	1,426
Restricted nostro account in Deutsche Bank, AG (Germany)	322	315
Amounts due from credit institutions	**5,557**	**7,207**

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 (2008: 0.5%).

As of 31 December 2009, GEL 1,014 (2008 – GEL 1,061) 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 930 was placed in two Georgian banks (2008 – GEL 894) and GEL 84 was with a US bank (2008 – GEL 167).

7. Loans to customers

	2009	2008
Corporate lending	189,246	214,910
Small business lending	51,001	83,188
Consumer lending	41,442	59,751
Loans to individuals secured by deposits	7,999	178
Other loans to individuals	5,713	7,210
Gross loans to customers	**295,401**	**365,237**
Less – Allowance for impairment	(39,970)	(39,467)
Loans to customers, net	**255,431**	**325,770**

(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 2009	*Small business lending 2009*	*Consumer lending 2009*	*Other loans to individuals 2009*	*Total 2009*
At 1 January 2009	30,447	3,865	1,615	3,540	**39,467**
Charge for the year	2,514	8,029	2,630	117	**13,290**
Recoveries of previously written off loans	6,872	229	436	2,116	**9,653**
Amounts written off	(11,019)	(6,569)	(3,673)	(1,179)	**(22,440)**
At 31 December 2009	**28,814**	**5,554**	**1,008**	**4,594**	**39,970**
Individual impairment	27,089	182	-	4,371	**31,642**
Collective impairment	1,725	5,372	1,008	223	**8,328**
	28,814	**5,554**	**1,008**	**4,594**	**39,970**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	50,213	233	-	4,576	**55,022**

	Corporate lending 2008	*Small business lending 2008*	*Consumer lending 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	3,925	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**	**3,865**	**1,615**	**3,540**	**39,467**
Individual impairment	28,456	231	-	3,122	**31,809**
Collective impairment	1,991	3,634	1,615	418	**7,658**
	30,447	**3,865**	**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**

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized, as of 31 December 2009, comprised GEL 4,459 (2008 – GEL 5,833).

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

- For commercial lending, charges over real estate properties, inventory, 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.

(Thousands of Georgian Lari)

7. Loans to customers (continued)

During the year, the Bank took possession of collateral with an estimated fair value of GEL 12,635 (2008 – GEL1,540), 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 2009, the Bank had a concentration of loans represented by GEL 149,883 due from the ten largest third party borrowers (51% of gross loan portfolio) (2008 – GEL 177,072 or 48%). An allowance of GEL 22,730 (2008 – GEL 11,947) was recognised against these loans. Included in total loans to customers is an exposure to a single borrower GEL 66,125 or 22% of total loan portfolio (2007 - GEL 84,975; 23%), 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:

	2009	*2008*
Private companies	221,833	250,260
Individuals	73,568	114,977
	295,401	**365,237**

As of 31 December 2009 and 2008 loans are principally issued within Georgia and their distribution by industry sectors is as follows:

	2009	*2008*
Energy	105,521	129,424
Individuals	73,568	114,977
Trading and service enterprises	68,103	67,499
Real estate construction	30,205	37,025
Manufacturing	7,877	9,175
Agriculture and food processing	1,148	844
Telecommunication and transportation	1,567	1,570
Other	7,412	4,723
	295,401	**365,237**

8. Investment securities

As of 31 December 2009 securities available-for-sale comprised corporate shares of 4 Georgian companies with total carrying value of GEL 112 and held-to-maturity securities of National Bank of Georgia with total carrying value of GEL 9,445. As of 31 December 2008 the Bank's investment in available-for-sale securities included corporate shares of 6 Georgian Companies with carrying value of GEL 1,389. This included purchase during 2008 of 10% investment in United Clearing Centre a Georgian company engaged in clearance of utility payments.

The movement in allowance of impairment of investment securities is given below:

	Investment securities available for sale
As of 31 December 2008	**-**
Write-offs	-
As of 31 December 2009	**-**
Charge	1,076
Write-offs	(1,076)
As of 31 December 2009	**-**

The charge and write-off is attributed to the investment in non-quoted corporate shares of a Georgian company JSC "Gudauri" equal to 8.5% of share capital of the company that the Bank held in 2008 and 2009. In 2009 the company reported net loss and negative equity for period ended 31 December 2009. As a result the Bank recognised impairment of its investment for full amount and consequently wrote it off as it does not expect to obtain any future economic benefits related to this investment.

