BANK OF GEORGIA

2010

ANNUAL REPORT

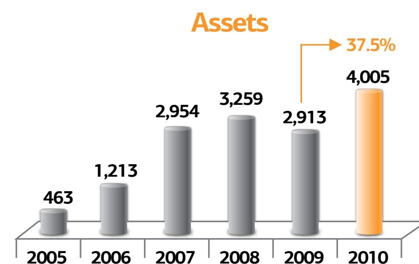
საქართველოს ბანკი
BANK OF GEORGIA

BANK OF GEORGIA HIGHLIGHTS

JSC Bank of Georgia (LSE: BGEO; GSE: GEB) is the leading Georgian bank offering a broad range of corporate and investment banking, retail banking, wealth management, brokerage and insurance services to its clients. Bank of Georgia is the largest bank in Georgia by assets, loans, deposits and equity, with 36.2%(1) market share by total assets. Bank of Georgia's activities are divided across business and geographical lines, with strong commercial banking footprint.

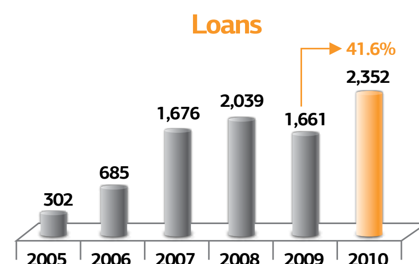
KEY FINANCIAL FIGURES (GEL *mln*)

	2010	2009	2008
Total Assets	4,005	2,913	3,259
Customer Loans	2,352	1,661	2,039
Client Deposits	2,005	1,272	1,193
Equity	693	598	719
Revenue(2)	347	298	336
Costs(3)	204	278	212
Net Income	83	(99)	0.2
Tier I Capital Adequacy Ratio (BIS)(4)	17.5%	22.4%	21.6%
Total Capital Adequacy Ratio (BIS)(4)	26.6%	34.7%	26.3%



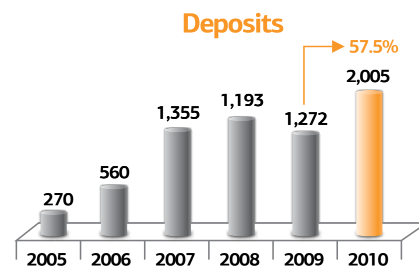
MARKET SHARES(1)

	2010	2009	2008	Market Position
Total Assets	36.2%	33.0%	32.9%	1
Customer Loans	35.9%	31.8%	32.9%	1
Client Deposits	32.6%	27.4%	28.8%	1



RATINGS

	Foreign Currency (Long-term/Short-term)	Local Currency
Standard & Poor's	B/B'	B/B'
Fitch Ratings	B+/B'	B+/B'
Moody's Investor Service	B1/NP'	Ba3/NP'



(1) Market data according to the information published by the National Bank of Georgia (NBG)

(2) Revenue equals sum of Net interest income, Net fee & commission income, Other non-interest income less Net insurance claims incurred

(3) Costs (or Expenses) equal Other non-interest expenses less Net insurance claims incurred (as presented in the JSC Bank of Georgia and Subsidiaries Consolidated Financial Statements)

(4) BIS Tier I and Total Capital Ratios are calculated on a standalone basis in accordance with the requirements of Basel Capital Accord I

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LETTER OF THE CHAIRMAN OF THE SUPERVISORY BOARD OF BANK OF GEORGIA

LETTER OF THE CHAIRMAN OF THE SUPERVISORY BOARD

It is my pleasure to write you for the first time since joining Bank of Georgia as Chairman of the Supervisory Board in June 2010. I joined the bank after retiring from a career at McKinsey and Company where I had the chance to work with financial institutions worldwide, though not in Georgia. Allow me this first time to share with you my thoughts with respect to the past year, the outlook for the future and most importantly the environment of Georgia, where the Bank of Georgia continues on its remarkable journey.

During the past year I had a chance to observe how young and determined country like Georgia fares with the effects of global financial crisis and to appreciate its government's resolve to stay on the free market path. It is this path that helped propel its once failing economy to the emerging economic success that it enjoys today. The most noteworthy accomplishment is the implementation of stunning reforms, which resulted in the eradication of corruption. This is a story that needs to be told to serve as an example for others.

Also of note, is the government's commitment to ensuring a business and investor friendly environment. These efforts were recognized by the international community, which in 2008, in the midst of global financial crisis, pledged US$ 4.5 billion, or 40% of Georgia's GDP, helping the country cope with the crisis and providing it with the means to continue to invest in its future.

Georgia ended 2010 with a respectable 6.4% real GDP growth, external debt level of 38% of GDP, stabilized currency and record level of foreign currency reserves at US$ 2 billion that continued to grow to US$ 2.5 billion by March 2011. With more than US$2.0 billion of donor funds still to flow into the country, Georgia is gearing to establish itself as a regional energy hub by utilizing the vast untapped hydro power potential.

Having eliminated corruption, a plague still tormenting the countries in the region, Georgia, with its liberal tax regime and abundant growth opportunities, has the right elements in place to become the destination of foreign investments, as Georgian economy advances and once the perception of risks diminishes. To this end, 2011 started on a positive note. Only several weeks ago, Georgia successfully placed its second US$ 500 million 10-year benchmark Eurobonds. With the yield of 7.125%, the new Eurobond is 37.5 bps lower than the yield of the existing shorter term 2013 Eurobonds. The improved pricing and the strong demand reflected in the deal 5.3 times oversubscribed serve as a testament of the increased investor confidence towards the country. In line with the improved investor sentiment, Fitch Ratings and Standard & Poor's, both of which have assigned 'B+' sovereign rating, have upgraded their respective outlooks from stable to positive in March and April 2011, respectively.

For Bank of Georgia, the country's largest bank, 2010 was a defining year in many ways. Having demonstrated its resilience in the times of global financial disruption, the bank weathered the tough economic environment without resorting to capital injection. More importantly, Bank of Georgia used its strength to capture the opportunities arising during the bad times and came out stronger from the crisis, reinforcing its leadership role on its home market. The sensible deployment of excess liquidity that we conservatively maintained during the downturn resulted in the healthy growth of the loan book and the improved loan quality in 2010. The country's most trusted top brand, Bank of Georgia attracted a record volume of client deposits both locally and internationally. These accomplishments, coupled with the increased efficiency, have led to the significant market share gains to the record high 36% by assets and by loans and 32% by deposits by the end of the year. Also, notably, international credit rating agencies have revised their ratings of Bank of Georgia. In August 2010, Fitch Ratings upgraded the bank's long-term foreign and local currency default ratings from 'B' to 'B+', the sovereign level. In January 2011, Moody's Investor Services, rated Bank of Georgia at 'B1', an improvement from B3. As of today, all three global credit rating agencies maintain stable outlook for Bank of Georgia.

The ability to align the strategy to the shifting trends in this fast-growing emerging market is one of the main success factors of Bank of Georgia. Acting upon the changed circumstances in our markets of operation, we made decisions that we believe

will benefit our bank and our shareholders: the exit from the loss-making Ukrainian banking operation will not only improve the bank's consolidated operating performance, but more importantly, it will free-up valuable management resource to allow us sharpen our focus on the considerable opportunities that the growing Georgian economy offers – the commitment we underlined as part of our strategy.

With its undisputedly leading banking franchise, Bank of Georgia is well-poised to continue to grow organically as the country's still modest banking sector loan penetration of less than 30% of GDP increases along with the expected growth of its economy. Furthermore, our new Georgia-focused strategy entails the continuation of the vertical integration of our market-leading insurance and healthcare businesses, aiming at capturing the opportunities that we envisage to come from the rapid growth of the underpenetrated insurance market, to be further boosted by the ongoing integration with the healthcare business. In addition, we have announced about our move into Georgia's affordable housing sector through our real estate subsidiary. The already allocated capital through the repossessed properties allows us to fill in the gap between the demand driven by significant housing shortage and the inability of real estate developers to satisfy such demand. We expect the insurance and real estate to contribute meaningfully to your bank's earnings over the next few years. You will get more details about the bank's performance in 2010 in the CEO's letter and other sections that follow in this report.

Corporate Governance was the focus of much of the Supervisory Board's attention in 2010. The move to a two-tier governance structure a year ago has aligned the Bank with international best practices. My fellow non-executive Supervisory Board members bring world-class investment, economic, legal and banking business expertise to the table, complementing the capable and talented group of executives that make up the Management Board of your bank. Building upon the bank's established results-oriented culture of teamwork and openness, we have put in place an Executive Compensation Policy which implemented the decision to abandon cash-based bonus compensation to replace it with a share based compensation scheme with the long-term share vesting program.

We started 2011 with confidence in our ability to continue building on our strength that will enable us capture the growth opportunities presented on our home market. Our short-to-medium term strategy entails aggressively pursuing these growth opportunities that we strongly believe will augment the Bank's growth to translate into increased shareholder value for our fellow shareholders. While 2010 saw a stellar growth of the Bank's share price of 142%, bringing it above its IPO price at the year-end, Bank of Georgia shares still trade at a substantial discount to CIS banks in terms of both PE and BV multiple. Having demonstrated the ability of turning challenges into opportunities, in 2011 we are looking forward to continue delivering results through superior execution of the strategy we believe will lead to fair valuation of your stock.

In closing, I would like to congratulate each member of the Supervisory Board, the management and the employees with the strong 2010 results and thank them for the remarkable efforts that made Bank of Georgia's success possible. In 2011 I am looking forward to working with this dedicated team and a highly engaged Supervisory Board as we continue to realize the full potential of your bank.

Sincerely,

Neil Janin
Chairman of the Supervisory Board
Bank of Georgia
April 2011

STATEMENT OF THE CHIEF EXECUTIVE OFFICER

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BANK OF GEORGIA

FOCUSING ON THE IMPORTANT

Dear Fellow Shareholders,

It is my pleasure to present you Bank of Georgia's results for 2010, which was a strong and important year for your bank. In 2010 the bank achieved a record operating income of GEL 346.9 million, a 17% increase from 2009, and earned a record net income of GEL 82.7, beating the announced management target of GEL 72 million. Looking back in the context of the past three challenging years, 2010 marks the end of the downturn and further strengthening your bank's industry leading position on its home market.

More importantly, these difficult times have demonstrated your bank's ability to achieve a remarkable balance between size and efficiency. The country's leading bank in terms of loans, deposits and other important metrics, tackled various challenges arising from difficult and changing environment by means of timely and decisive, yet sensible actions that only efficient companies with lean structures can afford. We ended 2010 with healthy revenue streams, positive operating leverage, reduced risks and our capital and liquidity levels remain strong. With these drivers of profitability in place we enter the future from a strong position. I would hereby like to share our vision for the next three years, which has been communicated to our shareholders at our Investor Days and various investor meetings.

At the beginning of 2010 we set out to deliver results that were outlined as part of our strategic priorities for the year. These priorities were growing the loan book following the deleveraging in 2009, decreasing our funding costs and improving our operating efficiency. The superiority of our lending machine was demonstrated by the 41.6% growth of the loan book enabling us to take away 4% share from the rest of the market in Georgia, which grew 14% in terms of loans during the year. Notably, our cost of risk were reduced while loan yield remained largely flat. On the back of continuous inflow of funds into the country, our client deposits grew by GEL 732.2 million, or 57.5% to a record level of GEL 2.0 billion, also gaining 4% market share by client deposits. As a result of the stellar growth of the client deposits in Georgia, which was also supported by the successful attraction of funds internationally by our wealth management operations, we are happy to report the further strengthened balance sheet structure. As of the year-end, Net Loan to Client Deposit Ratio was down to 117.3% from 130.6% a year ago. The successful reduction of interest rates on deposits to the average of 6.6% at the year-end have led to the decline of our cost of funding as the composition of our liabilities changed with cheaper deposits replacing wholesale funding. These developments and the excess liquidity allowed us to announce a tender offer to buyback Eurobonds maturing in 2012, further diminishing our reliance on expensive external wholesale funding.

2010 saw the improvement of the bank's loan quality. Along with the recovery of Georgia's economy, our non-performing loans represent 4.7% of the loan book compared to 7.7% in 2009 and our cost of risk of 1.8% is approaching the pre-crisis level.

In 2010 we committed ourselves to a constant strife towards efficiency. The effectiveness of the cost cutting measures implemented across the board and the benefits arising from technological advancements made us more efficient as demonstrated in the decline of our Cost Income ratio from 93.3% last year to 58.9% in 2010, and the increase of operating leverage, despite the high-cost burden incurred by BG Bank, Ukraine's operations. We are confident that the full advantages from the increased products offerings, distribution channels, full deployment of the new IT systems and the efficiencies of scale are yet to be realized, especially as retail lending accelerates. We remain committed to decreasing our expense base bringing our consolidated Cost/Income ratio below our current standalone Cost/Income ratio of 49%.

The performance of Bank of Georgia and the markets where we operate prompted us to revisit our strategy over the short-and-medium term and gave us the foundation to put in place a structure and a strategy in the context of our strengths, weaknesses and opportunities. First and foremost, our new strategy is based on our strong belief in investing sensibly where we see opportunities and where we are confident of our execution capabilities. The continuity of the Georgia's economic advancement and the ample growth opportunities it offers calls for our laser-sharp focus on our home market. This focus, we believe is the foundation of our strength and our ability to deliver to our clients and shareholders.

In line with the new strategy, we sold our equity interest in BG Bank in Ukraine, a decision that we believe will further improve our efficiency and allow us concentrate on the profitable growth of our Georgian business. The strong balance sheet, superior retail and corporate banking and insurance franchise positions the bank strongly to leverage on the growth of the Georgian economy, which will ultimately benefit our shareholders more than the pursuit of international expansion.

Our new strategy aims at delivering a ROAE of more than 20% and doubling our loan book by year-end 2013. Having grown by 6.4% in 2010, Georgia's real GDP is estimated to grow by 5.0% on average over the next three years. The decreasing interest rate environment and the growing corporate sector is expected to boost the banking sector lending, which is estimated to reach at least 40% of GDP from as low as current 29%. These reasonable and conservative assumptions provide us with immense role to play in the advancement of the country and our track record of execution and the market leading position puts us in the right place to capitalize on the organic growth of Georgian banking sector.

Bank of Georgia includes businesses that have strong positions in their respective promising sectors, but are not entirely central to our core business. Aldagi BCI (ABCI), the bank's insurance subsidiary and the country's leading insurance services provider, has made remarkable progress over the past several years. The backward integration of its rapidly growing health insurance business with healthcare business contributed considerably to ABCI's strong performance in 2010, producing 26% return on equity. Georgia's fragmented and underpenetrated health and life insurance sector is now gearing up for growth strongly supported by government programs, which envisage the establishment of small and mid-sized hospitals by private insurance companies. With healthcare spending accounting for 8% of Georgia's GDP and only 0.8% of GDP currently being spent through health insurance, ABCI, the country's top insurer, is strongly positioned to capture most of the healthcare spending and up-sell insurance products creating synergies between insurance business and healthcare provider. To this end, we decided to further enhance the vertical integration of ABCI with the view to enlarge the current business model currently consisting of six outpatient clinics and one mid-sized hospital operated by ABCI. The advantages that come from the advancements in the vertical integration and the increased insurance penetration are expected to raise ABCI's contribution to your bank's net income from five per cent in 2010 to more than 10% by 2013.

Another growth opportunity we are well-positioned to capitalize on is presented to us by the housing shortage, legacy of the Soviet era, and the near absence of primary supply to satisfy a large and growing demand for housing, as the financial crisis negatively affected the country's top three real estate developers. Such unsatisfied demand for new housing has translated into the slowdown of our mortgage book growth, an issue we are prepared to address by making a move into affordable housing business through SBRE, our real estate subsidiary. As a result of the crisis, we couldn't avoid allocating the capital through number of repossessed land plots, and we are successfully implementing a pilot project selling studio apartments. We intend to outsource architecture and construction works and plan to engage in the project management and sales of these apartments through our superior distribution channels of 143 branches and 1,500 sales force. We estimate to sell up to 2,000 units over the next three years, which will not only help boost our mortgage lending, but is expected to contribute more than 10% to our consolidated net income in the next few years.

Our drive for value creation has prompted us to consider a move to a holding structure. As Bank of Georgia's shareholder you have exposure to non-banking businesses, such as insurance and real estate, which have already grown and will continue to grow to the levels that will contribute more meaningfully to your bank's earnings. The separation of these businesses from banking operations and bringing them together under one holding structure, will not only free up capital of the core banking franchise, but will help maximize the value of each one of them separately. The new structure, we believe, will result in greater accountability of performance and will help fully realize your company's earnings power. We are working with our advisors on the optimal structure and the procedures for such move to ensure that it serves the best interests of our businesses and our shareholders. We will report on our progress as we move along this path.

In conclusion, strong performance in 2010 has positioned us strongly to capture the growth opportunities in our priority market and emphasized our task to ensure even better performance in the years to come.

Finally, I would like to thank our world-class supervisory board members for their support and invaluable guidance, my fellow management board members and the employees for their dedicated work and congratulate them with our achievements.

Sincerely,

Irakli Gilauri
Chief Executive Officer
Bank of Georgia
April 2011

ANNUAL FINANCIAL REPORT

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BANK OF GEORGIA

SUMMARY OF CONSOLIDATED PERFORMANCE

The following discussion may not contain all the information that is important to reader of this Annual Report. For a more complete understanding of the events, risks and uncertainties, as well as liquidity, market, credit and operational risks, affecting JSC Bank of Georgia and Subsidiaries ("Bank of Georgia" or the "Bank"), this Annual Report should be read in its entirety.

STATEMENT OF INCOME 2010 VS. 2009

OVERVIEW

Bank of Georgia reported a record 2010 Net income of GEL 82.7 million, or GEL 2.78 per share, compared to 2009 Net loss of GEL 98.9 million. The increase in Net income for the year was a result of a record performance of our banking business driven by improved Net interest income and asset quality, as well as higher Net fee and commission income and higher Gains on foreign currency dealings and improvement in our insurance business. Increased efficiency across the board also contributed significantly. Return on equity (ROE)[1] amounted to 12.6% in 2010.

GEL thousands	2009	2010	Change 10/09
Interest income	379,058	423,141	11.6%
Interest expense	(188,517)	(206,797)	9.7%
Net interest income	190,541	216,344	13.5%
Impairment charge on loans and finance lease receivables	(125,741)	(44,111)	-64.9%
Net interest income after impairment charge	64,800	172,233	165.8%
Net fee and commission income	55,025	63,420	15.3%
Other non-interest income	82,086	95,022	15.8%
Other non-interest expenses	(307,817)	(232,232)	-24.6%
Profit (loss) before income tax (expense) benefit	(105,906)	98,443	NMF
Income tax (expense) benefit	6,998	(15,776)	NMF
Profit (loss) for the year	**(98,908)**	**82,667**	**NMF**

NET INTEREST INCOME

Net interest income (Net interest income before impairment charge on interest-earning assets) increased by 13.5% to GEL 216.3 million in 2010, compared to the Net interest income of GEL 190.5 million in 2009. The increase was attributed to the Interest income growth driven by the significantly increased loan book (Loans to customers) and the decline of funding costs, in particular the average rates paid on customer account balances, which partially offset the impact of the substantial growth of client deposits (Amounts due to customers) in 2010.

[1] *Return on total shareholders' equity excluding non-controlling interests*

The following table and discussion describes the components of this increase.

GEL thousands	2009	2010	Change 10/09
Interest income			
Loans to customers	361,176	389,402	7.8%
Investment securities – held-to-maturity	5,725	12,498	118.3%
Amounts due from credit institutions	5,037	9,795	94.5%
Investment securities – available-for-sale	1,276	7,287	NMF
Finance lease receivables	5,844	4,159	-28.8%
Total interest income	**379,058**	**423,141**	**11.6%**
Interest expense			
Amounts due to customers	(96,749)	(114,654)	18.5%
Amounts due to credit institutions	(91,582)	(91,829)	0.3%
Debt securities issued	(186)	(314)	68.8%
Total interest expense	**(188,517)**	**(206,797)**	**9.7%**
Net interest income	**190,541**	**216,344**	**13.5%**

Interest income increased by GEL 44,083 million, or 11.6%, to GEL 423.1 million in 2010. Of that increase, GEL 28,226 million, or 64.0%, came from the increase of Interest income on Loans to customers to GEL 389.4 million. The increased lending activity during the year resulted in the growth of loan balances. Gross average loans to customers and finance lease receivables reached GEL 2,127.2 million, up by GEL 222.1 million, or 11.7%, compared to the prior year. *(see the* ***Average Interest Earning Assets and Average Interest Bearing Liabilities*** *table below).*

The interest-earning securities portfolio (investment securities Held-to-maturity and investment securities Available-for-sale), increased on average as the Bank kept most of its excess liquidity in higher yielding local currency liquid assets, resulting in the increases of Interest income from investment securities. *(see more on Investment securities under* ***Average Interest Earning Assets and Average Interest Bearing Liabilities*** *table, Assets discussion and note 11 of this Annual Report).*

Amounts due from credit institutions comprise inter-bank deposits (time deposits with effective maturity of more than 90 days), short-term interbank loans (inter-bank loan receivables) and obligatory reserves with the central banks. The main contributor to the growth of interest earned on Amounts due from credit institutions was the rise of interest earned from inter-bank deposits, a result of the increase in amounts placed at a number of international banking insti-

tutions. Obligatory reserves with the central banks grew to GEL 90.4 million from GEL 41.8 million in 2009 as a result of the increased reserve requirement (from nil to five percent) on the borrowed funds by the National Bank of Georgia (NBG) as of September 2010. The increase was also partially attributed to the strong client deposit growth in 2010. *(see more on Amounts due from credit institutions under Assets discussion and in Note 8 of this Annual Report. For more information on client deposits refer to Assets discussion and Note 20 of this Annual Report).*

In 2010 Interest expense increased by 9.7% to GEL 206.8 million, compared to GEL 188.5 million in 2009. The growth was primarily attributed to the 18.5% increase in Interest expense on client deposits to GEL 114.7 million, reflecting the 34.2% growth of Average amounts due to customers in 2010. The increase in Interest expense was in part offset by the decline of average rates paid on customer balances during the year. In 2010 effective average interest rate paid on customer account balances was 7.6% in 2010 compared to 8.4% in 2009.

The other major item of Interest expense is interest expense on the Amounts due to credit institutions, which was virtually flat in 2010, as the Bank's increase in the Borrowings from international credit institutions as well as the growth of Time deposits and Inter-bank loans by an aggregate of GEL 210.3 million mostly occurred in November and December 2010. There was also a small increase in Interest expense from Debt securities. *(see more on Amounts due to credit institutions and Debt securities issued under Assets discussion and Notes 18 and 19 of this Annual Report).*

Reflecting the decline of effective average interest rate paid on client deposits and insignificant growth of Interest expense on Amounts due to credit institutions, cost of funds[2] decreased to 8.2% in 2010 from 8.3% in 2009.

IMPAIRMENT CHARGE AND NET INTEREST INCOME AFTER IMPAIRMENT CHARGE

GEL thousands	2009	2010	Change 10/09
Impairment charge on loans to customers	(118,882)	(49,886)	-58.0%
Impairment reversal (charge) on finance lease receivables	(6,859)	5,775	-184.2%
Total impairment charge	**(125,741)**	**(44,111)**	**-64.9%**
Net interest income after impairment charge	**64,800**	**172,233**	**165.8%**

In line with the improvements in asset quality and Georgia's economic recovery during the year, the Loan impairment charge declined to GEL 49.9 million, compared to the Loan impairment charge of GEL 118.9 million in 2009. In 2010, approximately GEL 39.1 million Loan impairment charge was attributed to the Bank's loan book in Georgia and approximately GEL 9.7 million was related to the loan book of BG Bank in Ukraine. In 2009, the Loan impairment charge of GEL 84.8 million and GEL 35.0 million were attributed to the Bank's loan book in Georgia and BG Bank, respectively.

[2] *Average disclosures as well as average balances used in ratios are derived from the Bank's IFRS-based management reports in 2010, 2009 and 2008 and are based on monthly averages*

Also, reflecting significant recoveries in Ukrainian finance lease receivables as well as the improved economic environment in Georgia, the Bank's Reversal of impairment on finance lease receivables amounted to GEL 5.8 million in 2010 compared to the Impairment charge on finance lease receivable of GEL 6.9 million in 2009.

As a result of the decline of the Impairment charges on loans to customers and on finance lease receivables, the Bank's Net interest income after impairment charge grew 165.8% to GEL 172.2 million, compared to GEL 64.8 million in 2009.

NET FEE AND COMMISSION INCOME

GEL thousands	2009	2010	Change 10/09
Fee and commission income	64,599	74,265	15.0%
Fee and commission expense	(9,574)	(10,845)	13.3%
Net fee and commission income	**55,025**	**63,420**	**15.3%**

Net fee and commission income increased by 15.3% to GEL 63.4 million in line with the increases in sales of the Bank's fee generating products and services such as commission income from settlement operations, guarantees and letters of credit, cash operations and fees from advisory services. *(see more on Net fee and commission income in Note 23 of this Annual Report)*

OTHER NON-INTEREST INCOME

GEL thousands	2009	2010	Change 10/09
Net gains from for trading securities	2,763	1,217	-56.0%
Net gains (losses) from investment securities available-for-sale	174	789	NMF
Net gains (losses) from derivative financial instruments	(6,266)	(7,826)	24.9%
Net gains (losses) from revaluation of investment properties	(4,087)	350	NMF
Net gains (losses) from foreign currencies	28,766	33,749	17.3%
Net insurance premiums earned	45,477	44,561	-2.0%
Share of Profit(loss) of associates	(2,649)	255	NMF
Other operating income	17,908	21,927	22.4%
Other non-interest income	**82,086**	**95,022**	**15.8%**

The decrease of GEL 1.5 million in Net gains from trading securities from the prior year was predominantly due to the decline in brokerage activity in Ukraine by the Bank's brokerage subsidiary in line with the weakened economic environment in the country. The losses on derivatives were due to the appreciation of the fair value of the derivative financial liability related to the interest rate swap contract, entered by the Bank with International Finance Corporation (IFC) in May 2009 to hedge U.S dollar interest rate risk on the outstanding long-term borrowings.

The Bank owns several investment properties mostly in Georgia. As real estate prices stabilized during 2010 in line with recovery of Georgia's economy, a revaluation of the properties resulted in the Net gains of GEL 350 thousand.

Gains from foreign currencies, essentially comprised of com-

missions earned by the Bank from the currency exchange transactions, increased by 17.3% to GEL 33.7 million, the growth in line with the increased business activity and foreign currency exchange transactions in Georgia.

Net insurance revenue comprised of Net premiums earned less Net claims incurred, increased by 8.4% to GEL 16.7 million, mostly due to the notably improved claims management of the Aldagi BCI (ABCI), the Bank's insurance subsidiary, that led to GEL 2.2 million, or 7.3% decrease of Net insurance claims incurred to GEL 27.9 million. *(see more on Net Insurance claims incurred in the* ***Other Non-Interest Expenses*** *table. For more information on Net insurance revenue please see Note 24 of this Annual Report)*

The Bank's Share of loss of associates, where the Bank owned less than or equal to 50% equity interest, resulted in the total Share of gain of GEL 255 thousand in 2010 compared to the Share of loss of GEL 2.6 million in 2009. *(see more on Share of profit(loss) of associates in Note 12 of this Annual Report).*

OTHER NON-INTEREST EXPENSES

Other non-interest expenses were GEL 232.2 million, down GEL 75.6 million, or 24.6%, from the prior year.

GEL thousands	2009	2010	Change 10/09
Salaries and other employee benefits	(100,505)	(104,551)	4.0%
General and administrative expenses	(57,339)	(61,000)	6.4%
Net insurance claims incurred	(30,102)	(27,898)	-7.3%
Depreciation, amortization and impairment	(101,700)	(28,398)	-72.1%
Impairment charge on other assets and provisions	(6,431)	(3,587)	-44.2%
Other operating expenses	(11,740)	(6,798)	-42.1%
Other non-interest expenses	**(307,817)**	**(232,232)**	**-24.6%**

In line with the growth of business across the board, the Bank's salaries and other employee benefits increased 4.0% to GEL 104.6 million, mostly due to the average headcount increase from 4,885 in 2009 to 5,152 in 2010. Despite the increase in the headcount, the improved efficiency translated into the improved Other non-interest expense per average employee ratio, which declined from GEL 63.0 in 2009 to GEL 45.1 in 2010.

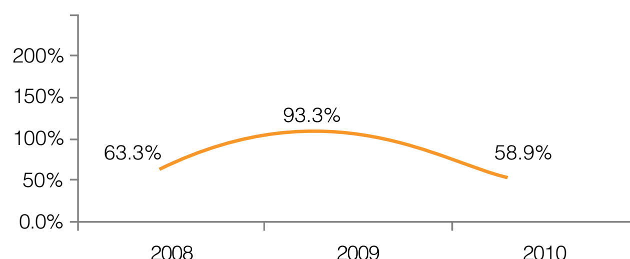
The main contributor to the 6.4% growth of General and Administrative expenses was marketing and advertising expenses, due to the increased lending and deposit gathering activities in Georgia.

In 2009 the Depreciation, amortization and impairment expense of GEL 101.7 million was burdened by the one-off Goodwill impairment charge of GEL 73.1 million related to the goodwill write off of BG Bank and the devaluation of BG Bank's property. The 2010 improvement reflects the return to more normal depreciation and amortization levels.

The improvement in the Impairment charge on other assets and provisions reflects the improvement of the credit quality of receivables of debtors related to documentary operations.

The decrease of Other operating expenses was attributed to the cost efficiency measures implemented during 2010 in the Bank and its subsidiaries. (*See more on Other non-interest expenses in Notes 14, 15, 17, 24 and 25 of this Annual Report).*

The improved operating efficiency, a result of cost containment and technological enhancement, are reflected in the improved Cost/Income ratio compared to the prior year. Other non-interest expense per average Total assets[3] improved from 9.2% in 2009 to 6.0% in 2010.



For the purposes of the Cost/Income ratio calculation, Income equals sum of Net Interest income before impairment charges, Net fee and commission income and Other non-interest income less Net insurance claims incurred. Cost equals Other non-interest expense excluding Net Insurance claims incurred.

Income tax expense for 2010 amounted to GEL 15.8 million, compared to Income tax benefit of GEL 7.0 million in 2009.

AVERAGE INTEREST EARNING ASSETS AND AVERAGE INTEREST BEARING LIABILITIES[2]

Net Interest Margin (NIM)[2] declined to 8.1% in 2010 from 9.1% in 2009. The decrease was a result of the increased liquidity, attributed to the higher growth rate of average client deposits relative to the growth rate of average loans and higher concentration of lower yielding corporate loans in the total loan book compared to the prior year. The Bank's Net interest income before impairment charge on interest earning-assets grew 13.5% to GEL 216.3 million in 2010.

GEL thousands	2009	2010	Change 10/09
Average amounts due from credit institutions	324,554	391,763	20.7%
Average loans to customers and finance lease receivables, gross	1,905,107	2,127,192	11.7%
Less: average allowance for impairment: loans to customers and finance lease receivables	(150,660)	(184,614)	22.5%
Average loans to customers and finance lease receivables, net	1,754,447	1,942,579	10.7%
Average interest earning investment securities	95,592	261,167	173.2%
Average interest earning assets	**2,174,593**	**2,595,509**	**19.4%**
Average amounts due to customers	1,137,895	1,526,794	34.2%
Average amounts due to credit institutions	1,054,023	1,076,455	2.1%
Average debt securities issued	159	3,362	NMF
Average interest bearing liabilities	**2,192,077**	**2,606,611**	**18.9%**

SEGMENT RESULTS

The overall results benefited from improved operating income and pre-tax profits of each of our operating segment and were driven by a strong performance in retail banking, corporate banking, brokerage and asset and wealth management and insurance.

The following discussion summarizes the Bank's income statement segment information. The amounts presented in each segment table below exclude corporate center and intercompany eliminations. *(See more information on Segment results in Note 6)*

RETAIL BANKING

GEL thousands	2009	2010	Change 10/09
Retail banking			
Total operating income	167,677	162,482	-3.1%
Result (Pre-tax profit/(loss))	(46,094)	44,618	-62.9%

In 2010 the decline in Retail banking was mostly attributable to the decline in net interest income generated by the retail loan book compared to the previous year, reflecting the strong growth of retail deposits and relatively modest increase of the retail loan book.

The 2010 pre-tax profit of GEL 44.6 million posted by Retail banking compares to the 2009 Pre-tax loss of GEL 46.1 million. The 2009 Pre-tax loss included high impairment charges on retail banking interest earning assets and the retail portion of the written-off goodwill of BG Bank, Ukraine. The 2010 retail banking result benefited from lower impairment charges compared to the previous year and lower retail banking costs due to increased efficiency that resulted in Retail banking Pre-tax profit of GEL 44.6 million in 2010.

CORPORATE BANKING

GEL thousands	2009	2010	Change 10/09
Corporate banking			
Total operating income	110,630	141,523	27.9%
Result (Pre-tax profit/(loss))	(13,583)	56,454	NMF

In 2010 corporate banking posted strong results due to significant growth of corporate lending in Georgia during the year. The growth of total operating income of corporate banking business by GEL 30.9 million, or 27.9% compared to 2009 was driven by increases in net interest income on corporate loan book and in net foreign currency gains as the Bank collected higher commissions on increased volumes of foreign currency transactions by the corporate clients compared to the prior year.

Corporate banking results in 2010 also benefited from the improved operating environment as reflected in the decline of impairment charges on corporate bank's interest earning assets from GEL 42.5 million in 2009 to GEL 15.8 million in 2010.

BROKERAGE AND ASSET AND WEALTH MANAGEMENT

GEL thousands	2009	2010	Change 10/09
Brokerage and Asset and Wealth management			
Total operating income	(20,453)	12,102	NMF
Result (Pre-tax profit/(loss))	(40,530)	(15,047)	NMF

Brokerage and Asset and Wealth Management business generated 2010 total operating income of GEL 12.1 million that compares to the total operating expense of GEL 20.5 million in 2009. The better operating result of the segment was largely driven by the improved operating performance of the wealth management business and the effects of the revaluation of properties held by the Bank's subsidiaries, mostly in Georgia. The enhanced operating performance of Brokerage and Asset and Wealth Management translated into the improved Pre-tax loss of GEL 15.0 million from the Pre-tax loss of GEL 40.5 million in 2009.

INSURANCE

GEL thousands	2009	2010	Change 10/09
Insurance			
Total operating income	47,790	48,711	1.9%
Result (Pre-tax profit/(loss))	2,883	5,481	90.1%

Insurance segment posted strong 2010 results that predominantly reflect the strong revenues generated by the Bank's insurance subsidiary, improvements in claims management and operating cost efficiency achieved during the year.

STATEMENT OF INCOME 2009 VS. 2008

OVERVIEW

The Net loss of GEL 98.9 million in 2009 was primarily a result of high impairment charge on Loans to customers of GEL 118.9 million and Goodwill impairment charge on Loans to customers of GEL 73.1 million, predominantly associated with the goodwill write-off of BG Bank, the Bank's subsidiary in Ukraine. The Bank's performance was also affected by the challenging business environment in the first half of 2009.

GEL thousands	2008	2009	Change 09/08
Interest income	403,939	379,058	-6.2%
Interest expense	(183,099)	(188,517)	3.0%
Net interest income	220,840	190,541	-13.7%
Impairment charge on loans and finance receivable	(124,147)	(125,741)	1.3%
Net interest income after impairment charge	96,693	64,800	-33.0%
Net fee and commission income	49,969	55,025	10.1%
Other non-interest income	91,756	82,086	-10.5%
Other non-interest expenses	239,222	307,817	28.7%
Loss before income tax benefit	(804)	(105,906)	NMF
Income tax benefit	978	6,998	NMF
Profit (loss) for the year	**174**	**(98,908)**	**NMF**

NET INTEREST INCOME

Net interest income decreased by 13.7% from 2008 to GEL 190.5 million in 2009, primarily due to significantly decreased yield on liquid assets and increased funding costs, a result of the growth of client deposits (Amounts owed to customers) and the increase in effective average interest rates on deposits in 2009 compared to 2008.

GEL thousands	2008	2009	Change 09/08
Interest income			
Loans to customers	363,013	361,176	-0.5%
Investment securities – held- to-maturity	16,457	5,725	-65.2%
Amounts due from credit institutions	10,732	5,037	-53.1%
Investment securities – available-for-sale	6,727	1,276	-81.0%
Finance lease receivables	7,010	5,844	-16.6%
Total interest income	**403,939**	**379,058**	**-6.2%**
Interest expense			
Amounts due to customers	(85,358)	(96,749)	13.3%
Amounts due to credit institutions	(97,035)	(91,582)	-5.6%
Debt securities issued	(706)	(186)	-73.7%
Total interest expense	**(183,099)**	**(188,517)**	**3.0%**
Net interest income	**220,840**	**190,541**	**-13.7%**

In 2009 all Interest income items contributed to the decline of total Interest income. Despite the contraction of the gross loan book by 14.8% during the year, interest income on Loans to customers remained largely unchanged, declining by 0.5% to GEL 361.2 million. In 2008 loan balances increased until mid-year and declined at the end of the year. Loan balances continued their decline during the first half of 2009, increasing only slightly towards the end of the year. *(see the **Average Interest Earning Assets and Average Interest Bearing Liabilities** table).*

Interest income on Bank of Georgia's securities portfolio (Investment securities held-to-maturity and available-for-sale taken together) decreased by GEL 16.2 million to GEL 7.0 million in 2009. The decline, despite growth in the Bank's securities portfolio from GEL 56.6 million as of 31 December 2008 to GEL 268.8 million as of 31 December 2009, was a result of higher average securities portfolio maintained by the Bank in 2008 *(see the **Average Interest Earning Assets and Average Interest Bearing Liabilities** table)* and significantly higher average interest rates on these instruments during 2008. The Bank's debt securities portfolio in 2009 was comprised of Certificates of Deposit of central banks and Ministry of Finance treasury bills of Georgia, both Held-to-maturity, and Available-for-sale securities such as Corporate bonds and Ministry of Finance treasury bills of Ukraine. *(see more on Investment securities under Assets discussion)*

Interest earned on Amounts due from credit institutions decreased by 53.1% to GEL 5.0 million in 2009, mostly due to the decline of interest earned from the interbank deposits (Time deposits with effective maturity of more than 90 days) placed at several international banking institutions. In 2009 Amounts due from credit institutions comprised of inter-bank deposits with effective maturity of more than 90 days, short-term interbank loans and Obligatory reserves with the central banks. Obligatory reserves with the central banks increased from GEL 39.7 million in 2008 to GEL 41.8 million in 2009, a result of deposit growth.

Interest expense, consisting of interest expense on the Amounts due to credit institutions, interest expense on deposits (Amounts due to customers) and interest expense on Debt securities issued, increased by 3.0% to GEL 188.5 million in 2009. The growth resulted primarily from the 13.3% increase in Interest expense on deposits (Amounts due to customers) to GEL 96.7 million, as deposits increased by 6.7% to GEL 1,272.5 million at 31 December 2009. Effective average interest rate paid on customer account balances was 8.4% in 2009 and 6.6% in 2008. Interest expense on the Amounts due to credit institutions declined by 5.6% to GEL 91.6 million as a result of the reduction of the Amounts due to credit institutions by GEL 288.1 million in 2009. As a result, cost of funds[2] increased from 8.1% in 2008 to 8.3% in 2009.

Despite the loan book contraction and high liquidity in the second half of the year, Bank of Georgia's NIM[2] stood at healthy 9.1% in 2009 (compared to 9.6% in 2008).

IMPAIRMENT CHARGE AND NET INTEREST INCOME AFTER IMPAIRMENT CHARGE

GEL thousands	2008	2009	Change 09/08
Impairment charge on loans to customers	(122,812)	(118,882)	-3.2%
Impairment charge on finance lease receivables	(1,335)	(6,859)	NMF
Total impairment charge	**(124,147)**	**(125,741)**	**1.3%**
Net interest income after impairment charge	**96,693**	**64,800**	**-33.0%**

Reflecting the improved but still weak operating environment in Georgia in 2009, the Loan impairment charge declined only slightly to GEL 118.9 million, compared to GEL 122.8 million in 2008. Approximately GEL 84.8 million Loan impairment charge was attributed to the Bank's loan book in Georgia and approximately GEL 35.0 million was related to the loan book of BG Bank in Ukraine. In 2008, the Loan impairment charge of GEL 110.6 million and GEL 18.0 million were attributed to the Bank's loan book in Georgia and BG Bank, respectively. The decline in Net interest income before impairment charge more than offset the improvements in Impairment charges on loans to customers resulting in the decline of Net interest income after impairment charge to GEL 64.8 million compared to GEL 96.7 million in 2008.

NET FEE AND COMMISSION INCOME

GEL thousands	2008	2009	Change 09/08
Fee and commission income	63,503	64,599	1.7%
Fee and commission expense	(13,534)	(9,574)	-29.3%
Net fee and commission income	**49,969**	**55,025**	**10.1%**

Net fee and commission income rose by 10.1% to GEL 55.0 million. Fee and commission income comprised fee and commission from settlement operations, guarantees and letters of credit, cash operations, currency conversion operations, brokerage services, advisory services and other fees. The growth in 2010 was driven by the increases in sales of fee generating products and services listed above.

