ANNUAL REPORT 2009

საქართველოს ბანკი
BANK OF GEORGIA

BANK OF GEORGIA HIGHLIGHTS

Statement of Income Figures	**Year**		**Change**
GEL mln	**2009**	**2008**	
Revenue [1]	298	336	-11%
Costs [2]	278	212	31%
Net Income	(99)	0.2	NMF

Balance Sheet Highlights	**As at period end**		**Change**
GEL mln	**2009**	**2008**	
Total Assets	2,913	3,259	-11%
Customer Loans	1,661	2,039	-19%
Deposits	1,272	1,193	7%
Equity	598	719	-17%

Capital Adequacy	**Year**		**Change**
	2009	**2008**	
Tier I Capital Adequacy Ratio (BIS) [3]	22.4%	21.6%	4%
Total Capital Adequacy Ratio (BIS) [3]	34.7%	26.3%	32%

Selected Operating Data [4]	**As at period end**		**Change**
	2009	**2008**	
Branches	141	151	-7%
ATMs	382	416	8%
Current Accounts	1,057,017	917,630	15%
Retail Clients	730,824	664,813	10%
Employees (full-time,consolidated)	4,781	4,979	-4%

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	'B3/NP'	'Ba3/NP'

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. With operations Georgia, Ukraine and Belarus, Bank of Georgia is the largest bank in Georgia by assets, loans, deposits and equity, with 33.0%[5] market share by total assets. Bank of Georgia's activities are divided across business and geographical lines, with strong commercial banking footprint.

(1) *Revenue equals sums of Net interest income, Net fee & commission income, Other non-interest income less Net insurance claims incurred*

(2) *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)*

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

(4) *For Georgia on a standalone basis, unless otherwise noted*

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

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STATEMENT OF THE CHIEF EXECUTIVE OFFICER

საქართველოს ბანკი
BANK OF GEORGIA

TURNING THE CORNER

Dear Shareholders,

2009 was an extraordinary year for Bank of Georgia. The Bank started the year with a tremendous task of tackling challenges such as deleveraging, tight liquidity, weakening of asset quality and significant deterioration of the Ukrainian economy, the results of global economic crisis and volatile operating environment. Throughout the year, we remained focused on maintaining strong balance sheet, succeeded in recovering and then growing our deposits to the record high level in Georgia, and finished the year with ample liquidity that will allow us to capture opportunities that lie ahead. We responded to the challenge of the weakening of the loan book by tightening our lending standards and reducing our lending activity for the most part of the year, have continued prudent provisioning of our loan book and have observed the stabilized NPLs as the market conditions towards the end of the year became more supportive of economic growth. As the Georgian economy started to show signs of recovery in the second half of 2009, we acted accordingly and stepped up our lending activity.

We maintained (and continue to maintain) strength that enables us to operate in any environment by sustaining strong capital adequacy ratios, whether measured by BIS or National Bank of Georgia standards and high liquidity. As of 31 December 2009, our Tier I Capital Adequacy Ratio was 22.4% and our Total Capital Adequacy Ratio was 34.7%. According the National Bank of Georgia standards, these ratios were 19.7% and 16.8%, respectively. Our tight liquidity management in the first half of the year resulted in high liquidity levels maintained during the second half. We ended the year with the liquidity ratio well above 30%, which compares to 20% minimum liquidity ratio required by the regulator and excess liquidity of GEL 226.5 million, or 12.4% of gross loans.

The economic downturn that lasted for the most part of the year negatively affected our 2009 results. To large extent, this year's performance was marred by two issues. The first was goodwill writedown in the amount of GEL 73.1 million, predominantly due to the entire goodwill write-off associated with BG Bank, our subsidiary in Ukraine. The second resulted from the loan impairment charge, which declined 3.2% compared to 2008 reflecting the improved but still weak economic environment in the second half of the year, was still significant at GEL 118.9 million. As a result, in 2009 Bank of Georgia reported Net Loss of GEL 98.9 million, or 3.0 per share, a decrease from 2008 Net Income of GEL 174 thousand, or GEL 0.1 per share.

REVIEW OF KEY DEVELOPMENTS IN 2009

Managing through the economic downturn was the top of the agenda in 2009. Georgian operating environment in 2009 was undergoing the negative effects of global financial crisis, military conflict with Russia in summer 2008, one-off 17% currency devaluation against the U.S.$. in November 2008 and internal political crisis that lasted through May 2009. We started the year with our top priorities adjusted to such environment. These priorities were: risk management, preserving liquidity, focus on efficiency, and reduction of the Bank's involvement in non-core assets, as part of our short-to-medium term strategy.

Even though we were managing the Bank during the downturn in 2009, we never stopped investing in our future. We took significant steps forward in terms of IT development and further strengthened the Bank's management team.

RISK MANAGEMENT

One of the most significant developments in the area of risk management was proactively working with our corporate and retail clients facing repayment difficulties and temporary tightening our lending activity. Corporate recovery and retail loan restructuring groups were operational from the beginning of the year and served as an important tool for enhanced credit portfolio management. Our efforts, supported by improving market environment in Georgia in the second half of the year, started to bear fruit as NPLs peaked at GEL 145 million in November and NPLs as percent of gross loans started to decline reaching 7.7% in Q4 2009. The conservative lending policy maintained by us throughout most of the year, resulted in the decline of the gross loan book by 14.8% to GEL 1,828 million as of December 2009.

LIQUIDITY MANAGEMENT

As a result of the system-wide decline in banking deposits in Georgia in 2008 that continued in the first months of 2009, rebuilding our deposit base was a strategically imperative task. We never stopped offering innovative retail deposit products such as "Green Deposits" and "Investment Deposits", now popular products on the Georgian market, and have kept on working consistently with the corporate clients offering attractive flexible deposit terms and bundled loan and deposit products. Our Wealth Management business grew markedly during the year and now plays a more significant role in our strategy. Responding to the urgency of attracting deposits, in February 2009 we started to operate our Wealth Management office in Tel Aviv (now covering Jordan as well) and most recently in Kiev. As a result, deposits from non-residents account for 60.4% of Wealth Management deposits and for 19.5% of total deposits, as of the end of 2009. Wealth Management deposits grew by 68.6% in 2009 and made up 12.8% of the Bank's total deposits.

These efforts, supported by the commencement of the inflow of donor funds, pledged by international community to help Georgia recover the aftermath of war, produced noteworthy results. As of 31 December 2009 the Bank's client deposits reached the record high level of GEL 1,273 million and loan to deposit ratio declined to 131% from 171% in 2008.

Global economic downturn prompted many banks, including Georgian ones, to significantly dilute their shareholders and/or seek rescue packages from their respective governments. We take pride in the fact that Bank of Georgia did not require government support and our shareholders' dilution is capped at 10% should our lenders convert the U.S.$. 52 million subordinated convertible loan portion of U.S.$. 200 million loan package we received in the beginning of 2009. The U.S.$. 200 million loan package from IFC and EBRD, consisting of U.S.$ 100 million senior loan, U.S.$ 48 million subordinated loan and U.S.$ 52 subordinated convertible loan, helped us with our liquidity and allowed us repay in aggregate U.S.$ 253.5 million of international debt funding. This includes U.S.$ 140 million Loan Passthrough Notes, part of which was repurchased by the Bank on favorable terms before the settlement of the remaining outstanding balance in June 2009. With this transaction we largely completed our international wholesale debt repayment obligations until 2012.

SELECTED HIGHLIGHTS

The tough economic conditions prompted us to reorganize our retail business in Georgia by adjusting it to declining retail lending volumes in 2008. In December 2008, we discontinued and/or downscaled those retail business lines that were most impacted by the economic slowdown and modified our retail strategy. But most importantly, we kept our core retail infrastructure and personnel, the price we had to pay in 2009 to get back in retail business in 2010 in an efficient and timely manner. Our new strategic priority entails an aggressive targeting of the mass affluent client base in Georgia and maximizing revenue per client by means of improved client service, cost control and efficiency. To this end, we launched for the first time in Georgia, Premier Banking, under the brand name "Solo", which is a comprehensive personal banking service for the affluent client base. As part of our mass affluent retail banking strategy, we

secured a multi-year agreement on an exclusive basis for issuing and acquiring American Express cards in Georgia and started issuing AmEx credit cards in November 2009.

Our insurance franchise remains to be the strongest on the market, with the market share exceeding 20%. 2009 was an exceptional year for Aldagi BCI, the Banks' insurance subsidiary in Georgia, which has returned to profitability as a result of cost-control and efficiency improvements during the year as well as better claims management.

Throughout the turbulent year, Bank of Georgia continued to support more than 850,000 clients in all of its markets of operation. As of December 2009, we served more than 730,000 retail, 82,000 corporate and 1,429 wealth management clients through 141 branches and 382 ATMs in Georgia, the largest footprint in the country.

TOWARDS HIGHER OPERATING EFFICIENCY

We maintained our relentless focus on operating costs and operating efficiency. As a result of various cost cutting initiatives across the board as well as the effects of the reorganization of Retail Banking, we successfully decreased our salaries and SG&A costs, traditionally our largest operating cost items, by 11% in 2009.

The slowdown in business activity and excess liquidity enabled us to seize opportunities that will increase our efficiency going forward. In 2009, we commenced the implementation of the core banking system, Temenos24, state-of-the-art core banking software acquired in September 2009. This fully integrated platform will enable us to simplify and streamline our infrastructure and increase our efficiency. The timing of this acquisition is also noteworthy. The agreement with Temenos in the midst of the global banking crisis has enabled us to capture an estimated project IRR of 20%.

This year we already started to deploy Softscape, a fully automated talent management system acquired in October 2009, which will enable Bank of Georgia to maximize its workforce potential by means of the integrated system that could be rolled out with multiple languages to support our entire multi-national organization. It will also provide Bank of Georgia with a powerful analytics tool to enable strategic insights into the data for employee development and performance improvement.

Another technological advancement of the year is CRIF Decision Solution acquired by the Bank in October 2009 to provide and develop the Bank's loan origination system. This state-of-the-art technology available on the market will allow us capture cross-border synergies through centralized decision making, will enhance the time to market while keeping risks under control, streamline the Bank's client acquisition processes and will serve as robust suite of tools to support the Bank's customer management processes.

GOVERNANCE

In a move to improve our governance, we have introduced a classical two-tier board structure with the Management Board, led by the Chief Executive Officer, and the Supervisory Board comprising only non-executive directors, including the Chairman. We believe the new governance structure to be more effective, as the line-up of the management team is now complete.

Our Supervisory Board was further strengthened by the additions of David Morrison in June 2009 as a Supervisory Board member and Al Breach, who has been engaged by the Bank in November 2009 as an advisor to the Supervisory Board. The Supervisory Board intends to propose Al's candidacy for the Supervisory Board membership at the next AGM. David, business lawyer, formerly one of the managing partners at Sullivan & Cromwell, prestigious international law firm, adds an important dimension to the Bank's Supervisory

Board. Al, who is a highly respected strategist and economist, formerly Head of Research at UBS Russia, gives the Bank access to world class macro-economic insight.

I would like to use this opportunity to thank Nicholas Enukidze, who has served as a Chairman of Bank of Georgia for more than two years, for his major contributions during probably one of the most challenging periods in the Bank's history. Nicholas will be stepping down from his executive function at the next AGM in line with the changes in our governance. Correspondingly, I will be resigning from the Supervisory Board to continue to serve, together with my deputies on the Management Board, as CEO.

In 2009, we further strengthened and realigned the Bank's management team by both attracting high-caliber individuals and through internal promotions, which provides depth for the future development of our officers. The two notable senior appointments include Archil Gachechiladze, who has worked at Merchant Banking Fund of Lehman Brothers in London prior to returning to Georgia, as Deputy CEO for Corporate Banking in Georgia and Nikoloz Shurgaia, formerly Principal Banker at EBRD in London, as Chairman of the Board of Belarusky Narodny Bank (BNB), Bank of Georgia's banking subsidiary in Belarus. Both Archil and Nikoloz bring invaluable local and international experience to their leadership roles.

Our international banking operations have been further enhanced by the appointment of Murtaz Kikoria as acting CEO of BG Bank since June 2009. Prior to this appointment Murtaz served Deputy CEO in charge of Compliance at Bank of Georgia and previously served as Principal EBRD Banker and Head of Banking Supervision at the National Bank of Georgia.

INTERNATIONAL BANKING SUBSIDIARIES

Continued financial challenges and difficult operating environment in Ukraine prompted us to revisit our Ukrainian banking strategy and re-assess our opportunities in this market. BG Bank, our Ukrainian banking subsidiary has suffered sizeable losses. During the year, we have shifted away from retail banking and have implemented cost-control measures closing down 9 branches and reducing the headcount by 165. We intend to further downscale the operations of BG Bank, bringing it down to predominantly trade finance operations with an aim of capturing part of the U.S.$ 1 billion trade between Georgia and Ukraine. BG Bank will also focus, together with BG Capital, the Bank's brokerage subsidiary, on private banking services, launched in Kiev in September 2009.

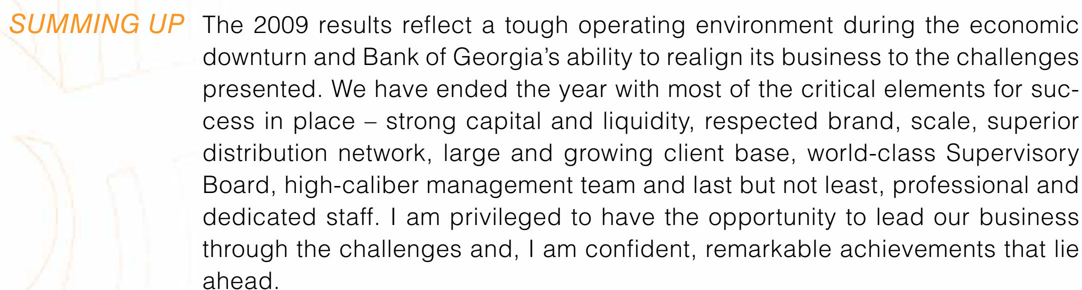
We remain optimistic about the future of Belarus and its economy. We have confirmed our commitment to BNB and have completed the buyout of the minority stake in December 2009. In order to meet the new minimum regulatory capital requirement set by the National Bank of the Republic of Belarus we have also increased BNB's capital by approximately EUR 10.4 million. As a result of these investments, Bank of Georgia now controls 99.98% of BNB's shares outstanding.

DIVESTING FROM NON-CORE BUSINESS

We have made good progress in refocusing Bank of Georgia on its core businesses and the sale of our stake in GTAM was an important step in this direction. We will also continue to explore our options in respect of both Liberty Consumer and SB Real Estate, with an aim to further reduce the Bank's exposure to these non-core assets.

INTERNATIONAL RECOGNITION

I would also like to note that our achievements in 2009 have been recognized by leading financial publications. Bank of Georgia was named the Bank of the Year by *The Banker* for the fifth consecutive year, The Best Bank in Georgia by *Global Finance* for the third consecutive year and received The Best Bank in Georgia Award for Excellence from *Euromoney* for the fourth consecutive time.



SUMMING UP The 2009 results reflect a tough operating environment during the economic downturn and Bank of Georgia's ability to realign its business to the challenges presented. We have ended the year with most of the critical elements for success in place – strong capital and liquidity, respected brand, scale, superior distribution network, large and growing client base, world-class Supervisory Board, high-caliber management team and last but not least, professional and dedicated staff. I am privileged to have the opportunity to lead our business through the challenges and, I am confident, remarkable achievements that lie ahead.

