PEOPLE'S BANK OF GEORGIA GROUP

Consolidated Financial Statements
For the Year Ended 31 December 2008

PEOPLE'S BANK OF GEORGIA GROUP

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PEOPLE'S BANK OF GEORGIA GROUP

STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditors' report set out on pages 2 and 3, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the consolidated financial statements of Joint Stock Company People's Bank of Georgia (the "Bank") and its subsidiaries (together referred to as the "Group").

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group as at 31 December 2008, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and prudent; and
- Preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of Georgia;
- Taking such steps that are reasonably available to them to safeguard the assets of the Group; and
- Detecting and preventing fraud, errors and other irregularities.

The consolidated financial statements for the year ended 31 December 2008 were authorized for issue on 9 December 2009 by the Management Board.

On behalf of the Management Board:

Executive Chairman and Chief Executive Officer	Chief Financial Officer
Lado Gurgenidze	Zurab Tsulaia
9 December 2009	*9 December 2009*
Tbilisi, Georgia	*Tbilisi, Georgia*

Deloitte.

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INDEPENDENT AUDITORS' REPORT

To the Shareholders and the Management Board of Joint Stock Company People's Bank of Georgia:

We have audited the accompanying consolidated financial statements of Joint Stock Company People's Bank of Georgia (the "Bank") and its subsidiaries (together referred to as the "Group"), which comprise the consolidated balance sheet as at 31 December 2008, the consolidated statements of operations, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of 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. Except as discussed in the basis for qualified opinion paragraph, 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 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 auditor's 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 Group'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 Group'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.

Deloitte.

Basis for the qualified opinion

The Group did not provide us with the breakdown of insurance contract provisions for claims included within other liabilities as at 31 December 2008 in the amount of GEL 2,566 thousand. Therefore, we were unable to satisfy ourselves as to the amounts and sufficiency of the respective provisions as at 31 December 2008 and the change in the insurance contract provisions for claims as part of other income and the related effect on income tax expense for the year then ended.

Opinion

In our opinion, except for the effect on the consolidated financial statements of the matters referred to in the basis for qualified opinion paragraph above, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without further qualifying our opinion we draw attention to Note 29 to the consolidated financial statements which describes significant events after the balance sheet date including changes in the Group's ownership and structure and disposal of a consolidated subsidiary, JSC People's Insurance Company.

As discussed in Note 4, the consolidated financial statements for the year ended 31 December 2007 have been restated.

Deloitte & Touche

9 December 2009
Tbilisi, Georgia

PEOPLE'S BANK OF GEORGIA GROUP

CONSOLIDATED STATEMENT OF OPERATIONS
FOR THE YEAR ENDED 31 DECEMBER 2008
(in thousands of Georgian Lari)

	Notes	Year ended 31 December 2008	Year ended 31 December 2007 (restated)
Interest income	5, 26	32,580	15,425
Interest expense	5, 26	(16,580)	(4,553)
NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS		16,000	10,872
Provision for impairment losses on interest bearing assets	6, 26	(27,864)	(8,286)
NET INTEREST (LOSS)/INCOME		(11,864)	2,586
Net gain on foreign exchange operations	7	460	1,495
Fee and commission income	8	29,419	28,178
Fee and commission expense	8	(1,340)	(788)
Provision for impairment losses on other transactions	6	(5,099)	(352)
Other income, net	9	11,177	10,092
NET NON-INTEREST INCOME		34,617	38,625
OPERATING INCOME		22,753	41,211
OPERATING EXPENSES	10, 26	(77,195)	(38,803)
(LOSS)/ PROFIT BEFORE SHARE OF RESULTS FROM ASSOCIATES		(54,442)	2,408
Share of results from associates	16	104	(9)
(LOSS)/PROFIT BEFORE INCOME TAX		(54,338)	2,399
Income tax benefit	11	8,641	176
NET (LOSS)/PROFIT		(45,697)	2,575
Attributable to:			
Equity holders of the parent		(45,491)	2,421
Minority interest		(206)	154
		(45,697)	2,575

On behalf of the Management Board:

Executive Chairman and Chief Executive Officer
Lado Gurgenidze
9 December 2009
Tbilisi, Georgia

Chief Financial Officer
Zurab Tsulaia
9 December 2009
Tbilisi, Georgia

The notes on pages from 9 to 62 form an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET
AS AT 31 DECEMBER 2008
(in thousands of Georgian Lari)

	Notes	31 December 2008	31 December 2007 (restated)
ASSETS:			
Cash and cash equivalents	12	57,069	33,988
Due from credit institutions	13	3,729	18,246
Loans to customers	14, 26	109,286	113,592
Investments available-for-sale	15	7,761	881
Investments in associates	16	893	789
Property, plant and equipment	17	98,655	93,524
Current income tax assets		630	636
Deferred income tax assets	11	1,149	-
Intangible assets	18	3,540	2,762
Other assets	19	35,519	18,645
TOTAL ASSETS		318,231	283,063
LIABILITIES AND EQUITY:			
LIABILITIES:			
Due to credit institutions	20	52,355	2,977
Customer accounts	21, 26	181,452	200,887
Other borrowed funds	22	29,806	-
Current income tax liabilities		1,451	1,294
Deferred income tax liabilities	11	-	8,087
Other liabilities	23	38,408	9,152
Total liabilities		303,472	222,397
EQUITY:			
Share capital	24	15,721	15,521
Treasury shares	24	(355)	(500)
Share premium	24	8,437	8,200
Property, plant and equipment revaluation reserve		36,707	37,499
Accumulated deficit		(45,725)	(234)
Total equity attributable to equity holders of the parent		14,785	60,486
Minority interest		(26)	180
Total equity		14,759	60,666
TOTAL LIABILITIES AND EQUITY		318,231	283,063

On behalf of the Management Board:

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Lado Gurgenidze
9 December 2009
Tbilisi, Georgia

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Zurab Tsulaia
9 December 2009
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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2008

(in thousands of Georgian Lari)

	Notes	Share capital	Treasury shares	Share premium	Property, plant and equipment revaluation reserve	Accumulated deficit	Total equity attributable to equity holders of the parent	Minority interest	Total equity
31 December 2006 (before restatement)		12,000	-	-	14,049	(1,302)	24,747	492	25,239
To adjust revaluation reserve for increase in fair value of land and buildings possessed by LLC Rustavi Central Cash Desk		-	-	-	171	-	171	-	171
To adjust fair value of net assets of LLC Rustavi Central Cash Desk over the cost of acquisition		-	-	-	-	4	4	-	4
31 December 2006 (restated)		**12,000**	**-**	**-**	**14,220**	**(1,298)**	**24,922**	**492**	**25,414**
Share capital increase	24	3,521	-	10,130	-	-	13,651	-	13,651
Gain on revaluation of land and buildings, net of deferred income tax of GEL 3,975 thousand and revaluation increase of GEL 352 thousand recognized in the statement of operations reversing a revaluation decrease of the same buildings previously recognized in statement of operations and eliminated depreciation of GEL 1,526 thousand	17	-	-	-	22,526	-	22,526	(466)	22,060
Effect of changes in income tax rate on revaluation reserve of land and buildings	4	-	-	-	753	-	753	-	753
Dividends declared		-	-	-	-	(1,357)	(1,357)	-	(1,357)
Purchase of treasury shares		-	(500)	(1,930)	-	-	(2,430)	-	(2,430)
Net profit		-	-	-	-	2,421	2,421	154	2,575
31 December 2007(restated)		**15,521**	**(500)**	**8,200**	**37,499**	**(234)**	**60,486**	**180**	**60,666**
Share capital increase	24	200	-	(200)	-	-	-	-	-
Impairment loss on previously revalued land and buildings, net of income tax of GEL 140 thousand and revaluation decrease of GEL 6,126 thousand recognized in the statement of operations and eliminated depreciation of GEL 1,925 thousand	17	-	-	-	(792)	-	(792)	-	(792)
Sale of treasury shares		-	145	437	-	-	582	-	582
Net loss		-	-	-	-	(45,491)	(45,491)	(206)	(45,697)
31 December 2008		**15,721**	**(355)**	**8,437**	**36,707**	**(45,725)**	**14,785**	**(26)**	**14,759**

On behalf of the Management Board:

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Lado Gurgenidze
9 December 2009
Tbilisi, Georgia

Chief Financial Officer
Zurab Tsulaia
9 December 2009
Tbilisi, Georgia

The notes on pages from 9 to 62 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2008
(in thousands of Georgian Lari)

	Notes	Year ended 31 December 2008	Year ended 31 December 2007 (restated)
CASH FLOWS FROM OPERATING ACTIVITIES:			
Interest received		29,678	14,334
Interest paid		(15,151)	(2,285)
Fees and commissions received		29,419	28,178
Fees and commissions paid		(1,340)	(788)
Realized gain on foreign exchange operations		3,517	1,575
Other operating income received		9,732	7,778
Operating expense paid		(51,146)	(32,721)
Cash flows from operating activities before changes in operating assets and liabilities		4,709	16,071
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the National Bank of Georgia		4,416	(2,000)
Due from credit institutions		(417)	(15,490)
Loans to customers		(7,812)	(84,107)
Other assets		(15,027)	(6,933)
(Decrease)/increase in operating assets:			
Due to credit institutions		49,314	(6,325)
Customer accounts		(19,857)	118,193
Other liabilities		18,571	2,407
Cash flows from operating activities before taxation		33,897	21,816
Income tax paid		(292)	-
Net cash inflow from operating activities		33,605	21,816
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property plant and equipment and intangible assets		(27,168)	(32,572)
Proceeds from disposal of property, plant and equipment and intangible assets		647	2,481
Purchase of investments available-for-sale		(7,644)	(119)
Acquisition of investments in associates		-	798
Dividend income		-	235
Net cash outflow from investing activities		(34,165)	(29,177)

CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2008

(in thousands of Georgian Lari)

	Notes	Year ended 31 December 2008	Year ended 31 December 2007 (restated)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Issue of ordinary share capital		-	3,521
Sale/(purchase) of treasury shares		145	(500)
Increase in share premium		437	8,200
Other borrowed funds		29,173	-
Dividends paid		-	(3,218)
Net cash inflow from financing activities		29,755	8,003
Effect of changes in foreign exchange rates		(3,057)	(80)
NET INCREASE IN CASH AND CASH EQUIVALENTS		26,138	562
CASH AND CASH EQUIVALENTS, beginning of the year	12	33,988	33,506
CASH AND CASH EQUIVALENTS, end of the year	12	57,069	33,988

On behalf of the Management Board:

Executive Chairman and Chief Executive Officer
Lado Gurgenidze
9 December 2009
Tbilisi, Georgia

Chief Financial Officer
Zurab Tsulaia
9 December 2009
Tbilisi, Georgia

The notes on pages from 9 to 62 form an integral part of these consolidated financial statements.

(in thousands of Georgian Lari)

1. ORGANISATION

People's Bank of Georgia (the "Bank") is a joint stock company, formed on the basis of the former State Bank AgromretsvBank. By the Decree of the Cabinet of Ministers of Georgia number 288, dated 14 April 1993, and the Ordinance of the President of Georgia number 178, dated 29 May 1994 the organizational forms of state owned banks and enterprises were transformed into Joint Stock Companies. The Bank operates under a general banking license issued by the National Bank of Georgia ("NBG") on February 10, 1993, as well as licenses for foreign currency operations.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides commercial and investments banking and insurance services to its commercial and retail customers. Its main office is in Tbilisi and it has 184 (2007 – 182) branches, outlets and pavilions operating in Georgia. The Bank's registered legal address is 74 Chavchavadze Avenue, 0162 Tbilisi, Georgia.

As of 31 December 2008 and 2007, the following shareholders owned more than 1% of the outstanding shares. Other shareholders owned less than 1% individually of the outstanding shares.

