JSC Liberty Bank and Subsidiaries

Consolidated Financial Statements

Year ended 31 December 2010
Together with Independent Auditors' Report

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Independent auditors' report

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

We have audited the accompanying consolidated financial statements of JSC Liberty Bank and its subsidiaries, which comprise the consolidated statement of financial position as at 31 December 2010, and the consolidated income statement, consolidated statements of comprehensive income, of changes in equity and of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

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

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

Opinion

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

ERNST & YOUNG LLC

29 April 2011

Consolidated statement of financial position

As of 31 December 2010

(Thousands of Georgian Lari)

	Notes	2010	2009
Assets			
Cash and cash equivalents	6	139,271	108,563
Amounts due from credit institutions	7	7,508	3,829
Loans to customers	9	159,166	82,752
Investment securities:			
- available-for-sale	10	717	2,260
- held-to-maturity	10	83,860	1,995
Investments in associates		-	788
Investment properties	11	21,115	20,184
Property and equipment	12	92,165	80,145
Intangible assets	13	5,357	4,560
Current income tax assets	14	630	630
Deferred income tax assets	14	1,610	1,313
Prepayments		5,614	6,275
Other assets	15	13,772	7,746
Total assets		530,785	321,040
Liabilities			
Amounts due to credit institutions	16	77,318	54,606
Amounts due to customers	17	385,445	246,638
Current income tax liabilities	14	182	82
Provisions	15	69	80
Derivative financial liabilities	8	102	-
Contingent capital participation notes	18	19,150	-
Other liabilities	15	13,909	10,410
Total liabilities		496,175	311,816
Equity	19		
Share capital		28,858	15,721
Additional paid-in capital		19,113	8,529
Treasury shares		(3,371)	(347)
Accumulated losses		(32,692)	(38,036)
Other reserves		22,702	23,357
Total Equity		34,610	9,224
Total equity and liabilities		530,785	321,040

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

Vladimer Gurgenidze — Executive Chairman and Chief Executive Officer

Zurab Tsulaia — Chief Financial Officer

29 April 2011

The accompanying notes on pages 6 to 55 are an integral part of these consolidated financial statements.

Consolidated income statement

For the year ended 31 December 2010

(Thousands of Georgian Lari)

	Notes	2010	2009
Interest income			
Loans to customers		45,771	23,826
Amounts due from credit institutions		1,148	275
Investment securities		3,268	4
		50,187	24,105
Interest expense			
Amounts due to customers		(24,299)	(10,750)
Amounts due to credit institutions		(4,129)	(9,065)
Contingent capital participation notes		(535)	-
Other		(74)	(104)
		(29,037)	(19,919)
Net interest income		21,150	4,186
Net impairment charge on interest-bearing assets	7, 9	(9,481)	(16,766)
Net interest income after impairment charges		11,669	(12,580)
Net fee and commission income	21	32,338	29,774
Net gains from disposal of associates/subsidiaries		105	14,124
Net gains/(losses) from foreign currencies:			
- Dealing		4,008	3,324
- Translation differences		(110)	110
Share of loss of associates		-	(105)
Other income	22	5,814	3,850
Non-interest income		42,155	51,077
Personnel expenses	23	(25,840)	(20,206)
General and administrative expenses	23	(14,126)	(14,822)
Depreciation, amortisation and impairment	12, 13	(5,986)	(6,906)
Other operating expenses	23	(671)	(615)
Other impairment and provisions	15	(2,582)	(2,295)
Non-interest expense		(49,205)	(44,844)
Profit /(loss) before income tax expense		4,619	(6,347)
Income tax benefit	14	110	899
Profit /(loss) for the year		4,729	(5,448)
Income / (loss) per share:	19		
- Basic income/(loss) per share (in full amount)		0.0018	(0.0035)
- Diluted income/(loss) per share (in full amount)		0.0013	(0.0035)

The accompanying notes on pages 6 to 55 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December 2010

(Thousands of Georgian Lari)

	Note	2010	2009
Profit /(loss) for the year		4,729	(5,448)
Other comprehensive income			
Unrealised (losses)/gains on investment securities available-for-sale	19	(47)	178
Revaluation of buildings	19	-	(113)
Income tax relating to components of other comprehensive income	14, 19	7	(27)
Other comprehensive (loss)/ income for the year, net of tax		(40)	38
Total comprehensive income/(loss) for the year		4,689	(5,410)

The accompanying notes on pages 6 to 55 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2010

(Thousands of Georgian Lari)

	Attributable to shareholders of the Bank							
	Share capital	*Additional paid-in capital*	*Treasury shares*	*Retained earnings*	*Other reserves*	*Total*	*Non-controlling interests*	*Total equity*
31 December 2008	15,721	8,437	(355)	(45,347)	36,078	14,534	(26)	14,508
Total comprehensive (loss)/income for the year	-	-	-	(5,448)	38	(5,410)	-	(5,410)
Depreciation of revaluation reserve (Note 19)	-	-	-	483	(483)	-	-	-
Transfer of revaluation reserve of investment property (Note 19)	-	-	-	12,276	(12,276)	-	-	-
Minority interest disposal, arising from disposal of subsidiary	-	-	-	-	-	-	26	26
Sale of treasury shares (Note 19)	-	92	8	-	-	100	-	100
31 December 2009	15,721	8,529	(347)	(38,036)	23,357	9,224	-	9,224
Total comprehensive income/(loss) for the year	-	-	-	4,729	(40)	4,689	-	4,689
Depreciation of revaluation reserve (Note 19)	-	-	-	483	(483)	-	-	-
Transfer of revaluation reserve of sold asset	-	-	-	132	(132)	-	-	-
Issue of share capital (Note 19)	13,137	9,448	-	-	-	22,585	-	22,585
Purchase of treasury shares (Note 19)	-	-	(3,384)	-		(3,384)	-	(3,384)
Sale of treasury shares (Note 19)	-	1,136	360	-	-	1,496	-	1,496
31 December 2010	28,858	19,113	(3,371)	(32,692)	22,702	34,610	-	34,610

The accompanying notes on pages 6 to 55 are an integral part of these consolidated financial statements.

Consolidated statement of cash flow

For the year ended 31 December 2010

(Thousands of Georgian Lari)

	Notes	2010	2009
Cash flows from operating activities			
Interest received		52,253	24,898
Interest paid		(27,590)	(21,772)
Fees and commissions received		35,034	31,278
Fees and commissions paid		(2,693)	(1,969)
Net realised gains from dealing in foreign currencies		4,110	3,324
Recoveries of assets previously written off	9, 15	845	1,235
Other income received	22	5,814	3,850
Personnel expenses paid		(24,009)	(20,041)
General, administrative and other operating expenses paid		(14,704)	(10,848)
Cash flows from operating activities before changes in operating assets and liabilities		29,060	9,955
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		(3,651)	(361)
Loans to customers		(89,951)	10,315
Other assets		(6,235,)	(3,089)
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		22,677	(26,834)
Amounts due to customers		135,449	66,230
Other liabilities		1,509	2,303
Net cash flows from operating activities before income tax		88,858	58,519
Income tax paid		(80)	-
Net cash from operating activities		88,778	58,519
Cash flows from investing activities			
Proceeds from disposal of subsidiaries and associates		800	10,201
Purchase of investments available-for-sale		-	(862)
Purchase of investment securities		(97,428)	-
Proceeds from redemption of investment securities		17,982	-
Purchase of property and equipment		(19,874)	(11,049)
Proceeds from sale of property and equipment		144	384
Net cash used in investing activities		(98,376)	(1,326)
Cash flows from financing activities			
Proceeds from issue of share capital		10,910	-
Increase in additional paid in capital		9,427	92
Sale of treasury shares		360	8
Proceeds from contingent capital participation notes		18,615	-
Net cash from financing activities		39,312	100
Effect of exchange rates changes on cash and cash equivalents		994	110
Net increase in cash and cash equivalents		30,708	57,403
Cash and cash equivalents, beginning	6	108,563	51,160
Cash and cash equivalents, ending	6	139,271	108,563

The accompanying notes on pages 6 to 55 are an integral part of these consolidated financial statements.