OUR PRIORITIES IN 2010

2010 started with the positive signs of the improving operating environment. The preliminary data for Q1 2010 for Georgia are quite encouraging. VAT collections, the indicator closely correlated with GDP growth, increased by 15% year on year and tax revenues rose 13% year on year. Trade balance deficit in the first two months in 2010 decreased by 19% year on year, as a result of the increase of exports by 10% and the decline of imports by 2%, compared to the same period in 2009. End of period inflation rose to 5.8% in the first quarter, up from 3.0% in 2009, indicating increased economic activity in the country. These first macro indicators give us reason to believe that Georgia's 2010 real GDP growth rate is likely to exceed 2%, as estimated by IMF. Only couple of weeks ago, S&P raised Georgia's sovereign rating from 'B' to 'B+', an upgrade that reflects the strengthening of economic structure of the country relative to peers and its growth prospects. We are confident that Georgia with its liberal economic system and low corruption level has a competitive advantage in the region and is strongly positioned to embark on rapid, long-term sustainable growth.

Based on the most conservative growth assumptions for Georgia's economy, we are targeting 2010 Net Income of GEL 72 million, as announced in November 2009. Our assumptions are subject to the 2% real GDP growth, moderate inflation rate of 3.2%, exchange rate stability and sustained geopolitical stability in the region in 2010.

In 2010 our strategic priorities are clear. One of our biggest challenges remains the loan book growth, the task that we will be focusing on relentlessly during the year. We will continue to grow retail business through differentiated products and services to target different retail segment with particular emphasis on mass affluent segment. The exclusive right for AmEx card issuance gives Bank of Georgia competitive advantage for penetrating the mass affluent segment and our superior retail banking franchise positions us strongly to benefit from the expected growth of retail lending in Georgia, which currently is estimated to be as low as 8% of GDP.

On the back of deleveraging in 2009, we expect the lending to the corporate sector to pick up in 2010, the process we already observe in the first few months of the year. In the corporate sector in Georgia we see opportunities in underleveraged utility sector (circa 9% loans to sector GDP), healthcare sector, which is currently under privatization and will need funding for growth (circa 2% to sector GDP), food processing and agribusiness that are expected to substitute imports in this segment and Hydropower sector, which is gearing for exports to Turkey. We will also be putting emphasis on the SME sector, where we have the lowest market share at about 15%.

We have every intention to build on the success of our wealth management business abroad and intend to expand wealth management business even further by building presence in developed countries.

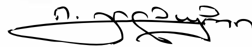
Cost containment is another most important challenge, especially during the

time of growth. Our investments in technology, described in detail earlier, are expected to increase our operational efficiency and improve service for our clients.

In December 2009, we announced our intention to resume distribution of dividends, subject to achieving 2010 financial targets outlined above. We intend to recommend GEL 0.30 dividend per share payable in 2011 in respect to 2010 financial year performance. Our first priority, as always, is to invest our capital in organic growth and when makes sense to make valuable acquisitions. The new dividend policy is a mechanism aimed to further increase our capital management discipline as we embark upon the growth at the right price.

Irakli Gilauri

Chief Executive Officer



MANAGEMENT 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 OVERVIEW

Bank of Georgia reported 2009 Net loss of GEL 98.9 million and total Net operating income (Revenue)[1] of GEL 297.6 million, compared with Net income of GEL 174 thousand and total Net operating income of GEL 335.7 million in 2008. The Net loss for the year was primarily a result of a high Impairment charge on Loans to customers of GEL 118.9 million and Goodwill impairment charge of GEL 73.1 million, predominantly associated with the goodwill write-off of BG Bank, the Bank's subsidiary in Ukraine. All of the goodwill associated with BG Bank has been written off.

REVENUE

Revenue of GEL 297.6 million was down GEL 38.1 million, or 11.4%, compared to the prior year. The decline resulted from the challenging business environment in the first half of 2009.

REVENUE DISTRIBUTION BY ITEM

GEL thousands	**2008**	**2009**	**Change**
Interest income			
Loans to customers	*363,013*	*361,176*	*-0.5%*
Finance lease receivables	*7,010*	*5,844*	*-16.6%*
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%*
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%
Net fee & commission income	49,969	55,025	10.1%
Net gains (losses) from trading securities	(5,447)	2,763	NMF
Net gains from investment securities available-for-sale	513	174	-66.1%
Net losses from derivative financial instruments	-	(6,266)	NMF
Net losses from revaluation of investment properties	(389)	(4,087)	NMF
Net gains from foreign currencies	47,134	28,766	-39.0%
Net insurance revenue	9,016	15,375	70.5%
Share of loss of associates	(713)	(2,649)	NMF
Other operating income	14,747	17,908	21.4%
Total Revenue	**335,670**	**297,550**	**-11.4%**

[1] *Revenue equals sum of Net interest income, Net fee and commission income and Other non-interest income less Net insurance claims incurred*

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 deposits (Amounts due to customers) and the increase in effective average interest rates on deposits in 2009 compared to 2008.

In 2009 all Interest income items contributed to the decline of total Interest income. Despite of 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*** below).

Interest income on Bank of Georgia's securities portfolio (interest income from 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 daily 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 interbank deposits, short-term interbank loans and Obligatory reserves with the central banks. Obligatory reserves with the central banks increased from GEL 57.9 million in 2008 to GEL 62.3 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 the record high level of GEL 1,272.5 million at 31 December 2009. Effective average interest rate paid on customer account balances was 8.3% in 2009 and 6.7% 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 8.4% in 2009.

AVERAGE INTEREST EARNING ASSETS AND AVERAGE INTEREST BEARING LIABILITIES[3]

GEL thousands	2008	2009	Change
Average amounts due from credit institutions	224,158	324,819	44.9%
Average loans to customers and finance lease receivables, net	1,965,982	1,754,691	-10.7%
- Average loans to customers, gross	*2,037,977*	*1,912,278*	*-6.2%*
Average investment securities[4]	124,776	95,592	-23.4%
Average interest earning assets	**2,314,917**	**2,175,102**	**-6.0%**
Average amounts due to customers	1,256,082	1,138,276	-9.4%
Average amounts due to credit institutions	1,010,814	1,055,986	4.5%
Average other liabilities - debt securities issued	7,504	159	-97.9%
Average interest bearing liabilities	**2,274,400**	**2,194,421**	**-3.5%**

Despite the loan book contraction and high liquidity in the second half of the year, Bank of Georgia's Net Interest Margin (NIM)[5] stood at healthy 9.2% in 2009 (compared to 9.3% in 2008).

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

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 mostly owned by the Bank through its subsidiaries 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 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.

EXPENSES[6] AND IMPAIRMENT CHARGE ON LOANS TO CUSTOMERS

GEL thousands	2008	2009	Change
Depreciation, amortization and impairment	20,532	101,700	395.3%
Salaries and other employee benefits	108,767	100,505	-7.6%
General and administrative expenses	68,649	57,339	-16.5%
Impairment charge on other assets and provisions	4,551	6,431	41.3%
Other operating expenses	9,828	11,740	19.5%
Total Expenses	**212,327**	**277,715**	**30.8%**
Impairment charge on loans to customers	122,812	118,882	-3.2%
Impairment charge on finance lease receivables	1,335	6,859	413.8%
Total Impairment charge	**124,147**	**125,741**	**1.3%**

In 2009 Salaries and other employee benefits decreased by 7.6% from 2008 to GEL 110.5 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 4,979 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 36.2% of the Expenses (compared to 51.2% in 2008).

General and administrative expenses declined by 16.5% to GEL 57.3 million and comprised of expenses for occupancy and rent, marketing and advertisement, legal and other professional services, communications, repairs and maintenance, operating taxes, security, office supplies, travel expenses, corporate hospitality and entertainment, banking services, penalties, insurance, personnel training and recruitment and other General and administrative expenses.

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 30.8% increase of the Bank's Expenses to GEL 277.7 million in 2009 (compared to 65.9% 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 devaluation of BG Bank property amounted to GEL 3.2 million. The Bank's charge for depreciation of property increased by GEL 3.6 million, or 19%, 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% to GEL 2.9 million, mostly due to American Express license acquired by the Bank in Decem-

[2] *Cost of funds calculation is based on monthly average balance in 2009 and 2008*

[3] *Average interest earning assets and Average interest bearing liabilities are based on monthly balances*

[4] *Includes held-to-maturity investment securities as well as Ministry of Finance treasury bills*

[5] *NIM calculations is based on monthly average balance in 2009 and 2008*

[6] *Expenses (Costs) comprise of Other non-interest expense less Insurance claims incurred*

ber 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.

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 40.8 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.

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.

BALANCE SHEET HIGHLIGHTS

ASSETS

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 11.6% of Total assets, decreased by 15.1% to GEL 337.4 million in 2009, mostly a result of the decrease in the Time deposits with credit institutions up to 90 days. The average liquidity ratio, based on the NBG standards, was 36.5% in 2009, compared to 31.4% 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 bonds in the aggregate value of GEL 3.8 million. In 2009, the Bank disposed of Corporate shares in the aggregate amount of GEL 8.3 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. The majority of lending was accounted for by commercial loans in 2009.

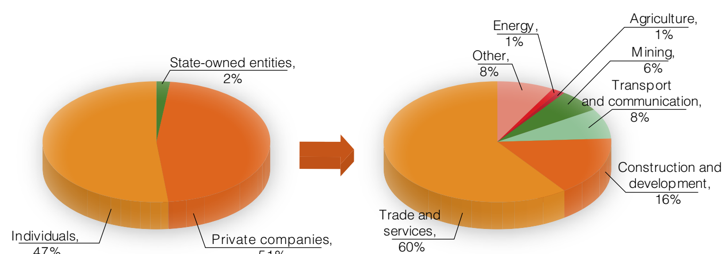
GROSS LOANS

GEL thousands	2008	2009	Change
Commercial loans	1,044,959	939,814	-10.1%
Residential mortgage loans	391,606	387,415	-1.1%
Consumer loans	496,197	332,537	-33.0%
Micro loans	151,313	99,981	-33.9%
Gold – pawn loans	46,374	62,829	35.5%
Others	15,174	5,241	-65.5%
Loans to customers, gross	**2,145,623**	**1,827,817**	**-14.8%**
Less – Allowance for loan impairment	(106,601)	(166,486)	5.0%
Loans to customers, net	**2,039,022**	**1,661,331**	**-9.1%**

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, accounted for 51.1% of total gross loan book at year end. 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.

GROSS LOANS BY CUSTOMER TYPE AND BY SECTOR



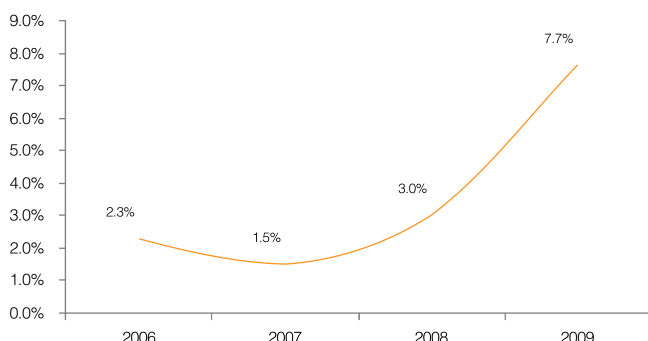
Allowance for the loan impairment increased from the prior year due to an increase in estimated losses predominantly for consumer loans, due to the weakening of economic environment. As a result, the Allowance for the loan impairment amounted to GEL 166.5 million, compared to GEL 106.6 million in 2008.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

ALLOWANCE FOR LOAN IMPAIRMENT

GEL thousands	2008	2009	Change
Commercial loans	45,755	82,042	79.3%
Consumer loans	42,153	54,989	30.5%
Residential mortgage loans	7,969	23,490	194.8%
Micro loans	4,921	3,788	-23.0%
Others	5,803	2,177	-62.5%
Total	**106,601**	**166,486**	**56.2%**

As of 31 December 2009 the non-performing loans (NPLs) accounted for 7.7% of total gross loans (NPLs are more than 90 days overdue loans including principal and interest payment).

NPLS/TOTAL GROSS LOANS



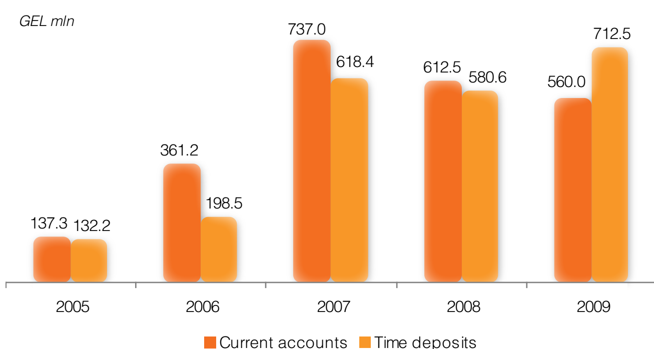
The Bank's loan book remains highly collateralized, with 87.9% of the total volume of gross loans to clients secured by mostly property, inventory and trade receivables for commercial lending and by mortgages over residential properties for individual lending.

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 wholesale debt funding by the Bank during the year.

Amounts due to customers, or deposits, increased by 6.7%, or GEL 79.3 million, to GEL 1,272.5 million in 2009 driven by 28.7% increase in 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 578.9 million, while deposits of State and budget organizations decreased by GEL 14.5 million, or 20.6%, to GEL 55.8 million.

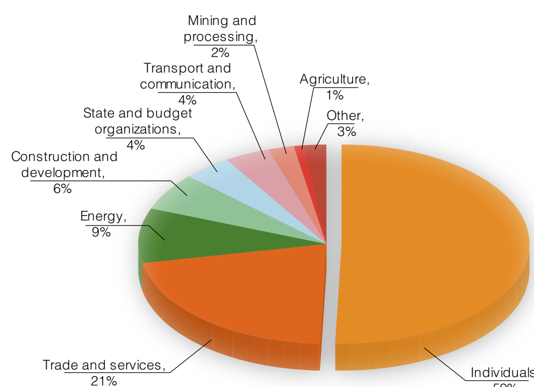
DEPOSITS BY TYPE



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 deposits, down from 27% in 2008.

DEPOSITS BY INDUSTRY



EQUITY

As of 31 December 2008, 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-capitalised position, based on Tier I and Total Capital Ratios (BIS) as of 31 December 2009 and 31 December 2008.

GEL thousands, unless otherwise noted	2008	2009
Ordinary shares	31,253	31,306
Share premium	468,732	478,779
Retained earnings	137,768	38,625
Tier I capital	**637,753**	**548,710**
Undisclosed reserves	56,913	-
General loan loss provisions	32,662	27,302
Revaluation reserves	26,201	24,387
Subordinated term debt	157,535	317,791
Tier II capital	**273,311**	**369,480**
Deductions from capital	(134,238)	(67,454)
Total Capital	**776,826**	**850,736**
Risk weighted assets	2,950,653	2,454,763
Tier I capital adequacy ratio	**21.6%**	**22.4%**
Total capital adequacy ratio	**26.3%**	**34.7%**

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 attribut-

able 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 of 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

31 December, 2009	Share
Bank of New York (Nominees), Limited	88.86%
East Capital Financial Institutions	4.36%
Others (less than 4% individually)	6.78%
Total	**100.00%**

As of 31 December 2009 the members of the Supervisory Board and Management Board owned 612,962 shares of Bank of Georgia. In addition, the members of the Supervisory Board and Management Board and employees were awarded 463,912 and 198,139 GDRs in 2009 and 2008, respectively. The following table depicts the interest of the members of the Supervisory Board and Management Board as of 31 December 2009.

	31-Dec-09
Shareholder	Shares and GDRs held
Irakli Gilauri, Chief Executive Officer (CEO)	214,230
Sulkhan Gvalia, Deputy CEO, Chief Risk Officer	136,049
Nicholas Enukidze, Chairman of the Supervisory Board	122,259
Allan Hirst, Vice Chairman of the Supervisory Board	46,772
Avto Namicheishvili, Deputy CEO, Legal Affairs	29,999
Irakli Burdiladze, Deputy CEO, Chief Operating Officer	23,035
Kakha Kiknavelidze, Member of the Supervisory Board	15,027
Mikheil Gomarteli, Deputy CEO, Retail Banking	9,916
David Morrison, Member of the Supervisory Board	7,342
Giorgi Chiladze, Deputy CEO, Finance	6,333
Total	**612,962**

RISK MANAGEMENT

საქართველოს ბანკი
BANK OF GEORGIA

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 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, 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.