Shareholder	**2008 Ownership interest, %**	**2007 Ownership interest, %**
Jincharadze Irina	25%	25%
Starcode Resources LLC (United Kingdom)	20%	21%
Kovalenko Elena	20%	21%
Agureva Anna	7%	8%
Marshania Tamar	6%	6%
Marshania Gaioz	1%	2%
Goguadze George	-	9%
Other shareholders (individual holding less than 1%)	21%	8%
Total	**100%**	**100%**

The Bank is a parent company of the banking group (the "Group") which consists of the following enterprises consolidated in the financial statements:

Name	**Country of incorporation**	**The Group ownership interest 2008**	**2007**	**Type of operation**
JSC People's Insurance Company	Georgia	100%	100%	Insurance
LLC Real Estate Development	Georgia	100%	100%	Real estate
LLC People's Post	Georgia	100%	100%	Postal
LLC Public Investment Management	Georgia	100%	100%	Brokerage
JSC Sakkalakmshenproekti	Georgia	98%	98%	Architectural design services and renting
LLC Social House	Georgia	100%	-	Medical services
LLC Rustavi Central Cash Desk	Georgia	100%	100%	Inactive

1. ORGANISATION (CONTINUED)

JSC People's Insurance Company was registered on 4 February 2004. The Company's principal activity is providing insurance services. The company holds insurance licenses N 004/2 dated 13 October 2006 and life insurance license N 002/1 dated 13 October 2006 granted by Insurance Regulatory Department of Georgia. The insurance company was bought by the Bank in 2005. Subsequently to year end the company has been sold by the Group on 14 May 2009 (Note 29).

LLC Real Estate Development was established on 18 November 2005 by the Tax Inspectorate of Tbilisi, Georgia, order number 1422/006. The company was owned by the Bank from the date of incorporation. The principal activity is leasing of commercial space on bus stations.

LLC People's Post was established on 27 September 2005. The company was owned by the Bank from the date of incorporation. The principal activity is providing postal and courier services.

LLC Public Investment Management was registered on 31 July 2006 by the Tax Inspectorate of Tbilisi, Georgia, order number 205168833. The company holds brokerage license number 129 dated 13 September 2006 granted by Securities National Commission of Georgia. The principal activity of the company is brokerage operations on local stock exchange market. The company was owned by the Bank from the date of incorporation.

JSC Sakkalakmshenproekti was bought by the Group in 2005. The Company's principal activity is providing architectural design and other related services.

LLC Social House was established by the Bank in association with People's Insurance. The entity operates a chain of policlinics, which provide various medical services to insured citizens.

LLC Rustavi Central Cash Desk was acquired by the Bank in 2004. The company possesses land and buildings and is inactive since 2005.

These consolidated financial statements were authorized for issue by the Management Board of the Group on 9 December 2009.

2. BASIS OF PREPARATION

General

These consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

These consolidated financial statements are presented in thousands of Georgian Lari ("GEL"), unless otherwise indicated. These consolidated financial statements have been prepared under the historical cost convention, except for the measurement at fair value of certain financial instruments and measurement of land and buildings at revalued amounts.

The Bank and its subsidiaries maintain their accounting records in accordance with IFRS. These consolidated financial statements have been prepared based on accounting records of the Bank and its subsidiaries.

Functional currency

The functional currency of the consolidated financial statements is Georgian Lari.

3. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and the entities controlled by the Bank (its subsidiaries) made up to 31 December each year. Control is achieved where the Bank has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

All significant intra-group transactions, balances, income and expenses are eliminated on consolidation.

Investments in associates

An associate is an entity over which the Group is in a position to exercise significant influence, but is neither a subsidiary nor a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associate are incorporated in these consolidated financial statements using the equity method of accounting. Investments in associates are carried in the consolidated balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investment. Losses of the associates in excess of the Group's interest in those associates are not recognized.

Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable assets, liabilities and contingent liabilities of the associate at the date of acquisition is recognized as goodwill. The goodwill is included in the carrying amount of the investment and is assessed for impairment as part of the investment. Any deficiency of the cost of acquisition below the Group's share of the fair values of the identifiable assets, liabilities and contingent liabilities of the associate at the date of acquisition (i.e. discount on acquisition) is credited in the consolidated statement of operations in the period of acquisition.

Where a Group company transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.

Financial assets

Initial recognition

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

Date of recognition

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

'Day 1' profit

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

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. Gains and losses are recognised in the consolidated statement of operations when the investments are impaired, as well as through the amortisation process.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the consolidated statement of operations 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 as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the consolidated statement of operations. However, interest calculated using the effective interest method is recognised in the consolidated statement of operations.

Determination of fair value

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

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Offsetting

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

Cash and cash equivalents

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

Amounts due from credit institutions

In the normal course of business, the Group maintains advances or deposits for various periods of time with other banks. Due from credit institutions are initially recognized at fair value. Due from credit institutions are subsequently measured at amortized cost using the effective interest method. Amounts due from credit institutions are carried net of any allowance for impairment losses.

Borrowings

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

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

Leases

Operating - Group as lessee

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Operating - Group as lessor

The Group presents assets subject to operating leases in the consolidated balance sheet according to the nature of the asset. Lease income from operating leases is recognised in the consolidated statement of operations on a straight-line basis over the lease term as other income. The aggregate cost of incentives provided to lessees is recognised 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.

Impairment of financial assets

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

Amounts due from credit institutions and loans to customers

For amounts due from credit institutions and loans to customers carried at amortised cost, the 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 statement of operations. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery 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 statement of operations.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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 statement of operations.

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 statement of operations.

Available-for-sale financial investments

For available-for-sale financial investments, the Group assesses at each balance sheet 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 statement of operations – is removed from equity and recognised in the consolidated statement of operations. Impairment losses on equity investments are not reversed through the consolidated statement of operations; increases in their fair value after impairment are recognised directly in equity.

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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Financial liabilities

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

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

Insurance and other accounts receivable

Accounts receivable are subsequently measured at amortized cost using effective interest method. Short-term accounts receivable, which are non-interest bearing are stated at their nominal value. Appropriate allowances for estimated irrecoverable amounts are recognized when there is objective evidence that the asset is impaired.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property, plant and equipment

Initial cost of property, plant and equipment is assessed based on actual expenses for their acquisition that comprise purchase price, including non-refundable purchase taxes and any directly attributed costs of bringing the asset to its working condition and location for intended use. Subsequent to initial recognition property, plant and equipment, except for land and buildings, are stated at historical cost less accumulated depreciation and accumulated impairment losses.

Depreciation is charged on the historical (revalued) cost of property, plant and equipment and is designed to write off assets over their useful economic lives. It is calculated on a straight line basis at the following annual prescribed rates:

Buildings and other real estate	2%-5%
Furniture and equipment	15%-20%
Computer equipment	20%-25%
Vehicles	20%-25%
Leasehold improvements	15%-25%

Leasehold improvements are amortized over the life of the related leased asset. Expenses related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization.

The carrying amounts of property, plant and equipment are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts, and where carrying values exceed this estimated recoverable amount, assets are written down to their recoverable amount.

Impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation charge for property, plant and equipment is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

Land and buildings held for use in supply of services, or for administrative purposes, are stated in the consolidated balance sheet at their revalued amounts, being the fair value at the date of revaluation, determined from market-based evidence by appraisal undertaken by professional independent appraisers, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date.

Any revaluation increase arising on the revaluation of such land and buildings is credited to the land and buildings revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognized as an expense, in which case the increase is credited to the consolidated statement of operations to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of such land and buildings is charged as an expense to the extent that it exceeds the balance, if any, held in the properties revaluation reserve relating to a previous revaluation of that asset.

Depreciation on revalued buildings is charged to statement of operations. On the subsequent sale or retirement of a revalued property, the attributable revaluation surplus remaining in the land and buildings revaluation reserve is transferred directly to retained earnings.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair value of land and buildings is assessed using three methods:

- The comparable sales method which involves analysis of market sales prices for similar real estate property;
- The income-based method which assumes a direct relationship between revenues generated by the property and its market value;
- The costs method which presumes the value of property to be equal to its recoverable amount less any depreciation charges.

Intangible assets

Intangible assets include computer software and licenses.

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

Taxation

Income tax expense represents the sum of the current and deferred income tax expense.

The current tax expense is based on taxable profit for the year. Taxable profit differs from net profit as reported in the statement of operations because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's current tax expense is calculated using tax rates that have been enacted during the reporting period.

Deferred income tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from the initial recognition of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognized for taxable temporary differences arising on property, plant and equipment, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the statement of operations, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt within equity.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the balance sheet if:

- The Group has a legally enforceable right to set off current income tax assets against current income tax liabilities; and
- Deferred income tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

Georgia also has various other taxes, which are assessed on the Group's activities. These taxes are included as a component of operating expenses in the statement of operations.

Amounts due to credit institutions, customer accounts and other borrowed funds

Amounts due to credit institutions, customer accounts and other borrowed funds are initially recognized at fair value. Subsequently, amounts due are stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the consolidated statement of operations over the period of the borrowings, using the effective interest method.

Provisions

Provisions are recognized 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 obligation can be made.

Insurance contract provision for unearned premiums

Insurance contract provision for unearned premiums represents the proportion of premiums written in the period that relates to unexpired terms of policies in force at the balance sheet date, calculated on a time apportionment basis.

Insurance contract provisions for claims

Insurance contract provisions represent the accumulation of estimates for ultimate losses and includes provision for reported but not settled claims ("RBNS") and provision for losses incurred but not yet reported ("IBNR").

RBNS is provided in respect of claims reported, but not settled as at the balance sheet date. The estimation is made on the basis of information received by the Group during investigation of insurance cases.

IBNR should be actuarially determined by the Group by line of business, and should include assumptions based on prior years' claims and claims handling experience. The methods of determining such estimates and establishing the resulting provisions are continually reviewed and updated. Resulting adjustments are reflected in the consolidated statement of operations as they arise.

The loss reserves are estimated on an undiscounted basis due to the relatively quick pattern of claims notification and payment.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial guarantee contracts issued and letters of credit

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 statement of operations. The premium received is recognised in the consolidated statement of operations on a straight-line basis over the life of the guarantee.

Contingencies

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

Share capital

Share capital

Ordinary shares represent equity capital. Contributions to share capital are recognized at their cost. Share premium represents the excess of contributions over the nominal value of the shares issued. 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.

Treasury shares

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

Dividends

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

Segment reporting

The Group's operations are highly integrated and primarily constitute a single industry segment, banking, that accounts for more than 98% of the Group's business. Accordingly for the purposes of IAS 14 "Segment Reporting" the Group is treated as one business segment. The Group's assets are concentrated primarily in Georgia, and the majority of the Group's revenues and net income is derived from operations in, and connected with, Georgia.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Retirement and other benefit obligations

In accordance with the requirements of the Georgian legislation, certain percentages of pension payments were withheld from total disbursements to staff to be transferred to the state pension fund till 1 January 2008, such that a portion of salary expense is withheld from the employee and instead paid to the state pension fund on behalf of the employee. This expense was charged in the period in which the related salaries were earned. Upon retirement, all retirement benefit payments are made by the state pension funds. The Group does not have any pension arrangements separate from the state pension system of Georgia. In addition, the Group has no post-retirement benefits or other significant compensated benefits requiring accrual.

Recognition of income and expense

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 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 income 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.

(in thousands of Georgian Lari)

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- *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 Group's right to receive the payment is established.

Foreign currency translation

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

Differences between the contractual exchange rate of a transaction in a foreign currency and the NBG exchange rate on the date of the transaction in consolidated statement of operations are included in net gain on foreign exchange operations.