OTHER NON-INTEREST INCOME

GEL thousands	2008	2009	Change 09/08
Net gains from for trading securities	(5,447)	2,763	NMF
Net gains (losses) from investment securities available-for-sale	513	174	-66.1%
Net gains (losses) from derivative financial instruments	-	(6,266)	-
Net gains (losses) from revaluation of investment properties	(389)	(4,087)	NMF
Net gains (losses) from foreign currencies	47,134	28,766	-39.0%
Net insurance premiums earned	35,911	45,477	26.6%
Share of loss of associates	(713)	(2,649)	NMF
Other operating income	14,747	17,908	21.4%
Other non-interest income	**91,756**	**82,086**	**-10.5%**

The Bank's Other non-interest income declined by 10.5% to GEL 82.1 million in 2009. Net gains from trading securities amounted to GEL 2.8 million in 2009, compared to the Net loss of GEL 5.4 million in 2008. Due to the drop in real estate prices in Georgia by approximately 20%, the revaluation of investment properties resulted in the Net losses of GEL 4.1 million, compared to the Net losses of GEL 0.4 million in 2008. Gains from foreign currencies decreased by 39.0% to GEL 28.8 million in 2009.

Net insurance revenue, comprised of Net premiums earned less Net claims incurred, increased by 70.5% to GEL 15.4 million, mostly a result of the increase in Net insurance premiums earned driven by the rise of the premiums earned on health insurance.

The Bank's Share of loss of associates, where the Bank owned less than or equal to 50% equity interest, resulted in the total Share of loss of GEL 2.6 million in 2009 compared to the Share of loss of GEL 0.7 million in 2008.

OTHER NON-INTEREST EXPENSES

GEL thousands	2008	2009	Change 09/08
Salaries and other employee benefits	(108,767)	(100,505)	-7.6%
General and administrative expenses	(68,649)	(57,339)	-16.5%
Net insurance claims incurred	(26,895)	(30,102)	11.9%
Depreciation, amortization and impairment	(20,532)	(101,700)	NMF
Impairment charge on other assets and provisions	(4,551)	(6,431)	41.3%
Other operating expenses	(9,828)	(11,740)	19.5%
Other non-interest expenses	**(239,222)**	**(307,817)**	**28.7%**

In 2009 Salaries and other employee benefits decreased by 7.6% from 2008 to GEL 100.5 million, a result of headcount reduction and cost optimization measures undertaken by the Bank in December 2008 and in 2009. The number of personnel of the Bank reached 4,781 employees at the year-end 2009 compared to 4,949 employees as of 31 December 2008 and 6,196 as of November 2008 immediately prior to the headcount reduction conducted by the Bank in December 2008. Salaries and other employee benefits accounted for 32.7% of Other non-interest expenses compared to 45.5% in 2008.

General and administrative expenses declined by 16.5% to GEL 57.3 million. Depreciation, amortization and impairment expense amounted GEL 101.7 million in 2009, an increase of GEL 81.2 million in 2009, which more than offset the decline in Salaries and other employee benefits expense and General and administrative expenses and resulted in a 28.7% increase of the Bank's Other non-interest expenses to GEL 307.8 million in 2009 (compared to 74.9% growth in 2008). The significant increase of the Depreciation, amortization and impairment cost in 2009 was largely driven by the Goodwill impairment charge of GEL 73.1 million associated predominantly with the goodwill write-off of BG Bank, while the impairment of BG Bank property amounted to GEL 3.2 million. The Bank's charge for depreciation of property increased by GEL 3.8 million, or 20.6%, to GEL 22.5 million due to additions of furniture and fixtures. The charge for amortization of intangibles increased by GEL 1.3 million, or 80.0% to GEL 2.9 million, mostly due to American Express license acquired by the Bank in December 2008 and other software additions during 2009.

Impairment charge on other assets and provisions increased to GEL 6.4 million in 2009, compared to Impairment charge on other assets and provisions in 2008 of GEL 4.6 million. Despite the reversal of Provision for guarantees and commitments in the amount of GEL 2.1 million, the increase of Impairment charge was driven by the Impairment charge for investments in associates of GEL 2.2 million and Impairment charge for other assets totaling GEL 5.5 million, which is predominantly attributable to the provisioning of the Bank's Receivable from documentary operations.

Income tax benefit for 2009 amounted to GEL 7.0 million, due to the Loss before income tax benefit for the year. Income tax benefit in 2008 amounted to GEL 1.0 million.

AVERAGE INTEREST EARNING ASSETS AND AVERAGE INTEREST BEARING LIABILITIES[2]

GEL thousands	2008	2009	Change 09/08
Average amounts due from credit institutions	220,931	324,554	46.9%
Average loans to customers and finance lease receivables, gross	2,038,632	1,905,107	-6.5%
Less: average allowance for impairment: loans to customers and finance lease receivables	(72,650)	(150,660)	107.4%
Average loans to customers and finance lease receivables, net	1,965,982	1,754,447	-10.8%
Average interest earning investment securities	124,776	95,592	-23.4%
Average interest earning assets	**2,311,689**	**2,174,593**	**-5.9%**
Average amounts due to customers	1,256,082	1,137,895	-9.4%
Average amounts due to credit institutions	1,010,814	1,054,023	4.3%
Average debt securities issued	7,504	159	-97.9%
Average interest bearing liabilities	**2,274,400**	**2,192,077**	**-3.6%**

BALANCE SHEET HIGHLIGHTS 2010 VS 2009
ASSETS

As of 31 December 2010, Bank of Georgia's Total assets reached GEL 4,004.9 million, growing by GEL 1,091.5 million, or 37.5%, from the prior year. As the deposit inflow outpaced the lending rate during 2010, the Bank increased its amounts placed on current and time deposit accounts at various international banks and central banks, resulting in the 70.9% growth of the Cash and cash equivalents to GEL 611.6 million. The Bank maintained high liquidity levels during the year and as of the year-end 2010 Cash and cash equivalents accounted for 15.3% of Total assets, compared to 12.3% in 2009, while the average liquidity ratio[3], based on the NBG standards, stood at 35.6% in 2010, higher than NBG's 30% requirement, compared to 36.5% in 2009, when the NBG required the minimum of 20% average liquidity ratio.

Amounts due from credit institutions grew to GEL 116.5 million from GEL 64.6 million in 2009. The 80.2% growth during 2010 was primarily due to the increase in Obligatory reserves with central banks from GEL 41.8 million in 2009 to GEL 90.4 million in 2010. The increase was due the introduction of five percent reserve requirement on the borrowed funds by the NBG and the solid growth of the client deposits during the year. The Bank's securities portfolio grew by GEL 26.2 million to GEL 295.0 million in 2010. The growth was predominantly a result of the purchase of Ministry of Finance treasury bonds available-for-sale. During the second half of 2010, the Bank sold part of the investment securities held-to-maturity and has reclassified most of the remaining investments as securities available-for-sale. As a result, Available-for-sale securities grew by GEL 275.4 million to GEL 294.9 million, while Held-to-maturity securities declined to GEL 21 thousand from GEL 249.2 million in 2009. As of 31 December, Available-for-sale securities held by the Bank comprised Ministry of Finance treasury bills and bonds of GEL 180.7 million, Certificates of deposit of central banks of GEL 105.0 million and Corporate shares in the amount of GEL 11.3 million, compared to an aggregate of GEL 16.4 million Corporate shares and bonds held by the Bank in 2009. *(see more on Investment securities in Note 11 of this Annual Report).*

In 2010 the Bank's gross loan book, which predominantly comprised of the loans issued in Georgia, grew to GEL 2,527.2 million, an increase of GEL 699.4 million, or 38.3%. The growth of the gross loans book was largely driven by the growth of commercial loans, which grew 51.6% to GEL 1,424.6 million and micro loans up 138.5% to GEL 238.5 million. Residential mortgage loans, consumer loans and gold-pawn loans increased by 5.8%, 15.4% and 6.2%, respectively.

[3] Liquidity ratio based on NBG standards is calculated as a percentage of liquid assets to total liabilities. Liquid assets include cash, mandatory reserves in NBG, nostro accounts in NBG and commercial banks, interbank deposits, Georgian state debt securities and NBG certificates of deposits, net of pledges.
Liabilities are calculated as the sum of the Bank's total liabilities and off-balance-sheet liabilities and do not include: those loans, subordinated debts and off-balance sheet liabilities, and/or their part, which will mature in more than six months; a part of the issued guarantees and outstanding letters of credit secured with funds blocked in the same bank; and commitments to trade foreign exchange.

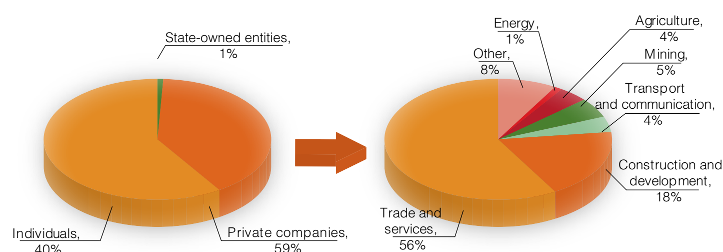
GROSS LOANS

GEL thousands	2008	2009	2010	Change 10/09
Commercial loans	1,044,959	939,814	1,424,550	51.6%
Residential mortgage loans	391,606	387,415	409,786	5.8%
Consumer loans	496,197	332,537	383,615	15.4%
Micro loans	151,313	99,981	238,462	138.5%
Gold – pawn loans	46,374	62,829	66,749	6.2%
Others	15,174	5,241	4,071	-22.3%
Loans to customers, gross	**2,145,623**	**1,827,817**	**2,527,233**	**38.3%**
Less – Allowance for loan impairment	(106,601)	(166,486)	(175,536)	5.4%
Loans to customers, net	**2,039,022**	**1,661,331**	**2,351,697**	**41.6%**

Loans to Private companies accounted for 58.9% of total gross loan book (includes portion of Micro loans), increasing by 59.3% to GEL 1,488.6 million in 2010 compared to GEL 934.5 million in 2009. Loans to individuals of GEL 1,006.0 million, increased by 16.7% compared to 2009, and represented 39.8% of total gross loans. Loans extended to State-owned entities in the amount of GEL 32.6 million, or a 5.3% increase from 2009, continued to hold the smallest share with 1.3% of the total gross loan book.

Bank of Georgia maintained the diversified loan book across various sectors of the economy. By the end of 2010, ten largest borrowers accounted for 15% of the total gross loan book, up from 11% in 2009.

GROSS LOANS BY CUSTOMER TYPE AND SECTORS



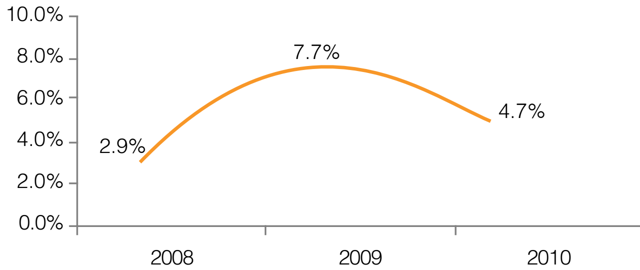
In line with the gross loan book growth during the year, Allowance for the loan impairment grew by GEL 9.1 million, or 5.4%, to GEL 175.5 million. As of 31 December 2010, Allowance for the loan impairment represented 6.9% of gross loans, which compares favourably to the Allowance for the loan impairment to gross loans ratio of 9.1% in 2009.

ALLOWANCE FOR LOAN IMPAIRMENT

GEL thousands	2008	2009	2010	Change 10/09
Commercial loans	45,755	82,042	114,499	39.6%
Consumer loans	42,153	54,989	31,873	-42.0%
Residential mortgage loans	7,969	23,490	22,424	-4.5%
Micro loans	4,921	3,788	5,951	57.1%
Others	5,803	2,177	789	-63.8%
Total	**106,601**	**166,486**	**175,536**	**5.4%**

As of 31 December 2010 the non-performing loans[4] (NPLs) improved, declining by 16.0% to GEL 117.6 million and accounting for 4.7% of total gross loans compared to the NPL/total gross loans ratio of 7.7% in 2009.

NPLS/TOTAL GROSS LOANS TO CLIENTS

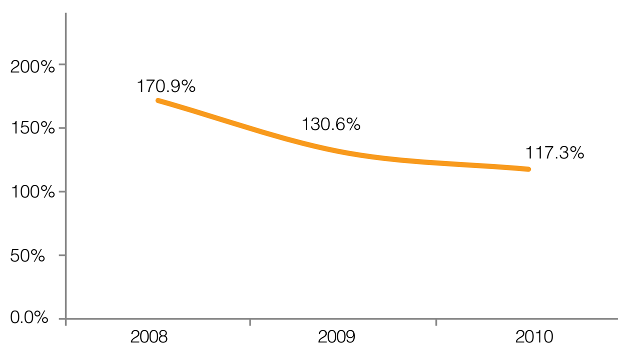


The Bank's loan book remained highly collateralized, with 92% of the total volume of gross loans to clients secured by mostly property, inventory and trade receivables for commercial lending and by mortgages over residential properties for individual lending.

LIABILITIES

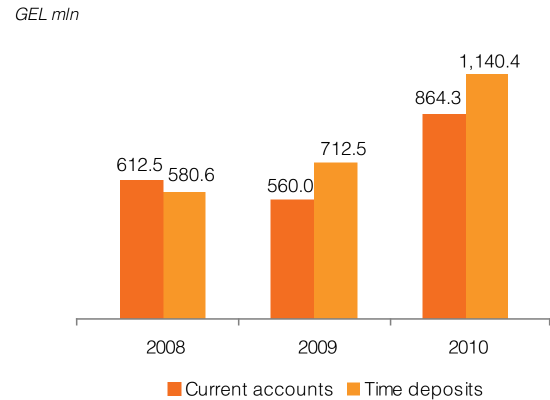
As of 31 December 2010, Total liabilities increased by 43.0% to GEL 3,311.6 million, driven by the 57.5% increase in client deposits to the record level of GEL 2,004.7 million, which compares to GEL 1,272.5 million in 2009. The growth was driven by 62.8% increase in client deposits from private enterprises increasing by GEL 363.7 million to GEL 942.5 million. Client deposits from Individuals increased by GEL 256.5 million to GEL 894.3 million as of 31 December 2010, while client deposits of State and budget organizations increased by GEL 112.0 million, or 200.6%, to GEL 167.8 million. Client deposits accounted for 60.5% of Total liabilities as compared to the same ratio of 55.0% in 2009. As a result of the strong growth of average client deposits during 2010, the Net Loans to Client Deposits ratio declined to 117.3% in 2010 from 130.6% in 2009.

NET LOANS/CLIENT DEPOSITS



Amounts due to credit institutions increased by 22.6% to GEL 1,138.9 million, compared to GEL 928.6 million in 2009. The increase from the prior year was mostly attributed to the increase in Time deposits and inter-bank loans by GEL 117.5 million to GEL 130.3 million and the increase in Borrowings from international credit institutions by GEL 90.3 million to GEL 1,003.9 million.

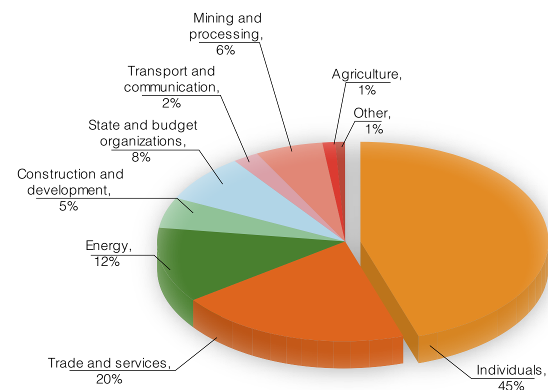
DEPOSITS BY TYPE



As of 31 December 2010, Time deposits of GEL 1,140.4 million were up by GEL 427.9 million, 60.1% and accounted for 56.9% of total client deposits, remaining largely at the same level of 56.0% in 2009. Current accounts grew by 54.3%, or GEL 304.3 million, to GEL 864.3 million up from GEL 560.0 million in 2009.

As of 31 December 2010, ten largest customers accounted for 18% (or GEL 360.2 million), of deposits, up from 17% in 2009.

DEPOSITS BY INDUSTRY



EQUITY

As of 31 December 2010, authorized share capital comprised of 43,308,125 ordinary shares, of which 31,344,860 were Ordinary shares issued and fully paid compared to 31,306,071 Ordinary shares issued and fully paid as of 31 December 2009.

[4] NPLs are more than 90 days overdue loans including principal and interest payment

REGULATORY CAPITAL AND CAPITAL ADEQUACY (BIS)

GEL thousands	2008	2009	2010
Ordinary shares	31,253	31,306	31,345
Share premium	468,732	478,779	477,285
Retained earnings	137,768	38,625	129,341
Tier I capital	**637,753**	**548,710**	**637,971**
Undisclosed reserves	56,913	-	-
General loan loss provisions	32,662	27,301	45,666
Revaluation reserves	26,201	24,387	26,816
Subordinated debt	157,535	317,791	332,306
Tier II capital	**273,311**	**369,480**	**404,788**
Deductions from capital	(134,238)	(67,454)	(70,722)
Total capital	**776,826**	**850,736**	**972,037**
Risk-weighted assets	2,950,653	2,454,763	3,653,247
Tier I capital adequacy ratio	**21.6%**	**22.4%**	**17.5%**
Total capital adequacy ratio	**26.3%**	**34.7%**	**26.6%**

Bank of Georgia ended the year with a strong capital position, based on Tier I and Total Capital Ratios (BIS).

Total capital was GEL 972.0 million as of 31 December 2010, compared with GEL 850.7 million in 2009, an increase of GEL 121.3 million. The increase in Total capital was largely attributable to the 16.3% increase of Tier I capital to GEL 638.0 million, driven by the increase in Retained earnings for the period. The Bank's Tier II capital grew by GEL 35.3 million, or 9.6% to GEL 404.8 million compared to Tier II capital of GEL 369.5 million in 2009. The growth in 2010 mostly related to the increase of general loan provisions by GEL 18.4 million and the increase of the subordinated debt by GEL 14.5 million.

Risk-weighted assets increased by 48.8% to GEL 3,653.2 million in 2010 compared to GEL 2,454.8 million in 2009, a result of the increase of the loan book during the year.

National Bank of Georgia requires capital adequacy calculation based on the NBG methodology, which is done on a standalone basis. Based on the NBG calculation method, Bank of Georgia's Tier I and Total Capital Ratios as of 31 December 2010 were at 13.0% and 14.5%, respectively, and above the statutory minimum of 8% for Tier I and 12% for Total Capital. In 2009, Tier I and Total Capital Ratios, based on the NBG methodology, amounted to 19.7% and 16.8% respectively. The decline in Tier I and Total Capital ratios in 2010 compared to 2009 was due to the changes in the calculation methods of risk-weighted assets by the NBG, entailing the increase of the risk-weighting on the foreign currency denominated loans from 150% in 2009 to 175% in 2010.

2009 vs. 2008

As of 31 December 2009 Bank of Georgia had Total assets of GEL 2,913.4 million, as compared to Total Assets of GEL 3,258.9 million in 2008, a decrease of 10.6%. Cash and cash equivalents, which accounted for 12.3% of Total assets, decreased by 13.9% to GEL 357.9 million in 2009, mostly a result of the decrease in the Time deposits with credit institutions up to 90 days. The average liquidity ratio[4], based on the NBG standards, was 36.5% in 2009, compared to 31.1% in 2008, higher than the NBG's 20% requirement. The Bank's securities portfolio grew by GEL 212.2 million to GEL 268.8 million in 2009, predominantly a result of GEL 144.1 million held-to-maturity Georgia's Ministry of Finance treasury bills purchased by the Bank in 2009. Available-for-sale securities decreased from GEL 33.7 million in 2008 to GEL 19.6 million in 2009, mostly attributable to the disposal of the Corporate shares in the aggregate value of GEL 8.3 million. In 2009, the Bank also disposed Corporate bonds in the aggregate amount of GEL 3.8 million.

In 2009, gross loan book predominantly comprised of the loans issued in Georgia, decreased by 14.8% to GEL 1,827.8 million. While residential mortgage loans held steady at -1.1%, the difficult business environment negatively affected all other loan categories except gold-pawn loans, which profited from the increased demand for this product during the economic downturn.

Loans to Private companies accounted for 51.1% of total gross loan book (includes portion of Micro Loans), decreased 9.2% to GEL 934.5 million in 2009. Loans to individuals of GEL 862.4 million, declined by 20.1% compared to 2008, and represented 47.2% of total gross loans. Loans extended to State-owned entities in the amount of GEL 31.0 million, or a 15.6% decrease from 2008, continued to hold the smallest share with 1.7% of the total gross loan book.

Bank of Georgia maintained the diversified loan book across various sectors of the economy. By the end of 2009, ten largest borrowers accounted for 11% of the total gross loan book, at the same level as in 2008.

Allowance for the loan impairment increased from the prior year due to an increase in estimated losses predominantly for consumer loans, due to the weakening of economic environment. As a result, the Allowance for the loan impairment amounted to GEL 166.5 million, compared to GEL 106.6 million in 2008. Allowance for the loan impairment to gross loans ratio in 2009 increased to 9.1% from 5.0% in 2008.

As of 31 December 2009 the non-performing loans (NPLs)[3] accounted for 7.7% of total gross loans.

The Bank's loan book remains highly collateralized, with 93% of the total volume of gross loans to clients secured by mostly property, inventory and trade receivables for commercial lending and by mortgages over residential properties for individual lending.

LIABILITIES

As of 31 December 2009, Total liabilities decreased 8.9% to GEL 2,315.0 million, primarily due to the 23.7% decrease in the Amounts due to credit institutions to GEL 928.6 million following the repayment of the aggregate of GEL 225 million wholesale debt funding by the Bank during the year.

Amounts due to customers, or client deposits, increased by 6.7%, or GEL 79.3 million, to GEL 1,272.5 million in 2009 driven by 28.7% increase in client deposits from Individuals, which

increased by GEL 142.0 million to GEL 637.8 million as of 31 December 2009. Deposits from Private enterprises declined by GEL 48.2 million, or 7.7% to GEL 578.8 million, while deposits of State and budget organizations decreased by GEL 14.5 million, or 20.6%, to GEL 55.8 million.

As of 31 December 2009, Time deposits of GEL 712.5 million accounted for 56.0% of total deposits, up from 48.7% in 2008, translating into the growth of 22.7%, or GEL 131.9 million. Current accounts declined by 8.6%, or GEL 52.5 million, to GEL 560.0 million.

As of 31 December 2009, ten largest customers accounted for 17% (or GEL 217.3 million), of client deposits, down from 27% in 2008.

EQUITY

As of 31 December 2009, authorized share capital comprised of 43,308,125 ordinary shares, of which 31,306,071 were Ordinary shares issued and fully paid compared to 31,253,283 Ordinary shares issued and fully paid as of 31 December 2008.

REGULATORY CAPITAL AND CAPITAL ADEQUACY (Bis)

Bank of Georgia maintained a well-capitalized position, based on Tier I and Total Capital Ratios (BIS) as of 31 December 2009 and 31 December 2008.

Total capital was GEL 850.7 million at 31 December 2009, compared with GEL 776.8 million in 2008, an increase of GEL 73.9 million. The increase in Total capital was largely attributable to the 35.2% increase of Tier II capital to GEL 369.5 million driven by the increase in subordinated term debt to GEL 317.8 million. The Bank's Tier I capital declined by 14.0% to GEL 548.7 million a result of the decline in Retained earnings to GEL 38.6 million in 2009.

Risk-weighted assets decreased by 16.8% to GEL 2,454.8 million in 2009 from GEL 2,950.7 in 2008, in line with the contraction of the loan book during the year.

National Bank of Georgia requires capital adequacy calculation based on the NBG methodology, which is done on a standalone basis. Based on the NBG calculation method, Bank of Georgia's Tier I and Total Capital Ratios as of 31 December 2009 were at 19.7%, and 16.8%, respectively, and above the statutory minimum of 8% for Tier I and 12% for Total Capital. In 2008, Tier I and Total Capital, based on the NBG methodology, amounted to 16.6% and 13.5%, respectively.

SHAREHOLDERS

End of period	2008	2009	2010
Bank of New York (Nominees), Limited	77.45%	88.86%	90.50%
East Capital Financial Institutions	4.37%	4.36%	4.36%
Firebird Avrora Fund	4.68%	-	-
Firebird Republics Fund	4.58%	-	-
Others (less than 4% individually)	8.92%	6.78%	5.14%
Total	**100.0%**	**100.0%**	**100.0%**

As of 31 December 2010 the members of the Supervisory Board and Management Board owned 448,232 shares of Bank of Georgia. In addition, the members of the Supervisory Board and Management Board and employees were awarded or were committed to award 1,341,918 and 1,130,412 GDRs in 2010 and 2009, respectively. The following table depicts the interest of the members of the Supervisory Board and Management Board as of 31 December 2010, 2009 and 2008

Shareholder	31-Dec-08	31-Dec-09	31-Dec-10
	Shares and GDRs held		
Irakli Gilauri	136,303	*216,230*	*200,379*
Sulkhan Gvalia	166,907	*136,049*	*60,638*
Allan Hirst	10,685	*46,772*	*56,311*
Avto Namicheishvili	12,489	*29,999*	*34,823*
Kaha Kiknavelidze	4,938	15,027	22,509
Irakli Burdiladze	10,036	23,035	17,504
David Morisson	-	7,342	15,351
Giorgi Chiladze	-	6,333	14,333
Mikheil Gomarteli	-	9,916	10,634
Al Breach	-	-	6,527
Neil Janin	-	-	3,945
Archil Gachechiladze	-	-	3,700
Ian Hague	-	-	1,578
Nicholas Enukidze	75,377	122,259	-
Ramaz Kukuladze	52,092	-	-
Total	**468,827**	**612,962**	**448,232**

RECENT EVENTS

Recent Developments

Sold of equity interest in BG Bank, Ukraine

In February 2011, JSC Bank of Georgia sold an 80.0% equity interest in BG Bank, its subsidiary in Ukraine. The total consideration including brokerage fees paid to BG Capital, the Bank's wholly owned brokerage subsidiary amounted to US$9.6 million (GEL 17.0 million). The aggregate pricing of the transaction translates into the valuation of 0.82 times book value of BG Bank, which stood at US$14.6 million (GEL 26.0 million) IFRS-based, as per Bank of Georgia's unaudited management accounts as of 31 January 2011. Bank of Georgia will retain 19.4% equity interest in BG Bank. Bank of Georgia does not have debt exposure to BG Bank or any other Ukrainian entity.

Announced the launch of the tender offer for Loan Participation Notes

On 19 April 2011 Bank of Georgia invited holders of the outstanding US$200,000,000 9.0 per cent. Loan Participation Notes due 2012 issued by BG Finance B.V. to submit offers to tender their Notes to Bank of Georgia for cash. Bank of Georgia will determine the purchase price and the aggregate principal amount of Notes to be purchased in accordance with a modified Dutch auction procedure. The invitation was made upon the terms and subject to the conditions contained in the invitation for offers dated 19 April 2011 prepared in connection with the Invitation, and is subject to certain jurisdictional restrictions set out in the Invitation for Offers. In particular, the Invitation was not made and will not be made, directly or indirectly, in or into, or by use of the mails of, or by any means or instrumentality (including, without limitation, facsimile transmission, telex, telephone, email and other forms of electronic transmission) of interstate or foreign commerce of, or any facility of a national securities exchange of, the United States, and no offer of Notes may be made by any such use, means, instrumentality or facility from or within the United States, or to U.S. persons or by persons located or resident in the United States. In addition, the communication of the invitation for offers and any other documents or materials relating to the invitation was not made, and such documents and/or materials have not been approved by, an authorised person for the purposes of section 21 of the Financial Services and Markets Act 2000. Bank of Georgia currently holds approximately 26.16% of the aggregate principal amount of Notes outstanding, being US$52,318,000 in aggregate principal amount.

CORPORATE GOVERNANCE

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BANK OF GEORGIA

CORPORATE GOVERMANCE

OVERVIEW

Georgia has not adopted a code of corporate governance. In December 2003, the National Bank of Georgia circulated an official letter to Georgian commercial banks requesting them to begin introducing the best corporate governance practices based on the 1999 OECD Corporate Governance Principles. However, no deadline for such implementation has been established. Bank of Georgia has, however, put in place a framework for corporate governance which it believes is suitable for a company of its size and nature (for further details see "Corporate Governance" on Bank of Georgia's website at www.bog.ge/ir/).

BANK OF GEORGIA'S CORPORATE BODIES

Bank of Georgia's corporate bodies are the General Meeting of Shareholders, the Supervisory Board and the Management Board, each having its own responsibilities and authorities in accordance with Georgian law and Bank of Georgia's Charter. The General Meeting of Shareholders elects the members of the Supervisory Board, which is responsible for supervising the Management Board. The Supervisory Board appoints the members of the Management Board, which is the executive body of Bank of Georgia directly responsible for day-to-day operations. According to the Georgian law, each bank in Georgia is required to have an audit committee, elected by the supervisory board, which mainly facilitates the activities of the internal audit and external auditors of a bank.

Under Georgian law and the Charter the shareholders are authorised to pass resolutions on certain issues at a General Meeting of Shareholders. According to the Charter, decisions on all other issues are made by the Supervisory Board and the Management Board within their respective capacities.

Supervisory Board

In accordance with Bank of Georgia's Charter, it is the responsibility of the Supervisory Board to supervise the Management Board. The Supervisory Board also assists the Management Board by giving advice. In performing their duties, the Supervisory Board members are required to act in the best interests of Bank of Georgia and its business.

The Supervisory Board consists of seven non-executive members. Members of the Supervisory Board may be appointed and dismissed at a General Meeting of Shareholders. Banking regulations contain certain limitations as to who may become a member of the Supervisory Board, for example, a person who has been convicted of money laundering, terrorist financing or economic crime cannot be elected to the Supervisory Board of a bank. The statutory term of each Supervisory Board member is four years. The Supervisory Board as well as each holder of voting shares is entitled to make a recommendation on one or more candidates for each vacant seat of the Supervisory Board. Furthermore, holders of shares representing in aggregate at least 20.0% of the issued share capital have the right to nominate, subject to the existence of a vacancy on the Supervisory Board, their representative to the Supervisory Board. The members of the Supervisory Board are elected by cumulative voting.

The Chairman of the Supervisory Board (or in case of his/her absence, the vice Chairman) convenes the Supervisory Board meetings and determines the agenda. Any member may add items to the agenda or request a meeting of the Supervisory Board.

Bank of Georgia's Supervisory Board currently consists of: Neil Janin (Chairman), David Morrison, Allan J. Hirst, Ian Hague, Kaha Kiknavelidze, Hanna Loikkanen and Al Breach.

Management Board

The Management Board is an executive body that is responsible for the day-to-day management of Bank of Georgia (with the exception of the functions reserved to the General Meeting of Shareholders and the Supervisory Board) and consists of the CEO and not less than three directors. The Management Board is accountable to the shareholders and the Supervisory Board and its members are appointed and dismissed by the Supervisory Board. Banking regulations contain certain limitations as to who may become a member of the Management Board and criteria that each director must fulfil. The Supervisory Board approves the remuneration and other conditions of employment for each member of the Management Board. Certain resolutions of the Management Board are subject to the prior approval of the Supervisory Board.

The Management Board is headed by the CEO. The CEO is responsible for: (i) acting independently on behalf of Bank of Georgia (subject to any required consents from the Supervisory Board); (ii) chairing meetings of the Management Board, supervising the implementation of decisions of the Management Board, Supervisory Board and the General Meeting of Shareholders, assigning tasks to the Management Board members with the consent of the Supervisory Board and to other managers of Bank of Georgia and issuing relevant orders, instructions and other directives for these purposes; (iii) submitting for approval by the Supervisory Board, recommendations on the remuneration and bonuses of Bank of Georgia's employees; (iv) appointing and dismissing employees in accordance with the employee recruitment plan approved by the Management Board; (v) carrying out any other activity required for attaining the goals of Bank of Georgia (except those that fall within the competence of the General Meeting of Shareholders or Supervisory Board). The CEO is entitled to delegate his direct tasks to other Management Board members or the heads of the relevant departments of Bank of Georgia.

Bank of Georgia's Management Board currently consists

of: Irakli Gilauri (Chief Executive Officer), Irakli Burdiladze, George Chiladze, Archil Gachechiladze, Mikheil Gomarteli, Sulkhan Gvalia and Avto Namicheishvili.

Audit Committee

According to the Banking Law, Georgian banks are required to have an audit committee which mainly facilitates the activities of the internal audit and external auditors of a bank. The audit committee is formed by the Supervisory Board. Bank of Georgia's Audit Committee is comprised of not less than three members. If there are independent members in the Supervisory Board, at least one of them shall be elected to the Audit Committee. If there are no independent members in the Supervisory Board, any other member of the Supervisory Board shall be elected to the Audit Committee. The Audit Committee is presided over by the chairman who is elected by the Supervisory Board.

Meetings of the Audit Committee are held at least once a quarter. In extraordinary cases, a meeting may be convened upon the request of the Supervisory Board. The Audit Committee passes resolutions by a simple majority of votes. The attending members do not have the right to abstain from voting.

Bank of Georgia's Audit Committee currently consists of: Allan J. Hirst, Kaha Kiknavelidze and David Morrison. Allan J Hirst, serves as a chairman of the Audit Committee.

Compensation Committee

The amount of remuneration paid to members of the Supervisory Board is determined by the General Meeting of Shareholders. The remuneration of the Management Board is determined by the Supervisory Board. In May 2006, the Supervisory Board established a Compensation Committee which is responsible for reviewing and approving compensation packages for the members of the Management Board and certain senior managers of Bank of Georgia. Bank of Georgia's Compensation Committee currently consists of: Al Breach (chairman of the committee), Ian Hague (member of the committee) and Hanna Loikkanen (member of the committee).

The Chairman of the Supervisory Board is not entitled to additional compensation for committee membership. Compensation is payable to the Supervisory Board and committee members quarterly in Bank of Georgia's shares and/or GDRs equivalent in value to the U.S. dollar figures, based on the average market share/GDR price for the relevant quarter.

For a discussion of Bank of Georgia's risk management systems, see "Risk Management" of this Annual Report

RISK MANAGEMENT

RISK MANAGEMENT

The following discussion may not contain all the information that is important to reader of this Annual Report. For a more complete understanding of risk management process and procedures of JSC Bank of Georgia and its Subsidiaries ("Bank of Georgia" or the "Bank"), please refer to the Note 27 of the accompanying Audited Consolidated Financial Statements of JSC Bank of Georgia and its Subsidiaries.

Risk is an inherent part of business activities of Bank of Georgia. The Bank's risk management system is based on the principle of continually assessing risk throughout the life of any operation. Risk 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 Bank of Georgia's continuing profitability and each individual within the bank is accountable for the risk exposures relating to his or her responsibilities.

The major risk types identified by the bank are liquidity risk, market risk (including currency exchange rate risk and interest rate risk), credit risk and operational risk.

RISK MANAGEMENT STRUCTURE

Bank of Georgia conducts its risk management activities within the framework of its unified risk management system. Responsibility for the conduct of the Bank's risk management activities are divided among Bank of Georgia's principal risk management bodies.

Supervisory Board is responsible for the overall risk management approach and for approving risk strategies and principals and is ultimately responsible for identifying and controlling risks. It approves the Bank's Credit Policy, which outlines credit risk control and monitoring procedures and the Bank's credit risk management systems and approves certain decisions which fall outside the scope of the Credit Committees' authority.

Management Board has overall responsibility for the Bank's asset, liability and risk management activities, policies and procedures. The Management Board delegates individual risk management functions to each of the various decision making and execution bodies within the Bank.

Audit Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions. Audit Committee facilitates the activities of the internal audit and external auditors of the Bank. The Audit Committee, an independent body, is elected and directly monitored by the Supervisory Board.

The Internal Audit department is responsible for the annual audit of the risk management processes of Bank of Georgia. Internal Audit department 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 finding and recommendations to the Audit Committee.

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

*Credit Committees.*The Bank has two credit committees one of which supervises and manages the Bank's credit risks in respect of retail loans and one which supervises and manages the Bank's credit risks in respect of corporate loans. Each Credit Committee approves individual loan transactions, establishes credit risk categories and provisioning rates on such transactions. The Deputy Chief Executive Officer ("Deputy CEO"), Chief Risk Officer (who is responsible for credit risk and asset recovery) and the Credit Risk Management department, in consultation with Bank of Georgia's CEO and Deputy CEO, Finance, adopt decisions on the acceleration and write-off of non-performing loans.

Each Credit Committee is comprised of tiers of subcommittees. The Credit Committee in respect of retail loans comprises four tier subcommittees and the Credit Committee in respect to corporate loans comprises three tiers of subcommittees. The tables below describe the approval limits for each subcommittee in respect to retail loans and corporate loans.

	Subcommittee Chair	Approval limit for RB loans (US$)
Tier I	Risk manager of the relevant Credit Risk Management Department	150,000
Tier II	Head of the relevant Credit Risk Management Department	150,000-300,000
Tier III	Chaired by Director of the Retail Banking Credit Risk Management Department	300,000-2,000,000
Tier IV	CEO	>2,000,000

	Subcommittee Chair	Approval limit for CB loans (US$)
Tier I	Risk manager of the relevant Credit Risk Management Department	New client: 200,000 Existing client 500,000
Tier II	Deputy Director of the relevant Credit Risk Management Department	New client: 200,000-750,000 Existing client: 500,000-1,500,000
Tier III	CEO	New client: > 750,000 Existing client: >1,500,000

All exposures to single CB borrowers over U.S.$25.0 million require approval by the Supervisory Board. Each of the subcommittees of the Credit Committees make their decisions by a majority vote of their respective members.

Asset and Liabilities Management Committee ("ALCO") establishes policy with respect to capital adequacy, market limits, medium and long term liquidity risk and interest rates. Specifically, ALCO

- Sets interbank lending limits, open currency position limits

with respect to overnight and intraday positions and stop-loss limits;

- Monitors compliance with established value-at-risk (“VAR”) limits on possible losses as a secondary measure;

- Sets ranges of interest rates for different maturities at which the Bank may place assets and attract liabilities with and without approval.

Compliance with the Bank's interest rate policy is monitored by the head of Financial Risk Management and the Treasury.

The ALCO is chaired by the CEO and meets on a monthly basis as well as any other time deemed necessary, with decisions made by a majority vote of its members. ALCO members include the CEO, Deputy CEO, Finance, Deputy CEO, Chief Risk Officer, Deputy CEO, Corporate Banking, Deputy CEO, Retail Banking, Head of Financial Risk Management, Head of the Treasury, Head of Wealth Management and Head of Debt Capital Markets. At its monthly meetings, the ALCO reviews financial reports and indices including the Bank's ALM limits/ratios, balance sheet, statement of operations, liquidity gap, interest rate gap, cash flow analyses for the past three months and future projections, deposit concentration and other financial and growth projections.

The Legal department’s principal purposes are to ensure the Bank’s activities conform to applicable legislation and to minimize losses from the materialization of legal risks. The Legal department is responsible for the application and development of mechanisms for identifying legal risks in the Bank’s activities in a timely manner, investigation of the Bank’s activities in order to identify any legal risks, planning and implementation of all necessary actions for the elimination of identified legal risks, participation in legal proceedings on behalf of the Bank where necessary and investigating possibilities for increasing the effectiveness of the Bank’s legal documentation and its implementation in the Bank’s daily activities. The Legal department is also responsible for providing legal support to structural units of the Bank.

RISK MANAGEMENT AND REPORTING

Bank of Georgia measures risk using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. These models use probabilities derived from historical experience, adjusted to reflect the economic environment. Bank of Georgia also runs worse case scenarios that could arise in the event those extreme events, however unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank of Georgia as well as the level of risk that it is willing to accept, with additional emphasis on selected industries. The Bank also conducts ongoing monitoring and control allowing efficient adjustments in case of any unexpected changes in the conditions on which the preliminary risk assessment was made. In addition the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risks types and activities.

The Bank maintains a management reporting system which requires the Credit Risk Management, Financial Management and Funding departments to prepare certain reports on a daily and monthly basis. On a daily basis, a statement of operations, balance sheet and Treasury Report (which includes the Bank's open foreign exchange positions, cash flows, limits and balances on NOSTRO and LORO correspondent accounts) and confirmation that there has been compliance with mandatory financial ratios must be provided by each department. On a monthly basis, a report on the structural liquidity gap, a report on interest rate risk, monthly financial statements, and a Supervisory Board report containing analysis of the Bank's performance against its budget are provided.

Information compiled from all the businesses is examined and processed in order to analyze, control and identify early risks. This information is presented and explained to the Management Board, and the head of each business division. The report includes aggregate credit exposure, hold limit exceptions, liquidity ratios and risk profile changes. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Management Board receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of Bank of Georgia.

Specifically tailored risk reports are prepared and distributed in for all levels throughout the Bank in order to ensure that all business divisions have access to extensive, relevant and up-to-date information.