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 is elected 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 Committee supervises and manages the Bank's credit risks i.e. approves individual transactions, establishes credit risk categories and provisioning rates on such transactions. Deputy CEO, Chief Risk Officer and the Credit Risk Management department adopts, in consultation with the Bank's CEO and Deputy CEO, Finance, decisions on the acceleration and write-off of non-performing loans. The Credit Committee is comprised of four tiers of subcommittees.

Subcommittee Chair			Approval limit for CB loans (US$)	Approval limit for RB loans (US$)
		Credit Risk Manager		<150,000
Tier I	New clients		<200,000	
	Existing clients		<500,000	
Tier II		Deputy Director of Credit Risk Management department		150,000-300,000
	New clients		200,001-500,000	
	Existing clients		500,001-1,000,000	
Tier III		Deputy CEO, Chief Risk Officer; Deputy CEO, Retail Banking		300,000-2,000,000
	New clients		500,001-3,000,000	
	Existing clients		1,000,001-3,000,000	
Tier IV		CEO	>3,000,000	>2,000,000
		Supervisory Board	>4,000,000	

During 2009, as a temporary measure, loan applications of borrowers, whose business activities fall within the following sectors: construction, materials, real estate management, auto dealing, electrical products and tourism are submitted for approval to the third and fourth tier subcommittees irrespective of the relevant borrower's total exposure.

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
- Sets ranges of interest rates for different maturities
- Reviews financial reports and indices

ALCO is composed of Chief Executive Officer (CEO), Deputy CEO, Chief Risk Officer, Deputy CEO, Chief Operating Officer, Deputy CEO, Finance, Head of Financial Risk Management, Head of Treasury, Head of Trade Finance and Head of Funding and is chaired by the CEO.

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 imple-

mentation 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.

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 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 geographical 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.

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 with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

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 2009, these ratios were as follows:

	2008, %	2009,%
Average liquidity ratio for the year	31.4%	36.5%
Maximum liquidity ratio	48.6%	45.7%
Minimum liquidity ratio	20.8%	21.9%

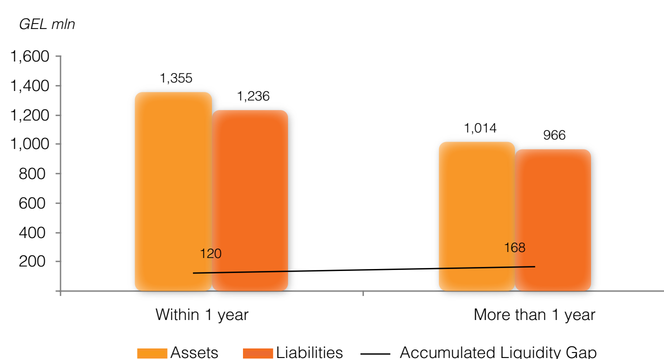
Average liquidity ratio is calculated on a stand- alone basis for JSC Bank of Georgia as annual average of daily liquidity ratios computed as percentage of liquid assets in liabilities determined by National Bank of Georgia as follows:

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 inter-bank 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 or settled 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.

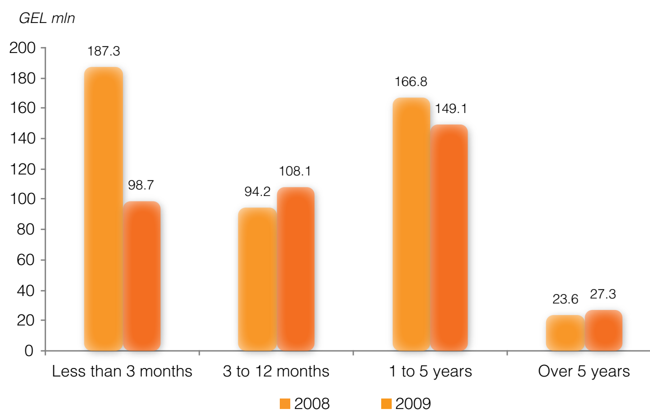
The table below shows the analysis of assets and liabilities according to which they are expected to be recovered and settled as of 31 December 2009. *(For the detailed breakdown of the underlying assets and liabilities as well as the summary of the maturity profile of the financial liabilities, please see the accompanying Notes to the Consolidated Financial Statements)*

ASSETS/LIABILITIES BY MATURITIES, 2009



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.

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 2009, all of Bank of Georgia's funding was unsecured as it was bound by negative pledge commitments to its lenders.

Deposits are a consistent source of funding for Bank of Georgia. As of 31 December 2009, total deposits were GEL 1,272 million, representing 55% of Total Liabilities.

Funding flexibility is also provided by Bank of Georgia's ability to raise wholesale funding from international markets. Borrowings from international credit institutions reached GEL 914 million as of 31 December 2009. During 2009, Bank of Georgia drew down US$ 200 million of the IFC and EBRD financing package. The financing package was comprised of:

IFC financing package of US$100 million, comprised of: US$50 million senior loan at LIBOR +5.5% annual interest rate and maturity of 55 months, US$24 million subordinated loan at LIBOR +10% annual interest rate and with the maturity of 120 months and US$26 million subordinated convertible loan at LIBOR +8% annual interest rate and maturity of 120 months.

EBRD financing package of US$100 million, comprised of: US$ 50 million senior loan at LIBOR +5.5% annual interest rate and maturity of 61 months, US$ 24 million subordinated loan at LIBOR +10% annual interest rate and maturity of 120 months and US$26 million subordinated, convertible loan at LIBOR +8% annual interest rate and maturity of 120 months.

In January 2009 the Bank repaid US$65 million loan facility arranged by Merrill Lynch and in February 2009 the bank repaid US$43.5 million, the second tranche of the syndicated loan received by the Bank in August 2007.

In June 2009 the Bank has completed the settlement of US$140 million Loan Passthrough Notes issued by Rubrika Finance Company Netherlands B.V., (maturing in June 2010) that were puttable to the Bank in June 2009. With this transaction the Bank has largely completed its international wholesale funding repayment obligations until 2012.

WHOLESALE DEBT FUNDING REPAYMENT SCHEDULE

US$ mln, unless otherwise noted	2010	2011	2012
WorldBusiness Capital	1.1	1.1	1.1
WBC (Georgian Leasing Company)	0.7	0.7	0.7
FMO	2.3	2.3	2.3
ADB	16.6	-	-
Eurobonds	-	-	200.0
OPIC	3.2	3.2	3.2
IFC 2013	-	16.7	16.7
EBRD 2014	-	14.3	14.3
Total	**23.9**	**38.2**	**238.2**

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 2009. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2009 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve.

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 2009. *(For the exposure to interest rates as of 31 December 2008, please see the accompanying Note to Consolidated Financial Statements).*

Currency	Increase in basis points	Sensitivity of net interest income	Sensitivity of other comprehensive income
	2009	**2009**	**2009**
EUR	0.10%	2	–
USD	0.10%	186	–
UAH	0.75%	–	52
Currency	**Decrease in basis points**	**Sensitivity of net interest income**	**Sensitivity of other comprehensive income**
	2009	**2009**	**2009**
EUR	-0.10%	(2)	–
USD	-0.10%	(186)	–
UAH	-0.75%	–	(52)

During 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 tables below indicate the currencies to which Bank of Georgia had significant exposure at 31 December 2009 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	Effect on profit before tax	Effect on other comprehensive income
	2009	2009	2009	2008	2008
EUR	12.70%	(3,792)	–	(832)	_
GBP	16.10%	63	–	17	_
RUR	0.30%	(1)	–	(6)	_
UAH	0.30%	–	228	8	_
USD	1.30%	(669)	–	(1,216)	_

During 2009 and 2008 sensitivity analysis did not reveal 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

GEL thousands	Effect on net interest income	Effect on other comprehensive income 2009
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 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).*

GEL thousands, unless otherwise noted	Gross maximum exposure 2009	Gross maximum exposure 2008
Cash and cash equivalents (excluding cash on hand)	182,511	233,128
Amounts due from credit institutions	85,137	99,633
Loans to customers	1,661,331	2,039,022
Finance lease receivables	16,896	41,605
Investment securities:		
– Available-for-sale	19,590	33,737
– Held-to-maturity	249,196	22,845
	2,214,661	**2,469,970**
Financial commitments and contingencies	288,766	352,772
Total credit risk exposure	**2,503,427**	**2,822,742**

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 2009. *(For the credit quality of each class of asset as of 31 December 2008, please see the accompanying Notes to the Consolidated Financial Statements).*

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.

	NEITHER PAST DUE NOR IMPAIRED				
	High grade	Standard grade	Sub-standard grade	Past due or individually impaired	Total
GEL thousands, unless otherwise noted	**2009**	**2009**	**2009**	**2009**	**2009**
Amounts due from credit institutions	84,220	917	-	-	85,137
Loans to customers:					
Corporate lending	447,481	122,983	94,215	275,135	939,814
Consumer lending	227,765	26,748	1,915	76,109	332,537
Residential mortgages	267,593	26,133	9,772	83,917	387,415
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	7,913	11,441	115	4,571	24,040
Investment securities:					
Available-for-sale	6,325	13,265	-	818	20,408
Held-to-maturity	249,196	-	-	-	249,196
	255,521	**13,265**	**-**	**818**	**269,604**
Total	**1,429,325**	**214,214**	**113,253**	**449,806**	**2,206,598**

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, please see the accompanying Notes to the Consolidated Financial Statements).*

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

	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
GEL thousands, unless otherwise noted	**2009**	**2009**	**2009**	**2009**	**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**

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 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

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, please see the accompanying Notes to the Consolidated Financial Statements.)*

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 department is responsible for identification and assessment of operational risk categories with 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 and developing business- process optimization schemes, including document circulation, information streams, distribution of functions, permissions and responsibilities. An operational risk manager, who reports to the Deputy CEO, Chief Risk Officer is responsible for the oversight of the Bank's operational risks.

COMPLIANCE AND INTERNAL CONTROL

The Compliance and Internal Control department is responsible for developing and updating policies and procedures and ensuring that these policies and procedures meet or ex-

	2009		
GEL thousands, unless otherwise noted	**Georgia**	**OECD**	**CIS and other foreign countries**
Assets:			
Cash and cash equivalents	133,888	127,816	75,668
Amounts due from credit institutions	59,964	12,664	12,509
Loans to customers	1,520,174	-	141,157
Finance lease receivables	8,927	-	7,969
Investment securities:			
available-for-sale	13,256	157	6,177
held-to-maturity	249,196	-	-
All other assets	455,769	8,056	80,082
	2,441,174	**148,693**	**323,562**
Liabilities:			
Amounts due to customers	1,024,771	10,375	237,324
Amounts due to credit institutions	20,102	899,651	8,862
All other liabilities	85,588	9,618	18,721
	1,130,461	**919,644**	**264,907**
Net balance sheet position	**1,310,713**	**(770,951)**	**58,655**

ceed applicable legal and regulatory requirements. It is also responsible for monitoring and assessing the levels of the Bank's internal control systems to detect any infringement or errors on the part of the Bank's departments and divisions. Bank of Georgia has procedures and operative documents aimed at preventing money laundering and terrorist financing, including a general anti-money laundering policy and internal control procedures 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 FMS. The FMS was established in 2003 and serves as Georgia's financial intelligence unit. These procedures aim to, among other things, minimize the risk to Bank of Georgia of being used as a vehicle for money laundering or terrorist financing, protect Bank of Georgia 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 is in process of the implementation the new requirements of EU's Third Directive, which requires financial institutions to identify and verify the identity of the customer and its beneficial owner, to monitor transactions of the customer, while taking into account a risked-based approach (RBA) .

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 the risk(s), undertaking an assessment of the risk(s) and developing strategies to manage and mitigate the identified risks.

For this purpose, the bank is working on the appropriate risk-based procedures to determine whether the customer is a PEP (Politically Exposed Person) or other high risk customer.

Anti-money laundering procedures include (i) KYC procedures that require clear identification of clients, verification of their identity and appraisal of risk of their engaging in money laundering and/or terrorist financing, (ii) "know your correspondent bank" procedures that carefully screen the Bank's potential partners with regard to their anti-money laundering policies, and (iii) "know your employee" procedures that ensure prevention of a Bank employee's possible involvement in money laundering and terrorism financing. KYC procedures require clear identification of the beneficial ownership of a transaction. The Bank practices a risk-based approach and therefore enhanced due diligence procedures are implemented if the risk of particular clients engaging in money laundering and/ or terrorist financing is determined to be significant. Bank of Georgia identifies transactions that must be monitored and reported pursuant to Georgian anti-money laundering legislation. Such legislation requires Bank of Georgia to monitor and report suspicious transactions and activity over a certain threshold amount (currently GEL 30,000 or foreign currency equivalent). Bank of Georgia maintains a database containing information on all clients and transactions in which they engage, which facilitates identification of unusual transactions. In addition, Bank of Georgia verifies each client's identity, legal status and authority to engage in particular transactions. Bank of Georgia does not enter into business relationships with clients that refuse to provide sufficient identity and authority information.

The AML Unit is a special designated unit for AML/CFT compliance, chief of unit serving as a Chief AML Officer. The AML Unit is fully independent of all other business functions. Its primary goal is development, periodic review and update of AML policies and procedures and KYC policies and procedures, as well as ensuring strict adherence to all business processes in the Bank to the adopted AML measures. The AML Unit is also responsible for the daily reporting to the FMS in accordance with current legislation, and training of the employees in AML/KYC policies and procedures. Within the scope of the Bank's KYC policies and procedures, the AML Unit conducts due diligence on potential business partners, carefully screens counterparties and the adequacy of their AML capabilities and compliance with FATF/GAFI Recommendations. The AML Unit also monitors client transactions and the activities of all of Bank of Georgia's departments for compliance with applicable Georgian anti-money laundering legislation. Bank of Georgia's other departments notify this department of suspicious transactions, using the criteria set out in the Bank of Georgia's internal anti-money laundering regulations. The AML Unit pays particular attention to transactions involving large sums of money or significant amounts of cash. If monitoring indicates that a client may be engaged in money-laundering or terrorist financing, the level of monitoring of such client is increased. Activities are analyzed on an ongoing basis, which allows detection of money-laundering schemes. If necessary, the AML Unit obtains additional information about a particular transaction's purpose and/ or suspends suspicious transactions.

The AML Unit also provides education and training of personnel regarding Bank of Georgia's anti-money laundering procedures.

The Bank operates special AML software, which meets the industry requirements. The program covers every sanctions lists, as well as debarred and banned individuals and organizations. It allows fully-automated monitoring of all transactions against "black lists".

In addition, Bank of Georgia is implementing the new software for the detection of the transactions, which fall under monitoring, including: a transaction or series of transactions that exceed GEL 30,000 (or its equivalent in any other currency) for both cash and non-cash settlements. The new software is also designed to transactions that are suspicious according to the law of Georgia on Facilitating the Prevention of Illicit Income Legalization, which are sophisticated transactions, that need detailed analysis for the detection of possible legal, reputational risks associated with ML and TF.

The bank is obliged to notify the Financial Monitoring Service of Georgia by means of special form of report on the transactions, which are subject to monitoring. The reports are filled in manually by the AML Department. Bank of Georgia is in process of implementing the new tool for filling in the mentioned reports automatically.

RISKS AND UNCERTAINTIES

სააქართველოს ბანკი
BANK OF GEORGIA

The following discussion sets forth certain risks and uncertainties that Bank of Georgia believes are material. If any of these 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 currently is 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

Emerging markets are subject to greater risk than more developed markets, including in some cases significant political, economic and legal risks. In addition to its principal banking operations in Georgia, the Bank has business operations and assets in Ukraine and Belarus. 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.

