

JSC VTB Bank (Georgia)

Consolidated financial statements

For the year ended 31 December 2010

Together with independent auditors' report

Contents

Independent auditors' report

Consolidated statement of financial position	1
Consolidated income statement.....	2
Consolidated statement of comprehensive income.....	3
Consolidated statement of changes in equity	4
Consolidated statement of cash flows.....	5

Notes to consolidated financial statements

1. Introduction	6
2. Basis of preparation and significant accounting policies.....	6
3. Critical accounting estimates and judgements in applying accounting policies	14
4. Changes in accounting policies and adoption of new or revised standards and interpretations	16
5. New accounting pronouncements	18
6. Cash and cash equivalents	19
7. Amounts due from credit institutions	20
8. Loans to customers.....	20
9. Investment securities held-to-maturity	22
10. Property and equipment	23
11. Investment property	24
12. Taxation	24
13. Other assets and liabilities	25
14. Amounts due to credit institutions	27
15. Amounts due to customers	27
16. Other borrowed funds	28
17. Equity.....	28
18. Commitments and contingencies	29
19. Net fee and commission income.....	30
20. Other income	30
21. Personnel and other operating expenses	31
22. Risk management	31
23. Fair value of financial instruments	39
24. Maturity analysis of financial assets and liabilities	41
25. Related party disclosures.....	42
26. Capital adequacy	43
27. Event after the reporting period	43

Independent auditors' report

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

We have audited the accompanying consolidated financial statements of JSC VTB Bank (Georgia) and its subsidiaries ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2010, 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 information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our 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 about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ERNST & YOUNG LLC

29 April 2011

Consolidated statement of financial position**As of 31 December 2010***(Thousands of Georgian Lari)*

	<i>Notes</i>	<i>2010</i>	<i>2009 (adjusted)</i>
Assets			
Cash and cash equivalents	6	37,988	60,972
Amounts due from credit institutions	7	11,583	5,557
Loans to customers	8	200,458	253,332
Investment securities:			
- Available-for-sale		94	113
- Held-to-maturity	9	31,382	9,445
Property and equipment	10	30,250	30,043
Investment property	11	17,897	13,925
Current income tax assets	12	286	286
Deferred income tax assets	12	7,257	6,456
Other assets	13	3,556	1,698
Total assets		340,751	381,827
Liabilities			
Amounts due to credit institutions	14	5,644	87,555
Amounts due to customers	15	180,576	153,052
Other borrowed funds	16	63,676	81,338
Deferred income tax liabilities		-	2
Other liabilities	13	7,184	5,409
Subordinated loan	25	21,534	20,494
Total liabilities		278,614	347,850
Equity			
Share capital	17	148,043	104,543
Land and buildings revaluation reserve		1,609	1,969
Accumulated losses		(87,515)	(72,535)
Total equity		62,137	33,977
Total liabilities and equity		340,751	381,827

Signed and authorised for release on behalf of the Management Board of the Bank on 29 April 2011.


 Archil Kontselidze
 General Director




 Mamuka Jijaladze
 Chief Accountant

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated income statement**For the year ended 31 December 2010***(Thousands of Georgian Lari)*

	<i>Notes</i>	2010	2009 (adjusted)
Interest income			
Loans to customers		45,903	55,167
Investment securities held-to-maturity		1,393	32
Cash and cash equivalents		1,080	147
Amounts due from credit institutions		21	104
		<u>48,397</u>	<u>55,450</u>
Interest expense			
Amounts due to credit institutions		(12,378)	(20,800)
Amounts due to customers		(12,315)	(11,232)
Amounts due to the National Bank of Georgia and the Government		(1,184)	(6)
		<u>(25,877)</u>	<u>(32,038)</u>
Net interest income			
Loan impairment charge	8	(23,013)	(13,290)
Net interest (expense)/income after loan impairment charge		<u>(493)</u>	<u>10,122</u>
Non-interest income			
Net fee and commission income	19	2,919	2,691
Net gains/(losses) from foreign currencies:			
- dealing		6,454	3,637
- translation differences		(151)	22
Gain arising from sale of investment securities available-for-sale		-	14
Impairment of investment securities available-for-sale		(3)	(1,076)
Net losses from disposal of investment property		(17)	(25)
Net gains/(losses) on investment property revaluation	11	70	(510)
Other income	20	3,044	3,304
Non-interest income		<u>12,316</u>	<u>8,057</u>
Non-interest expenses			
Personnel expenses	21	(17,607)	(16,711)
Depreciation	10	(2,273)	(2,271)
Other operating expenses	21	(7,587)	(8,705)
Other impairment and provisions charge	13	(499)	(745)
Non-interest expenses		<u>(27,966)</u>	<u>(28,432)</u>
Loss before income tax expense			
		(16,143)	(10,253)
Income tax benefit	12	803	1,130
Loss for the year		<u>(15,340)</u>	<u>(9,123)</u>

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income**For the year ended 31 December 2010***(Thousands of Georgian Lari)*

	<i>Note</i>	<i>2010</i>	<i>2009 (adjusted)</i>
Loss for the year		(15,340)	(9,123)
Other comprehensive income:			
Revaluation of land and buildings	10	-	(3,686)
Income tax relating to components of other comprehensive income	12	-	553
Other comprehensive loss for the year, net of tax		<u>-</u>	<u>(3,133)</u>
Total comprehensive loss for the year		<u>(15,340)</u>	<u>(12,256)</u>

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity**For the year ended 31 December 2010***(Thousands of Georgian Lari)*

	<i>Note</i>	<i>Share capital</i>	<i>Land and buildings revaluation reserve</i>	<i>Accumulated losses</i>	<i>Total equity</i>
As of 31 December 2008		86,356	5,692	(64,002)	28,046
Total comprehensive loss for the year (adjusted)		-	(3,133)	(9,123)	(12,256)
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	17	18,187	-	-	18,187
As of 31 December 2009 (adjusted)		104,543	1,969	(72,535)	33,977
Total comprehensive loss for the year		-	-	(15,340)	(15,340)
Depreciation of revaluation reserve, net of tax		-	(43)	43	-
Transfer of property revaluation reserve upon disposal, net of tax		-	(317)	317	-
Issuance of share capital	17	43,500	-	-	43,500
As of 31 December 2010		148,043	1,609	(87,515)	62,137

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of cash flows
For the year ended 31 December 2010

(Thousands of Georgian Lari)

	<i>Notes</i>	2010	2009
Cash flows from operating activities			
Interest received		50,908	55,682
Interest paid		(25,679)	(31,822)
Fees and commissions received		4,161	3,652
Fees and commissions paid		(1,271)	(1,237)
Realised gains less losses from dealing in foreign currencies		6,507	3,637
Other income received		2,909	3,320
Personnel expenses paid		(15,790)	(16,224)
Other operating expenses paid		(7,391)	(7,576)
Cash flows from operating activities before changes in operating assets and liabilities		14,354	9,432
<i>Net (increase)/decrease in operating assets</i>			
Amounts due from credit institutions		(6,338)	1,650
Loans to customers		22,995	47,129
Other assets		(281)	(74)
<i>Net increase/(decrease) in operating liabilities</i>			
Amounts due to credit institutions		(81,149)	(26,382)
Amounts due to customers		26,824	(1,209)
Other liabilities		(740)	(1,334)
Net cash flows (used in)/from operating activities before income tax		(24,335)	29,212
Income tax paid		-	-
Net cash (used in)/from operating activities		(24,335)	29,212
Cash flows from investing activities			
Purchase of investment securities		(69,044)	(9,428)
Proceeds from sale and redemption of investment securities		47,796	214
Purchase of property, equipment and intangible assets		(3,884)	(6,105)
Proceeds from sale of property and equipment		317	603
Proceeds from disposal of investment property		359	42
Purchases of investment property		(277)	(1,090)
Net cash used in investing activities		(24,733)	(15,764)
Cash flows from financing activities			
Proceeds from issuance of share capital	17	43,500	18,187
Other borrowed funds received		17,453	9,272
Redemption of other borrowed funds		(34,936)	(26,676)
Net cash from financing activities		26,017	783
Effect of exchange rates changes on cash and cash equivalents		67	11
Net (decrease)/increase in cash and cash equivalents		(22,984)	14,242
Cash and cash equivalents, beginning	6	<u>60,972</u>	<u>46,730</u>
Cash and cash equivalents, ending	6	<u><u>37,988</u></u>	<u><u>60,972</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

(Thousands of Georgian Lari)

1. Introduction

These consolidated financial statements have been prepared for JSC VTB Bank (Georgia) (the "Bank" hereafter) and its subsidiaries (together referred to as "the Group").