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

RISK MITIGATION AND EXCESSIVE RISK CONCENTRATION

As part of its overall risk management, Bank of Georgia uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions. While these are intended for hedging, these do not qualify for hedge accounting.

Bank of Georgia actively uses collateral to reduce its credit risks.

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

graphical location.

In order to avoid excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. *(see more under Credit Risk)*

LIQUIDITY RISK

Liquidity risk is the risk that Bank of Georgia will be unable to meet its payment obligations when they fall due under normal and stress circumstances. Liquidity risk is managed through the ALCO approved liquidity framework. The Treasury department manages liquidity on a daily basis and submits monthly reports to the ALCO. In order to manage liquidity risk, it performs daily monitoring of future expected cash flows on client's and banking operations, which is a part of the assets/liabilities management process. The ALCO sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level on interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

The liquidity risk management framework models the ability of the Bank to fund under both normal conditions and during a crisis situation.To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets withliquidity in mind, and monitors future cash flows and liquidity on a regular 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.

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

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratios established by the NBG. As at 31 December 2010, these ratios were as follows:

	2008	2009	2010
Average liquidity ratio for the year	31.4%	36.5%	35.6%
Maximum liquidity ratio	48.6%	45.7%	44.5%
Minimum liquidity ratio	20.8%	21.9%	29.1%

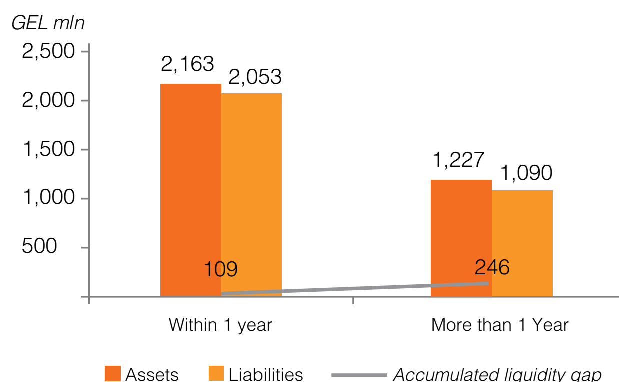
Average liquidity ratio is calculated on a stand- alone basis for JSC Bank of Georgia as annual average of daily liquidity ratios computed as percentage of liquid assets in liabilities determined by National Bank of Georgia as follows:

Liquid assets - comprise cash, cash equivalents and other assets that can be immediately converted into cash. Those assets include investment securities issued by Georgian Government plus Certified Deposits issued by NBG and not including amounts due from credit institutions other than interbank deposits and/or debts securities of Government and Central Banks of non-OECD countries, amounts due to Nostro Accounts that are under lien, impaired inter-bank deposits, amounts on obligatory reserve with NBG that are pledged due to borrowings from NBG.

Liabilities - comprise sum of total liabilities and off-balance sheet commitments not including subordinated loans, those commitments that are to be exercised orsettled not earlier than six month from reporting date, financial guarantees and Letter of credits fully collateralized by cash covers in the Bank, commitments due to dealing operations with foreign currencies. Maximum and minimum rates of liquidity ratio are taken from historical data of appropriate reporting years.

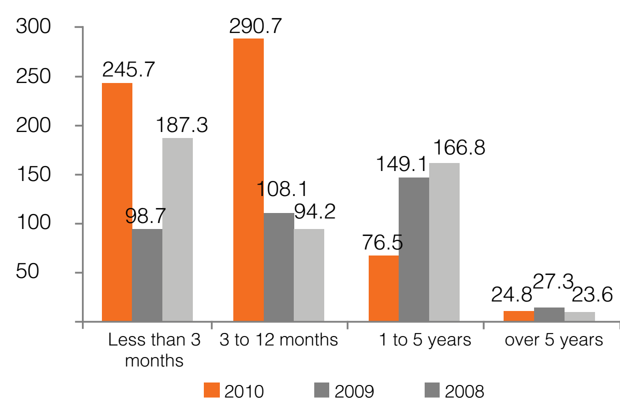
The table below shows the analysis of assets and liabilities according to which they are expected to be recovered and settled as of 31 December 2010. *(For the detailed breakdown of the underlying assets and liabilities as well as the summary of the maturity profile of the financial liabilities, please see the accompanying Notes to the Consolidated Financial Statements)*

ASSETS/LIABILITIES BY MATURITIES, 2010



Bank of Georgia has commitments and contingent liabilities in respect of, inter alia, guarantees, letters of credit on behalf of its clients. While these instruments bear a credit risk similar to that of loans granted to clients, the outstanding contractual amount of any guarantee or letter of credit does not necessarily represent future cash requirements, as many of these commitments may expire or terminate without need to be funded. The Bank also has commitment in respect of operating leases and capital expenditures.

The following chart shows the contractual expiry by maturity of the Bank's commitments and contingencies.



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

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

Included in Amounts due to customers are term deposits of individuals. In accordance with the Georgian legislation, the Bank is obliged to repay such deposits upon demand of a depositor. *(For more information please see Note 20 of the accompanying Notes to the Consolidated Financial Statements)*

FUNDING

SOURCES OF FUNDS

Diversification of funding is an important component of Bank of Georgia's liquidity management strategy. The principal sources of liquidity are debt issues, borrowings, deposits (or Amounts due to Customers), interbank deposits, principal repayments on loans, interest income and fees and commissions income. As of 31 December 2010, all of Bank of Georgia's funding was unsecured as it was bound by negative pledge commitments to its lenders.

Client Deposits (Amounts Due to Customers) are a consistent source of funding for Bank of Georgia. As of 31 December 2010, client deposits were GEL 2,004.7 million, representing 60.5% of Total liabilities. As of 31 December 2009, total deposits accounted to 55.0% of Total liabilities.

Funding flexibility is also provided by Bank of Georgia's ability to raise wholesale funding from international markets. Amounts due to credit institutions reached GEL 1,138.9 million as of 31 December 2010, or 34.4% of Total liabilities. As of 31 December 2009, Amounts due to credit institutions were GEL 928.6 million, or 40.1% of Total liabilities.

During 2010, Bank of Georgia has signed three loan agreements in the aggregate amount of US$50 million with European Bank for Reconstruction and Development (EBRD). The facilities under the financing package bear maturity of five years and can be drawn down by Bank of Georgia within 18 months.

In November 2010 Bank of Georgia and the European Fund for Southeast Europe have signed a loan agreement for US$ 50 million seven year financing package that will contribute to expanding the housing and micro and small enterprise (MSE) lending of the Bank.

In December 2010 Bank of Georgia signed a loan agreement in the amount of US$ 50 million with Asian Development Bank (ADB). The ADB facility bears maturity of five years and will be used for financing SME loans in Georgia.

WHOLESALE DEBT FUNDING REPAYMENT SCHEDULE

US$ mln, unless otherwise noted	2011	2012	2013
Eurobonds (Loan Participation Notes)	-	147.7	-
Senior Term Loan from IFC	16.7	16.7	16.7
Senior Term Loan from EBRD	14.3	14.3	14.3
Senior Term Loan from FMO	2.3	2.3	2.3
Senior Term Loan from EBRD (SME)	-	2.9	5.7
Senior Term Loan from World Business Capital	1.1	1.1	1.1
Senior Term Loan from WBC (Georgian Leasing Company)	0.7	0.7	0.7
Senior Term Loan from ADB	-	6.3	6.3
Senior Loan Term Loan from OPIC	3.2	3.2	3.2
Total	**38.2**	**195.0**	**50.2**

Please see Recent Developments section of this Annual Report for the announced launch of the tender offer for the Loan Participation Notes.

In addition, Bank of Georgia has trade finance lines from various international financial institutions and credit lines for interbank operations from both Georgian and non-resident banks.

MARKET RISK

Bank of Georgia is exposed to market risk, which 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. Bank of Georgia aims to limit and reduce the amount of possible losses on open market positions, which may be incurred by the Bank due to negative changes in currency exchange rates and interest rates.

Bank of Georgia classifies exposures to market risk into either trading or non-trading portfolios. Trading and non-trading positions are managed and monitored using other sensitivity analysis. Except for the concentrations within foreign currency, Bank of Georgia has no significant concentration of market 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 sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2010. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2010 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve.

Similarly to other Georgian banks, the majority of the Bank's assets and deposits have fixed interest rates. In order to minimise interest rate risk, the Bank monitors its duration gap and maintains an interest rate margin (net interest income before impairment of interest earning assets divided by average interest earning assets) sufficient to cover operational expenses and risk premium. The ALCO proposes and the Management Board approves ranges of interest rates for different maturities at which the Bank may place assets and attract liabilities with and without approvals. Compliance with the Bank's interest rate policy is monitored by the Head of the Financial Risk Management department and the Head of the Treasury department.

As of 31 December 2010, the Bank's floating rate borrowings accounted for approximately 8.9% of the Bank's total liabilities. In June 2009, Bank of Georgia completed U.S. dollar interest rate swap contract in an aggregate nominal value of US$197.0 million with IFC, hedging its exposure to U.S. dollar floating interest rates for approximately 80% of its long-term floating rate liabilities.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of Bank of Georgia's income statement as of 31 December 2010. *(For the exposure to interest rates as of 31 December 2008, 2009, please see the accompanying Note to Consolidated Financial Statements)*.

Currency	Increase in basis points	Sensitivity of net interest income	Sensitivity of other comprehensive income
	2010	2010	2010
EUR	0,01%	1	–
USD	0,00%	46	–
UAH	0,75%	–	34

Currency	Decrease in basis points	Sensitivity of net interest income	Sensitivity of other comprehensive income
	2010	2010	2010
EUR	-0.01%	-1	–
USD	-0.00%	-46	–
UAH	-0.75%	–	-34

During 2010, 2009 and 2008 sensitivity analysis did not reveal significant potential effect on Bank of Georgia's equity.

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

The Bank is exposed to the effects of fluctuation in the prevailing foreign currency exchange rates on its financial position. The Bank's currency risk is calculated as an aggregate of open positions and is controlled by setting a VAR calculation (established by the ALCO) with respect to the Bank's currency basket. The Bank uses the historical simulation method based on one-year statistical data. Its open currency positions are managed by the Treasury department on a day-to-day basis and are monitored by the Head of Treasury on a real-time basis. The ALCO sets open currency position limits with respect to both overnight and intraday positions and stop-loss limits. Currently, the Bank's proprietary trading position is limited by the ALCO to a VAR of 5 basis points of the regulatory capital for a one-day trading period with a 95.0% "tolerance threshold", but the open position is limited to a maximum of 15.0% of its regulatory capital. The ALCO limit of 15.0% is more conservative than NBG and Basel I, which allows banks to keep open positions of up to 20.0% of regulatory capital. The Bank additionally limits open foreign currency positions other than U.S. dollars and Lari to 1% of the regulatory capital.

The tables below indicate the currencies to which Bank of Georgia had significant exposure at 31 December 2010 on its trading and 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 Georgian Lari, with all other variables held constant on the income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase.

Currency	Change in currency rate in %	Effect on profit before tax	Effect on other comprehensive income
	2010	2010	2010
EUR	0.8%	234	–
GBP	0.8%	1	–
RUR	0.7%	3	–
UAH	0.3%	–	91
USD	0.3%	323	–

During 2010, 2009 and 2008 sensitivity analysis did not rreveal significant potential effect to Bank of Georgia's equity.

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

Bank of Georgia uses regression models to project the impact of varying levels of prepayment on its net interest income. The

model makes a distinction between the different reasons for repayment (e.g. relocation, refinancing and renegotiation) and takes into account the effect of any prepayment penalties. The model is back tested against actual outcomes.

PREPAYMENT EFFECT ON PROFIT FOR ONE YEAR AND ON EQUITY

	Effect on net interest income	Effect on other comprehensive income, 2010
2010	-67,605	-
2009	-14,557	-
2008	-34,546	-

CREDIT RISK

Credit risk is the risk that its customers, clients or counterparties will be unable to pay amounts in full or when due. Bank of Georgia provides credit to corporate and retail clients. Loans advanced are typically short, medium and long term and secured by collateral.

Bank of Georgia manages and controls its credit risk by setting limits on the amount of risk it is willing to accept with respect to individual corporate borrowers or groups of related borrowers, industry sectors and standard products, liability of insurance companies, types of banking operations and by complying with the exposure limits established by the NBG.

Bank of Georgia also mitigates its credit risk by obtaining collateral and using other security arrangements. The Bank monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for the loan impairment. The exposure to individual corporate borrowers (including financial institutions) is further restricted by sub-limits covering on and off-balance sheet exposures and daily delivery risk limits with respect to trading terms such as foreign exchange contracts.

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

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the statement of the financial position.

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

The table below shows the maximum exposure to credit risk of the balances sheet, including derivatives as of 31 December 2010, 31 December 2009 and 31 December 2008. The maximum gross exposure is shown before the effect of mitigation through the use of master netting and collateral agreements. Those financial instruments that are recorded at fair value represent the current credit risk exposure but not the maximum exposure that could arise in the future as the result of changes in values. *(For more detail on the maximum exposure to credit risk for each class of financial instrument please see the accompanying Notes to the Consolidated Financial Statements).*

	Gross maximum exposure		
GEL thousands	**2010**	**2009**	**2008**
Cash and cash equivalents (excluding cash on hand)	*449,835*	203,028	251,358
Amounts due from credit institutions	116,469	64,620	81,403
Loans to customers	2,351,697	1,661,331	2,039,022
Finance lease receivables	14,419	16,896	41,605
Investment securities:			
– Available-for-sale	283,646	6,172	12,014
– Held-to-maturity	21	249,196	22,845
	3,216,087	2,201,243	2,448,247
Financial commitments and contingencies	546,323	288,766	352,772
Total credit risk exposure	**3,762,410**	**2,490,009**	**2,801,019**

The credit quality of financial assets is managed by the Bank's internal credit ratings. It is Bank of Georgia'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 analytical tools 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 Bank of Georgia's rating policy. The attributable risk ratings are assessed and updated regularly.

The table below reflects credit quality of each class of asset for the non-related lines in the statement of financial position, based on Bank of Georgia's credit rating system as of 31 December 2010. *(For the credit quality of each class of asset as of 31 December 2008, and 31 December 2009 please see the accompanying Notes to the Consolidated Financial Statements).*

	Neither past due nor impaired				
	High grade	Standard grade	Sub-standard grade	Past due or individually impaired	Total
GEL thousands	**2010**	**2010**	**2010**	**2010**	**2010**
Amounts due from credit institutions	115,622	847	-	-	116,469
Loans to customers:					
Corporate lending	924,320	254,675	42,449	203,106	1,424,550
Consumer lending	334,430	13,841	703	34,641	383,615
Residential mortgages	324,474	13,889	9,251	62,172	409,786
Micro-loans	220,820	4,317	3,636	9,689	238,462
Gold Pawn Loans	66,749	-	-	-	66,749
Other	2,168	696	7	1,200	4,071
	1,872,961	**287,418**	**56,046**	**310,808**	**2,527,233**
Finance lease receivables	10,533	311	872	3,291	15,007
Investment securities:					
Available-for-sale	285,628	-	-	-	285,628
Held-to-maturity	21	-	-	-	21
	285,649	**-**	**-**	**-**	**285,649**
Total	**2,284,765**	**288,576**	**56,918**	**314,099**	**2,944,358**

Past due loans to customers include those that are only past due by a few days. An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired. (For analysis of the past due loan by age as of 31 December 2008 and 31 December 2009 please see the accompanying Notes to the Consolidated Financial Statements). The credit risk assessment policy for non-past due and individually non-impaired financial assets has been determined by the Bank as follows:

	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
GEL thousands	**2010**	**2010**	**2010**	**2010**	**2010**
Loans to customers:					
Corporate lending	2,925	-	2,115	5,290	10,330
Micro-loans	503	6	128	-	637
Consumer lending	12,538	11	3	93	12,645
Residential mortgages	6,967	1,387	275	1,956	10,585
Other	-	143	84	-	227
Finance lease receivables	1,212	-	-	2,079	3,291
Total	**24,145**	**1,547**	**2,605**	**9,418**	**37,715**

A financial asset that is neither been in past due more than 30 days nor individually impaired is assessed as a financial asset with High Grade. A financial asset that is neither past due nor impaired for reporting date, but historically used to be past due more than 30 days is assessed as a financial asset with Standard Grade. A financial asset that is neither past due nor impaired for reporting date, but historically used to be past due more than 60 days or borrower of this loan has at least an additional borrowing in the past due more than 60 days as of reporting date is assessed as a financial asset with Sub-Standard Grade.

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 150 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. Bank of Georgia addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Bank of Georgia determines the allowances appropriate for each individually significant loan on an individual basis.

Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realizable 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.

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

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

The following table shows the geographical concentration of the Bank's monetary assets and liabilities. *(For the geographical con- centration of the Bank's monetary assets as of 31 December 2008 and 31 December 2009 please see the accompanying Notes to the Consolidated Financial Statements.)*

	2010		
GEL thousands	Georgia	OECD	CIS and other foreign countries
Assets:			
Cash and cash equivalents	188,426	364,616	58,542
Amounts due from credit institutions	91,715	14,538	10,216
Loans to customers	2,135,962	8	215,727
Finance lease receivables	10,036	-	4,383
Investment securities:	-	-	-
– available-for-sale	281,134	-	4,494
– held-to-maturity	21	-	-
All other assets	498,175	9,508	108,109
	3,205,469	**388,670**	**401,471**
Liabilities:			
Amounts due to customers	1,638,164	101,960	264,574
Amounts due to credit institutions	145,398	962,691	30,838
All other liabilities	157,404	4,232	6,320
	1,940,966	**1,068,883**	**301,732**
Net balance sheet position	**1,264,503**	**(680,213)**	**99,739**

OPERATIONAL RISK

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

The Bank manages its operational risks by establishing, monitoring and continuously improving policies relating to various aspects of the Bank's cash payments, accounting, trading and core processing operations and data backup and disaster recovery arrangements.

The Operational Risk Management and Control department is responsible for identification and assessment of operational risk categories within the Bank's processes and operations, detecting critical risk areas or groups of operations with an increased risk level, developing response actions and the imposition of restrictions in critical risk zones to neutralise identified risk and developing business-process optimisation schemes,

including document circulation, information streams, distribution of functions, permissions and responsibilities. The Operational Risk Management and Control department is also responsible for developing and updating policies and procedures and ensuring that these policies and procedures meet or exceed legal and regulatory requirements and help to ensure that material operating risks are within acceptable levels. It also monitors and periodically reviews the Bank's internal control systems to detect errors or infringements by the Bank's departments and divisions. An operational risk manager, who reports to the Deputy CEO (Chief Risk Officer) is responsible for the oversight of the Bank's operational risks.

Anti Money Laundering Compliance

The Bank's AML Compliance department is responsible for the implementation of the Bank's AML programme (including the development of AML policies and procedures, transaction monitoring and reporting and employee training) throughout the Bank and its subsidiaries. The AML programme is based on recommendations and requirements of Georgian and international organisations including FATF/GAFI and OFAC recommendations. The Bank's Internal Audit department audits the AML Compliance department and monitors implementation of the AML programme. It is fully independent of all other business functions within the Bank.

The Bank has policies and procedures aimed at preventing money laundering and terrorist financing, including a general anti-money laundering policy and rules on counteracting money laundering and financing of individuals and legal entities engaged in terrorist activities, as well as procedures for reporting to the Financial Monitoring Service (the **"FMS"**), a legal entity of public law. The FMS was established in 2003 and serves as Georgia's financial intelligence unit. These procedures aim to, among other things, minimize the risk of the Bank being used as a vehicle for money laundering or terrorist financing, protect the Bank from financing and reputation risks of being associated with money laundering or terrorist financing activities and ensure that banking services are provided only to bona fide clients.

The Bank has implemented specific policies and procedures in order to satisfy the requirements of the EU's Third Directive, which requires financial institutions to identify and verify the identity of its customers and their beneficial owners and monitor its customers' transactions, while taking into account a risked-based approach. Adopting a risk-based approach implies the adoption of a risk management process for dealing with money laundering and terrorist financing. This process encompasses recognising the existence of risks, undertaking an assessment of those risks and developing strategies to manage and mitigate the identified risks. The Bank uses a risk assessment matrix based on the client, sector, country and product risk. The Bank has a general AML policy; "know your customer" procedures that require it to identity its clients, verify their identity and their ultimate beneficial owners as well as the economic rationale of their transactions; "know your correspondent bank" procedures that involve careful screening of prospective correspondent banks' AML policies; and "know your employee" procedures to prevent its employees' involvement in money laundering and financing terrorism.

The Bank's risk-based approach means that it applies enhanced due diligence procedures if it determines that there is a significant risk that particular clients are engaged in money laundering and financing terrorism.

The Bank carries out transaction monitoring using profiling and rules-based methodologies. Customer profiling is used to identify unusual patterns of activity by comparing current patterns with previous transactions by the same customer or peer group. Under the rule-based methodology, all transactions over GEL 30,000 or its equivalent in foreign currencies as well as transactions involving certain jurisdictions are subject to monitoring and reporting.

The Bank's transaction monitoring system is supported by a software application that enables fully-automated monitoring of all transactions against blacklists. These blacklists include all sanctions lists and lists of banned individuals and organisations maintained by OFAC, the EU, the United Nations and Interpol, including OFAC's specially designated nationals list, among others. The Bank also screens clients to determine whether they are politically exposed persons or other high risk customers. It applies special KYC procedures prior to opening an account for a politically exposed person and requires approval from a deputy CEO.

The Bank is obliged to notify the FMS of all transactions that are subject to monitoring. These reports are currently filed manually by the AML Compliance department, although the Bank is implementing a new application to enable automated filing.

Internal Audit

The Internal Audit department ensures that the Bank's policies conform to current legislation and regulation and professional norms and ethics. The Internal Audit department is responsible for monitoring and assessing the adequacy of compliance with internal procedures at all levels of the Bank's management. This department regularly inspects the integrity, reliability and compliance with applicable law of operations conducted by the Bank's risk management departments, and regularly reviews the reliability of the Bank's information technology systems in accordance with a predetermined schedule. It also assesses the reliability and security of financial information and monitors the Bank's internal controls and reporting procedures.

The Internal Audit department is independent of the Bank's Management Board. The head of the Internal Audit department is appointed by the Supervisory Board and reports directly to the Audit Committee. The Internal Audit department has a staff of twelve employees. The Bank's Internal Audit Department audits all of the Bank's subsidiaries apart from BNB and Aldagi, which have their own internal audit departments that report to the Bank's Internal Audit Department.

The principal function of the Internal Audit department is to reduce the levels of operational and other risks, audit the Bank's internal control systems, and detect any infringements or errors on the part of the Bank's departments and divisions.

As part of its auditing procedures, the Internal Audit department is responsible for the following:

- identifying and assessing potential risks regarding the Bank's operations;
- reviewing the adequacy of the existing controls established in order to ensure compliance with the Bank's policies, plans, procedures and business objectives;
- developing internal auditing standards and methodologies;
- carrying out planned and random inspections of the Bank's branches and subdivisions and auditing its subsidiaries;
- analysing the quality of the Bank's products;
- participating in external audits and inspections by the NBG;
- making recommendations to management on the basis of external and internal audits to improve internal controls; and
- monitoring the implementation of auditors' recommendations.

The Internal Audit Department applies a risk-based audit approach to asses the significant risks that impact the Bank's business, how (and how well) those risks are managed and controlled, what measures are used to monitor the process, the reliability of the Bank's key performance indicators and management information and the efficiency of the process.

RISKS AND UNCERTAINTIES

RISK FACTORS

The following discussion sets forth certain risks and uncertainties that Bank of Georgia believes are material. If any of the following risks actually occur, the Bank's business, financial condition, results of operations or prospects could be materially adversely affected. The risks and uncertainties described below may not be the only ones the Bank faces. Additional risks and uncertainties, including those that the Bank is currently not aware of or deems immaterial, may also result in decreased revenues, incurred expenses or other events that could result in a decline in the value of Bank of Georgia's securities.

Emerging Market Risks

The Bank has its principal banking operations in Georgia and certain business operations and assets in Ukraine and Belarus (Georgia, Ukraine and Belarus together, the "**Principal Markets"**). Higher risks associated with investing in securities involving emerging markets include, but are not limited to, higher volatility, limited liquidity, a narrow export base, current account deficits and changes in the political, economic, social, legal and regulatory environment. Emerging economies, such as the Georgian, Ukrainian and Belarusian economies, are subject to rapid change and are particularly vulnerable to market conditions and economic downturns elsewhere in the world and the information set out in this Annual Report may become outdated relatively quickly. Companies operating in emerging markets are exposed to reduced liquidity and increased financing costs. Availability of credit to companies operating in emerging markets is significantly influenced by the prevailing levels of investor confidence in those markets and any factors which affect the levels of investor confidence in those markets could affect the availability and/or price of financing for companies operating in emerging markets, such as Bank of Georgia.

Emerging markets may also experience more instances of corruption of government officials and misuse of public funds than more mature markets. These risks may be compounded by incomplete, unreliable or unavailable economic and statistical data on Georgia, Ukraine and Belarus, including elements of information provided in this Annual Report.

Risks Relating To the Bank's Business

The Bank's financial condition and business prospects are affected by global and local economic and market conditions

The global banking sector and financial markets have faced significant volatility, dislocation and liquidity constraints since the onset of the global financial crisis in the autumn of 2007. In 2007, dramatic declines began in the housing market in the United States, as well as in a number of other countries, and such declines have substantially worsened since September 2008. Many developed economies entered recession and growth slowed in many emerging economies, with serious adverse consequences for asset values, employment, consumer confidence and levels of economic activity. The financial services industry faced extraordinary turbulence and suffered a shortage of liquidity, lack of funding, pressure on capital and extreme price volatility across a wide range of asset classes. In response to the financial crisis affecting the global banking sector and financial markets, many governments and central banks have announced, and in many cases begun to implement, significant rescue packages, which include, among other things, the recapitalisation of banks through the state purchase of common and preferred equity securities, the state guarantee of certain forms of bank debt, the purchase by the state of distressed assets from banks and other financial institutions and the provision by the state of guarantees of distressed assets held by banks and other financial institutions. Despite these programmes, the volatility and market disruption in the global banking sector has continued and there can be no assurance as to when all of these programmes will be fully implemented and, when and if implemented, what impact they will have on the financial markets, nor whether further measures will be required in addition to those already implemented or announced. Furthermore, there can be no assurance that such measures will succeed in returning stability to the global banking sector and financial markets in the short term or beyond.

The financial crisis affecting the global banking sector and financial markets has impacted the Georgian, Ukrainian and Belarusian economies and, in turn, the Bank's financial condition and results of operations. Although the economic conditions in the Principal Markets have improved since the beginning of the second half of 2009 and the Bank has returned to profit in 2010, the Bank's financial condition and business prospects are likely to continue to be adversely affected by global and local economic and market conditions. A worsening of these conditions in the Principal Markets may exacerbate the impact of these difficult market conditions on the Bank and other financial institutions and could have a material adverse effect on the Bank's business, financial condition, results of operations and prospects.

The Bank's financial condition and business prospects may be adversely affected if it fails to grow its loan portfolio or fails to properly manage its loan portfolio

In response to the increased volatility of the financial markets globally and in Georgia, and due to concerns regarding the decreasing credit quality of borrowers, the Bank implemented a conservative liquidity and credit management policy in 2008 through 2009 which involved, among other things, reducing the levels of the Bank's lending and focusing on maintaining adequate funding levels. This, combined with a reduction in demand from customers following the economic downturn, resulted in a 14.8% decline in the Bank's gross loan portfolio from GEL 2.1 billion in 2008 from GEL 1.8 billion in 2009. The latest data published by the National Statistics Office shows that the Georgian economy

bottomed out in the second half of 2009 and continued to recover in the first half of 2010, as gross domestic product ("GDP") rose in the third and fourth quarters of 2009 and the first half of 2010. Recognising that there had been a recovery in the Georgian economy in the second half of 2009, the Bank implemented a slightly less conservative liquidity management policy in 2010 and its gross loan portfolio increased to GEL 2.5 billion as at 31 December 2010.

As global and local conditions continue to improve, the Bank intends to increase its lending activity in order to increase its interest income on loans to customers and to adjust its credit risk management policies and procedures accordingly. However, there can be no assurance that the Bank will succeed in increasing its loan portfolio or that it will do so at the right price. Any failure to increase the loan portfolio, or to increase it at the right price, could have an adverse impact on the level of the Bank's interest income on loans to customers and therefore the Bank's business in the future. However, if the Bank does succeed in growing its loan portfolio, this will further increase the Bank's credit risk exposure and put additional pressure on its loan monitoring and control procedures. Any failure to manage the Bank's growing loan portfolio while maintaining the quality of its assets through effective credit risk policies could require further provisioning and increase non-performing loan levels and/or write-offs, which may have a material adverse effect on the Bank's business, financial condition, results of operations or prospects.

In addition, management of the Bank's loan portfolio growth will require, among other things, continued development of the Bank's financial and information management systems, successful implementation of its new information systems, such as its new core banking system (TEMENOS (SIX: TEMN) T24), loan origination, management and administration systems for the Bank and its banking subsidiaries (being CRIF/StrategyOne, Megapolis and Clever, respectively) and its talent management system (Softscape), and the ability to manage risk and business processes. If the Bank fails to successfully develop its financial and information management systems in line with any growth in its loan portfolio, or fails to manage its risk and business processes in line with any such growth, this may have material adverse effect on its business, financial condition, results of operations or prospects.

Bank of Georgia is required to comply with Georgian banking regulations and mandatory financial ratios, lending limits and other economic ratios set by the NBG. If Bank of Georgia breaches any applicable banking regulations, mandatory financial ratios, lending limits and other economic ratios, this could have a material adverse effect on the Bank.

Bank of Georgia is required to comply with Georgian banking regulations and requirements. In addition, the NBG is authorised to set mandatory capital adequacy ratios, lending limits and other economic ratios in Georgia which Bank of Georgia is required to comply with. According to Georgian banking regulations, Bank of Georgia is required to, among other things, comply with minimum reserve requirements and mandatory financial ratios and regularly file periodic reports. The Georgian authorities, including the NBG, have the right to, and do, conduct periodic inspections of Bank of Georgia's operations throughout each year. If, in the future, Georgian banking regulations or the mandatory financial ratios, lending limits and other economic ratios set by the NBG change and Bank of Georgia is unable to comply with them, or any of them, or Bank of Georgia breaches any banking regulations, mandatory financial ratios, lending limits, other economic ratios, the NBG may impose penalty sanctions or temporary administration on Bank of Georgia, or attach certain conditions and/or limitations to, or ultimately, if the NBG considers the breach in question to be particularly significant, revoke, the general banking licence of Bank of Georgia which may have a material adverse effect on the Bank's business, financial condition, results of operations or prospects or prevent it from carrying on its banking activities (see "— The Bank's business depends on it having a licence for all of its banking and other operations.) If Bank of Georgia loses or breaches any of its licences, or fails to obtain any further licences that it may be require in the future, this could have a material adverse effect on the Bank" below).

The Bank's business depends on it having a licence for all of its banking and other operations. If the Bank loses or breaches any of its licences, or fails to obtain any further licences that it may require in the future, this could have a material adverse effect on the Bank.

All banking operations and various related operations in Georgia require a general banking licence from the NBG. Bank of Georgia has a current licence for all of its banking and other operations. Although Bank of Georgia believes that it is currently in compliance with its existing material licence and reporting obligations to the NBG and otherwise, there is no assurance that Bank of Georgia will be able to maintain the necessary licence or obtain other required licences in the future.

The loss of a licence, a breach of the terms of a licence by the Bank or a failure to obtain any further licences that may be required in the future could have a material adverse effect on the Bank's business, financial condition, results of operations and prospects. If the NBG revokes Bank of Georgia's general banking licence, then Bank of Georgia will be unable to accept deposits, which would severely restrict its ability to continue to operate and could ultimately lead to Bank of Georgia's liquidation.

The Bank faces certain risks associate with conducting international operations

The Bank has made investments in countries of the Commonwealth of Independent States (the "CIS"), in particular Ukraine and Belarus. The Bank's international presence exposes it to risks that it would not face as a purely domestic bank, including certain political and economic risks, compliance risks, liquidity risks, foreign currency exchange

risk as well as the risk of failure to market adequately to potential customers in other countries. By way of example, the Bank's financial results in 2009 were adversely affected by a goodwill write-down in the amount of GEL 73.1 million, predominantly due to the write-off of the entire goodwill associated with BG Bank, the Bank's subsidiary in Ukraine, as a result of a weak economic environment in Ukraine and high loan impairment charges in respect of BG Bank in 2008 and 2009 (see "— The Bank's financial condition and business prospects are affected by global and local economic and market conditions"). In view of the significant deterioration in the quality of the loan portfolio in BG Bank, Bank of Georgia sold 80% of its equity interest in BG Bank on 18 February 2011.

To the extent the Bank expands its international operations further in the future, it will become exposed to additional risks in other countries. Any failure to manage such risks may cause the Bank to incur increased liabilities and have a possible negative impact on the Bank's financial performance in respect of such operations.

The Bank depends upon its ability to access financial resources whenever required to meet its obligations.

The Bank faces the risk that it will be unable to meet its payment obligations when they fall due (under normal and stress circumstances), known as liquidity risk. The Bank tries to manage its liquidity risk by, among other things, maintaining a diverse funding base comprising short-term sources of funding (including core retail and corporate customer deposits) and longer-terms sources of funding (including borrowing from international financial institutions ("IFIs"), sales and purchases of securities, interbank borrowing and lending, borrowing from the central banks in the Principal Markets, issuing debt securities and cash flow). However, during the economic downturn, the costs of borrowing in the wholesale debt markets increased and the debt capital markets were effectively closed to banks in emerging markets. As a result, IFIs became the principal sources of long-term funding for the Bank. In addition, the economic downturn (and, in the case of Georgia, the Conflict) resulted in a reduction in the Bank's sources of short-term funding as deposits in the banking systems in the Principal Markets in the second half of 2008 and the first half of 2009 decreased.

In the future, the Bank aims to continue attracting deposits in its Principal Markets and internationally, as well as diversifying its funding sources by accessing the international and Georgian debt markets. However, if the Bank experiences any future unanticipated decreases in customer deposits and/ or unexpected withdrawals of deposits, or any difficulties in accessing the international and Georgian debt markets and/or IFI funding to an extent sufficient to meet its funding needs, including the refinancing of outstanding debt falling due, or maturity mismatches between the Bank's assets and liabilities this may, together, or separately, have a material adverse effect on the Bank's business, financial condition, results of operations and prospects.

The Bank's funding levels also affect the Bank's ability to comply with the mandatory financial ratios, lending limits, other economic ratios and minimum regulatory requirements set by the NBG. However, if, in the future, due to the Bank's inability to meet its funding needs, Bank of Georgia is unable to comply with some or all of the mandatory financial ratios, lending limits, other economic ratios and minimum regulatory requirements set by the NBG, the NBG may impose penalty sanctions or temporary administration on Bank of Georgia, or attach certain conditions and/or limitations to, or ultimately, if the NBG considers the breach in question to be particularly significant, revoke, the general banking licence of Bank of Georgia which may have a material adverse effect on the Bank's business, financial condition, results of operations or prospects or prevent it from carrying on its banking activities

The Bank is exposed to credit risk in respect of its corporate and retail clients in the Principal Markets and U.S. dollar to Lari exchange rate fluctuations, in particular, can have a significant impact on a client's credit risk

The financial performance of corporates in the Principal Markets is generally more volatile, and the credit quality of such corporates on average is less predictable, than that of similar companies doing business in more mature markets and economies. An accurate assessment of default risk on loans provided to corporate clients may be difficult for the Bank to make due to the unpredictability of economic conditions in the Principal Markets and abroad. Although the operating environment has been improving since the second half of 2009, the Bank continues to face significant credit risk as a result of the economic downturn. Even though the Bank requires regular disclosure of its corporate clients' financial statements, such financial statements may not always present a complete and accurate picture of each client's financial condition. Furthermore, the Bank's corporate clients do not typically have extensive or externally verified credit histories, and their accounts may not be audited by a reputable external auditor. Therefore, notwithstanding the Bank's credit risk evaluation procedures, it may be unable to evaluate correctly the current financial condition of each prospective corporate borrower and to determine accurately the ability of such corporate borrower to repay its loans when due. Similarly, the financial condition of private individuals transacting business with the Bank is difficult to assess and predict as the vast majority of retail borrowers have no or very limited credit history.

While the substantial majority (91.8% as at 31 December 2010) of the Bank's loans to customers are secured by collateral, if a significant number of its corporate or individual borrowers and/or guarantors experience poor financial performance due to a significant deterioration in domestic or regional economic conditions, including a devaluation of the Lari, or volatility in certain sectors of the domestic or regional economies or if their financial condition deteriorates significantly for any reason, this could have an adverse im-

pact on their ability to pay their obligations as they fall due which, in turn, could have a material adverse effect on the Bank's financial performance and results of operations. For example, as the majority (as at 31 December 2010, 75.0%) of the Bank's loans to customers on a standalone basis, were denominated in foreign currencies, (97.3% of these were denominated in U.S. dollars as at 31 December 2010, with the remainder predominantly denominated in Euro), the depreciation of the Lari to U.S. dollar exchange rate in the second half of 2008 (caused by the NBG allowing the Lari to depreciate by 14% against the U.S. dollar in the first two weeks of November 2008) as well as in the first half of 2010 had an adverse impact on the ability of borrowers with Lari incomes to pay amounts due on U.S. dollar denominated loans with the Bank, thereby contributing to a deterioration in the Bank's loan portfolio quality. If there are significant fluctuations in the Lari to U.S. dollar exchange rates in the future, this could have an adverse impact on individual borrowers' ability to pay their obligations as they fall due which, in turn, could have a material adverse effect on the Bank's financial performance and results of operations.

The Bank is exposed to the risk of a decline in, or unstable, collateral values

The main forms of collateral taken by the Bank in respect of corporate lending are charges over real estate properties, inventory and trade receivables and the main form of collateral taken by the Bank in respect of retail lending is a mortgage over residential property. As at 31 December 2010, 91.8% of the Bank's loans to customers were secured by collateral. If there is a decline in real estate values, or other collateral values in the Principal Markets, or if there is a downturn in the real estate market or other collateral markets in the Principal Markets in the future, this will affect the value of the Bank's collateral and its ability to realise the value of that collateral on a timely basis, or at all, which, in turn, could lead to the Bank experiencing lower than expected recovery levels on collateralised non-performing loans **("NPLs")**. If the Bank experiences lower than expected recovery levels on NPLs in the future, this could have a materially adverse effect on the Bank's financial performance and results of operations.

In addition, declining or unstable collateral prices in the Principal Markets may make it difficult for the Bank to accurately value collateral held by the Bank and, in the future, then-prevailing market conditions may result in significant changes to the fair value of the collateral held by the Bank. If the fair value of the collateral held by the Bank declines significantly in the future, the Bank could be required to record additional provisions and could experience lower than expected recovery levels on collateralised NPLs which could, in turn, materially adversely affect the Bank's financial performance and results of operations.

A decrease in the Bank's loan book quality may have a material adverse impact on the Bank's loan impairment charges, NPLs and Restructured Loans

During 2008 and 2009, the Bank's loan book quality was negatively affected by the economic slowdown in the Principal Markets as well as by the Conflict. This led to the Bank's loan impairment charges being high in 2008 (GEL 122.8 million) and to loan impairment charges remaining high (GEL 118.9 million) in 2009. Although the Bank's loan impairment charges decreased to GEL 49.9 million in 2010 as a result of improved economic circumstances experienced from the second half of 2009 onwards, if the Bank's loan book quality is negatively affected by further economic slowdowns or political instability in the Principal Markets or the Bank implementing less conservative credit risk policies in the future, this could have a material adverse effect on the Bank's financial performance and results of operations.

The Bank invests significant time and effort estimating its allowance for impairment losses. The Bank establishes provisions for impairment losses of financial assets when there is objective evidence that a financial asset or group of financial assets is impaired. The Bank creates provisions by reference to the particular borrower's financial condition and the number of days the relevant loan is overdue. If in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by an adjusted provision account. The determination of provisions for impairment losses is based on NBG regulations and on an analysis of the assets at risk and reflects the amount which, in the judgment of Management, is adequate to provide for losses incurred. Provisions are made as a result of an individual appraisal of financial assets. As of 31 December 2010, 2009 and 2008, the Bank's net allowance for impairment losses on loans to customers was GEL 175.5 million, GEL 166.5 million and GEL 106.6 million, respectively, and the Bank's net allowance for loan impairment / gross loan book ratio was 6.9%, 9.1% and 5.0%. The Bank's net allowance for loan impairment losses during 2008, 2009 and 2010 increased principally as a result of the economic slowdown in the Principal Markets as well as the Conflict. If the Bank fails to accurately estimate the impairment allowances in respect of loans and the allowance for impairment losses proves to be inadequate now or in the future, this may have a material adverse effect on the Bank's business, financial condition, results of operations and prospects.