RISKS RELATING TO THE BANK'S BUSINESS

VOLATILITY OF THE FINANCIAL MARKETS

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 to a degree unprecedented in recent history 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 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 Bank's principal markets of Georgia, Ukraine and Belarus (the "**Principal Markets**") may exacerbate the impact of these difficult market conditions on the Bank and other financial institutions and could have an adverse effect on the Bank's business, financial condition, results of operations and prospects.

LOAN PORTFOLIO GROWTH

In response to the increased volatility of the financial markets globally and in Georgia, the Bank implemented a conservative liquidity management policy in 2008, which resulted in a 14.8% decline in the the Bank's gross loan portfolio from GEL 1,827.8 million in 2009 from GEL 2,145.6 in 2008.

The latest data published by the National Statistics Office of Georgia (the "**National Statistics Office**") shows that the Georgian economy bottomed out in the second half of 2009, as GDP rose in both quarters. The Bank's expectations of continued stabilisation and economic recovery during 2010 are based on the following observations:

- Standard & Poor's increase in the long-term sovereign rating of Georgia from 'B' to 'B+';
- Sector-wide deposit inflow;
- The Value Added Tax (VAT) revenue, which is highly sensitive to GDP growth, grew by 15% year on year in Q1 2010 while overall tax revenue collection was up 13% year on year in Q1 2010, according to the preliminary data published by the Government of Georgia;
- FDI grew by 13% in 2H 2009 compared to 1H 2009 according to the National Statistics Office; and
- Trade balance deficit in the first two months in 2010 decreased by 19 % year on year, as a result of the increase of exports by 10% and the decline of imports by 2%, compared to the same period last year, according to the National Statistics Office.

As global and local conditions continue to improve, the Bank intends to continue to accelerate its lending activity as well as adjust its credit risk management policies and procedures.

The management of the Bank's growth will require, among other things, continued development of the Bank's financial and information management system, successful imple-

menation of its new information systems such as new core banking system, a loan origination system for the Bank and its banking subsidiaries and talent management system and the ability to manage risk and business processes.

If the Bank fails to grow its loan portfolio and properly manage the growth, such failure may have material adverse effect on its business, financial condition, results of operations or prospects.

DEPENDENCE ON BANKING AND OTHER LICENSES

Bank of Georgia is subject to banking regulations and requirements in Georgia, which have been adopted by the Georgian Parliament and the National Bank of Georgia ("**NBG**").

All banking operations and various related operations in Georgia require a general banking licence from the NBG. In addition, the NBG requires Georgian banks to comply with mandatory financial ratios, minimum reserve requirements and regularly file periodic reports. Georgian authorities, including the NBG, have the right to, and do, conduct periodic inspections of Bank of Georgia's operations throughout each year. The NBG may attach certain conditions/limitations to or revoke the general banking licence of Bank of Georgia if it concludes that the Bank has violated the applicable banking regulations.

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 Bank of Georgia or failure to obtain any further required licences in the future could have a material adverse effect on Bank of Georgia'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 will lead to Bank of Georgia's liquidation.

To the extent the Bank expands its international operations further, it will be exposed to additional risks in other countries. Any failure to manage such risks may cause the Bank to incur increased liabilities in respect to such operations.

GEOGRAPHICAL DIVERSIFICATION

In accordance with its strategy, the Bank has made investments into countries of 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. To the extent the Bank expands its international operations further, it will be exposed to additional risks. Any failure to manage such risks may cause the Bank to incur increased liabilities in respect of such operations.

LIQUIDITY RISKS

The Bank depends upon its ability to access financial resources whenever required to meet its obligations. To this end, the Bank's liquidity is managed through maintenance of a funding base comprising core retail and corporate customer deposits, sales and purchases of securities, interbank borrowing and lending, borrowing from the central banks in the Principal Markets, borrowing from international financial institutions, issuing debt securities and cash flow.

The extreme market conditions facing the financial services industry have been reflected in the shortages of liquidity, lack of funding, pressure on capital and extreme price volatility across a wide range of asset classes. The extreme market conditions and economic downturn resulted in a reduction of deposits in the banking systems in the Principal Markets in the first half of 2009. Although the Bank and the financial services industry in Georgia experienced a deposit inflow in the second half of 2009 and continues to see an increase in customer deposits, unanticipated decreases in customer deposits and/or unexpected withdrawals of deposits may result in liquidity gaps.

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.

Any difficulties experienced by the Bank in accessing the international and Georgian debt markets 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 may, together, or separately, have a material adverse effect on the Bank's business, financial condition, results of operations and prospects.

EXPOSURE TO CREDIT RISK OF CORPORATE AND RETAIL CLIENTS

The Bank is exposed to credit risks of corporate and retail clients in the Principal Markets. 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 began to improve in 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 his-

tories. 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 accurately determine 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.

The majority of loans to customers are denominated in U.S. Dollars or Euro. A customer's ability to repay such loans may be impaired due to the devaluation of the Lari, if such customer's principal income is predominantly in Lari. While the substantial majority 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 a material adverse effect on the Bank's financial performance and results of operations.

ALLOWANCE FOR IMPAIRMENT LOSS RISK

As of 31 December 2009, the Bank's net allowance for impairment losses on loans to customers was GEL 116.5 million and the ratio of the Bank's allowance for impairment losses to total gross loans to customers was 9.1%. 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 judgement of Management, is adequate to provide for losses incurred. Provisions are made as a result of an individual appraisal of financial assets. If the impairment allowances prove to be inadequate, this may have a material adverse effect on the Bank's business, financial condition, results of operations and prospects.

ENFORCEMENT OF SECURITY

The Bank enters into security and/or guarantee arrangements for 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 in the Bank's business, financial condition, results of operations and prospects.

FOREIGN EXCHANGE AND CURRENCY RISK

The Bank is exposed to the effects of fluctuation in the prevailing foreign currency exchange rates on its financial position. Approximately 20% of the Bank's liabilities are denominated in GEL, while approximately 44% of its assets are denominated in GEL. Assets associated with operations in Ukraine and Belarus are denominated predominantly in hryvnia and Belarus roubles, respectively. The Bank translates such assets and liabilities, as well as interest earned or paid on such assets and liabilities, and gains/(losses) realised upon the sale of such assets, into Lari when preparing its financial statements. As a result, the Bank's reported income is affected by changes in the value of the Lari with respect to such foreign currencies. The overall effect of exchange rate movements on the Bank's results of operations depends upon the rate of depreciation or appreciation of the Lari against its principal trading and financing currencies.

Partly in response to the increased demand for foreign currencies during the months following the armed conflict between Georgia and Russian that broke out in August 2008 (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 17% at the beginning of November 2008. In 2009, the Lari stabilised and depreciated by 1.1%, as compared to 4.7% in 2008. Any significant depreciation of Lari can result in foreign exchange losses at the subsidiary level as well as a deterioration in Bank of Georgia's capital adequacy ratios. The ability of the Government and the NBG to limit any further depreciation of the Lari will depend on a number of political and economic factors, including the Government's ability to control inflation, the availability of foreign currency reserves and FDI inflows. Annual inflation rates in Georgia (as measured by the end-of-period Consumer Price Index (the "**CPI**") for 2006, 2007, 2008 and 2009 (estimate) were 8.8%, 11.0%, 5.5%, and 3.0% respectively, according to the information provided by the National Statistics Office.

Any additional depreciation of the Lari 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.

INTEREST RATE RISK

The Bank is also exposed to risks resulting from mismatches between the interest rates on its interest-bearing liabilities and interest-earning assets. While the Bank monitors interest rates with respect to its assets and liabilities, and believes that its interest margin is sufficient to absorb movements in interest rates, to the extent the Bank is unable to pass on increases in interest rates to its customers, interest rate movements my ad-

versely affect the Bank's financial position. The Bank's results of operations largely depend 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 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.

RISKS ASSOCIATED WITH COST-CONTROL MEASURES AND PLANNED DISPOSALS

The Bank implemented a cost control programme as one of the Bank's strategic priorities for 2009 and will continue to do so in 2010. As part of this strategy, the Bank intends to close certain branches in Georgia and Ukraine, optimise its staff in the Principal Markets as well as focus on operational efficiencies and improvement of delivery channels. In the event that planned 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.

The Bank also plans to continue to dispose of certain non-core and non-performing assets over the next two to three years. 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 Georgia. 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 disposals are delayed, not consummated or result in unforeseen liabilities, this could have a material adverse effect on the Bank's financial condition and prospects.

COMPETITION

In Georgia, the Bank principally competes with TBC Bank, VTB Bank Georgia, ProCredit Bank, Cartu Bank, Bank Republic and HSBC. In Ukraine and Belarus, the Bank competes with a wide range of local and international banks.

In the near future, the Bank expects increased competition for lending in particular. If the Bank is unable to continue to compete successfully in the Principal Markets 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.

TECHNOLOGICAL RISKS

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 commenced the implementation of a new core banking system in Georgia, a loan origination system for the Bank and its banking subsidiaries and has largely completed the deployment of a talent management system. However, there can be no assurance that the new systems will be implemented and integrated 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.

RESTRICTIVE COVENANTS

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 the 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 prohibit, 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 certain of these covenants. While Bank of Georgia and its subsidiaries have obtained waivers from the relevant lenders in respect of its past breaches when they took place, there can be no assurance that 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 would 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.

DEPENDENCE ON 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 RELATED TO GEORGIA AND THE OTHER PRINCIPAL MARKETS

POLITICAL RISK

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 this decade. 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.

On 7 November 2007, after five days of demonstrations blocking the main avenue outside the Parliament, riot police broke up the protests and a two-week state of emergency banning all privately-owned broadcast media and public gatherings was imposed. On 8 November 2007, President Saakashvili announced that early presidential elections would be held on 5 January 2008, thereby reducing his constitutional term by a year, and that a plebiscite would be held on rescheduling parliamentary elections for spring 2008. President Saakashvili was re-elected on 5 January 2008 with 53.5% of the vote and the 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".

In April 2009, the Georgian opposition renewed protests demanding President Saakashvili's resignation, which culminated in large-scale public demonstrations.

In July 2009, President Saakashvili, in his speech addressed to the Parliament of Georgia, proposed moving the date of local elections in Georgia forward to 30 May 2010, instead of the originally planned date in the autumn of 2010 as well as electing the Tbilisi Mayor directly by popular vote. Such proposals were subsequently adopted by the Parliament of Georgia. In addition, the Parliament of Georgia increased the number of members of the Tbilisi City Council to 50 and made certain other changes to the election code.

There can be no assurance that the Government will be able to maintain political and civil stability or that reform and economic growth will not be hindered as a result of the political disruptions. Any adverse changes in the political climate in Georgia, in particular any such changes affecting the stability of the Government or involving a rejection or reversal of its current reform policies, could adversely affect the Bank or the price of the Bank's securities.

REGIONAL TENSIONS

Since the restoration of its independence in 1991, Georgia has had ongoing disputes with local separatists in Abkhazia and South Ossetia. Moreover, relations with Russia have been continuously strained, primarily due to Russia's involvement in the unresolved disputes in Abkhazia and South Ossetia. From March 2008 until July 2008, a series of actions, including Russia's unilateral withdrawal from a 1996 CIS treaty banning trade and certain other economic links with Abkhazia, statements by the Russian State Duma calling on the Russian government to consider the expediency of recognising Abkhazia and South Ossetia, statements by the Russian President promising to increase Russian support for Abkhazia and South Ossetia if Georgia was awarded a North Atlantic Treaty Organization ("**NATO**") Membership Action Plan and Russia's deployment of extra peacekeeping troops to Abkhazia, resulted in the further deterioration of Russian-Georgian political relations.

There were reports of periodic exchanges of fire between the South Ossetian militia and Georgian troops throughout June and July 2008. Clashes between them in early August led to deaths on both sides and each of the South Ossetian militia and Georgian troops accused the other of opening fire first. During the first week of August, fighting intensified and on 7 August, President Saakashvili ordered a unilateral ceasefire. According to the Georgian military, fighting intensified despite the unilateral ceasefire and Georgian villages were shelled. Georgia responded by launching military operations against the break-away region of South Ossetia, in which Russian peacekeeping troops were stationed.

In August 2008, Russian tanks entered South Ossetia and occupied the region. In five days of fighting, Georgian forces were ousted from both South Ossetia and Upper Abkhazia and the Russian military took up positions inside Georgia. On 10 August 2008, Georgia ordered a ceasefire in South Ossetia and offered to hold peace talks with Moscow, which offer was declined by Russia. Over the following few days, Russia sent warships to land ground troops in Abkhazia and continuously bombed targets throughout the territory of Georgia, including the vicinity of Tbilisi Airport.

After mediation by the Euopean Union, the parties reached a preliminary ceasefire agreement on 12 August, signed by

Georgia and Russia by 16 August, the terms of which called for the prohibition of force, cessation of all military action, full withdrawal of Russian troops to pre-Conflict positions and free access to humanitarian aid. On 26 August 2008, Russia formally recognised the independence of South Ossetia and Abkhazia. On 29 August 2008, Georgia severed direct diplomatic relations with Russia and currently conducts humanitarian discussions via special interest sections at the Swiss Embassy.

Despite the terms of the ceasefire agreement, Russian forces maintained positions at new checkpoints on the territory of Georgia outside South Ossetia and Abkhazia. In October 2008, Russian troops withdrew from new checkpoints within Georgia, although they remain stationed in South Ossetia and Abkhazia, including in areas under Georgian control before the Conflict. Furthermore, Russia has announced its intention to station 7,600 troops in South Ossetia and 3,800 in Abkhazia, many of whom would be stationed in post-Conflict positions, which Georgia considers a violation of the 12 August ceasefire agreement.

As a result of the Conflict, Russia faced strong criticism from certain Western countries, including the United States, the United Kingdom, Poland, Sweden, the Baltic states and other EU countries. The unilateral recognition of both South Ossetia and Abkhazia by Russia was met by condemnation from NATO, the UN Secretary General, the OSCE Chairman, the Presidency of the Council of the European Union and the European Commission.

In January 2009, the United States and Georgia signed a Charter on Strategic Partnership, which is based on the principles of strategic cooperation between the two states and support for the sovereignty, independence, territorial integrity, inviolability of borders and the strengthening of democracy and stability.

Any further attempt by the Russian government to provide arms, munitions or other military assistance to the separatists in South Ossetia and/or Abkhazia, to challenge the territorial integrity of Georgia or otherwise to materially intervene in Georgia's internal affairs could increase political uncertainty, create instability and potentially lead to hostilities, all of which would have a detrimental impact on the Georgian economy and in turn an adverse effect on the Bank's business, financial position, results of operations and prospects.

ECONOMIC INSTABILITY

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 global financial crisis have affected Georgia through economic slowdown, as well as a decrease in exports and private capital inflows. Based on preliminary statistics provided by the National Statistics Office, real GDP declined by 3.9% from 2008 to 2009 as compared to year on year growth of 2.1% from 2007 to 2008. Foreign direct investment ("**FDI**"), in 2009 decreased to U.S. Dollar 759.1 million from U.S.1,564.0 million in to 2008, according to the preliminary data published by National Statistics Office. Furthermore, in the wake of the global financial crisis, the Lari has depreciated by 17% 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. Although the foreign exchange market stabilised and a portion of donor pledges ("discussed in "Dependence on Donor Pledges" below) 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 further.

Further 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 and could negatively affect the Bank's business, results of operations, financial condition and prospects.