As of 31 December 2010 and 2009 the Bank's subsidiaries include the following wholly-owned companies, registered and operating in Georgia:

- ▶ "Georgian Fund Company" Ltd. Its paid-up share capital amounts to GEL 11. The company operates as a brokerage agent.
- ▶ "GT+". Its paid up share capital amounts to GEL 0.2 . The company owns and operates tennis courts in Tbilisi.

The Bank 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 (the "NBG") on 19 May 1995.

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 corporate and retail customers. Its main office is in Tbilisi, Georgia. As of 31 December 2010 the Bank has 13 branches (5 of them in Tbilisi) and 1 service centre. As of 31 December 2009 the Bank had 15 branches (6 of them in Tbilisi) and 3 service centers.

The Bank's registered legal address is 14 Chanturia str, Tbilisi, Georgia.

As of 31 December 2010, the following shareholders owned more than 1% of the outstanding shares:

<i>Shareholder</i>	<i>2010</i> %	<i>2009</i> %
VTB Bank OJSC	96.31	87.38
Lacarpa Enterprises Limited	2.08	2.94
European Bank of Reconstruction and Development (EBRD)	-	7.39
Other	1.61	2.29
Total	100.0	100.0

VTB Bank OJSC ("the Parent bank") is the immediate parent of the Bank. The ultimate controlling party for the Group is the State of the Russian Federation ("RF"), acting through the Federal Property Agency, which holds 85.5% of issued and outstanding shares of the Parent bank as of 31 December 2010 and 2009.

As of 31 December 2010 and 2009 none of the Supervisory Council and Management Board members owned shares of the Bank.

As of 31 December 2010 the Bank had 693 employees (2009: 739).

2. Basis of preparation and significant accounting policies

Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention except for land and buildings, investment property, investment securities available-for-sale and financial instruments at fair value through profit or loss, which are carried at fair value.

These consolidated financial statements are presented in thousands of Georgian Lari ("GEL"), unless otherwise indicated. GEL is utilised as the functional currency as the majority of the Group'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. Refer to Note 4.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Subsidiaries

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

Financial assets

Initial recognition

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

Date of recognition

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Group commits to purchase 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.

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.

Held-to-maturity investments

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

If the Group has both the intention and ability to hold investment securities available-for-sale to maturity, they may be reclassified as investment securities held-to-maturity. In this case the fair value of securities as of the date of reclassification becomes their new amortised cost. For instruments with a fixed maturity the revaluation reserve as of the date of reclassification is amortised to profit or loss during the period until maturity using the effective interest rate method.

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.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Financial assets (continued)

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 and other relevant valuation models.

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 Group enters into certain derivative financial instruments contracts primarily including foreign exchange forwards and swaps. Such financial instruments are recorded at fair value. The fair values are estimated based on 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 foreign currencies dealing.

Borrowings

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

Amounts due to credit institutions represent funds attracted to manage the Group's liquidity, while other borrowed funds comprises funds received for general capital working purposes and under basic agreements with international credit institutions to finance activities of the Group's customers.

Operating lease - Group as lessee

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

Impairment of financial assets

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

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Impairment of financial assets (continued)

Loans to customers, investment securities held-to-maturity, amounts due from credit institutions

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

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. 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.

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

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group's internal credit grading system that considers credit risk characteristics such as asset type, industry, 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. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Available-for-sale financial investments

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

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss - measured as the difference between the acquisition cost 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.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Restructuring of financial assets

The Group from time to time restructures some of its financial assets. This mostly relates to loans and receivables. The accounting treatment of such restructuring is conducted in 3 basic scenarios:

- ▶ If the currency of the loan has been changed, the old loan is derecognized and the new loan is recognized, which requires the estimation of a new effective interest rate. If the new effective interest rate is below the market interest rate, the loss on initial recognition is recognized in the reporting period.
- ▶ If the loan restructuring is not caused by the financial difficulties of the borrower but the cash flows were renegotiated, the loan is not recognized as impaired. The loan is not derecognised but the new effective interest rate is determined based on the remaining cash flows under the loan agreement till maturity. If the new effective interest rate is below the market rate at the date of restructuring, the new carrying amount is calculated as the fair value of the loan after restructuring, being the present value of the future cash flows discounted using the market rate at the date of restructuring. In this case, the difference between the carrying amount before restructuring and the fair value of the loan after restructuring is recognized as a loss on loans restructuring.
- ▶ If the loan is impaired after restructuring, the Group uses the original effective interest rate in respect of new cash flows to estimate the recoverable amount of the loan. The difference between the recalculated present value of the new cash flows taking into account collateral and the carrying amount before restructuring is included in loan impairment charge for the period.

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Non-performing loans

According to the Group's policy, non-performing loans are derecognized as follows:

- ▶ individually significant loans are being written off based on respective decision of the Bank's Credit committee;
- ▶ other loans are being written off individually when become overdue for 150 days.

In case the Group receives any amounts from the borrower subsequently to the loan write off, respective amounts are recognized within allowance for loan impairment as recoveries.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

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.

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.

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, primarily consisting of letters of credit and guarantees. Financial guarantees are initially recognised in the consolidated financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required 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 Group's activities. These taxes are included as a component of other operating expenses.

Property and equipment

Property and equipment, except for land and buildings, 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. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Property and equipment (continued)

Any revaluation surplus is credited to the revaluation reserve for land and buildings 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.

Construction in progress is carried at cost, less provision for impairment where required. Upon completion, assets are transferred to office premises or other premises at their carrying amount. Construction in progress is not depreciated until the asset is available for use.

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.

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:

	<u>Years</u>
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.

Investment property

Investment property is land or building or a part of a building held to earn rental income or for capital appreciation and which is not used by the Group or held for sale in the ordinary course of business.

Investment property is initially recognized at cost, including transaction costs, and subsequently remeasured at fair value which reflects current market value and represents potential price between knowledgeable, willing parties in an arm's length transaction. Revaluation of investment property is held on each reporting date and recognised in consolidated income statement as gains/losses on investment property revaluation. Earned rental income is recorded in consolidated income statement within other operating income.

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. 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.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Provisions

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

Retirement and other employee benefit obligations

The Group does not have any pension arrangements separate from the State pension system of the Republic of Georgia.

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.

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 Group and the revenue can be reliably measured.

Interest income and expense

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

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

Fee and commission income

Commission income on settlements and cash operations are recognized when the service is delivered to the customer.

Loan commitment fees for loans that are likely to be drawn down and other credit related fees, including fee on guarantees and letters of credit issued, are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

Dividend income

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

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Foreign currency translation

The consolidated financial statements are presented in Georgian Lari, which is the Group'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 2010 and 31 December 2009 were 1.7728 GEL and 1.6858 GEL to 1 USD, respectively. The official NBG rate as of 29 April 2011 is 1.6388 GEL to 1 USD.

3. Critical accounting estimates and judgements in applying accounting policies

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

Going concern

The Group's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources and the financial support of the Parent 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 Group's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

Allowance for loan impairment

The Group regularly reviews its loans and receivables to assess impairment. The Group 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 Group 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 Group uses its judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

Revaluation of property

The Group 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 Group 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. Land and buildings have been revalued to market value at 31 December 2009. Revalued buildings are depreciated in accordance with their remaining useful life since 1 January 2010. The Group's management believes that carrying value of land and buildings does not differ materially from that which would be determined using fair value as of December 31, 2010.

(Thousands of Georgian Lari)

3. Critical accounting estimates and judgements in applying accounting policies (continued)*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 Group 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 Group. 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 Group has accrued all applicable taxes.

Deferred tax assets

The recognised deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded in the statement of financial position. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are probable in the future are based on management expectations that are believed to be reasonable under the circumstances.

Changes in presentation

For the purposes of more accurate and fair presentation of net losses from disposal of investment property; net gains/(losses) on investment property revaluation and depreciation and amortization in the consolidated income statement, the presentation of comparative figures have been adjusted to conform to the presentation of the current year amounts.

The effect of reclassifications on the consolidated income statement for the year ended 31 December 2009 is as follows:

	<i>As previously reported</i>	<i>Reclassification</i>	<i>As reclassified</i>
Other operating expenses	9,154	(449)	8,705
Loss on revaluation of investment property	-	510	510
Net loss from disposal of investment property	-	25	25
Depreciation and amortization	2,357	(2,357)	-
Depreciation	-	2,271	2,271

For the purposes of more accurate and fair presentation of intangible assets in the consolidated statement of financial position, the presentation of comparative figures have been adjusted to conform to the presentation of the current year amounts.