The economic slowdown in the Principal Markets and the Conflict also led to an increase in the Bank's level of NPLs, which are defined as loans more than 90 days overdue (including principal and interest payment). In addition, as part of the Bank's loan portfolio quality improvement measures and borrower debt service improvement measures, the Bank restructured certain loans, including commercial, mortgage and consumer loans. Restructured loans **("Restructured Loans")** are defined as loans that would otherwise be overdue or impaired (but which are less than 90 days overdue) whose terms (including as to principal and interest payment) have been renegotiated. As of 31 December 2010, NPLs accounted for 4.7% of total gross loans compared to 7.7% and 2.9% as of 31 December 2009 and

2008, respectively. In addition, as of 31 December 2010, Restructured Loans accounted for 4.1% of total gross loans compared to 4.3% and 1.7%, as of 31 December 2009 and 2008, respectively. If the Bank's loan book quality is negatively affected by further developments outside its control in the future, such as further economic slowdowns or political instability in the Principal Markets, this could have an adverse effect on the Bank's level of NPLs and/or Restructured Loans which, in turn, could have a material adverse effect on the Bank's financial performance and results of operations.

If the Bank has any difficulties enforcing its security, this may have an adverse effect on the Bank's results of operations

The Bank obtains security in relation to the substantial majority of its loans made to individuals and legal entities. Pursuant to the laws of the Principal Markets, enforcement of security may require state registration or require perfection through registration or through possession, which can result in unexpected and/or conflicting claims of secured creditors. In addition, pledges over moveable property may be impracticable due to the incapability of the pledgee to restrict the subsequent sale of such moveable property. Any delay or difficulty in perfecting or enforcing pledges may have an adverse effect on the Bank's business, financial condition, results of operations and prospects.

The Bank's results of operations are significantly affected by its ability to manage risks that are inherent to the banking business

The Bank's business is subject to various risks inherent in the banking business. The Bank is exposed to the risk that it will be unable to meet its payment obligations when they fall due (under normal and stress circumstances), known as liquidity risk. This risk is likely to materialize if the Bank is unable to access financial resources whenever required to meet its obligations (see "— The Bank depends upon its ability to access financial resources whenever required to meet its obligations"). The Bank is also exposed to market risk (including currency exchange rate risk and interest rate risk), which is the risk that the fair value or future cash flows of its financial instruments will fluctuate due to changes in market variables. In addition, the Bank is exposed to credit risk, which is the risk that a borrower or counterparty will be unable to pay amounts in full or in part when due. See "— The Bank is exposed to credit risk in respect of its corporate and retail clients in the Principal Markets and U.S. dollar to Lari exchange rate fluctuations, in particular, can have a significant impact on a client's credit risk". Finally, the Bank is also exposed to operational and legal risks arising out of the various operational activities in which it is engaged. Operational risk is the risk of loss arising from systems failure, human error, fraud or external events.

If the Bank does not adequately manage its exposure to liquidity risk, market risk and credit risk in the future, this may lead to the Bank suffering financial loss which will, in turn, have an adverse impact on the Bank's results of operations. In addition, if the Bank fails to adequately manage the operational risks that it faces and, as a result, the Bank experiences systems failures, human errors or fraud, or other external events affect the Bank, this may cause damage to the Bank's reputation, have legal or regulatory implications for the Bank, or lead to it suffering financial loss, any of which may, in turn, have a material adverse impact on the Bank's business, financial condition, results of operations and prospects.

The Bank's results and its ability to comply with certain Basel I and/or NBG financial ratios are significantly affected by currency fluctuations and, in particular, currency fluctuations affecting the Lari, Hryvnia and Belarusian Rouble.

The Bank's operations are significantly affected by fluctuations in the Lari to U.S. dollar exchange rate as the majority of the Bank's loans to customers on a standalone basis are denominated in foreign currencies (75.0% as at 31 December 2010, of which 97.3% were denominated in U.S. dollars). 100% (as at 31 December 2010) of its foreign currency denominated loans are in its risk weighted assets and the majority (70.0% as at 31 December 2010, 84.5% of which are in U.S. dollars) of its interest-earning assets and (77.5% as at 31 December 2010, 83.9% of which are in U.S. dollars) of its interest-bearing liabilities are in foreign currencies, which in turn impacts its net interest income results. As of 31 December 2010, 25.3% of the Bank's net loans to customers were denominated in GEL, while 32.3% of its deposits were denominated in GEL. The Bank's operations are also significantly affected by the Lari to Hryvnia and Lari to Belarusian Rouble exchange rates as these affect the value of the Bank's equity interests in its Ukrainian and Belarusian subsidiaries on a consolidated basis and its ability to comply with the following mandatory financial ratios: (i) the Basel I Total Capital Adequacy Ratio, calculated on a consolidated basis; (ii) any ratios using Basel I Total Regulatory Capital, as a component; and (iii) any ratios using total consolidated shareholders' equity of the Bank as a component.

Partly in response to the increased demand for foreign currencies during the months following the Conflict and partly as a result of the downturn in the global economy and its impact on the Georgian economy (including a reduction in FDI, lower remittances to Georgia from abroad and a slowing of exports), the NBG allowed the Lari to depreciate by 14% against the U.S. dollar in the first two weeks of November 2008. In 2009, the Lari stabilised and depreciated by 1.1% as compared to 4.7% in 2008. In 2010 the Lari depreciated by 4.7% according to the NBG. As of 20 April 2011, the Lari appreciated by 7.9% according to the NBG. As a result of the depreciation of the Lari against the U.S. dollar at the beginning of November 2008, the Bank suffered from deterioration in certain of its capital adequacy ratios, including Basel I and NBG mandatory capital adequacy ratios in 2008 and 2009. In addition, depreciations in the Lari to U.S. dollar and Euro exchange rates in the second half of 2008 as well as in the first half of 2010 con-

tributed to deterioration in the Bank's loan portfolio quality as it affected the ability of borrowers with Lari incomes to pay amounts due on foreign currency loans with the Bank. Furthermore, as a result of the deterioration of the economic environment in Ukraine and the devaluation of the Hryvnia by approximately 29% against the Lari in the second half of 2008, the value of the Bank's shareholders' equity decreased upon consolidation of its Ukrainian subsidiaries in the Annual Financial Statements in 2008. The respective unrealized foreign currency translation losses incurred by the Bank during consolidation of its Ukrainian subsidiaries during 2008, mostly BG Bank, amounted to GEL 25.8 million and were recognized in other comprehensive income of the Bank in its 2008 Annual Financial Statements, with no effect on regular earnings per share or fully diluted earnings per share. Moreover, as a result of the deterioration of the economic environment in Belarus and the devaluation of the Belarusian Rouble by approximately 23% against the Lari in the first half of 2009, the value of the Bank's shareholders' equity decreased upon consolidation of its Belarusian subsidiaries in the Annual Financial Statements in 2009. The respective unrealized foreign currency translation losses incurred by the Bank during consolidation of its Belarusian subsidiaries during 2009, mostly BNB, comprised GEL 5.3 million and were recognized in other comprehensive income of the Bank in its 2009 Annual Financial Statements, with no effect on regular earnings per share or fully diluted earnings per share.

Although Management has adopted a conservative approach to the management of the Bank's open foreign currency positions in order to protect against the Bank's foreign exchange risk (as a result of which the Bank's open foreign currency positions have remained low), has set limits on Bank of Georgia's foreign currency positions in accordance with NBG regulations, has partially hedged its exposure to the Belarusian Rouble through a currency SWAP agreement with the Central Bank of Belarus and, in respect of its exposure to other foreign currencies (mainly U.S. dollar and Euro) uses on- and off-balance sheet instruments (such as currency SWAPS and currency options) to hedge respective positions within its subsidiaries, there can be no assurance that these measures will protect against foreign exchange risks. Any additional depreciation of the Lari, Hryvnia or Belarusian Rouble may lead to further erosion of the Bank's regulatory capital and pressure on its capital adequacy ratios, which could adversely affect the Bank's business, financial condition, results of operations and prospects.

Significant changes in interest rates could have a material adverse effect on the Bank's business financial condition, results of operations and prospects

The Bank is exposed to risks resulting from mismatches between the interest rates on its interest-bearing liabilities and interest-earning assets. 9.2% of the Bank's interest-bearing liabilities bear interest at a floating rate, with the rest bearing interest at a fixed rate. 100% of interest-earning assets bear interest at a fixed rate. While the Bank monitors interest rates with respect to its assets and liabilities, believes that its net interest margin (which was 8.1% in 2010 compared to 9.1% and 9.6% 2009 and 2008, respectively) is sufficient to absorb movements in interest rates and hedged its exposure to U.S. dollar floating interest rates for approximately 80% of its long-term floating rate liabilities in June 2009, to the extent the Bank is unable to pass on increases in interest rates to its customers or hedge its exposure, interest rate movements may adversely affect the Bank's financial position. The Bank's results of operations depend to a significant extent on its net interest income. Although, currently, net interest margins in the Principal Markets are generally higher than those in most Western jurisdictions, interest rates are highly sensitive to many factors beyond the Bank's control, including the reserve policies of the central banks in the Principal Markets and domestic and international economic and political factors. There can be no assurance that the Bank will be able to protect itself from the negative effects of future interest rate declines. Any declines in the market interest rates, global benchmark rates and/or increases in rates payable on deposits could lead to a reduction in net interest income and net interest margin. Such a reduction in net interest income and net interest margin could have a material adverse effect on the Bank's business, financial condition, results of operations and prospects.

If the Bank's cost control measures fail to result in adequate cost savings, or if the Bank is unable to dispose of its non-core assets in a timely fashion, on commercial terms acceptable to the Bank or at all, this may have a material adverse impact on the Bank

The Bank continues to implement a cost control programme as one of the Bank's strategic priorities for 2011. As part of this strategy, during 2009 and 2010 the Bank closed certain branches in Georgia and Ukraine, optimised its staff levels in the Principal Markets and focused on operational efficiencies and improvement of delivery channels. In the event that these cost control measures fail to result in the cost savings anticipated by the Bank, this could have a material adverse effect on the Bank's financial condition and prospects.

As part of the Bank's restructuring of its non-core asset management business, the Bank sold its entire equity interest in GTAM in September 2009 and plans to continue to explore its options to dispose of other non-core assets and non-performing assets over the next two to three years, such as BG Bank, Liberty Consumer and SB Real Estate. Achievement of the Bank's disposal strategy will be dependent on a number of conditions beyond the Bank's control, including stabilisation of the global financial markets and global economic recovery as well as political and economic stability in the Principal Markets. There can be no assurance that disposals will be completed in a timely fashion, on commercial terms acceptable to the Bank, or at all, or will result in the anticipated benefits to the Bank's business, or will not result in unforeseen liabilities and losses. In the event that planned cost control measures fail to result in the cost savings anticipated by the Bank, or planned dispos-

als are delayed, not consummated or result in unforeseen liabilities, this could have a material adverse effect on the Bank's financial condition and prospects.

The Bank faces competition in the Principal Markets in which it operates

As of 31 December 2010, there were 19 commercial banks licensed to operate in Georgia, 16 of which had foreign capital investment and 2 of which were branches of non-resident foreign banks. Bank of Georgia competes with a number of these banks, including TBC Bank, VTB Bank Georgia, ProCredit Bank, Cartu Bank, Bank Republic and HSBC. In particular, as HSBC has a strong trade finance presence in Georgia, Bank of Georgia faces competition from HSBC in relation to its trade financing activities and, as ProCredit Bank has a large market share in respect of small and medium enterprise ("SME") and micro finance loans, Bank of Georgia faces competition from ProCredit Bank in relation to SME and micro financing in Georgia. In addition, both the mortgage market and the market for the provision of financial services to high net worth individuals are highly competitive in Georgia, with some competitors in the mortgage market implementing aggressive pricing policies in order to retain or build their market share. Additionally, in Belarus, the Bank competes with a wide range of local and international banks.

Some of the banks with which the Bank competes may have greater access to sources of funding than the Bank because they are subsidiaries or branches of foreign banks and this may have an adverse effect both on the Bank's ability to price as aggressively as those banks and its ability to retain and/or grow its loan portfolio in the future. If the Bank is unable to continue to compete successfully in the Principal Markets in the future, or to execute its business strategy, this could have a material adverse effect on the Bank's business, financial condition, results of operations or prospects.

If any of the Bank's information technology systems prove to be insufficient to meet the needs of the Bank's business, or the Bank suffers a failure or shutdown of its information technology systems (whether permanent or temporary), this may have a material adverse effect on the Bank

The Bank relies heavily on information systems to process a large number of transactions efficiently and accurately and is currently upgrading a number of its information systems. The Bank has started to introduce a new core banking system in Georgia (TEMENOS (SIX: TEMN) T24), as well as loan origination, management and administration systems for the Bank and its banking subsidiaries (being CRIF/StrategyOne, Megapolis and Clever, respectively), and has largely completed the deployment of a talent management system (Softscape). However, there can be no assurance that the new systems will be implemented in a timely manner, or without cost overruns, that the new systems will address all of the shortcomings of the current systems or will be sufficient to meet the needs of the Bank's business. In addition, although the Bank has developed back-up systems and a fully-equipped disaster recovery centre, and may continue some of its operations through branches in case of emergency, if the Bank's information technology systems fail, even for a short period of time, then it could be unable to serve some or all of its clients' needs in a timely manner and could lose business as a result. A temporary shutdown of the Bank's information systems could result in unexpected costs that may be required for information retrieval and verification. Any failure or interruption of the Bank's information technology systems could result in failures or interruptions in the Bank's decision-making processes and risk management procedures or a disruption in the Bank's business activities, any of which could have a material adverse effect on its business, financial condition, results of operations and prospects. Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that Bank of Georgia will be unable to comply with its obligations as a company with securities admitted to the Official List.

If Bank of Georgia and/or its subsidiaries breach any of their respective restrictive covenants contained in their loan agreements this could constitute a default under the relevant loan agreement and could trigger a cross default under other agreements to which such entity is party

Bank of Georgia and/or its subsidiaries are parties to a number of loan agreements that contain covenants imposing significant operating and financial restrictions on it/them as borrower. These restrictions require Bank of Georgia and/or its subsidiaries, among other things, to maintain compliance with specified financial ratios and significantly limit, and in some cases restrict, among other things, the ability of Bank of Georgia and certain of its subsidiaries to incur additional indebtedness, create liens on assets, undertake corporate reorganisations, enter into business combinations or engage in certain transactions with companies within the Bank. From time to time in the past, Bank of Georgia and its subsidiaries have breached a covenant to keep net non performing loans (defined for these purposes as (i) the aggregate amount of all gross loans in respect of which any amounts have been outstanding for a period of more than ninety (90) days after the relevant due dates provided for under the relevant loan agreements; (ii) the gross loans restructured due to the relevant borrowers' inability to meet their payment obligations under the relevant loan agreement; and (iii) any other gross loans which in the reasonable opinion of Management (with the passage of time or otherwise) may qualify as non-performing loans under (i) and/or ii)) below 10% of its/their Tier 1 Capital. While Bank of Georgia and its subsidiaries have obtained waivers from the relevant lenders in respect of its/their past breaches, there can be no assurance that such waivers will be granted for any breaches that may occur in the future.

A failure by Bank of Georgia and/or its subsidiaries to comply with the covenants in their loan agreements may constitute a default under the relevant agreements and could trigger a cross-default under other agreements to which such

entity is a party, including, in the case of Bank of Georgia, its outstanding Eurobonds. In the event of such a default, the Bank's obligations under one or more of these agreements could, under certain circumstances, become immediately due and payable, which could have a material adverse effect on the Bank's business, financial condition, results of operations or prospects.

The Bank depends on its key management and qualified personnel

The Bank's ability to continue to retain, motivate and attract qualified and experienced banking and management personnel is vital to the Bank's business. There can be no assurance that the Bank will be able to successfully recruit and retain the necessary qualified personnel. The loss or diminution in the services of members of the Bank's senior management team or an inability to recruit, train and/or retain necessary personnel could have a material adverse effect on its business, results of operations, financial condition and prospects.

Risks Relating To Georgia and the Other Principal Markets

Political and governmental instability in Georgia could adversely affect the local economy and Bank of Georgia's business

Since the restoration of its independence in 1991, Georgia has undergone a substantial political transformation from a constituent republic in a federal socialist state to an independent sovereign democracy. Political conditions in Georgia were highly volatile in the 1990s and in the early part of the 2000s. Since January 2004, following the peaceful uprising in November 2003, known as the "Rose Revolution", Mikheil Saakashvili has served as President of Georgia. The first few years of President Saakashvili's term in office were marked by relative political stability and the introduction of policies oriented towards the acceleration of political and economic reforms. However, President Saakashvili's term has also been marked by a number of high-profile events since 2006, which have triggered a wave of popular protests.

In November 2007, after five days of demonstrations in Tbilisi, a two-week state of emergency banning all privately-owned broadcast media and public gatherings was imposed. In January 2008, President Saakashvili was re-elected with 53.5% of the vote and the United National Movement Party won the majority of votes in the parliamentary elections held in May 2008. Following the further deterioration of already strained political relations between Russia and Georgia, the Conflict took place, after which Russia formally recognised the independence of South Ossetia and Abkhazia. See "—Regional Tensions may have a negative effect on the Georgian economy and on the business, results of operations and financial condition of the Bank ".

In April 2009, the Georgian opposition renewed protests demanding President Saakashvili's resignation, which culminated in large-scale public demonstrations. In agreement with the opposition parties, municipal elections were held in Georgia on 30 May 2010 in order to elect (through direct voting) municipal council members throughout the country and, for the first time in Georgia's history, a Mayor of the capital city, Tbilisi. The ruling United National Movement Party won the municipal elections, with approximately 65% of the vote, and Giorgi Ugulava (the candidate for the United National Movement Party) was elected as Mayor of Tbilisi with approximately 55% of the vote.

Although President Saakashvili's United National Movement party won the majority of votes in the municipal council elections in May 2010, there can be no assurance that current Government policies or economic or regulatory reforms will continue at the same pace or at all. President Saakashvili and the Government face several challenges, including resolving the status of Abkhazia and South Ossetia, the improvement of relations with Russia, the implementation of further economic reforms and the maintaining of a political consensus. No assurance can be given that reform and economic growth will not be hindered as a result of the disruption of Government continuity or any other changes affecting the stability of the Government or as a result of a rejection or reversal of reform policies. Political instability in Georgia could have negative effects on the economy and thus could have a material adverse effect on Bank of Georgia's business, financial condition and results of operations.

Regional tensions may have a negative effect on the Georgian economy and on the business, results of operations and financial condition of Bank of Georgia

Since the restoration of its independence in 1991, Georgia has had ongoing violent disputes with local separatists in Abkhazia and South Ossetia regions and with Russia. These disputes have led to sporadic violence and breaches of peacekeeping operations. In August 2008, the conflict with South Ossetia escalated as Georgian troops engaged with local separatist fighters and Russian forces that had crossed the border. In the days that followed the initial outbreak, Georgia declared a state of war as Russian forces launched bombing raids deep into Georgia, targeted and destroyed Georgian infrastructure, blockaded part of the Georgian coast, took control of Tskhinvali (the South Ossetian administrative centre) and the Abkhazia region and landed marines on the Abkhazia coast. After five days of heavy fighting, the Georgian forces were defeated, enabling the Russians to enter Georgia uncontested and occupy the cities of Poti, Gori, Senaki and Zugdidi. In August 2008, Georgia and Russia signed a French-brokered cease-fire that called for the withdrawal of Russian forces, but tensions continue. Russia's subsequent recognition of the independence of Abkhazia and South Ossetia was condemned by Georgia, and Georgia withdrew from the CIS in August 2009.

Russia views the North Atlantic Treaty Organisation's **("NATO's")** eastward expansion, potentially including ex-Soviet

republics, such as Georgia, as hostile. Any future deterioration or worsening of Georgia's relationship with Russia, including any major changes in Georgia's relations with Western governments and institutions, in particular in terms of national security, Georgia's importance to Western energy supplies, the amount of aid granted to Georgia or the ability of Georgian manufacturers to access world export markets, may have a negative effect on the Georgian economy and on the business, results of operations and financial condition of Bank of Georgia.

Economic instability in Georgia in the future could have a material adverse effect on Bank of Georgia's business, results of operations, financial condition and prospects

Since the dissolution of the Soviet Union in the early 1990s, Georgia's society and economy have undergone a rapid transformation from a one-party state with a centrally-planned economy to a pluralist democracy with a market economy. This transformation has been marked by periods of significant instability resulting at various times in declines in GDP, hyperinflation, an unstable currency, high levels of state debt relative to GDP, the existence of a "black" and "grey" market economy, high unemployment and underemployment and the impoverishment of a large portion of the Georgian population.

The Conflict and the global financial crisis have affected Georgia through economic slowdown, as well as a decrease in exports and private capital inflows. According to the National Statistics Office, in 2010 Georgia's real GDP grew by an estimated 6.4% compared to 3.8% decline in real GDP in 2009 and 2.3% growth in real GDP in 2008. In 2010, an estimated U.S.$553 million of FDI had been received in Georgia, compared to U.S.$759.1 million in 2009 and U.S.$1,564.0 million in 2008, according to the National Statistics Office. The Lari depreciated by 14% relative to the U.S. dollar as a result of the NBG's one-off correction in November 2008, which also resulted in the depreciation of the Lari relative to other major currencies. Between 1 January 2010 and 1 January 2011, the Lari further depreciated by approximately 4.7% and appreciated in 2011 by approximately 7.9% by 20 April 2011, according to the NBG (see "—Risks Relating To the Bank's Business—The Bank's results and its ability to comply with certain Basel I and/or NBG financial ratios are significantly affected by currency fluctuations and, in particular, currency fluctuations affecting the Lari, Hryvnia and Belarusian Rouble"). Although the foreign exchange market has stabilised and a portion of donor pledges (see "—Any change in the levels of FDI or foreign aid could have an adverse effect on the Georgian economy and therefore the Bank's business ") have been committed and/or distributed, resulting in greater economic stability, there can be no assurance that the depreciation of Lari will not continue or that FDI will not decrease in the future.

A material depreciation of the Lari relative to the U.S. dollar or other currencies, changes in monetary policy, inflation, delays in private capital inflows, reduction of remittances, protracted suspension of trade activities or other factors could adversely affect Georgia's economy in the future which could, in turn, result in a material adverse effect on Bank of Georgia's business, results of operations, financial condition and prospects.

Any change in the levels of FDI or foreign aid could have an adverse effect on the Georgian economy and therefore Bank of Georgia's business

The Georgian economy is to a certain extent dependent upon FDI and foreign aid. FDI reduced significantly as a result of the Conflict and the global financial crisis, dropping by 51.5% between 2008 and 2009 (see "—Economic instability in Georgia in the future could have a material adverse effect on Bank of Georgia's business, results of operations, financial condition and prospects").

On 22 October 2008, the European Commission and World Bank sponsored a Georgia donors' conference in Brussels in order to rally support for Georgia in the wake of the Conflict. At the conference, a total of over U.S.$4.5 billion was pledged to Georgia by the European Community, EU Member States, the United States, Japan, the European Bank for Reconstruction and Development **(the "EBRD")**, the European Investment Bank ("EIB"), the Asian Development Bank (**"ADB")**, the World Bank and the International Finance Corporation (the "IFC"), among others, with disbursements to be made within three years. The Georgian banking sector was specifically allocated over U.S.$852.0 million from the total pledges.

By the end of November 2010, Georgia had entered into contractual agreements in respect of its receipt of around U.S.$4.0 billion of the U.S.$4.5 billion pledged, of which U.S.$2.0 billion had already been disbursed. The donor money is intended to help stabilise the Georgian economy and, in particular, provide funding to the Georgian banking sector. However, there can be no assurance that Georgia will receive the total amount pledged, or that the donor money will result in the expected improvements to the Georgian economy. If Georgia does not receive the total amount pledged and the amount pledged is not replaced by a corresponding increase in FDI, or the donor money and/or FDI does not result in the expected improvements in the Georgian economy, this could adversely affect the Georgian economy as a whole and thus Bank of Georgia's business

A lack of growth or instability in the Georgian domestic currency market may adversely affect the development of Georgia's economy and therefore Bank of Georgia's business

Although the Lari is a fully convertible currency, there is generally no market outside Georgia for the exchange of the Lari. A market exists within Georgia for the conversion of Lari into other currencies, but it is limited in size. According to the NBG, in 2010, the total volume of trading turnover in the Lari-U.S. dollar market amounted to U.S.$2.9 billion

compared to U.S.$2.2 billion in 2009 and U.S.$4.8 billion in 2008. The official exchange rate of the Lari against the U.S. dollar is fixed at the Tbilisi Interbank Foreign Exchange, which is used to determine the official exchange rate of the Lari against foreign currencies.

According to the NBG, the NBG had approximately U.S.$2.0 million worth of currency reserves as at 31 December 2010 and 31 December 2009 compared to U.S.$1.46 billion as at 31 December 2008. While the Government believes that the reserves will be sufficient to sustain the domestic currency market in the short-term, there can be no assurance that a relatively stable market will continue indefinitely and a lack of growth of this currency market may hamper the development of Georgia's economy, negatively affect the business of Bank of Georgia's corporate clients, and in turn, Bank of Georgia's business, results of operations, financial condition and prospects.

The uncertainties of the judicial systems in the Principal Markets, or any arbitrary or discriminatory state action taken in the Principal Markets in the future may have an adverse impact on the local economy and therefore on the Bank's business

Each of the Principal Markets, to varying degrees, is still developing an adequate legal framework required for the proper functioning of a market economy. For example, several fundamental Georgian civil, criminal, tax, administrative and commercial laws have only recently come into effect. Furthermore, the continued significant changes in Georgian legislation have led to confusion regarding the proper interpretation and implementation of laws and regulations due to the lack of sufficient time in which to develop a consistent body of practice. The recent nature of much of Georgian legislation and the rapid evolution of the Georgian legal system, place the quality, the enforceability and underlying constitutionality of laws in doubt and result in ambiguities and inconsistencies in their application.

In addition, the court system is understaffed and underfunded, and judges and courts in Georgia are generally inexperienced in the area of business and corporate law. Most court decisions are not readily available to the public, and the enforcement of court judgments can, in practice, be difficult in Georgia. Furthermore, state authorities have a high degree of discretion in Georgia and at times may exercise their discretion arbitrarily, in a manner not fully consistent with established laws or regulations or on a selective basis.

The uncertainties of the Georgian judicial system or any arbitrary or discriminatory state action taken in the future could have a negative effect on the economy and the Bank's ability to operate in Georgia could be adversely affected by difficulties in protecting and enforcing its rights and by future changes to local laws and regulations. Similar risks are characteristic of the Ukrainian and Belarus legal systems.

There can be no assurance that Bank of Georgia's corporate governance policies are in line with international standards or that they will comply with such standards in the future

Georgia has not adopted a code of corporate governance. In December 2003, the NBG circulated an official letter to Georgian commercial banks requesting them to begin introducing the best corporate governance practices based on the 1999 OECD Corporate Governance Principles. However, no deadline for such implementation has been established. As a general matter, Georgian companies do not have corporate governance procedures that are in line with international standards, including the standards set forth in the UK Corporate Governance Code of May 2010, the US Sarbanes-Oxley Act of 2002 or with generally accepted international standards, and there can be no assurance that Bank of Georgia's corporate governance policies will comply with such standards in the future.

If, in the future, the Bank fails to comply with any applicable regulations relating to, or the Bank is associated with, money laundering and/or terrorist financing, this could have an adverse impact on the Bank's reputation, result of operations, financial conditions and prospects

Although the Bank has implemented a comprehensive anti-money laundering **("AML")** and "know-your-customer" **("KYC")** policy, and is in the process of implementing such policies throughout its financial subsidiaries (including insurance and brokerage), that are monitored by its AML Compliance Department, and adheres to all requirements under applicable legislation aimed at preventing it being used as a vehicle for money laundering, there can be no assurance that these measures will be completely effective. If, in the future, the Bank fails to comply with timely reporting requirements or other AML regulations and/or is associated with money laundering and/or terrorist financing, its reputation, result of operations, financial conditions and prospects may be adversely affected. In addition, involvement in such activities may carry criminal or regulatory fines and sanctions.

Uncertainties of the tax systems in the Principal Markets may result in the Bank facing tax adjustments and/or fines in the future

In the Principal Markets, tax laws have not been in force for significant periods of time, compared to more developed market economies, and often result in unclear or non-existent implementing regulations. Moreover, such tax laws are subject to frequent changes and amendments, which can result in unusual complexities for the Bank and its business generally. A new Tax Code was adopted in Georgia on 17 September 2010 and came into effect on 1 January 2011. Differing opinions regarding the interpretation of various provisions exist both among and within governmental ministries and organisations, including the tax authorities, creating uncertainties, inconsistencies and areas of conflict. While the Bank believes that it is currently in compliance with the tax laws affecting its operations, it is possible that the relevant authorities could take differing positions with

regard to interpretative issues, which may result in the Bank facing tax adjustments and/or fines.

Statistical information relating to Georgia may be more limited in scope and published less frequently than in the case of other countries

A range of ministries and institutions, including the National Statistics Office, the Ministry of Finance, the NBG and the Ministry of Economy and Sustainable Development, produce statistics relating to Georgia and its economy. Georgia adheres to the International Monetary Fund **("IMF")** General Data Dissemination Standards. However, these statistics may be more limited in scope and published less frequently than in the case of other countries such that adequate monitoring of key fiscal and economic indicators may be difficult. Statistical data appearing in this Annual Report has, unless otherwise stated, been obtained from public sources and documents. Similar statistics may be available from other sources, but the underlying assumptions, methodology and, consequently, the resulting data may vary from source to source.

Possible non-enforceability of foreign judgements and arbitral awards

On the basis of certain precedents established by foreign judiciaries, it may not be possible for investors to effect service of process against Bank of Georgia in courts outside Georgia or in a jurisdiction to which Bank of Georgia has not explicitly submitted. Pursuant to Article 68.2 of the Law of Georgia on Private International Law foreign court judgments against Bank of Georgia will not be recognised and enforceable in Georgian courts if: (i) the matter is within exclusive competence of Georgia; (ii) there is a violation in the service of process or other procedures under the law of the country of the court which rendered the judgment; (iii) a dispute involving the same subject matter between the same parties has already been decided by a Georgian court or by a foreign court, judgment of which has been recognised in Georgia; (iv) the court rendering the judgment is not considered competent to adjudicate the dispute under Georgian legislation; (v) the country whose court has rendered the judgment does not recognise the judgments of Georgian courts; (vi) a dispute involving the same subject matter between the same parties is already being heard in a Georgian court; or (vii) the judgment of the foreign court contradicts fundamental legal principles of Georgia. No treaty exists between Georgia and most Western jurisdictions (including the United Kingdom) for the reciprocal enforcement of foreign court judgments. As a result, the Supreme Court of Georgia will decide whether to recognise a foreign judgment according to whether the relevant jurisdiction recognises a Georgian judgment, or by application of Article 68.3 of the Law of Georgia on Private International Law, which permits recognition of a foreign judgment even if the relevant foreign state does not recognise Georgian judgments so long as the judgment does not relate to property rights and the courts of Georgia do not have exclusive jurisdiction over the matter. If recognition is denied by the Supreme Court of Georgia, the claimant may be required to bring new proceedings in Georgia in respect of the matter covered by a judgment already obtained in a foreign jurisdiction against Bank of Georgia. In addition, Georgian courts have relatively limited experience in the recognition and enforcement of foreign court judgments, and in general mandatory enforcement procedures take a considerable amount of time. The limitations described above, including the general procedural grounds set out in Georgian legislation for the refusal to recognise and enforce foreign court judgments in Georgia, as well as unofficial political resistance, may significantly delay the enforcement of any such judgment or potentially deprive a claimant of effective legal recourse for claims.

Holders of GDRS may enforce their rights by arbitration. Georgia is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards **(the "New York Convention")**. Therefore, an arbitration award obtained in a country which is also a party to the New York Convention, such as the United Kingdom, would be enforceable in Georgia, subject to the terms of the New York Convention and compliance with Georgian civil procedure regulations and other procedures and requirements established by Georgian legislation. It may be difficult, however, to enforce arbitral awards in Georgia due to a number of factors, including the lack of experience of Georgian courts in international commercial transactions, certain procedural ambiguities, Georgian courts' inability to enforce such orders and unofficial political resistance, all of which could introduce delay and unpredictability into the process of enforcing any foreign arbitral award in Georgia.

Furthermore, the choice of English law as the governing law of the Deposit Agreement relating to the GDRs and the Notes and the related transaction documents may not be given effect, and the recognition or enforcement of foreign court judgments and arbitral awards may be limited, by application of the Georgian law principle requiring compliance with mandatory provisions of the law of the country most closely connected to the transaction, including mandatory provisions of Georgian law. The nature and scope of such mandatory provisions are subject to a considerable degree of discretionary authority by the court in which recognition or enforcement of the judgment or arbitral award is being sought.

RESPONSIBILITY STATEMENT

The Management Board confirms to the best of their knowledge that:

the consolidated financial statements have been prepared in accordance with International Financial Reporting Standards;

the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Bank and the undertakings included in the consolidation taken as a whole; and

the Annual Report and Accounts include a fair review of the development and performance of the business and the position of the Bank and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

FORWARD LOOKING STATEMENTS

This document contains statements that constitute "forward-looking statements", including , but not limited to, statements concerning expectations, projections , objectives, targets, goals, strategies, future events, future revenues or performance, capital expenditures, financing needs, plans or intentions relating to acquisitions, competitive strengths and weaknesses, plans or goals relating to financial position and future operations and development.

While these forward-looking statements represent our judgments and future expectations concerning the development of our business, a number of risks, uncertainties and other factors could cause actual developments and results to differ materially from our expectations.

These factors include, but are not limited to, (1) general market, macroeconomic, governmental, legislative and regulatory trends, (2) movements in local and international currency exchange rates; interest rates and securities markets, (3) competitive pressures, (4) technological developments, (5) changes in the financial position or credit worthiness of our customers, obligors and counterparties and developments in the market in which they operate, (6) management changes and changes to our group structure and (7) other key factors that we have indicated could adversely affect our business and financial performance, which are contained elsewhere in this document and in our past and future filings and reports, including those filed with the respective authorities.

When relying on forward-looking statements, investors should carefully consider the foregoing factors and other uncertainties and events. Accordingly, we are under no obligations (and expressly disclaim and such obligations) to update or alter our forward-looking statements whether as a result of new information, future events, or otherwise.

BANK OF GEORGIA SUPERVISORY AND MANAGMENT BOARD

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BANK OF GEORGIA

SUPERVISORY BOARD

NEIL JANIN
Chairman of the
Supervisory Board

DAVID MORRISON
Vice Chairman of the
Supervisory Board

Audit Committee Member

IAN HAGUE
Member of the Supervisory
Board

Compensation Committee
Member

ALLAN HIRST
Member of the Supervisory
Board

Chairman of the Audit
Committee

Kaha Kiknavelidze,
Member of the Supervisory
Board

Audit Committee Member

ALASDAIR (AL) BREACH
Member of the Supervisory
Board

Chairman of the
Compensation Committee

HANNA LOIKKANNEN,
Member of the Supervisory
Board

Compensation Committee
Member

MANAGEMENT BOARD

IRAKLI GILAURI
Chief Executive Officer

IRAKLI BURDILADZE
Deputy Chief Executive Officer,
In charge of SB Real Estate

MIKHEIL GOMARTELI
Deputy Chief Executive Officer,
Retail Banking

SULKHAN GVALIA
Deputy Chief Executive Officer,
Chief Risk Officer

AVTO NAMICHEISHVILI
Deputy Chief Executive Officer,
Legal Affairs

GEORGE CHILADZE
Deputy Chief Executive Officer,
Finance

ARCHIL GACHECHILADZE
Deputy Chief Executive Officer,
Corporate Banking

JSC BANK OF GEORGIA AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATMENTS

YEARS ENDED 31 DECEMBER 2010, 2009 AND 2008
TOGETHER WITH INDEPENDENT AUDITORS' REPORT

საქართველოს ბანკი
BANK OF GEORGIA

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated financial statements of JSC Bank of Georgia and its subsidiaries, which comprise the consolidated statements of financial position as at 31 December 2010, 2009 and 2008, and the consolidated income statements, consolidated statements of comprehensive income, of changes in equity and of cash flows for the years 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 audits. We conducted our audits 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 referred to above present fairly, in all material respects, the financial position of JSC Bank of Georgia and its subsidiaries as at 31 December 2010, 2009 and 2008 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

10 March 2011

ERNST & YOUNG LLC

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
As at 31 December 2010, 2009 and 2008
(Thousands of Georgian Lari)

	Notes	2010	2009	2008
Assets				
Cash and cash equivalents	7	611,584	357,889	415,821
Amounts due from credit institutions	8	116,469	64,620	81,403
Loans to customers	9	2,351,697	1,661,331	2,039,022
Finance lease receivables	10	14,419	16,896	41,605
Investment securities:				
– available-for-sale	11	294,940	19,590	33,737
– held-to-maturity	11	21	249,196	22,845
Investments in associates	12	5,632	10,323	16,716
Investment properties	13	113,496	79,509	47,289
Property and equipment	14	285,852	278,729	301,784
Goodwill and other intangible assets	15	91,602	85,442	152,459
Current income tax assets	16	2,247	7,997	8,095
Deferred income tax assets	16	18,178	15,487	4,691
Prepayments		23,365	18,140	18,319
Other assets	18	75,420	48,280	75,121
Total assets		**4,004,922**	**2,913,429**	**3,258,907**
Liabilities				
Amounts due to customers	20	2,004,698	1,272,470	1,193,124
Amounts due to credit institutions	19	1,138,927	928,615	1,216,722
Current income tax liabilities	16	4,251	574	779
Deferred income tax liabilities	16	30,901	24,661	23,615
Provisions	17, 22	4,407	2,126	4,263
Other liabilities	18	128,397	86,566	101,555
Total liabilities		**3,311,581**	**2,315,012**	**2,540,058**
Equity	21			
Share capital		31,345	31,306	31,253
Additional paid-in capital		477,285	478,779	468,732
Treasury shares		(1,510)	(1,677)	(2,018)
Other reserves		26,816	24,387	26,201
Retained earnings		130,314	46,163	141,491
Total equity attributable to shareholders of the Bank		**664,250**	**578,958**	**665,659**
Non-controlling interests		29,091	19,459	53,190
Total equity		**693,341**	**598,417**	**718,849**
Total liabilities and equity		**4,004,922**	**2,913,429**	**3,258,907**

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

Irakli Gilauri Chief Executive Officer

David Vakhtangishvili Chief Financial Officer

10 March 2011

The accompanying notes on pages 6 to 83 are an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENTS
For the years ended 31 December 2010, 2009 and 2008
(Thousands of Georgian Lari)

	Notes	*2010*	*2009*	*2008*
Interest income				
Loans to customers		389,402	361,176	363,013
Investment securities – held-to-maturity		12,498	5,725	16,457
Amounts due from credit institutions		9,795	5,037	10,732
Investment securities – available-for-sale		7,287	1,276	6,727
Finance lease receivables		4,159	5,844	7,010
		423,141	**379,058**	**403,939**
Interest expense				
Amounts due to customers		(114,654)	(96,749)	(85,358)
Amounts due to credit institutions		(91,829)	(91,582)	(97,035)
Debt securities issued		(314)	(186)	(706)
		(206,797)	**(188,517)**	**(183,099)**
Net interest income before impairment charge on interest-earning assets		**216,344**	**190,541**	**220,840**
Impairment charge on loans to customers	9	(49,886)	(118,882)	(122,812)
Reversal of impairment (Impairment charge) on finance lease receivables	10	5,775	(6,859)	(1,335)
Net interest income after impairment charge		**172,233**	**64,800**	**96,693**
Fee and commission income		74,265	64,599	63,503
Fee and commission expense		(10,845)	(9,574)	(13,534)
Net fee and commission income	23	**63,420**	**55,025**	**49,969**
Net gains (losses) from trading securities		1,217	2,763	(5,447)
Net gains from investment securities available-for-sale		789	174	513
Net losses from derivative financial instruments		(7,826)	(6,266)	–
Net gains (losses) from revaluation of investment properties	13	350	(4,087)	(389)
Net gains from foreign currencies:				
– dealing		33,651	25,945	39,443
– translation differences		98	2,821	7,691
Net insurance premiums earned	24	44,561	45,477	35,911
Share of profit (loss) of associates	12	255	(2,649)	(713)
Other operating income		21,927	17,908	14,747
Other non-interest income		**95,022**	**82,086**	**91,756**
Salaries and other employee benefits	25	(104,551)	(100,505)	(108,767)
General and administrative expenses	25	(61,000)	(57,339)	(68,649)
Net insurance claims incurred	24	(27,898)	(30,102)	(26,895)
Depreciation, amortization and impairment	14, 15	(28,398)	(101,700)	(20,532)
Impairment charge on other assets and provisions	17	(3,587)	(6,431)	(4,551)
Other operating expenses		(6,798)	(11,740)	(9,828)
Other non-interest expenses		**(232,232)**	**(307,817)**	**(239,222)**
Profit (loss) before income tax benefit		**98,443**	**(105,906)**	**(804)**
Income tax (expense) benefit	16	(15,776)	6,998	978
Profit (loss) for the year		**82,667**	**(98,908)**	**174**
Attributable to:				
– shareholders of the Bank		83,640	(91,370)	3,897
– non-controlling interests		(973)	(7,538)	(3,723)
		82,667	**(98,908)**	**174**
Earnings per share:	21			
– basic earnings (losses) per share		2.785	(2.996)	0.129
– diluted earnings (losses) per share		2.739	(2.996)	0.129