DEPENDENCE ON DONOR PLEDGES

On 22 October 2008, the European Commission and World Bank sponsored a Georgia donor's conference in Brussels in order to rally support for Georgia in the wake of the Conflict . At the conference, a total of over US$4.5 billion was pledged to Georgia by the European Community, EU Member States, the United States, Japan, the EBRD, EIB, ADB, World Bank and IFC, among others, with disbursements to be made through 2010. The Georgian banking sector was specifically allocated over US$852 million from total pledges. As of the end of 2009, Georgia has entered into contracutal commitment for and/or received approximately US$3.0 billion for public and private sector operations and is expected to receive 90% of the total pledged amount by the end of 2010, with a possiblity of further upward adjustment.

The donor money is intended to help stabilise the Georgian economy and in particular, provide funding to the Georgian banking sector. 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, which could adversely affect the Georgian economy as a whole and thus the Bank's business.

CURRENCY REGULATION

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 2009, the total volume of trading turnover in the Lari-

U.S. Dollar market amounted to U.S.$416.9 million billion. The exchange rate of the Lari against the U.S. Dollar is fixed at the Tbilisi Interbank Foreign Exchange, which is used to determine the official exchange rate of the Lari against foreign currencies. According to the NBG, the NBG had in excess of U.S.$ 2.1 billion worth of currency reserves as at 31 December 2009. 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 Bank's business and the businesses of its corporate clients, and in turn, the Bank's business, results of operations, financial condition and prospects.

DEVELOPING LEGAL SYSTEMS

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 become effective. Furthermore, continual and 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 enforcement of court judgments can, in practice, be difficult in Georgia. The uncertainties of the Georgian judicial system 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.

RISKS RELATED TO MONEY LAUNDERING AND/OR TERRORIST FINANCING

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 the Bank and/or its financial subsidiaries in the future fail 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 TAX SYSTEMS

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. 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

A range of ministries and institutions, including the National Statistics Office, the Ministry of Finance, the NBG and the Ministry of Economic Development, produce statistics relating to Georgia and its economy. Georgia adheres to the 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 obtainable from other sources, but the underlying assumptions, methodology and, consequently, the resulting data may vary from source to source.

POSSIBLE NON-ENFORCEABILITY OF FOREIGN JUDGMENTS AND ARBITRAL AWARDS

Bank of Georgia is incorporated under the laws of Georgia and most of its assets are located in Georgia. In addition, most of Bank of Georgia's management and executive officers reside or are located outside of the United Kingdom. As a result, it may not be possible for investors to effect service of process upon Bank of Georgia or its management or executive officers. There is a risk that a lawsuit concerning an agreement governed by English law cannot be brought in an original action in Georgia and that a judgment of the English courts will not be enforced in Georgia under certain circumstances.

Generally, foreign court judgments are recognised and enforceable in Georgia unless there is a pending case on the same matter in Georgian courts, the courts of the country rendering the judgment do not recognise the judgments of Georgian courts, the judgment contradicts basic legal principles of Georgia, or one of several other conditions is not satisfied. No treaty exists between Georgia and most Western jurisdictions (including the United Kingdom and the United States) for the

reciprocal enforcement of foreign court judgments, which may require new proceedings to be brought in Georgia in respect of a judgment already obtained in any such jurisdiction against Bank of Georgia or its directors or executive officers. In addition, Georgian courts have limited experience in the enforcement of foreign court judgments. 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, may significantly delay the enforcement of any such judgment, or potentially deprive an interested party of effective legal recourse for claims.

Holders of GDRs may enforce their rights by arbitration. Georgia is a party to the New York Convention. Therefore, an arbitral 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, compliance with the Law of Georgia on Arbitration, the Georgian civil procedure regulations and other procedures, and requirements established by Georgian legislation. However, it may be difficult in practice 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, official and unofficial political resistance to enforcement of awards against Georgian companies in favour of foreign investors and Georgian courts' inability to enforce such orders, thereby introducing delay and unpredictability into the process of enforcing any foreign judgment or any foreign arbitral award in Georgia.

Furthermore, any arbitral award made pursuant to arbitration proceedings in accordance with the Rules of the LCIA and the application of foreign law to the Deposit Agreement and GDRs may be limited by the mandatory provisions of Georgian laws, including those relating to the exclusive jurisdiction of Georgian courts and the application of Georgian laws with respect to bankruptcy, rehabilitation, temporary administration or liquidation of Georgian companies and credit organisations in particular.

VOLATILITY OF THE TRADING MARKET

The market for Bank of Georgia securities will be influenced by economic and market conditions in Georgia and, to varying degrees, interest rates, currency exchange rates and inflation rates in other countries, such as the United States, the Member States of the EU and elsewhere. There can be no assurance that an active trading market for Bank of Georgia securities will develop further, or, if one does develop, that events in Georgia, in the CIS or elsewhere will not cause market volatility or that such volatility will not adversely affect the liquidity or the price of Bank of Georgia securities or that economic and market conditions will not have any other adverse effect.

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.

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 MANAGEMENT BOARD

საქართველოს ბანკი
BANK OF GEORGIA

Ian Hague,
Member of the Supervisory Board

Allan Hirst,
Vice Chairman of the Supervisory Board

Nicholas Enukidze,
Chairman of the Supervisory Board

David Morrison
Member of the Supervisory Board

Kaha Kiknavelidze,
Member of the Supervisory Board

Jyrki Talvitie,
Member of the Supervisory Board

SUPERVISORY BOARD

George Chiladze,
Deputy Chief Executive Officer,
Finance

Irakli Gilauri,
Chief Executive Officer

Irakli Burdiladze,
Deputy Chief Executive Officer,
Chief Operating Officer

Mikheil Gomarteli,
Deputy Chief Executive Officer,
Retail Banking

MANAGEMENT BOARD

Avto Namicheishvili,
Deputy Chief Executive Officer,
Legal Affairs

Archil Gachechiladze
Deputy Chief Executive Officer,
Corporate Banking

Sulkhan Gvalia,
Deputy Chief Executive Officer,
Chief Risk Officer

MANAGEMENT BOARD

JSC BANK OF GEORGIA AND SUBSIDIARIES CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2009 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 statement of financial position as at 31 December 2009, and the consolidated income statement, consolidated statement of comprehensive income, of changes in equity and of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

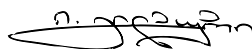
15 March 2010

ERNST & YOUNG LLC

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
As at 31 December 2009
(Thousands of Georgian Lari)

	Notes	2009	2008
Assets			
Cash and cash equivalents	7	337,372	397,591
Amounts due from credit institutions	8	85,137	99,633
Loans to customers	9	1,661,331	2,039,022
Finance lease receivables	10	16,896	41,605
Investment securities:			
– available-for-sale	11	19,590	33,737
– held-to-maturity	11	249,196	22,845
Investments in associates	12	10,323	16,716
Investment properties	13	79,509	47,289
Property and equipment	14	278,729	301,784
Goodwill and other intangible assets	15	85,442	152,459
Current income tax assets	16	7,997	8,095
Deferred income tax assets	16	15,487	4,691
Prepayments		18,140	18,319
Other assets	18	48,280	75,121
Total assets		**2,913,429**	**3,258,907**
Liabilities			
Amounts due to customers	20	1,272,470	1,193,124
Amounts due to credit institutions	19	928,615	1,216,722
Current income tax liabilities	16	574	779
Deferred income tax liabilities	16	24,661	23,615
Provisions	17,22	2,126	4,263
Other liabilities	18	86,566	101,555
Total liabilities		**2,315,012**	**2,540,058**
Equity	21		
Share capital		31,306	31,253
Additional paid-in capital		478,779	468,732
Treasury shares		(1,677)	(2,018)
Other reserves		24,387	26,201
Retained earnings		46,163	141,491
Total equity attributable to shareholders of the Bank		**578,958**	**665,659**
Minority interest		19,459	53,190
Total equity		**598,417**	**718,849**
Total liabilities and equity		**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

15 March 2010

The accompanying notes on pages 6 to 73 are an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT
For the year ended 31 December 2009
(Thousands of Georgian Lari)

	Notes	2009	2008
Interest income			
Loans to customers		361,176	363,013
Finance lease receivables		5,844	7,010
Investment securities – held-to-maturity		5,725	16,457
Amounts due from credit institutions		5,037	10,732
Investment securities – available-for-sale		1,276	6,727
		379,058	**403,939**
Interest expense			
Amounts due to customers		(96,749)	(85,358)
Amounts due to credit institutions		(91,582)	(97,035)
Debt securities issued		(186)	(706)
		(188,517)	**(183,099)**
Net interest income before impairment charge on interest-earning assets		**190,541**	**220,840**
Impairment charge on loans to customers	9	(118,882)	(122,812)
Impairment charge on finance lease receivables	10	(6,859)	(1,335)
Net interest income after impairment charge		**64,800**	**96,693**
Fee and commission income		64,599	63,503
Fee and commission expense		(9,574)	(13,534)
Net fee and commission income	23	**55,025**	**49,969**
Net gains (losses) from for trading securities		2,763	(5,447)
Net gains from investment securities available-for-sale		174	513
Net losses from derivative financial instruments		(6,266)	–
Net losses from revaluation of investment properties	13	(4,087)	(389)
Net gains from foreign currencies:			
– dealing		25,945	39,443
– translation differences		2,821	7,691
Net insurance premiums earned	24	45,477	35,911
Share of loss of associates	12	(2,649)	(713)
Other operating income		17,908	14,747
Other non-interest income		**82,086**	**91,756**
Depreciation, amortization and impairment	14, 15	(101,700)	(20,532)
Salaries and other employee benefits	25	(100,505)	(108,767)
General and administrative expenses	25	(57,339)	(68,649)
Net insurance claims incurred	24	(30,102)	(26,895)
Impairment charge on other assets and provisions	17	(6,431)	(4,551)
Other operating expenses		(11,740)	(9,828)
Other non-interest expenses		**(307,817)**	**(239,222)**
Loss before income tax benefit		**(105,906)**	**(804)**
Income tax benefit	16	6,998	978
(Loss) profit for the year		**(98,908)**	**174**
Attributable to:			
– shareholders of the Bank		(91,370)	3,897
– minority interest		(7,538)	(3,723)
		(98,908)	**174**
Earnings per share:	21		
– basic earnings per share		(2.996)	0.129
– diluted earnings per share		(2.996)	0.129

The accompanying notes on pages 6 to 73 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2009
(Thousands of Georgian Lari)

	Note	2009	2008
(Loss) profit for the year		**(98,908)**	**174**
Other comprehensive income			
– Revaluation of property, plant & equipment		(1,842)	(10,455)
– Revaluation of available-for-sale securities		7,533	(9,687)
– Realized losses on available-for-sale securities reclassified to the consolidated income statement		(174)	(513)
– Losses from currency translation differences		(12,145)	(22,435)
– Unrealized gain from acquiring shares in existing subsidiaries		7,624	–
Income tax relating to components of other comprehensive income	16	(704)	3,189
Other comprehensive income (loss) for the year, net of tax		**292**	**(39,901)**
Total comprehensive loss for the year		**(98,616)**	**(39,727)**
Attributable to:			
– shareholders of the Bank		(91,078)	(36,004)
– minority interest		(7,538)	(3,723)
		(98,616)	**(39,727)**

The accompanying notes on pages 6 to 73 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2009
(Thousands of Georgian Lari)

	Attributable to shareholders of the Bank							
	Share capital	Additional paid-in capital	Treasury shares	Other reserves	Retained earnings	Total	Minority interests	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 minority shareholders	–	–	–	–	–	–	31,278	31,278
Minority 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 minority shareholders	–	–	–	–	(6,064)	(6,064)	(1,479)	(7,543)
Acquisition of minority interests in existing subsidiaries	–	–	–	–	–	–	(24,730)	(24,730)
Minority 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**

The accompanying notes on pages 6 to 73 are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT
For the year ended 31 December 2009
(Thousands of Georgian Lari)

	Notes	2009	2008
Cash flows from operating activities			
Interest received		377,043	384,802
Interest paid		(205,054)	(173,534)
Fees and commissions received		64,599	63,503
Fees and commissions paid		(9,574)	(13,534)
Net realized gains (losses) from trading securities		587	(5,432)
Net realized gains from investments securities		174	498
Net realized gains from foreign currencies		25,945	39,443
Recoveries of loans to customers	9	32,579	11,176
Insurance premiums received		31,319	24,262
Insurance claims paid		(16,801)	(11,095)
Other operating income received		22,022	11,499
Salaries and other employee benefits paid		(88,365)	(106,605)
General and administrative and operating expenses paid		(80,026)	(62,174)
Cash flows from operating activities before changes in operating assets and liabilities		**154,448**	**162,809**
Net (increase) decrease in operating assets			
Amounts due from credit institutions		12,646	62,312
Loans to customers		239,093	(488,574)
Finance lease receivables		12,448	3,722
Prepayments and other assets		(28,696)	(3,678)
Net increase (decrease) in operating liabilities			
Amounts due to credit institutions		(276,916)	339,654
Amounts due to customers		81,713	(211,774)
Other liabilities		455	(9,813)
Net cash flows from (used in) operating activities before income tax		**195,191**	**(145,342)**
Income tax paid		(1,275)	(19,580)
Net cash flows from (used in) from operating activities		**193,916**	**(164,922)**
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired	5	(2,970)	(41,740)
Purchase of additional interests by minority shareholders		(1,479)	31,794
Proceeds from sale of investment securities: available-for-sale		25,323	166,175
Purchase of investment securities: held-to-maturity		(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	755	–
Purchase of property and equipment and intangible assets	14,15	(24,524)	(122,881)
Net cash used in investing activities		**(230,170)**	**8,240**
Cash flows from financing activities			
Proceeds from increase in share capital		306	150,594
Purchase of treasury shares		(4,159)	(8,505)
Sale of treasury shares		1,796	5,800
Purchase of additional interests in existing subsidiaries, net of cash acquired		(24,730)	–
Redemption of debt securities issued		–	(4,988)
Net cash (used in) from financing activities		**(26,787)**	**142,901**
Effect of exchange rates changes on cash and cash equivalents		2,822	5,602
Net decrease in cash and cash equivalents		**(60,219)**	**(8,179)**
Cash and cash equivalents, beginning		**397,591**	**405,770**
Cash and cash equivalents, ending	7	**337,372**	**397,591**

The accompanying notes on pages 6 to 73 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, and was formerly known as State Bank Binsotsbanki. 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 2009 the Bank has 141 operating outlets in all major cities of Georgia (2008: 151). The Bank's registered legal address is 3 Pushkin Street, Tbilisi 0105, Georgia.

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

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

Shareholder	*31 December 2009, shares held*	*31 December 2008, shares held*
Irakli Gilauri	216,230	136,303
Sulkhan Gvalia	136,049	166,907
Nicholas Enukidze	122,259	75,377
Allan Hirst	46,772	10,685
Avto Namicheishvili	29,999	12,489
Irakli Burdiladze	23,035	10,036
Kakha Kiknavelidze	15,027	4,938
Mikheil Gomarteli	9,916	–
David Morisson	7,342	–
Giorgi Chiladze	6,333	–
Ramaz Kukuladze*	–	52,092
Total	**612,962**	**468,827**

In addition to shares held, the members of the Supervisory Board and Management Board were awarded 463,912 and 198,139 Global Depository Receipts ("GDR") in 2009 and 2008, respectively. The awards are subject to three-year vesting. As of 31 December 2009 419,814 GDRs owned by the members of the Supervisory Board and Management Board vested and comprised as follows (in 2008: 313,330):

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

* Resigned from the Management Board of the Bank on 15 November 2009.