Rates of exchange

The exchange rates used by the Group in the preparation of the consolidated financial statements as at 31 December 2008 and 2007 are as follows:

	31 December 2008	31 December 2007
GEL/1 US Dollar	1.6670	1.5916
GEL/1 Euro	2.3648	2.3315

Areas of significant management judgment and sources of estimation uncertainty

The preparation of the Group's consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the balance sheet date and the reported amount of income and expenses during the period ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The following estimates and judgments are considered important to the portrayal of the Group's financial condition.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for impairment of loans

The Group regularly reviews its loans to assess for impairment. The Group's loan impairment provisions are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Group considers accounting estimates related to allowance for impairment of loans and receivables a key source of estimation uncertainty because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and receivables are based on recent performance experience, and (ii) any significant difference between the Group's estimated losses and actual losses would require the Group to record provisions which could have a material impact on its financial statements in future periods.

The Group uses management's judgment to estimate the amount of any impairment loss in cases where a borrower has 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 past performance, past customer behavior, observable data indicating an adverse change in the payment status of borrowers in a group, and 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. The Group uses management's judgment to adjust observable data for a group of loans to reflect current circumstances not reflected in historical data.

The allowances for impairment of financial assets in the consolidated financial statements have been determined on the basis of existing economic and political conditions. The Group is not in a position to predict what changes in conditions will take place in Georgia and what effect such changes might have on the adequacy of the allowances for impairment of financial assets in future periods.

Valuation of financial instruments

Financial instruments that are classified as available-for-sale are stated at fair value. The fair value of such financial instruments is the estimated amount at which the instrument could be exchanged between willing parties, other than in a forced or liquidation sale. If a quoted market price is available for an instrument, the fair value is calculated based on the market price. When valuation parameters are not observable in the market or cannot be derived from observable market prices, the fair value is derived through analysis of other observable market data appropriate for each product and pricing models which use a mathematical methodology based on accepted financial theories. Pricing models take into account the contract terms of the securities as well as market-based valuation parameters, such as interest rates, volatility, exchange rates and the credit rating of the counterparty. Where market-based valuation parameters are missed, management will make a judgment as to its best estimate of that parameter in order to determine a reasonable reflection of how the market would be expected to price the instrument. In exercising this judgment, a variety of tools are used including proxy observable data, historical data, and extrapolation techniques. The best evidence of fair value of a financial instrument at initial recognition is the transaction price unless the instrument is evidenced by comparison with data from observable markets. Any difference between the transaction price and the value based on a valuation technique is not recognized in the consolidated statement of operations on initial recognition.

Subsequent gains or losses are only recognized to the extent that it arises from a change in a factor that market participants would consider in setting a price.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Group considers that the accounting estimate related to valuation of financial instruments where quoted markets prices are not available is a key source of estimation uncertainty because: (i) it is highly susceptible to change from period to period because it requires management to make assumptions about interest rates, volatility, exchange rates, the credit rating of the counterparty, valuation adjustments and specific feature of the transactions and (ii) the impact that recognizing a change in the valuations would have on the assets reported on its balance sheet as well as its profit/loss could be material.

Had management used different assumptions regarding the interest rates, volatility, exchange rates, the credit rating of the counterparty and valuation adjustments, a larger or smaller change in the valuation of financial instruments where quoted market prices are not available would have resulted that could have had a material impact on the Group's reported net income.

Insurance contract provisions

For insurance contract provisions estimates have to be made both for the expected ultimate cost of claims reported but not settled at the balance sheet date ("RBNS") and for the expected ultimate cost of claims incurred but not yet reported at the balance sheet date ("IBNR"). It can take a significant period of time before the ultimate claims cost can be established with certainty and for some type of policies, IBNR claims form the majority of the balance sheet liability.

The main assumption underlying techniques used by the Group is that the Group's past claims development experience is used to project future claims development and, hence, ultimate claims costs. As such, these techniques extrapolate the development of paid and incurred losses, average costs per claim and claim numbers based on the observed development of earlier years and expected loss ratios. Historical claims development is mainly analyzed by significant business lines. Large claims are usually separately addressed, either by being reserved at the face value of loss adjustor estimates or separately projected in order to reflect their future development. In most cases, no explicit assumptions are made regarding future rates of claims inflation or loss ratios. Instead, the assumptions used are those implicit in the historic claims development data on which the projections are based. Additional qualitative judgment is used to assess the extent to which past trends may not apply in future, in order to arrive at the estimated ultimate cost of claims that present the likely outcome from the range of possible outcomes, taking account of all the uncertainties involved.

Further judgment is made as to the recoverability of amounts due from reinsurers. Provisions for bad debts are made specifically based on the solvency of the reinsurers, payment experience with them and any discrepancies of which the Group is aware.

The carrying values of insurance contract provision for claims as at 31 December 2008 and 2007 were GEL 2,566 thousand and GEL 459 thousand, respectively.

Property, plant and equipment

Certain property (land and buildings) is measured at revalued amounts. The date of the latest appraisal was 31 December 2008. The next revaluation is scheduled as at 31 December 2009. Other items of property, plant and equipment are stated at cost less accumulated depreciation and less any accumulated impairment losses. The estimation of the useful life of an item of property, plant and equipment is a matter of management judgment based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any one of these conditions or estimates may result in adjustments to future depreciation rates.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Adoption of new and revised standards

In the current year, the Group has adopted all of the new and revised Standards and Interpretations issued by the IASB and IFRIC of the IASB that are relevant to its operations and effective for annual reporting periods ending on 31 December 2008. The adoption of these new and revised Standards and Interpretations has not resulted in significant changes to the Group's accounting policies that have affected the amounts reported for the current or prior years.

Amendments to IAS 1 "Capital Disclosures" ("IAS 1") – On 18 August 2005, the IASB issued amendments to IAS 1 which requires certain disclosures to be made regarding the entity's objectives, policies and processes for managing capital. Additional information was disclosed in the consolidated financial statements for the current and comparative reporting periods as required by amended IAS 1.

Amendments to IAS 39, "Financial Instruments: Recognition and Measurement", and IFRS 7, "Financial Instruments: Disclosures", titled "Reclassification of Financial Assets" – On 13 October 2008 IASB issued amendments to IAS 39 and IFRS 7 which permits certain reclassifications of non-derivative financial assets (other than those designated as at fair value through profit or loss at initial recognition under the fair value option) out of the fair value through profit or loss category and also allow reclassification of financial assets from the available-for-sale category to the loans and receivables category in particular circumstances. The amendments to IFRS 7 introduce additional disclosure requirements if an entity has reclassified financial assets in accordance with the amendments to IAS 39. The amendments are effective as at 13 October 2008 and in certain circumstances can be applied retrospectively from 1 July 2008.

Future changes in accounting policies

Standards and interpretations issued and not yet adopted

At the date of authorization of these consolidated financial statements, the following Interpretations were in issue but not yet effective.

Improvements to IFRS

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

IAS 1 Presentation of Financial Statements (Revised)

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

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 financial statements as the Group has not entered into any such hedges.

IAS 7 – Amendments to IAS 7, "Statement of Cash Flows" (part of Improvements to IFRSs (2009)) specify that only expenditures that result in a recognized asset in the statement of financial position can be classified as investing activities in the statement of cash flows (effective for the annual periods beginning on or after 1 January 2010).

IAS 23 – On March 2007 the IASB issued a revised IAS 23 "Borrowing Costs". The main change is the removal of the option of immediately recognizing as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalize borrowing costs as part of the cost of such asset. The Standard applies to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009.

IAS 27 – In 2008 the Standard was amended as part of the second phase of the business combinations project. That phase of the project was undertaken jointly with the US Financial Accounting Standards Board (FASB). The amendments related, primarily, to accounting for non-controlling interests and the loss of control of a subsidiary. The boards concluded the second phase of the project by the IASB issuing the amended IAS 27 and the FASB issuing FASB Statement No. 160 Noncontrolling Interests in Consolidated Financial Statements, along with, respectively, a revised IFRS 3 Business Combinations and FASB Statement No. 141 (revised 2007) Business Combinations. He amended Standard must be applied for annual periods beginning on or after 1 July 2009. Earlier application is permitted. However, an entity must not apply the amendments for annual periods beginning before 1 July 2009 unless it also applies IFRS 3 (as revised in 2008).

IAS 28 (as revised in 2008), "Investments in Associates" – IAS 28 (2008) is effective for annual periods beginning on or after 1 July 2009. The loss of control is recognized as a disposal and re-acquisition of any retained interest at fair value is extended by consequential amendment to IAS 28; therefore, when significant influence is lost, the investor measures any investment retained in the former associate at fair value, with any consequential gain or loss recognized in profit or loss.

IFRIC 9 "Reassessment of Embedded Derivatives" which requires that there should be no reassessment of whether an embedded derivative should be separated from the host contract after initial recognition, unless there have been changes to the contract. The adoption of IFRIC 9 had no impact on the Group's profit or loss or financial position.

IFRIC 13 "Customer Loyalty Programmes" was issued in June 2007 and becomes 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. The Group expects that this interpretation will have no impact on the Group's financial statements as no such schemes currently exist.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

Amendment to IFRS 2 were issued in January 2008 and become 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 will have no impact on the financial position or performance of the Group.

IFRS 3 – On 10 January 2008, the IASB issued an amendment to IFRS 3 "Business Combinations", which clarifies and changes certain elements of accounting for a business combination, including measurement of contingent consideration, step acquisition and intangible assets and also widens the scope of this standard. The amendment to IFRS 3 is effective for periods beginning on or after 1 January 2009.

IFRS 5, "Non-current Assets Held for Sale and Discontinued Operations" – as part of improvements to IFRSs (2009) the IASB clarified that the disclosure requirements in the Standards other than IFRS 5 do not generally apply to non-current assets classified as held for sale and discontinued operations (effective for the annual periods beginning on or after 1 January 2010).

IFRS 7 – In March 2009 the IASB issued "Improving Disclosures about Financial Instruments" (Amendments to IFRS 7). The amendments require enhanced disclosure about fair value measurments and liquidity risk. Entities are required to apply the amendments for annual periods beginning on or after 1 January 2009, with earlier application permitted.

IFRS 8 – The IASB issued IFRS 8 "Operating Segments" in December 2006. This will replace IAS 14 "Segment Reporting" for accounting periods beginning on or after 1 January 2009. IFRS 8 requires segmental analysis reported by an entity to be based on information used by management. Management is currently assessing the impact of the adoption of IFRS 8.

4. PRIOR PERIOD ADJUSTMENTS AND RECLASSIFICATIONS

In 2008 the Group's management discovered errors in the consolidated financial statements for the years ended 31 December 2007 and 2006. In accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" the correction of the errors was done retrospectively. Comparative amounts were restated and the corrections were made to the earliest prior period presented. The buildings and other real estate were restated due to identification of unconsolidated subsidiary, Rustavi Central Cash Desk LLC, which was acquired by the Bank in 2004 and was not recorded as a subsidiary. The restatement of deferred tax liability and land and buildings revaluation reserve are solely attributable to consolidation of this subsidiary and to the unaccounted changes in the income tax rate.