(Thousands of Georgian Lari)

1. Principal activities

JSC Liberty Bank (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 organisational 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 (the "NBG"), the central bank of Georgia, on 10 February 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 broker-dealer services to its commercial and retail customers. Its main office is in Tbilisi, Georgia and it has 204 (2009: 184) branches, outlets, centers and mobile banking units operating in Georgia. The Bank's registered legal address is 74 Chavchavadze Avenue, 0162 Tbilisi, Georgia.

As of 31 December 2010 and 2009, the following shareholders owned more than 1% of the outstanding shares. Other shareholders owned less than 1% individually of the outstanding shares.

	2010	*2009*
Shareholder	*Ownership interest, %*	*Ownership interest, %*
Liberty Capital LLC	77.34%	91.22%
Stichting Liberty ESOP*	5.61%	-
BG Capital (Nominees)	1.43%	-
Other shareholders (individually holding less than 1% and treasury shares)	15.62%	8.78%
Total	100%	100%

**Shares sold on a deferred payment basis to Stichting Liberty ESOP as the trustee for the share based compensation programme Note 19.*

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

Name	Country of incorporation	The Group ownership interest 2010	2009	Date of incorporation	Activities
Liberty Securities LLC	Georgia	100%	100%	2 September 2009	Securities broker-dealer
Smartex LLC (a)	Georgia	100%	100%	5 January 2009	Postal services
Bus Stop LLC	Georgia	100%	100%	27 August 2009	Outdoor advertising
Real Management Company LLC(b)	Georgia	0%	100%	27 April 2009	Real estate
NewSakkalakmshenproekti LLC	Georgia	100%	100%	4 September 2009	Real estate
Rustavi Central Cash Desk LLC	Georgia	100%	100%	2004	Inactive/Real estate

(a) Formerly known as People's Post of Georgia LLC
(b) No longer Group subsidiary due to merger with the Bank in 2010.

The majority equity interest of the Group is ultimately beneficially owned and controlled by Dan Costache Patriciu.

2. Basis of preparation

General

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

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.

The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below.

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

(Thousands of Georgian Lari)

2. Basis of preparation (continued)

Reclassifications

In the course of preparation of the consolidated financial statements for the year ended 31 December 2010, the Bank identified the following reclassifications which have been made as at 31 December 2009 and for the year then ended to conform to the 2010 presentation:

- Reclassification of accounts with the NBG from amounts due from credit institutions to cash and cash equivalents.
- Reclassification of blocked deposits at international payment systems from due from credit institutions to other assets.

The cumulative effect of the reclassifications is as follows:

	As previously reported	*Reclassifications*	*As adjusted*
Consolidated statement of financial position as at 31 December 2009			
Cash and cash equivalents	98,818	9,745	108,563
Amounts due from credit institutions	14,423	(10,594)	3,829
Other assets	6,897	849	7,746

3. Summary of accounting policies

Changes in accounting policies

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

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

IFRS 3 "Business Combinations" (revised in January 2008) and IAS 27 "Consolidated and Separate Financial Statements" (revised in January 2008)
The revised standards were issued in January 2008 and became effective for financial years beginning on or after 1 July 2009. Revised IFRS 3 introduces a number of changes in the accounting for business combinations that impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. Revised IAS 27 requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change has no impact on goodwill, nor it gives rise to a gain or loss. Furthermore, the revised standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes introduced by the revised Standards are applied prospectively.

IFRS 2 Share-based Payment: Group Cash-settled Share-based Payment Transactions
The amendment to IFRS 2 was issued in June 2009 and became effective for financial years beginning on or after1 January 2010. The amendment clarifies the scope and the accounting for group cash-settled share-based payment transactions. This amendment also supersedes IFRIC 8 and IFRIC 11. This amendment had no impact on the Group's consolidated financial statements.

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

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

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

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

- IFRS 8 Operating Segment Information: clarifies that segment assets and liabilities need only be reported when those assets and liabilities are included in measures that are used by the chief operating decision maker. As the Group's chief operating decision maker does review segment assets and liabilities, the Group continues to disclose this information.
- IAS 7 Statement of Cash Flows: Explicitly states that only expenditure that results in recognising an asset can be classified as a cash flow from investing activities.
- IAS 36 Impairment of Assets: The amendment clarifies that the largest unit permitted for allocating goodwill, acquired in a business combination, is the operating segment as defined in IFRS 8 before aggregation for reporting purposes. The amendment had no impact on the Group as the annual impairment test is performed at operating segment.

Basis of consolidation

Basis of consolidation from 1 January 2010

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

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses are attributed to the non-controlling interests even if that results in a deficit balance.

If the Group loses control over a subsidiary, it derecognises the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests, the cumulative translation differences, recorded in equity; recognises the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in profit or loss and reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss.

Basis of consolidation prior to 1 January 2010

In comparison to the above mentioned requirements which were applied on a prospective basis, the following differences applied:

- Losses incurred by the Group were attributed to the non-controlling interests until the balance reduces to nil. Any further excess losses were attributable to the parent, unless the non-controlling interests had a binding obligation to cover these.
- Upon loss of control, the Group accounted for the investment retained at its proportionate share of net asset value at the date control was lost.

Business combinations

Business combinations from 1 January 2010

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

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

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

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

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Business combinations (continued)

Goodwill is initially measured at cost being the excess of the consideration transferred over the Group's net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

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

Business combinations prior to 1 January 2010

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

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

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

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

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

Investments in associates

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

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

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

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.

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 income statement when the investments are impaired, as well as through the amortisation process.

Loans and receivables

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

Available-for-sale financial assets

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

Determination of fair value

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

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

Offsetting

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

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Cash and cash equivalents

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

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 recognised at fair value. Due from credit institutions are subsequently measured at amortised cost using the effective interest method. Amounts due from credit institutions are carried net of any allowance for impairment losses.

Derivative financial instruments

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

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

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to credit institutions, amounts due to customers 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 income statement when the borrowings are derecognised as well as through the amortisation process.

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

Leases

i. *Finance - Group as lessee*

The Group recognises finance leases as assets and liabilities in the consolidated statement of financial position at the date of commencement of the lease term at amounts equal to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. In calculating the present value of the minimum lease payments the discount factor used is the interest rate implicit in the lease, when it is practicable to determine; otherwise, the Group's incremental borrowing rate is used. Initial direct costs incurred are included as part of the asset. Lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Leases (continued)

The costs identified as directly attributable to activities performed by the lessee for a finance lease, are included as part of the amount recognised as an asset under the lease.

ii. *Operating - Group as lessee*

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

iii. *Operating - Group as lessor*

The Group presents assets subject to operating leases in the consolidated statement of financial position according to the nature of the asset. Lease income from operating leases is recognised in the consolidated income statement on a straight-line basis over the lease term as other income. The aggregate cost of incentives provided to lessees is 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 reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Amounts due from credit institutions and loans to customers

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

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

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

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

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

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

Held-to-maturity financial investments

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

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

Available-for-sale financial investments

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

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

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

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

(Thousands of Georgian Lari)

3. Summary of 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 income statement.

Financial guarantees

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

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

Taxation

The current income tax expense is calculated in accordance with the regulations of Georgia. It represents the sum of the current and deferred tax expenses.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting date.

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

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

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Property and equipment

Property and equipment is carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.
The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

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

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

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

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

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

Costs related to repairs and renewals are charged when incurred and included in other operating expenses, unless they qualify for capitalisation.

Construction-in-progress comprise costs directly related to construction of property and equipment including an appropriate allocation of directly attributable variable and fixed overheads that are incurred in construction. Depreciation of these assets, on the same basis as similar property assets, commences when the assets are put into operation.