The accompanying notes on pages 6 to 83 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the years ended 31 December 2010, 2009 and 2008
(Thousands of Georgian Lari)

	Notes	*2010*	*2009*	*2008*
Profit (loss) for the year		**82,667**	**(98,908)**	**174**
Other comprehensive (loss) income				
– Revaluation of property & equipment	14	(2,859)	(1,842)	(10,455)
– Revaluation of available-for-sale securities		6,077	7,533	(9,687)
– Realized gains on available-for-sale securities reclassified to the consolidated income statement		(789)	(174)	(513)
– Gain (loss) from currency translation differences		5,116	(12,145)	(22,435)
– Unrealized (loss) gain from acquiring / selling shares in existing subsidiaries		(3,250)	7,624	–
Income tax relating to components of other comprehensive income	16	206	(704)	3,189
Other comprehensive income (loss) for the year, net of tax		**4,501**	**292**	**(39,901)**
Total comprehensive income(loss) for the year		**87,168**	**(98,616)**	**(39,727)**
Attributable to:				
– shareholders of the Bank		86,580	(91,078)	(36,004)
– non-controlling interest		588	(7,538)	(3,723)
		87,168	**(98,616)**	**(39,727)**

The accompanying notes on pages 6 to 83 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
For the years ended 31 December 2010, 2009 and 2008
(Thousands of Georgian Lari)

	Attributable to shareholders of the Bank							
	Share capital	*Additional paid-in capital*	*Treasury shares*	*Other reserves*	*Retained earnings*	*Total*	*Non-controlling interest*	*Total equity*
31 December 2007	**27,155**	**315,415**	**(1,737)**	**67,354**	**136,342**	**544,529**	**13,462**	**557,991**
Total comprehensive income (loss)	–	–	–	(39,901)	3,897	(36,004)	(3,723)	(39,727)
Depreciation of revaluation reserve, net of tax	–	–	–	(1,252)	1,252	–	–	–
Issuance of shares arising from business combination (Note 21)	89	573	–	–	–	662	–	662
Increase in share capital arising from share-based payments (Note 21)	9	8,590	341	–	–	8,940	–	8,940
Share offering costs adjustment	–	(357)	–	–	–	(357)	–	(357)
Increase in share capital from issuance of GDRs (Note 21)	4,000	146,594	–	–	–	150,594	–	150,594
Acquisition of additional interests in existing subsidiaries by non-controlling shareholders	–	–	–	–	–	–	31,278	31,278
Non-controlling interests arising on acquisition of subsidiary	–	–	–	–	–	–	12,173	12,173
Sale of treasury shares	–	5,544	256	–	–	5,800	–	5,800
Purchase of treasury shares	–	(7,627)	(878)	–	–	(8,505)	–	(8,505)
31 December 2008	**31,253**	**468,732**	**(2,018)**	**26,201**	**141,491**	**665,659**	**53,190**	**718,849**
Total comprehensive income (loss)	–	–	–	1,563	(92,641)	(91,078)	(7,538)	(98,616)
Depreciation of revaluation reserve, net of tax	–	–	–	(3,377)	3,377	–	–	–
Increase in share capital arising from share-based payments (Note 21)	53	2,523	153	–	–	2,729	–	2,729
Share offering costs adjustment	–	306	–	–	–	306	–	306
Equity component of compound financial instrument	–	9,769	–	–	–	9,769	–	9,769
Acquisition of additional interests in existing subsidiaries by non-controlling shareholders	–	–	–	–	(6,064)	(6,064)	(1,479)	(7,543)
Acquisition of non-controlling interests in existing subsidiaries	–	–	–	–	–	–	(24,730)	(24,730)
Non-controlling interests arising on acquisition of subsidiary	–	–	–	–	–	–	16	16
Sale of treasury shares	–	1,154	642	–	–	1,796	–	1,796
Purchase of treasury shares	–	(3,705)	(454)	–	–	(4,159)	–	(4,159)
31 December 2009	**31,306**	**478,779**	**(1,677)**	**24,387**	**46,163**	**578,958**	**19,459**	**598,417**
Total comprehensive income	–	–	–	4,692	81,888	86,580	588	87,168
Depreciation of revaluation reserve, net of tax	–	–	–	(2,263)	2,263	–	–	–
Increase in share capital arising from share-based payments (Note 21)	39	8,497	610	–	–	9,146	–	9,146
Acquisition of additional interests in existing subsidiaries by non-controlling shareholders	–	–	–	–	–	–	11,973	11,973
Acquisition of non-controlling interests in existing subsidiaries	–	–	–	–	–	–	(6,854)	(6,854)
Non-controlling interests arising on acquisition of subsidiary	–	–	–	–	–	–	3,925	3,925
Sale of treasury shares	–	7,104	448	–	–	7,552	–	7,552
Purchase of treasury shares	–	(17,095)	(891)	–	–	(17,986)	–	(17,986)
31 December 2010	**31,345**	**477,285**	**(1,510)**	**26,816**	**130,314**	**664,250**	**29,091**	**693,341**

The accompanying notes on pages 6 to 83 are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENTS
For the years ended 31 December 2010, 2009 and 2008
(Thousands of Georgian Lari)

	Notes	*2010*	*2009*	*2008*
Cash flows from operating activities				
Interest received		412,407	377,043	384,802
Interest paid		(194,622)	(205,054)	(173,534)
Fees and commissions received		74,265	64,599	63,503
Fees and commissions paid		(10,845)	(9,574)	(13,534)
Net realized gains (losses) from trading securities		2,267	587	(5,432)
Net realized gains from investments securities		789	174	498
Net realized gains from foreign currencies		33,651	25,945	39,443
Recoveries of loans to customers and finance lease receivables	9, 10	42,739	32,579	11,176
Insurance premiums received		46,159	31,319	24,262
Insurance claims paid		(32,007)	(16,801)	(11,095)
Other operating income received		9,483	22,022	11,499
Salaries and other employee benefits paid		(93,870)	(88,365)	(106,605)
General and administrative and operating expenses paid		(71,872)	(80,026)	(62,174)
Cash flows from operating activities before changes in operating assets and liabilities		**218,544**	**154,448**	**162,809**
Net (increase) decrease in operating assets				
Amounts due from credit institutions		(45,090)	14,933	22,488
Loans to customers		(813,482)	239,093	(488,574)
Finance lease receivables		8,252	12,448	3,722
Prepayments and other assets		100	(28,696)	(3,678)
Net increase (decrease) in operating liabilities				
Amounts due to credit institutions		190,994	(276,916)	339,654
Amounts due to customers		731,184	81,713	(211,774)
Other liabilities		21,981	455	(9,813)
Net cash flows from (used in) operating activities before income tax		**312,483**	**197,478**	**(185,166)**
Income tax paid		(3,144)	(1,275)	(19,580)
Net cash flows from (used in) operating activities		**309,339**	**196,203**	**(204,746)**
Cash flows from investing activities				
Acquisition of subsidiaries, net of cash acquired	5	(139)	(2,970)	(41,740)
Proceeds from sale of investment securities: available-for-sale		1,518	25,323	166,175
Purchase of investment securities: held-to-maturity		(28,769)	(226,804)	–
Purchase of investments in associates	12	–	–	(13,355)
Proceeds from sale of investments in associates	12	–	24	860
Purchase of investment properties	13	–	(495)	(12,613)
Proceeds from sale of investment properties	13	5,490	755	–
Purchase of property and equipment and intangible assets	14, 15	(41,839)	(27,928)	(122,881)
Proceeds from sale of property and equipment and intangible assets	14, 15	13,312	3,404	–
Net cash flows used in investing activities		**(50,427)**	**(228,691)**	**(23,554)**
Cash flows from financing activities				
Proceeds from increase in share capital		–	306	150,594
Purchase of treasury shares		(17,986)	(4,159)	(8,505)
Sale of treasury shares		7,552	1,796	5,800
Purchase of additional interests by non-controlling shareholders		11,973	(1,479)	31,278
Purchase of additional interests in existing subsidiaries, net of cash acquired		(6,854)	(24,730)	–
Redemption of debt securities issued		–	–	(4,472)
Net cash (used in) from financing activities		**(5,315)**	**(28,266)**	**174,695**
Effect of exchange rates changes on cash and cash equivalents		98	2,822	5,602
Net increase (decrease) in cash and cash equivalents		**253,695**	**(57,932)**	**(48,003)**
Cash and cash equivalents, beginning	7	**357,889**	**415,821**	**463,824**
Cash and cash equivalents, ending	7	**611,584**	**357,889**	**415,821**

The accompanying notes on pages 6 to 83 are an integral part of these consolidated financial statements.

1. Principal Activities

JSC Bank of Georgia (the "Bank") was established on 21 October 1994 as a joint stock company ("JSC") under the laws of Georgia. The Bank operates under a general banking license issued by the National Bank of Georgia ("NBG"; the Central Bank of Georgia) on 15 December 1994. The Bank is the ultimate parent of a group of companies (the "Group") incorporated in Georgia, Ukraine, Belarus and Cyprus, primary business activities include providing banking, leasing, insurance, brokerage and wealth management services, to corporate and individual customers. The list of companies included in the Group is provided in Note 2. The Bank is the Group's main operating unit and accounts for most of the Group's activities.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and international and exchanges currencies. Its main office is in Tbilisi, Georgia. At 31 December 2010 the Bank has 142 operating outlets in all major cities of Georgia (2009: 141, 2008: 151). The Bank's registered legal address is 3 Pushkin Street, Tbilisi 0105, Georgia.

As of 31 December 2010, 2009 and 2008 the following shareholders owned more than 4% of the outstanding shares of the Bank. Other shareholders individually owned less than 4% of the outstanding shares.

Shareholder	*31 December 2010, %*	*31 December 2009, %*	*31 December 2008, %*
Bank of New York (Nominees), Limited	90.50%	88.86%	77.45%
East Capital Financial Institutions	4.36%	4.36%	4.37%
Firebird Avrora Fund	–	–	4.68%
Firebird Republics Fund	–	–	4.58%
Others (less than 4% individually)	5.14%	6.78%	8.92%
Total	**100.00%**	**100.00%**	**100.00%**

As of 31 December 2010, the members of the Supervisory Board and Board of Directors owned 448,232 shares and Global Depositary Receipts ("GDRs") (or 1.43%; 2009: 612,962 shares and GDRs or 1.96%, 2008: 468,827 shares and GDRs or 1.50%) of the Bank. Interests of the members of the Supervisory Board and Management Board were as follows:

Shareholder	*31 December 2010, shares held*	*31 December 2009, shares held*	*31 December 2008, shares held*
Irakli Gilauri	200,379	216,230	136,303
Sulkhan Gvalia	60,638	136,049	166,907
Allan Hirst	56,311	46,772	10,685
Avto Namicheishvili	34,823	29,999	12,489
Kakha Kiknavelidze	22,509	15,027	4,938
Irakli Burdiladze	17,504	23,035	10,036
David Morisson	15,351	7,342	–
Giorgi Chiladze	14,333	6,333	–
Mikheil Gomarteli	10,634	9,916	–
Al Breach	6,527	–	–
Neil Janin	3,945	–	–
Archil Gachechiladze	3,700	–	–
Jan Hague	1,578	–	–
Nicholas Enukidze*	–	122,259	75,377
Ramaz Kukuladze**	–	–	52,092
Total	**448,232**	**612,962**	**468,827**

1. Principal Activities (continued)

In addition to shares held, the members of the Supervisory Board and Management Board were awarded or were committed to award 1,290,711, 463,912 and 198,139 Global Depository Receipts ("GDR") in 2010, 2009 and 2008, respectively. Out of the total of 1,290,711 in 2010, 915,000 shares that were committed to be awarded to the Management Boards are subject to four-year vesting and the rest of the awards are subject to three-year vesting. As of 31 December 2010, 292,395 GDRs owned by the members of the Supervisory Board and Management Board vested and comprised as follows (in 2009: 419,814, 2008: 313,330):

Member of the Supervisory Board and/or Management Board	*31 December 2010, GDRs vested*	*31 December 2009, GDRs vested*	*31 December 2008, GDRs vested*
Irakli Gilauri	198,792	214,643	134,716
Avto Namicheishvili	34,001	29,999	11,667
Irakli Burdiladze	17,134	22,665	9,666
Giorgi Chiladze	14,333	6,333	–
Sulkhan Gvalia	13,801	13,999	26,857
Mikheil Gomarteli	10,634	9,916	–
Archil Gachechiladze	3,700	–	–
Kakha Kiknavelidze	–	–	4,000
Nicholas Enukidze*	–	122,259	74,332
Ramaz Kukuladze**	–	–	52,092
Total	**292,395**	**419,814**	**313,330**

** Resigned as a chairman of the Supervisory Board of the Bank on 18 May 2010.*
*** Resigned from the Management Board of the Bank on 15 November 2009.*

2. Bases of Preparation

General

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The Bank and its Georgian-based subsidiaries are required to maintain their records and prepare their financial statements for regulatory purposes in Georgian Lari in accordance with IFRS, while Subsidiaries established outside of Georgia are in their respective local currencies. These consolidated financial statements are prepared under the historical cost convention except for the measurement at fair value of financial assets and liabilities held for trading, available-for-sale securities, investment properties and revalued property and equipment.

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

2. Bases of Preparation (continued)

Subsidiaries

The consolidated financial statements as of 31 December 2010, 2009 and 2008 include the following direct and indirect subsidiaries:

Subsidiaries	Ownership / voting, %			Country of incorporation	Industry	Date of incorporation	Date of acquisition
	31 December 2010	31 December 2009	31 December 2008				
JSC BG Bank	99.4%	99.4%	99.4%	Ukraine	Banking	26/01/1994	1/10/2007
Valimed, Unitarnoe Predpreyatie (originally LLC)	100.0%	100.0%	100.0%	Belarus	Investment	14/09/2000	3/06/2008
Proscale M, UE	(a)	100.0%	–	Belarus	Business servicing	15/05/2003	4/12/2009
JSC Belarusky Narodny Bank	79.99%	99.98%	70.0%	Belarus	Banking	16/04/1992	3/06/2008
BNB Leasing, LLC	99.9%	76.0%	76.0%	Belarus	Leasing	30/03/2006	3/06/2008
JSC BG Capital (Georgia) (formerly known as JSC Galt and Taggart Securities)	100.0%	100.0%	100.0%	Georgia	Brokerage and asset management	19/12/1995	28/12/2004
Benderlock Investments Limited	100.0%	100.0%	–	Cyprus	Investments	12/05/2009	13/10/2009
BG Tax Advisory, LLC (formerly known as Galt and Taggart Tax Advisory, LLC)	100.0%	100.0%	100.0%	Georgia	Tax consulting	25/09/2007	–
BG Commodities (Georgia), LLC	100.0%	100.0%	–	Georgia	Commodity Trading	16/04/2009	–
BG Commodities (Ukraine), LLC	100.0%	100.0%	–	Ukraine	Commodity Trading	24/11/2009	–
Galt and Taggart Holdings Limited	100.0%	100.0%	100.0%	Cyprus	Investment	3/07/2006	–
BG Trading Limited	100.0%	100.0%	100.0%	Cyprus	Investment	26/03/2007	–
JSC Galt and Taggart Securities, SA (Moldova)	(b)	95.1%	95.1%	Moldova	Investment	7/07/2008	–
BG Capital (Ukraine), LLC	100.0%	100.0%	100.0%	Ukraine	Brokerage	23/10/2006	–
BG Capital (Belarus), LLC	100.0%	100.0%	100.0%	Belarus	Brokerage	19/02/2008	–
Brooksby Investments Limited	100.0%	100.0%	100.0%	Cyprus	Investments	4/03/2008	18/06/2008
Galt & Taggart Securities MMC, LLC	–	(c)	75.0%	Azerbaijan	Investment banking and brokerage services	30/06/2008	–
GTAM Limited	–	(c)	80.0%	Cyprus	Investment activity	23/10/2007	–
Galt and Taggart Asset Management, LLC	–	(c)	100.0%	Georgia	Asset management	31/05/2007	–
JSC Belorussian Investments	–	(c)	100.0%	Georgia	Consumer goods production & distribution	14/05/2008	–
JSC Liberty Financial Opportunities	–	(c)	100.0%	Georgia	Investment	3/09/2008	–
JSC Insurance Company Aldagi BCI	100.0%	100.0%	100.0%	Georgia	Insurance	22/06/2007	–
JSC My Family Clinic	100.0%	100.0%	100.0%	Georgia	Healthcare	3/10/2005	–
JSC Kutaisi St. Nicholas Surgery Hospital	55.0%	55.0%	55.0%	Georgia	Medical services	3/11/2000	20/05/2008
Kutaisi Regional Clinical Hospital, LLC	100.0%	–	–	Georgia	Medical services	19/07/2010	1/10/2010

2. Bases of Preparation (continued)

Subsidiaries (continued)

	Ownership / voting, %						
Subsidiaries	*31 December 2010*	*31 December 2009*	*31 December 2008*	*Country of incorporation*	*Industry*	*Date of incorporation*	*Date of acquisition*
Georgian Leasing Company, LLC	100.0%	100.0%	100.0%	Georgia	Leasing	29/10/2001	31/12/2004
□ JSC DBL.ge	(d)	100.0%	100.0%	Georgia	Investment	23/04/2007	–
□ JSC DBL Capital	(d)	100.0%	100.0%	Georgia	Brokerage	27/04/2007	–
JSC GC Holdings (formerly LLC)	100.0%	100.0%	100.0%	Georgia	Investment	29/10/2007	–
□ GC Ukraine, LLC	(b)	100.0%	100.0%	Ukraine	Card processing	30/07/2008	–
□ JSC Georgian Card	71.78%	55.8%	55.7%	Georgia	Card processing	17/01/1997	20/10/2004
□ JSC Nova Technology	–	(c)	51.0%	Georgia	Electronic payment services	19/03/2007	11/11/2007
□ Direct Debit Georgia, LLC	100.0%	100.0%	100.0%	Georgia	Electronic payment services	7/03/2006	–
□ MetroNet, LLC	100.0%	100.0%	100.0%	Georgia	Communication services	23/04/2007	–
JSC SB Real Estate	100.0%	61.4%	52.1%	Georgia	Real estate	27/09/2006	–
JSC Liberty Consumer	65.3%	65.3%	65.4%	Georgia	Investment	24/05/2006	–
□ JSC Teliani Valley	52.33%	27.19%	27.19%	Georgia	Winery	30/06/2000	28/02/2007
□ Teliani Trading (Georgia), LLC	100.0%	–	–	Georgia	Distribution	10/01/2006	27/03/2007
□ Teliani Trading (Ukraine), LLC	100.0%	–	–	Ukraine	Distribution	03/10/2006	31/12/2007
□ Le Caucase, LLC	100.0%	–	–	Georgia	Cognac Production	23/09/2006	20/03/2007
□ Kupa, LLC	70.0%	–	–	Georgia	Oak Barrel Production	12/10/2006	20/03/2007
□ Vere+, LLC	–	(e)	100.0%	Georgia	Real estate	22/05/1996	6/02/2007
□ Alegro, LLC	–	(f)	100.0%	Georgia	Commercial	9/09/1996	12/03/2008
□ JSC SB Outdoor & Indoor	(g)	100.0%	100.0%	Georgia	Advertising	9/06/2006	–
□ JSC Intertour	97.02%	83.6%	83.6%	Georgia	Travel agency	29/03/1996	25/04/2006
□ Intertour Ukraine, LLC	100.0%	–	–	Ukraine	Travel agency	19/02/2010	–
□ Holiday Travel, LLC	100.0%	100.0%	100.0%	Georgia	Travel agency	11/02/2005	4/09/2006
□ JSC Prime Fitness	100.0%	100.0%	100.0%	Georgia	Fitness centre	3/07/2006	–
□ Planeta Forte, LLC	51.0%	51.0%	–	Georgia	Newspaper Retail	31/10/1995	1/01/2009
JSC Galt and Taggart Holdings (Georgia)	100.0%	100.0%	100.0%	Georgia	Investment	4/11/2008	–
□ JSC Club 24	(h)	100.0%	100.0%	Georgia	Entertainment	27/11/2007	–
□ Metro Service +, LLC	100.0%	100.0%	100.0%	Georgia	Business servicing	10/05/2006	–
□ SB Transport, LLC	–	(i)	100.0%	Georgia	Transportation	20/02/2007	–
□ JSC SB Trade	–	(i)	100.0%	Georgia	Import and distribution	26/02/2007	–
□ Georgia Financial Investments, LLC	100.0%	100.0%	–	Israel	Information Sharing and Market Research	9/02/2009	–
□ Real Estate Brokerage-Presto, LLC	(h)	100.0%	100.0%	Georgia	Real estate brokerage	16/11/2007	–
□ JSC SB Immobiliare	(h)	100.0%	100.0%	Georgia	Real estate, Construction	12/03/2008	–
□ JSC SB Iberia	(j)	100.0%	49.0%	Georgia	Real estate, Construction	13/12/2007	19/08/2009
□ JSC SB Iberia 2	(j)	100.0%	49.0%	Georgia	Real estate, Construction	28/03/2008	19/08/2009
□ Bank of Georgia Representative Office UK Limited	100.0%	–	–	London	Information Sharing and Market Research	17/08/2010	–
JSC United Securities Registrar of Georgia	100.0%	100.0%	100.0%	Georgia	Registrar	29/05/2006	–

(a) No longer Group subsidiary due to sale in 2010.
(b) No longer Group subsidiary due to liquidation in 2010.
(c) No longer Group subsidiary due to sale in 2009.
(d) Merged to JSC BG Capital (Georgia) in 2010.
(e) No longer Group subsidiary due to liquidation in 2009.
(f) Transferred to JSC Caucasus Energy and Infrastructure (former subsidiary of the Group) in 2009 in exchange of a loan payable.
(g) Merged to JSC Prime Fitness in 2010.
(h) Investment in JSC Club 24, Real Estate Brokerage-Presto, LLC and JSC SB Immobiliare had been contributed to the capital of JSC SB Real Estate (SBRE) by JSC Galt and Taggart Holdings (GTH). These subsidiaries (except for GTH) merged to JSC SB Real Estate in 2010.
(i) JSC Galt and Taggart Holdings (Georgia) contributed its investments in JSC SB Trade and SB Transport, LLC to the capital of Club 24, LLC. Both of these companies merged to Club 24, LLC, subsequently reorganized into a joint stock company.
(j) Merged to JSC SB Immobiliare in 2010.

3. Summary of Significant Accounting Policies

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.

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.

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.

3. Summary of Significant Accounting Policies (continued)

Adoption of new or revised standards and interpretations (continued)

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 the accounting policies, financial position or performance of the Group, except the following amendments resulting in changes to accounting policies, as described below.

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

Reclassifications

The following reclassifications were made to 2009 and 2008 balances to conform with the year ended 31 December 2010 presentation requirements:

Year Ended	Caption Consolidated Statement of Financial Position:	*As previously reported*	*As reclassified*	*Comment*
2009	Cash and cash equivalents	337,372	357,889	Reclassification of national currency denominated mandatory account with NBG due to their non-restrictive nature.
2009	Amounts due from credit institutions	85,137	64,620	
2008	Cash and cash equivalents	397,591	415,821	
2008	Amounts due from credit institutions	99,633	81,403	

Subsidiaries

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

3. Summary of Significant Accounting Policies (continued)

Subsidiaries (continued)

Business combinations from 1 January 2010

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interests in the acquiree. For each business combination, the Group measures the non-controlling interests in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the Group's previously held equity interest in the acquiree is remeasured to fair value as at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the Group is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability, will be recognised in accordance with IAS 39 either in profit or loss or as change to other comprehensive income. If the contingent consideration is classified as equity, it shall not be remeasured until it is finally settled within equity.

Goodwill is initially measured at cost being the excess of the consideration transferred over the Group's net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in profit or loss. After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Business combinations prior to 1 January 2010

In comparison to the above mentioned requirements, the following differences applied:

Business combinations were accounted for using the purchase method. Transaction costs directly attributable to the acquisition formed part of the acquisition costs. The non-controlling interests (formerly known as minority interest) were measured at the proportionate share of the acquiree's identifiable net assets.

Business combinations achieved in stages were accounted for as separate steps. Any additional acquired share of interest did not affect previously recognised goodwill.

When the Group acquired a business, embedded derivatives separated from the host contract by the acquiree were not reassessed on acquisition unless the business combination resulted in a change in the terms of the contract that significantly modified the cash flows that otherwise would have been required under the contract.

Contingent consideration was recognised if, and only if, the Group had a present obligation, the economic outflow was more likely than not and a reliable estimate was determinable. Subsequent adjustments to the contingent consideration affected goodwill.

3. Summary of Significant Accounting Policies (continued)

Subsidiaries (continued)

Acquisition of subsidiaries from parties under common control

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

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

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

Investments in associates

Associates are entities in which the Group generally has between 20% and 50% of the voting rights, or is otherwise able to exercise significant influence, but which it does not control or jointly control. Investments in associates are accounted for under the equity method and are initially recognised at cost, including goodwill. Subsequent changes in the carrying value reflect the post-acquisition changes in the Group's share of net assets of the associate. The Group's share of its associates' profits or losses is recognised in the consolidated income statement, and its share of movements in reserves is recognised in other comprehensive income. However, when the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses, unless the Group is obliged to make further payments to, or on behalf of, the associate.

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

Financial assets

Initial recognition

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

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.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category 'financial assets at fair value through profit or loss'. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognised in the consolidated income statement.

3. Summary of Significant Accounting Policies (continued)

Financial assets (continued)

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Group has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held-to-maturity investments are subsequently measured at amortised cost. Amortised cost is computed as the amount initially recognised minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initially recognised amount and the maturity amount. This calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts. For investments carried at amortised cost, gains and losses are recognised in the consolidated income statement when the investments are impaired, as well as through the amortisation process.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortised cost using the effective interest method. This calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts. For investments carried at amortised cost, gains and losses are recognised in the consolidated income statement when the investments are impaired, as well as through the amortisation process. Gains and losses are recognised in the consolidated income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

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

Determination of fair value

The fair value of financial instruments that are actively traded in organised financial markets is determined by reference to quoted market bid prices for long positions and ask price for short positions at the close of business on the reporting date, without any deduction for transaction costs.

For all other financial instruments where there is no active market, fair value is determined using valuation techniques. Valuation techniques include using recent arm's length market transactions, which are determined not to be a result of a forced transaction, involuntary liquidation or distress sale, reference to the current market value of similar instrument, discounted cash flow analysis and other relevant valuation models.

Offsetting

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

Cash and cash equivalents

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

3. Summary of Significant Accounting Policies (continued)

Derivative financial instruments

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

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

Promissory notes

Promissory notes purchased are included in trading securities, or in amounts due from credit institutions or in loans to customers or in available-for-sale securities, depending on their substance and are accounted for in accordance with the accounting policies for these categories of assets.

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 each or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to credit institutions, amounts due to customers and debt securities issued. These are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the consolidated income statement when the borrowings are derecognised as well as through the amortisation process.

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

Leases

i. Finance – Group as lessor

The Group recognizes finance lease receivables in the consolidated statement of financial position at value equal to the net investment in lease, starting from the date of commencement of the lease term. In calculating the present value of the minimum lease payments the discount factor used is the interest rate implicit in the lease. Initial direct costs are included in the initial measurement of the finance lease receivables. Lease payments received are apportioned between the finance income and the reduction of the outstanding lease receivable. Finance income is based on a pattern reflecting a constant periodic rate of return on the net investment outstanding.

ii. Operating – Group as lessee

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

iii. Operating – Group as lessor

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

3. Summary of Significant Accounting Policies (continued)

Impairment of financial assets

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

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

Amounts due from credit institutions and loans to customers

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

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

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

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

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

3. Summary of Significant Accounting Policies (continued)

Impairment of financial assets (continued)

Held-to-maturity financial investments

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

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

Available-for-sale financial assets

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 to the consolidated income statement. Impairment losses on equity investments are not reversed through the consolidated income statement; increases in their fair value after impairment are recognised in other comprehensive income.

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

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.
The accounting treatment of such restructuring is as follows:

- If the currency of the loan has been changed the old loan is derecognised and the new loan is recognised.
- If the loan restructuring is not caused by the financial difficulties of the borrower the Group uses the same approach as for financial liabilities described below.
- If the loan restructuring is due to the financial difficulties of the borrower and the loan is impaired after restructuring, the Group recognizes the difference between the present value of the new cash flows discounted using the original effective interest rate and the carrying amount before restructuring in the provision charges for the period. In case loan is not impaired after restructuring the Group recalculates the effective interest rate.

Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original or current effective interest rate.

3. Summary of Significant Accounting Policies (continued)

De-recognition of financial assets and liabilities

Financial assets

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

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

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

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

Financial liabilities

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

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

Financial guarantees

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

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

Taxation

The current income tax expense is calculated in accordance with the regulations in force in the respective territories that the Bank and its Subsidiaries operate.

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.

3. Summary of Significant Accounting Policies (continued)

Taxation (continued)

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, Ukraine, Belarus and Cyprus also have various operating taxes that are assessed on the Group's activities. These taxes are included as a component of other operating expenses.

Investment properties

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

Property and equipment

Property and equipment, except for buildings, are carried at cost less accumulated depreciation and any accumulated impairment in value. 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.

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

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

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

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

Depreciation of an asset, including assets under construction, commences from the date the asset is ready and available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	50
Furniture and fixtures	10
Computers and office equipment	5
Motor vehicles	5

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

3. Summary of Significant Accounting Policies (continued)

Property and equipment (continued)

Leasehold improvements are amortized over the life of the related leased asset. The assets 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.

Goodwill

Goodwill acquired in a business combination is initially measured at cost, being the excess of the consideration transferred over the Group's net identifiable assets acquired and liabilities assumed. Goodwill on an acquisition of a subsidiary is included in intangible assets. Goodwill on an acquisition of an associate is included in the investments in associates. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- is not larger than a segment as defined in IFRS 8 "Operating Segments".

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. Impairment losses cannot be reversed in future periods.

Other intangible assets

The Group's other intangible assets include computer software and licenses. Computer software and licenses are recognized at cost and amortized using the straight-line method over its useful life, but not exceeding a period of ten years.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 4 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end.

Intangible assets with indefinite useful lives are not amortised, but tested for impairment annually either individually or at the cash-generating unit level.

Costs associated with maintaining computer software programmes are recorded as an expense as incurred. Software development costs (relating to the design and testing of new or substantially improved software) are recognised as intangible assets only when the Group can demonstrate the technical feasibility of completing the software so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete and the ability to measure reliably the expenditure during the development. Other software development costs are recognised as an expense as incurred.

3. Summary of Significant Accounting Policies (continued)

Insurance and reinsurance receivables

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

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

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

Insurance liabilities

General insurance liabilities

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

Provision for unearned premiums

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

Liability adequacy test

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

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 provides management and employees of the Group, with private pension plans. These are defined contribution pension plans covering substantially all full-time employees of the Group. The Group collects contributions from its employees. When an employee reaches the pension age, aggregated contributions, plus any earnings earned on the employee's behalf are paid to the employee according to the schedule agreed with the employee. Aggregated amounts are distributed during the period when the employee will receive accumulated contributions.

3. Summary of Significant Accounting Policies (continued)

Share-based payment transactions

Employees (including senior executives) of the Group receive share-based remuneration, whereby employees render services as consideration for the equity instruments ('equity settled transactions').

Equity-settled transactions

The cost of equity settled transactions with employees is measured by reference to the fair value at the date on which they are granted.

The cost of equity settled transactions is recognized together with the corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date when the relevant employee is fully entitled to the award ('the vesting date'). The cumulative expense recognized for equity settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The consolidated income statement charge or credit for the period represents the movement in cumulative expense recognized as at the beginning and end of that period.

No expense is recognized for the awards that do not ultimately vest except for the awards where vesting is conditional upon market conditions (a condition linked to the price of the Bank's shares) which are treated as vesting irrespective whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity settled award are modified, the minimum expense is recognized as if the terms had not been modified. An additional expense is recognized for any modification which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of the modification.

Where an equity-settled award is cancelled, it is treated as if it has vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. However if a new award is substituted for the cancelled award, and designated as the replacement award on the date that it is granted, the cancelled and the new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

Share capital

Share capital

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

Treasury shares

Where the Bank or its subsidiaries purchases the Bank's shares, the consideration paid, including any attributable transaction costs, net of income taxes, is deducted from total equity as treasury shares until they are cancelled or reissued. Where such shares are subsequently sold or reissued, any consideration received is included in equity. Treasury shares are stated at par value, with adjustment of premiums against 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.

Segment reporting

The Group's segmental reporting is based on the following operating segments: Retail banking, Corporate banking, Brokerage, Wealth Management, Asset Management, Insurance and Corporate Center.

3. Summary of Significant Accounting Policies (continued)

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.

Income and expense recognition

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

Interest and similar income and expense

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

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

Fee and commission income

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

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

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

Fee income from providing transaction services

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

Dividend income

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

Insurance premium income

For non-life insurance business, premiums written are recognized at policy inception and earned on a pro rata basis over the term of the related policy coverage. Estimates of premiums written as at the reporting date but not yet received, are assessed based on estimates from underwriting or past experience and are included in premiums earned.

3. Summary of Significant Accounting Policies (continued)

Income and expense recognition (continued)

Insurance claims

General insurance claims incurred include all claim losses occurring during the year, whether reported or not, including the related handling costs and reduction for the value of salvage and other recoveries and any adjustments to claims outstanding from previous years.

Functional and reporting currencies and foreign currency translation

The consolidated financial statements are presented in Georgian Lari, which is the Bank's presentation currency. The Bank's functional currency is US Dollar effective 1 January 2007. Prior to 1 January 2007, Georgian Lari was its functional currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional 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 into functional currency at functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the consolidated income statement as gains less losses from foreign currencies – translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a certain transaction and the NBG exchange rate on the date of the transaction are included in gains less losses from foreign currencies (dealing). The official NBG exchange rates at 31 December 2010, 2009 and 2008 were 1.7728, 1.6858 and 1.6670 Lari to USD 1, 2.3500, 2.4195 and 2.3648 Lari to EUR 1, 2.2272, 2.1156 and 2.1649 Lari to UAH 10 and 5.9093, 5.8882 and 7.5770 to BYR 10,000, respectively.

As at the reporting date, the assets and liabilities of the entities whose functional currency is different from the presentation currency of the Group are translated into Georgian Lari at the rate of exchange ruling at the reporting date and, their income statements are translated at the weighted average exchange rates for the year. The exchange differences arising on the translation are taken to other comprehensive income. On disposal of a subsidiary or an associate whose functional currency is different from the presentation currency of the Group, the deferred cumulative amount recognised in other comprehensive income relating to that particular entity is recognised in the consolidated income statement.

Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operations and translated at closing rate.

Standards and interpretations that are issued but not yet effective

Up to the date of approval of the consolidated financial statements, certain new standards, interpretations and amendments to existing standards have been published that are not yet effective for the current reporting period and which the Group has not early adopted, as follows:

Amendments to IAS 24 "Related Party Disclosures"

The amended standard is effective for annual periods beginning on or after 1 January 2011. It clarified the definition of a related party to simplify the identification of such relationships and to eliminate inconsistencies in its application. The revised standard introduces a partial exemption of disclosure requirements for government-related entities. The bank does not expect any impact on its financial position or performance. Early adoption is permitted for either the partial exemption for government-related entities or for the entire standard.

3. Summary of Significant Accounting Policies (continued)

Standards and interpretations that are issued but not yet effective (continued)

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

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

IFRS 9 "Financial Instruments"

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

IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments"

IFRIC Interpretation 19 was issued in November 2009 and is effective for annual periods beginning on or after 1 July 2010. The interpretation clarifies the accounting when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor to extinguish all or part of the financial liability. IFRIC 19 is not expected to have any material impact on the Group's consolidated financial statements.

Improvements to IFRSs

In May 2010 the IASB issued the third 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 2011. There are separate transitional provisions for each standard. Amendments included in May 2010 "Improvements to IFRS" will have impact on the accounting policies, financial position or performance of the Group, as described below.

- IFRS 3 Business combinations: limits the scope of the measurement choices that only the components of NCI that are present ownership interests that entitle their holders to a proportionate share of the entity's net assets, in the event of liquidation, shall be measured either at fair value or at the present ownership instruments' proportionate share of the acquiree's identifiable net assets. As the amendment should be applied from the date the Group applies IFRS 3 Revised, it may me required to restate for effects incurred under IFRS 3 Revised, but before the adoption of this amendment. The Group expects that other amendments to IFRS 3 will have no impact on financial statements of the Group.
- IFRS 7 Financial instruments: Disclosures; introduces the amendments to quantitative and credit risk disclosures. The additional requirements are expected to have minor impact as information is expected to be readily available.
- IAS 34 Interim Financial Reporting: adds disclosure requirements about the circumstances affecting fair values and classification of financial instruments, about transfers of financial instruments between levels of the fair value hierarchy, changes in classification of financial assets and changes in contingent liabilities and assets. Additional disclosures required will be introduced in interim financial statements of the Group.
- Amendments to IFRS 1, IAS 1, IAS 27 and IFRIC 13 will have no impact on the accounting policies, financial position or performance of the Group.

4. Significant Accounting Judgements and Estimates

In the process of applying the Group's accounting policies, management uses its judgment and made estimates in determining the amounts recognized in the consolidated financial statements. The most significant use of judgments and estimates are as follows:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values.

Determination of collateral value

Management monitors market value of collateral on a regular basis. Management uses its experienced judgment or independent opinion to adjust the fair value to reflect current circumstances. The amount and type of collateral required depends on the assessment of credit risk of the counterparty.

Measurement of fair value of investment properties and property and equipment

Fair value of investment properties as well as of the property and equipment is determined by independent professionally qualified appraisers. Fair value is determined using the combination of internal capitalization method (also known as discounted future cash flow method) and sales comparison method.

The estimates described above are subject to change as new transaction data and market evidence becomes available.

Allowance for impairment of loans and receivables and finance lease receivables

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

Contingent liabilities

The Group is subject to the possibility of various loss contingencies arising in the ordinary course of business. The Group considers the likelihood of the loss or the incurrence of a liability as well as its ability to reasonably estimate the amount of loss in determining loss contingencies. An estimated loss contingency is accrued when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. The Group regularly evaluates current information available to determine whether such accruals are required. As of 31 December 2010, the Group did not record any contingent liabilities.

Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose an appropriate discount rate in order to calculate the present value of those cash flows.

Impairment of long-lived assets

Long-lived assets consist primarily of real estate investments, property, investments in associates, goodwill and intangible assets. The Group evaluates the long-lived assets for impairment annually or when events or changes in circumstances indicate, in management's judgment, that the carrying value of such assets may not be recoverable.

4. Significant Accounting Judgements and Estimates (continued)

Impairment of investments

The Group holds investments in several companies, including those that do not trade in an active market. Future adverse changes in market conditions or poor operating results could result in losses that may not be reflected in an investment's current carrying value, thereby requiring an impairment charge in the future. The Group regularly reviews its investments to determine if there have been any indicators that the value may be impaired. These reviews require estimating the outcome of future events and determining whether factors exist that indicate impairment has occurred.

5. Business Combinations

Acquisitions in 2010

JSC Teliani Valley

On 28 February 2010 JSC Liberty Consumer acquired 52.33% of "JSC Teliani Valley", a winery operating in Georgia and Ukraine. The fair values of identifiable assets, liabilities and contingent liabilities acquired, and goodwill arising from JSC Teliani Valley as of the date of acquisition was:

	Fair value recognized on acquisition
Cash and cash equivalents	296
Trading securities	954
Accounts receivable	3,596
Property and equipment	8,038
Goodwill and other intangible assets	151
Deferred income tax assets	78
Other assets	6,751
	19,864
Amounts owed to credit institutions	8,622
Accounts payable	916
Deferred income tax liabilities	395
Other liabilities	1,698
	11,631
Total identifiable net assets	**8,233**
Non-controlling interests (47.67%)	3,925
Fair value of the previously held equity interests (27.19%)	3,451
Goodwill arising on acquisition	3,292
Consideration given [1]	**4,149**

The net cash inflow on acquisition was as follows:

	2010
Cash paid	–
Cash acquired with the subsidiary	(296)
Net cash inflow	**(296)**

[1] Consideration comprised of the Group's investment in available-for-sale investment securities in the form of common shares of JSC Nikora.

At the acquisition date, non-controlling interests comprised GEL 3,925 and was measured at the non-controlling interests' proportionate share of the acquiree's identifiable net assets.

Since the acquisition date, the Group recorded GEL 8,293, GEL 355 and GEL 115 of revenue, profit and other comprehensive income, respectively. If the combination had taken place at the beginning of the year, there would be no major, material difference in the net income and revenue of the Group.

The total amount of goodwill is expected to be deductible for tax purposes upon disposal of the subsidiary.