The effect of the adjustments made to the consolidated financial statements for the year ended 31 December 2007 is as follows:

(in thousands of Georgian Lari)

4. PRIOR PERIOD ADJUSTMENTS AND RECLASSIFICATIONS (CONTINUED)

Type of correction	Amount of correction	Financial statements item	As previously reported 31 December 2007/year ended 31 December 2007	As restated 31 December 2007/year ended 31 December 2007
Restatement of land and buildings of LLC Rustavi Central Cash Desk	219	Property, plant and equipment	93,298	93,517
Deferred tax liabilities arising from restatement of land and buildings of LLC Rustavi Central Cash Desk	(33)	Deferred income tax liability	(8,807)	(8,840)
Restatement of land and buildings revaluation reserve arising from restatement of land and buildings of LLC Rustavi Central Cash Desk	(190)	Property, plant and equipment revaluation reserve	(36,556)	(36,746)
Restatement of accumulated deficit arising from depreciation of buildings of LLC Rustavi Central Cash Desk	4	Accumulated deficit	369	373
Restatement of accumulated deficit arising from consolidation of LLC Rustavi Central Cash Desk	(4)	Accumulated deficit	373	369
Restatement of other assets arising from consolidation of investment in LLC Rustavi Central Cash Desk	(4)	Other assets	21,421	21,417
Restatement of cash and cash equivalents arising from consolidation of investment in LLC Rustavi Central Cash Desk	1	Cash and cash equivalents	28,049	28,050
Restatement of land and buildings arising from consolidation of LLC Rustavi Central Cash Desk	7	Property, plant and equipment	93,517	93,524
Restatement of deferred income tax liability arising from effect of changes in income tax rate on land and buildings revaluation reserve	753	Deferred income tax liability	(8,840)	(8,087)
Restatement of property, plant and equipment revaluation reserve arising from effect of changes in income tax rate on land and buildings revaluation reserve	(753)	Property, plant and equipment revaluation reserve	(36,746)	(37,499)
Restatement of impairment allowance for intra-group loan eliminated on consolidation	140	Loans to customers	120,457	120,597
Restatement of impairment allowance for intra-group loan eliminated on consolidation	140	Provision for impairment losses on interest bearing assets	(8,426)	(8,286)
Restatement of accrued interest income on intra-group loan eliminated on consolidation	(5)	Interest income	15,430	15,425
Restatement of accrued interest income on intra-group loan eliminated on consolidation	(5)	Loans to Customers	120,597	120,592
Restatement of loans to customers for intra-group loan eliminated on consolidation	(7,000)	Loans to customers	120,592	113,592
Restatement of loans to customers for intra-group loan eliminated on consolidation	7,000	Customer accounts	(207,887)	(200,887)

(in thousands of Georgian Lari)

4. PRIOR PERIOD ADJUSTMENTS AND RECLASSIFICATIONS (CONTINUED)

Certain reclassifications have been made to the consolidated financial statements as at 31 December 2007 and for the year then ended to conform to the presentation as at 31 December 2008 and for the year then ended as current year presentation provides better view of the financial position of the Group.

Type of correction	Amount of correction	Financial statements item	As previously reported 31 December 2007/year ended 31 December 2007	As restated 31 December 2007/year ended 31 December 2007
Investment available-for-sale classified as other assets	10	Investments available-for-sale	871	881
Investment available-for-sale classified as other assets	(10)	Other assets	21,417	21,407
Intangible assets classified as other assets	(2,762)	Other assets	21,407	18,645
Intangible assets classified as other assets	2,762	Intangible assets	-	2,762
Reclassification of due from credit institutions with the maturity of up to three months and balances with NBG to cash and cash equivalents	(5,938)	Due from credit institutions	24,184	18,246
Reclassification of due from credit institutions with the maturity of up to three months and balances with NBG to cash and cash equivalents	5,938	Cash and cash equivalents	28,050	33,988

(in thousands of Georgian Lari)

5. NET INTEREST INCOME

	Year ended 31 December 2008	Year ended 31 December 2007 (restated)
Interest income comprises:		
Interest income on financial assets recorded at amortized cost:		
- interest income on assets that have been collectively assessed for impairment	26,484	12,768
- interest income on assets that have been individually assessed for impairment	5,158	524
- interest income on unimpaired financial assets	938	2,133
Total interest income	**32,580**	**15,425**
Interest on loans to customers	31,642	14,845
Interest on due from credit institutions	930	524
Interest on investments held-to-maturity	8	56
Total interest income	**32,580**	**15,425**
Interest expense comprises:		
Interest expense on financial assets recorded at amortized cost:		
Interest on customer accounts	(9,782)	(4,252)
Interest on due to credit institutions	(4,479)	(301)
Interest on other borrowed funds	(2,319)	-
Total interest expense	**(16,580)**	**(4,553)**
Net interest income before provision for impairment losses on interest bearing assets	**16,000**	**10,872**

6. ALLOWANCE FOR IMPAIRMENT LOSSES, OTHER PROVISIONS

The movements in allowance for impairment losses on interest earning assets were as follows:

	Due from credit institutions	Loans to customers	Total
31 December 2006	**-**	**3,989**	**3,989**
Provision (restated)	-	8,286	8,286
Write-off of assets		(1,892)	(1,892)
31 December 2007	**-**	**10,383**	**10,383**
Provision	10,500	17,364	27,864
Write-off of assets	-	(2,337)	(2,337)
Recoveries of assets previously written off	-	11	11
31 December 2008	**10,500**	**25,421**	**35,921**

(in thousands of Georgian Lari)

6. ALLOWANCE FOR IMPAIRMENT LOSSES, OTHER PROVISIONS (CONTINUED)

The movements in allowances for impairment losses on other transactions were as follows:

	Other assets	Guarantees and other commitments	Investments available-for-sale	Total
31 December 2006	721	-	-	721
Provision	206	146	-	352
Write-off of assets	(8)	-	-	(8)
31 December 2007	919	146	-	1,065
Provision/(Recovery of provision)	4,481	(146)	764	5,099
Write-off of assets	(345)	-	-	(345)
31 December 2008	5,055	-	764	5,819

7. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprises:

	Year ended 31 December 2008	Year ended 31 December 2007
Dealing, net	3,517	1,575
Translation differences, net	(3,057)	(80)
Total net gain on foreign exchange operations	**460**	**1,495**

8. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended 31 December 2008	Year ended 31 December 2007
Fee and commission income:		
Settlement from pension operations and social aid operations	14,212	12,248
Swift money transfers	6,606	6,029
Settlements	4,070	3,428
Cash operations	3,236	3,360
Voucherization and scholarship state program	-	1,449
Other	1,295	1,664
Total fee and commission income	**29,419**	**28,178**
Fee and commission expense:		
Processing of VISA cards	(644)	(327)
Cash operations	(379)	(210)
Correspondent bank service	(247)	(220)
Other	(70)	(31)
Total fee and commission expense	**(1,340)**	**(788)**

(in thousands of Georgian Lari)

9. OTHER INCOME, NET

Other income comprises:

	Year ended 31 December 2008	Year ended 31 December 2007
Insurance income	24,067	4,641
Change in unearned premium reserve	(8,669)	(2,108)
Change in the insurance contract provisions for claims	(2,115)	(318)
Insurance claims incurred	(9,237)	(426)
Insurance income, net	**4,046**	**1,789**
Income from architectural works and rent	2,662	2,432
Income from postal and courier services	2,153	656
Revenue from fines	1,081	371
Gain from sale of land	162	2,434
Revenue from servicing documentary stamps	120	48
Revenue from guarantees and letter of credit	71	427
Other	882	1,935
Total other income, net	**11,177**	**10,092**

10. OPERATING EXPENSES

Operating expenses comprise:

	Year ended 31 December 2008	Year ended 31 December 2007
Salary and bonuses	35,836	16,007
Land and buildings impairment loss	6,126	-
Depreciation and amortization	4,697	3,296
Advertizing costs	3,614	3,094
Stationery and other materials	2,980	1,984
Bad debts write off	2,810	-
Rent	2,737	1,826
Representative expenses	1,880	1,345
Taxes, other than income tax	1,243	646
Penalties and fines	1,197	985
Security	1,050	1,051
Utilities	1,041	2,081
Professional services	985	657
Business trip expenses	684	533
Property, plant and equipment maintenance	571	725
Plastic card operation	412	118
Bank forms and documents production	140	168
Other expenses	9,192	4,287
Total operating expenses	**77,195**	**38,803**

(in thousands of Georgian Lari)

11. INCOME TAXES

The Group provides for taxes based on the tax accounts maintained and prepared in accordance with Georgian tax regulations, which differ from International Financial Reporting Standards.

The Group is subject to certain permanent tax differences due to non-tax deductibility of certain expenses and a tax free regime for certain income.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at 31 December 2008 and 2007 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Temporary differences as at 31 December 2008 and 2007 comprise:

	31 December 2008	31 December 2007 (restated)
Deductible temporary differences:		
Impairment of goodwill	1,085	1,085
Property, plant and equipment	6,771	5,833
Other liabilities	36,970	368
Total deductible temporary differences	**44,826**	**7,286**
Taxable temporary differences:		
Property, plant and equipment	(88,482)	(79,466)
Total taxable temporary differences	**(88,482)**	**(79,466)**
Net deferred temporary differences at 15% rate	(6,548)	(10,827)
Tax loss carry forward	7,697	2,740
Net deferred income tax assets/(liabilities)	**1,149**	**(8,087)**

Relationships between tax expenses and accounting profit for the years ended 31 December 2008 and 2007 are explained as follows:

	Year ended 31 December 2008	Year ended 31 December 2007 (restated)
(Loss)/profit before income tax	(54,338)	2,399
Tax at the statutory tax rate (15%)	(8,151)	360
Effect of change in tax rate	-	(2,395)
Tax effect of permanent differences	(490)	1,859
Income tax benefit	**(8,641)**	**(176)**
Current income tax expense	455	1,311
Deferred income tax benefit	(9,096)	(1,487)
Income tax benefit	**(8,641)**	**(176)**

(in thousands of Georgian Lari)

11. INCOME TAXES (CONTINUED)

Deferred income tax liabilities/(assets)	**Year ended 31 December 2008**	**Year ended 31 December 2007 (restated)**
Beginning of the period	8,087	6,352
Deferred income tax on property, plant and equipment charged to equity	(140)	3,975
Effect of changes in income tax rate on revaluation reserve for property, plant and equipment	-	(753)
Decrease in income tax liabilities for the period charged to statement of operations	(9,096)	(1,487)
End of the period	**(1,149)**	**8,087**

12. CASH AND CASH EQUIVALENTS

	31 December 2008	**31 December 2007 (restated)**
Cash on hand	11,652	16,582
Correspondent accounts with other banks	16,646	13,507
Placements with other banks with original maturity of less than 90 days	6,327	18
Cash balances with the NBG (other than obligatory minimum reserve deposits)	22,444	3,881
Total cash and cash equivalents	**57,069**	**33,988**

Included in cash and cash equivalents are accrued interest in the amount of GEL 12 thousand and nil as at 31 December 2008 and 2007, respectively.

13. DUE FROM CREDIT INSTITUTIONS

Due from credit institutions comprise:

	31 December 2008	**31 December 2007 (restated)**
Time deposits with other banks	11,058	10,659
NBG obligatory reserve deposits	3,171	7,587
Less allowance for impairment losses on due from credit institutions	(10,500)	-
Total due from credit institutions	**3,729**	**18,246**

Movements in allowances for impairment losses on cash and cash equivalents for the years ended 31 December 2008 and 2007 are disclosed in Note 6.

The Group is required to maintain the reserve balance with the NBG at all times.

(in thousands of Georgian Lari)

13. DUE FROM CREDIT INSTITUTIONS (CONTINUED)

Included in due from credit institutions are accrued interest in the amount of nil and GEL 18 thousand as at 31 December 2008 and 2007, respectively.

As at 31 December 2008 and 2007 the Group had due from one bank, which individually comprised 10% of the Group's equity.

As at 31 December 2008 and 2007 the maximum credit risk exposure on due from credit institutions amounted to GEL 3,729 thousand and GEL 18,246 thousand, respectively.

As at 31 December 2008 and 2007 included in balances due from credit institutions are guarantee deposits placed by the Group for its plastic cards operations in the amount of GEL 558 thousand and GEL 159 thousand, respectively.