Investment properties

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

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.

Provisions

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

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Assets classified as held-for-sale

The Group classifies a non-current asset as held-for-sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the non-current asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable.

The sale qualifies as highly probable if the Bank's management is committed to a plan to sell the non-current asset (or disposal group) and an active program to locate a buyer and complete the plan must have been initiated. Further, the non-current asset (or disposal group) must have been actively marketed for a sale at price that is reasonable in relation to its current fair value and in addition the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification of the non-current asset (or disposal group) as held for sale.

The Group measures an asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell. The Group recognises an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell if events or changes in circumstance indicate that their carrying amount may be impaired.

Share capital

Share capital

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

Treasury shares

Where the Bank purchase 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, sold 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 reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the financial statements are authorised for issue.

Segment reporting

The Group's segment reporting is based on the following operating segments: Retail Banking, Corporate and Merchant Banking, Private Banking and Corporate Centre functions.

Contingencies

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

Retirement and other benefit obligations

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 expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. 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

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

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.

- *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 Groups' right to receive the payment is established.

Foreign currency translation

The consolidated financial statements are presented in Georgian Lari, which is the Bank's and subsidiaries' functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the consolidated income statement as gains less losses from foreign currencies - translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as 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 are included in gains less losses from dealing in foreign currencies

The exchange rates used by the Group in the preparation of the consolidated financial statements as at 31 December 2010 and 2009 are as follows:

	29 April 2011	*31 December 2010*	*31 December 2009*
GEL/1 US Dollar	1.6388	1.7728	1.6858
GEL/1 Euro	2.4285	2.3500	2.4195

(Thousands of Georgian Lari)

3. Summary of accounting policies (continued)

Future changes in accounting policies

Standards and interpretations issued but not yet effective

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

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

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

Improvements to IFRSs
In May 2010 the IASB issued the third omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. Most of the amendments are effective for annual periods beginning on or after 1 January 2011. There are separate transitional provisions for each standard. Amendments included in May 2010 "Improvements to IFRS" will have impact on the accounting policies, financial position or performance of the Group, as described below.

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

Amendments to IFRS 7 "Financial Instruments: Disclosures"
The Amendments were issued in October 2010 and are effective for annual periods beginning on or after 1 July 2011. The Amendments introduce additional disclosure requirements for transferred financial assets that are not derecognised. The Group expects that these amendments will have no impact on the Group's financial position.

Amendments to IAS 12 "Income Taxes" – Deferred tax: Recovery of underlying assets
In December 2010 the IASB issued amendments to IAS 12 effective for annual periods beginning on or after 1 January 2012. IAS 12 has been updated to include a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale and a requirement that deferred tax on non-depreciable assets, measured using the revaluation model in IAS 16, should always be measured on a sale basis The Group now evaluates the impact of the adoption of these amendments.

(Thousands of Georgian Lari)

4. Significant accounting judgments and estimates

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 year 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 Group's financial condition.

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 consolidated 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 recognised in the consolidated statement of operations on initial recognition.

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

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 recognising 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.

(Thousands of Georgian Lari)

4. Significant accounting judgments and estimates (continued)

Property 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 preliminarily determined as at 31 December 2011. No material changes have been observed in the real estate market since the last revaluation date that would require unexpected revaluation of existing property. 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.

Valuation of investment property

Fair value of investment properties was determined by independent professionally qualified appraisers. Fair value was determined by applying income approach based on discounted cash flow method, supported by the terms of any existing lease and other contracts and, when available, by external evidence such as current market rents for similar properties in a comparable location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows. The estimates of future cash flows include projections of cash outflows for rent or purchase of the land. The key assumptions used to determine the fair value of the investment properties, are further explained in Note 11.

(Thousands of Georgian Lari)

5. Segment information

For management purposes, the Group is organised into the following operating segments based on products and service:

Retail Banking	Principally handling individual customers' deposits, and providing consumer loans, overdrafts, credit cards facilities and funds transfer facilities.
Corporate and Merchant Banking	Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers.
Private Banking	Principally providing private banking and wealth management services to high net worth individuals.
Corporate Center	Principally providing back office services to all operating segments of the Bank.
Other	Segments not classified above

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance, as explained in the table below, is measured differently from profit or loss in the consolidated financial statements. Income taxes are managed on a group basis and are not allocated to operating segments.

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

Revenue from transactions with Social Service Agency amounted to GEL 17,015 (2009: GEL 17,323) representing 18% (2009: 23%) of the Group's total revenue in 2010.

(Thousands of Georgian Lari)

5. Segment information (continued)

2010	Retail Banking	Corporate & Merchant Banking	Private Banking	Corporate Centre	Other	Adjustments & Eliminations	Total
Revenue							
Third party							
Interest income	32,602	7,363	1,036	9,194	38	(46)	50,187
Net fee and commission income	19,451	8,669	80	4,179	(44)	3	32,338
Net gains from investment securities available-for-sale	-	-	-	-	105	-	105
Net gains from foreign currencies	781	585	117	2,420	(5)	-	3,898
Other income	268	2,469	130	268	3,398	(719)	5,814
Total revenue	53,102	19,086	1,363	16,061	3,492	(762)	92.342
Interest expense	(14,364)	(7,998)	(727)	(5,948)	(196)	196	(29,037)
Net impairment charge on interest-bearing assets	(1,974)	(4,047)	(40)	(3,421)	1	-	(9,481)
Personnel expenses	(18,325)	(3,878)	(245)	(2,312)	(1,167)	87	(25,840)
Depreciation, amortisation and impairment	(3,547)	(886)	-	(1,477)	(2,024)	1,948	(5,986)
Other impairment and provisions	(1,449)	(835)	(58)	(126)	(119)	5	(2,582)
General and administrative and other operating expenses	(7,743)	(2,190)	(216)	(4,071)	(1,110)	533	(14,797)
Segment results	5,700	(748)	77	(1,294)	(1,123)	2,007	4,619
Income tax benefit							110
Profit for the year							4,729
Segment assets	324,561	168,575	11,637	25,523	3,159	(2,670)	530,785
Segment liabilities	158,927	280,115	36,338	20,877	812	(894)	496,175
Other segment information							
Investments in associates	-	-	-	-	-	-	-
Share of loss of associates	-	-	-	-	-	-	-

2009	Retail Banking	Corporate & Merchant Banking	Private Banking	Corporate Centre	Other	Adjustments & Eliminations	Total
Revenue							
Third party							
Interest income	13,922	4,758	631	4,814	-	(20)	24,105
Net fees and commission income	16,958	9,007	87	3,723	-	(1)	29,774
Net gains from foreign currencies	502	377	76	1,556	(1)	924	3,434
Other income	3,324	3,324	82	4,580	1,066	5,598	17,974
Total revenue	34,706	17,466	876	14,673	1,065	6,501	75,287
Interest expense	(8,470)	(6,087)	(206)	(5,156)	(20)	20	(19,919)
Net impairment charge on interest-bearing assets	(553)	(19,131)	(17)	2,935	-	-	(16,766)
Share of loss of associate	-	(105)	-	-	-	-	(105)
Salaries and other employee benefits	(14,528)	(3,332)	(203)	(1,732)	(411)	-	(20,206)
Depreciation, amortisation and impairment	(2,950)	(737)	-	(1,229)	(52)	(1,938)	(6,906)
Other impairment and provisions	-	-	-	(2,295)	-	-	(2,295)
General and administrative and other operating expenses	(7,269)	(2,485)	(181)	(5,429)	(421)	348	(15,437)
Segment results	936	(14,411)	269	1,767	161	4,931	(6,347)
Income tax benefit							899
Loss for the year							(5,448)
Segment assets	196,653	64,210	2,552	59,587	6,384	(8,346)	321,040
Segment liabilities	118,283	166,113	15,416	11,965	614	(575)	311,816
Other segment information							
Investments in associates	-	-	-	788	-	-	788
Share of loss of associates	-	-	-	(105)	-	-	(105)

(Thousands of Georgian Lari)

6. Cash and cash equivalents

Cash and cash equivalents comprise:

	2010	*2009*
Cash on hand	49,709	44,075
Current accounts with the NBG	13,662	34,308
Current accounts with other credit institutions	59,354	19,664
Time deposits with credit institutions up to 90 days	16,546	10,516
Cash and cash equivalents	139,271	108,563

As of 31 December 2010 GEL 53,226 (2009: GEL 16,794) was placed on current and time deposit accounts with internationally recognised OECD banks that are the counterparties of the Group in performing international settlements.