5. Business Combinations (continued)

Acquisitions in 2010 (continued)

Kutaisi Regional Clinical Hospital, LLC

On 1 October 2010 JSC My Family Clinic acquired 100% of Kutaisi Regional Clinical Hospital, LLC, a medical services provider company operating in Georgia. The fair values of identifiable assets, liabilities and contingent liabilities acquired, and goodwill arising from Kutaisi Regional Clinical Hospital, LLC as of the date of acquisition was:

	Fair value recognized on acquisition	*Carrying value*
Property and equipment	658	481
	658	**481**
Accounts payable	17	17
Deferred income tax liabilities	27	27
	44	**44**
Fair value of net assets	**614**	**437**
Share in fair value of net assets acquired (100%)	614	
Negative goodwill arising on acquisition	(179)	
Consideration given	**435**	

The net cash outflow on acquisition was as follows:

	2010
Cash paid	435
Cash acquired with the subsidiary	–
Net cash outflow	**435**

If the combination had taken place at the beginning of the year, there would be no major, material difference in the net income and revenue of the Group.

Since the acquisition date, the Group recorded GEL 629 and GEL 98 of revenue and profit, respectively. If the combination had taken place at the beginning of the year, there would be no major, material difference in the net income and revenue of the Group.

The total amount of negative goodwill is expected to be taxable upon disposal of the subsidiary.

5. Business Combinations (continued)

Acquisitions in 2009

Planeta Forte, LLC

On 1 January 2009 JSC Liberty Consumer acquired 51% of "Planeta Forte, LLC", a newspaper retailer company operating in Georgia. The fair values of identifiable assets, liabilities and contingent liabilities of Planeta Forte, LLC as of the date of acquisition were estimated at:

	Fair value recognized on acquisition	*Carrying value*
Cash and cash equivalents	4	4
Property and equipment	55	55
Other assets	460	460
	519	**519**
Other liabilities	486	486
	486	**486**
Fair value of net assets	**33**	**33**
Share in fair value of net assets acquired (51%)	17	
Goodwill arising on acquisition	364	
Consideration given	**381**	

The net cash outflow on acquisition was as follows:

	2009
Cash paid	381
Cash acquired with the subsidiary	(4)
Net cash outflow	**377**

If the combination had taken place at the beginning of the year, there would be no major, material difference in the net income and revenue of the Group.

At the acquisition date, non-controlling interest comprised GEL 16 and was measured at the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

The total amount of goodwill is expected to be deductible for tax purposes upon disposal of the subsidiary.

5. Business Combinations (continued)

Acquisitions in 2009 (continued)

JSC SB Iberia

On 19 August 2009 JSC SB Immobiliare, a fully owned subsidiary of the Bank acquired 100% of JSC "SB Iberia", a real estate developing company operating in Georgia. The fair values of identifiable assets, liabilities and contingent liabilities of JSC SB Iberia as of the date of acquisition were estimated at:

	Fair value recognized on acquisition	*Carrying value*
Cash and cash equivalents	11	11
Investment property	4,547	4,547
Deferred income tax assets	826	826
Prepayments	102	102
Other assets	7	7
	5,493	**5,493**
Amounts due to credit institutions	6,900	6,900
Accounts payable (trade & service)	2,156	2,156
Deferred income tax liabilities	12	12
	9,068	**9,068**
Fair value of net assets	**(3,575)**	**(3,575)**
Share in fair value of net assets acquired (100%)	(3,575)	
Goodwill arising on acquisition	3,907	
Consideration given	**332**	

The net cash outflow on acquisition was as follows:

	2009
Cash paid	332
Cash acquired with the subsidiary	(11)
Net cash outflow	**321**

If the combination had taken place at the beginning of the year, there would be no major, material difference in the net income and revenue of the Group.

The total amount of goodwill is expected to be deductible for tax purposes upon disposal of the subsidiary.

5. Business Combinations (continued)

Acquisitions in 2009 (continued)

JSC SB Iberia 2

On 19 August 2009 JSC SB Immobiliare, a fully owned subsidiary of the Bank acquired 100% of JSC "SB Iberia 2", a real estate developing company operating in Georgia. The fair values of identifiable assets, liabilities and contingent liabilities of JSC SB Iberia 2 as of the date of acquisition were estimated at:

	Fair value recognized on acquisition	*Carrying value*
Cash and cash equivalents	14	14
Investment property	8,083	8,083
Deferred income tax assets	778	778
Prepayments	6	6
Other assets	64	64
	8,945	**8,945**
Amounts due to credit institutions	5,913	5,913
Deferred income tax liabilities	8	8
	5,921	**5,921**
Fair value of net assets	**3,024**	**3,024**
Share in fair value of net assets acquired (100%)	3,024	
Goodwill arising on acquisition	744	
Consideration given	**3,768**	

The net cash outflow on acquisition was as follows:

	2009
Cash paid	2,286
Cash acquired with the subsidiary	(14)
Net cash outflow	**2,272**

If the combination had taken place at the beginning of the year, there would be no major, material difference in the net income and revenue of the Group.

The total amount of goodwill is expected to be deductible for tax purposes upon disposal of the subsidiary.

5. Business Combinations (continued)

Acquisitions in 2008

JSC Belarusky Narodny Bank

On 1 July 2008 the Bank acquired 70% of JSC "Belarusky Narodny Bank", a banking institution operating in Belarus. The fair values of identifiable assets, liabilities and contingent liabilities of JSC Belarusky Narodny Bank as of the date of acquisition were estimated at:

	Fair value recognized on acquisition	*Carrying value*
Cash and cash equivalents	8,908	8,908
Due from credit institutions	1,022	1,022
Loans to customers	36,234	36,234
Deferred tax asset	297	297
Property and equipment	17,445	17,445
All other assets	520	520
	64,426	**64,426**
Amounts due to credit institutions	9,501	9,501
Amounts due to customers	18,231	18,231
All other liabilities	513	513
	28,245	**28,245**
Fair value of net assets	**36,181**	**36,181**
Share in fair value of net assets acquired (70%)	25,327	
Recognized Core Deposit Intangible	843	
Goodwill arising on acquisition	23,394	
Consideration given	**49,564**	

The net cash outflow on acquisition was as follows:

	2008
Cash paid	49,564
Cash acquired with the subsidiary	(8,908)
Net cash outflow	**40,656**

If the combination had taken place at the beginning of the year, the net income of the Group would have been GEL 1,887 and the total revenue would have been GEL 367,820.

The primary factor that contributed to the cost of business combination that resulted in the recognition of goodwill was the positive synergy brought into the Group's operations.

At the acquisition date, non-controlling interest comprised GEL 10,854 and was measured at the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

The total amount of goodwill is expected to be deductible for tax purposes upon disposal of the subsidiary.

5. Business Combinations (continued)

Acquisitions in 2008 (continued)

JSC Kutaisi St. Nickolas Surgery Clinic

On 31 May 2008 JSC Insurance Company Aldagi BCI, a fully owned subsidiary of the Bank, acquired 55% of JSC "Kutaisi St. Nickolas Surgery Clinic". The fair values of identifiable assets, liabilities and contingent liabilities of JSC "Kutaisi St. Nickolas Surgery Clinic" as of the date of acquisition were estimated at:

	Fair value recognized on acquisition	*Carrying value*
Cash and cash equivalents	7	7
Property and equipment	2,802	2,802
All other assets	223	223
	3,032	**3,032**
Amounts due to credit institutions	457	457
All other liabilities	791	791
	1,248	**1,248**
Fair value of net assets	**1,784**	**1,784**
Share in fair value of net assets acquired (55%)	981	
Goodwill arising on acquisition	288	
Consideration given	**1,269**	

The net cash outflow on acquisition was as follows:

	2008
Cash paid	1,091
Cash acquired with the subsidiary	(7)
Net cash outflow	**1,084**

If the combination had taken place at the beginning of the year, there would be no major, material difference in the net income and revenue of the Group.

The primary factor that contributed to the cost of business combination that resulted in the recognition of goodwill was the positive synergy brought into the Group's operations.

At the acquisition date, non-controlling interest comprised GEL 803 and was measured at the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

The total amount of goodwill is expected to be deductible for tax purposes upon disposal of the subsidiary.

6. Segment Information

For management purposes, the Group is organised into seven operating segments based on products and services as follows:

Retail Banking	Principally handling individual customers' deposits, and providing consumer loans, overdrafts, credit card facilities and funds transfer facilities.
Corporate Banking	Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers.
Brokerage	Principally providing brokerage, custody and corporate finance services to its individual as well as corporate customers. Brokerage also possesses its own proprietary book for trading as well as for non-trading purposes, comprising primarily of trading and investment securities.
Wealth Management	Principally providing wealth management services to VIP individual customers.
Asset Management	Principally providing asset management services to VIP corporate customers.
Insurance	Principally providing wide-scale insurance services to corporate and individual customers.
Corporate Centre	Principally providing back office services to all operating segments of the Bank

For purposes of presentation in these consolidated financial statements, due to the insignificance of certain operating segments to be separately shown, Management has combined Brokerage, Asset Management and Wealth Management operating segments into one. Therefore, operating segment information presented in these consolidated financial statements is classified as follows:

Retail Banking
Insurance
Corporate Banking
Brokerage and Asset and Wealth Management
Corporate Centre

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance, as explained in the table below, is measured in the same manner as profit or loss in the consolidated financial statements. Income taxes are managed on a group basis and are not allocated to operating segments. There are no asymmetrical allocations to reportable segments.

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

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Group's total revenue in 2010, 2009 or 2008.

In 2010 the Group changed its estimates in respect of the allocation of indirect revenues and indirect expenses in JSC Bank of Georgia (stand-alone) among corporate banking, retail banking and wealth management. Effects of these changes in estimates have been applied to prior periods, and respective comparative information for 2009 and 2008 has been properly recalculated. These changes in allocation estimates had no impact on subsidiaries. Instead, it only resulted in re-allocation of certain indirect revenues and indirect expenses in JSC Bank of Georgia stand-alone segment reporting, with no consequence on totals of segments across each line.

6. Segment Information (continued)

The following tables present income and profit and certain asset and liability information regarding the Group's operating segments for the year ended 31 December 2010:

	Retail banking	*Corporate banking*	*Brokerage and Asset and wealth management*	*Corporate center*	*Insurance*	*Inter – company elimination*	*Total*
Revenue							
External operating income:							
Net interest income (expense)	108,609	109,090	(9,475)	8,846	(726)	–	216,344
Net fees and commission income	42,633	7,948	1,863	10,976	–	–	63,420
Net foreign currency gains	9,211	21,929	300	2,042	267	–	33,749
Other external revenues	2,137	1,671	15,207	(5,105)	47,363	–	61,273
Operating income from other segments	(108)	885	4,207	3,801	1,807	(10,592)	–
Total operating income (expense)	**162,482**	**141,523**	**12,102**	**20,560**	**48,711**	**(10,592)**	**374,786**
Impairment charge on interest earning assets	29,813	15,789	(2,264)	–	–	773	44,111
Results							
Segment results	44,618	56,454	(15,047)	7,710	5,481	(773)	98,443
Unallocated expenses							–
Income before income tax expense							**98,443**
Income tax expense							(15,776)
Profit for the year							**82,667**
Assets and liabilities							
Segment assets	1,767,442	1,860,680	126,938	266,829	60,971	(98,363)	3,984,497
Unallocated assets							20,425
Total assets							**4,004,922**
Segment liabilities	1,338,207	1,690,862	373,596	(85,403)	57,530	(98,363)	3,276,429
Unallocated liabilities							35,152
Total liabilities							**3,311,581**
Other segment information							
Capital expenditures, of which:	**26,164**	**9,401**	**4,804**	**1,574**	**3,339**	**–**	**45,282**
Property, plant and equipment	22,467	7,926	1,238	1,503	3,300	–	36,434
Intangible assets	3,697	1,475	3,566	71	39	–	8,848
Depreciation	16,300	5,564	1,595	417	634	–	24,510
Amortization	2,538	706	88	92	29	–	3,453
Impairment	318	109	8	–	–	–	435
Investments in associates	–	–	5,632	–	–	–	5,632
Share of profit of associates	–	–	255	–	–	–	255

6. Segment Information (continued)

The following tables present income and profit and certain asset and liability information regarding the Group's operating segments for the year ended 31 December 2009:

	Retail banking	*Corporate banking*	*Brokerage and Asset and wealth management*	*Corporate center*	*Insurance*	*Inter – company elimination*	*Total*
Revenue							
External operating income:							
Net interest income (expense)	120,657	83,644	(4,857)	(7,868)	(1,035)	–	190,541
Net fees and commission income	34,971	9,286	2,931	7,115	722	–	55,025
Net foreign currency gains	9,825	14,869	1,123	2,888	61	–	28,766
Other external revenues (expenses)	1,705	4,509	(11,737)	9,449	49,394	–	53,320
Operating income from other segments	519	(1,678)	(7,913)	(2,811)	(1,352)	13,235	–
Total operating income (expense)	**167,677**	**110,630**	**(20,453)**	**8,773**	**47,790**	**13,235**	**327,652**
Impairment charge on interest earning assets	71,876	42,472	3,626	9,194	–	(1,427)	125,741
Results							
Segment results	(46,094)	(13,583)	(40,530)	(10,009)	2,883	1,427	(105,906)
Unallocated expenses							–
Loss before income tax benefit							**(105,906)**
Income tax benefit							6,998
Loss for the year							**(98,908)**
Assets and liabilities							
Segment assets	1,217,852	1,126,010	136,327	407,005	48,351	(45,600)	2,889,945
Unallocated assets							23,484
Total assets							**2,913,429**
Segment liabilities	1,039,246	1,076,514	190,530	(10,149)	39,236	(45,600)	2,289,777
Unallocated liabilities							25,235
Total liabilities							**2,315,012**
Other segment information							
Capital expenditures, of which:	**16,171**	**6,536**	**6,284**	**2,970**	**982**	**–**	**32,943**
Property, plant and equipment	13,275	5,592	1,114	2,486	960	–	23,427
Intangible assets	2,896	944	5,170	484	22	–	9,516
Depreciation	13,798	5,904	1,426	833	555	–	22,516
Amortization	1,988	657	104	144	19	–	2,912
Impairment	40,306	27,691	4,701	3,574	–	–	76,272
Investments in associates	–	–	10,323	–	–	–	10,323
Share of loss of associates	–	–	(2,649)	–	–	–	(2,649)

6. Segment Information (continued)

The following tables present income and profit and certain asset and liability information regarding the Group's operating segments for the year ended 31 December 2008:

	Retail banking	*Corporate banking*	*Brokerage and Asset and wealth management*	*Corporate center*	*Insurance*	*Inter – company elimination*	*Total*
Revenue							
External operating income:							
Net interest income (expense)	141,700	78,838	545	(149)	(94)	–	220,840
Net fees and commission income (expense)	35,190	8,485	5,059	6,573	(5,338)	–	49,969
Net foreign currency gains	19,674	19,133	3,364	4,963	–	–	47,134
Other external revenues (expenses)	4,025	1,336	(849)	1,825	38,285	–	44,622
Operating income from other segments	(744)	(284)	(3,945)	–	(466)	5,439	–
Total operating income	**199,845**	**107,508**	**4,174**	**13,212**	**32,387**	**5,439**	**362,565**
Impairment charge on interest earning assets	61,003	61,749	1,532	5,510	–	(5,647)	124,147
Results							
Segment results	13,153	7,503	(15,780)	7,118	(6,951)	5,647	10,690
Unallocated expenses							(11,494)
Loss before income tax benefit							**(804)**
Income tax benefit							978
Profit for the year							**174**
Assets and liabilities							
Segment assets	1,405,256	1,296,553	109,679	377,077	51,377	6,179	3,246,121
Unallocated assets							12,786
Total assets							**3,258,907**
Segment liabilities	1,155,871	1,153,221	104,520	44,062	57,990	–	2,515,664
Unallocated liabilities							24,394
Total liabilities							**2,540,058**
Other segment information							
Capital expenditures, of which:	**79,322**	**28,996**	**8,877**	**2,842**	**2,842**	**–**	**122,879**
Property, plant and equipment	69,615	26,282	8,550	2,601	2,834	–	109,882
Intangible assets	9,707	2,714	327	241	8	–	12,997
Depreciation	12,780	3,901	1,310	270	409	–	18,670
Amortization	1,197	251	60	80	30	–	1,618
Impairment	244	–	–	–	–	–	244
Investments in associates	–	–	16,716	–	–	–	16,716
Share of loss of associates	–	–	(713)	–	–	–	(713)

Geographic information

The Group operates in three main geographical markets: (a) Georgia, (b) Ukraine and Cyprus and (c) Belarus. The following table shows the distribution of the Group's external income, total assets and capital expenditure allocated based on the location of the Group's assets, for the year ended 31 December 2010:

	Georgia 2010	*Ukraine and Cyprus 2010*	*Belarus 2010*	*Total 2010*
External income				
Net interest income (loss)	200,789	5,849	9,706	216,344
Net fee and commission income	58,606	3,157	1,657	63,420
Net foreign currency gains	29,437	2,817	1,495	33,749
Other non-interest income	58,389	1,626	1,258	61,273
Total external income (loss)	**347,221**	**13,449**	**14,116**	**374,786**
Total assets	**3,624,214**	**275,680**	**105,028**	**4,004,922**
Capital expenditures	**38,115**	**5,420**	**1,747**	**45,282**

6. Segment Information (continued)

Geographic information (continued)

The following table shows the distribution of the Group's external income, total assets and capital expenditure, allocated based on the location of the Group's assets, for the year ended 31 December 2009:

	Georgia 2009	Ukraine and Cyprus 2009	Belarus 2009	Total 2009
External income				
Net interest income	171,203	14,416	4,922	190,541
Net fee and commission income (expense)	50,132	3,404	1,489	55,025
Net foreign currency gains	23,660	3,480	1,626	28,766
Other non-interest income	50,522	2,372	426	53,320
Total external income	**295,517**	**23,672**	**8,463**	**327,652**
Total assets	**2,606,676**	**226,739**	**80,014**	**2,913,429**
Capital expenditures	**29,338**	**3,214**	**391**	**32,943**

The following table shows the distribution of the Group's external income, total assets and capital expenditure, allocated based on the location of the Group's assets, for the year ended 31 December 2008:

	Georgia 2008	Ukraine and Cyprus 2008	Belarus 2008	Total 2008
External income				
Net interest income	198,027	20,479	2,334	220,840
Net fee and commission income (expense)	44,751	6,022	(804)	49,969
Net foreign currency gains	43,348	2,257	1,529	47,134
Other non-interest income	43,582	871	169	44,622
Total external income	**329,708**	**29,629**	**3,228**	**362,565**
Total assets	**3,096,938**	**113,782**	**48,187**	**3,258,907**
Capital expenditures	**113,865**	**8,158**	**856**	**122,879**

Amounts of non-current assets, other than financial instruments, concentrated in foreign locations (outside Georgia) are immaterial compared to total assets of the Group.

7. Cash and Cash Equivalents

	2010	2009	2008
Cash on hand	161,749	154,861	164,463
Current accounts with central banks, excluding obligatory reserves	58,958	44,101	43,961
Current accounts with other credit institutions	161,290	34,944	44,080
Time deposits with credit institutions up to 90 days	229,587	123,983	163,317
Cash and cash equivalents	**611,584**	**357,889**	**415,821**

As of 31 December 2010 GEL 367,956 (2009: GEL 127,816, 2008: GEL 222,332) was placed on current and time deposit accounts with internationally recognized OECD banks and central banks that are the counterparties of the Group in performing international settlements. The Group earned up to 1.74% interest per annum on these deposits (2009: 0.17%, 2008: 1.16%).

8. Amounts Due from Credit Institutions

	2010	2009	2008
Obligatory reserves with central banks	90,378	41,791	39,661
Time deposits with effective maturity of more than 90 days	20,809	18,599	37,414
Inter-bank loan receivables	5,282	4,230	4,328
Amounts due from credit institutions	**116,469**	**64,620**	**81,403**

Obligatory reserves with central banks represent amounts deposited with the NBG ("National Bank of Georgia"), the NBU ("National Bank of Ukraine") and the NBRB (National Bank of the Republic of Belarus). Credit institutions are required to maintain an interest-earning cash deposit (obligatory reserve) with central banks, the amount of which depends on the level of funds attracted by the credit institution. The Group's ability to withdraw these deposits is restricted by the statutory legislature. The Group earned up to 2% annual interest on obligatory reserve with NBG in 2010, 2009 and 2008.

As of 31 December 2010 GEL 14,538 (2009: GEL 10,940, 2008: GEL 3,913) was placed on current accounts and inter-bank time deposits with three (2009: seven, 2008: three) internationally recognised OECD banks. Those amounts were pledged to the counterparty bank as security for open commitments.

As of 31 December 2010 inter-bank loan receivables include GEL 4,436 (2009: GEL 4,215, 2008: GEL 4,328) placed with an Azerbaijani bank.

9. Loans to Customers

	2010	2009	2008
Commercial loans	1,424,550	939,814	1,044,959
Residential mortgage loans	409,786	387,415	391,606
Consumer loans	383,615	332,537	496,197
Micro loans	238,462	99,981	151,313
Gold – pawn loans	66,749	62,829	46,374
Others	4,071	5,241	15,174
Loans to customers, gross	**2,527,233**	**1,827,817**	**2,145,623**
Less – Allowance for loan impairment	(175,536)	(166,486)	(106,601)
Loans to customers, net	**2,351,697**	**1,661,331**	**2,039,022**

9. Loans to Customers (continued)

Allowance for loan impairment

Movements of the allowance for impairment of loans to customers by class are as follows:

	Commercial loans 2010	*Consumer loans 2010*	*Residential mortgage loans 2010*	*Micro loans 2010*	*Gold-pawn loans 2010*	*Others 2010*	*Total 2010*
At 1 January 2010	**82,042**	**54,989**	**23,490**	**3,788**	**–**	**2,177**	**166,486**
Charge	23,932	7,571	18,440	1,474	–	(1,531)	49,886
Recoveries	21,090	15,208	3,249	3,150	–	42	42,739
Write-offs	(13,074)	(42,798)	(19,441)	(2,138)	–	–	(77,451)
Interest accrued on impaired loans	(1,392)	(3,306)	(3,681)	(360)	–	–	(8,739)
Currency translation difference	1,901	209	367	37	–	101	2,615
At 31 December 2010	**114,499**	**31,873**	**22,424**	**5,951**	–	**789**	**175,536**
Individual impairment	68,145	13,148	16,606	2,433	–	315	100,647
Collective impairment	46,354	18,725	5,818	3,518	–	474	74,889
	114,499	**31,873**	**22,424**	**5,951**	**–**	**789**	**175,536**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**192,778**	**21,996**	**51,585**	**9,051**	**–**	**973**	**276,383**

	Commercial loans 2009	*Consumer loans 2009*	*Residential mortgage loans 2009*	*Micro loans 2009*	*Gold-pawn loans 2009*	*Others 2009*	*Total 2009*
At 1 January 2009	**45,755**	**42,153**	**7,969**	**4,921**	**–**	**5,803**	**106,601**
Charge	44,357	52,839	19,023	5,981	8	(3,326)	118,882
Recoveries	17,839	8,469	2,170	2,016	–	11	30,505
Write-offs	(24,295)	(43,073)	(5,209)	(8,207)	(8)	(1)	(80,793)
Interest accrued on impaired loans	(1,088)	(5,216)	(396)	(891)	–	–	(7,591)
Currency translation difference	(526)	(183)	(67)	(32)	–	(310)	(1,118)
At 31 December 2009	**82,042**	**54,989**	**23,490**	**3,788**	**–**	**2,177**	**166,486**
Individual impairment	75,684	42,824	20,479	1,907	–	–	140,894
Collective impairment	6,358	12,165	3,011	1,881	–	2,177	25,592
	82,042	**54,989**	**23,490**	**3,788**	**–**	**2,177**	**166,486**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**351,835**	**67,345**	**84,448**	**6,731**	**–**	**2,037**	**512,396**

9. Loans to Customers (continued)

Allowance for loan impairment (continued)

	Commercial loans 2008	*Consumer loans 2008*	*Residential mortgage loans 2008*	*Micro loans 2008*	*Gold-pawn loans 2008*	*Others 2008*	*Total 2008*
At 1 January 2008	**11,120**	**13,158**	**2,757**	**1,676**	**–**	**218**	**28,929**
Charge	53,349	50,190	7,164	5,415	–	6,694	122,812
Recoveries	3,265	5,088	1,327	1,496	–	–	11,176
Write-offs	(17,685)	(22,082)	(2,724)	(3,221)	–	–	(45,712)
Interest accrued on impaired loans	(3,067)	(3,730)	(199)	(333)	–	–	(7,329)
Currency translation difference	(1,227)	(471)	(356)	(112)	–	(1,109)	(3,275)
At 31 December 2008	**45,755**	**42,153**	**7,969**	**4,921**	**–**	**5,803**	**106,601**
Individual impairment	37,905	25,920	5,068	3,071	–	650	72,614
Collective impairment	7,850	16,233	2,901	1,850	–	5,153	33,987
	45,755	**42,153**	**7,969**	**4,921**	**–**	**5,803**	**106,601**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**290,561**	**42,338**	**35,280**	**8,505**	**–**	**857**	**377,541**

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized as at 31 December 2010 comprised GEL 18,640 (2009: GEL 17,055, 2008: GEL 10,241).

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

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

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

9. Loans to Customers (continued)

Concentration of loans to customers

As of 31 December 2010 concentration of loans granted by the Group to ten largest third party borrowers comprised GEL 383,971 accounting for 15% of gross loan portfolio of the Group (2009: GEL 206,981 and 11% respectively, 2008: GEL 230,733 and 11% respectively). An allowance of GEL 3,837 (2009: GEL 9,891, 2008: GEL 10,224) was established against these loans.

As of 31 December 2010, 2009 and 2008 loans are principally issued within Georgia, and their distribution by industry sector is as follows:

	2010	*2009*	*2008*
Individuals	1,006,046	862,365	1,079,945
Trade and services	858,878	578,623	667,557
Construction and development	274,623	150,676	158,702
Mining	137,583	62,622	34,526
Transport and communication	77,792	81,532	52,631
Energy	62,424	11,667	66,145
Agriculture	18,089	13,730	20,134
Others	91,798	66,602	65,983
Loans to customers, gross	**2,527,233**	**1,827,817**	**2,145,623**
Less – allowance for loan impairment	(175,536)	(166,486)	(106,601)
Loans to customers, net	**2,351,697**	**1,661,331**	**2,039,022**

Loans have been extended to the following types of customers:

	2010	*2009*	*2008*
Private companies	1,488,577	934,494	1,029,008
Individuals	1,006,046	862,365	1,079,945
State-owned entities	32,610	30,958	36,670
Loans to customers, gross	**2,527,233**	**1,827,817**	**2,145,623**
Less – allowance for loan impairment	(175,536)	(166,486)	(106,601)
Loans to customers, net	**2,351,697**	**1,661,331**	**2,039,022**

The following is a reconciliation of the individual and collective allowances for impairment losses on loans to customers:

	2010			*2009*			*2008*		
	Individual impairment 2010	*Collective impairment 2010*	*Total 2010*	*Individual impairment 2009*	*Collective impairment 2009*	*Total 2009*	*Individual impairment 2008*	*Collective impairment 2008*	*Total 2008*
At 1 January	**140,894**	**25,592**	**166,486**	**72,614**	**33,987**	**106,601**	**9,659**	**19,270**	**28,929**
Charge (reversal) for the year	(8,950)	58,836	49,886	105,477	13,405	118,882	73,311	49,501	122,812
Recoveries	25,247	17,492	42,739	17,237	13,268	30,505	6,690	4,486	11,176
Write-offs	(54,534)	(22,917)	(77,451)	(49,587)	(31,206)	(80,793)	(12,757)	(32,955)	(45,712)
Interest accrued on impairment loans to customers	(7,216)	(1,523)	(8,739)	(3,801)	(3,790)	(7,591)	(1,933)	(5,396)	(7,329)
Currency translation differences	5,206	(2,591)	2,615	(1,046)	(72)	(1,118)	(2,356)	(919)	(3,275)
At 31 December	**100,647**	**74,889**	**175,536**	**140,894**	**25,592**	**166,486**	**72,614**	**33,987**	**106,601**

10. Finance Lease Receivables

	31 December 2010	*31 December 2009*	*31 December 2008*
Minimum lease payments receivables	18,521	27,816	50,565
Less – Unearned finance lease income	(3,514)	(3,776)	(6,797)
	15,007	**24,040**	**43,768**
Less – Allowance for impairment	(588)	(7,144)	(2,163)
Finance lease receivables, net	**14,419**	**16,896**	**41,605**

The difference between the minimum lease payments to be received in the future and the finance lease receivables represents unearned finance income.

As of 31 December 2010, concentration of investments in five largest leases comprised GEL 3,541 or 24% of total finance lease receivables (2009: GEL 16,013 or 67%, 2008: GEL 32,112 or 73%) and finance income received from them as of 31 December 2010 comprised GEL 479 or 12% of total finance income from lease (2009: GEL 1,567 or 27%, 2008: GEL 3,512 or 50%).

Future minimum lease payments to be received after 31 December 2010, 31 December 2009 and 31 December 2008 are as follows:

	31 December 2010	*31 December 2009*	*31 December 2008*
Within 1 year	10,266	19,693	37,550
From 1 to 5 years	8,255	8,123	13,015
More than 5 years	–	–	–
Minimum lease payment receivables	**18,521**	**27,816**	**50,565**

Minimum lease payments to be received after 31 December 2010, 2009 and 2008 are denominated in the following currencies:

	31 December 2010	*31 December 2009*	*31 December 2008*
Euros	7,993	5,851	5,919
US Dollars	5,840	9,554	41,959
Belarusian Roubles	4,688	1,035	2,687
Ukrainian Hryvnas	–	11,376	–
Minimum lease payment receivables	**18,521**	**27,816**	**50,565**

The equipment the Group leases out at 31 December 2010, 2009 and 2008 can be segregated into the following categories:

	31 December 2010		*31 December 2009*		*31 December 2008*	
	Amount	*Number of projects*	*Amount*	*Number of projects*	*Amount*	*Number of projects*
Air and land transport	10,022	141	7,559	116	37,650	126
Machinery & equipment	4,356	38	3,885	31	3,930	46
Construction equipment	4,143	30	16,372	21	8,985	46
Minimum lease payment receivables	**18,521**	**209**	**27,816**	**168**	**50,565**	**218**

10. Finance Lease Receivables (continued)

Allowance for impairment of finance lease receivables

Movements of the allowance for impairment of finance lease receivables are as follows:

	Finance lease receivables 2010	*Finance lease receivables 2009*	*Finance lease receivables 2008*
At 1 January	**7,144**	**2,163**	**816**
(Reversal) Charge	(5,775)	6,859	1,335
Recoveries	–	2,074	–
Amounts written-off	(1,210)	(3,689)	–
Currency translation difference	429	(263)	12
At 31 December	**588**	**7,144**	**2,163**
Individual impairment	232	6,916	1,600
Collective impairment	356	228	563
	588	**7,144**	**2,163**
Gross amount of lease receivables, individually determined to be impaired, before deducting any individually assessed impairment allowance	–	**13,703**	**2,730**

11. Investment Securities

Available-for-sale securities comprise:

	2010	*2009*	*2008*
Ministry of Finance treasury bills	128,539	4,044	5,266
Certificates of deposit of central banks	104,969	–	–
Ministry of Finance treasury bonds	52,120	–	–
Corporate shares	11,294	13,418	21,723
Corporate bonds	–	2,946	6,748
	296,922	**20,408**	**33,737**
Less – Allowance for impairment (Note 17)	(1,982)	(818)	–
Available-for-sale securities	**294,940**	**19,590**	**33,737**

Corporate shares as of 31 December 2010 are primarily comprised of investments in a chain of drug stores of GEL 4,282 (2009: 4,413, 2008: nil), a Georgian retail chain of GEL 3,146 (2009: GEL 2,677, 2008: GEL 9,175) and a real estate company of GEL 1,145 (2009, 2008: nil).

Nominal interest rates and maturities, in years, of these securities are as follows:

	31 December 2010		*31 December 2009*		*31 December 2008*	
	%	*Maturity*	*%*	*Maturity*	*%*	*Maturity*
Ministry of Finance treasury bills	10.03	1	9.50	1-2	11.95%	1-3
Certificates of deposit of central banks	9.98	1	–	–	–	–
Ministry of Finance treasury bonds	15.32%	1-2	–	–	–	–
Corporate bonds	–	–	19.76%	1-2	14.41%	1-3

11. Investment Securities (continued)

Held-to-maturity securities comprise:

	2010		*2009*		*2008*	
	Carrying value	*Nominal value*	*Carrying value*	*Nominal value*	*Carrying value*	*Nominal value*
Corporate Bonds	21	20	–	–	–	–
Certificates of deposit of central banks	–	–	105,143	105,624	14,826	15,000
Ministry of Finance treasury bills	–	–	144,053	149,124	–	–
State debt securities	–	–	–	–	8,019	8,047
Held-to-maturity securities	**21**	**20**	**249,196**	**254,748**	**22,845**	**23,047**

Contractual interest rates and maturities of these securities are as follows:

	31 December 2010		*31 December 2009*		*31 December 2008*	
	%	*Maturity*	*%*	*Maturity*	*%*	*Maturity*
Corporate Bonds	10.0	2011	–	–	–	–
Certificates of deposit of central banks	–	–	3.11	2010	11.79	2009
Ministry of Finance treasury bills	–	–	6.33	2010	–	–
State debt securities	–	–	–	–	13.00	2009

During the second half of 2010, the Group sold part of investment securities classified as held-to-maturity. Following this transaction, the Group reclassified the remaining investments as available-for-sale, as prescribed by paragraph 52 of IAS 39. Information about the reclassified financial assets is presented in the table below:

	31 December 2010		
	Amortised cost	*Fair value*	*Fair value gain (loss) recognised in other comprehensive income*
Central banks' treasury bills	123,785	124,045	260
Certificates of deposit of central banks	104,982	104,969	(13)
Central banks' treasury bonds	51,542	52,120	578
Total reclassified	**280,309**	**281,134**	**825**

12. Investments in Associates

The following associates are accounted for under the equity method:

2010 **Associates**	*Ownership / Voting, %*	*Country*	*Date of incorporation*	*Industry*	*Date of acquisition*
JSC N Tour	30.00%	Georgia	1/11/2001	Travel services	29/05/2008
JSC Hotels and Restaurants Management Group – m/Group	25.00%	Georgia	30/05/2005	Food retail	29/05/2008
JSC iCall	27.03%	Georgia	22/03/2005	Call center	22/11/2006
JSC Info Georgia XXI	50.00%	Georgia	26/04/2001	Business services	20/05/2008
JSC Caucasus Automotive Retail	36.14%	Georgia	18/04/2008	Car retail	2/05/2008
Style +, LLC	32.45%	Georgia	1/08/2005	Advertising	7/08/2008

12. Investments in Associates (continued)

2009 Associates	*Ownership / Voting, %*	*Country*	*Date of incorporation*	*Industry*	*Date of acquisition*
JSC N Tour	30.00%	Georgia	1/11/2001	Travel services	29/05/2008
JSC Hotels and Restaurants Management Group – m/Group	25.00%	Georgia	30/05/2005	Food retail	29/05/2008
JSC Teliani Valley	27.19%	Georgia	30/06/2000	Winery	13/02/2007
JSC iCall	27.03%	Georgia	22/03/2005	Call center	22/11/2006
JSC Info Georgia XXI	50.00%	Georgia	26/04/2001	Business services	20/05/2008
JSC Caucasus Automotive Retail	30.00%	Georgia	18/04/2008	Car retail	2/05/2008
Style +, LLC	32.45%	Georgia	1/08/2005	Advertising	7/08/2008

2008 Associates	*Ownership / Voting, %*	*Country*	*Date of incorporation*	*Industry*	*Date of acquisition*
JSC SB Iberia	49.00%	Georgia	13/12/2007	Construction	20/03/2008
JSC SB Iberia 2	49.00%	Georgia	28/03/2008	Construction	
JSC Teliani Valley	27.19%	Georgia	30/06/2000	Winery	13/02/2007
JSC One Team	25.00%	Georgia	23/04/2007	Entertainment	
JSC iCall	27.03%	Georgia	22/03/2005	Call centre	22/11/2006
JSC N Tour	30.00%	Georgia	1/11/2001	Travel Services	29/05/2008
JSC Hotels and Restaurants Management Group – m/Group	50.00%	Georgia		Food retail	29/05/2008
JSC Info Georgia XXI	50.00%	Georgia	26/04/2001	Business service	20/05/2008
JSC Caucasus Automotive Retail	30.00%	Georgia	18/04/2008	Car retail	2/05/2008
Style +, LLC	32.45%	Georgia	1/08/2005	Advertising	7/08/2008

Movements in investments in associates were as follows:

	2010	*2009*	*2008*
Investments in associates, beginning of year, gross	**12,834**	**16,990**	**5,208**
Purchase cost	–	–	13,355
Write-off	(1,768)	–	–
Disposal	–	(24)	(860)
Transfers (reclassifications)	(3,451)	(1,483)	–
Net share of (loss) profit	255	(2,649)	(713)
Investments in associates, end of year, gross	**7,870**	**12,834**	**16,990**
Less – Allowance for impairment (Note 17)	(2,238)	(2,511)	(274)
Investments in associates, end of year, net	**5,632**	**10,323**	**16,716**

Investments in associates at 31 December 2010 include goodwill of GEL 3,399 (2009: GEL 3,120, 2008: GEL 7,354). Write-off of GEL 1,768 comprises investment in JSC Teliani Valley of GEL 1,495. Reclassification of GEL 3,451 in 2010 comprises investment in JSC Teliani Valley. Reclassifications of GEL 1,483 in 2009 comprise investments in SB Iberia and SB Iberia 2. Subsequent to acquisition of controlling stakes in these companies, the Group added previous investments of GEL 1,483 to total acquisition cost of these companies and this amount affected the respective price allocation, contributing to respective goodwill arising on these acquisitions.

12. Investments in Associates (continued)

The following table summarises certain financial information of the associates:

Aggregated assets and liabilities of associates	*2010*	*2009*	*2008*
Assets	16,610	33,861	58,171
Liabilities	(8,608)	(18,329)	(32,023)
Net assets	**8,002**	**15,532**	**26,148**

Aggregated revenue and profit of associates	*2010*	*2009*	*2008*
Revenue	20,654	48,672	34,663
Profit (loss)	712	445	(1,607)

13. Investment Properties

	2010	*2009*	*2008*
At 1 January	**79,509**	**47,289**	**35,065**
Acquisition through business combinations (Note 5)	–	12,630	–
Additions*	35,146	495	12,613
Disposals	(5,490)	(755)	–
Net change in fair value through profit and loss	350	(4,087)	(389)
Transfers from property and equipment and other assets	3,981	23,937	–
At 31 December	**113,496**	**79,509**	**47,289**

**2010 additions comprise foreclosed properties, no cash transactions were involved.*

Investment properties are stated at fair value, which has been determined based on the valuation performed by Georgian Valuation Company, an accredited independent appraiser, as at 31 December 2010, 2009 and 2008. Georgian Valuation Company is an industry specialist in valuing these types of investment properties. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards Committee standards.