(Thousands of Georgian Lari)

9. Property and equipment

The movements in property and equipment during 2009 and 2008 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 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**
Additions	1,767	486	490	63	88	2,953	5,847
Disposals	(916)	(241)	(419)	(323)	(305)		(2,204)
Loss on revaluation of premises recognised in income statement	(505)						(505)
Loss on revaluation of premises recognised in other comprehensive income	(4,101)						(4,101)
31 December 2009	**25,414**	**5,297**	**3,209**	**1,928**	**321**	**3,031**	**39,200**
Accumulated depreciation							
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)**
Depreciation charge	(585)	(800)	(425)	(389)	(72)		**(2,271)**
Disposals	106	230	319	206	305		**1,166**
Loss on revaluation of premises recognised in income statement	51						**51**
Loss on revaluation of premises recognised in other comprehensive income	415						**415**
31 December 2009	**(2,276)**	**(3,942)**	**(1,737)**	**(1,121)**	**(81)**	**-**	**(9,157)**
Net book value:							
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**
31 December 2009	**23,138**	**1,355**	**1,472**	**807**	**240**	**3,031**	**30,043**

On 30 September 2009, 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. As of 31 December 2009 the independent appraiser performed an analysis of the change in the fair value of buildings that occurred during the period from 30 September 2009 to 31 December of 2009 concluding that no material changes to the fair value of the Bank's premises has occurred since the date of valuation report till 31 December 2009. As a result of this revaluation the Bank recognised loss on revaluation of premises in the total amount of GEL 4,140 with GEL 3,686 reported in consolidated statement of comprehensive income and GEL 454 reported in consolidated income statement and included in other operating expenses (Note 24). In respect of the revaluation performed the Bank recognised reversal of deferred tax liability equal to GEL 553 through consolidated statement of comprehensive income and GEL 68 through consolidated income statement. As of December 31, 2009, a deferred tax liability for the amount of GEL 374 (2008 – GEL 1,017) was calculated in respect of the above fair value revaluation.

If no revaluation of property and equipment had been performed, the original cost of property and equipment as of December 31, 2009 and December 31, 2008 recorded under the caption "Land andBuildings " would have amounted to GEL 22,547 (2008 – GEL 21,698) and accumulated depreciation would have amounted to GEL 2,117 (2008 – GEL 1,645).

The total value of fully depreciated property and equipment in use as of 31 December 2009 and 2008 amounted to GEL 2,884 and GEL 2,569, respectively.

(Thousands of Georgian Lari)

10. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
31 December 2007	**172**	**382**	**554**
Additions	-	18	18
31 December 2008	**172**	**400**	**572**
Additions	163	176	339
31 December 2009	**335**	**576**	**911**
Accumulated amortization			
31 December 2007	**(150)**	**(110)**	**(260)**
Amortisation charge	(10)	(46)	(56)
31 December 2008	**(160)**	**(156)**	**(316)**
Amortisation charge	(24)	(62)	(86)
31 December 2009	**(184)**	**(218)**	**(402)**
Net book value:			
31 December 2007	**22**	**272**	**294**
31 December 2008	**12**	**244**	**256**
31 December 2009	**151**	**358**	**509**

11. Investment property

	2009	*2008*
Opening balance at January 1	1,540	-
Disposals	(68)	
Additions	12,963	1,540
Loss on revaluation	(510)	-
Closing balance at 31 December	**13,925**	**1,540**

Investment property is a real estate property comprised of land and buildings which was obtained by the Bank through repossession of collateral on defaulted loans. It was recognized in the consolidated statement of financial position at fair value. As of 31 December 2009 the Bank performed a revaluation of the investment property and recognised loss on revaluation in the amount of GEL 510 that was recorded in the consolidated income statement and included in other operating expenses (Note 24).

12. Taxation

The corporate income tax expense comprises:

	2009	*2008*
Current tax expense	-	-
Deferred tax benefit – origination and reversal of temporary differences	(1,368)	(1,836)
Less deferred tax recognised directly in other comprehensive income	553	11
Income tax benefit	**(815)**	**(1,825)**

Georgian legal entities must file individual tax declarations. Corporate income tax rate in Georgia was reduced from 20% to 15% effective 1 January 2008.

(Thousands of Georgian Lari)

12. Taxation (continued)

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

	2009	*2008*
Loss before income tax expense	**(8,154)**	**(30,252)**
Statutory tax rate	15%	15%
Theoretical income tax benefit at the statutory rate	**(1,223)**	**(4,538)**
Change in unrecognized deferred tax asset	738	1,041
Non-deductible expenditures:		
- interest	-	34
- charity	1	334
- entertainment expense	6	12
Other non-temporary differences	(337)	1,292
Income tax benefit	**(815)**	**(1,825)**