14. LOANS TO CUSTOMERS

Loans to customers comprise:

	31 December 2008	31 December 2007 (restated)
Originated loans	129,265	121,453
Accrued interest	5,442	2,522
	134,707	123,975
Less allowance for impairment losses	(25,421)	(10,383)
Total loans to customers	**109,286**	**113,592**

Movements in allowances for impairment losses for the years ended 31 December 2008 and 2007 are disclosed in Note 6.

The table below summarizes the amount of loans secured by type of collateral, rather than the fair value of the collateral itself:

	31 December 2008	31 December 2007 (restated)
Loans collateralized by real estate	37,266	26,836
Loans collateralized by salary	29,719	36,706
Loans collateralized by other collateral	18,351	3,641
Loans collateralized by pension funds	12,402	9,215
Loans collateralized by cash or guarantees from Georgian government	5,116	2,649
Loans collateralized by guarantees	4,239	1,601
Loans collateralized by gold	1,635	2,678
Loans collateralized by inventory and equipment	647	14,228
Loans collateralized by securities	-	1,987
Unsecured loans	25,332	24,434
	134,707	123,975
Less allowance for impairment losses	(25,421)	(10,383)
Total loans to customers	**109,286**	**113,592**

(in thousands of Georgian Lari)

14. LOANS TO CUSTOMERS (CONTINUED)

	31 December 2008	31 December 2007 (restated)
Analysis by sector:		
Individuals	89,635	79,115
Trade and services	13,719	6,721
Real estate and construction	6,814	5,437
Energy	2,737	9,995
Manufacturing	-	4,919
Agriculture	1,448	2,023
Other	20,354	15,765
	134,707	123,975
Less allowance for impairment losses	(25,421)	(10,383)
Total loans to customers	**109,286**	**113,592**

During the years ended 31 December 2008 and 2007 the Group received non-financial assets by taking possession of collateral held as security. As at 31 December 2008 and 2007 such assets in amount of GEL 468 thousand are included in other assets.

Loans to individuals comprise the following products:

	31 December 2008	31 December 2007
Consumer loans	70,747	68,521
Overdrafts	8,312	3,687
Other	10,576	6,907
	89,635	79,115
Less allowance for impairment losses	(8,621)	(4,043)
Total loans to individuals	**81,014**	**75,072**

As at 31 December 2008 and 2007 a maximum credit risk exposure on loans to customers amounted to GEL 109,286 thousand and GEL 113,592 thousand, respectively.

As at 31 December 2008 and 2007 the Group granted loans to 9 and 5 customers, totaling GEL 28,402 thousand and GEL 20,313 thousand, respectively, which individually exceeded 10% of the Group's equity as at 31 December 2008 and 2007, respectively.

As at 31 December 2008 and 2007 all loans were granted to companies operating in Georgia, which represents a significant geographical concentration in one region.

As at 31 December 2008 and 2007 loans to customers included loans in the amount of GEL 3,901 thousand (3 loans) and GEL 4,263 thousand (7 loans), respectively, whose terms have been renegotiated. Otherwise these loans would be past due or impaired.

As at 31 December 2008 and 2007 loans to customers included loans in amount of GEL 43,793 thousand and GEL 16,340 thousand, respectively which were individually impaired.

(in thousands of Georgian Lari)

15. INVESTMENTS AVAILABLE-FOR-SALE

Investments available-for-sale comprise:

	Ownership interest	31 December 2008	Ownership interest	31 December 2007 (restated)
Equity securities				
GMC Group	30%	7,644	0%	-
Partnership "Main Business Center"	50%	827	50%	827
JSC Tbilisi Inter-bank Stock Exchange	8%	44	8%	44
LLC Legal Insurance Group	50%	10	50%	10
LLC "Mevenakhis Sakhli"	50%	0.2	50%	0.2
Less allowance for losses		(764)		-
Total investments available-for-sale		**7,761**		**881**

16. INVESTMENTS IN ASSOCIATES

The following enterprises were recorded in the consolidated financial statements using the equity method:

	31 December 2008		31 December 2007	
	Ownership interest	Carrying value	Ownership interest	Carrying value
United System for Instant Payments JSC	30%	893	30%	789
		893		**789**

The percentage held of the above associates represents both direct and/or indirect ownership of the Group.

The movements of investments in associates comprise:

	31 December 2008	31 December 2007
Balance at beginning of the year	789	-
Acquisition	-	798
Share of post-acquisition profit/(loss)	104	(9)
Balance at end of the year	**893**	**789**

(in thousands of Georgian Lari)

16. INVESTMENTS IN ASSOCIATES (CONTINUED)

Summarized financial information in respect of the Group's associates is set out below:

	31 December 2008	**31 December 2007**
Total assets	2,665	3,498
Total liabilities	(2,348)	(3,468)
Net assets	317	30
Group's share of net assets of associates	**95**	**9**

	Year ended 31 December 2008	**Year ended 31 December 2007**
Total revenue	6,411	5,889
Net profit/(loss)	346	(30)
Group's share of results from associates	**104**	**(9)**

(in thousands of Georgian Lari)

17. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings	Furniture and equipmentt	Computer equipment	Vehicles	Leasehold improvements	Construction in progress	Total
At cost/revalued amount							
31 December 2006 (restated)	32,242	7,165	3,852	1,331	2,162	298	47,050
Additions	17,072	5,028	1,481	420	850	1,366	26,217
Revaluation increase	25,327	-	-	-	-	-	25,327
Disposals	(44)	-	-	(16)	-	-	(60)
31 December 2007 (restated)	74,597	12,193	5,333	1,735	3,012	1,664	98,534
Additions	8,133	4,938	1,645	317	883	1,115	17,031
Revaluation decrease	(8,983)	-	-	-	-	-	(8,983)
Disposals	(69)	(320)	(1)	(146)	(97)	(192)	(825)
31 December 2008	73,678	16,811	6,977	1,906	3,798	2,587	105,757
Accumulated depreciation							
31 December 2006 (restated)	594	1,103	1,331	389	71	-	3,488
Charge for the year	1,029	867	905	209	49	-	3,059
Eliminated on revaluation	(1,526)	-	-	-	-	-	(1,526)
Eliminated on disposals	(2)	-	-	(9)	-	-	(11)
31 December 2007 (restated)	95	1,970	2,236	589	120	-	5,010
Charge for the year	1,890	1,077	1,040	282	68	-	4,357
Eliminated on revaluation	(1,925)	-	-	-	-	-	(1,925)
Eliminated on disposals	(60)	(136)	(1)	(139)	(4)	-	(340)
31 December 2008	-	2,911	3,275	732	184	-	7,102
Net book value							
31 December 2008	**73,678**	**13,900**	**3,702**	**1,174**	**3,614**	**2,587**	**98,655**
31 December 2007	**74,502**	**10,223**	**3,097**	**1,146**	**2,892**	**1,664**	**93,524**

As at 31 December 2008 and 2007 included in property, plant and equipment were fully depreciated assets of GEL 1,896 thousand and GEL 1,571 thousand, respectively.

The Group's land and buildings were revalued based on appraisals of independent expert Georgian Valuation Company LLC as at 31 December 2008. The fair values of revalued items were determined directly by reference to observable prices in an active market and recent market transactions on arm's length terms.

(in thousands of Georgian Lari)

17. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

Had the buildings been carried under the cost method the book value would be GEL 36,977 thousand as at 31 December 2008. The total revaluation surplus net of tax recognized in equity amounted to GEL 36,707 thousand as at 31 December 2008.

The impairment loss of GEL 792 thousand, net of deferred income tax in the amount of GEL 140 thousand has been recognized in the equity as decrease in a land and buildings revaluation reserve for the year ended 31 December 2008. The revaluation decrease of GEL 6,126 thousand has been recognized in the consolidated statement of operations for the year ended 31 December 2008.

The revaluation increase of GEL 22,526 thousand, net of deferred income tax of GEL 3,975 thousand has been recognized under the equity as a land and buildings revaluation reserve as at 31 December 2007. The revaluation increase of GEL 352 thousand has been recognized in the consolidated statement of operations for the year ended 31 December 2007.

18. INTANGIBLE ASSETS

Intangible assets include software, patents and licenses.

	Intangible assets
At initial cost	
31 December 2006	1,967
Additions	1,148
31 December 2007	3,115
Additions	1,118
31 December 2008	4,233
Accumulated amortization	
31 December 2006	116
Charge for the year	237
31 December 2007	353
Charge for the year	340
31 December 2008	693
Net book value	
31 December 2008	**3,540**
31 December 2007	**2,762**

(in thousands of Georgian Lari)

19. OTHER ASSETS

Other assets comprise:

	31 December 2008	31 December 2007 (restated)
Other financial assets:		
Receivables arising from insurance contracts	10,909	2,206
Prepayments and other debtors	12,597	2,579
Less allowance for impairment losses	(5,055)	(919)
Other non-financial assets:		
Prepayments for property, plant and equipment	9,019	5,207
Prepaid operating taxes	5,114	3,939
Voucherization income receivable	-	3,036
Repossessed assets	468	468
Other	2,467	2,129
Total other assets	**35,519**	**18,645**

Movements in allowances for impairment losses on other assets for the years ended 31 December 2008 and 2007 are disclosed in Note 6.

20. DUE TO CREDIT INSTITUTIONS

Due to credit institutions comprise:

	31 December 2008	31 December 2007
Correspondent accounts of other banks	7	19
Loans from banks and financial institutions	34,217	-
Term deposits of banks and other financial institutions	18,131	2,958
Total due to credit institutions	**52,355**	**2,977**

As at 31 December 2008 and 2007 accrued interest expenses included in due to credit institutions amounted to GEL 88 thousand and GEL 24 thousand, respectively.

As at 31 December 2008 and 2007 due to credit institutions in the amounts of GEL 34,217 thousand (65%) and GEL 2,000 thousand (67%), respectively, were due to one bank, which represents significant concentration.

(in thousands of Georgian Lari)

21. CUSTOMER ACCOUNTS

Customer accounts comprise:

	31 December 2008	31 December 2007 (restated)
Time deposits	77,138	48,188
Repayable on demand	104,314	152,699
Total customer accounts	**181,452**	**200,887**

As at 31 December 2008 and 2007 accrued interest expenses included in customers accounts amounted to GEL 2,944 thousand and GEL 2,522 thousand, respectively.

As at 31 December 2008 and 2007 customer accounts amounted to GEL 13,529 thousand and GEL 2,301 thousand, respectively, were held as security against guarantees issued.

As at 31 December 2008 and 2007 customer accounts of GEL 6,487 thousand (4%) and GEL 6,734 thousand (3%), respectively, were due to one customer, which represents significant concentration.

	31 December 2008	31 December 2007 (restated)
Analysis by sector:		
Individuals	113,510	106,990
Government of Georgia	22,879	44,501
Construction	7,006	2,626
Trade and service	6,940	7,871
Transport and communication	2,279	2,941
State controlled entities	969	13,060
Energy	613	2,219
Agriculture	303	118
Mining	22	490
Other	26,931	20,071
Total customer accounts	**181,452**	**200,887**

22. OTHER BORROWED FUNDS

Other borrowed funds comprise:

	31 December 2008	31 December 2007
Ricardo Master Holdings	8,516	-
Growth Master Holdings	4,258	-
Kazbek Master Holdings	8,516	-
Synergy Global Finance Master Fund	8,516	-
Total other borrowed funds	**29,806**	**-**

(in thousands of Georgian Lari)

22. OTHER BORROWED FUNDS (CONTINUED)

As at 31 December 2008 and 2007 accrued interest expenses included in other borrowed funds amounted to GEL 633 thousand and nil, respectively.