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

	2010	*2009*	*2008*
Rental income	2,750	3,026	1,211
Direct operating expenses	(136)	(114)	(76)

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

14. Property and Equipment

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

	Land & buildings	*Furniture & fixtures*	*Computers & equipment*	*Motor vehicles*	*Leasehold improvements*	*Assets under construction*	*Total*
Cost or revaluation							
31 December 2009	**137,705**	**90,082**	**34,753**	**7,622**	**7,870**	**55,719**	**333,751**
Acquisition through business combinations (Note 5)	3,171	258	4,628	269	–	370	8,696
Additions	805	11,250	2,824	585	830	20,140	36,434
Disposals	(2,224)	(3,843)	(643)	(607)	(2,315)	(11,762)	(21,394)
Transfers	21,929	(17)	(19)	196	994	(23,083)	–
Transfers to investment properties	(3,714)	–	–	–	–	(267)	(3,981)
Revaluation	(9,365)	–	–	–	–	–	(9,365)
Currency translation adjustment	2,209	2,829	640	276	151	1,649	7,754
31 December 2010	**150,516**	**100,559**	**42,183**	**8,341**	**7,530**	**42,766**	**351,895**
Accumulated impairment							
31 December 2009	**3,435**	**262**	**200**	**14**	**–**	**–**	**3,911**
Impairment charge	435	–	–	–	–	–	435
Disposals	(1,648)	–	(82)	–	–	–	(1,730)
31 December 2010	**2,222**	**262**	**118**	**14**	**–**	**–**	**2,616**
Accumulated depreciation							
31 December 2009	**4,463**	**23,870**	**16,173**	**3,680**	**2,925**	**–**	**51,111**
Depreciation charge	3,891	11,510	6,048	1,715	1,346	–	24,510
Currency translation difference	103	31	6	19	–	–	159
Disposals	(322)	(3,219)	(326)	(227)	(1,753)	–	(5,847)
Revaluation	(6,506)	–	–	–	–	–	(6,506)
31 December 2010	**1,629**	**32,192**	**21,901**	**5,187**	**2,518**	**–**	**63,427**
Net book value:							
31 December 2009	**129,807**	**65,950**	**18,380**	**3,928**	**4,945**	**55,719**	**278,729**
31 December 2010	**146,665**	**68,105**	**20,164**	**3,140**	**5,012**	**42,766**	**285,852**

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

	Land & buildings	*Furniture & fixtures*	*Computers & equipment*	*Motor vehicles*	*Leasehold improvements*	*Assets under construction*	*Total*
Cost or revaluation							
31 December 2008	**147,030**	**76,603**	**36,500**	**7,825**	**8,466**	**58,550**	**334,974**
Acquisition through business combinations (Note 5)	–	22	–	33	–	–	55
Additions	2,025	12,813	1,609	821	593	5,566	23,427
Disposals	(4,638)	(350)	(3,426)	(1,084)	(1,896)	(173)	(11,567)
Transfers	588	503	222	49	653	(2,015)	–
Transfers to investment properties	–	–	–	–	–	(6,387)	(6,387)
Revaluation	(3,205)	–	–	–	–	–	(3,205)
Currency translation adjustment	(4,095)	491	(152)	(22)	54	178	(3,546)
31 December 2009	**137,705**	**90,082**	**34,753**	**7,622**	**7,870**	**55,719**	**333,751**
Accumulated impairment							
31 December 2008	**625**	**1**	**84**	**1**	**–**	**–**	**711**
Impairment charge	2,810	261	116	13	–	–	3,200
31 December 2009	**3,435**	**262**	**200**	**14**	**–**	**–**	**3,911**
Accumulated depreciation							
31 December 2008	**1,049**	**14,168**	**11,867**	**2,593**	**2,802**	**–**	**32,479**
Depreciation charge	3,380	10,257	5,579	1,681	1,619	–	22,516
Currency translation difference	280	26	20	15	4	–	345
Disposals	–	(163)	(811)	(392)	(1,500)	–	(2,866)
Revaluation	(246)	(418)	(482)	(217)	–	–	(1,363)
31 December 2009	**4,463**	**23,870**	**16,173**	**3,680**	**2,925**	**–**	**51,111**
Net book value:							
31 December 2008	**145,356**	**62,434**	**24,549**	**5,231**	**5,664**	**58,550**	**301,784**
31 December 2009	**129,807**	**65,950**	**18,380**	**3,928**	**4,945**	**55,719**	**278,729**

14. Property and Equipment (continued)

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

	Land & buildings	*Furniture & fixtures*	*Computers & equipment*	*Motor vehicles*	*Leasehold improvements*	*Assets under construction*	*Total*
Cost or revaluation							
31 December 2007	**135,084**	**42,285**	**21,516**	**5,765**	**4,111**	**12,973**	**221,734**
Acquisition through business combinations (Note 5)	18,162	696	1,095	75	–	219	20,247
Additions	1,174	33,398	13,215	3,416	779	57,902	109,884
Disposals	(4,677)	(1,934)	(468)	(1,491)	(1,023)	(1,976)	(11,569)
Transfers	7,815	167	480	263	4,096	(12,821)	–
Revaluation	(11,669)	–	–	–	–	–	(11,669)
Currency translation adjustment	1,141	1,991	662	(203)	503	2,253	6,347
31 December 2008	**147,030**	**76,603**	**36,500**	**7,825**	**8,466**	**58,550**	**334,974**
Accumulated impairment							
31 December 2007	**467**	**–**	**–**	**–**	**–**	**–**	**467**
Impairment charge	158	1	84	1	–	–	244
31 December 2008	**625**	**1**	**84**	**1**	**–**	**–**	**711**
Accumulated depreciation							
31 December 2007	**62**	**7,531**	**6,602**	**1,306**	**1,110**	**–**	**16,611**
Depreciation charge	2,832	7,048	5,515	1,480	1,795	–	18,670
Currency translation difference	(68)	(116)	(88)	(63)	2	–	(333)
Disposals	(563)	(295)	(162)	(130)	(105)	–	(1,255)
Revaluation	(1,214)	–	–	–	–	–	(1,214)
31 December 2008	**1,049**	**14,168**	**11,867**	**2,593**	**2,802**	**–**	**32,479**
Net book value:							
31 December 2007	**134,555**	**34,754**	**14,914**	**4,459**	**3,001**	**12,973**	**204,656**
31 December 2008	**145,356**	**62,434**	**24,549**	**5,231**	**5,664**	**58,550**	**301,784**

The Group engaged Georgian Valuation Company, an independent appraiser, to determine the fair value of its buildings. Fair value is determined by reference to market-based evidence. The most recent revaluation report for the Bank's buildings was 31 December 2010. If the buildings were measured using the cost model, the carrying amounts of the buildings as of 31 December 2010, 2009 and 2008 would be as follows:

	2010	*2009*	*2008*
Cost	79,800	60,797	66,917
Accumulated depreciation and impairment	(7,550)	(10,487)	(7,353)
Net carrying amount	**72,250**	**50,310**	**59,564**

15. Goodwill and Other Intangible Assets

Movements in goodwill and intangible assets during 2010 were as follows:

	Goodwill	*Core deposit intangible*	*Computer software and license*	*Total*
Cost				
31 December 2009	**138,849**	**2,530**	**24,681**	**166,060**
Acquisition through business combinations (Note 5)	3,435	–	8	3,443
Additions	–	–	5,405	5,405
Disposals	–	–	(296)	(296)
Currency translation difference	–	–	938	938
31 December 2010	**142,284**	**2,530**	**30,736**	**175,550**
Accumulated amortization and impairment				
31 December 2009	**73,072**	**–**	**7,546**	**80,618**
Amortization charge	–	–	3,453	3,453
Disposals	–	–	(117)	(117)
Currency translation difference	–	–	(6)	(6)
31 December 2010	**73,072**	**–**	**10,876**	**83,948**
Net book value:				
31 December 2009	**65,777**	**2,530**	**17,135**	**85,442**
31 December 2010	**69,212**	**2,530**	**19,860**	**91,602**

Movements in goodwill and intangible assets during 2009 were as follows:

	Goodwill	*Core deposit intangible*	*Computer software and license*	*Total*
Cost				
31 December 2008	**134,238**	**2,499**	**20,791**	**157,528**
Acquisition through business combinations (Note 5)	5,015	–	–	5,015
Additions	–	33	4,468	4,501
Disposals	(411)	–	(577)	(988)
Currency translation difference	7	(2)	(1)	4
31 December 2009	**138,849**	**2,530**	**24,681**	**166,060**
Accumulated amortization and impairment				
31 December 2008	**–**	**–**	**5,069**	**5,069**
Amortization charge	–	–	2,912	2,912
Charge for impairment	73,072	–	–	73,072
Disposals	–	–	(404)	(404)
Currency translation difference	–	–	(31)	(31)
31 December 2009	**73,072**	**–**	**7,546**	**80,618**
Net book value:				
31 December 2008	**134,238**	**2,499**	**15,722**	**152,459**
31 December 2009	**65,777**	**2,530**	**17,135**	**85,442**

15. Goodwill and Other Intangible Assets (continued)

Impairment charge of Goodwill in 2009 comprise: JSC BG Bank – GEL 68,016, SB Iberia – GEL 3,907, SB Iberia 2 – GEL 744, JSC United Securities Registrar of Georgia – GEL 366 and JSC Intertour – GEL 39. In all of these instances, the main reason for impairment was insufficient future operating cash flows expected to be received per forecasts of the respective cash generating units.

Movements in goodwill and intangible assets during 2008 were as follows:

	Goodwill	*Core deposit intangible*	*Computer software and license*	*Total*
Cost				
31 December 2007	**110,498**	**1,688**	**7,611**	**119,797**
Acquisition through business combinations (Note 5)	23,682	843	117	24,642
Additions	–	–	12,997	12,997
Disposals	–	–	(170)	(170)
Currency translation difference	58	(32)	236	262
31 December 2008	**134,238**	**2,499**	**20,791**	**157,528**
Accumulated amortization and impairment				
31 December 2007	**426**	–	**3,382**	**3,808**
Amortization charge	–	–	1,618	1,618
Disposals	(426)	–	(12)	(438)
Currency translation difference	–	–	81	81
31 December 2008	**–**	**–**	**5,069**	**5,069**
Net book value:				
31 December 2007	**110,072**	**1,688**	**4,229**	**115,989**
31 December 2008	**134,238**	**2,499**	**15,722**	**152,459**

As of 31 December 2010 goodwill acquired through business combinations has been allocated to the following cash-generating units for impairment testing purposes:

- JSC Bank of Georgia
- JSC Belarusky Narodny Bank
- JSC Insurance Company Aldagi – BCI
- JSC My Family Clinic
- JSC Intertour
- Planeta Forte, LLC

The recoverable amount of each cash-generating unit has been determined based on a value-in-use calculation through a cash flow projection based on the approved budget under the assumption that business will not grow and the cash flows will be stable. The discount rate applied to cash flow projections is the weighted average cost of capital ("WACC") of each particular cash-generating unit.

15. Goodwill and Other Intangible Assets (continued)

Carrying amount of goodwill (less impairment) allocated to each of the cash-generating units follows:

		WACC applied for impairment			*Carrying amount of goodwill*		
	Effective annual growth rate in three-year financial budgets	*2010*	*2009*	*2008*	*31 December 2010*	*31 December 2009*	*31 December 2008*
JSC Belarusky Narodny Bank	90.30%	8.51%	16.26%	N/A	23,394	23,394	23,394
JSC Bank of Georgia	20.17%	8.82%	8.70%	7.5%	22,398	22,398	22,391
JSC Insurance Company Aldagi – BCI	20.17%	12.61%	17.20%	15.8%	18,742	18,742	18,742
JSC Teliani Valley	27.17%	14.56%	N/A	N/A	3,292	–	–
JSC Intertour	20.00%	14.96%	14.08%	12.0%	659	659	698
Planeta Forte, LLC	20.00%	2.78%	17.20%	N/A	364	364	–
JSC My Family Clinic	20.17%	12.61%	17.20%	15.8%	220	220	220
Teliani Trading (Ukraine), LLC	27.17%	14.56%	N/A	N/A	143	–	–
JSC BG Bank	–	–	10.01%	11.7%	–	–	68,016
JSC United Securities Registrar of Georgia	–	–	19.85%	14.0%	–	–	366
JSC Nova Technology (disposed)	N/A	N/A	N/A	14.0%	–	–	411
Total					**69,212**	**65,777**	**134,238**

The three-year effective growth rate indicated in the table above represents the effective average annual growth rate that is embedded into the respective three-year financial budget of the respective entity, as approved by its management, calculated individually per each respective entity. Third year operating cash flows were taken at perpetuity and zero growth-rate was applied beyond the third year.

Goodwill amount that arose from JSC Intellect Bank and JSC Tbiluniversal Bank acquisition is allocated to JSC Bank of Georgia, mainly due to the fact that JSC Bank of Georgia has utilized the assets and liabilities of the said financial institutions.

Impairment testing of goodwill and other intangible assets with indefinite lives

Goodwill acquired through business combinations with indefinite lives have been allocated to four individual cash-generating units, which are also reportable segments, for impairment testing: corporate banking, retail banking, insurance and asset & wealth management and brokerage.

The carrying amount of goodwill allocated to each of the cash-generating units is as follows:

	2010	*2009*	*2008*
Retail banking	35,827	38,102	78,420
Insurance	18,962	18,962	18,962
Corporate banking	9,965	7,690	35,381
Brokerage and asset & wealth management	4,458	1,023	1,475
Total	**69,212**	**65,777**	**134,238**

15. Goodwill and Other Intangible Assets (continued)

Key assumptions used in value in use calculations

The recoverable amounts of the cash generating units have been determined based on a value-in-use calculation, using cash flow projections based on financial budgets approved by senior management covering from one to three-year period. Discount rates were not adjusted for either a constant or a declining growth rate beyond the three-year periods covered in financial budgets.

The following rates are used by the Bank for corporate banking and retail banking:

	Corporate Banking			*Retail Banking*		
	2010, %	*2009, %*	*2008, %*	*2010, %*	*2009, %*	*2008, %*
Discount rate	8.9%	9.1%	7.5%	8.9%	8.8%	7.5%

The following rates are used by the Bank for Insurance and Brokerage and Asset & Wealth Management:

	Insurance			*Asset & wealth management and brokerage*		
	2010, %	*2009, %*	*2008, %*	*2010, %*	*2009, %*	*2008, %*
Discount rate	12.6%	17.2%	15.8%	14.5%	16.45%	12% – 14%

The calculation of value-in-use for both Asset Management and Retail Banking units is most sensitive to interest margins and discount rates assumptions:

Discount rates

Discount rates reflect management's estimate of return of capital employed (ROCE) required in each business. This is the benchmark used by management to assess operating performance and to evaluate future investment proposals. Discount rates are calculated by using WACC.

16. Taxation

The corporate income tax expense comprises:

	2010	*2009*	*2008*
Current income tax expense	(12,365)	(1,872)	(6,762)
Deferred income tax (expense) benefit	(3,411)	8,870	7,740
Income tax (expense) benefit	**(15,776)**	**6,998**	**978**
Deferred income tax benefit (expense) recognized in other comprehensive income	**206**	**(704)**	**3,189**

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

	2010	*2009*	*2008*
Net gains (losses) on investment securities available for sale	146	(620)	1,530
Revaluation of buildings	(58)	124	1,659
Other	118	(208)	–
Income tax (expense) benefit to other comprehensive income	**206**	**(704)**	**3,189**

16. Taxation (continued)

The income tax rate applicable to the majority of the Group's income is the income tax rate applicable to subsidiaries income which ranges from 15% to 26% (2009: from 15% to 26%, 2008: from 15% to 26%). The tax rate for interest income on state securities changed from 10% to 7.5%, effective 1 January 2009 and further from 7.5% to 0%, effective 9 August 2009. Reconciliation between the expected and the actual taxation charge is provided below.

The effective income tax rate differs from the statutory income tax rates. As of 31 December 2010, 2009 and 2008 a reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2010	*2009*	*2008*
Income (loss) before income tax (expense) benefit	**98,443**	**(105,906)**	**(804)**
Statutory tax rate	15%	15%	15%
Theoretical income tax (expense) benefit at statutory tax rate	**(14,766)**	**15,886**	**121**
Tax at the domestic rates applicable to profits in the respective country	(291)	3,614	837
Non-deductible share-based compensation expenses	(1,325)	(717)	(1,240)
Other operating income	229	408	(207)
State securities at lower tax rates	564	677	1,020
Tax effect of inter-company transactions	–	–	783
Non-deductible expenses:			
– Business trips	(288)	–	–
– Entertainment	(71)	–	–
– Charity	(10)	–	–
– Impairment of intangible assets	–	(10,308)	–
– Other impairment recoveries	–	(2,460)	(171)
– Other	182	(102)	(165)
Income tax (expense) benefit	**(15,776)**	**6,998**	**978**

Applicable taxes in Georgia, Ukraine and Belarus include corporate income tax (profits tax), individuals' withholding taxes, property tax and value added tax, among others. However, regulations are often unclear or nonexistent and few precedents have been established. This creates tax risks in Georgia, Ukraine and Belarus, substantially more significant than typically found in countries with more developed tax systems. Management believes that the Group is in substantial compliance with the tax laws affecting its operations. However, the risk remains that relevant authorities could take differing positions with regard to interpretative issues.

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

	2010	*2009*	*2008*
Current income tax assets	2,247	7,997	8,095
Deferred income tax assets	18,178	15,487	4,691
Income tax assets	**20,425**	**23,484**	**12,786**
Current income tax liabilities	4,251	574	779
Deferred income tax liabilities	30,901	24,661	23,615
Income tax liabilities	**35,152**	**25,235**	**24,394**

16. Taxation (continued)

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

		Origination and reversal of temporary differences				*Origination and reversal of temporary differences*				*Origination and reversal of temporary differences*			
	2007	*In the income statement*	*In other compre-hensive income*	*Effect of business combi-nation*	*2008*	*In the income statement*	*In other compre-hensive income*	*Effect of business combi-nation*	*2009*	*In the income statement*	*In other compre-hensive income*	*Effect of business comb-nation*	*2010*
Tax effect of deductible temporary differences:													
Amounts due to credit institutions	35	(35)	–	–	–	–	–	–	–	–	–	–	–
Investment securities: available-for-sale	–	296	1,530	–	1,826	(295)	(620)	–	911	20	279	–	1,210
Loans to customers	80	390	–	–	470	9,659	–	–	10,129	440	–	–	10,569
Investment properties	–	–	–	–	–	–	–	1,604	1,604	349	–	–	1,953
Securities issued	55	(55)	–	–	–	–	–	–	–	–	–	–	–
Reinsurance assets	124	119	–	–	243	129	–	–	372	(117)	–	–	255
Reinsurance premiums receivables	–	2,073	–	–	2,073	(376)	–	–	1,697	–	–	–	1,697
Allowances for impairment and provisions for other losses	225	240	–	–	465	732	–	–	1,197	867	–	–	2,064
Tax losses carried forward	1,313	16,689	–	–	18,002	1,516	(26)	–	19,492	(15,020)	–	–	4,472
Finance lease receivables	7	277	–	–	284	35	–	–	319	–	–	–	319
Intangible assets	181	58	–	–	239	25	–	–	264	24	–	–	288
Property and equipment	2	(175)	1,659	297	1,783	149	289	–	2,221	(20)	290	78	2,569
Other assets	115	348	–	–	463	359	–	–	822	147	34	–	1,003
Other liabilities	302	433	–	–	735	1,190	–	–	1,925	(698)	–	–	1,227
Gross deferred tax assets	**2,439**	**20,658**	**3,189**	**297**	**26,583**	**13,123**	**(357)**	**1,604**	**40,953**	**(14,008)**	**603**	**78**	**27,626**
Unrecognized deferred tax assets	(207)	207	–	–	–	–	(131)	–	(131)	131	–	–	–
Deferred tax assets	**2,232**	**20,865**	**3,189**	**297**	**26,583**	**13,123**	**(488)**	**1,604**	**40,822**	**(13,877)**	**603**	**78**	**27,626**
Tax effect of taxable temporary differences:													
Fair value measurement of securities	–	–	–	–	–	–	–	–	–	203	–	–	203
Amounts due to credit institutions	1,710	341	–	–	2,051	(317)	–	–	1,734	39	–	–	1,773
Amounts due to customers	625	(117)	–	–	508	–	–	–	508	1,078	(119)	–	1,467
Securities available-for-sale	182	–	–	–	182	–	–	–	182	249	133	–	564
Loans to customers	4,491	2,612	–	–	7,103	13,776	–	–	20,879	(10,314)	–	–	10,565
Reinsurance assets	27	–	–	–	27	–	–	–	27	13	–	–	40
Insurance premium receivables	6	(6)	–	–	–	–	–	–	–	–	–	–	–
Allowances for impairment and provisions for other losses	38	1,185	–	–	1,223	(1,223)	–	–	–	770	–	–	770
Other insurance liabilities & pension fund obligations	–	–	–	–	–	–	–	–	–	7	–	–	7
Property and equipment	20,156	8,324	–	–	28,480	(6,194)	165	–	22,451	(3,756)	348	379	19,422
Investment properties	3,203	(342)	–	–	2,861	(2,313)	–	–	548	20	–	–	568
Intangible assets	1,008	1,289	–	–	2,297	87	28	–	2,412	1,364	–	–	3,776
Other assets	936	(595)	–	–	341	399	23	20	783	(677)	35	–	141
Other liabilities	–	434	–	–	434	38	–	–	472	538	–	43	1,053
Deferred tax liabilities	**32,382**	**13,125**	**–**	**–**	**45,507**	**4,253**	**216**	**20**	**49,996**	**(10,466)**	**397**	**422**	**40,349**
Net deferred tax assets (liabilities)	**(30,150)**	**7,740**	**3,189**	**297**	**(18,924)**	**8,870**	**(704)**	**1,584**	**(9,174)**	**(3,411)**	**206**	**(344)**	**(12,723)**

17. Other Impairment Allowance and Provisions

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

	Impairment allowance for investments in associates	*Impairment allowance for other assets*	*Impairment allowance for available-for-sale investment securities*	*Provision for guarantees and commitments*	*Total*
31 December 2007	**–**	**6**	**–**	**1,003**	**1,009**
Charge	274	580	–	3,697	4,551
Write-offs	–	(57)	–	(437)	(494)
Recoveries	–	20	–	–	20
31 December 2008	**274**	**549**	–	**4,263**	**5,086**
Charge (reversal)	2,237	5,513	818	(2,137)	6,431
Write-offs	–	(342)	–	–	(342)
31 December 2009	**2,511**	**5,720**	**818**	**2,126**	**11,175**
Charge (reversal)	1,495	(2,130)	1,941	2,281	3,587
Write-offs	(1,768)	(345)	(777)	–	(2,890)
Recoveries	–	64	–	–	64
31 December 2010	**2,238**	**3,309**	**1,982**	**4,407**	**11,936**

Allowance for impairment of assets is deducted from the carrying amounts of the related assets. Provisions for claims, guarantees and commitments are recorded in liabilities.

18. Other Assets and Other Liabilities

Other assets comprise:

	2010	*2009*	*2008*
Insurance premiums receivable	21,413	20,619	20,497
Accounts receivable	17,093	4,026	7,243
Inventory	9,828	1,212	1,966
Reinsurance assets	7,307	4,920	21,493
Settlements on operations with securities	5,182	3,027	39
Receivables from money transfers	3,358	2,508	5,208
Derivative financial assets	2,933	1,129	255
Operating taxes receivables	1,793	1,296	1,363
Assets purchased for finance lease purposes	1,434	2,316	–
Receivable from documentary operations	1,338	4,338	–
Trading securities owned	1,218	2,268	92
Foreclosed assets	1,049	946	3,464
Prepayments for purchase of property and equipment	959	344	245
Receivables from sale of assets	797	1,420	2,317
Assets held-for-sale	314	–	4,469
Operating lease receivables	266	426	448
Receivables from factoring operations	–	–	4,539
Other	2,447	3,205	2,032
	78,729	**54,000**	**75,670**
Less – Allowance for impairment of other assets (Note 17)	(3,309)	(5,720)	(549)
Other assets	**75,420**	**48,280**	**75,121**

Foreclosed assets represent assets repossessed from the borrowers of the Bank. These assets are not used for their intended purposes and are being held for short-term purposes with intent of sale.

18. Other Assets and Other Liabilities (continued)

Other liabilities comprise:

	2010	2009	2008
Insurance contracts liabilities	32,695	30,304	44,340
Accruals for employee compensation	25,111	21,860	14,165
Debt securities issued	21,610	660	5
Derivative financial liabilities	17,525	7,460	1,323
Creditors	8,412	4,226	5,858
Pension benefit obligations	4,949	3,856	1,642
Other insurance liabilities	4,431	6,152	9,424
Accruals and deferred income	3,268	35	–
Accounts payable	2,617	6,269	12,803
Other taxes payable	2,418	2,862	4,783
Dividends payable	303	314	314
Amounts payable for share acquisitions	259	254	–
Amounts payable for purchase of intangible assets	9	78	5,959
Other	4,790	2,236	939
Other liabilities	**128,397**	**86,566**	**101,555**

The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of the credit risk.

	2010			2009			2008		
	Notional amount	Fair values Asset	Liability	Notional amount	Fair value Asset	Liability	Notional amount	Fair value Asset	Liability
Interest rate contracts									
Forwards and Swaps – foreign	338,369	–	14,527	332,108	–	6,447	–	–	–
Foreign exchange contracts									
Forwards and Swaps – domestic	66,058	777	597	24,410	–	288	2,501	–	252
Options – foreign	54,121	1,815	2,211	1,096	82	–	–	–	–
Equity / Commodity contracts									
Put options – foreign	–	–	–	–	–	–	700	177	–
Call options – foreign	3,014	341	–	8,429	1,047	–	1,667	78	–
Embedded derivatives from investment deposits	–	–	190	–	–	725	–	–	1,071
Total derivative assets / liabilities	**461,562**	**2,933**	**17,525**	**366,043**	**1,129**	**7,460**	**4,868**	**255**	**1,323**

19. Amounts Due to Credit Institutions

Amounts due to credit institutions comprise:

	2010	2009	2008
Borrowings from international credit institutions	1,003,926	913,579	1,108,014
Time deposits and inter-bank loans	130,284	12,761	91,389
Sub-total	**1,134,210**	**926,340**	**1,199,403**
Correspondent accounts	4,717	2,275	17,319
Amounts due to credit institutions	**1,138,927**	**928,615**	**1,216,722**

19. Amounts Due to Credit Institutions (continued)

During 2010 the Group received short-term funds from Georgian banks in different currencies. As of 31 December 2010 the Group had an equivalent of GEL 13,030 (2009: GEL 1,566, 2008: GEL 32,795) in foreign currencies received as deposits from Georgian banks. In 2010 the Group paid up to 4.0% interest on these deposits (2009: 0.2%, 2008: 4.85%).

Borrowings from international credit institutions, time deposits and inter-bank loans were comprised of:

As of 31 December 2010 *Credit institution*	*Grant date*	*Contractual maturity*	*Currency*	*Interest rate per annum*	*Facility amount in original currency*	*Outstanding Balance as of 31 December 2010 in GEL (*)*
BG Finance B.V.	8-Feb-07	8-Feb-12	USD	9.00%	200,000	270,880
International Financial Corporation	13-Jan-09	15-Jul-13	USD	LIBOR +5.5%	50,000	89,015
European Bank for Reconstructions and Development	13-Jan-09	15-Jan-14	USD	LIBOR +5.5%	50,000	88,258
National Bank of Georgia	30-Dec-10	6-Jan-11	GEL	7.5%	66,300	66,300
Merrill Lynch International **	17-Aug-07	17-Aug-12	USD	LIBOR+5.99%	35,000	62,476
Netherland Development Finance Company **	18-Jul-08	15-Oct-18	USD	LIBOR + 7.25%	30,000	52,916
Overseas Private Investment Corporation	23-Dec-08	19-Dec-18	USD	5.75%	29,000	45,209
Asian Development Bank	1-Dec-10	1-Jun-16	USD	LIBOR+5.5%	50,000	43,566
European Bank for Reconstructions and Development**	13-Jan-09	15-Jan-19	USD	LIBOR + 10%	23,956	43,402
International Financial Corporatation **	13-Jan-09	15-Jan-19	USD	LIBOR + 10%	23,956	43,396
International Financial Corporation **	13-Jan-09	15-Jan-19	USD	LIBOR +8%	26,044	42,796
European Bank for Reconstructions and Development **	13-Jan-09	15-Jan-19	USD	LIBOR +8%	26,044	42,708
European Bank for Reconstructions and Development	12-Nov-10	5-Dec-15	USD	LIBOR+5.25%	20,000	35,272
European Fund for Southeast Europe	15-Dec-10	15-Jun-18	USD	LIBOR+5.5%	30,000	35,016
Semper Augustos B.V. **	31-Oct-07	25-Oct-17	USD	11.65%	15,000	27,134
European Fund for Southeast Europe	15-Dec-10	15-Jun-18	USD	LIBOR+5.5%	20,000	24,529
Overseas Private Investment Corporation **	23-Dec-08	19-Dec-18	USD	7.75%	10,000	17,477
Netherland Development Finance Company	22-Jan-07	15-Mar-14	USD	LIBOR+3.3%	12,500	13,502
International Financial Corporation	21-Oct-10	15-Dec-14	USD	LIBOR+4.0%	5,000	8,774
World Business Capital	17-Feb-06	1-Oct-16	USD	LIBOR+2.75%	10,000	8,699
JSC Cartu Bank	23-Dec-10	6-Jan-11	GEL	7.5%	7,500	7,512
JSC HSBC Bank Georgia	15-Nov-10	15-Feb-11	USD	4.0%	4,000	7,112
OJSC Pasha Bank	8-Nov-10	8-Feb-11	EUR	5.0%	3,000	7,050
World Business Capital	29-May-07	25-Mar-17	USD	LIBOR+2.75%	4,151	6,441
JSC International Bank of Azerbaijan - Georgia	31-Dec-10	3-Jan-11	GEL	7.5%	6,400	6,400
JSC BTA Bank	10-Nov-10	22-Feb-11	USD	4.0%	3,000	5,335
UAB Medicinos Bankas	12-Nov-10	11-Feb-11	USD	4.0%	3,000	5,335
Balances less than 5,000 KGEL	various	various	various	various	various	27,700
Total						**1,134,210**

19. Amounts Due to Credit Institutions (continued)

As of 31 December 2009 *Credit institution*	*Grant date*	*Contractual maturity*	*Currency*	*Interest rate per annum*	*Facility amount in original currency*	*Outstanding Balance as of 31 December 2009 in GEL (*)*
BG Finance B.V.	8-Feb-07	8-Feb-12	USD	9.00%	200,000	303,164
International Financial Corporation	13-Jan-09	15-Jul-13	USD	LIBOR +5.5%	50,000	85,979
European Bank for Reconstructions and Development	13-Jan-09	15-Jan-14	USD	LIBOR +5.5%	50,000	85,920
Merrill Lynch International **	17-Aug-07	17-Aug-12	USD	LIBOR+5.99%	35,000	59,472
Netherland Development Finance Company **	18-Jul-08	15-Oct-18	USD	LIBOR + 7.25%	30,000	49,570
Overseas Private Investment Corporation	23-Dec-08	19-Dec-18	USD	5.75%	29,000	48,602
European Bank for Reconstructions and Development**	13-Jan-09	15-Jan-19	USD	LIBOR + 10%	23,956	42,365
International Financial Corporatation **	13-Jan-09	15-Jan-19	USD	LIBOR + 10%	23,956	42,344
European Bank for Reconstructions and Development **	13-Jan-09	15-Jan-19	USD	LIBOR +8%	26,044	40,700
International Financial Corporation **	13-Jan-09	15-Jan-19	USD	LIBOR +8%	26,044	40,694
Semper Augustos B.V. **	31-Oct-07	25-Oct-17	USD	11.65%	15,000	25,803
Netherland Development Finance Company	22-Jan-07	15-Mar-14	USD	LIBOR+3.3%	12,500	17,029
Overseas Private Investment Corporation **	23-Dec-08	19-Dec-18	USD	7.75%	10,000	16,844
Citibank International PLC	17-Aug-07	20-Feb-10	USD	LIBOR+2.75%	8,333	14,157
Citibank International PLC	17-Aug-07	20-Aug-10	USD	LIBOR+2.75%	8,333	14,000
World Business Capital	17-Feb-06	1-Oct-16	USD	LIBOR+2.75%	10,000	9,705
World Business Capital	29-May-07	25-Mar-17	USD	LIBOR+2.75%	4,151	6,998
Commerzbank AG	30-Dec-05	30-Dec-10	USD	LIBOR+1.3%	3,837	6,172
Balances less than 5,000 KGEL	various	various	various	various	various	16,822
Total						**926,340**

As of 31 December 2008 *Credit institution*	*Grant date*	*Contractual maturity*	*Currency*	*Interest rate per annum*	*Facility amount in original currency*	*Outstanding Balance as of 31 December 2008 in GEL (*)*
BG Finance B.V.	8-Feb-07	8-Feb-12	USD	9%	200,000	340,864
Rubrika Finance Company Netherlands B.V.	6-Jun-08	6-Jun-10	USD	LIBOR+9%	140,000	230,740
Merrill Lynch International	21-Dec-07	21-Jan-09	USD	LIBOR+7.65%	65,000	111,806
Citibank International PLC	17-Aug-07	17-Feb-09	USD	LIBOR+2.2%	43,500	73,780
Merrill Lynch International **	17-Aug-07	17-Aug-12	USD	LIBOR+5.99%	35,000	59,488
National Bank of Georgia	30-Sep-08	30-Sep-09	GEL	13%	58,900	58,900
Netherland Development Finance Company **	30-Jun-08	15-Oct-18	USD	LIBOR+7.25%	30,000	50,351
Overseas Private Investment Corporation	19-Dec-08	19-Dec-18	USD	5.75%	29,000	47,605
Citibank International PLC	20-Aug-07	20-Aug-10	USD	LIBOR+2.75	25,000	41,875
Semper Augustos B.V. **	31-Oct-07	25-Oct-17	USD	11.65%	15,000	25,515
Netherland Development Finance Company	22-Jan-07	15-Mar-14	USD	LIBOR+3.3%	12,500	20,387
Overseas Private Investment Corporation **	19-Dec-08	19-Dec-18	USD	7.75%	10,000	16,379
JSC TBC Bank	31-Dec-08	5-Jan-09	EUR	5%	5,000	11,824
World Business Capital	17-Feb-06	1-Oct-16	USD	LIBOR+2.75%	10,000	11,242
Hillside Apex Fund Ltd **	14-Aug-06	14-Aug-16	USD	LIBOR+6.20%	5,000	8,630
JSC TBC Bank	26-Dec-08	5-Jan-09	USD	4%	5,000	8,340
World Business Capital	29-Mar-07	25-Mar-17	USD	LIBOR+2.75%	5,226	7,633
JSC HSBC Bank Georgia	29-Jul-08	29-Jan-09	USD	9%	4,000	6,926
Commerzbank AG	16-Dec-05	30-Dec-10	USD	LIBOR+1.3%	5,000	5,408
JSC TBC Bank	29-Dec-08	6-Jan-09	GEL	4.5%	5,000	5,001
Balances less than GEL 5,000	various	various	various	various	various	56,709
Total						**1,199,403**

*** - includes accrued interest**
**** - total subordinated loans comprised GEL 332,305 as at 31 December 2010 (2009: GEL 317,792, 2008: GEL 160,363)**

Agreements for significant borrowings contain certain covenants requiring the Group for different limits for capital adequacy, liquidity, currency position, credit exposures, leverage and others. At 31 December 2010, 2009 and 2008, the Group complied with all the financial covenants of the loans received from credit institutions.

The borrowings received on 13 January 2009 from European Bank for Reconstructions and Development and International Financial Corporation, comprising USD 26,044 thousand each, had a convertibility feature valid for 5 years from the loan granting date (convertibility period). Number of estimated potential shares to be issued under these convertible facilities comprises 3,474,614 ordinary shares (Note 21) of the Bank.

20. Amounts Due to Customers

The amounts due to customers include the following:

	2010	*2009*	*2008*
Current accounts	864,327	559,987	612,502
Time deposits	1,140,371	712,483	580,622
Amounts due to customers	**2,004,698**	**1,272,470**	**1,193,124**
Held as security against letters of credit and guarantees (note 22)	**20,336**	**56,758**	**70,441**

At year-end, amounts due to customers of GEL 360,166 (18%) were due to the 10 largest customers (2009: GEL 217,264 (17%), 2008: GEL 323,662 (27%)).

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

	2010	*2009*	*2008*
Individuals	894,312	637,789	495,747
Private enterprises	942,540	578,849	627,049
State and budget organizations	167,846	55,832	70,328
Amounts due to customers	**2,004,698**	**1,272,470**	**1,193,124**

The breakdown of customer accounts by industry sector is as follows:

	2010	*2009*	*2008*
Individuals	894,312	637,789	495,747
Trade and services	399,528	273,190	296,110
Energy	256,275	116,810	134,275
State and budget organizations	167,846	55,832	70,328
Mining and processing	113,283	27,638	16,364
Construction and development	93,827	79,082	40,146
Transport and communication	35,226	47,166	70,806
Agriculture	21,379	13,588	8,426
Other	23,022	21,375	60,922
Amounts due to customers	**2,004,698**	**1,272,470**	**1,193,124**

21. Equity

Share capital

As of 31 December 2010, authorized share capital comprised 43,308,125 common shares, of which 31,344,860 were issued and fully paid (2009: 43,308,125 common shares, of which 31,306,071 were issued and fully paid, 2008: 39,835,619 common shares, of which 31,253,283 were issued and fully paid). Each share has a nominal value of one (1) Georgian Lari. Shares issued and outstanding as of 31 December 2010 are described below:

	Number of shares Ordinary	*Amount of shares Ordinary*
31 December 2007	**27,154,918**	**27,155**
Increase in share capital	4,089,000	4,089
Increase in share capital arising from share-based payments (Note 26)	9,365	9
31 December 2008	**31,253,283**	**31,253**
Increase in share capital arising from share-based payments (Note 26)	52,788	53
31 December 2009	**31,306,071**	**31,306**
Increase in share capital arising from share-based payments (Note 26)	38,789	39
31 December 2010	**31,344,860**	**31,345**

21. Equity (continued)

Share capital of the Group was paid by the shareholders in Georgian Lari and they are entitled to dividends in Georgian Lari. 2010 net income attributable to ordinary shareholders of the Bank comprise GEL 83,640 (2009: net loss of GEL 91,370, 2008: net income of GEL 3,897). At 31 December 2010 weighted average number of ordinary shares outstanding during the year was 30,037,041 (2009: 30,494,397, 2008: 30,160,451). At 31 December 2010 the diluted number of ordinary shares was 33,511,655 (2009: 30,494,397, 2008: 30,160,451). The basic and diluted earnings per share amounted to GEL 2.785 and GEL 2.739, respectively (2009: both basic and diluted loss per share amounted to GEL 2.996, 2008: both basic and diluted earnings per share amounted to GEL 0.129). The 3,474,614 potential shares underlying the convertible debt instruments held by the Group as at 31 December 2010 (Note 19) were treated as dilutive, because their conversion would decrease earnings per share from continuing operations, as prescribed in IAS 33 – "Earnings per share". This conversion would also reduce the Group's interest expenses on these debt instruments and increase 2010 profit attributable to ordinary shareholders of the Bank by GEL 8,143 to a total of GEL 91,783.

Treasury shares

Treasury shares of GEL 1,072 as of 31 December 2010 comprise the Bank's shares owned by the Bank and its subsidiaries (2009: GEL 668, 2008: GEL 890). Purchases and sales of treasury shares were conducted by the Bank's subsidiaries in the open market: JSC BG Capital, BG Trading LLC, Galt and Taggart Holdings Limited LLC, GC Holdings LLC and JSC Insurance Company Aldagi BCI.

Treasury shares amounting to GEL 438 as of 31 December 2010 (2009: GEL 1,009, 2008: GEL 1,128) are kept by the Bank's custodian –Abacus Corporate Trustee Limited.

During the year ended 31 December 2010, 38,789 ordinary shares of GEL 39 par value and additional paid-in capital of GEL 523 have been vested as compensation to top management (2009: 52,788 ordinary shares of GEL 53 par value and additional paid-in capital of GEL 430, 2008: 9,365 ordinary shares of GEL 9 par value and additional paid-in capital of GEL 470).

Dividends

No dividends were declared nor paid during 2010, 2009 and 2008.

Nature and purpose of other reserves

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

Unrealised gains (losses) on investment securities available-for-sale
This reserve records fair value changes on investments available-for-sale.

Unrealised gains (losses) from dilution or sale / acquisition of shares in existing subsidiaries
This reserve records unrealised gains (losses) from dilution or sale / acquisition of shares in existing subsidiaries.

Foreign currency translation reserve
The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries. Movement of foreign currency translation reserve was as follows:

	Foreign currency translation reserve
31 December 2007	**5,454**
Currency translation loss recognised in other comprehensive loss	(22,435)
31 December 2008	**(16,981)**
Currency translation loss recognised in other comprehensive loss	(12,145)
31 December 2009	**(29,126)**
Currency translation gain recognised in other comprehensive income	5,116
31 December 2010	**(24,010)**

Movements in other reserves during 2010, 2009 and 2008 are presented in the statements of other comprehensive income.

22. Commitments and Contingencies

Legal

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

Financial commitments and contingencies

As of 31 December 2010, 2009 and 2008 the Group's financial commitments and contingencies comprised the following:

	2010	2009	2008
Credit-related commitments			
Undrawn loan facilities	138,057	76,999	90,023
Letters of credit	58,779	30,038	32,547
Guarantees issued	374,230	240,613	304,906
	571,066	**347,650**	**427,476**
Operating lease commitments			
Not later than 1 year	7,016	6,281	5,874
Later than 1 year but not later than 5 years	13,984	13,396	12,832
Later than 5 years	6,037	6,497	5,993
	27,037	**26,174**	**24,699**
Capital expenditure commitments	**39,523**	**9,309**	**19,851**
Less – Provisions (Note 17)	(4,407)	(2,126)	(4,263)
Less – Cash held as security against letters of credit and guarantees (Note 20)	(20,336)	(56,758)	(70,441)
Financial commitments and contingencies, net	**612,883**	**324,249**	**397,322**

As of 31 December 2010 the capital expenditures represented the commitment for purchase of property and capital repairs of GEL 32,311 and software and other intangible assets of GEL 7,212. As of 31 December 2009 the capital expenditures represented the commitment for purchase of property and capital repairs of GEL 1,512 and software and other intangible assets of GEL 7,797. As of 31 December 2008 the capital expenditures represented the commitment for purchase of property GEL 2,132, equipment of GEL 4,721 and software and other intangible assets of GEL 12,998.