		Origination and reversal of temporary differences			*Origination and reversal of temporary differences*		
	2007	*In the income statement*	*In other comprehensive income*	*2008*	*In the income statement*	*In other comprehensive income*	*2009*
Tax effect of deductible temporary differences:							
Allowance for loan impairment	3,938	(3,058)		880	277		1,157
Tax losses carried forward	2,807	5,941		8,748	1,381		10,129
Accrued interest expense	634	(634)		-	-		-
Financial instruments adjustment for effective interest rates	124	95		219	(219)		-
Accrued expenses	121	560		681	(33)		648
Securities available for sale	-	-		-	161		161
Investment property	-	-		-	76		76
Other	26	(24)		2	10		12
Gross deferred tax asset	**7,650**	**2,880**		**10,530**	**1,653**		**12,183**
Unrecognised deferred tax asset	(3,334)	(1,041)		(4,375)	(738)		(5,113)
Deferred tax assets	**4,316**	**1,839**		**6,155**	**915**		**7,070**
Tax effect of taxable temporary differences:							
Property and equipment	(353)	-		(353)	178		(175)
Property revaluation	(1,028)		11	(1,017)	68	553	(396)
Financial instruments adjustment for effective interest rate	-	-		-	(360)	-	(360)
Other	–	(14)		(14)	14		-
Deferred tax liabilities	**(1,381)**	**(14)**	**11**	**(1,384)**	**(100)**	**553**	**(931)**
Net deferred tax assets	**2,935**	**1,825**	**11**	**4,771**	**815**	**553**	**6,139**

Deferred income tax liabilities on the consolidated statement of position in amount of GEL 2 present are related to the wholly owned subsidiary "GT+" Ltd.

The Bank and its subsidiaries have available GEL 18,713 of tax losses carried forwards which will expire in 2012, GEL 39,604 of tax losses carried forwards which will expire in 2013 and GEL 9,210 of tax losses carried forwards which will expire in 2014, if not utilised.

As of 31 December 2009 current income tax assets amounted to GEL 286 (2008 – GEL 603) which related to current year interest income taxed at the source of payment that can be offset against future income tax payable.

(Thousands of Georgian Lari)

13. Other impairment and provisions

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

	Allowance for impairment of other assets	*Provision for legal claim*	*Total*
31 December 2007	**118**	**-**	**118**
Charge	(8)	3,334	3,326
Written off	(128)	-	(128)
Recoveries	18	-	18
31 December 2008	**-**	**3,334**	**3,334**
Charge	110	635	745
Written off	(110)	-	(110)
Utilization of provision	-	(1,282)	(1,282)
31 December 2009	**-**	**2,687**	**2,687**

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

14. Other assets and liabilities

Other assets comprise:

	2009	*2008*
Prepayments for purchase of premises and equipment	478	219
Unsettled transactions	216	237
Repossessed collateral (equipment)	181	-
Prepaid expenses	168	128
Prepaid operational taxes	69	-
Accrued commission receivable on guarantees and LC	19	33
Other	60	6
Other assets	**1,191**	**623**

Other liabilities comprise:

	2009	*2008*
Provision for legal claim (Notes 13 and 20)	2,687	3,334
Accrued expenses	2,148	1,504
Dividends payable to shareholders of the Bank	233	233
Settlements on plastic cards	108	87
Operational taxes payable	90	9
Settlements on acquisition of property and equipment and inventory (Note 5)	85	11
Unsettled transactions	40	87
Advances paid	18	9
Other	-	18
Other liabilities	**5,409**	**5,292**

15. Amounts due to credit institutions

	2009	*2008*
Current accounts	66,459	92,388
Time deposits and loans	21,096	22,207
Amounts due to credit institutions	**87,555**	**114,595**

(Thousands of Georgian Lari)

15. Amounts due to credit institution (continued)

Current account includes the current account of VTB Bank OJSC for total amount of GEL 66,098 or 98% of total current accounts (in 2008 – GEL 91,509 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 loan from VTB Bank OJSC for total amount of GEL 5,078 or 24% of total term deposits and loans (in 2008 – GEL 16,110 or 73%) with contractual maturity of 3 months. The interest accrued on this loan is 5.43% per annum (2008 – 9.50% - 15.00%).

16. Amounts due to customers

	2009	*2008*
Current accounts	95,671	68,402
Time deposits	57,381	84,861
Amounts due to customers	**153,052**	**153,263**
Held as security against guarantees	**1,301**	**439**
Held as security against settlement operations	**4**	**16**

At 31 December 2009, amounts due to customers of GEL 46,975 (31%) were due to the ten largest third party customers (2008 – GEL 53,207 (35%)).

Included in time deposits are deposits of individuals in the amount of GEL 51,118 (2008 – GEL 62,367) and legal entities – GEL – 6,263 (2008 - GEL 22,494). 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 23.

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

	2009	*2008*
State and budgetary organisations	21,387	7,629
Private enterprises	60,666	67,881
Individuals	70,999	77,753
Amounts due to customers	**153,052**	**153,263**

Included in the current accounts of State and budgetary organization are current accounts of municipal authorities for the total amount of GEL 16,424 as of 31 December 2009 (2008 – nil). Interest rate on those current accounts varies from 14% p.a. to 22% p.a. depending on the amount outstanding on a daily basis. The interest expense recognized in the consolidated income statement for the year ended 31 December 2009 in respect to those current accounts is GEL 773.