The effect of reclassifications on the consolidated statement of financial position for the year ended 31 December 2009 is as follows:

	<i>As previously reported</i>	<i>Reclassification</i>	<i>As reclassified</i>
Intangible assets	509	(509)	-
Other assets	1,189	509	1,698

(Thousands of Georgian Lari)

4. Changes in accounting policies and adoption of new or revised standards and interpretations

Voluntary change in accounting policies

In 2010 the Group revised its accounting policy with respect to restructured financial assets, primarily loans and advances. Accounting policy specification was made to ensure the single approach to evaluation of the effect of various types of restructuring of the financial assets.

Management of the Group believes that application of the revised accounting policy allows the Group to present reliable and more relevant information regarding the impact of various types of restructuring on the Group's financial position and results of its operations and cash flows.

In accordance with the revised policy, if the loan restructuring is not caused by the financial difficulties of the borrower but the cash flows were renegotiated, the loan is not derecognised but the new effective interest rate is determined based on the remaining cash flows under the loan agreement till maturity.

Respective policy became effective for annual period ended 31 December 2010, comparative data for 2009 was revised as follows:

	<i>For the year ended 31 December 2009</i>		
	<i>As initially reported</i>	<i>Effect of change in accounting policy</i>	<i>Adjusted</i>
Consolidated statement of financial position			
Loans to customers	295,401	(2,100)	293,301
Deferred tax asset	6,141	315	6,456
Consolidated income statement			
Interest income from loans to customers	57,312	(2,145)	55,167
Translation differences	(23)	45	22
Loss for the year	7,339	1,783	9,122
Consolidated statement of comprehensive income			
Total comprehensive loss for the year	10,472	1,783	12,255
Consolidated statement of changes in equity			
Accumulated losses	70,752	1,783	72,535
Equity	35,760	1,783	33,977

The change in accounting policy had no impact on comparative statement of financial position as of 31 December 2008.

Adoption of new or revised standards and interpretations

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

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

The amendment to IAS 39 was issued in August 2008, and became 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. The amendment did not affect the Group's consolidated financial statements as the Group has not entered into any such hedges.

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

The revised standards were issued in January 2008 and became 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 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 has no impact on goodwill, nor it gives rise 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 are applied prospectively. The amendment did not affect the Group's consolidated financial statements as the Group has not entered into any business combinations.

(Thousands of Georgian Lari)

4. Changes in accounting policies and adoption of new or revised standards and interpretations (continued)

Adoption of new or revised standards and interpretations (continued)

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

The amendment to IFRS 2 was issued in June 2009 and became 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. This amendment had no impact on the Group's consolidated financial statements as the Group has not entered in any share-based transactions.

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. This interpretation had no impact on the Group's consolidated financial statements as no distributions to owners have taken place.

Improvements to IFRSs

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

- ▶ *IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*: clarifies that the disclosures required in respect of non-current assets and disposal groups classified as held for sale or discontinued operations are only those set out in IFRS 5. The disclosure requirements of other IFRSs only apply if specifically required for such non-current assets or discontinued operations.
- ▶ *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.

(Thousands of Georgian Lari)

5. New accounting pronouncements

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2011 or later periods and which the Group has not early adopted:

Classification of Rights Issues - Amendment to IAS 32 (issued 8 October 2009; effective for annual periods beginning on or after 1 February 2010). The amendment exempts certain rights issues of shares with proceeds denominated in foreign currencies from classification as financial derivatives. The Group does not expect the amendment to have any material effect on the Group's future consolidated financial statements.

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

Deferred tax: Recovery of underlying assets - Amendment to IAS 12 (issued in December 2010 and effective for annual periods beginning on or after 1 January 2012). IAS 12 has been updated to include a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale and a requirement that deferred tax on non-depreciable assets, measured using the revaluation model in IAS 16, should always be measured on a sale basis. The Group does not expect the amendments to have any material effect on the Group's future consolidated financial statements as the same principals are applied by the Group.

IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments (effective for annual periods beginning on or after 1 July 2010). This IFRIC clarifies the accounting when an entity renegotiates the terms of its debt with the result that the liability is extinguished through the debtor issuing its own equity instruments to the creditor. A gain or loss is recognised in profit or loss based on the fair value of the equity instruments compared to the carrying amount of the debt. The Group does not expect the interpretation to have any material effect on the Group's future consolidated financial statements.

Prepayments of a Minimum Funding Requirement - Amendment to IFRIC 14 (effective for annual periods beginning on or after 1 January 2011). This amendment will have no impact on the Group's consolidated financial statements as it applies only to companies that are required to make minimum funding contributions to a defined benefit pension plan. It removes an unintended consequence of IFRIC 14 related to voluntary pension prepayments when there is a minimum funding requirement.

IFRS 9, Financial Instruments Part 1: Classification and Measurement. IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of:

- (i) financial assets. Key features are as follows:
 - ▶ Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
 - ▶ An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.

All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in consolidated income statement, as long as they represent a return on investment.

- (ii) Relating to measurement of financial liabilities at fair value through profit or loss a requirement was introduced to recognize changes in fair value caused by credit risks in other comprehensive income.

While adoption of IFRS 9 is mandatory from 1 January 2013, earlier adoption is permitted. The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

(Thousands of Georgian Lari)

5. New accounting pronouncements (continued)

Disclosures - Transfers of Financial Assets - Amendments to IFRS 7 (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party yet remain on the entity's statement of financial position. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognised but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. The amendment is not expected to have any impact on the Group's financial statements.

Improvements to International Financial Reporting Standards (issued in May 2010 and effective from 1 January 2011). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations:

- ▶ IFRS 1 was amended (i) to allow previous GAAP carrying value to be used as deemed cost of an item of property, plant and equipment or an intangible asset if that item was used in operations subject to rate regulation, (ii) to allow an event driven revaluation to be used as deemed cost of property, plant and equipment even if the revaluation occurs during a period covered by the first IFRS financial statements and (iii) to require a first-time adopter to explain changes in accounting policies or in the IFRS 1 exemptions between its first IFRS interim report and its first IFRS financial statements;
- ▶ IFRS 3 was amended (i) to require measurement at fair value (unless another measurement basis is required by other IFRS standards) of non-controlling interests that are not present ownership interest or do not entitle the holder to a proportionate share of net assets in the event of liquidation, (ii) to provide guidance on acquiree's share-based payment arrangements that were not replaced or were voluntarily replaced as a result of a business combination and (iii) to clarify that the contingent considerations from business combinations that occurred before the effective date of revised IFRS 3 (issued in January 2008) will be accounted for in accordance with the guidance in the previous version of IFRS 3;
- ▶ IFRS 7 was amended to clarify certain disclosure requirements, in particular (i) by adding an explicit emphasis on the interaction between qualitative and quantitative disclosures about the nature and extent of financial risks, (ii) by removing the requirement to disclose carrying amount of renegotiated financial assets that would otherwise be past due or impaired, (iii) by replacing the requirement to disclose fair value of collateral by a more general requirement to disclose its financial effect, and (iv) by clarifying that an entity should disclose the amount of foreclosed collateral held at the reporting date and not the amount obtained during the reporting period;
- ▶ IAS 1 was amended to clarify that an entity will present an analysis of other comprehensive income for each component of equity, either in the statement of changes in equity or in the notes to the financial statements;
- ▶ IAS 27 was amended by clarifying the transition rules for amendments to IAS 21, 28 and 31 made by the revised IAS 27 (as amended in January 2008);
- ▶ IAS 34 was amended to add additional examples of significant events and transactions requiring disclosure in a condensed interim financial report, including transfers between the levels of fair value hierarchy, changes in classification of financial assets or changes in business or economic environment that affect the fair values of the entity's financial instruments;
- ▶ and IFRIC 13 was amended to clarify measurement of fair value of award credits.

The Group does not expect the amendments to have any material effect on its consolidated financial statements.

6. Cash and cash equivalents

	<u>2010</u>	<u>2009</u>
Cash on hand	18,348	20,298
Current accounts with other credit institutions	9,864	7,645
Time deposits with credit institutions	4,501	-
Current accounts with the NBG	3,475	33,029
Time deposits with the NBG	1,800	-
Cash and cash equivalents	<u>37,988</u>	<u>60,972</u>

As of 31 December 2010, 67% of total current accounts with credit institutions are placed with 2 non-resident credit institutions (2009: 76%).