2. Basis 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.

Subsidiaries

The consolidated financial statements as of 31 December 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 2009	31 December 2008				
JSC BG Bank	99.4%	99.4%	Ukraine	Banking	26/01/1994	1/10/2007
Valimed, LLC	100.0%	100.0%	Belarus	Investment	14/09/2000	3/6/2008
⇒ Proscale M, UE	100.0%	–	Belarus	Business servicing	15/05/2003	4/12/2009
⇒ JSC Belarusky Narodny Bank	99.98%	70.0%	Belarus	Banking	16/04/1992	3/6/2008
⇒ BNB Leasing, LLC	76.0%	76.0%	Belarus	Leasing	30/03/2006	3/6/2008
JSC BG Capital (Georgia) (formerly known as JSC Galt and Taggart Securities)	100.0%	100.0%	Georgia	Brokerage and asset management	19/12/1995	28/12/2004
⇒ Benderlock Investments Limited	100.0%	–	Cyprus	Investments	12/5/2009	13/10/2009
⇒ BG Tax Advisory, LLC (formerly known as Galt and Taggart Tax Advisory, LLC)	100.0%	100.0%	Georgia	Tax consulting	25/09/2007	–
⇒ BG Commodities (Georgia), LLC	100.0%	–	Georgia	Commodity Trading	16/4/2009	–
⇒ BG Commodities (Ukraine), LLC	100.0%	–	Ukraine	Commodity Trading	24/11/2009	–
⇒ Galt and Taggart Holdings Limited	100.0%	100.0%	Cyprus	Investment	3/7/2006	–
⇒ BG Trading Limited (formerly known as Galt and Taggart Trading Limited)	100.0%	100.0%	Cyprus	Investment	26/03/2007	–
⇒ JSC Galt and Taggart Securities, SA (Moldova) (e)	95.1%	95.1%	Moldova	Investment	7/7/2008	–
⇒ BG Capital (Ukraine), LLC (formerly known as Galt and Taggart Securities (Ukraine), LLC)	100.0%	100.0%	Ukraine	Brokerage	23/10/2006	–
⇒ BG Capital (Belarus), LLC (formerly known as Galt and Taggart Securities (Belarus), LLC)	100.0%	100.0%	Belarus	Brokerage	19/02/2008	–
⇒ Brooksby Investments Limited	100.0%	100.0%	Cyprus	Investments	4/3/2008	18/06/2008
⇒ Galt & Taggart Securities MMC, LLC	(a)	75.0%	Azerbaijan	Investment banking and brokerage services	30/06/2008	–
⇒ GTAM Limited	(a)	80.0%	Cyprus	Investment activity	23/10/2007	–
⇒ Galt and Taggart Asset Management, LLC	(a)	100.0%	Georgia	Asset management	31/05/2007	–
⇒ JSC Belorussian Investments	(a)	100.0%	Georgia	Consumer goods production & distribution	14/05/2008	–
⇒ JSC Liberty Financial Opportunities	(a)	100.0%	Georgia	Investment	3/9/2008	–

2. Basis of Preparation (continued)

Subsidiaries (continued)

Subsidiaries	Ownership / voting, % December 31, 2009	Ownership / voting, % December 31, 2008	Country of incorporation	Industry	Date of incorporation	Date of acquisition
JSC Insurance Company Aldagi BCI	100.0%	100.0%	Georgia	Insurance	22/06/2007	–
⇒ JSC My Family Clinic	100.0%	100.0%	Georgia	Healthcare	3/10/2005	–
⇒ JSC Kutaisi St. Nicholas Surgery Hospital	55.0%	55.0%	Georgia	Medical services	3/11/2000	20/05/2008
Georgian Leasing Company, LLC	100.0%	100.0%	Georgia	Leasing	29/10/2001	31/12/2004
⇒ JSC DBL.ge	100.0%	100.0%	Georgia	Investment	23/04/2007	–
⇒ JSC DBL Capital	100.0%	100.0%	Georgia	Brokerage	27/04/2007	–
GC Holdings, LLC	100.0%	100.0%	Georgia	Investment	29/10/2007	–
⇒ GC Ukraine, LLC	100.0%	100.0%	Ukraine	Card processing	30/07/2008	–
⇒ JSC Georgian Card	55.8%	55.7%	Georgia	Card processing	17/01/1997	20/10/2004
⇒ JSC Nova Technology	(a)	51.0%	Georgia	Electronic payment services	19/03/2007	11/11/2007
⇒ Direct Debit Georgia, LLC	100.0%	100.0%	Georgia	Electronic payment services	7/3/2006	–
JSC SB Real Estate	61.4%	52.1%	Georgia	Real estate	27/09/2006	–
JSC Liberty Consumer	65.3%	65.4%	Georgia	Investment	24/05/2006	–
⇒ Vere+, LLC	(c)	100.0%	Georgia	Real estate	22/05/1996	6/2/2007
⇒ Alegro, LLC	(d)	100.0%	Georgia	Commercial	9/9/1996	12/3/2008
⇒ JSC SB Outdoor & Indoor	100.0%	100.0%	Georgia	Advertising	9/6/2006	–
⇒ JSC Intertour	83.6%	83.6%	Georgia	Travel agency	29/03/1996	25/04/2006
⇒ Holiday Travel, LLC	100.0%	100.0%	Georgia	Travel agency	11/2/2005	4/9/2006
⇒ JSC Prime Fitness	100.0%	100.0%	Georgia	Fitness centre	3/7/2006	–
⇒ MetroNet, LLC	100.0%	100.0%	Georgia	Communication services	23/04/2007	–
⇒ Planeta Forte, LLC	51.0%	–	Georgia	Newspaper Retail	31/10/1995	1/1/2009
JSC Galt and Taggart Holdings (Georgia)	100.0%	100.0%	Georgia	Investment	4/11/2008	–
⇒ JSC Club 24 (b)	100.0%	100.0%	Georgia	Entertainment	27/11/2007	–
⇒ Metro Service +, LLC	100.0%	100.0%	Georgia	Business servicing	10/5/2006	–
⇒ SB Transport, LLC	(b)	100.0%	Georgia	Transportation	20/02/2007	–
⇒ JSC SB Trade	(b)	100.0%	Georgia	Import and distribution	26/02/2007	–
⇒ Georgia Financial Investments, LLC	100.0%	–	Israel	Information Sharing and Market Research	9/2/2009	–
⇒ Real Estate Brokerage-Presto, LLC	100.0%	100.0%	Georgia	Real estate brokerage	16/11/2007	–
⇒ JSC SB Immobiliare	100.0%	100.0%	Georgia	Real estate, Construction	12/3/2008	–
⇒ JSC SB Iberia	100.0%	49.0%	Georgia	Real estate, Construction	13/12/2007	19/08/2009
⇒ JSC SB Iberia 2	100.0%	49.0%	Georgia	Real estate, Construction	28/3/2008	19/08/2009
JSC United Securities Registrar of Georgia	100.0%	100.0%	Georgia	Registrar	25/01/199	30/09/2006

(a) No longer Group subsidiary due to sale in 2009.
(b) 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.
(c) Liquidated in 2009.
(d) Transferred to JSC Caucasus Energy and Infrastructure (former subsidiary of the Group sold in 2008) in 2009 in exchange of a loan payable.
(e) Dormant.

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:

Improvements to IFRS

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

IAS 1 Presentation of Financial Statements (Revised)

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

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

IFRS 7 "Financial Instruments: Disclosures"

The amendments to IFRS 7 were issued in March 2009, to enhance fair value and liquidity disclosures. With respect to fair value, the amendments require disclosure of a three-level fair value hierarchy, by class, for all financial instruments recognised at fair value and specific disclosures related to the transfers between levels in the hierarchy and detailed disclosures related to level 3 of the fair value hierarchy. In addition, the amendments modify the required liquidity disclosures with respect to derivative transactions and assets used for liquidity management.

IAS 23 "Borrowing Costs"(Revised)

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

3. Summary of Significant Accounting Policies (continued)

Adoption of new or revised standards and interpretations (continued)

IAS 24 "Related party disclosures" (Revised)

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

Amendments to IAS 32 "Financial Instruments: Presentation" and IAS 1 "Presentation of Financial Statements" – Puttable Financial Instruments and Obligations Arising on Liquidation

These amendments were issued in February 2008, and became effective for annual periods beginning on or after 1 January 2009. The amendments require puttable instruments that represent a residual interest in an entity to be classified as equity, provided they satisfy certain conditions. These amendments did not have any impact on the Group.

Amendments to IFRS 2 "Share-based Payment"- Vesting Conditions and Cancellations

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

IFRS 8 "Operating Segments"

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

IFRIC 13 "Customer Loyalty Programmes"

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

IFRIC 15 "Agreements for the Construction of Real Estate"

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

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

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

3. Summary of Significant Accounting Policies (continued)

Adoption of new or revised standards and interpretations (continued)

Amendments to IFRIC 9 "Reassessment of Embedded Derivatives"

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

IFRIC 18 Transfers of Assets from Customers

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

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.

Acquisition of subsidiaries

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

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

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

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

3. Summary of Significant Accounting Policies (continued)

Subsidiaries (continued)

Increases in ownership interests in subsidiaries

The differences between the carrying values of net assets attributable to interests in subsidiaries acquired and the consideration given for such increases at the date of increase in ownership interests are charged or credited to retained earnings.

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.

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.

3. Summary of Significant Accounting Policies (continued)

Financial assets (continued)

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 coast and the current fair value, less any impairment loss on that investment previously recognised in the consolidated income statement – is reclassified from other comprehensive income 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. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

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.

3. Summary of Significant Accounting Policies (continued)

De-recognition of financial assets and liabilities (continued)

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the 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.

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.

3. Summary of Significant Accounting Policies (continued)

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.

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.

3. Summary of Significant Accounting Policies (continued)

Goodwill

Goodwill acquired in a business combination is initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of acquisition. 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. Where goodwill forms part of a cash-generating unit (group of cash-generating units) 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.

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 2009 and 2008 were 1.6858 and 1.6670 Lari to USD 1 and 2.4195 and 2.3648 Lari to EUR 1, 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:

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

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

3. Summary of Significant Accounting Policies (continued)

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

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

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

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

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

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" will have 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. The Group expects that this amendment will have no impact on the Group's consolidated financial statements.
- 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 will continue 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 will have no impact on the Group as the annual impairment test is performed before aggregation.

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.

4. Significant Accounting Judgments 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.

4. Significant Accounting Judgments and Estimates (continued)

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 2009, 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.

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 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 provisionally 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 paid	**381**	

The net cash outflow on acquisition was as follows:

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

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 provisionally 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.

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 provisionally 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.

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 paid	**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.

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.

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 differently from profit or loss in the consolidated financial statements. Income taxes are managed on a group basis and are not allocated to operating 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 2009 or 2008.

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	128,005	114,698	(5,161)	(45,966)	(1,035)	–	190,541
Net fees and commission income	31,376	19,241	3,727	(41)	722	–	55,025
Net foreign currency gains	1,495	4,892	1,372	20,946	61	–	28,766
Other external revenues	1,139	4,012	(11,470)	10,245	49,394	–	53,320
Operating income from other segments	519	(1,678)	(7,913)	(2,811)	(1,352)	13,235	–
Total operating income	**162,534**	**141,165**	**(19,445)**	**(17,627)**	**47,790**	**13,235**	**327,652**
Impairment charge on interest earning assets	53,230	49,760	2,711	21,467	–	(1,427)	125,741
Results							
Segment results	(21,975)	18,535	(37,711)	(69,065)	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	1,228,861	1,392,189	162,902	103,242	48,351	(45,600)	2,889,945
Unallocated assets							23,484
Total assets							**2,913,429**
Segment liabilities	893,703	1,143,356	215,630	43,452	39,236	(45,600)	2,289,777
Unallocated liabilities							25,235
Total liabilities							**2,315,012**
Other segment information							
Capital expenditures, of which:	**11,580**	**11,167**	**6,246**	**2,968**	**982**	**–**	**32,943**
Property, plant and equipment	9,328	9,573	1,081	2,485	960	–	23,427
Intangible assets	2,252	1,594	5,165	483	22	–	9,516
Depreciation and impairment	9,689	10,047	1,392	4,033	555	–	25,716
Amortization and impairment	41,835	28,811	4,801	518	19	–	75,984
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	155,290	89,724	597	(24,677)	(94)	–	220,840
Net fees and commission income	30,317	17,047	5,684	2,259	(5,338)	–	49,969
Net foreign currency gains	3,918	7,471	3,259	32,486	–	–	47,134
Other external revenues	3,862	1,181	(699)	1,993	38,285	–	44,622
Operating income from other segments	(744)	(284)	(3,944)	–	(466)	5,438	–
Total operating income	**192,643**	**115,139**	**4,897**	**12,061**	**32,387**	**5,438**	**362,565**
Impairment charge on interest earning assets	57,343	62,947	1,596	7,907	–	(5,646)	124,147
Results							
Segment results	33,003	24,222	(14,971)	(30,260)	(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	1,401,747	1,538,783	134,974	113,061	51,377	6,179	3,246,121
Unallocated assets							12,786
Total assets							**3,258,907**
Segment liabilities	965,078	1,275,716	135,977	80,903	57,990	–	2,515,664
Unallocated liabilities							24,394
Total liabilities							**2,540,058**
Other segment information							
Capital expenditures, of which:	**51,193**	**56,542**	**9,460**	**2,842**	**2,842**	**–**	**122,879**
Property, plant and equipment	44,403	50,971	9,073	2,601	2,834	–	109,882
Intangible assets	6,790	5,571	387	241	8	–	12,997
Depreciation and impairment	9,263	7,583	1,388	271	409	–	18,914
Amortization and impairment	993	450	65	80	30	–	1,618
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 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**

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 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**

7. Cash and Cash Equivalents

	2009	2008
Cash on hand	154,861	164,463
Current accounts with central banks, excluding obligatory reserves	23,584	25,731
Current accounts with other credit institutions	34,944	44,080
Time deposits with credit institutions up to 90 days	123,983	163,317
Cash and cash equivalents	**337,372**	**397,591**

As of 31 December 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 0.17 % interest per annum on these deposits (2008: 1.16%).

8. Amounts Due from Credit Institutions

	2009	2008
Obligatory reserves with central banks	62,308	57,891
Time deposits with effective maturity of more than 90 days	18,599	37,414
Inter-bank loan receivables	4,230	4,328
Amounts due from credit institutions	**85,137**	**99,633**

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 2009 and 2008.

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

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

9. Loans to Customers

	2009	2008
Commercial loans	939,814	1,044,959
Residential mortgage loans	387,415	391,606
Consumer loans	332,537	496,197
Micro loans	99,981	151,313
Gold – pawn loans	62,829	46,374
Others	5,241	15,174
Loans to customers, gross	**1,827,817**	**2,145,623**
Less – Allowance for loan impairment	(166,486)	(106,601)
Loans to customers, net	**1,661,331**	**2,039,022**

Allowance for loan impairment

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

	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**

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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 2009 comprised GEL 17,055 (GEL 10,241 in 2008).

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

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

	2009	*2008*
Individuals	862,365	1,079,945
Trade and services	578,623	667,557
Construction and development	150,676	158,702
Transport and communication	81,532	52,631
Mining	62,622	34,526
Agriculture	13,730	20,134
Energy	11,667	66,145
Others	66,602	65,983
Loans to customers, gross	**1,827,817**	**2,145,623**
Less – allowance for loan impairment	(166,486)	(106,601)
Loans to customers, net	**1,661,331**	**2,039,022**

Loans have been extended to the following types of customers:

	2009	*2008*
Private companies	934,494	1,029,008
Individuals	862,365	1,079,945
State-owned entities	30,958	36,670
Loans to customers, gross	**1,827,817**	**2,145,623**
Less – allowance for loan impairment	(166,486)	(106,601)
Loans to customers, net	**1,661,331**	**2,039,022**

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

	2009			*2008*		
	Individual impairment 2009	*Collective impairment 2009*	*Total 2009*	*Individual impairment 2008*	*Collective impairment 2008*	*Total 2008*
At 1 January	**72,614**	**33,987**	**106,601**	**9,659**	**19,270**	**28,929**
Charge (reversal) for the year	105,477	13,405	118,882	73,311	49,501	122,812
Recoveries	17,237	13,268	30,505	6,690	4,486	11,176
Write-offs	(49,587)	(31,206)	(80,793)	(12,757)	(32,955)	(45,712)
Interest accrued on impairment loans to customers	(3,801)	(3,790)	(7,591)	(1,933)	(5,396)	(7,329)
Currency translation differences	(1,046)	(72)	(1,118)	(2,356)	(919)	(3,275)
At 31 December	**140,894**	**25,592**	**166,486**	**72,614**	**33,987**	**106,601**

10. Finance Lease Receivables

	31 December 2009	31 December 2008
Minimum lease payments receivables	27,816	50,565
Less – Unearned finance lease income	(3,776)	(6,797)
	24,040	**43,768**
Less – Allowance for impairment	(7,144)	(2,163)
Finance lease receivables, net	**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 2009, concentration of investments in five largest lessees comprised GEL 16,013 or 67% of total finance lease receivables (2008: GEL 32,112 or 73.4%) and finance income received from them as of 31 December 2009 comprised GEL 1,567 or 27% of total finance income from lease (2008: GEL 3,512 or 50.1%).