An analysis of customer accounts by industry follows:

	2009	*2008*
Individuals	70,999	77,753
Transport and communication	11,541	35,056
Trade and service	28,276	14,367
Government	20,518	5,810
Manufacturing	4,790	5,464
Real estate constructions	3,226	4,323
Energy	2,615	2,958
Insurance	4,731	345
Fuel	745	690
Other	5,611	6,497
Amounts due to customers	**153,052**	**153,263**

(Thousands of Georgian Lari)

17. Other borrowed funds

	2009	*2008*
Borrowings from commercial banks	58,602	72,476
Borrowings from international financial institutions	22,736	26,608
Other borrowed funds	**81,338**	**99,084**

Borrowings from commercial banks as of 31 December 2009 contained facilities in U.S. dollars with maturities ranging from July 2010 till September 2012 (2008 - July 2010 till September 2012) and interest rate from 10.16% till 12.03% and one loan issued in Libor +2% (2008: from 10.16% till 14% ; Libor+2%).

Borrowings from international financial institutions as of 31 December 2009 contained facilities in U.S. dollars and Euro with maturities ranging from April 2010 till December 2032 (2008 - from July 2009 till December 2032) and interest rates from Libor 3.5% till Libor+6.5% and one loan issued in 0.75% (2008 - from Libor +2% till Libor+4.25%; 0.75%).

18. 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+6% payable quarterly and maturing on 26 October 2016. As of 31 December 2009 the outstanding amount was equal to GEL 20,494 (2008- GEL 20,254). In case of liquidation of the Bank, this loan is only repayable after all the obligations to the Bank senior creditors have been met.

19. Equity

Share capital

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

	Number of shares	*Nominal amount*
	Ordinary	*Ordinary*
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**
Increase in share capital	18,187,000	18,187
31 December 2009	**104,542,701**	**104,543**

The number of authorised ordinary shares is 104,575,002 (2008- 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 104,542,701 (2008-86,355,701).

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 2009 there have been 2 share issues: GEL 15,748 in May and GEL 2,439 in November.

Based on the decision made at the extraordinary shareholders' meeting on 8 August 2008 the Bank has prepared an issue prospectus for the issuance of 15,748,425 ordinary shares. The issued prospectus was approved by the Financial Supervisory Agency of Georgia on 15 May 2009 under the order N15–05/1, whereupon the total number of shares has been placed.

Based on the decision made at the extraordinary shareholders' meeting on 24 July 2009 the Bank has prepared an issue a prospectus for the issuance of 2,438,575 ordinary shares. The issued prospectus was approved by the Financial Supervisory Agency of Georgia on 22 October 2009 under the order N22–10/3, whereupon the total number of shares has been placed.

(Thousands of Georgian Lari)

19. Equity (continued)

Dividends

In accordance with the Georgian legislation and the Bank's Bylaws, dividends may only be declared to the shareholders of the Bank from the accumulated undistributed and unreserved earnings as shown in the Bank's consolidated financial statements prepared in accordance with IFRS. The Bank had GEL (70,751) of accumulated losses as of 31 December 2009 (2008 – GEL (64,002)).

Property revaluation reserve

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. As of 31 December 2009 property revaluation reserve was equal to GEL 1,969 (2008: GEL 5,692).

20. Commitments and contingencies

Operating environment

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

The Georgian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The military conflict in August 2008 involving Georgia and the Russian Federation, and the financial crisis which significantly affected global economies from last quarter of 2008. During 2009 Participants of conflict passed to peaceful development and the country is no longer under threat of military conflict, but conflict regions have not come out of difficult economic situation yet.

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 not have a material adverse effect on the financial condition or the results of future operations of the Bank.

A legal case was filed by Harwisk Ltd, a Cypriot based company, against the Bank in the London Court of International Arbitration in 2008. The company has claimed USD 6,500 thousand. On 30 December, 2009 the London Court of International Arbitration issued final award and declared Harwisk Ltd is entitled to GEL 2,555 which was settled in January 2010. Legal costs associated with this case equalled GEL 1,414.

In November 2009 a legal case was filed in the Georgian court of arbitration by the Georgian telecommunications company Caucasus Online against the Bank. The company claims GEL 274 and 0.5% on every overdue day from September 2, 2009 before the court's decision plus related legal costs in amount of GEL 16. The Bank assesses the probability of negative outcome for the Bank of this legal case is possible. Based on the Bank's assessment total maximum amount of loss that could be incurred in connection with this case will not exceed GEL 180.