The Bank signed a term loan facility agreement with GML Capital LLP on 24 July 2008. According to the signed agreement, the Bank obtained financing through GML Capital LLP from the above disclosed counterparties for the total amount of USD 25,000 thousand. The annual interest on each loan facility equals to 11.5 percent. The loan facilities are due on 24 July 2010.

23. OTHER LIABILITIES

Other liabilities comprise:

	31 December 2008	31 December 2007
Other financial liabilities:		
Pension funds	541	759
State social aid project funds	4,579	3,322
Post war state social aid	16,620	-
Total other financial liabilities	21,740	4,081
Other non-financial liabilities:		
Insurance contract provision for unearned premiums	10,764	2,186
Insurance contract provisions for claims	2,566	459
Sundry creditors	1,604	1,240
Operating taxes payable	679	-
Provision for guarantees and other commitments	-	146
Tax penalties and fines	28	-
Other	1,027	1,040
Total other liabilities	**38,408**	**9,152**

Movements in allowances for impairment losses on guarantees and other commitments for the years ended 31 December 2008 and 2007 are disclosed in Note 6.

Pension funds, state social aid project funds and post war state social aid represent the amounts received from the Government of Georgia with the purpose of further distribution of these amounts to the population and other concerned parties.

24. SHARE CAPITAL AND SHARE PREMIUM

As at 31 December 2008 and 2007 the Group's authorized, issued and paid-in share capital consisted of 1,572,110,000 and 1,552,110,000 ordinary shares, respectively with par value of GEL 0.01 each. Out of 1,472,110,000 and 1,552,110,000 ordinary shares, the treasury shares comprised 500,000,000 and 355,000,000 as at 31 December 2008 and 2007, respectively.

(in thousands of Georgian Lari)

24. SHARE CAPITAL AND SHARE PREMIUM (CONTINUED)

The below table provides a reconciliation of the par value of shares outstanding as at 31 December 2008 and 2007:

	Ordinary shares
31 December 2006	12,000
Issue of shares	3,521
Buy back of shares	(500)
31 December 2007	**15,021**
Issue of shares	200
Sale of treasury shares	145
31 December 2008	**15,366**

Share premium represents an excess of contributions received over the nominal value of shares issued.

At 31 December 2008 no dividends were declared and distributed.

As at 31 December 2007 GEL 1,357 thousand dividends were declared and distributed.

25. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Group is a party to financial instruments with off-balance sheet risk in order to meet the needs of its customers. These instruments, involving varying degrees of credit risk, are not reflected in the balance sheet.

The Group's maximum exposure to credit loss under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

The Group uses the same credit control and management policies in undertaking off-balance sheet commitments as it does for on-balance operations.

Provision for losses on contingent liabilities amounted to nil and GEL 146 thousand as at 31 December 2008 and 2007, respectively.

As at 31 December 2008 and 2007 the nominal or contract amounts were:

	31 December 2008 Nominal amount	**31 December 2007 Nominal amount**
Contingent liabilities and credit commitments		
Guarantees issued and similar commitments	15,060	8,102
Total contingent liabilities and credit commitments	**15,060**	**8,102**

25. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Extension of loans to customers within credit line limits is approved by the Group on a case-by-case basis and depends on borrowers' financial performance, debt service and other conditions. The tranches within the credit line are issued under separate agreements, therefore as at 31 December 2008 and 2007 the commitment within the credit lines equaled to nil.

Capital commitments – The Group had no material commitments for capital expenditures outstanding as at 31 December 2008 and 2007.

Operating lease commitments – No material rental commitments were outstanding as at 31 December 2008 and 2007.

Legal proceedings – From time to time and in the normal course of business, claims against the Group are received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these consolidated financial statements.

Taxation **–** Due to the presence in Georgian commercial legislation, and tax legislation in particular, of provisions allowing more than one interpretation, and also due to the practice developed in a generally unstable environment by the tax authorities of making arbitrary judgment of business activities, if a particular treatment based on Management's judgment of the Group's business activities was to be challenged by the tax authorities, the Group may by assessed additional taxes, penalties and interest. Such uncertainty may relate to valuation of financial instruments, loss and impairment provisions and market level for deals' pricing. The Group believes that it has already made all tax payments, and therefore no allowance has been made in the financial statements.

Operating environment – The Group's principal business activities are within Georgia. Laws and regulations affecting the business environment in Georgia are subject to rapid changes and the Group's assets and operations could be at risk due to negative changes in the political and business environment.

Specific volatility in global and Georgian financial markets **–** Recently a number of major economies around the world have experienced volatile capital and credit markets. A number of major global financial institutions have either been placed into bankruptcy, taken over by other financial institutions and/or supported by government funding. As a consequence of the recent market turmoil in capital and credit markets both globally and in Georgia, notwithstanding any potential economic stabilisation measures that may be put into place by the Georgian Government, there exists as at the date these consolidated financial statements are authorized for issue economic uncertainties surrounding the continual availability, and cost, of credit both for the entity and its counterparties, the potential for economic uncertainties to continue in the foreseeable future and, as a consequence, the potential that assets may not be recovered at their carrying amount in the ordinary course of business, and a corresponding impact on the Group's profitability.

The counterparties of the Group didn't decrease the limits on the Group and didn't otherwise change the terms of cooperation with the Group, which would became less advantageous for the Group.

Recoverability of financial assets **–** As a result of recent economic turmoil in capital and credit markets globally, and the consequential economic uncertainties existing as at balance sheet date, there exists the potential that assets may not be recovered at their carrying amount in the regular course of business.

(in thousands of Georgian Lari)

25. COMMITMENTS AND CONTINGENCIES (CONTINUED)

As at 31 December 2008 and 2007, the Group had financial assets. The recoverability of these financial assets depends on a large extent on the efficacy of the fiscal measures and other measures and other actions, beyond the Group's control, undertaken within various countries to achieve economic stability and recovery. The recoverability of the Group's financial assets is determined based on conditions prevailing and information available as at balance sheet date. It is the management's opinion that no additional provision on financial assets is needed at present, based on prevailing conditions and available information.

26. TRANSACTIONS WITH RELATED PARTIES

Related parties or transactions with related parties, as defined by IAS 24 "Related party disclosures", represent:

(a) Parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Group (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Group that gives then significant influence over the Group; and that have joint control over the Group;

(b) Members of key management personnel of the Group or its parent;

(c) Close members of the family of any individuals referred to in (a) or (b);

(d) Parties that are entities controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (b) or (c).

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Group had the following transactions outstanding as at 31 December 2008 and 2007 with related parties:

	31 December 2008		**31 December 2007**	
	Related party balances	**Total category as per financial statements caption**	**Related party balances**	**Total category as per financial statements caption (restated)**
Loans to customers	2,343	134,707	1,897	123,975
- Key management personnel	222		42	
- Shareholders/members of supervisory board	1,999		1,855	
- Other related parties	122		-	
Allowance for impairment losses	(2,005)	(25,421)	(1,069)	(10,383)
- Key management personnel	(100)		(1)	
- Shareholders/members of supervisory board	(1,905)		(1,068)	
Customer accounts	6,182	181,452	1,597	200,887
- Key management personnel	-		1,553	
- Shareholders/members of supervisory board	30		44	
- Other related parties	6,152		-	

(in thousands of Georgian Lari)

26. TRANSACTIONS WITH RELATED PARTIES (CONTINUED)

	Year ended 31 December 2008		Year ended 31 December 2007	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Key management personnel compensation:				
- short-term employee benefits	108	35,836	1,342	16,007

Included in the statement of operations for the years ended 31 December 2008 and 2007 are the following amounts which arose due to transactions with related parties:

	Year ended 31 December 2008		Year ended 31 December 2007	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption (restated)
Interest income	23	32,580	337	15,425
- Key management personnel	16		10	
- Shareholders/members of supervisory board	-		327	
- Other related parties	7		-	
Interest expense	-	(16,580)	(4)	(4,553)
- Key management personnel	-		(4)	
Provision for impairment losses on interest bearing assets	(936)	(27,864)	(1,069)	(8,286)
- Key management personnel	(99)		(1)	
- Shareholders/members of supervisory board	(837)		(1,068)	
Operating expenses	(2,234)	(77,195)	(2,022)	(38,803)
- Key management personnel	(966)		(1,368)	
- Shareholders/members of supervisory board	(1,268)		(654)	

27. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. The estimates presented herein are not necessarily indicative of the amounts the Group could realize in a market exchange from the sale of its full holdings of a particular instrument.

(in thousands of Georgian Lari)

27. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The fair value of financial assets and liabilities compared with the corresponding carrying amount in the balance sheet of the Group is presented below:

	31 December 2008		31 December 2007	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and cash equivalents	57,069	57,069	33,988	33,988
Due from credit institutions	3,729	3,729	18,246	18,246
Loans to customers	109,286	109,286	113,597	113,597
Investments available-for-sale	7,761	7,761	881	881
Other financial assets	23,506	23,506	4,785	4,785
Due to credit institutions	52,355	52,355	2,977	2,977
Customer accounts	181,452	181,452	200,887	200,887
Other borrowed funds	29,806	29,806	-	-
Other financial liabilities	21,740	21,740	4,081	4,081

28. REGULATORY MATTERS

The following table analyzes the Group's regulatory capital resources for capital adequacy purposes:

	2008	2007
Movement in tier 1 capital:		
At 1 January	23,321	10,382
Increase in share capital	200	3,521
Increase in share premium	237	8,200
Dividends declared	-	(1,357)
(Loss)/Profit for the year	(45,697)	2,575
At 31 December	(21,939)	23,321

As at 31 December 2008 the Group's total capital amount for Capital Adequacy purposes was GEL (31,350) thousand and tier 1 capital was GEL (21,939) thousand with ratios of (17)% and (12)%, respectively.

As at 31 December 2007 the Group's total capital amount for Capital Adequacy purposes was GEL 43,248 thousand and tier 1 capital was GEL 23,321 thousand with ratios of 26% and 14%, respectively.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total 8% and tier 1 capital 4% to risk weighted assets.

The ratio was calculated according to the principles employed by the Basle Committee.

29. MANAGEMENT PLANS AND EVENTS AFTER THE BALANCE SHEET DATE

The consolidated financial statements have been prepared on the basis that the Group will continue as going concern for the foreseeable future.

As at 31 December 2008 the Bank has breached Regulatory Capital Ratio, Supervisory Capital Ratio (total capital reduced by intangible assets to risk weighted assets), Average Liquidity Ratio and Property Investment Ratio (total investments and property, plant and equipment to total capital) requirements ("Ratios") of the Financial Supervisory Agency of Georgia (the "GFSA") in relation to the Group's net loss for the year ended 31 December 2008.

As at 31 December 2008 the Group has an accumulated deficit in the amount of GEL 45,725 thousand and incurred a net loss in the amount of GEL 45,697 thousand for the year than ended. The Group has negative cumulative interest sensitivity gaps up to and over 5 years as at 31 December 2008 (Note 31).

The Group's management does not consider incompliance with Ratios prescribed by regulatory bodies, losses for the year ended 31 December 2008 and negative liquidity gaps as at 31 December 2008 as factors affecting long-term viability of the Group and considers that preparation of these consolidated financial statements on going concern basis is appropriate due to the following actions and events that took place subsequent to 2008 year end:

Change of ownership of the Group and financial support commitments received

On 22 September 2009, the Bank announced a change of control, whereby Liberty Capital LLC, a wholly-owned subsidiary of Liberty Investments Holding B.V. purchased a 91.218% share in the Bank. The ultimate shareholders of Liberty Capital LLC are Dinu Patriciu and Lado Gurgenidze.

On 14 May 2009 the Bank sold 100% share in JSC Peoples Insurance Company to insurance company IC Group LLC for GEL 10,200 thousand.