Non-cash transactions performed by the Group during 2010 are represented by the acquisition of inventory and property and equipment for GEL 219 (2009: GEL 85) and by acquisition of investment property for GEL 3,989 (2009: GEL 11,873).

(Thousands of Georgian Lari)

7. Amounts due from credit institutions

	<u>2010</u>	<u>2009</u>
Obligatory reserve with the NBG	9,472	3,801
Time deposits with credit institutions	2,111	1,434
Restricted nostro account in Deutsche Bank, AG (Germany)	-	322
Amounts due from credit institutions	<u>11,583</u>	<u>5,557</u>

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 Group's ability to withdraw such deposit is restricted by the statutory legislation.

In 2010 and 2009 the obligatory reserve on USD account bears Interest at the rate of Federal Reserve System less 0.5 p.a.; on EUR account - the rate of the European Central Bank less 0.5 p.a. In any case the effective rate is not less than zero.

As of 31 December 2010, GEL 1,577 (2009: GEL 1,014) 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 983 was placed in two Georgian banks (2009: GEL 930); GEL 505 - with a Belgium Bank (2009: nil) and GEL 89 with an US Bank (2009: GEL 84).

8. Loans to customers

	<u>2010</u>	<u>2009 (adjusted)</u>
Corporate lending	132,308	187,169
Consumer lending	51,817	41,442
Small business lending	42,264	51,001
Loans to individuals secured by deposits	5,716	7,999
Other loans to individuals	2,159	5,690
Gross loans to customers	<u>234,264</u>	<u>293,301</u>
Less - Allowance for impairment	(33,806)	(39,969)
Loans to customers, net	<u>200,458</u>	<u>253,332</u>

Allowance for impairment of loans to customers

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

	<u>Corporate lending 2010</u>	<u>Consumer lending 2010</u>	<u>Small business lending 2010</u>	<u>Other loans to individuals 2010</u>	<u>Total 2010</u>
At 1 January 2010	28,814	1,008	5,553	4,594	39,969
Charge for the year	21,081	(922)	1,075	1,779	23,013
Recoveries of previously written off loans	6,421	1,880	3,262	419	11,982
Amounts written off	(30,368)	(1,276)	(3,779)	(5,735)	(41,158)
At 31 December 2010	<u>25,948</u>	<u>690</u>	<u>6,111</u>	<u>1,057</u>	<u>33,806</u>
Individual impairment	23,431	-	360	704	24,495
Collective impairment	2,517	690	5,751	353	9,311
	<u>25,948</u>	<u>690</u>	<u>6,111</u>	<u>1,057</u>	<u>33,806</u>
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	<u>44,071</u>	<u>-</u>	<u>981</u>	<u>1,409</u>	<u>46,461</u>

Included in loans to customers written off in 2010 are certain individually significant corporate loans amounting to GEL 29,009. Following the Group's policy, respective decision was approved by the Group's Credit Committee.

(Thousands of Georgian Lari)

8. Loans to customers (continued)

	<i>Corporate lending 2009 (adjusted)</i>	<i>Small business lending 2009 (adjusted)</i>	<i>Consumer lending 2009</i>	<i>Other loans to individuals 2009</i>	<i>Total 2009 (adjusted)</i>
At 1 January 2009	30,447	3,865	1,615	3,540	39,467
Charge for the year	2,515	8,028	2,630	117	13,290
Recoveries of previously written off loans	6,871	229	436	2,116	9,652
Amounts written off	(11,019)	(6,569)	(3,673)	(1,179)	(22,440)
At 31 December 2009	28,814	5,553	1,008	4,594	39,969
Individual impairment	27,089	181	-	4,371	31,641
Collective impairment	1,725	5,372	1,008	223	8,328
	28,814	5,553	1,008	4,594	39,969
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	49,316	233	-	4,576	54,125

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized, as of 31 December 2010, comprised GEL 4,742 (2009: GEL 4,459).

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

The value of collateral is subject to monitoring. The Group 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.

As of 31 December 2010 the Group held collaterals (land and building) repossessed during the year with cost as of repossession date of GEL 4,266 (2009: GEL 12,963), which were classified as investment property. Refer to Note 11.

It is the Group'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 Group does not occupy repossessed properties for business use.

Concentration of loans to customers

As of 31 December 2010, the Group had a concentration of loans represented by GEL 88,069 due from the ten largest third party group of borrowers (37.5% of gross loan portfolio) (2009: GEL 149,883 or 51%). An allowance of GEL 21,086 (2009: GEL 22,730) was recognised against these loans.

As of 31 December 2010 included in total loans to customers is an exposure to a single greatest borrower of GEL 23,397 or 11.67 % of total loan portfolio (2009: GEL 24,288; 9.59%), that bears 14% p.a. and matures in July 2012. This loan was financed and fully guaranteed by the Parent bank.

As of 31 December 2009 the Group's exposure to a single greatest borrower amounted to 66,125 or 22% of total loan portfolio. That loan born 12.75% p.a. and had contractual maturity in May 2012. However, the loan was redeemed in full in 2010 according to the offer agreement drawn with the Parent bank.

(Thousands of Georgian Lari)

8. Loans to customers (continued)

Loans have been extended to the following types of customers:

	<u>2010</u>	<u>2009 (adjusted)</u>
Private companies	165,876	219,756
Individuals	68,388	73,545
Gross loans to customers	<u>234,264</u>	<u>293,301</u>

As of 31 December 2010 and 2009 loans are principally issued within Georgia and their distribution by industry sectors is as follows:

	<u>2010</u>	<u>2009 (adjusted)</u>
Trading and service enterprises	91,375	67,692
Individuals	68,388	73,545
Real estate construction	32,818	29,439
Energy	31,059	104,714
Agriculture and food processing	1,809	1,148
Manufacturing	1,077	7,784
Telecommunication and transportation	1,036	1,567
Other	6,702	7,412
Gross loans to customers	<u>234,264</u>	<u>293,301</u>

9. Investment securities held-to-maturity

As of 31 December 2010 securities held-to-maturity comprised securities of the National Bank of Georgia with total carrying value of GEL 15,848 (2009: GEL 9,445) and securities of the Ministry of Finance of Georgia with total carrying value of GEL 15,534 (2009: nil).

(Thousands of Georgian Lari)

10. Property and equipment

The movements in property and equipment during 2010 and 2009 were as follows:

	<i>Land and buildings</i>	<i>Computers and communication equipment</i>	<i>Furniture, fixtures and office equipment</i>	<i>Motor vehicles</i>	<i>Leasehold improvements</i>	<i>Construction in progress</i>	<i>Total</i>
Cost or revalued amount							
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 land and buildings recognised in income statement	(505)	-	-	-	-	-	(505)
Loss on revaluation of land and buildings 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
Additions	-	1,190	516	527	-	1,371	3,604
Transfers	2,228	-	580	-	-	(2,808)	-
Disposals	(884)	(294)	(330)	(36)	(29)	(230)	(1,803)
31 December 2010	26,758	6,193	3,975	2,419	292	1,364	41,001
Accumulated depreciation							
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)
Depreciation charge	(578)	(766)	(516)	(379)	(34)	-	(2,273)
Disposals	94	293	244	19	29	-	679
31 December 2010	(2,760)	(4,415)	(2,009)	(1,481)	(86)	-	(10,751)
Net book value:							
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
31 December 2010	23,998	1,778	1,966	938	206	1,364	30,250

As of 31 December 2009, an independent appraiser performed the valuation of the fair value of the Group'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.

If no revaluation of property and equipment had been performed, the original cost of land and buildings as of 31 December 2010 would have amounted to GEL 23,891 (2009: GEL 22,547) and accumulated depreciation would have amounted to GEL 2,588 (2009: GEL 2,117).

The total value of fully depreciated property and equipment in use as of 31 December 2010 amounted to GEL 3,940 (2009: GEL 2,884).

(Thousands of Georgian Lari)

11. Investment property

	<u>2010</u>	<u>2009</u>
Opening balance at 1 January	13,925	1,540
Additions	4,266	12,963
Reclassified from premises	12	-
Disposals	(376)	(68)
Gain/ (loss) on revaluation	70	(510)
Closing balance at 31 December	<u>17,897</u>	<u>13,925</u>

Investment property is a real estate property comprised of land and buildings which was obtained by the Group through repossession of collateral on defaulted loans. Refer to Note 8. As of 31 December 2010 the Group performed a revaluation of the investment property and recognised related gain of GEL 70 (2009: loss of GEL 510) in the consolidated income statement.