23. Net Fee and Commission Income

	2010	2009	2008
Settlements operations	50,511	33,907	33,659
Guarantees and letters of credit	12,362	10,764	8,625
Cash operations	8,061	6,145	6,947
Advisory	1,129	578	2,032
Currency conversion operations	677	1,024	1,766
Brokerage service fees	545	1,891	2,626
Other	980	10,290	7,848
Fee and commission income	**74,265**	**64,599**	**63,503**
Settlements operations	(7,324)	(4,299)	(3,974)
Guarantees and letters of credit	(1,164)	(2,106)	(2,038)
Cash operations	(780)	(1,619)	(564)
Insurance brokerage service fees	(646)	(534)	(5,965)
Currency conversion operations	(14)	(28)	(430)
Other	(917)	(988)	(563)
Fee and commission expense	**(10,845)**	**(9,574)**	**(13,534)**
Net fee and commission income	**63,420**	**55,025**	**49,969**

24. Net Insurance Revenue

Net insurance premiums earned, net insurance claims incurred and respective net insurance revenue for the years ended 31 December 2010, 2009 and 2008 comprised:

	2010	*2009*	*2008*
Life insurance contracts premium written	2,562	2,865	3,456
General insurance contracts premium written	53,744	56,694	53,201
Total premiums written	**56,306**	**59,559**	**56,657**
Gross change in life provision	96	(377)	86
Gross change in general insurance contracts unearned premium provision	(1,001)	1,690	(6,311)
Total gross premiums earned on insurance contracts	**55,401**	**60,872**	**50,432**
Reinsurers' share of life insurance contracts premium written	(1,321)	(1,086)	(981)
Reinsurers' share of general insurance contracts premium written	(11,038)	(9,502)	(15,271)
Reinsurers' share of change in life provision	(57)	254	(4)
Reinsurers' share of change in general insurance contracts unearned premium provision	1,576	(5,061)	1,735
Total reinsurers' share of gross earned premiums on insurance contracts	**(10,840)**	**(15,395)**	**(14,521)**
Net insurance premiums earned	**44,561**	**45,477**	**35,911**
Life insurance claims paid	(1,272)	(830)	(455)
General insurance claims paid	(28,493)	(43,137)	(30,175)
Total insurance claims paid	**(29,765)**	**(43,967)**	**(30,630)**
Reinsurers' share of life insurance claims paid	988	523	351
Reinsurers' share of general insurance claims paid	1,497	12,356	5,443
Gross change in total reserves for claims	(1,486)	12,563	(6,053)
Reinsurers' share of change in total reserves for claims	868	(11,577)	3,994
Net insurance claims incurred	**(27,898)**	**(30,102)**	**(26,895)**
Net insurance revenue	**16,663**	**15,375**	**9,016**

25. Salaries and Other Employee Benefits, and General and Administrative Expenses

	2010	*2009*	*2008*
Salaries and bonuses	(103,352)	(96,745)	(104,039)
Social security costs	(1,199)	(3,760)	(4,728)
Salaries and other employee benefits	**(104,551)**	**(100,505)**	**(108,767)**
Marketing and advertising	(12,534)	(9,847)	(12,251)
Occupancy and rent	(10,082)	(10,431)	(12,811)
Repairs and maintenance	(6,205)	(5,313)	(5,441)
Legal and other professional services	(6,149)	(7,010)	(6,391)
Communication	(4,975)	(5,482)	(6,117)
Operating taxes	(4,188)	(4,960)	(3,496)
Office supplies	(3,786)	(2,484)	(2,813)
Security	(3,055)	(4,647)	(4,951)
Travel expenses	(1,975)	(2,019)	(2,948)
Corporate hospitality and entertainment	(1,709)	(1,307)	(1,393)
Banking services	(756)	(623)	(2,293)
Insurance	(678)	(399)	(2,886)
Personnel training and recruitment	(416)	(177)	(545)
Penalties	(178)	(510)	(745)
Other	(4,314)	(2,130)	(3,568)
General and administrative expenses	**(61,000)**	**(57,339)**	**(68,649)**

25. Salaries and Other Employee Benefits, and General and Administrative Expenses (continued)

Salaries and bonuses include GEL 8,920, GEL 10,530 and GEL 7,820 of the Executives' Equity Compensation Plan costs in 2010, 2009 and 2008, respectively, associated with the existing share-based compensation scheme approved in the Group (Notes 26 and 30).

26. Share-based Payments

Executives' Equity Compensation Plan

Abacus Corporate Trustee Limited (the "Trustee") acts as the trustee of the Bank's Executives' Equity Compensation Plan ("EECP").

In May 2008 the Bank's Supervisory Board resolved to recommend to the Trustee to award 172,000 Bank's ordinary shares in the form of restricted GDRs to the Group's 22 executives pursuant to the EECP in respect of the year ended 31 December 2007. The awards are subject to three year vesting, with a continuous employment being the only vesting condition. The Group considers 21 February 2008 as the grant date for 54,000 of the Bank of Georgia shares in the form of restricted GDRs and 6 May 2008 grant date for the remaining 118,000 of the Bank's ordinary shares in the form of restricted GDRs. The Bank estimates that the fair value of the shares on 21 February 2008 was Georgian Lari 39.72 per share and on 6 May 2008 – Georgian Lari 33.68 per share.

In February 2009 the Bank's Supervisory Board resolved to recommend to the Trustee to award 306,500 Bank's ordinary shares in the form of restricted GDRs to the Group's 17 executives pursuant to the EECP in respect of the year ended 31 December 2008. The awards are subject to three year vesting, with a continuous employment being the only vesting condition. The Group considers 12 February 2009 as the grant date. The Bank estimates that the fair value of the shares on 12 February 2009 was Georgian Lari 5.02 per share.

In February 2010 the Bank's Supervisory Board resolved to recommend to the Trustee to award 432,495 Bank's ordinary shares in the form of restricted GDRs to the Group's 19 executives pursuant to the EECP in respect of the year ended 31 December 2009. The awards are subject to three year vesting, with a continuous employment being the only vesting condition. The Group considers 18 February 2010 as the grant date. The Bank estimates that the fair value of the shares on 18 February 2010 was Georgian Lari 17.29 per share.

Additionally, in March 2010 Deputies of the CEO of the Bank and in May 2010 CEO of the Bank signed a three-year guaranteed share-based compensation agreement with the Bank for the total of 915,000 GDRs. Total amount of GDRs guaranteed to each executive will be awarded in three equal instalments during the 3 consecutive years starting January 2011, of which each award will be subject to four-year vesting period. The Group considers 29 March 2010 as the grant date for the awards of the Deputies and 25 May 2010 as the grant date for the award of the CEO. The Bank estimates that the fair value of the shares on 29 March 2010 was Georgian Lari 18.48 per share and the fair value of shares on 25 May 2010 was Georgian Lari 18.16.

One-off Award

In August 2009 the Bank's Supervisory Board resolved to buy through its brokerage subsidiary the Bank's 420,000 ordinary shares in the form of restricted GDRs and award them to the Group's 21 executives to reinforce long-term motivation of these executives. The awards are subject to three year cliff-vesting, with a continuous employment being the only vesting condition. The Group considers 10 August 2009 as the grant date. The Bank estimates that the fair value of the shares on 10 August 2009 was Georgian Lari 9.61 per share.

Top Grant, Special Grant and Annual Grants to top executives

In August 2007 the Bank's Supervisory Board resolved to propose to the Trustee of the Bank's EECP the award of shares of the Bank in the form of restricted GDRs to the top three executives of the Bank (top two from January 1, 2008 as one resigned before 31 December 2007). Each award will vest fully, or partially, or will not vest at all, at the third anniversary of the date of the grant, depending solely on clearly defined and measurable market-based condition. The awards of each executive comprise top grant and annual grant.

26. Share-based Payments (continued)

Top Grant, Special Grant and Annual Grants to top executives (continued)

Top grant is a one-time award and was given in 2007 only and its value is restricted by the 200% of the annual base salary of the respective executive in 2007. Annual grant is awarded every year during the three consecutive years' period that such executive is employed by the Bank. In 2007 its value was restricted by 100% of the annual base salary of the respective executive during the vesting period. Based on the changes approved by the Bank's Supervisory Board, the value of the annual grant in 2008 was restricted by the 200%.

The Bank estimated the annual expense of share-based compensation related to 2007 top and annual grants equal 300% of the annual base salary of each executive in 2007.

Based on the Bank's share price performance calculated by an independent consultant the Bank estimated the annual expense of share-based compensation related to 2008 annual grant equals to nil.
In September 2009 the Bank's Supervisory Board resolved to adopt changes to the original version of the annual grant approved in August 2007. Namely, the 2009 Annual Grant comprising 245,773 GDRs was granted to the two top executives of the Bank without market-based vesting conditions, with continuous employment being the only 3-year, cliff-vesting condition. The Group considers 11 September 2009 as the grant date. The Bank estimates that the fair value of the shares on 11 September 2009 was Georgian Lari 12.83 per share.

By the same resolution, in September 2009, the Bank's Supervisory Board resolved to award a Special Grant to the same two executives comprising 68,139 GDRs. The award is subject to two year vesting, with a continuous employment being the only vesting condition. The Group considers 11 September 2009 as the grant date. The Bank estimates that the fair value of the shares on 11 September 2009 was Georgian Lari 12.83 per share.

Summary

Fair value of the shares granted at the measurement date is determined based on available market quotations.

The weighted average fair value of share-based awards at the grant date comprised Georgian Lari 17.96 per share in 2010 (2009: Georgian Lari 9.46, 2008: Georgian Lari 33.42).

The Group's total share-based payment expenses for 2010 comprised GEL 8,920 (2009: 10,530, 2008: 7,820).

Below is the summary of the key share-based payments related data:

Ordinary shares	*2010*	*2009*	*2008*
Number of shares awarded	38,789	128,908	29,298
– Among them, to supervisory board members	*38,789*	*55,158*	*16,010*
Number of shares vested	38,789	52,788	9,365
Weighted average value at grant date, per share (GEL in full amount)	17.20	9.04	41.44
Value at grant date, total (GEL)	**667**	**1,165**	**1,214**
Expense recognized during the year (GEL)	**(667)**	**(1,390)**	**(1,017)**

GDRs	*2010*	*2009*	*2008*
Number of GDRs awarded	1,341,918	1,130,412	258,139
*– Among them, to top management**	*461,922*	*463,912*	*198,139*
Number of GDRs vested	610,000	153,000	282,606
Weighted average value at grant date, per share (GEL in full amount)	17.99	9.51	32.51
Value at grant date, total (GEL)	**24,135**	**10,747**	**8,391**
Expense recognized during the year (GEL)	**(8,253)**	**(9,140)**	**(6,803)**

26. Share-based Payments (continued)

Summary (continued)

All instruments	*2010*	*2009*	*2008*
Total number of equity instruments awarded	1,380,707	1,259,320	287,437
– Among them, to top management and supervisory board members*	*500,711*	*519,070*	*214,149*
Total number of equity instruments vested	648,789	205,788	291,971
Weighted average value at grant date, per share (GEL in full amount)	17.96	9.46	33.42
Value at grant date, total (GEL)	**24,802**	**11,912**	**9,605**
Total expense recognized during the year (GEL) (notes 25 and 30)	**(8,920)**	**(10,530)**	**(7,820)**

*** The Chairman and the Chief Executive Officer**

27. Risk Management

Introduction

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

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

Risk management structure

The Supervisory Board is ultimately responsible for identifying and controlling risks.

Supervisory Board

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

Management Board

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

Audit Committee

The Audit Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions. It is an independent body and is directly monitored by the Supervisory Board.

Bank Treasury

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

Internal audit

Risk management processes throughout the 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 Audit Committee.

27. Risk Management (continued)

Introduction (continued)

Risk measurement and reporting systems

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

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

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

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

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

Risk mitigation

As part of its overall risk management, the Group uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions. While these are intended for hedging, these do not qualify for hedge accounting.

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

Excessive risk concentration

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

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

Credit risk

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

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

27. Risk Management (continued)

Credit risk (continued)

Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the statement of the financial position

Credit-related commitments risks

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

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

	Notes	*Gross maximum exposure 2010*	*Gross maximum exposure 2009*	*Gross maximum exposure 2008*
Cash and cash equivalents (excluding cash on hand)	7	449,835	203,028	251,358
Amounts due from credit institutions	8	116,469	64,620	81,403
Loans to customers	9	2,351,697	1,661,331	2,039,022
Finance lease receivables	10	14,419	16,896	41,605
Investment securities:				
– Available-for-sale	11	283,646	6,172	12,014
– Held-to-maturity	11	21	249,196	22,845
		3,216,087	**2,201,243**	**2,448,247**
Financial commitments and contingencies	22	546,323	288,766	352,772
Total credit risk exposure		**3,762,410**	**2,490,009**	**2,801,019**

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

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

27. Risk Management (continued)

Credit risk (continued)

Credit quality per class of financial assets

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

		Neither past due nor impaired				
	Notes	*High grade 2010*	*Standard grade 2010*	*Sub-standard grade 2010*	*Past due or individually impaired 2010*	*Total 2010*
Amounts due from credit institutions	8	115,622	847	–	–	116,469
Loans to customers:	9					
Corporate lending		924,320	254,675	42,449	203,106	1,424,550
Consumer lending		334,430	13,841	703	34,641	383,615
Residential mortgages		324,474	13,889	9,251	62,172	409,786
Micro loans		220,820	4,317	3,636	9,689	238,462
Gold – pawn loans		66,749	–	–	–	66,749
Other		2,168	696	7	1,200	4,071
		1,872,961	**287,418**	**56,046**	**310,808**	**2,527,233**
Finance lease receivables	10	10,533	311	872	3,291	15,007
Investment securities:						
Available-for-sale	11	285,628	–	–	–	285,628
Held-to-maturity	11	21	–	–	–	21
		285,649	**–**	**–**	**–**	**285,649**
Total		**2,284,765**	**288,576**	**56,918**	**314,099**	**2,944,358**

		Neither past due nor impaired				
	Notes	*High grade 2009*	*Standard grade 2009*	*Sub-standard grade 2009*	*Past due or individually impaired 2009*	*Total 2009*
Amounts due from credit institutions	8	63,703	917	–	–	64,620
Loans to customers:	9					
Corporate lending		447,481	122,983	94,215	275,135	939,814
Residential mortgages		267,593	26,133	9,772	83,917	387,415
Consumer lending		227,765	26,748	1,915	76,109	332,537
Micro loans		76,003	9,506	6,884	7,588	99,981
Gold – pawn loans		62,829	–	–	–	62,829
Other		–	3,221	352	1,668	5,241
		1,081,671	**188,591**	**113,138**	**444,417**	**1,827,817**
Finance lease receivables	10	7,913	11,441	115	4,571	24,040
Investment securities:						
Available-for-sale	11	6,172	–	–	818	6,990
Held-to-maturity	11	249,196	–	–	–	249,196
		255,368	**–**	**–**	**818**	**256,186**
Total		**1,408,655**	**200,949**	**113,253**	**449,806**	**2,172,663**

27. Risk Management (continued)

Credit risk (continued)

Credit quality per class of financial assets (continued)

		Neither past due nor impaired				
	Notes	*High grade 2008*	*Standard grade 2008*	*Sub-standard grade 2008*	*Past due or individually impaired 2008*	*Total 2008*
Amounts due from credit institutions	8	81,403	–	–	–	81,403
Loans to customers:	9					
Corporate lending		639,988	112,558	23,428	268,985	1,044,959
Residential mortgages		337,445	13,477	1,868	38,816	391,606
Consumer lending		381,299	42,126	11,576	61,196	496,197
Micro loans		129,666	4,894	5,182	11,571	151,313
Gold – pawn loans		46,374	–	–	–	46,374
Other		713	2,514	9,414	2,533	15,174
		1,535,485	**175,569**	**51,468**	**383,101**	**2,145,623**
Finance lease receivables	10	12,201	2,232	204	29,131	43,768
Investment securities:						
Available-for-sale	11	12,014	–	–	–	12,014
Held-to-maturity	11	22,845	–	–	–	22,845
		34,859	**–**	**–**	**–**	**34,859**
Total		**1,663,948**	**177,801**	**51,672**	**412,232**	**2,305,653**

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

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics 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. Attributable risk ratings are assessed and updated regularly.

The credit risk assessment policy for non-past due and individually non-impaired financial assets has been determined by the Bank as follows:

A financial asset that has neither been in past due more than 30 days nor individually impaired is assessed as a financial asset with High Grade;

A financial asset that is neither past due nor impaired for reporting date, but historically used to be past due more than 30 is assessed as a financial asset with Standard Grade;

A financial asset that is neither past due nor impaired for reporting date, but historically used to be past due more than 60 days or borrower of this loan has at least an additional borrowing in past due more than 60 days as of reporting date is assessed as a financial asset with Sub-Standard Grade.

27. Risk Management (continued)

Credit risk (continued)

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

	Less than 30 days 2010	31 to 60 days 2010	61 to 90 days 2010	More than 90 days 2010	Total 2010
Loans to customers:					
Corporate lending	2,925	–	2,115	5,290	10,330
Micro-loans	503	6	128	–	637
Consumer lending	12,538	11	3	93	12,645
Residential mortgages	6,967	1,387	275	1,956	10,585
Other	–	143	84	–	227
Finance lease receivables	1,212	–	–	2,079	3,291
Total	**24,145**	**1,547**	**2,605**	**9,418**	**37,715**

	Less than 30 days 2009	31 to 60 days 2009	61 to 90 days 2009	More than 90 days 2009	Total 2009
Loans to customers:					
Corporate lending	12,057	1,124	2,841	28,509	44,531
Micro-loans	615	4	–	9	628
Consumer lending	14,259	58	–	4	14,321
Residential mortgages	3,502	57	–	16	3,575
Other					
Finance lease receivables	1,461	9	–	–	1,470
Total	**31,894**	**1,252**	**2,841**	**28,538**	**64,525**

	Less than 30 days 2008	31 to 60 days 2008	61 to 90 days 2008	More than 90 days 2008	Total 2008
Loans to customers:					
Corporate lending	12,107	4,937	6,990	15,118	39,152
Micro-loans	2,751	270	67	196	3,284
Consumer lending	21,375	764	336	2,469	24,944
Residential mortgages	6,887	6	–	86	6,979
Other	256	712	2,160	3,128	6,256
Finance lease receivables	–	46	–	24,380	24,426
Total	**43,376**	**6,735**	**9,553**	**45,377**	**105,041**

See Notes 9 and 10 for more detailed information with respect to the allowance for impairment of loans to customers and finance lease receivables, respectively.

The Group specifically monitors performance of the loans with overdue payments in arrears for more than 90 days. Gross carrying value (i.e. carrying value before deducting any allowance for impairment) of such loans comprised GEL 117,580, GEL 139,954 and GEL 61,474 as at 31 December 2010, 2009 and 2008 respectively.

27. Risk Management (continued)

Credit risk (continued)

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

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

	2010	*2009*	*2008*
Loans to customers:			
Commercial lending	263,163	473,845	384,404
Micro loans	4,664	7,540	5,952
Residential mortgages	4,386	38,137	6,193
Consumer lending	2,092	26,624	19,384
Other	–	11	8,194
Financial lease receivables	1,882	2,349	3,173
Total	**276,187**	**548,506**	**427,300**

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 150 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Group addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

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

Collectively assessed allowances

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

The collective assessment takes into account the impairment that is likely to be present in the portfolio even though there is not yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration the following information: historical losses on the portfolio, current economic conditions, the appropriate delay between the time a loss is likely to have been uncured and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. Local management is responsible for deciding the length of this period which can extend for as long as one year, depending on a product. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

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

27. Risk Management (continued)

Credit risk (continued)

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

	2010				*2009*				*2008*			
	Georgia	*OECD*	*CIS and other foreign countries*	*Total*	*Georgia*	*OECD*	*CIS and other foreign countries*	*Total*	**Georgia**	**OECD**	**CIS and other foreign countries**	**Total**
Assets:												
Cash and cash equivalents	188,426	364,616	58,542	611,584	154,405	127,816	75,668	357,889	171,466	208,997	35,358	415,821
Amounts due from credit institutions	91,715	14,538	10,216	116,469	39,447	12,664	12,509	64,620	45,851	3,414	32,138	81,403
Loans to customers	2,135,962	8	215,727	2,351,697	1,520,174	–	141,157	1,661,331	2,008,652	–	30,370	2,039,022
Finance lease receivables	10,036	–	4,383	14,419	8,927	–	7,969	16,896	37,405	–	4,200	41,605
Investment securities:												
– available-for-sale	281,134	–	4,494	285,628	–	–	6,172	6,172	12,014	–	–	12,014
– held-to-maturity	21	–	–	21	249,196	–	–	249,196	22,845	–	–	22,845
All other assets	498,175	9,508	108,109	615,792	455,769	8,056	80,082	543,907	586,214	1,210	37,050	624,474
	3,205,469	**388,670**	**401,471**	**3,995,610**	**2,427,918**	**148,536**	**323,557**	**2,900,011**	**2,884,447**	**213,621**	**139,116**	**3,237,184**
Liabilities:												
Amounts due to customers	1,638,164	101,960	264,574	2,004,698	1,024,771	10,375	237,324	1,272,470	1,152,244	2,477	38,403	1,193,124
Amounts due to credit institutions	145,398	962,691	30,838	1,138,927	20,102	899,651	8,862	928,615	129,091	1,080,179	7,452	1,216,722
All other liabilities	157,404	4,232	6,320	167,956	85,588	9,618	18,721	113,927	118,978	7,216	4,018	130,212
	1,940,966	**1,068,883**	**301,732**	**3,311,581**	**1,130,461**	**919,644**	**264,907**	**2,315,012**	**1,400,313**	**1,089,872**	**49,873**	**2,540,058**
Net balance sheet position	**1,264,503**	**(680,213)**	**99,739**	**684,029**	**1,297,457**	**(771,108)**	**58,650**	**584,999**	**1,484,134**	**(876,251)**	**89,243**	**697,126**

Liquidity risk and funding management

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

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

The liquidity position is assessed and managed by the Bank primarily on a stand-alone basis, based on certain liquidity ratios established by the NBG. As at 31 December, these ratios were as follows:

	2010, %	*2009, %*	*2008, %*
Average liquidity ratio for the year	35.6%	36.5%	31.4%
Maximum Liquidity ratio	44.5%	45.7%	48.6%
Minimum Liquidity ratio	29.1%	21.9%	20.8%

Average liquidity ratio is calculated on stand-alone bases for JSC Bank of Georgia as annual average (arithmetic mean) of daily liquidity ratios computed as ratio of liquid assets to liabilities determined by National Bank of Georgia as follows:

Liquid assets – comprise cash, cash equivalents and other assets that have character to be immediately converted into cash. Those assets include investment securities issued by Georgian Government plus Certificates of Deposit issued by NBG and not including amounts due from credit institutions, other than inter-bank deposits, and/or debt securities of Governments and Central Banks of non-OECD countries, amounts in nostro accounts which are under lien, impaired inter-bank deposits, amounts on obligatory reserve with NBG that are pledged due to borrowings from NBG.

27. Risk Management (continued)

Liquidity risk and funding management (continued)

Liabilities – comprise sum of total liabilities and off-balance sheet commitments not including subordinated loans, those commitments that are to be exercised or settled later than six month from reporting date, financial guarantees and letters of credit fully collateralized by cash covers in the bank, commitments due to dealing operations with foreign currencies. Maximum and minimum rates of liquidity ratio are taken from historical data of appropriate reporting years.

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 Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

Financial liabilities **As at 31 December 2010**	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to customers	1,394,442	505,079	153,963	8,859	2,062,343
Amounts due to credit institutions	151,404	145,753	780,504	530,547	1,608,208
Debt securities issued and other liabilities	8,049	56,838	15,649	4,949	85,485
Total undiscounted financial liabilities	**1,553,895**	**707,670**	**950,116**	**544,355**	**3,756,036**

Financial liabilities **As at 31 December 2009**	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to customers	899,697	332,714	83,097	7,624	1,323,132
Amounts due to credit institutions	76,468	86,724	726,243	511,713	1,401,148
Debt securities issued and other liabilities	18,079	23,581	7,468	3,856	52,984
Total undiscounted financial liabilities	**994,244**	**443,019**	**816,808**	**523,193**	**2,777,264**

Financial liabilities **As at 31 December 2008**	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to customers	869,050	266,412	74,947	4,712	1,215,121
Amounts due to credit institutions	291,471	131,625	922,928	259,148	1,605,172
Debt securities issued and other liabilities	1,373	90	5	–	1,468
Total undiscounted financial liabilities	**1,161,894**	**398,127**	**997,880**	**263,860**	**2,821,761**

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

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
2010	245,684	290,662	76,464	24,816	637,626
2009	98,735	108,050	149,063	27,285	383,133
2008	187,311	94,245	166,843	23,627	472,026

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

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

Included in due to customers are term deposits of individuals. In accordance with the Georgian legislation, the Bank Group is obliged to repay such deposits upon demand of a depositor. Refer to Note 20.

27. Risk Management (continued)

Market risk

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

Interest rate risk

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

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2010. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2010 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve. During 2010, 2009 and 2008 sensitivity analysis did not reveal significant potential effect on the Group Equity.

Currency	*Increase in basis points 2010*	*Sensitivity of net interest income 2010*	*Sensitivity of other comprehensive income 2010*
EUR	0.01%	1	–
USD	0.00%	46	–
UAH	0.75%	–	34

Currency	*Decrease in basis points 2010*	*Sensitivity of net interest income 2010*	*Sensitivity of other comprehensive income 2010*
EUR	-0.01%	(1)	–
USD	-0.00%	(46)	–
UAH	-0.75%	–	(34)

Currency	*Increase in basis points 2009*	*Sensitivity of net interest income 2009*	*Sensitivity of other comprehensive income 2009*
EUR	0.10%	2	–
USD	0.10%	186	–
UAH	0.75%	–	52

Currency	*Decrease in basis points 2009*	*Sensitivity of net interest income 2009*	*Sensitivity of other comprehensive income 2009*
EUR	-0.10%	(2)	–
USD	-0.10%	(186)	–
UAH	-0.75%	–	(52)

Currency	*Increase in basis points 2008*	*Sensitivity of net interest income 2008*	*Sensitivity of other comprehensive income 2008*
UAH	0.75%	–	72
EUR	1.50%	79	–
USD	0.55%	3,434	–

Currency	*Decrease in basis points 2008*	*Sensitivity of net interest income 2008*	*Sensitivity of other comprehensive income 2008*
UAH	-1.25%	–	(121)
EUR	-1.50%	(79)	–
USD	-0.55%	(3,434)	–

27. Risk Management (continued)

Market risk (continued)

Currency risk

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

The tables below indicate the currencies to which the Group had significant exposure at 31 December 2010 on its trading and 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 Georgian Lari, with all other variables held constant on the income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase. During 2010, 2009 and 2008 sensitivity analysis did not reveal significant potential effect on Group Equity.

Currency	*Change in currency rate in % 2010*	*Effect on profit before tax 2010*	*Effect on other comprehensive income 2010*	*Change in currency rate in % 2009*	*Effect on profit before tax 2009*	*Effect on other comprehensive income 2009*	*Change in currency rate in % 2008*	*Effect on profit before tax 2008*	*Effect on other comprehensive income 2008*
EUR	0.8%	234	–	12.7%	(3,792)	–	14.9%	(832)	–
GBP	0.8%	1	–	16.1%	63	–	24.9%	17	–
RUR	0.7%	3	–	0.3%	(1)	–	0.3%	(6)	–
UAH	0.3%	–	91	0.3%	–	228	2.8%	8	–
USD	0.3%	323	–	1.3%	(669)	–	9.2%	(1,216)	–

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 Group uses regression models to project the impact of varying levels of prepayment on its net interest income. The model makes a distinction between the different reasons for repayment (e.g. relocation, refinancing and renegotiation) and takes into account the effect of any prepayment penalties. The model is back tested against actual outcomes.

The effect on profit for one year and on equity is as follows:

	Effect on net interest income	*Effect on other comprehensive income, 2010*
2010	(67,605)	–
2009	(14,557)	–
2008	(34,546)	–

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.

27. Risk Management (continued)

Operating environment

As an emerging market, Georgia does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature market economy. Operations in Georgia may involve risks that are not typically associated with those in developed markets (including the risk that the Georgian Lari is not freely convertible outside of the country and undeveloped debt and equity markets). However over the last few years the Georgian government has made a number of developments that positively affect the overall investment climate of the country, specifically implementing the reforms necessary to create banking, judicial, taxation and regulatory systems. This includes the adoption of a new body of legislation (including new Tax Code and procedural laws). In management's view, these steps contribute to mitigate the risks of doing business in Georgia.

The existing tendency aimed at the overall improvement of the business environment is expected to persist. 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. However, the Georgian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world.

28. Fair Values of Financial Instruments

Financial instruments recorded at fair value

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

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

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

	Level 1	*Level 2*	*Level 3*	*Total 2010*
Financial assets				
Investment securities – available-for-sale	4,958	284,573	5,409	294,940
Other assets – derivative financial assets	2,250	683	–	2,933
Other assets – trading securities owned	1,218	–	–	1,218
	8,426	**285,256**	**5,409**	**299,091**
Financial liabilities				
Other liabilities – derivative financial liabilities	2,211	15,314	–	17,525
	16,927	**598**	**–**	**17,525**

	Level 1	*Level 2*	*Level 3*	*Total 2009*
Financial assets				
Investment securities – available-for-sale	4,320	11,005	4,265	19,590
Other assets – derivative financial assets	1,129	–	–	1,129
Other assets – trading securities owned	2,268	–	–	2,268
	7,717	**11,005**	**4,265**	**22,987**
Financial liabilities				
Other liabilities – derivative financial liabilities	288	7,172	–	7,460
	288	**7,172**	**–**	**7,460**

28. Fair Values of Financial Instruments (continued)

Financial instruments recorded at fair value (continued)

	Level 1	*Level 2*	*Level 3*	*Total 2008*
Financial assets				
Investment securities – available-for-sale	17,644	16,093	–	33,737
Other assets – derivative financial assets	255	–	–	255
Other assets – trading securities owned	92	–	–	92
	17,991	**16,093**	–	**34,084**
Financial liabilities				
Other liabilities – derivative financial liabilities	1,323	–	–	1,323
	1,323	**–**	**–**	**1,323**

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

Derivatives

Derivatives valued using a valuation technique with market observable inputs are mainly interest rate swaps, currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, 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.

Trading securities and investment securities available-for-sale

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

Movements in level 3 financial instruments measured at fair value

The following tables show a reconciliation of the opening and closing amounts of Level 3 financial assets and liabilities which are recorded at fair value:

	At 1 January 2010	*Purchase of AFS securities*	*At 31 December 2010*
Financial assets			
Investment securities – available-for-sale	4,265	1,144	5,409
Total level 3 financial assets	**4,265**	**1,144**	**5,409**
Total net level 3 financial assets / (liabilities)	**4,265**	**1,144**	**5,409**

	At 1 January 2009	*Transfer from other assets*	*At 31 December 2009*
Financial assets			
Investment securities – available-for-sale	–	4,265	4,265
Total level 3 financial assets	–	**4,265**	**4,265**
Total net level 3 financial assets / (liabilities)	**–**	**4,265**	**4,265**

28. Fair Values of Financial Instruments (continued)

Financial instruments recorded at fair value (continued)

No financial instruments were transferred during 2010 from level 1 and level 2 to level 3 of the fair value hierarchy. Gains or losses on level 3 financial instruments during 2010 comprised nil.

No financial instruments were transferred during 2010 between level 1 and level 2 of the fair value hierarchy.

Impact on fair value of level 3 financial instruments measured at fair value of changes to key assumptions

The following table shows the impact on the fair value of level 3 instruments of using reasonably possible alternative assumptions:

	Carrying amount	*Effect of reasonably possible alternative assumptions*	*Carrying amount*	*Effect of reasonably possible alternative assumptions*
	31 December 2010		*31 December 2009*	
Financial assets				
Investment securities – available-for-sale	5,409	+/- 814	4,265	+/- 642

In order to determine reasonably possible alternative assumptions the Group adjusted key unobservable model inputs as follows:

For equities, the Group adjusted the EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) multiple by increasing and decreasing the assumed multiple ratio by 10%, which is considered by the Group to be within a range of reasonably possible alternatives based on the EBITDA multiples used across peers within the same geographic area of the same industry.

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

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

	Carrying value 2010	*Fair value 2010*	*Unrecognised loss 2010*	*Carrying value 2009*	*Fair value 2009*	*Unrecognised loss 2009*	*Carrying value 2008*	*Fair value 2008*	*Unrecognised loss 2008*
Financial assets									
Cash and cash equivalents	611,584	611,584	–	357,889	357,889	–	415,821	415,821	–
Amounts due from credit institutions	116,469	116,469	–	64,620	64,620	–	81,403	81,403	–
Loans to customers	2,351,697	2,319,388	(32,309)	1,661,331	1,621,779	(39,552)	2,039,022	1,991,449	(47,573)
Finance lease receivables	14,419	14,419	–	16,896	16,896	–	41,605	41,605	–
Investment securities:									
– held-to-maturity	21	21	–	249,196	249,196	–	22,845	22,845	–
Financial liabilities									
Amounts due to customers	2,004,698	2,019,793	(15,095)	1,272,470	1,271,298	1,172	1,193,124	1,201,746	(8,622)
Amounts due to credit institutions	1,138,927	1,138,927	–	928,615	928,615	–	1,216,722	1,216,722	–
Total unrecognised change in unrealised fair value			**(47,404)**			**(38,380)**			**(56,195)**

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

Assets for which fair value approximates carrying value

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

28. Fair Values of Financial Instruments (continued)

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.

29. Maturity Analysis of Financial Assets and Liabilities

The table below shows an analysis of financial assets and liabilities according to when they are expected to be recovered or settled. See Note 27 "Risk management" for the Group's contractual undiscounted repayment obligations.

	2010			2009			2008		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Financial assets									
Cash and cash equivalents	611,584	–	611,584	357,889	–	357,889	415,821	–	415,821
Amounts due from credit institutions	107,707	8,762	116,469	60,121	4,499	64,620	68,975	12,428	81,403
Loans to customers	1,191,914	1,159,783	2,351,697	655,906	1,005,425	1,661,331	897,167	1,141,855	2,039,022
Finance lease receivables	8,828	5,591	14,419	12,466	4,430	16,896	33,375	8,230	41,605
Investment securities:									
– available–for–sale	242,535	52,405	294,940	19,590	–	19,590	33,737	–	33,737
– held–to–maturity	21	–	21	249,196	–	249,196	22,845	–	22,845
Total	**2,162,589**	**1,226,541**	**3,389,130**	**1,355,168**	**1,014,354**	**2,369,522**	**1,471,920**	**1,162,513**	**2,634,433**
Financial liabilities									
Amounts due to customers	1,859,761	144,937	2,004,698	1,197,697	74,773	1,272,470	1,124,598	68,526	1,193,124
Amounts due to credit institutions	193,386	945,541	1,138,927	37,866	890,749	928,615	402,094	814,628	1,216,722
Total	**2,053,147**	**1,090,478**	**3,143,625**	**1,235,563**	**965,522**	**2,201,085**	**1,526,692**	**883,154**	**2,409,846**
Net	**109,442**	**136,063**	**245,505**	**119,605**	**48,832**	**168,437**	**(54,772)**	**279,359**	**224,587**

The Group's capability to discharge its liabilities relies on its ability to realize an equivalent amount of assets within the same period of time. 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 undiscounted financial liability analysis gap 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 one month in the tables above.

The Group's principal sources of liquidity are as follows:

- deposits;
- borrowings from international credit institutions;
- inter-bank deposit agreement;
- debt issues;
- proceeds from sale of securities;
- principal repayments on loans;
- interest income; and
- fees and commissions income.

29. Maturity Analysis of Financial Assets and Liabilities (continued)

As of 31 December 2010 deposits amounted to GEL 2,004,698 (2009: GEL 1,272,470, 2008: GEL 1,193,124) and represented 61% (2009: 55%, 2008: 47%) of Group's total liabilities. These funds continue to provide a majority of the Group's funding and represent a diversified and stable source of funds. As of 31 December 2010 amounts owed to credit institutions amounted to GEL 1,138,927 (2009: GEL 928,615, 2008: GEL 1,216,722) and represented 34% (2009: 40%, 2008: 48%) of total liabilities.

In management's opinion, liquidity is sufficient to meet the Group's present requirements.

30. Related Party Disclosures

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

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

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

	2010			*2009*			*2008*		
	Parent	*Asso-ciates*	*Key management personnel*	*Parent*	*Asso-ciates*	*Key management personnel*	*Parent*	*Asso-ciates*	*Key management personnel*
Loans outstanding at 1 January, gross	**–**	**9,255**	**5,791**	**265**	**21,644**	**5,572**	**–**	**13,598**	**520**
Loans issued during the year	–	624	7,125	–	7,736	5,616	1,339	12,085	8,229
Loan repayments during the year	–	(707)	(6,877)	(265)	(10,322)	(8,633)	(1,074)	(9,709)	(3,375)
Other movements	–	(6,981)	(1,281)	–	(9,803)	3,236	–	5,670	198
Loans outstanding at 31 December, gross	**–**	**2,191**	**4,758**	**–**	**9,255**	**5,791**	**265**	**21,644**	**5,572**
Less: allowance for impairment at 31 December	–	(1,564)	(119)	–	(870)	(212)	–	(3,181)	(1,064)
Loans outstanding at 31 December, net	**–**	**627**	**4,639**	**–**	**8,385**	**5,579**	**265**	**18,463**	**4,508**
Interest income on loans	–	344	611	–	1,250	799	–	2,125	468
Loan impairment charge	–	661	65	–	594	(92)	–	3,099	120
Deposits at 1 January	**12,098**	**506**	**6,919**	**12,733**	**177**	**18,324**	**12,733**	**4,485**	**626**
Deposits received during the year	41,646	16,185	36,658	–	27,989	42,908	–	79,356	53,081
Deposits repaid during the year	(16,851)	(16,127)	(33,522)	(635)	(27,792)	(54,647)	–	(83,638)	(35,450)
Other movements	(483)	162	(1,056)	–	132	334	–	(26)	67
Deposits at 31 December	**36,410**	**726**	**8,999**	**12,098**	**506**	**6,919**	**12,733**	**177**	**18,324**
Interest expense on deposits	1,681	68	471	–	5	425	–	2	14
Other income	1,671	–	69	437	–	35	767	_	32

30. Related Party Disclosures (continued)

Compensation of key management personnel was comprised of the following:

	2010	2009	2008
Salaries and other benefits	20,530	17,833	9,975
– Among them, termination benefits	*426*	*759*	*10*
Share-based payments compensation (notes 25, 26)	8,920	10,530	7,820
– Among them, termination benefits	*1,183*	*2,178*	–
Social security costs	441	256	94
Recruitment costs	–	–	28
Total key management compensation	**29,891**	**28,619**	**17,917**

The number of key management personnel at 31 December 2010 was 163 (2009: 151, 2008: 105).

31. Capital Adequacy

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

During 2009, the Bank and the Group had complied in full with all its externally imposed capital requirements.

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

The Group 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 Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

NBG capital adequacy ratio

The NBG requires banks to maintain a minimum capital adequacy ratio of 12% of risk-weighted assets, computed based on the bank's stand-alone special purpose financial statements prepared in accordance with NBG regulations and pronouncements. As of 31 December 2010, 2009 and 2008, the Bank's capital adequacy ratio on this basis was as follows:

	2010	*2009*	*2008*
Core capital	494,128	535,427	573,146
Supplementary capital	423,389	269,729	162,902
Less: Deductions from capital	(367,418)	(347,853)	(269,427)
Total regulatory capital	**550,099**	**457,303**	**466,621**
Risk-weighted assets	**3,800,624**	**2,717,084**	**3,458,133**
Total capital adequacy ratio	**14.5%**	**16.8%**	**13.5%**

Regulatory capital consists of Core capital, which comprises share, additional paid-up capital, retained earnings including current year profit, foreign currency translation and non-controlling interests less accrued dividends, net long positions in own shares and goodwill. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the NBG. The other component of regulatory capital is Supplementary capital, which includes subordinated long-term debt, preference shares and revaluation reserves.

31. Capital Adequacy (continued)

Capital adequacy ratio under Basel Capital Accord 1988

The Bank's capital adequacy ratio based on consolidated statement of financial position and computed in accordance with the Basel Capital Accord 1988, with subsequent amendments including the amendment to incorporate market risks, as of 31 December 2010, 2009 and 2008, follows:

	2010	*2009*	*2008*
Tier 1 capital	637,971	548,710	637,753
Tier 2 capital	404,788	369,480	273,311
Less: Deductions from capital	(70,722)	(67,454)	(134,238)
Total regulatory capital	**972,037**	**850,736**	**776,826**
Risk-weighted assets	**3,653,247**	**2,454,763**	**2,950,653**
Total capital ratio	26.6%	34.7%	26.3%
Tier 1 capital ratio	17.5%	22.4%	21.6%
Minimum capital adequacy ratio	**8%**	**8%**	**8%**

32. Event after the Reporting Period

On 18 February 2011 the Group disposed 80% equity interest in JSC BG Bank for a total consideration of USD 9.6 million. Net realized loss on disposal of this foreign subsidiary comprised GEL 5,446.

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Registered under number 06/5-07 by Krtsanisi District Court
Tbilisi, Georgia
Registration date: 29 November 1995

Stock Listing

London Stock Exchange (LSE)
Ticker symbol for Bank of Georgia GDR is BGEO
Bloomberg: BGEO LI

Georgian Stock Exchange (GSE)
Ticker symbol for Bank of Georgia share is GEB

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