In 2009 a legal case filed in the Appeal court of Reims by the Lloyd's France, Liberty Mutual Insurance Europe Limited, SA Coface, SA Gan Eurocourtage IARD, Assicurazioni Generali UK branch against the Bank. The petitioners claim 832 kGEL for the guarantee issued by the Bank in 1996. The Bank assesses the probability of negative outcome for the Bank of this legal case as possible, however management believes that it has good chances to win the case. Based on the Bank's assessment total maximum amount of loss that could be incurred in connection with this case will not exceed GEL 832.

(Thousands of Georgian Lari)

20. Commitments and contingencies (continued)

Financial commitments and contingencies

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

	2009	*2008*
Credit-related commitments		
Undrawn loan facilities	7,117	9,095
Guarantees issued	7,345	7,054
Letters of credit	324	454
Financial commitments and contingencies (before deducting collateral)	**14,786**	**16,603**
Less – Cash held as security against letters of credit and guarantees issued	(1,301)	(439)
Financial commitments and contingencies	**13,485**	**16,164**
Operating lease commitments		
Not later than 1 year	78	91
Later than 1 year but not later than 5 years	78	77
	156	**168**

Insurance

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

21. Net fee and commission income

	2009	*2008*
Commission on settlements operations	2,503	2,900
Commission on cash operations	645	987
Commission on guarantees and letters of credit issued	485	646
Other	122	98
Fee and commission income	**3,755**	**4,631**
Commission on settlements operations	(900)	(899)
Commission on cash operations	(83)	(137)
Commission on guarantees and letters of credit issued	(60)	(36)
Other	(21)	(77)
Fee and commission expense	**(1,064)**	**(1,149)**
Net fee and commission income	**2,691**	**3,482**

22. 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.

(Thousands of Georgian Lari)

23. Other income

	2009	*2008*
Penalties received from lending operations	2,246	975
Penalties received for deposit redemption before maturity	837	106
Other penalties	7	29
Gain on sale of repossessed collateral	-	463
Other	213	79
Other income	**3,303**	**1,652**

24. Personnel and other operating expenses

	2009	*2008*
Salaries and bonuses	16,711	17,108
Personnel expenses	**16,711**	**17,108**
Legal and consultancy	1,538	801
Repairs and maintenance of property and equipment	939	834
Office supplies	772	1,059
Communications	663	598
Marketing and advertising	638	1,093
Occupancy and rent	537	861
Operating taxes	515	519
Loss on revaluation of investment property (Note 11)	510	-
Loss on disposal of property and equipment	457	155
Loss on revaluation of property and equipment (Note 9)	454	-
Utilities	390	343
Business travel and related expenses	275	363
Insurance	272	233
Security	259	586
Entertainment	189	258
Penalties incurred	134	262
Net loss from disposal of investment property measured at fair value	25	-
Charity	8	2,227
Other	579	516
Other operating expenses	**9,154**	**10,708**

25. 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.

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.

(Thousands of Georgian Lari)

25. Risk management (continued)

Supervisory Board

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

Management Board

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

Risk measurement and reporting systems (continued)

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)

25. 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 consolidated statement of financial position, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	Notes	*Gross maximum exposure 2009*	*Gross maximum exposure 2008*
Cash and cash equivalents (excluding cash on hand)	5	40,674	31,753
Amounts due from credit institutions	6	5,557	7,207
Loans to customers	7	255,431	325,770
Investment securities	8	9,445	-
All other assets (excluding settlements with tax authorities)		45,668	34,064
		356,775	**398,794**
Financial commitments and contingencies	20	14,786	16,603
Total credit risk exposure		**371,561**	**415,397**

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.
For the purpose of these consolidated financial statements all not past due collectively assessed loans to legal entities (Corporate lending and small business lending) are classified in three quality groups presented in the tables below. The high grade group includes borrowers with sound level of liquidity and profitability. The probability of breach of loan agreement terms is assessed as low. The standard grade includes borrowers with average level of liquidity and profitability. The probability of breach of loan agreement terms is assessed as moderate. Sub-standard grade group includes borrowers with satisfactory level of liquidity and profitability. The probability of breach of loan agreement terms is assessed as above moderate.

For the purpose of these consolidated financial statements all not past due collectively assessed loans to individuals are classified in three quality groups presented in the tables below. The high grade group includes borrowers with good debt servicing and excellent financial position of the borrower, loans secured with deposits, loans secured with gold. The standard grade group includes borrowers with good/average debt servicing and excellent/moderate financial position of the borrower. The sub-standard grade group is represented by loans with average debt servicing and moderate financial position of the borrower.

(Thousands of Georgian Lari)

25. Risk management (continued)

Credit risk (continued)

The table below shows the credit quality by class of asset for loan-related lines in the statement of financial position.