7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2010	*2009*
Obligatory reserve with the NBG	5,636	3,611
Time deposits for more than 90 days or overdue	1,872	218
Less – allowance for impairment	-	-
Amounts due from credit institutions	7,508	3,829

Credit institutions are required to maintain an interest earning cash deposit with the NBG, the amount of which depends on the level of funds attracted by the credit institution. The Group's ability to withdraw such deposit is significantly restricted by the statutory legislation.

As of 31 December 2010, GEL 1,872 (2009: GEL 218) was placed on current accounts and inter-bank deposits with number of internationally recognised OECD banks, who are the main counterparties of the Group in performing international settlements.

The movements in allowance for impairment of amounts due from credit institutions were as follows:

	2010	*2009*
1 January	-	10,499
(Reversal)	-	(102)
Write-offs	-	(10,397)
31 December	-	-

(Thousands of Georgian Lari)

8. Derivative financial instruments

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

	2010			*2009*		
	Notional amount	*Fair values Asset*	*Fair values Liability*	*Notional amount*	*Fair value Asset*	*Fair value Liability*
Foreign exchange contracts						
Forwards – with foreign counterparty	7,091	-	102	-	-	-
Total derivative assets/liabilities		-	102		-	-

Foreign and domestic in the table above stand for counterparties where foreign means non-Georgian entities and domestic means Georgian entities.

As of 31 December 2010, the Group has positions in the following type of derivative:

Forwards

Forward contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market.

9. Loans to customers

Loans to customers comprise:

	2010	*2009*
Loans to legal entities	66,878	43,403
Pension advances	45,355	28,468
Payroll loans	38,056	16,598
Consumer loans	28,745	18,512
Residential mortgage loans	4,911	561
Gross loans to customers	183,945	107,542
Less – allowance for impairment	(24,779)	(24,790)
Loans to customers	159,166	82,752

Allowance for impairment of loans to customers

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

	Loans to legal entities 2010	*Consumer loans 2010*	*Residential mortgage loans 2010*	*Payroll loans 2010*	*Pension advances 2010*	*Total 2010*
At 1 January 2010	16,946	6,854	-	661	329	24,790
Charge for the year	7,672	958	-	620	231	9,481
Recoveries	747	69	-	-	3	819
Amounts written off	(7,505)	(752)	-	(45)	(277)	(8,579)
Interest accrued on impaired loans	(1,566)	(165)	-	(1)	-	(1,732)
At 31 December 2010	16,294	6,964	-	1,235	286	24,779
Individual impairment	16,059	5,611	-	1,031	252	22,953
Collective impairment	235	1,353	-	203	35	1,826
	16,294	6,964	-	1,234	287	24,779
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	28,701	5,611	-	1,031	252	35,595

(Thousands of Georgian Lari)

9. Loans to customers (continued)

	Loans to legal entities 2009	*Consumer loans 2009*	*Residential mortgage loans 2009*	*Payroll loans 2009*	*Pension advances 2009*	*Total 2009*
At 1 January 2009	11,463	10,356	5	3,596	1	25,421
Charge for the year	19,234	208	(5)	(2,935)	366	16,868
Recoveries	1,159	23	–	–	–	1,182
Amounts written off	(14,290)	(3,442)	–	–	(38)	(17,770)
Interest accrued on impaired loans	(620)	(291)	–	–	–	(911)
At 31 December 2009	16,946	6,854	–	661	329	24,790
Individual impairment	16,784	5,854	–	586	288	23,512
Collective impairment	162	1,000	–	75	41	1,278
	16,946	6,854	–	661	329	24,790
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	35,543	5,854	–	682	290	42,369

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognised as at 31 December 2010 comprised GEL 4,911 (2009: GEL 3,288). Related allowance charges were recognised both in 2010 and 2009 and are recorded in consolidated income statement under net impairment charge on interest-bearing assets.

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

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

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

(Thousands of Georgian Lari)

9. Loans to customers (continued)

Concentration of loans to customers

As of 31 December 2010, the concentration of loans granted by the Group to ten largest third party borrowers comprised GEL 34,720 accounting for 18.9% of the gross loan portfolio of the Group (2009: GEL 33,358 and 31.02%, respectively). An allowance of GEL 11,524 (2009: GEL 13,043) was established against these loans.

Loans have been extended to the following types of customers:

	2010	*2009*
Individuals	121,304	64,139
Private companies	62,641	43,353
State owned companies	-	50
Loans to customers, gross	183,945	107,542
Less - allowance for loan impairment	(24,779)	(24,790)
Loans to customers, net	159,166	82,752

Loans are made principally within Georgia in the following industry sectors:

	2010	*2009*
Individuals	121,304	64,139
Trade and service	41,569	37,686
Construction	3,610	3,909
Energy	57	1,129
Agriculture	359	2
Other	17,046	677
Loans to customers, gross	183,945	107,542
Less - allowance for loan impairment	(24,779)	(24,790)
Loans to customers, net	159,166	82,752

10. Investment securities

Available-for-sale securities comprise:

	2009	*2009*
Corporate shares	5,627	5,670
Less – allowance for impairment (Note 15)	(4,910)	(3,410)
Available-for-sale securities	717	2,260

Corporate shares as of 31 December 2010 are primarily comprised of investments in a Georgian casual dining restaurant chain of GEL 408, net (2009: GEL 1,909, net) and global payments technology company VISA Inc. GEL 272 (2009: GEL 319).

Held-to-maturity securities comprise:

	2010	*2009*
Treasury bills of the Ministry of Finance	16,254	1,995
Treasury bonds of the Ministry of Finance	51,520	-
Certificates of Deposit of the NBG	12,793	-
Corporate bonds of state owned Georgian Railway LLC*	2,764	-
Promissory notes	529	-
	83,860	1,995
Held-to-maturity securities	83,860	1,995

* Bloomberg: GRAIL

(Thousands of Georgian Lari)

11. Investment properties

	2010	*2009*
At 1 January	20,184	–
Additions	931	20,184
At 31 December	21,115	20,184

Investment properties primarily comprise class B office spaces at Liberty Tower building with separate entrance and lobby area, in Liberty Tower, an 18 storey building in a prime residential and commercial downtown area of Tbilisi, which is wholly owned by the Bank and where its headquarters is located. Total rental space comprises 4,453 sqm, of which 1,897 sqm was rented out during 2010 (2009: 1,346 sqm). Investment properties are stated at fair value, which has been determined based on valuation performed by GREMIC, an accredited independent appraiser, as at 31 December 2010. GREMIC is an industry specialist in valuing these types of investment property. The fair value represents the amount at which asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards Committee standards. GREMIC used the income approach for the purposes of valuation of the investment properties.