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

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

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

	31 December 2009	31 December 2008
Ukrainian Hryvnas	11,376	–
US Dollars	9,554	41,959
Euros	5,851	5,919
Belarussian Roubles	1,035	2,687
Minimum lease payment receivables	**27,816**	**50,565**

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

	31 December 2009		31 December 2008	
	Amount	Number of projects	Amount	Number of projects
Construction equipment	16,372	21	8,985	46
Air and land transport	7,559	116	37,650	126
Machinery & equipment	3,885	31	3,930	46
Minimum lease payment receivables	**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 2009	*Finance lease receivables 2008*
At 1 January	**2,163**	**816**
Charge	6,859	1,335
Recoveries	2,074	–
Amounts written-off	(3,689)	–
Currency translation difference	(263)	12
At 31 December	**7,144**	**2,163**
Individual impairment	6,916	1,600
Collective impairment	228	563
	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:

	2009	*2008*
Corporate shares	13,418	21,723
Ministry of Finance treasury bills	4,044	5,266
Corporate bonds	2,946	6,748
	20,408	**33,737**
Less – Allowance for impairment (Note 17)	(818)	–
Available-for-sale securities	**19,590**	**33,737**

Corporate shares as of 31 December 2009 are primarily comprised of investments in a Georgian retail chain of GEL 2,677 (2008: GEL 9,175), a meat processing company of GEL 5,394 (2008: GEL 6,842) and a chain of drug stores of GEL 4,413 (2008: nil).

Corporate bonds as of 31 December 2009 are comprised of GEL 2,946 investments in several financial institutions in Ukraine (2008: GEL 6,748).

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

	31 December 2009		*31 December 2008*	
	%	*Maturity*	*%*	*Maturity*
Corporate bonds	19.76%	1-2 years	14.41%	1-3 years
Ministry of Finance treasury bills	9.50%	1-2 years	11.95%	1-3 years

11. Investment Securities (continued)

Held-to-maturity securities comprise:

	2009		2008	
	Carrying value	Nominal value	Carrying value	Nominal value
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	**249,196**	**254,748**	**22,845**	**23,047**

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

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

12. Investments in Associates

The following associates are accounted for under the equity method:

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

12. Investments in Associates (continued)

Movements in investments in associates were as follows:

	2009	*2008*
Investments in associates, beginning of year, gross	**16,990**	**5,208**
Purchase cost	–	13,355
Disposal	(24)	(860)
Transfers (reclassifications)	(1,483)	–
Net share of loss	(2,649)	(713)
Investments in associates, end of year, gross	**12,834**	**16,990**
Less – Allowance for impairment (Note 17)	(2,511)	(274)
Investments in associates, end of year, net	**10,323**	**16,716**

Investments in associates at 31 December 2009 include goodwill of GEL 3,120 (2008: GEL 7,354). 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.

The following table summarises certain financial information of the associates:

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

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

JSC Teliani Valley, an associate company, is listed on the Georgian Stock Exchange. As of 31 December 2009 the carrying value of the investment in JSC Teliani Valley was GEL 4,946 (2008: GEL 5,042) while the fair value is GEL 5,644 (2008: GEL 7,263).

13. Investment properties

	2009	*2008*
At 1 January	**47,289**	**35,065**
Acquisition through business combinations	12,630	–
Purchases	495	12,613
Disposals	(755)	–
Net change in fair value through profit and loss	(4,087)	(389)
Transfers from property and equipment and other assets	23,937	–
At 31 December	**79,509**	**47,289**

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 2009. 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:

	2009	*2008*
Rental income	3,026	1,211
Direct operating expenses	(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 2009 were as follows:

	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**

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

	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**

14. Property and Equipment (continued)

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 2008. If the buildings were measured using the cost model, the carrying amounts of the buildings as of 31 December 2009 and 31 December 2008 would be as follows:

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

15. Goodwill and Other Intangible Assets

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**

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.

15. Goodwill and Other Intangible Assets (continued)

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 2009 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 BG Bank
- JSC Insurance Company Aldagi – BCI
- JSC My Family Clinic
- Planeta Forte, LLC
- JSC Intertour
- JSC United Securities Registrar of Georgia

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.

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

			Carrying amount of goodwill	
	Effective annual growth rate in three-year financial budgets	*WACC applied for impairment*	*31 December 2009*	*31 December 2008*
JSC Belarusky Narodny Bank	93.74%	16.26%	23,394	23,394
JSC Bank of Georgia	11.00%	8.70%	22,398	22,391
JSC Insurance Company Aldagi – BCI	11.00%	17.20%	18,742	18,742
JSC Intertour	11.00%	14.08%	659	698
Planeta Forte, LLC	11.00%	17.20%	364	–
JSC My Family Clinic	11.00%	17.20%	220	220
JSC BG Bank	–	10.01%	–	68,016
JSC United Securities Registrar of Georgia	5.00%	19.85%	–	366
JSC Nova Technology (disposed)	N/A	N/A	–	411
Total			**65,777**	**134,238**

15. Goodwill and Other Intangible Assets (continued)

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:

	2009	*2008*
Retail banking	38,102	78,408
Insurance	18,962	18,962
Corporate banking	7,690	35,381
Brokerage and asset & wealth management	1,023	1,487
Total	**65,777**	**134,238**

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*	
	2009, %	*2008, %*	*2009, %*	*2008, %*
Discount rate	9.1%	7.5%	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*	
	2009, %	*2008, %*	*2009, %*	*2008, %*
Discount rate	17.2%	15.8%	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:

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

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

	2009	2008
Net (losses) gains on investment securities available for sale	(620)	1,530
Revaluation of buildings	(7)	1,659
Other	(77)	–
Income tax (charge) benefit to other comprehensive income	**(704)**	**3,189**

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% (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 2009 and 2008 a reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2009	2008
Loss before income tax benefit	**(105,906)**	**(804)**
Statutory tax rate	15%	15%
Theoretical income tax benefit at statutory tax rate	**(15,886)**	**(121)**
Tax at the domestic rates applicable to profits in the respective country	(3,614)	(837)
Non-deductible share-based compensation expenses	717	1,240
Other operating income	(408)	207
State securities at lower tax rates	(677)	(1,020)
Tax effect of inter-company transactions	–	(783)
Non-deductible expenses:		
– impairment of intangible assets	10,308	–
– other impairment losses	2,460	171
– other	102	165
Income tax benefit	**(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.

16. Taxation (continued)

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

	2009	*2008*
Current income tax assets	7,997	8,095
Deferred income tax assets	15,487	4,691
Income tax assets	**23,484**	**12,786**
Current income tax liabilities	574	779
Deferred income tax liabilities	24,661	23,615
Income tax liabilities	**25,235**	**24,394**

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*			
	2007	*In the income statement*	*In other comprehensive income*	*Effect of business combination*	*2008*	*In the income statement*	*In other comprehensive income*	*Effect of business combination*	*2009*
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
Loans to customers	80	390	–	–	470	9,659	–	–	10,129
Investment properties	–	–	–	–	–	–	–	1,604	1,604
Securities issued	55	(55)	–	–	–	–	–	–	–
Reinsurance assets	124	119	–	–	243	129	–	–	372
Reinsurance premiums receivables	–	2,073	–	–	2,073	(376)	–	–	1,697
Allowances for impairment and provisions for other losses	225	240	–	–	465	732	–	–	1,197
Tax losses carried forward	1,313	16,689	–	–	18,002	1,516	(26)	–	19,492
Finance lease receivables	7	277	–	–	284	35	–	–	319
Intangible assets	181	58	–	–	239	25	–	–	264
Property and equipment	2	(175)	1,659	297	1,783	149	289	–	2,221
Other assets	115	348	–	–	463	359	–	–	822
Other liabilities	302	433	–	–	735	1,190	–	–	1,925
Gross deferred tax assets	**2,439**	**20,658**	**3,189**	**297**	**26,583**	**13,123**	**(357)**	**1,604**	**40,953**
Unrecognized deferred tax assets	(207)	207	–	–	–	–	(131)	–	(131)
Deferred tax assets	**2,232**	**20,865**	**3,189**	**297**	**26,583**	**13,123**	**(488)**	**1,604**	**40,822**
Tax effect of taxable temporary differences:									
Amounts due to credit institutions	1,710	341	–	–	2,051	(317)	–	–	1,734
Amounts due to customers	625	(117)	–	–	508	–	–	–	508
Securities available-for-sale	182	–	–	–	182	–	–	–	182
Loans to customers	4,491	2,612	–	–	7,103	13,776	–	–	20,879
Reinsurance assets	27	–	–	–	27	–	–	–	27
Insurance premium receivables	6	(6)	–	–	–	–	–	–	–
Allowances for impairment and provisions for other losses	38	1,185	–	–	1,223	(1,223)	–	–	–
Other insurance liabilities & pension fund obligations	–	–	–	–		–	–	–	–
Property and equipment	20,156	8,324	–	–	28,480	(6,194)	165	–	22,451
Investment properties	3,203	(342)	–	–	2,861	(2,313)	–	–	548
Intangible assets	1,008	1,289	–	–	2,297	87	28	–	2,412
Other assets	936	(595)	–	–	341	399	23	20	783
Other liabilities	–	434	–	–	434	38	–	–	472
Deferred tax liabilities	**32,382**	**13,125**	**–**	**–**	**45,507**	**4,253**	**216**	**20**	**49,996**
Net deferred tax assets (liabilities)	**(30,150)**	**7,740**	**3,189**	**297**	**(18,924)**	**8,870**	**(704)**	**1,584**	**(9,174)**

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 / (reversal)	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)
Recoveries	–	–	–	–	–
31 December 2009	**2,511**	**5,720**	**818**	**2,126**	**11,175**

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:

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

	2009	*2008*
Insurance contracts liabilities	30,304	44,340
Accruals for employee compensation	21,860	14,165
Derivative financial liabilities	7,460	1,323
Accounts payable	6,269	12,803
Other insurance liabilities	6,152	9,424
Creditors	4,226	5,858
Pension benefit obligations	3,856	1,642
Other taxes payable	2,862	4,783
Debt securities issued	660	5
Dividends payable	314	314
Amounts payable for share acquisitions	254	–
Amounts payable for purchase of intangible assets	78	5,959
Accruals and deferred income	35	–
Other	2,236	939
Other liabilities	**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.

	2009			*2008*		
	Notional amount	*Fair values Asset*	*Fair values Liability*	*Notional amount*	*Fair value Asset*	*Fair value Liability*
Interest rate contracts						
Forwards and Swaps – foreign	197,003	–	6,447	–	–	–
Foreign exchange contracts						
Forwards and Swaps – domestic	24,410	–	288	2,501	–	252
Options – foreign	1,096	82	–	–	–	–
Equity / Commodity contracts						
Put options – foreign	–	–	–	700	177	–
Call options – foreign	8,429	1,047	–	1,667	78	–
Embedded derivatives from investment deposits	–	–	725	–	–	1,071
Total derivative assets / liabilities	**230,938**	**1,129**	**7,460**	**4,868**	**255**	**1,323**

19. Amounts Due to Credit Institutions

Amounts due to credit institutions comprise:

	2009	*2008*
Borrowings from international credit institutions	913,579	1,108,014
Time deposits and inter-bank loans	12,761	91,389
Correspondent accounts	2,275	17,319
Amounts due to credit institutions	**928,615**	**1,216,722**

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

19. Amounts Due to Credit Institutions (continued)

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

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+5.995	35,000	59,472
Overseas Private Investment Corporation	23-Dec-08	19-Dec-18	USD	5.75%	29,000	48,602
Netherland Development Finance Company **	18-Jul-08	15-Oct-18	USD	LIBOR + 7.25%	30,000	49,570
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						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+5.995%	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 317,792 as at 31 December 2009 (2008: GEL 160,363)**

19. Amounts Due to Credit Institutions (continued)

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 2009 and 2008, the Group complied with all the 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:

	2009	*2008*
Current accounts	559,987	612,502
Time deposits	712,483	580,622
Amounts due to customers	**1,272,470**	**1,193,124**
Held as security against letters of credit and guarantees	**56,758**	**70,441**

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

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

	2009	*2008*
Individuals	637,789	495,747
Private enterprises	578,849	627,049
State and budget organizations	55,832	70,328
Amounts due to customers	**1,272,470**	**1,193,124**

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

	2009	*2008*
Individuals	637,789	495,747
Trade and services	273,190	296,110
Energy	116,810	134,275
Construction and development	79,082	40,146
State and budget organizations	55,832	70,328
Transport and communication	47,166	70,806
Mining and processing	27,638	16,364
Agriculture	13,588	8,426
Other	21,375	60,922
Amounts due to customers	**1,272,470**	**1,193,124**

21. Equity

Share capital

As of 31 December 2009, authorized share capital comprised 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 2009 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**

Share capital of the Group was paid by the shareholders in Georgian Lari and they are entitled to dividends in Georgian Lari. 2009 net loss attributable to ordinary shareholders of the Bank comprise GEL 91,370 (2008: net income of GEL 3,897). At 31 December 2009 weighted average number of ordinary shares outstanding during the year was 30,494,397 (2008: 30,160,451). At 31 December 2009 the diluted number of ordinary shares was 30,494,397 (2008: 30,160,451). Both, the basic and diluted loss per share amounted to GEL 2.996 (2008: 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 2009 (Note 19) were not treated as dilutive, because their conversion would neither decrease earnings per share nor increase loss per share from continuing operations, as prescribed in IAS 33 – "Earnings per share".

Treasury shares

Treasury shares of GEL 668 as of 31 December 2009 comprise the Bank's shares owned by its subsidiaries (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 1,009 as of 31 December 2009 (2008: GEL 1,128) are kept by the Bank's custodian – Abacus Corporate Trustee Limited.

During the year ended 31 December 2009, 52,788 ordinary shares of GEL 53 par value and additional paid-in capital of GEL 430 have been granted as compensation to top management (2008: 19,933 ordinary shares of GEL 20 at par value and additional paid-in capital of GEL 470).

Dividends

No dividends were declared nor paid during 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.

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.