		Neither past due nor impaired			*Past due or*	
	Notes	***High grade 2009***	***Standard grade 2009***	***Sub-standard grade 2009***	***individually impaired 2009***	***Total 2009***
Amounts due from credit institutions	6	5,557	-	-	-	5,557
Loans to customers						
Corporate lending		95,570	28,454	13,658	51,564	189,246
Small business lending		7,355	30,990	6,813	5,843	51,001
Consumer lending		21,668	17,464	946	1,364	41,442
Loans to individuals secured with deposits		7,999	-	-	-	7,999
Other loans to individuals		6	772	96	4,839	5,713
	7	**132,598**	**77,680**	**21,513**	**63,610**	**295,401**
Total		**138,155**	**77,680**	**21,513**	**63,610**	**300,958**

		Neither past due nor impaired			*Past due or*	
	Notes	***High grade 2008***	***Standard grade 2008***	***Sub-standard grade 2008***	***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 to individuals 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**

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.

(Thousands of Georgian Lari)

25. Risk management (continued)

Credit risk (continued)

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

	Less than 30 days 2009	*31 to 60 days 2009*	*61 to 90 days 2009*	*More than 90 days 2009*	*Total 2009*
Loans to customers					
Corporate lending	208	-	-	1,143	1,351
Small business lending	455	1,309	474	3,372	5,610
Consumer lending	598	162	218	386	1,364
Loans collateralized with deposits	-	-	-	-	-
Other loans to individuals	58	-	-	205	263
Total	**1,319**	**1,471**	**692**	**5,106**	**8,588**

	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
Loans collateralized with deposits	-	-	-	-	-
Other loans to individuals	50	-	-	253	303
Total	**2,196**	**861**	**1,597**	**2,102**	**6,756**

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.

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

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

	2009	*2008*
Loans to customers		
Corporate lending	48,454	39,316
Small business lending	5,897	411
Consumer lending	2,205	-
Loans secured by deposits	712	-
Other loans to individuals	206	224
Total	**57,474**	**39,951**

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.

25. Risk management (continued)

Credit risk (continued)

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 incurred 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.

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

	2009				*2008*			
	Georgia	***OECD***	***CIS and other foreign countries***	***Total***	***Georgia***	***OECD***	***CIS and other foreign countries***	***Total***
Assets:								
Cash and cash equivalents	54,160	6,639	173	60,972	25,699	20884	147	46,730
Amounts due from credit institutions	5,150	407		5,557	6,725	482	-	7,207
Loans to customers	255,431			255,431	325,770	-	-	325,770
Investment securities								
available-for-sale	113			113	1,389	-	-	1,389
held to maturity	9,445			9,445	-	-	-	-
Other assets	52,093			52,093	39,438			39,438
	376,392	**7,046**	**173**	**383,611**	**399,021**	**21,366**	**147**	**420,534**
Liabilities:								
Amounts due to credit institutions	13,558	88	73,909	87,555	6,150	212	108,233	114,595
Amounts ue to customers	142,783	7,483	2,786	153,052	137,583	4,094	11,586	153,263
Other borrowed funds		31,607	49,731	81,338	-	38,237	60,847	99,084
Subordinated loan			20,494	20,494	-	-	20,254	20,254
Other liabilities	2,639	2,772		5,411	5,292	-	-	5,292
	158,980	**41,950**	**146,920**	**347,850**	**149,025**	**42,543**	**200,920**	**392,488**
Net assets/(liabilities)	**217,412**	**(34,904)**	**(146,747)**	**35,761**	**249,996**	**(21,177)**	**(200,733)**	**28,046**
Net financial commitments	**14,144**	**34**	**608**	**14,786**	**15,005**	**1,557**	**42**	**16,603**

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.

(Thousands of Georgian Lari)

25. Risk management (continued)

Liquidity risk and funding management (continued)

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratio established by National Bank of Georgia (NBG). As of 31 December, the ratio was as follows:

	2009, %	***2008, %***
LK "Average Liquidity Ratio" (Average monthly volume of liquid assets / Average monthly volume of liabilities)	42%	25%

In 2009 minimum limit of average liquidity ratio is 20% (2008: 20%).

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2009 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 of 31 December 2009	***Less than 3 months***	***3 to 12 months***	***1 to 5 years***	***Over 5 years***	***Total***
Amounts due to credit institutions	26,151	22,154	39,250	-	87,555
Amounts due to customers	109,351	27,542	16,035	124	153,052
Other borrowed funds	3,964	23,802	48,519	5,053	81,338
Subordinated loan	264	-	-	20,230	20,494
Other liabilities	4,913	488	8	-	5,409
Total undiscounted financial liabilities	**144,643**	**73,986**	**103,812**	**25,407**	**347,848**

Financial liabilities As of 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**

Analysis of financial liabilities by remaining contractual maturities (continued)

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***
2009	4,099	5,021	5,659	7	**14,786**
2008	5,823	4,474	6,249	57	**16,603**

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.

(Thousands of Georgian Lari)

25. 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 income statement.