The table below sets out the rental income and the direct operating expenses arising from the investment properties:

	2010	*2009*
Rental income	532	420
Direct operating expenses	15	53

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

(Thousands of Georgian Lari)

12. Property and equipment

The movements in property and equipment were as follows:

	Land and buildings	*Furniture and fixtures*	*Computers and office equipment*	*Motor vehicles*	*Leasehold improvements*	*Assets under construction*	*Total*
Cost or revalued amount							
31 December, 2009	53,556	18,108	8,144	3,150	4,079	4,588	91,625
Additions	2,995	8,969	1,479	1,747	776	1,549	17,515
Disposals	(135)	-	-	-	-	-	(135)
Transfers	2,853	-	-	-	-	(2,853)	-
31 December, 2010	59,269	27,077	9,623	4,897	4,855	3,284	109,005
Accumulated depreciation							
31 December , 2009	778	4,431	4,695	1,329	247	-	11,480
Depreciation charge	1,026	2,082	1,439	695	123	-	5,365
Disposals	(5)	-	-	-	-	-	(5)
31 December 2010	1,799	6,513	6,134	2,024	370	-	16,840
Net book value:							
31 December 2009	52,778	13,677	3,449	1,821	3,832	4,588	80,145
31 December 2010	57,470	20,564	3,489	2,873	4,485	3,284	92,165

	Land and buildings	*Furniture and fixtures*	*Computers and office equipment*	*Motor vehicles*	*Leasehold improvements*	*Assets under construction*	*Total*
Cost or revalued amount							
31 December 2008	73,772	16,811	7,805	1,906	3,798	4,676	108,768
Additions	3,914	1,714	525	1,366	281	3	7,803
Disposals	(3,946)	(417)	(186)	(122)	–	(91)	(4,762)
Transfers to investment property	(20,184)	–	–	–	–	–	(20,184)
31 December 2009	53,556	18,108	8,144	3,150	4,079	4,588	91,625
Accumulated depreciation							
31 December 2008	112	2,911	3,405	873	184	–	7,485
Depreciation charge	980	1,616	1,345	485	63	–	4,489
Disposals	(314)	(96)	(55)	(29)	–	–	(494)
31 December 2009	778	4,431	4,695	1,329	247	–	11,480
Net book value:							
31 December 2008	73,660	13,900	4,400	1,033	3,614	4,676	101,283
31 December 2009	52,778	13,677	3,449	1,821	3,832	4,588	80,145

If the buildings were measured using the cost model, the carrying amounts would be as follows:

	2010	*2009*
Cost	64,280	57,302
Accumulated depreciation and impairment	5,531	4,315
Net carrying amount	58,749	52,987

(Thousands of Georgian Lari)

13. Intangible assets

The movements in intangible assets, which comprised computer software, were as follows:

	Computer software
Cost	
31 December 2009	7,663
Additions	1,428
Disposals	(12)
31 December 2010	9,079
Accumulated amortisation	
31 December 2009	3,103
Amortisation charge	621
Disposals	(2)
31 December 2010	3,722
Net book value:	
31 December 2009	4,560
31 December 2010	5,357

	Computer software
Cost	
31 December 2008	4,233
Additions	3,457
Disposals	(27)
31 December 2009	7,663
Accumulated amortisation and impairment	
31 December 2008	693
Amortisation charge	469
Disposals	(7)
Impairment	1,948
31 December 2009	3,103
31 December 2008	3,540
31 December 2009	4,560

14. Taxation

The corporate income tax expense comprises:

	2010	*2009*
Current tax charge	180	26
Deferred tax charge – origination and reversal of temporary differences	(290)	(925)
Less: deferred tax recognised in other comprehensive income	7	(27)
Income tax benefit	(110)	(899)

(Thousands of Georgian Lari)

14. Taxation (continued)

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

	2010	*2009*
Net gains /(losses) on investment securities available for sale	(47)	178
Statutory tax rate	15%	15%
Income tax charged on other comprehensive income	7	27

Georgian legal entities must file individual tax declarations. The tax rate for banks for profits other than on state securities was 15% for 2010 and 2009. The tax rate for interest income on state securities changed from 10% to 7.5%, effective 1 January 2009 and further from 7.5% to 0%, effective 9 August 2009.

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

	2010	*2009*
Profit/(loss) before tax	4,619	(6,347)
Statutory tax rate	15%	*15%*
Theoretical income tax expense/(benefit) at the statutory rate	692	(952)
Change in unrecognised deferred tax asset	(269)	-
Income from state securities at 0%	(463)	-
Other	(70)	53
Income tax benefit	(110)	(899)

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

	2010	*2009*
Current income tax assets	630	630
Deferred income tax assets	1,610	1,313
Income tax assets	2,240	1,943
Current income tax liabilities	182	82
Deferred income tax liabilities	–	–
Income tax liabilities	182	82

(Thousands of Georgian Lari)

14. Taxation (continued)

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

	2008	Origination and reversal of temporary differences: In the income statement	Origination and reversal of temporary differences: In other comprehensive income	Disposal	2009	Origination and reversal of temporary differences: In the income statement	Origination and reversal of temporary differences: In other comprehensive income	2010
Tax effect of deductible temporary differences:								
Impairment of goodwill	163	(163)	-	-	-	-	-	
Property and equipment	1,016	(1,016)	-	-	-	269	-	269
Tax loss carry forward	7,741	(301)	-	-	7,440	204	-	7,644
Loans to customers	-	580	-	-	580	583	-	1,163
Other assets	-	587	-	-	587	(329)	-	258
Equity investments	-	377	-	-	377	653	-	1,030
Deferred tax assets	8,920	64	-	-	8,984	1,380	-	10,364
Unrecognised deferred tax asset	-	-	-	-	-	(269)	-	(269)
Tax effect of taxable temporary differences:								
Property and equipment/Intangible assets	(7,659)	983	-	(879)	(7,555)	(687)	-	(8,242)
Other liabilities	-	-	-	-	-	(134)		(134)
Securities owned	(21)	(122)	27		(116)		7	(109)
Deferred tax liabilities (assets)	(7,680)	861	27	(879)	(7,671)	(821)	7	(8,485)
Deferred tax assets (liabilities)	1,240	925	27	(879)	1,313	290	7	1,610

The Group has available GEL 50,957 (2009: GEL 49,606) of tax losses carried forward which begin to expire in 2012, if not utilised. The Group has recognised a tax loss carry forward related deferred tax asset of GEL 7,644 and GEL 7,440 in 2010 and 2009, respectively.

15. Other assets and liabilities

Other assets comprise:

	2010	*2009*
Receivable from the Social Service Agency	6,607	–
Receivables from remittances systems operators	2,062	3,464
Assets held-for-sale	1,889	2,032
Guarantee deposits placed	1,457	849
Receivable from guarantees paid	801	445
Prepaid taxes other than income tax	552	611
Receivable from documentary operations	202	215
Other	1,716	731
	15,286	8,347
Less – allowance for impairment of other assets	(1,514)	(601)
Other assets	13,772	7,746

Receivable from the Social Service Agency in the amount of GEL 6,607 represents disbursements made to the pensioners at the yearend that were subsequently repaid by the Social Service Agency within 30 days of the disbursement date in accordance with the service contract.

Guarantee deposits placed at 31 December 2010 primarily represents pledged funds at VISA Inc. and MasterCard Inc. in amount of GEL 594 and GEL 810, respectively. (2009: Visa Inc for GEL 565).

(Thousands of Georgian Lari)

15. Other assets and liabilities (continued)

Other liabilities comprise:

	2010	*2009*
Funds pending settlements	6,341	3,479
Unclaimed funds	3,141	3,183
Sundry creditors	1,163	2,361
Bonus accrual	1,069	–
Share based payment accrual	927	–
Operating taxes payable	253	158
Net liabilities under finance lease agreements	94	457
Other	921	772
Other liabilities	13,909	10,410

Liabilities under finance lease agreements as at 31 December 2010 are analysed as follows:

	2010	*2009*
Minimum lease payments:		
Not later than 1 year	111	412
Later than 1 year and not later than 5 years	–	149
Later than 5 years	–	–
	111	561
Less – future finance costs	(17)	(104)
Net liabilities under finance lease agreements	94	457

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

	Investment securities Available-for-sale	*Other assets*	*Guarantees and commitments*	*Total*
31 December 2008	764	5,212	–	5,976
Charge (reversal)	2,917	(702)	80	2,295
Write-offs	(271)	(3,962)	–	(4,233)
Recoveries	–	53	–	53
31 December 2009	3,410	601	80	4,091
Charge (reversal)	1,593	1,000	(11)	2,582
Write-offs	(93)	(113)	-	(206)
Recoveries	-	26	-	26
31 December 2010	4,910	1,514	69	6,493

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

(Thousands of Georgian Lari)

16. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2010	*2009*
Current accounts	160	6
Time deposits and loans	77,158	54,600
Amounts due to credit institutions	77,318	54,606

During 2010, the Group placed with and received short-term funds from Georgian and OECD banks in different currencies. As of 31 December 2010 the Group had an equivalent of GEL 16,549 (2009: GEL 9,000) received as deposits from Georgian banks.