12. Taxation

The corporate income tax benefit comprises:

	<u>2010</u>	<u>2009</u> <i>(adjusted)</i>
Deferred tax benefit - origination and reversal of temporary differences	803	1,683
Less deferred tax recognised directly in other comprehensive income	-	(553)
Income tax benefit	<u>803</u>	<u>1,130</u>

Georgian legal entities must file individual tax declarations. The tax rate for banks for profits was 15% for 2010. The tax rate for companies other than banks was also 15%. According to the Georgian legislation, revenue from state securities are exempted from taxation.

In 2010 and 2009 the Group incurred no current income tax expense.

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:

	<u>2010</u>	<u>2009</u> <i>(adjusted)</i>
Loss before income tax expense	16,143	10,253
Statutory tax rate	15%	15%
Theoretical income tax benefit at the statutory rate	2,421	1,538
Change in unrecognized deferred tax assets	(1,747)	(738)
Non-deductible expenses	(28)	(57)
Interest income from state securities	212	-
Other tax exempt income	75	512
Income recognized for tax purposes only	(130)	(125)
Income tax benefit	<u>803</u>	<u>1,130</u>

(Thousands of Georgian Lari)

12. Taxation (continued)

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

	Origination and reversal of temporary differences (adjusted)			Origination and reversal of temporary differences			
	2008	In the income statement	In other comprehend- sive income	2009 (adjusted)	In the income statement	In other comprehend- sive income	2010
Tax effect of deductible temporary differences:							
Allowance for loan impairment	880	277	-	1,157	(651)	-	506
Tax losses carried forward	8,748	1,381	-	10,129	3,383	-	13,512
Accrued interest expense	-	-	-	-	-	-	-
Financial instruments adjustment for effective interest rates	219	(219)	-	-	19	-	19
Accrued expenses	681	(33)	-	648	(57)	-	591
Securities available-for-sale	-	161	-	161	1	-	162
Investment property	-	76	-	76	(22)	-	54
Other	2	10	-	12	19	-	31
Gross deferred tax assets	10,530	1,653	-	12,183	2,692	-	14,875
Unrecognised deferred tax asset	(4,375)	(738)	-	(5,113)	(1,747)	-	(6,860)
Deferred tax assets	6,155	915	-	7,070	945	-	8,015
Tax effect of taxable temporary differences:							
Property and equipment	(353)	178	-	(175)	(143)	-	(318)
Property revaluation	(1,017)	68	553	(396)	-	-	(396)
Allowances for impairment and provision for other losses	-	-	-	-	(44)	-	(44)
Financial instruments adjustment for effective interest rate	-	(45)	-	(45)	45	-	-
Other	(14)	14	-	-	-	-	-
Deferred tax liabilities	(1,384)	215	553	(616)	(142)	-	(758)
Net deferred tax assets	4,771	1,130	553	6,454	803	-	7,257

The Group has available GEL 18,713 of tax losses carried forward which begins to expire in 2012, GEL 39,604 of tax losses carried forwards which will expire in 2013, GEL 9,213 of tax losses carried forwards which will expire in 2014 and GEL 22,549 of tax losses carried forwards which will expire in 2015 if not utilised.

As of 31 December 2010 current income tax assets amounted to GEL 286 (2009: GEL 286) which related to current year interest income taxed at the source of payment that can be offset against future income tax payable.

13. Other assets and liabilities

Other assets comprise:

	2010	2009
Unsettled transactions on money transfers	854	216
Intangible assets	794	509
Assets held for sale	595	-
Inventories in stock	388	-
Advances paid	320	478
Prepaid expenses	277	168
Repossessed collateral (equipment)	181	181
Prepaid operational taxes	87	69
Accrued commission receivable on guarantees and letters of credit	15	19
Derivative financial assets	15	-
Other	30	58
Other assets	3,556	1,698

As of 31 December 2010 included in other assets are certain assets held for sale carried at fair value less costs to sell. In January 2011 the Group disposed of those assets.

(Thousands of Georgian Lari)

13. Other assets and liabilities (continued)

Other liabilities comprise:

	<u>2010</u>	<u>2009</u>
Accrued bonuses	2,896	1,132
Unsettled transactions on money transfers	1,072	40
Advances received	876	18
Accrued expenses	628	472
Payables for unused vacations	542	544
Provision for legal claims	330	2,687
Settlements on plastic cards	308	108
Dividends payable to shareholders of the Bank	233	233
Settlements on acquisition of property and equipment and inventory (Note 6)	219	85
Operational taxes payable	14	90
Derivative financial liabilities	66	-
Other liabilities	<u>7,184</u>	<u>5,409</u>

As of 31 December 2010 the Group's derivative financial instruments comprised of foreign exchange forwards and were attributable to the Level 2 of fair value hierarchy. Refer to Note 23.

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

	<i>Allowance for impairment of other assets</i>	<i>Provision for legal claim</i>	<i>Total</i>
31 December 2008	-	3,334	3,334
Charge	110	635	745
Reversal	(110)	-	(110)
Utilization of provision	-	(1,282)	(1,282)
31 December 2009	-	2,687	2,687
Charge	38	461	499
Reversal	(38)	-	(38)
Utilization of provision	-	(2,818)	(2,818)
31 December 2010	-	330	330

In November 2009 a legal case was filed in the Georgian court of arbitration by the Georgian telecommunications company Caucasus Online against the Group. The company claims GEL 274 and 0.5% on every overdue day from 2 September 2009 before the court's decision plus related legal costs in amount of GEL 16. In 2010 the Group was charged: GEL 262, penalty GEL 55 and related legal costs GEL 13. The Group appealed this decision in Tbilisi appeal court and recognize respective provision for the claim. By 31 December 2010 the case has not been reviewed by the court.

In January 2010 the Bank settled the legal claim of Harwisk Ltd in the amount of GEL 2,818 based on the final award issued by the London Court of International Arbitration on 30 December 2009.

(Thousands of Georgian Lari)

14. Amounts due to credit institutions

	<u>2010</u>	<u>2009</u>
Time deposits and loans	5,323	21,096
Current accounts	321	66,459
Amounts due to credit institutions	<u>5,644</u>	<u>87,555</u>

As of 31 December 2010 time deposits and loans due to credit institutions comprised of loan from the Parent bank amounted to GEL 5,323 (2009: GEL 5,079) with contractual maturity of 6 months. The interest accrued on this loan is 4.18% per annum (2009: 5.43%).

Current accounts include facility from the Parent bank of GEL 186 (2009: GEL 66,298).

15. Amounts due to customers

	<u>2010</u>	<u>2009</u>
Individuals:		
- Current/demand accounts	27,922	19,882
- Term deposits	53,357	51,118
Total due to individuals	<u>81,279</u>	<u>71,000</u>
State and budgetary organisations:		
- Current/settlement accounts	15,436	21,387
- Term deposits	242	-
Total due to state and budgetary organisations	<u>15,678</u>	<u>21,387</u>
Private enterprises:		
- Current/settlement accounts	66,389	54,402
- Term deposits	17,230	6,263
Total due to private enterprises	<u>83,619</u>	<u>60,665</u>
Total due to legal entities	<u>99,297</u>	<u>82,052</u>
Total amounts due to customers	<u>180,576</u>	<u>153,052</u>
Held as security against guarantees issued	<u>472</u>	<u>1,301</u>
Held as security against letters of credit issued	<u>378</u>	<u>-</u>
Held as security against settlement operations	<u>6</u>	<u>4</u>

At 31 December 2010 the Group had ten largest customers with aggregate balance due of GEL 53,078 or 29% of total amounts due to customers (2009: GEL 46,975 or 31%).

In accordance with the internal rules, the Bank is obliged to repay term deposits upon demand of a customer. In case a term deposit is repaid upon demand of the customer 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.

(Thousands of Georgian Lari)

15. Amounts due to customers (continued)

An analysis of customer accounts by industry follows:

	<u>2010</u>	<u>2009</u>
Individuals	81,279	70,999
Trade and service	26,072	28,276
Transport and communication	23,141	11,541
Government	14,589	20,518
Insurance	10,782	4731
Energy	8,331	2,615
Real estate constructions	6,785	3,226
Manufacturing	2,484	4,790
Fuel	2,339	745
Other	4,774	5,611
Amounts due to customers	<u>180,576</u>	<u>153,052</u>

16. Other borrowed funds

	<u>2010</u>	<u>2009</u>
Borrowings from commercial banks	42,097	58,602
Borrowings from international financial institutions	21,579	22,736
Other borrowed funds	<u>63,676</u>	<u>81,338</u>

Borrowings from international financial institutions as of 31 December 2010 contained facilities in U.S. dollars and Euro with maturities ranging from April 2011 to December 2032 (2009: from April 2010 till December 2032) and interest rates from Libor+3% to Libor+6.5% and one loan bearing annual interest at 0.75% (2009: from 3.5% till Libor+6.5%; 0.75%).