The sensitivity of the consolidated income statement 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 2009***	***Sensitivity of pre-tax income 2009***
USD	0.19%	(86)
USD	(0.19%)	86

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

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 Georgian Financial Supervisory Agency ("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 2009 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 income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on the consolidated income statement. A negative amount in the table reflects a potential net reduction in consolidated income statement or equity, while a positive amount reflects a net potential increase.

Currency	***Increase in currency rate in % 2009***	***Effect on profit before tax 2009***	***Increase in currency rate in % 2008***	***Effect on profit before tax 2008***
USD	16.20%	(14,523)	11.20%	(1,567)
EUR	13.20%	(2,963)	19.30%	(207)

Currency	***Decrease in currency rate in % 2009***	***Effect on profit before tax 2009***	***Decrease in currency rate in % 2008***	***Effect on profit before tax 2008***
USD	(16.20%)	14,523	(11.20%)	1,567
EUR	(13.20%)	2,963	(19.30%)	207

25. 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
2009	6,582
2008	6,471

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 2009 the Bank obtained Banker's Blanket Bond and Computer Crime insurance coverage of GEL 1,264 (2008: GEL 1,250) from Lloyd's insurance company.

26. Fair value of financial instruments

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

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

As of December 31, 2009 the Bank's investments recognized at fair value comprised of investments in securities available for sale GEL 113 (2008: GEL 1,383).

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

At 31 December 2009	*Level 1*	*Level 2*	*Level 3*	*Total*
Financial assets				**-**
Investment securities - available-for-sale			113	**113**

At 31 December 2008	*Level 1*	*Level 2*	*Level 3*	*Total*
Financial assets				
Investment securities - available-for-sale			1,389	**1,389**

(Thousands of Georgian Lari)

26. Fair value of financial instruments (continued)

Movements in level 3 financial instruments measured at fair value

The following table shows a reconciliation of the opening and closing amount of Level 3 financial assets and liabilities which are recorded at fair value:

	At 1 January 2009	*Total loss recorded in profit or loss*	*Purchases*	*Sales*	*At 31 December 2009*
Financial assets					
Investment securities - available-for-sale	1,389	(1,062)	-	(214)	113
Total level 3 financial assets	1,389	(1,062)	-	(214)	113

Losses on level 3 financial instruments included in the profit or loss for the period comprise of GEL (1,062) of realized losses including gain of GEL 14 on available for sale securities sold and GEL 1,076 of impairment of available for sale securities which were written-off by the end of 2009 (Note 8).

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

	Carrying value 2009	*Fair value 2009*	*Unrecognised gain/(loss) 2009*	*Carrying value 2008*	*Fair value 2008*	*Unrecognised gain/(loss) 2008*
Financial assets						
Cash and cash equivalents	60,972	60,972	-	46,730	46,730	-
Amounts due from credit institutions	5,557	5,557	-	7,207	7,207	-
Loans to customers	255,431	254,365	(1,066)	325,770	314,691	(11,079)
Investment securities held-to-maturity	9,445	9,445	-	-	-	-
Financial liabilities						
Amounts due to credit institutions	87,555	87,555	-	114,595	114,595	-
Amounts due to customers	153,052	150,579	2,473	153,263	148,524	4,739
Other borrowed funds	81,338	77,387	3,951	99,084	95,228	3,856
Subordinated loan	20,494	20,494	-	20,254	20,254	-
Total unrecognised change in unrealised fair value			**5,358**			**(2,484)**

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 three 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.

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.

(Thousands of Georgian Lari)

27. 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 25 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2009			*2008*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Financial assets						
Cash and cash equivalents	60,972	-	60,972	46,730	-	**46,730**
Amounts due from credit institutions	3,521	2,036	5,557	4,877	2,330	**7,207**
Loans to customers	59,462	195,969	255,431	69,735	256,035	**325,770**
Investment securities						
available-for-sale	-	113	113	-	1,389	**1,389**
held-to-maturity	9,445	-	9,445			
Total	**133,400**	**198,118**	**331,518**	**121,342**	**259,754**	**381,096**
Financial liabilities						
Amounts due to credit institutions	48,305	39,250	87,555	49,908	64,687	**114,595**
Amounts due to customers	136,893	16,159	153,052	134,215	19,048	**153,263**
Other borrowed funds	27,765	53,573	81,338	9,024	90,060	**99,084**
Subordinated debt	264	20,230	20,494	250	20,004	**20,254**
Total	**213,227**	**129,212**	**342,439**	**193,398**	**193,798**	**387,196**
Net	**(79,827)**	**68,906**	**(10,921)**	**(72,056)**	**65,956**	**(6,100)**

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 as well as in total, 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 statement of position date to the contractual maturity date: less than 3 months – GEL 2,213; from 3 months to 1 year – GEL 1,860; from 1 year to 5 years - GEL 9,331. As of 31 December 2009 the Bank did not comply with 1 covenant relating to the EBRD facility. EBRD has been informed of this non-compliance and agreed currently in writing 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.