As of 31 December 2010	*Grant date*	*Contractual maturity*	*Currency*	*Interest rate per annum*	*Facility amount in original currency*	*Balance as of 31 December 2010 in GEL*
The NBG	30-Dec-10	6-Jan-11	GEL	7.63%	60,000	60,013
BTA Bank Georgia	31-Dec-10	6-Jan-11	GEL	7.75%	2,000	2,000
BTA Bank Georgia	31-Dec-10	3-Jan-11	GEL	7.60%	1,000	1,000
KOR Standard Bank	31-Dec-10	6-Jan-11	GEL	9.00%	3,550	3,550
KOR Standard Bank	24-Nov-10	24-Nov-13	USD	0.50%	100	177
Bank Of Georgia	31-Dec-10	6-Jan-11	USD	1.50%	5,640	9,999
Landes Bank	22-Aug-07	14-Aug-12	USD	LIBOR+1.75%	234	419
Total						77,158

As of 31 December 2009	*Grant date*	*Contractual maturity*	*Currency*	*Interest rate per annum*	*Facility amount in original currency*	*Balance as of 31 December 2009 in GEL*
The NBG	28-Jul-09	28-Jul-14	GEL	13%	45,000	45,000
TBC Bank	31-Dec-09	4-Jan-10	GEL	5%	5,000	5,000
Basis Bank	31-Dec-09	4-Jan-10	GEL	4%	4,000	4,000
Landes Bank	22-Aug-07	14-Aug-12	USD	LIBOR+1.75%	355	600
Total						54,600

17. Amounts due to customers

The amounts due to customers include the following:

	2010	*2009*
Current accounts	268,256	187,253
Time deposits	117,189	59,385
Amounts due to customers	385,445	246,638
Held as security against guarantees issued	849	8,133

At 31 December 2010, amounts due to customers of GEL 139,445 (36%) were due to the ten largest customers (2009: GEL 112,630 (46%)).

(Thousands of Georgian Lari)

17. Amounts due to customers (continued)

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

	2010	*2009*
State and budgetary organisations	162,290	102,244
Private enterprises	64,044	50,656
Individuals	159,111	93,738
Amounts due to customers	385,445	246,638

An analysis of customer accounts by economic sector follows:

	2010	*2009*
State & Public Sector	162,290	102,244
Individuals	159,111	93,738
Trade	7,257	5,441
Real estate constructions	5,380	1,293
Transport and communication	1,951	1,258
Energy	1,348	674
Agriculture	456	407
Mining	972	46
Other	46,680	41,537
Amounts due to customers	385,445	246,638

18. Contingent Capital Participation Notes

	2010	*2009*
Principal amount outstanding	18,615	-
Accrued interest	535	-
Contingent Capital Participation Notes	19,150	-

The Bank is regulated by the NBG. As such, the Bank submits to the NBG monthly reports of its financial position and operation (the "Monthly Supervision Report"), which, *inter alia*, contains the Bank's Tier I and Total Capital Adequacy Ratios, calculated in accordance with the methodology required by the NBG. The capital adequacy calculation methodology adopted by the NBG differs in certain material respects from the BIS (Basel I) framework, but has historically been more stringent, due, *inter alia*, to the higher market-risk weighing of the assets.

Minimum Tier I and Total Capital Adequacy Ratios required by the NBG are 8% and 12%, respectively, of the risk weighted assets.

The Bank's Tier I and Total Capital Adequacy Ratios are below the minimum requirements as of 31 December 2010 and 2009 (Note 28). However, the Bank operates under the waiver (the "Waiver") granted by the NBG in September 2009 and expiring in September 2012, whereby the prudential requirements (including, without limitation, the capital adequacy ratios) are calculated as though the Bank's actual Tier I Capital were increased by GEL 108,000. (Note 28)

The Bank issued two-year GEL-denominated contingent capital participation notes (the "Notes") on 22 October 2010 with initial maturity of 23 October 2012 (the "Initial Maturity Date"). The annual interest rate of the Notes (the "Initial Interest Rate") is 15 per cent. per annum. Redemption of the Notes depends on the following conditions:

Condition A (Tier I Capital Shortage as of 30 September 2012)

In the event that the Bank's Tier I Capital, as reported in the Monthly Supervision Report in respect of September 2012 and calculated in accordance with the NBG's methodology then in effect, is less than eight per cent. (8%) of the Bank's Risk Weighted Assets ("RWA") as of 30 September 2012 (as reported in such Monthly Supervision Report), the Notes shall be automatically converted, on the Initial Maturity Date, into newly issued ordinary shares of the Bank at a specified price. Any fraction of such newly issued ordinary shares shall be rounded down. The newly issued ordinary shares received by the Note holders in the event of such automatic conversion shall rank *pari passu* to all other ordinary shares then outstanding, and other rights in accordance with the Bank's Charter then in effect.

Condition B (Total Capital Shortage as of 30 September 2012)

In the event that the Bank's Tier I Capital, as reported in the Monthly Supervision Report in respect of September 2012 and calculated in accordance with the NBG's methodology then in effect, is equal to or higher than eight per cent. (8%) of the Bank's RWA as of 30 September 2012 (as reported in such Monthly Supervision Report), but the Bank's Total Capital, as reported in the Monthly Supervision Report in respect of September 2012 and calculated in accordance with the NBG's methodology then in effect, is less than 12 per cent. (12%) of the Bank's RWA as of 30 September 2012 (as reported in such Monthly Supervision Report), the Notes

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18. Contingent Capital Participation Note (continued)

shall become subordinated to other unsubordinated indebtedness and monetary obligations of the Bank, the maturity of the Notes shall be automatically extended for five years from the Initial Maturity Date, ending on 22 October 2017 and the interest rate shall be reset and equal the Initial Interest Rate plus 200 basis points.

Change of Control/Condition C

In the event that, at any time prior to the Initial Maturity Date, a change of control of the Bank occurs, whereby a person or a group of persons acting in concert acquires more than 50% of the ordinary shares of the Bank then outstanding, then:

i) The Bank shall have an option to call, within 60 calendar days from the date of such change of control, all (but not less than all) Notes at the price equal to 100% of their face value, plus any accrued but unpaid interest and the amount of interest that would have accrued until the Initial Maturity Date if the Notes had not been called by the Bank; and

ii) Each Note holder shall have an option to put to the Bank, within 60 calendar days from the date of such change of control, the Notes to the Bank at the price equal to 100% of their face value, plus any accrued but unpaid interest.

In all other cases the Notes shall be redeemed at their face value.

Liberty Capital subscribed to and held on 31 December 2010, 95.7% of the Notes, with the remainder held by certain minority shareholders.

19. Equity

Share capital

As of 31 December 2010, authorised share capital comprised 6,000,000,000 ordinary shares of which 3,114,913,609 were issued and 2,663,902,689 shares were fully paid (2009: 1,572,109,700 common shares, of which 1,572,109,700 were issued and fully paid). Each share has nominal value of GEL 0.01 in full amount.