Borrowings from commercial banks as of 31 December 2010 contained facility in U.S. dollars with maturities ranging from July 2011 till September 2012 (2009: from July 2010 till September 2012) and interest rate from 5.18% till 10.945% and one loan issued in Libor+2% (2009: 10.16% till 12.03%; Libor+2%).

As of 31 December 2010 borrowings from commercial banks include facilities from the Parent bank GEL 35,878 (2009: GEL 49,731) with contractual maturities ranging from July 2011 till September 2012 (2009: from July 2010 till July 2011) and interest rates from 5.81% to 10.95% (2009: from 10.16% to-12.03%). Refer to Note 25.

17. Equity*Share capital*

Movements in ordinary shares authorized and fully paid were as follows:

	<u>Number of shares authorized</u>	<u>Number of shares fully paid</u>	<u>Nominal amount, GEL</u>
31 December 2008	86,388,002	86,355,701	86,356
Increase in share capital	18,187,000	18,187,000	18,187
31 December 2009	104,575,002	104,542,701	104,543
Increase in share capital	43,500,000	43,500,000	43,500
31 December 2010	<u>148,075,002</u>	<u>148,042,701</u>	<u>148,043</u>

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.

(Thousands of Georgian Lari)

17. Equity (continued)

Share capital (continued)

On 8 August 2008 the Annual Shareholders Meeting made a decision to increase the number of authorized shares by 18,187,000. Based on that decision, as amended on 24 July 2009, and in accordance with the Bank's charter the Bank made two placements of additional common shares in 2009:

- ▶ On 14 April 2009 the Supervisory Board made a decision to issue 15,748,425 ordinary shares. Related share issue prospectus was approved by the Financial Supervisory Agency of Georgia on 15 May 2009 under the decree #15-05/1. The additional issue was placed in full.
- ▶ On 9 October 2009 the Supervisory Board made a decision to issue 2,438,575 ordinary shares. Related share issue prospectus was approved by the Financial Supervisory Agency of Georgia on 22 October 2009 under the decree #22-10/3. The additional issue was placed in full.

On 2 June 2010 the Annual Shareholders Meeting made a decision to increase the number of authorized shares by 43,500,000. Based on that decision and in accordance with the Bank's charter on 2 June 2010 the Supervisory Board made a decision to issue 43,500,000 ordinary shares. Related share issue prospectus was approved by the National Bank of Georgia on 18 June 2010 under the order #537. The additional issue was placed in full.

In February 2011 the Group cancelled 32,302 authorized but not paid shares. Refer to Note 27.

Dividends

In accordance with the Georgian legislation, dividends may only be declared to the shareholders of the Bank from the net income as shown in the Bank's separate financial statements prepared in accordance with the NBG requirements.

18. 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 global economic slowdowns. In 2010 gradual economic recovery was accompanied by financial stabilization, however, there continues to be uncertainty regarding further economic growth, which could negatively affect the Group's future financial position, results of operations and business prospects.

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

Legal

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

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 Group. The petitioners claim 909 GEL for the guarantee issued by the Group in 1996. The first instance court of France rejected petitioners claim. Petitioners appealed decision, then in 2010 the case was suspend by petitioners. According to legislation of France if the case is suspend more than a two year , petitioner losses the right for renewal.

Management believes that it is not probable that an outflow of resources embodying economic benefits will be required to settle this obligation.

Refer to Note 13 for details of provision for legal claims.

*(Thousands of Georgian Lari)***18. Commitments and contingencies (continued)****Financial commitments and contingencies**

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

	<u>2010</u>	<u>2009</u>
Credit related commitments		
Undrawn loan facilities	18,941	7,117
Guarantees issued	14,715	7,345
Letters of credit	1,441	324
Financial commitments and contingencies (before deducting collateral)	<u>35,097</u>	<u>14,786</u>
Less - cash held as security against letters of credit and guarantees issued (Note 15)	<u>(850)</u>	<u>(1,301)</u>
Financial commitments and contingencies	<u><u>34,247</u></u>	<u><u>13,485</u></u>
Operating lease commitments		
Not later than 1 year	78	78
Later than 1 year but not later than 5 years	76	78
	<u>154</u>	<u>156</u>

Insurance

The Group has arrangement for employee's medical insurance with insurance company "IC Group". According to the agreement, the Group makes monthly payments of insurance premium to the insurer.

19. Net fee and commission income

	<u>2010</u>	<u>2009</u>
Commission on settlements operations	2,777	2,503
Commission on guarantees and letters of credit issued	632	485
Commission on cash operations	617	645
Other	149	122
Fee and commission income	<u>4,175</u>	<u>3,755</u>
Commission on settlements operations	(1,166)	(900)
Commission on cash operations	(63)	(83)
Commission on guarantees and letters of credit issued	(18)	(60)
Other	(9)	(21)
Fee and commission expense	<u>(1,256)</u>	<u>(1,064)</u>
Net fee and commission income	<u><u>2,919</u></u>	<u><u>2,691</u></u>

20. Other income

	<u>2010</u>	<u>2009</u>
Penalties received from lending operations	2,362	2,246
Other penalties	271	7
Penalties received for deposit redemption before maturity	-	837
Other	411	214
Other income	<u><u>3,044</u></u>	<u><u>3,304</u></u>

(Thousands of Georgian Lari)

21. Personnel and other operating expenses

	<u>2010</u>	<u>2009</u>
Salaries and bonuses	17,607	16,711
Personnel expenses	<u>17,607</u>	<u>16,711</u>
Legal and consultancy	1,312	1,538
Marketing and advertising	944	638
Office supplies	806	772
Repairs and maintenance of property and equipment	723	939
Communications	585	663
Operating taxes	520	515
Utilities	457	390
Occupancy and rent	446	537
Entertainment	278	189
Business travel and related expenses	273	275
Insurance	231	272
Security	143	259
Amortisation of intangible assets	124	86
Loss on disposal of property and equipment	103	457
Charity	28	8
Penalties incurred	2	134
Loss on revaluation of property and equipment	-	454
Other	612	579
Other operating expenses	<u>7,587</u>	<u>8,705</u>

22. Risk management

The Group is required to manage financial risks that arise as a consequence of its operations to deliver its policy objectives as well as in the course of managing the Group's statement of financial position. These risks primarily include credit risk, liquidity risk, interest rate risk, foreign exchange risk and operational risk.

Risk is inherent to the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities.

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

Risk management structure

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

Supervisory Council

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

Management Board

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

(Thousands of Georgian Lari)

22. Risk management (continued)

Risk Controlling Unit

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

Bank Treasury

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

Internal Audit

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

Risk measurement and reporting systems

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

Information compiled from all the business divisions is examined and processed to analyse, control and identify risks timely. This information is provided 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. Risk management department assesses the appropriateness of the allowance for credit losses on a monthly basis.

A daily summary on liquidity utilisation is provided to the Management Board and all other relevant employees of the Group.

Risk mitigation

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

Credit risk

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

Credit-related commitments risks

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

(Thousands of Georgian Lari)

22. Risk management (continued)**Credit risk (continued)**

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

	<i>Notes</i>	<i>Gross maximum exposure 2010</i>	<i>Gross maximum exposure 2009 (adjusted)</i>
Cash and cash equivalents (excluding cash on hand)	6	19,641	40,674
Amounts due from credit institutions	7	11,583	5,557
Loans to customers	8	200,458	253,332
Investment securities held-to-maturity	9	31,382	9,445
All other assets (excluding settlements with tax authorities)		884	236
		<u>263,948</u>	<u>309,244</u>
Financial commitments and contingencies	18	35,097	14,786
Total credit risk exposure		<u><u>299,045</u></u>	<u><u>324,030</u></u>

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 Group 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)

22. Risk management (continued)**Credit risk (continued)**

The table below shows the credit quality by class of credit risk bearing assets:

	Notes	Neither past due nor impaired			Past due or individually impaired	Total 2010
		High grade 2010	Standard grade 2010	Sub-standard grade 2010	2010	
Amounts due from credit institutions	7	11,583	-	-	-	11,583
Investment securities held-to-maturity	9	31,382	-	-	-	31,382
Loans to customers	8					
Corporate lending		34,273	49,728	542	21,816	106,359
Small business lending		192	27,138	5,635	3,189	36,154
Consumer lending		49,359	-	1,341	427	51,127
Loans to individuals						
secured with deposits		5,716	-	-	-	5,716
Other loans to individuals		-	-	364	738	1,102
		<u>89,540</u>	<u>76,866</u>	<u>7,882</u>	<u>26,170</u>	<u>200,458</u>
Total		<u>132,505</u>	<u>76,866</u>	<u>7,882</u>	<u>26,170</u>	<u>243,423</u>