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.

(Thousands of Georgian Lari)

28. 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 2009 and 2008 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 2009 and 2008 transactions with related parties were performed on market terms unless otherwise disclosed.

As of 31 December 2009 and 2008 outstanding balances on related party transactions are as follows:

	2009				*2008*			
	Shareholders	*Entities under common control*	*Key management personnel*	*Total per statement of financial position*	*Shareholders*	*Entities under common control*	*Key management personnel*	*Total per statement of financial position*
Cash and cash equivalents	33	2,701	-	**60,972**	65	8,810	-	**46,730**
Amounts due from credit institutions	-	-	-	**5,557**	-	-	-	**7,207**
Loans to customers, gross	-	25,091	-	**295,401**	-	23,913	40	**365,237**
Less: allowance for impairment	-	-	-	**(39,970)**	-	-	-	**(39,467)**
Loans to customers, net	-	25,091	-	**255,431**	-	-	40	**325,770**
Amounts due to credit institutions	71,465	2,533	-	**87,555**	108,229	5	-	**114,595**
Amounts due to customers	–	932	45	**153,052**	–	1,690	630	**153,263**
Other borrowed funds	63,134	-	-	**81,338**	78,144	-	-	**99,084**
Subordinated loan	20,494	-	-	**20,494**	20,254	-	-	**20,254**

Related party transactions include the current account of VTB Bank. The Parent bank placed GEL 66,098 (in 2008 – GEL 91,509) 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 15. Current accounts also include loans from

28. Related party disclosures (continued)

VTB Bank OJSC for total amount of GEL 5,078 (in 2008 – GEL 16,110) with contractual maturities of 3 months and current account of GEL 201 (in 2008 – GEL 610).

Borrowings from Parent bank (other borrowed funds and subordinated loan) include loans of GEL 70,225 thousand (in 2008 – GEL 76,958) which bear interest rates ranging from 10.16% to 12.03% 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 20,494 thousand as of 31 December 2009 (in 2008- GEL 20,254). The loan bears an interest rate of Libor+6% (2008 - Libor+3.5%) which is payable quarterly and matures on 25 October 2016 (2008 - 25 October 2011). Amendment to agreement concerning prolongation of maturity date and change of interest rate was signed on 30 June 2009. 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 17 and 18.

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

	2009				*2008*			
	Shareholders	***Entities under common control***	***Key management personnel***	***Total per income statement***	***Shareholders***	***Entities under common control***	***Key management personnel***	***Total per income statement***
Interest income	1	4,193	3	**57,595**	1	1,117	2	**61,332**
Interest expense	(19,873)	(296)	(15)	**(32,038)**	17,128	303	11	**(33,788)**
Loan impairment charge	-	-	(1)	**(13,290)**	-	-	-	**(72,748)**
Fee and commission income	-	16	-	**3,755**	-	-	-	**4,631**
Fee and commission expense	-	(52)	-	**(1,064)**	-	-	-	**(1,149)**
Gain arising from sale of financial assets at fair value through profit or loss	-	-	-	**-**	28,683	-	-	**38,342**

Compensation of key management personnel was comprised of the following:

	2009	*2008*
Salaries and other short-term benefits	1,638	2,214
Total key management compensation	**1,638**	**2,214**

Key management personnel as of 31 December 2009 comprise 8 (2008 –15) members of the Supervisory Board and the Management Board of JSC VTB Bank (Georgia).

29. 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 National Bank of Georgia (the "NBG") 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.

(Thousands of Georgian Lari)

29. Capital adequacy (continued)

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 NBG. 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 NBG 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 stand-alone Bank calculated based on these financial statements are as follows:

	2009	*2008*
Tier 1 capital	40,612	50,524
Tier 2 capital	14,093	(15,095)
Total regulatory capital for ratio calculation	**54,705**	**35,429**
Risk weighted assets	**289,376**	**384,197**
Capital adequacy ratio	18.90%	9.22%

The Bank was not in compliance with the capital adequacy ratio calculated based on the NBG requirement as of 31 December 2008, and has accordingly obtained a waiver letter on capital adequacy ratio from the NBG until 31 May 2009.

The Bank was in compliance with the capital adequacy ratio calculated based on the NBG requirement as of 31 December 2009.

30. Events after the reporting period

In January 2010 the Bank finally settled the legal claim of Harwisk Ltd in the amount of GEL 2,555 based on the final award issued by the London Court of International Arbitration on 30 December 2009.

As at 31 March 2010 the Bank was violating 2 prudential ratios of NBG. The waiver letter of the Bank was valid till 31 March 2010.The Bank applied NBG for extension and obtained a new letter waiving violation of prudential ratios till 1 August 2010.