Shares issued and outstanding, net of treasury shares, and movements are described below:

	Number of shares (thousand shares)	*Nominal amount*
	Ordinary	*Ordinary*
31 December 2008	1,536,553	15,366
Sale of treasury shares	841	8
31 December 2009	1,537,394	15,374
Increase in share capital	1,313,658	13,137
Purchase of treasury shares	(222,715)	(2,227)
Sale of treasury shares	35,565	356
31 December 2010	2,663,902	26,640

The share capital of the Bank was contributed by the shareholders in Georgian Lari and they are entitled to dividends and any capital distribution in GEL.

On 4 February 2010 and 18 September 2010 the authorised share capital of the Bank was increased by GEL 10,000 and GEL 20,000, respectively, from GEL 30,000 as of 31 December 2009 to GEL 60,000 by September 2010 comprising of 6,000,000 thousand shares. The increase is in anticipation of the future increase in the share capital by way of selling the newly issued shares to third party investors.

Basic/diluted income per share

2010 net income attributable to ordinary shareholders of the Group comprise GEL 4,729 (2009: net loss GEL 5,448). At 31 December 2010 weighted average number of ordinary shares outstanding during the year was 2,677,708,434 (2009: 1,537,238,340), resulting in income per share of GEL 0.0018 (full amount) for 2010 (2009: loss per share of GEL 0.00350). At 31 December 2010 diluted number of shares was 3,735,363,718 (2009: 1,537,238,340), resulting in diluted income per share of GEL 0.0013 (full amount) for 2010 (2009: loss per share of GEL 0.0035). The 2010 dilution includes the effect of dilution by the issuance of 1,057,655,284 ordinary shares as a result of the possible conversion of the CCPN (Note 18) into ordinary shares at GEL 0.0176 per share, which is the lowest of the several possible conversion price alternatives and, as such, is the most conservative assumption.

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19. Equity (continued)

ESOP Programme

The Bank's management and eligible key personnel received a share based compensation package (the "ESOP") entitling them to purchase ordinary shares at the nominal value of GEL 0.01 per share. The effective date of such award is 1 January 2010 with a vesting period of three years, with one third of the respective share allocations vesting on each of 1 January 2011, 2012 and 2013, subject to the recipient being employed by the Bank on such vesting dates. The shares designated for the ESOP programme (174,678,856 newly issued shares) have been sold in 2010, on a deferred payment basis, to Stichting Liberty ESOP, a foundation incorporated under the laws of the Netherlands. Of those shares, 158,948,953 have been granted to 47 eligible employees of the Bank during 2010. During 2010, 8,821,282 shares have been forfeited and none of the shares vested.

In connection with the ESOP programme, the Bank has recognised expense in the amount of GEL 927 for the year ended 31 December 2010 (2009: 0). This expense is based on the weighted average price of GEL 0.0197 per share, determined on the basis of the quoted market prices at the respective actual dates such awards have been granted during the year.

Treasury shares

Treasury shares of GEL 3,371 as of 31 December 2010 (2009: GEL 347) comprise the shares owned by the Bank.

Dividends

No dividends were declared and paid in respect of 2010 and 2009.

Other reserves

Movements in other reserves were as follows:

	Revaluation reserve for property and equipment	*Unrealised gains/(losses) on investment securities available-for-sale*	*Total*
At 1 January 2009	35,958	120	36,078
Transfer of revaluation reserve to accumulated losses	(12,276)	–	(12,276)
Depreciation of revaluation reserve	(483)	–	(483)
Net unrealised gains / (losses) on available-for-sale investments	–	178	178
Reversal of revaluation reserve of sold asset	(113)	–	(113)
Tax effect of net gains on investment securities available-for-sale	–	(27)	(27)
At 31 December 2009	23,086	271	23,357
Depreciation of revaluation reserve	(483)	-	(483)
Net unrealised gains / (losses) on available-for-sale investments	-	(47)	(47)
Reversal of revaluation reserve of sold asset	(132)	-	(132)
Tax effect of net gains on investment securities available-for-sale	-	7	7
At 31 December 2009	22,471	231	22,702

Nature and purpose of other reserves

Revaluation reserve for property and equipment

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

Unrealised gains/(losses) on investment securities available-for-sale

This reserve records fair value changes on available-for-sale investments.

(Thousands of Georgian Lari)

20. Commitments and contingencies

Operating environment

Georgia continues economic reforms and development of its legal, tax and regulatory frameworks, with its transformation into an open market economy largely accomplished. The future stability of the Georgian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Georgian Government and the NBG.

The Georgian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The global financial crisis has resulted in a decline in the gross domestic product, capital markets instability, significant deterioration of liquidity in the banking sector, and tighter credit conditions within Georgia. While the Georgian Government has introduced a range of stabilisation measures aimed at providing liquidity to Georgian banks and companies, there continues to be uncertainty regarding the access to capital and cost of capital for the Group and its subsidiaries, which could affect the Group's financial position, results of operations and business prospects.

Also, factors including increased unemployment in Georgia, reduced corporate liquidity and profitability, and increased corporate and personal insolvencies in 2008 and 2009, have affected and continue to affect the Group's borrowers' ability to repay the amounts due to the Group. In addition, changes in economic conditions have resulted in deterioration in the value of collateral held against loans and other obligations. To the extent that information is available, the Group has reflected revised estimates of expected future cash flows in its impairment assessment.

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

As at 31 December 2010 the Group has accumulated losses of GEL 32,692 (2009: accumulated losses of GEL 38,036), net income of GEL 4,729 for the year ended 31 December 2010 (2009: Net loss of GEL 5,448) and has negative liquidity gap through one year of GEL 151,508 (2009: GEL 76,634) in total as disclosed in Note 26. 2010 has been the first year of the turnaround for the Group after it has been acquired in 2009 and net income of GEL 4,729 has been generated. The Group has the standby facility from the NBG in the amount of GEL 45,000 and new capital was injected into the Group (Note 29). In 2010 Fitch Ratings assigned the Bank a Long-Term Foreign Currency Issuer Default Rating (IDR) of 'B', Short-term IDR of 'B', Individual Rating of 'D/E', Support Rating of '4' and Support Rating Floor of 'B'. The Outlook for the Long-term IDR is Stable. The Group's management believes that these conditions do not indicate the existence of material uncertainty which may cast significant doubt about the Group's ability to continue as a going concern. Based on its assessment, the Group's management believes that it has adequate resources, is able to improve liquidity, and is taking appropriate measures, to continue as a going concern, and that the preparation of the consolidated financial statements on going concern basis is appropriate.

Legal

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

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20. Commitments and contingencies (continued)

Commitments and contingencies

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

	2010	*2009*
Credit related commitments		
Guarantees	18,704	7,527
Letters of credit	1,123	-
Undrawn loan commitments	-	1,439
	19,827	8,966
Operating lease commitments		
Not later than 1 year	1,895	1,860
Later than 1 year but not later than 5 years	5,700	4,861
Later than 5 years	2,750	1,320
	10,345	8,041
Capital expenditure commitments	4,632	6,078
Contingent tax liability	-	250
Less – provisions (Note 15)	(69)	(80)
Commitments and contingencies (before deducting collateral)	34,735	23,255
Less – cash held as security against guarantees issued (Note 17)	(849)	(8,133)
Commitments and contingencies	33,886	15,122

Insurance

As of 31 December 2010, the Bank had Bankers Blanket Bond insurance and Directors and Officers liability insurance coverage.