Movements in other reserves during 2009 and 2008 are presented in the statement 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 2009 and 2008 the Group's financial commitments and contingencies comprised the following:

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

Financial commitments and contingencies (continued)

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

	2009	*2008*
Settlements operations	33,907	33,659
Guarantees and letters of credit	10,764	8,625
Cash operations	6,145	6,947
Brokerage service fees	1,891	2,626
Currency conversion operations	1,024	1,766
Advisory	578	2,032
Other	10,290	7,848
Fee and commission income	**64,599**	**63,503**
Settlements operations	(4,299)	(3,974)
Guarantees and letters of credit	(2,106)	(2,038)
Cash operations	(1,619)	(564)
Insurance brokerage service fees	(534)	(5,965)
Currency conversion operations	(28)	(430)
Other	(988)	(563)
Fee and commission expense	**(9,574)**	**(13,534)**
Net fee and commission income	**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 December 31, 2009 and 2008 comprised:

	2009	*2008*
Life insurance contracts premium written	2,865	3,456
General insurance contracts premium written, direct	56,694	53,201
Total premiums written	**59,559**	**56,657**
Gross change in life provision	(377)	86
Gross change in unearned premium provision	1,690	(6,311)
Total gross premiums earned on insurance contracts	**60,872**	**50,432**
Reinsurers' share of life insurance contracts premium written	(1,086)	(981)
Reinsurers' share of general insurance contracts premium written	(9,502)	(15,271)
Reinsurers' share of change in life provision	254	(4)
Reinsurers' share of change in general insurance contracts unearned premium provision	(5,061)	1,735
Total reinsurers' share of gross earned premiums on insurance contracts	**(15,395)**	**(14,521)**
Net insurance premiums earned	**45,477**	**35,911**
Life insurance claims paid	(830)	(455)
General insurance claims paid, direct	(43,137)	(30,175)
Total insurance claims paid	**(43,967)**	**(30,630)**
Reinsurers' share of life claims paid	523	351
Reinsurers' share of general claims paid	12,356	5,443
Gross change in total insurance contracts liabilities	12,563	(6,053)
Reinsurers' share of change in total insurance contracts liabilities	(11,577)	3,994
Net insurance claims incurred	**(30,102)**	**(26,895)**
Net insurance revenue	**15,375**	**9,016**

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

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

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

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

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.

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.

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.

26. Share-based Payments (continued)

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

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 measurement date comprised Georgian Lari 9.46 per share in 2009 (2008: Georgian Lari 33.4).

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

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

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

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

All instruments	*2009*	*2008*
Total number of equity instruments awarded	1,259,320	287,437
– *Among them, to top management* and supervisory board members*	*519,070*	*207,504*
Total number of equity instruments vested	205,788	298,616
Weighted average value at grant date, per share (GEL in full amount)	9.46	33.42
Value at grant date, total (GEL)	11,912	**9,605**
Total expense recognized during the year (GEL)	**(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.

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.

27. Risk Management (continued)

Introduction (continued)

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.

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.

27. Risk Management (continued)

Credit risk (continued)

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 2009	Gross maximum exposure 2008
Cash and cash equivalents (excluding cash on hand)	7	182,511	233,128
Amounts due from credit institutions	8	85,137	99,633
Loans to customers	9	1,661,331	2,039,022
Finance lease receivables	10	16,896	41,605
Investment securities:			
– Available-for-sale	11	19,590	33,737
– Held-to-maturity	11	249,196	22,845
		2,214,661	**2,469,970**
Financial commitments and contingencies	22	288,766	352,772
Total credit risk exposure		**2,503,427**	**2,822,742**

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.

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 2009	Standard grade 2009	Sub-standard grade 2009	Past due or individually impaired 2009	Total 2009
Amounts due from credit institutions	8	84,220	917	–	–	85,137
Loans to customers:	9					
Corporate lending		447,481	122,983	94,215	275,135	939,814
Consumer lending		227,765	26,748	1,915	76,109	332,537
Residential mortgages		267,593	26,133	9,772	83,917	387,415
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	4571	24,040
Investment securities:						
Available-for-sale	11	6,325	13,265	–	818	20,408
Held-to-maturity	11	249,196	–	–	–	249,196
		255,521	**13,265**	**–**	**818**	**269,604**
Total		**1,429,325**	**214,214**	**113,253**	**449,806**	**2,206,598**

27. Risk Management (continued)

Credit risk (continued)

	Notes	Neither past due nor impaired				
		High grade 2008	Standard grade 2008	Sub-standard grade 2008	Past due or individually impaired 2008	Total 2008
Amounts due from credit institutions	8	99,633	–	–	–	99,633
Loans to customers:	9					
Corporate lending		639,988	112,558	23,428	268,985	1,044,959
Consumer lending		381,299	42,126	11,576	61,196	496,197
Residential mortgages		337,445	13,477	1,868	38,816	391,606
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	33,737	–	–	–	33,737
Held-to-maturity	11	22,845	–	–	–	22,845
		56,582	**–**	**–**	**–**	**56,582**
Total		**1,703,901**	**177,801**	**51,672**	**412,232**	**2,345,606**

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 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 Note 9 for more detailed information with respect to the allowance for impairment of loans to customers.

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

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

	2009	2008
Loans to customers:		
Commercial lending	473,845	384,404
Micro loans	7,540	5,952
Consumer lending	26,624	19,384
Residential mortgages	38,137	6,193
Other	11	8,194
Financial lease receivables	2,349	3,173
Total	**548,506**	**427,300**

27. Risk Management (continued)

Credit risk (continued)

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.

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

	2009				2008			
	Georgia	OECD	CIS and other foreign countries	Total	Georgia	OECD	CIS and other foreign countries	Total
Assets:								
Cash and cash equivalents	133,888	127,816	75,668	337,372	153,236	208,997	35,358	397,591
Amounts due from credit institutions	59,964	12,664	12,509	85,137	64,081	3,414	32,138	99,633
Loans to customers	1,520,174	–	141,157	1,661,331	2,008,652	–	30,370	2,039,022
Finance lease receivables	8,927	–	7,969	16,896	37,405	–	4,200	41,605
Investment securities:								
– available-for-sale	13,256	157	6,177	19,590	33,420	201	116	33,737
– held-to-maturity	249,196	–	–	249,196	22,845	–	–	22,845
All other assets	455,769	8,056	80,082	543,907	586,214	1,210	37,050	624,474
	2,441,174	**148,693**	**323,562**	**2,913,429**	**2,905,853**	**213,822**	**139,232**	**3,258,907**
Liabilities:								
Amounts due to customers	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	20,102	899,651	8,862	928,615	129,091	1,080,179	7,452	1,216,722
All other liabilities	85,588	9,618	18,721	113,927	118,978	7,216	4,018	130,212
	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	**1,310,713**	**(770,951)**	**58,655**	**598,417**	**1,505,540**	**(876,050)**	**89,359**	**718,849**

27. Risk Management (continued)

Liquidity risk and funding management

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, 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:

	2009	*2008, %*
Average liquidity ratio for the year	36.5%	31.4%
Maximum Liquidity ratio	45.7%	48.6%
Minimum Liquidity ratio	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.

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 2009 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the 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 2009	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to credit institutions	76,468	86,724	726,243	511,713	1,401,148
Amounts due to customers	899,697	332,714	83,097	7,624	1,323,132
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 credit institutions	291,471	131,625	922,928	259,148	1,605,172
Amounts due to customers	869,050	266,412	74,947	4,712	1,215,121
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**

27. Risk Management (continued)

Liquidity risk and funding management (continued)

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*
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.

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 2009. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2009 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve. During 2009 and 2008 sensitivity analysis did not reveal significant potential effect on the Group Equity.

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)

27. Risk Management (continued)

Market risk (continued)

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)	–

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 2009 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 2009 and 2008 sensitivity analysis did not reveal significant potential effect on Group Equity.

Currency	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	12.7%	(3,792)	–	14.9%	(832)	–
GBP	16.1%	63	–	24.9%	17	–
RUR	0.3%	(1)	–	0.3%	(6)	–
UAH	0.3%	–	228	2.8%	8	–
USD	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 2009
2009	(14,557)	–
2008	(34,546)	–

27. Risk Management (continued)

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.

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 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 – trading securities owned	92	–	–	92
	17,736	**16,093**	**–**	**33,829**
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 table shows a reconciliation of the opening and closing amount of Level 3 financial assets and liabilities which are recorded at fair value:

	At 1 January 2009	Transfer from other assets	At 31 December 2009
Financial assets			
Investment securities – available-for-sale	–	4,264	4,264
Total level 3 financial assets	–	**4,264**	**4,264**
Total net level 3 financial assets / (liabilities)	**–**	**4,264**	**4,264**

No financial instruments were transferred during 2009 from level 1 and level 2 to level 3 of the fair value hierarchy. Gains or losses on level 3 financial instruments during 2009 comprised nil.

No financial instruments were transferred during 2009 between level 1 and level 2 of the fair value hierarchy.

28. Fair Values of Financial Instruments (Continued)

Financial instruments recorded at fair value (continued)

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:

	31 December 2009	
	Carrying amount	Effect of reasonably possible alternative assumptions
Financial assets		
Investment securities – available-for-sale	4,264	+/- 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 2009	Fair value 2009	Unrecognised loss 2009	Carrying value 2008	Fair value 2008	Unrecognised loss 2008
Financial assets						
Cash and cash equivalents	337,372	337,372	–	397,591	397,591	–
Amounts due from credit institutions	85,137	85,137	–	99,633	99,633	–
Loans to customers	1,661,331	1,621,779	(39,552)	2,039,022	1,991,449	(47,573)
Finance lease receivables	16,896	16,896	–	41,605	41,605	–
Investment securities:						
– held-to-maturity	249,196	249,196	–	22,845	22,845	–
Financial liabilities						
Amounts due to customers	1,272,470	1,271,298	1,172	1,193,124	1,201,746	(8,622)
Amounts due to credit institutions	928,615	928,615	–	1,216,722	1,216,722	–
Total unrecognised change in unrealised fair value			**(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.

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.

	2009			2008		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Financial assets						
Cash and cash equivalents	337,372	–	337,372	397,591	–	397,591
Amounts due from credit institutions	80,638	4,499	85,137	87,205	12,428	99,633
Loans to customers	655,906	1,005,425	1,661,331	897,167	1,141,855	2,039,022
Finance lease receivables	12,466	4,430	16,896	33,375	8,230	41,605
Investment securities:						
– available–for–sale	19,590	–	19,590	33,737	–	33,737
– held–to–maturity	249,196	–	249,196	22,845	–	22,845
Total	**1,355,168**	**1,014,354**	**2,369,522**	**1,471,920**	**1,162,513**	**2,634,433**
Financial liabilities						
Amounts due to customers	1,197,697	74,773	1,272,470	1,124,598	68,526	1,193,124
Amounts due to credit institutions	37,866	890,749	928,615	402,094	814,628	1,216,722
Total	**1,235,563**	**965,522**	**2,201,085**	**1,526,692**	**883,154**	**2,409,846**
Net	**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.

As of 31 December 2009 deposits amounted to GEL 1,272,470 (2008: GEL 1,193,124) and represented 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 2009 amounts owed to other credit institutions amounted to GEL 928,615 (2008: GEL 1,216,722) and represented 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:

	2009			2008		
	Parent	Asso-ciates	Key management personnel	Parent	Asso-ciates	Key management personnel
Loans outstanding at 1 January, gross	**265**	**21,644**	**5,572**	**–**	**13,274**	**510**
Loans issued during the year	–	7,736	5,616	1,339	12,085	8,229
Loan repayments during the year	(265)	(10,322)	(8,633)	(1,074)	(9,709)	(3,375)
Other movements	–	(9,803)	3,236	–	5,994	208
Loans outstanding at 31 December, gross	**–**	**9,255**	**5,791**	**265**	**21,644**	**5,572**
Less: allowance for impairment at 31 December	–	(870)	(212)		(3,181)	(1,064)
Loans outstanding at 31 December, net	**–**	**8,385**	**5,579**	**265**	**18,463**	**4,508**
Interest income on loans	–	1,250	799	–	2,125	468
Loan impairment charge	–	594	(92)	–	3,099	120
Deposits at 1 January	**12,733**	**177**	**18,324**	**12,733**	**4,485**	**626**
Deposits received during the year	–	27,989	42,908	–	79,356	53,081
Deposits repaid during the year	(635)	(27,792)	(54,647)	–	(83,638)	(35,450)
Other movements	–	132	334	–	(26)	67
Deposits at 31 December	**12,098**	**506**	**6,919**	**12,733**	**177**	**18,324**
Interest expense on deposits	–	5	425	–	2	14
Other income	437	–	35	767	_	32

Compensation of key management personnel was comprised of the following:

	2009	2008
Salaries and other benefits	17,833	9,975
– Among them, termination benefits	*759*	*10*
Share-based payments compensation	10,530	7,820
– Among them, termination benefits	*2,178*	*–*
Social security costs	256	94
Recruitment costs	–	28
Total key management compensation	**28,619**	**17,917**

The number of key management personnel at 31 December 2009 was 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 2009 and 2008, the Bank's capital adequacy ratio on this basis was as follows:

	2009	*2008*
Core capital	535,427	573,146
Supplementary capital	269,729	162,902
Less: Deductions from capital	(347,853)	(269,427)
Total regulatory capital	**457,303**	**466,621**
Risk-weighted assets	**2,717,084**	**3,458,133**
Total capital adequacy ratio	**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 minority 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.

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 2009 and 2008, follows:

	2009	*2008*
Tier 1 capital	548,710	637,753
Tier 2 capital	369,480	273,311
Less: Deductions from capital	(67,454)	(134,238)
Total regulatory capital	**850,736**	**776,826**
Risk-weighted assets	**2,454,763**	**2,950,653**
Total capital ratio	34.7%	26.3%
Tier 1 capital ratio	22.4%	21.6%
Minimum capital adequacy ratio	**8%**	**8%**

32. Events After the Reporting Date

Termination of the executive functions of the Chairman

On 19 February 2010 the Supervisory Board decided to terminate the executive functions of its chairman – Nicholas Enukidze (the "Chairman"). In light of this decision, the Supervisory Board decided not to renew the service agreement with the Chairman, upon its expiration in May 2010. The Chairman and the Bank have signed a separation agreement on 20 February 2010, on the following terms:

- The Service Agreement is terminated effective 10 April 2010, provided that the Chairman remains a non-executive chairman until the next annual general meeting of shareholders (the "AGM");
- The Chairman will be entitled to his base salary for the period until the next AGM;
- As per Service Agreement, the Chairman will be entitled to the following separation package:
  - All of the 255,188 awarded but unvested shares and/or GDRs and/or options which have vested as of 5th of March 2010 (fully recognized as expense in 2009 consolidated income statement);
  - The Chairman has been paid a separation payment in the amount of 100% of his annual base salary (fully recognized as expense in 2009 consolidated income statement);
  - The Chairman has been granted 44,177 fully vested GDRs for his performance in 2009 (for full recognition as an expense in 2010 consolidated income statement).

Disposal of an available-for-sale financial investment and acquisition of a new subsidiary

On 16 February 2010, the Group disposed its investment in the 8.5% of a meat processing company – JSC "Nikora", carried at GEL 5,394 as of the disposal date. This 8.5% share ownership was sold back to JSC "Nikora" in the exchange for USD 1,700 thousand cash plus JSC "Nikora"'s investment in 25.14% equity of JSC Teliani Valley, which was an associate company of the Group at 16 February 2010.

As a result of this exchange, total shareholdings of the Group in JSC Teliani Valley comprised 52.33%, resulting in acquisition of control by the Group in JSC Teliani Valley – a business combination under IFRS 3. As of the date of acquisition, net value of the consideration given for the acquisition of control comprised GEL 7,437. This amount comprised as follows:

- GEL 4,946 – carrying value of the Group's investment in JSC Teliani Valley as of the acquisition date;
- plus GEL 5,394 – the carrying value of the investment in JSC "Nikora" as of disposal date;
- less GEL 2,903 – equivalent of USD 1,700 thousand received from JSC "Nikora" translated applying the official exchange rate of the National Bank of Georgia effective as of the acquisition date.

Total assets of JSC Teliani Valley as of acquisition date comprised GEL 19,351, total liabilities comprised GEL 10,712, resulting in net book value of GEL 8,639, of which 52.33% (i.e. GEL 4,521) was attributable to the shareholders of the Group. From this transaction, the Group has provisionally estimated goodwill of GEL 2,916, subject to any adjustments that might be necessary subsequent to more accurate fair valuation of the acquiree's assets and liabilities as of the acquisition date and more accurate purchase price allocation.

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Bloomberg: BGEO LI

Georgian Stock Exchange (GSE)
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