	Notes	Neither past due nor impaired (adjusted)			Past due or individually impaired	Total 2009 (adjusted)
		High grade 2009	Standard grade 2009	Sub-standard grade 2009	2009 (adjusted)	
Amounts due from credit institutions	7	5,557	-	-	-	5,557
Investment securities held-to-maturity	9	9,445	-	-	-	9,445
Loans to customers	8					
Corporate lending		94,443	28,124	12,673	23,116	158,356
Small business lending		6,816	28,403	5,507	4,721	45,447
Consumer lending		13,402	16,801	910	1,323	32,436
Loans to individuals						
secured with deposits		7,999	-	-	-	7,999
Other loans to individuals		8,004	621	76	393	9,094
		<u>130,664</u>	<u>73,949</u>	<u>19,166</u>	<u>29,553</u>	<u>253,332</u>
Total		<u>145,666</u>	<u>73,949</u>	<u>19,166</u>	<u>29,553</u>	<u>268,334</u>

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

Past due but not impaired loans and advances include solely loans and advances that are not individually significant and are overdue by less than 150 days. The tables below show aging analysis of past due loans.

(Thousands of Georgian Lari)

22. Risk management (continued)**Credit risk (continued)**

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

<i>As of 31 December 2010</i>	<i>Less than 30 days 2010</i>	<i>31 to 60 days 2010</i>	<i>61 to 90 days 2010</i>	<i>More than 90 days 2010</i>	<i>Total 2010</i>
Loans to customers					
Corporate lending	-	-	-	1,176	1,176
Small business lending	617	119	127	1,705	2,568
Consumer lending	302	17	6	102	427
Other loans to individuals	-	-	-	33	33
Total	919	136	133	3,016	4,204

<i>As of 31 December 2009</i>	<i>Less than 30 days 2009 (adjusted)</i>	<i>31 to 60 days 2009 (adjusted)</i>	<i>61 to 90 days 2009 (adjusted)</i>	<i>More than 90 days 2009 (adjusted)</i>	<i>Total 2009 (adjusted)</i>
Loans to customers					
Corporate lending	208	-	-	681	889
Small business lending	391	1,191	418	2,669	4,669
Consumer lending	585	156	209	373	1,323
Other loans to individuals	47	-	-	141	188
Total	1,231	1,347	627	3,864	7,069

For the purpose of these consolidated financial statements a loan is considered past due when the borrower fails to make any payment due under the loan agreement at the reporting date. In this case the aggregate amount of all amounts due from borrower under the respective loan agreement including accrued interest and commissions is recognised as past due.

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 8.

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.

	2010	2009 (adjusted)
Loans to customers		
Corporate lending	12,934	46,361
Small business lending	5,856	5,897
Consumer lending	1,320	2,205
Loans secured by deposits	-	712
Other loans to individuals	-	183
Total	20,110	55,358

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 Group addresses impairment assessment in two areas- individually assessed allowances and collectively assessed allowances.

(Thousands of Georgian Lari)

22. Risk management (continued)**Credit risk (continued)***Individually assessed allowances*

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

Collectively assessed allowances

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

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the appropriate delay between the time a loss is likely to have been 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 Risk management department to ensure alignment with the Group's overall policy.

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

	2010				2009 (adjusted)			
	Georgia	OECD	CIS and other foreign countries	Total	Georgia	OECD	CIS and other foreign countries	Total
Assets:								
Cash and cash equivalents	29,749	7,868	371	37,988	54,160	6,639	173	60,972
Amounts due from credit institutions	10,965	618	-	11,583	5,150	407	-	5,557
Loans to customers	200,458	-	-	200,458	253,332	-	-	253,332
Investment securities								
available-for-sale	94	-	-	94	113	-	-	113
held-to-maturity	31,382	-	-	31,382	9,445	-	-	9,445
Other assets	869	-	15	884	236	-	-	236
	<u>273,517</u>	<u>8,486</u>	<u>386</u>	<u>282,389</u>	<u>322,436</u>	<u>7,046</u>	<u>173</u>	<u>329,655</u>
Liabilities:								
Amounts due to credit institutions	103	31	5,510	5,644	13,558	88	73,909	87,555
Amounts due to customers	165,702	10,537	4,337	180,576	142,783	7,483	2,786	153,052
Other borrowed funds	-	27,798	35,878	63,676	-	31,607	49,731	81,338
Subordinated loan	-	-	21,534	21,534	-	-	20,494	20,494
Other liabilities	5,827	72	66	5,965	2,594	85	-	2,679
	<u>171,632</u>	<u>38,438</u>	<u>67,325</u>	<u>277,395</u>	<u>158,935</u>	<u>39,263</u>	<u>146,920</u>	<u>345,118</u>
Net assets/(liabilities)	<u>101,885</u>	<u>(29,952)</u>	<u>(66,939)</u>	<u>4,994</u>	<u>163,501</u>	<u>(32,217)</u>	<u>(146,747)</u>	<u>(15,463)</u>
Net financial commitments	<u>34,690</u>	<u>355</u>	<u>53</u>	<u>35,098</u>	<u>14,144</u>	<u>34</u>	<u>608</u>	<u>14,786</u>

(Thousands of Georgian Lari)

22. Risk management (continued)**Liquidity risk and funding management**

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

The Group maintains a portfolio of state securities that can be pledged to the NBG to obtain financing in the event of demand. The Group also has committed lines of credit that it can assess to meet liquidity needs.

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. As of 31 December 2010 and 2009 the ratio was as follows:

	<u>2010</u>	<u>2009 (adjusted)</u>
LK "Average Liquidity Ratio" (Average monthly volume of liquid assets / Average monthly volume of liabilities)	42%	42%

In 2010 minimum limit of average liquidity ratio is 30% (2009: 20%).

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2010 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

<i>Financial liabilities</i> As of 31 December 2010	<u>Less than 3 months</u>	<u>3 to 12 months</u>	<u>1 to 5 years</u>	<u>Over 5 years</u>	<u>Total</u>
Amounts due to credit institutions	375	5,373	-	-	5,748
Amounts due to customers	135,540	30,843	18,106	754	185,243
Other borrowed funds	4,894	43,498	14,084	4,932	67,408
Subordinated loan	363	1,088	5,804	22,725	29,980
Other liabilities	4,139	1,805	21	-	5,965
Total undiscounted financial liabilities	<u>145,311</u>	<u>82,607</u>	<u>38,015</u>	<u>28,411</u>	<u>294,344</u>
<i>Financial liabilities</i> As of 31 December 2009	<u>Less than 3 months</u>	<u>3 to 12 months</u>	<u>1 to 5 years</u>	<u>Over 5 years</u>	<u>Total</u>
Amounts due to credit institutions	27,544	26,865	43,400	-	97,809
Amounts due to customers	109,149	28,972	17,559	635	156,315
Other borrowed funds	5,359	27,544	51,166	5,362	89,431
Subordinated loan	369	1,106	5,900	23,180	30,555
Other liabilities	2,240	439	-	-	2,679
Total undiscounted financial liabilities	<u>144,661</u>	<u>84,926</u>	<u>118,025</u>	<u>29,177</u>	<u>376,789</u>

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

	<u>Less than 3 months</u>	<u>3 to 12 months</u>	<u>1 to 5 years</u>	<u>Over 5 years</u>	<u>Total</u>
2010	9,409	16,081	8,777	830	35,097
2009	4,099	5,021	5,659	7	14,786

(Thousands of Georgian Lari)

22. Risk management (continued)

Liquidity risk and funding management (continued)

The Group 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 Group for the foreseeable future and that in the event of withdrawal of funds, the Group 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.

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 and interest rate risks, the Group 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. The Group's activity in market risks area is limited by NBG Deposit certificates, Ministry of Finance of Georgia Treasury Bills, CDs operations, also interbank loans and deposits, and exchange operations. The Group does not perform derivative trading.

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 Group'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.

<i>Currency</i>	<i>Increase in basis points 2010</i>	<i>Sensitivity of pre-tax income 2010</i>
USD	0.66%	(281)
USD	(0.66%)	281
<i>Currency</i>	<i>Increase in basis points 2009</i>	<i>Sensitivity of pre-tax income 2009</i>
USD	0.19%	(86)
USD	(0.19%)	86

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 National Bank of Georgia (NBG) regulations. Positions are monitored on a daily basis.