In agreement with the GFSA and in order to improve the Group's financial position and meet regulatory compliance requirements new shareholders committed to contribute USD 10 ml (GEL 16,670 thousand) in share capital by the end of six month period after the acquisition of the Group. These funds were placed on the Bank's accounts as a deposit in October 2009.

In December 2009 Liberty Capital LLC also provided the Group with a letter confirming its intention to support the development of the Group.

Maturity gap and capital management

Starting from second half of 2009 the Group undertook actions on limiting the maturity mismatch between its assets and liabilities and improving the liquidity gap specifically for the period up to twelve months in the amount of GEL 84,684 thousand . As a result of negotiations and restructuring actions the Group was able to significantly shorten its maturity gaps. The most notable actions were:

- one-year loan extendable, in the Group's sole discretion, for up to five years received in July 2009 from the NBG in amount of GEL 45,000 thousand and option to take additional GEL 25,000 thousand by the end of 2009;
- prepayment of fee for agent services amounted GEL 50,000 thousand from the Ministry of Finance of Georgia under a three-year service agreement in respect of the distribution of state pensions and welfare payments by the Bank concluded in October 2009.

29. MANAGEMENT PLANS AND EVENTS AFTER THE BALANCE SHEET DATE (CONTUNUED)

On 2 November 2009 the authorized share capital of the Bank was increased to GEL 30,000 thousand, the authorized quantity of shares to 3,000,000 thousand with anticipation of future increase of free float and attraction of new investors. In the press release announcing the acquisition of a controlling interest in the Bank by Liberty Capital LLC, ultimate owners of the Group stated an intention to increase the free float of the Bank's shares to 20%-25% from less than 10% at the time of the acquisition. The Bank changed its ticker symbol on the Georgian Stock Exchange (the "GSE") to "BANK" and upgraded its status on the GSE from its shares being admitted to trading on the GSE to being listed under B listing category.

Resolution of regulatory ratios non-compliance

On 19 September 2009 the Group has received a waiver letter from the GFSA that the Bank's existing regulatory capital shall be treated as though it were increased by the amount of GEL 108,000 thousand during the period from 21 September 2009 to 21 September 2012 for the purposes of calculation of prudential ratios under the regulations of the National Bank of Georgia and the GFSA, as the case may be. Furthermore the amount of GEL 108,000 thousand shall be considered as Tier 1 Capital and shall be included in the calculation of the GFSA regulatory ratios.

The Group's management believes that in accordance with the relevant regulations such non-compliance will not lead to the imposition of material penalties and fines.

30. CAPITAL MANAGEMENT

The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision and the GFSA.

The primary objectives of the Group's capital management are to ensure that the Group complies with all externally imposed capital requirements and maintains strong credit ratings and healthy capital ratios in order to ensure that entities in the Group will be able to continue as a going concern while enhancing the return to the Group's shareholders.

The capital structure of the Group consists of debt and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in the statement of changes in equity.

The management board reviews the capital structures on annual basis. As a part of this review, the Board considers the cost of capital and the risks associated with each class of capital. Based on recommendations of the Board, the Group balances its overall capital structure through the payment of dividends, new share issues as well as the issue of new debt or the redemption of existing debt.

The Group's overall capital risk management policy is revised on an annual basis.

The Group's overall capital risk management policy remains unchanged from 2007.

31. RISK MANAGEMENT POLICIES

Management of risk is fundamental to the banking business and is an essential element of the Group's operations. The main risks inherent to the Group's operations are those related to:

- Credit exposures
- Liquidity risk
- Market risk

The Group recognizes that it is essential to have efficient and effective risk management processes in place. To enable this, the Group has established a risk management framework, whose main purpose is to protect the Group from risk and allow it to achieve its performance objectives.

A description of the Group's risk management policies in relation to those risks follows.

Credit risk

The Group is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers.

Limits on the level of credit risk by borrower are reviewed and approved by the Supervisory Board twice a year. Actual exposure per borrower against limits is monitored on new loans granted. The Credit Committee may initiate a change in the limits; however this must be approved by the Supervisory Board.

Where appropriate, and in the case of most loans, the Group obtains collateral and corporate guarantees. The credit risks are monitored on a continuous basis and are subject to annual or more frequent reviews, especially where no such security can be obtained.

Commitments to extend credit represent unused portions of credit in the form of loans, guarantees or letters of credit. The credit risk on off-balance sheet financial instruments is defined as a probability of losses due to the inability of the counterparty to comply with the contractual terms and conditions. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group applies the same credit policy to the contingent liabilities as it does to the balance sheet financial instruments, i.e. the one based on the procedures for approving the grant of loans, using limits to mitigate the risk, and current monitoring. The Group monitors the term to maturity of credit commitments because longer term commitments generally have a greater degree of credit risk than shorter term commitments.

Maximum exposure

The Groups maximum exposure to credit risk varies significantly and is dependant on both individual risks and general market economy risks.

The following table presents the maximum exposure to credit risk of balance sheet and off balance sheet financial assets. For financial assets in the balance sheet, the maximum exposure is equal to the carrying amount of those assets prior to any offset or collateral. For financial guarantees and other off balance sheet assets, the maximum exposure to credit risk is the maximum amount the Group would have to pay if the guarantee was called on or in the case of commitments, if the loan amount was called on.

(in thousands of Georgian Lari)

31. RISK MANAGEMENT POLICIES (CONTINUED)

As at 31 December 2008:

	Maximum exposure
Cash and cash equivalents	45,418
Due from credit institutions	3,729
Loans to customers	109,286
Investments available-for-sale	7,761
Other financial assets	23,506
Guarantees issued and similar commitments	15,060

As at 31 December 2007:

	Maximum exposure
Cash and cash equivalents	17,406
Due from credit institutions	18,246
Loans to customers	113,592
Investments available-for-sale	881
Other financial assets	4,785
Contingent liabilities and credit commitments	8,102

Financial assets, such as amounts due from credit institutions are graded according to the current credit rating they have been issued by an internationally regarded agency such as Standard and Poor's. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade. The Group does not have an internal rating system, thus financial assets, other than cash and cash equivalents and amounts due from credit institutions, are not rated.

The following table details the credit ratings of financial assets held by the Group as at 31 December 2008:

	AAA	AA	A	BBB	<BBB	Not rated	Total at 31 December 2008
Cash and cash equivalents	-	1,992	11,359	36	375	43,307	57,069
Due from credit institutions	-	-	-	-	-	3,729	3,729
Loans to customers	-	-	-	-	-	109,286	109,286
Investments available-for-sale	-	-	-	-	-	7,761	7,761
Other financial assets	-	-	-	-	-	23,506	23,506

As at 31 December 2007:

	AAA	AA	A	BBB	<BBB	Not rated	Total at 31 December 2007
Cash and cash equivalents	-	6,845	572	1,407	74	25,090	33,988
Due from credit institutions	-					18,246	18,246
Loans to customers	-	-	-	-	-	113,592	113,592
Investments available-for-sale	-	-	-	-	-	881	881
Other financial assets	-	-	-	-	-	4,785	4,785

(in thousands of Georgian Lari)

31. RISK MANAGEMENT POLICIES (CONTINUED)

The banking industry is generally exposed to credit risk through its loans to customers and inter bank deposits. With regard to the loans to customers this risk exposure is concentrated within Georgia. The exposure is monitored on a regular basis to ensure that the credit limits and credit worthiness guidelines established by the Group's risk management policy are not breached.

The following table details the carrying value of assets that are past due but not impaired:

As at 31 December 2008:

	Financial assets past due but not impaired			
	0-3 months	**3-6 months**	**6 months to 1 year**	**Greater than one year**
Loans to customers	118	-	-	130

As at 31 December 2007:

	Financial assets past due but not impaired			
	0-3 Months	**3-6 months**	**6 months to 1 year**	**Greater than one year**
Loans to customers	4,849	918	15,761	15,806

Geographical concentration

The Assets and Liabilities Management Committee (the "ALMC") exercises control over the risk in the legislation and regulatory arena and assess its influence on the Group's activities. This approach allows the Group to minimize potential losses from investment climate fluctuations in Georgia.

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

	Georgia	**Other non-OECD countries**	**OECD countries**	**31 December 2008 Total**
FINANCIAL ASSETS				
Cash and cash equivalents	40,053	5,031	11,985	57,069
Due from credit institutions	3,171		558	3,729
Loans to customers	109,286	-	-	109,286
Investments available-for-sale	7,761	-	-	7,761
Other financial assets	23,506	-	-	23,506
TOTAL FINANCIAL ASSETS	**183,777**	**5,031**	**12,543**	**201,351**
FINANCIAL LIABILITIES				
Due to credit institutions	51,557	-	798	52,355
Customer accounts	181,452	-	-	181,452
Other borrowed funds	-	-	29,806	29,806
Other financial liabilities	21,740	-	-	21,740
TOTAL FINANCIAL LIABILITIES	**254,749**	**-**	**30,604**	**285,353**
NET POSITION	**(70,972)**	**5,031**	**(18,061)**	

(in thousands of Georgian Lari)

31. RISK MANAGEMENT POLICIES (CONTINUED)

	Georgia	Other non-OECD countries	OECD countries	31 December 2007 Total
FINANCIAL ASSETS				
Cash and cash equivalents	33,988	-	-	33,988
Due from credit institutions	8,471	4,157	5,618	18,246
Loans to customers	113,592	-	-	113,592
Investments available-for-sale	881	-	-	881
Other financial assets	4,785	-	-	4,785
TOTAL FINANCIAL ASSETS	**161,717**	**4,157**	**5,618**	**171,492**
FINANCIAL LIABILITIES				
Due to credit institutions	2,043	-	934	2,977
Customer accounts	200,887	-	-	200,887
Other financial liabilities	4,081	-	-	4,081
TOTAL FINANCIAL LIABILITIES	**207,011**	**-**	**934**	**207,945**
NET POSITION	**(45,294)**	**4,157**	**4,684**	

Liquidity risk

Liquidity risk refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due. In order to manage liquidity risk, the Group performs daily monitoring of expected future cash flows on clients' and banking operations, which is a part of the assets/liabilities management process. The ALMC sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of inter-bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

An analysis of the liquidity risk on balance sheet transactions is presented in the following table:

(in thousands of Georgian Lari)

31 RISK MANAGEMENT POLICIES (CONTINUED)

As at 31 December 2008:

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	31 December 2008 Total
FINANCIAL ASSETS						
Cash and cash equivalents	14,090	893	-	-	-	14,983
Due from credit institutions	-	-	-	-	558	558
Loans to customers	5,553	7,479	39,698	34,875	21,681	109,286
Total interest bearing assets	19,643	8,372	39,698	34,875	22,239	124,827
Cash and cash equivalents	42,086	-	-	-	-	42,086
Due from credit institutions	-	-	-	-	3,171	3,171
Investments available-for-sale	-	-	-	-	7,761	7,761
Other financial assets	-	12,597	10,909	-	-	23,506
TOTAL FINANCIAL ASSETS	**61,729**	**20,969**	**50,607**	**34,875**	**33,171**	**201,351**
FINANCIAL LIABILITIES						
Due to credit institutions	52,185	15	-	148	-	52,348
Customer accounts	13,445	7,434	49,512	6,680	67	77,138
Other borrowed funds	-	-	29,806	-	-	29,806
Total interest bearing liabilities	65,630	7,449	79,318	6,828	67	159,292
Due to credit institutions	7	-	-	-	-	7
Customer accounts	104,314	-	-	-	-	104,314
Other financial liabilities	21,740	-	-	-	-	21,740
TOTAL FINANCIAL LIABILITIES	**191,691**	**7,449**	**79,318**	**6,828**	**67**	**285,367**
Liquidity gap	(129,962)	13,520	(28,711)	28,047	33,104	
Interest sensitivity gap	(45,987)	923	(39,620)	28,047	22,172	
Cumulative interest sensitivity gap	(45,987)	(45,064)	(84,684)	(56,637)	(34,465)	
Cumulative interest sensitivity gap as a percentage of total assets	(14%)	(14%)	(27%)	(18%)	(11%)	