The tables below indicate the currencies to which the Group had significant exposure at 31 December 2010 and 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 consolidated statement of comprehensive income 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 consolidated statement of comprehensive income, while a positive amount reflects a net potential increase.

(Thousands of Georgian Lari)

22. Risk management (continued)**Market risk (continued)**

<i>Currency</i>	<i>Increase in currency rate in % 2010</i>	<i>Effect on profit before tax 2010</i>	<i>Increase in currency rate in % 2009</i>	<i>Effect on profit before tax 2009</i>
USD	5.17%	38	16.20%	(14,523)
EUR	(2.07%)	-	13.20%	(2,963)

<i>Currency</i>	<i>Decrease in currency rate in % 2010</i>	<i>Effect on profit before tax 2010</i>	<i>Decrease in currency rate in % 2009</i>	<i>Effect on profit before tax 2009</i>
USD	(5.17%)	(38)	(16.20%)	14,523
EUR	2.07%	-	(13.20%)	2,963

Prepayment risk

Prepayment risk is the risk that the Group 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:

	<i>Effect on net interest income</i>
2010	4,200
2009	6,582

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group 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 2010 the Group obtained Banker's Blanket Bond and Computer Crime insurance coverage of GEL 886 (2009: GEL 1,264) from Lloyd's insurance company.

23. Fair value of financial instruments

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

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

As of 31 December 2010 the Group's financial assets recognized at fair value comprised of investment securities available-for-sale totaling GEL 94 (2009: GEL 113), classified into Level 3 (2009: Level 3) of fair value hierarchy. In addition, the Group had certain derivative financial instruments classified into Level 2. Refer to Note 13.

In 2009 the Group recognized impairment of investments securities available-for-sale amounted to GEL 1,076.

(Thousands of Georgian Lari)

23. Fair value of financial instruments (continued)

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

	Carrying value 2010	Fair value 2010	Unrecognised gain/(loss) 2010	Carrying value 2009 (adjusted)	Fair value 2009 (adjusted)	Unrecognised gain/(loss) 2009 (adjusted)
Financial assets						
Cash and cash equivalents	37,988	37,988	-	60,972	60,972	-
Amounts due from credit institutions	11,583	11,583	-	5,557	5,557	-
Loans to customers	200,458	204,453	3,995	253,332	253,505	173
Investment securities held-to-maturity	31,382	31,382	-	9,445	9,445	-
Financial liabilities						
Amounts due to credit institutions	5,644	5,644	-	87,555	87,555	-
Amounts due to customers	180,576	181,529	(953)	153,052	150,579	2,473
Other borrowed funds	63,676	60,542	3,134	81,338	77,387	3,951
Subordinated loan	21,534	21,534	-	20,494	20,494	-
Total unrecognised change in unrealised fair value			<u>6,176</u>			<u>6,597</u>

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) or bear floating interest rate, 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.

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.

Derivatives

Derivatives valued using a valuation technique with market observable inputs are mainly forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves.

(Thousands of Georgian Lari)

24. 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. Refer to Note 22 for the Bank's contractual undiscounted repayment obligations.

	2010			2009 (adjusted)		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Financial assets						
Cash and cash equivalents	37,988	-	37,988	60,972	-	60,972
Amounts due from credit institutions	9,805	1,778	11,583	3,521	2,036	5,557
Loans to customers	71,896	128,562	200,458	59,421	193,911	253,332
Investment securities						
available-for-sale	-	94	94	-	113	113
held-to-maturity	27,339	4,043	31,382	9,445	-	9,445
Other assets	877	7	884	236	-	236
Total	147,905	134,484	282,389	133,595	196,060	329,655
Financial liabilities						
Amounts due to credit institutions	5,644	-	5,644	48,305	39,250	87,555
Amounts due to customers	164,010	16,566	180,576	136,893	16,159	153,052
Other borrowed funds	45,566	18,110	63,676	27,765	53,573	81,338
Subordinated debt	260	21,274	21,534	264	20,230	20,494
Other liabilities	5,944	21	5,965	2,679	-	2,679
Total	221,424	55,971	277,395	215,906	129,212	345,118
Net	(73,519)	78,513	4,994	(82,311)	66,848	(15,463)

The Bank's ability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is substantial negative discrepancy of the liquidity for the period less than a year, which is connected to increase of the Bank clients funds. Hereby it should be underlined that in the clients funds "on demand" (2010: 109,747) "stable" part (is calculated according to the Bank's methods on basis of historical modeling for the particular historical period and with the confidence interval - 99%) makes about 65 % of total volume of funds "on demand" (2010: 71,275). Taking into account that the factual divergence of the liquidity for the period up to 1 year makes insignificant amount, which practically is foreseen by the Bank while managing the liquidity divergence.

The Bank has received the following funds from VTB Bank OJSC as of 31 December 2010: GEL 62,921 (2009: GEL 141,602). Management believes that this level of funding will remain with the Group 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.

(Thousands of Georgian Lari)

25. Related party disclosures

As of 31 December 2010 and 2009 outstanding balances on related party transactions are as follows:

	2010			2009 (adjusted)		
	The Parent bank	Entities under common control	Key management personnel	The Parent bank	Entities under common control	Key management personnel
Cash and cash equivalents	69	3,480	-	33	2,701	-
Amounts due from credit institutions	-	-	-	-	-	-
Loans to customers, gross	-	23,397	13	-	24,288	-
Less: allowance for impairment	-	-	-	-	-	-
Loans to customers, net	-	23,397	13	-	24,288	-
Other assets	15	-	2	-	-	-
Amounts due to credit institutions (Note 14)	5,509	-	-	71,377	2,533	-
Amounts due to customers	-	1,155	381	-	932	45
Other borrowed funds (Note 16)	35,878	-	-	49,731	-	-
Subordinated loan	21,534	-	-	20,494	-	-
Other liabilities	66	-	-	-	-	-

Entities under common control are companies that directly or indirectly through one or more intermediaries control or are controlled by or are under common control with the Bank (this includes holding companies subsidiaries and fellow subsidiaries). In these consolidated financial statements included into entities under common control are the members of VTB Group and other legal entities controlled by the Russian Federation.

On 25 October 2005, the Group 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 maturity on 26 October 2016. In the case of a liquidation of the Group, this loan is only repayable after all the obligations to the Group senior creditors have been met.

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

	2010			2009 (adjusted)		
	The Parent bank	Entities under common control	Key management personnel	The Parent bank	Entities under common control	Key management personnel
Interest income	-	3,033	5	1	3,277	3
Interest expense	(11,060)	(283)	(13)	(19,069)	(296)	(15)
Loan impairment charge	-	-	-	-	-	(1)
Fee and commission income	-	5	-	-	16	-
Fee and commission expense	(1)	(52)	-	-	(52)	-

Key management personnel as of 31 December 2010 comprise 5 members of the Supervisory Board and 5 members of the Management Board of the Bank. (2009: 5 members of the Supervisory Board and 3 members of the Management Board).

The Group had no significant transactions with members of the Supervisory Board in 2010 and 2009.

For the year ended 31 December 2010, remuneration of the members of the key management personnel comprised salaries, bonuses and other staff related expenses totalling GEL 1,250 (2009: GEL 1,638).

(Thousands of Georgian Lari)

26. 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 return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

Capital adequacy ratio

Regulatory capital consists of Tier 1 capital, which comprises common shares, reserve fund and retained earnings excluding current year profit or loss 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 or loss 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:

	<u>2010</u>	<u>2009 (adjusted)</u>
Tier 1 capital	72,300	40,564
Tier 2 capital	<u>6,748</u>	<u>9,042</u>
Total regulatory capital for ratio calculation	<u>79,048</u>	<u>49,606</u>
Risk weighted assets	<u>335,454</u>	<u>286,605</u>
Capital adequacy ratio	23.56%	17.31%

As of 31 December 2010 the Bank's capital adequacy ratio as calculated in accordance with the NBG requirements was 22.88% (2009: 18.98%).

The Bank was in compliance with the capital adequacy ratio calculated based on the NBG requirement as of 31 December 2010 and 2009.

27. Event after the reporting period

On 31 January 2011 the decision to cancel authorized and unpaid common shares in full was taken. On 11 February 2011 the Bank's registrar, JSC "Kavkasreestri", recorded the cancellation of 32,301 unpaid common shares of the Bank.