(in thousands of Georgian Lari)

31. RISK MANAGEMENT POLICIES (CONTINUED)

As at 31 December 2007:

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	31 December 2007 Total
FINANCIAL ASSETS						
Due from credit institutions	-	-	-	10,500	159	10,659
Loans to customers	28,733	10,434	28,368	45,200	857	113,592
Total interest bearing assets	28,733	10,434	28,368	55,700	1,016	124,251
Cash and cash equivalents	33,988	-	-	-	-	33,988
Due from credit institutions	-	-	-	-	7,587	7,587
Investments available-for-sale	-	-	881	-	-	881
Other financial assets	4,785	-	-	-	-	4,785
TOTAL FINANCIAL ASSETS	**67,506**	**10,434**	**29,249**	**55,700**	**8,603**	**171,492**
FINANCIAL LIABILITIES						
Due to credit institutions	2,024	933	-	-	1	2,958
Customer accounts	4,505	4,325	35,239	4,103	16	48,188
Total interest bearing liabilities	6,529	5,258	35,239	4,103	17	51,146
Due to credit institutions	19	-	-	-	-	19
Customer accounts	152,699	-	-	-	-	152,699
Other financial liabilities	4,081	-	-	-	-	4,081
TOTAL FINANCIAL LIABILITIES	**163,328**	**5,258**	**35,239**	**4,103**	**17**	**207,945**
Liquidity gap	(95,822)	5,176	(5,990)	51,597	8,586	
Interest sensitivity gap	22,204	5,176	(6,871)	51,597	999	
Cumulative interest sensitivity gap	22,204	27,380	20,509	72,106	73,105	
Cumulative interest sensitivity gap as a percentage of total assets	8%	10%	7%	25%	26%	

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. Long-term credits are generally not available in Georgia, except for programs established by international financial institution. However, in the Georgian marketplace, many short-term credits are granted with the expectation of renewing the loans at maturity. As such, the ultimate maturity of assets may be different from the analysis presented above. In addition, the maturity gap analysis does not reflect the historical stability of customer 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.

(in thousands of Georgian Lari)

31. RISK MANAGEMENT POLICIES (CONTINUED)

Analysis of contractual undiscounted cash flows is presented below:

	Weighted average effective interest rate, %	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	31 December 2008 Total
LIABILITIES							
Due to credit institutions	11.23%	39,944	-	-	-	12,773	52,717
Customer accounts	11.56%	35,035	7,556	52,960	7,601	172	103,324
Other borrowed funds	11.50%	-	-	-	32,585	-	32,585
Total interest bearing liabilities		74,979	7,556	52,960	40,186	12,945	188,626
Due to credit institutions		7	-	-	-	-	7
Customer accounts		104,300	-	-	-	-	104,300
Other financial liabilities		21,740	-	-	-	-	21,740
Total potential future payments for financial obligations		**201,026**	**7,556**	**52,960**	**40,186**	**12,945**	**314,673**

	Weighted average effective interest rate, %	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	31 December 2007 Total
LIABILITIES							
Due to credit institutions	6.47%	2,026	1,241	-	-	1	3,268
Customer accounts	12.10%	4,516	4,381	44,721	4,531	36	58,185
Total interest bearing liabilities		6,542	5,622	44,721	4,531	37	61,453
Due to credit institutions		19	-	-	-	-	19
Customer accounts		152,699	-	-	-	-	152,699
Other financial liabilities		4,081	-	-	-	-	4,081
Total potential future payments for financial obligations		**163,341**	**5,622**	**44,721**	**4,531**	**37**	**218,252**

Market risk

Market risk covers interest rate risk, currency risk and other pricing risks to which the Group is exposed. There have been no changes as to the way the Group measures risks it is exposed.

The Group is exposed to interest rate risks as entities in the Group borrow funds at both fixed and floating rates. The risk is managed by the Group maintaining an appropriate mix between fixed and floating rate borrowings.

The ALMC also manages interest rate and market risks by matching the Bank's interest rate position, which provides the Group with a positive interest margin. The Department of Financial Control conducts monitoring of the Group's current financial performance, estimates the Group's sensitivity to changes in interest rates and its influence on the Group's profitability.

(in thousands of Georgian Lari)

31. RISK MANAGEMENT POLICIES (CONTINUED)

Cash flow interest rate risk

Cash flow interest rate risk is the risk that the future cash flow of a financial instrument will fluctuate because of changes in market interest rates.

The ALMC also manages interest rate and market risks by matching the Group's interest rate position, which provides the Group with a positive interest margin. The majority of the Group's loan contracts and other financial assets and liabilities that bear interest are either variable or contain clauses enabling the interest rate to be changed at the option of the lender. The Group monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

The following table presents an analysis of interest rate risk and thus the potential of the Group for gain or loss. Effective interest rates are presented by categories of financial assets and liabilities to determine interest rate exposure and effectiveness of the interest rate policy used by the Group.

	2008			2007		
	GEL	USD	Other currencies	GEL	USD	Other currencies
ASSETS						
Cash and cash equivalents	12.00%	4.70%	-	-	-	-
Due from credit institutions	-	-	-	6.70%	6.00%	-
Loans to customers	23.98%	16.17%	14.98%	24.00%	23.00%	-
LIABILITIES						
Due to credit institutions	11.13%	11.23%	12.00%	6.60%	6.70%	-
Customer accounts	12.10%	11.40%	10.16%	12.30%	11.80%	-
Other borrowed funds	-	11.50%	-	-	-	-

Interest rate sensitivity

The Group manages fair value interest rate risk through periodic estimation of potential losses that could arise from adverse changes in market conditions. The Department of Financial Control conducts monitoring of the Group's current financial performance, estimates the Group's sensitivity to changes in fair value interest rates and its influence on the Group's profitability.

The following table presents a sensitivity analysis of interest rate risk, which has been determined based on "reasonably possible changes in the risk variable". The level of these changes is determined by management and is contained within the risk reports provided to key management personnel.

Impact on profit before tax:

	As at 31 December 2008		As at 31 December 2007	
	Interest rate +1%	Interest rate -1%	Interest rate +1%	Interest rate -1%
Assets:				
Cash and cash equivalents	239	(239)	89	(89)
Due from credit institutions	-	-	-	-
Loans to customers	1,499	(1,499)	550	(550)
Liabilities:				
Due to credit institutions	(373)	373	(17)	17
Customer accounts	(988)	988	(392)	392
Other borrowed funds	(110)	110	-	-
Net impact on profit before tax	**267**	**(267)**	**230**	**(230)**

(in thousands of Georgian Lari)

31. RISK MANAGEMENT POLICIES (CONTINUED)

Impact on shareholders equity:

	As at 31 December 2008		As at 31 December 2007	
	Interest rate +1%	**Interest rate -1%**	**Interest rate +1%**	**Interest rate -1%**
Assets:				
Cash and cash equivalents	191	(191)	-	-
Due from credit institutions	-	-	71	(71)
Loans to customers	1,199	(1,199)	440	(440)
Liabilities:				
Due to credit institutions	(387)	387	(14)	14
Customer accounts	(790)	790	(314)	314
Other borrowed funds	-	-	-	-
Net impact on shareholders equity	**213**	**(213)**	**183**	**(183)**

Currency risk

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The ALMC controls currency risk by management of the open currency position on the estimated basis of Georgian Lari devaluation and other macroeconomic indicators, which gives the Group an opportunity to minimize losses from significant currency rates fluctuations toward its national currency. The Treasury Department performs daily monitoring of the Group's open currency position with the aim to match the requirements of National Bank of Georgia.

The Group's exposure to foreign currency exchange rate risk is presented in the table below:

(in thousands of Georgian Lari)

31. RISK MANAGEMENT POLICIES (CONTINUED)

As at 31 December 2008:

	GEL	USD USD 1 = 1.6670 GEL	EUR EUR 1 = 2.3648 GEL	Other currency	31 December 2008 Total
FINANCIAL ASSETS					
Cash and cash equivalents	16,048	17,726	23,058	237	57,069
Due from credit institutions	-	3,729	-	-	3,729
Loans to customers	55,870	52,920	496	-	109,286
Investments available-for-sale	7,761	-	-	-	7,761
Other financial assets	23,506	-	-	-	23,506
TOTAL FINANCIAL ASSETS	**103,185**	**74,375**	**23,554**	**237**	**201,351**
FINANCIAL LIABILITIES					
Due to credit institutions	39,705	798	11,851	1	52,355
Customer accounts	115,287	53,928	12,209	28	181,452
Other borrowed funds	-	29,806	-	-	29,806
Other financial liabilities	21,740	-	-	-	21,740
TOTAL FINANCIAL LIABILITIES	**176,732**	**84,532**	**24,060**	**29**	**285,353**
OPEN BALANCE SHEET POSITION	**(73,547)**	**(10,157)**	**(506)**	**208**	

As at 31 December 2007:

	GEL	USD USD 1 = 1.5916 GEL	EUR EUR 1 = 2.3315 GEL	Other currency	31 December 2007 Total
FINANCIAL ASSETS					
Cash and cash equivalents	15,344	12,790	5,516	338	33,988
Due from credit institutions	7,711	10,535	-	-	18,246
Loans to customers	90,714	22,761	117	-	113,592
Investments available-for-sale	881	-	-	-	881
Other financial assets	4,785	-	-	-	4,785
TOTAL FINANCIAL ASSETS	**119,435**	**46,086**	**5,633**	**338**	**171,492**
FINANCIAL LIABILITIES					
Due to credit institutions	2,013	964	-	-	2,977
Customer accounts	148,078	50,555	9,250	4	207,887
Other financial liabilities	4,081	-	-	-	4,081
TOTAL FINANCIAL LIABILITIES	**154,172**	**51,519**	**9,250**	**4**	**214,945**
OPEN BALANCE SHEET POSITION	**(34,737)**	**(5,433)**	**(3,617)**	**334**	

(in thousands of Georgian Lari)

31. RISK MANAGEMENT POLICIES (CONTINUED)

Currency risk sensitivity

The following table details the Group's sensitivity to a 10% increase and decrease in the USD against the GEL. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Group where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

	As at 31 December 2008		As at 31 December 2007	
	GEL/USD +10%	GEL/USD -10%	GEL/USD +10%	GEL/USD -10%
Impact on profit or loss	(1,341)	1,341	(447)	447
Impact on equity	(1,073)	1,073	(358)	358

Limitations of sensitivity analysis

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analyses do not take into consideration that the Group's assets and liabilities are actively managed. Additionally, the financial position of the Group may vary at the time that any actual market movement occurs. For example, the Group's financial risk management strategy aims to manage the exposure to market fluctuations. As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation and taking other protective action. Consequently, the actual impact of a change in the assumptions may not have any impact on the liabilities, whereas assets are held at market value on the balance sheet. In these circumstances, the different measurement bases for liabilities and assets may lead to volatility in shareholder equity.

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Group's view of possible near-term market changes that cannot be predicted with any certainty; and the assumption that all interest rates move in an identical way.

Price risk

Price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market. The Group is exposed to price risks of its products which are subject to general and specific market fluctuations.

31. RISK MANAGEMENT POLICIES (CONTINUED)

The Group manages price risk through periodic estimation of potential losses that could arise from adverse changes in market conditions and establishing and maintaining appropriate stop-loss limits and margin and collateral requirements. With respect to undrawn loan commitments the Group is potentially exposed to a loss of an amount equal to the total amount of such commitments. However, the likely amount of a loss is less than that, since most commitments are contingent upon certain conditions set out in the loan agreements.