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21. Net fee and commission income

Net fee and commission income comprises:

	2010	*2009*
Fee income received from the Social Service Agency and other State entities	17,199	17,552
Remittances	6,775	6,047
Plastic card operations	3,799	2,068
Settlements operations	3,732	2,445
Cash operations	1,577	1,748
Fee income received from utility payments	1,292	1,525
Guarantees and letters of credit	549	289
Other	98	78
Fee and commission income	35,021	31,752
Plastic card operations	(1,730)	(928)
Settlements operations	(861)	(865)
Guarantees and letters of credit	(90)	(107)
Cash operations	(2)	(78)
Direct fee and commission expense	(2,683)	(1,978)
Net fee and commission income	32,338	29,774

On 7 July 2009 the Bank renewed an exclusive agreement for pension distribution service with the Social Service Agency for 41 months (expiring on 31 December 2012) with the total flat commission fee of GEL 49,000 payable in equal monthly installments over the contract period. In 2010 fee income from pension distribution comprised GEL 14,000 (2009: GEL 14,364). The remaining income to be received up to 31 December 2012 is GEL 27,999..

On 10 March, 2010 the Bank renewed an exclusive agreement for social welfare payment distribution service with the Social Service Agency for 34 months (expiring on 31 December 2012) with the total flat commission fee of GEL 8,496 payable in equal monthly installments over the contract period. In 2010 fee income comprised GEL 2,499 (2009: GEL 2,958). The remaining income to be received up to 31 December 2012 is GEL 5,997.

During the year there were other one-off agreements with the Social Service Agency and local municipalities on social welfare distributions which are included in fee income received from the State.

22. Other income

	2010	*2009*
Income from penalty on late payments on customer loans & advances	1,727	2,711
Income from brokerage operations	1,090	-
Income from rent	984	286
Income from architectural works	810	408
Income from postal and courier services	294	296
Gain from sale of assets	13	–
Other	896	149
Total other income	5,814	3,850

(Thousands of Georgian Lari)

23. Personnel and other operating expenses

Personnel and other operating expenses comprise:

	2010	*2009*
Salaries	22,980	19,819
Variable bonuses	1,033	387
Performance based discretionary bonus pool	900	-
Share based payment compensation	927	-
Personnel expenses	25,840	20,206
Occupancy and rent	3,803	3,011
Marketing and advertising	1,292	527
Operating taxes	1,207	1,232
Utility expense	1,097	1,081
Office supplies	1,052	1,049
Security	977	1,000
Communication	930	994
Legal and other professional services	738	1,691
Corporate hospitality and entertainment	526	1,160
Travel expenses	441	352
Banking services	436	586
Insurance	331	234
Cash packing	49	103
Repair and maintenance	126	491
Subscription expense	22	20
Personnel training and recruitment	44	6
Other	1,055	1,285
General and administrative expenses	14,126	14,822

Other operating expenses comprise:

	2010	*2009*
Penalties and fines	102	-
Other expenses	569	615
Other operating expenses	671	615

(Thousands of Georgian Lari)

24. Risk management

Introduction

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

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

Risk Management Structure

The Supervisory Board is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Supervisory Board

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

Management Board

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

Audit Committee

The Audit Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Risk Management

The Risk Management Unit is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Risk Controlling

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

Group Treasury

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

Internal Audit

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

Risk Measurement and Reporting Systems

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

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24. Risk management (continued)

Introduction (continued)

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

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

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

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

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

Excessive risk concentration

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

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

Credit risk

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

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

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.

Credit-related commitments risks

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

(Thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

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

	Notes	*Maximum exposure 2010*	*Maximum exposure 2009*
Cash and cash equivalents (excluding cash on hand)	6	89,562	64,488
Amounts due from credit institutions	7	7,508	3,829
Loans to customers	9	159,166	82,752
Investment securities	10		
Held-to-maturity		83,860	1,995
		340,096	153,064
Financial commitments and contingencies	20	18,909	753
Total credit risk exposure		359,005	153,817

Where financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 9.

(Thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group internal credit ratings. The table below shows the credit quality by class of asset for loan-related lines in the statement of financial position, based on the categories specified in the tables.

As at 31 December 2010	*Notes*	*Neither past due nor impaired 2010*	*Past due but not impaired 2010*	*Individually impaired 2010*	*Total 2010*
Amounts due from credit institutions	7	7,508	-	-	7,508
					-
Loans to customers:	9				-
Loans to legal entities		35,859	2,318	28,701	66,878
Pension advances		45,103	-	252	45,355
Payroll loans		36,225	800	1,031	38,056
Consumer loans		21,318	1,816	5,611	28,745
Residential mortgage loans		4,755	156	-	4,911
		143,260	5,090	35,595	183,945
Investment securities	10				-
Held-to-maturity		83,860	-	-	83,860
		83,860	-	-	83,860
Total		234,628	5,090	35,595	275,313

As at 31 December 2009	*Notes*	*Neither past due nor impaired 2009*	*Past due but not impaired 2009*	*Individually impaired 2009*	*Total 2009*
Amounts due from credit institutions	7	3,829	-	-	3,829
Loans to customers:	9				
Loans to legal entities		6,710	1,150	35,543	43,403
Pension advances		28,178	-	290	28,468
Payroll loans		14,140	1,776	682	16,598
Consumer loans		9,669	2,989	5,854	18,512
Residential mortgage loans		561	-	-	561
		59,258	5,915	42,369	107,542
Investment securities	10				
Held-to-maturity		1,995	-	-	1,995
		1,995	-	-	1,995
Total		65,082	5,915	42,369	113,366

Past due loans to customers include those that are only past due by a few days. An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

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

(Thousands of Georgian Lari)

24. Risk management (continued)

Credit risk (continued)

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

As at 31 December 2010	Notes	Less than 30 days 2010	31 to 60 days 2010	61 to 90 days 2010	More than 90 days 2010	Total 2010
Loans to customers:	9					
Loans to legal entities		240	287	519	1,272	2,318
Consumer loans		980	562	274	-	1,816
Residential mortgage loans		156	-	-	-	156
Payroll loans		652	65	83	-	800
Total		2,028	914	876	1,272	5,090

As at 31 December 2009	Notes	Less than 30 days 2009	31 to 60 days 2009	61 to 90 days 2009	More than 90 days 2009	Total 2009
Loans to customers:	9					
Loans to legal entities		346	7	30	767	1,150
Consumer loans		1,622	596	547	224	2,989
Payroll loans		816	197	296	467	1,776
Total		2,784	800	873	1,458	5,915

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

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

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

	2010	2009
Loans to customers:		
Loans to legal entities	23,612	17,701
Consumer loans	4,786	2,027
Payroll loans	421	1,546
Residential mortgage loans	156	26
Pension advances	-	-
Total	28,975	21,300

(Thousands of Georgian Lari)

24. Risk management (continued)

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Group addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

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

Collectively assessed allowances

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

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

Financial guarantees and letters of credit are assessed and provisions are made in a similar manner as for loans.

The geographical concentration of the group's assets and liabilities is put out below:

	2010				*2009*			
	Georgia	*OECD*	*CIS and other foreign countries*	*Total*	*Georgia*	*OECD*	*CIS and other foreign countries*	*Total*
Assets:								
Cash and cash equivalents	80,636	54,349	4,286	139,271	89,170	16,794	2,599	108,563
Amounts due from credit institutions	7,459	49	-	7,508	3,611	218	-	3,829
Loans to customers	159,166	-	-	159,166	82,752	-	-	82,752
Investment securities:	-	-	-	-	-	-	-	-
- available-for-sale	446	271	-	717	1,941	319	-	2,260
- held-to-maturity	83,860	-	-	83,860	1,995	-	-	1,995
All other assets	136,265	3,399	599	140,263	117,651	3,990	-	121,641
	467,832	58,068	4,885	530,785	297,120	21,321	2,599	321,040
Liabilities:								
Amounts due to credit institutions	76,902	416	-	77,318	54,007	599	-	54,606
Derivative financial liabilities	-	102	-	102	-	-	-	-
Amounts due to customers	357075	25,407	2,963	385,445	226,587	20,051	-	246,638
Contingent capital participation notes	19,150	-	-	19,150	-	-	-	-
All other liabilities	14,160	-	-	14,160	10,572	-	-	10,572
	467,287	25,925	2,963	496,175	291,166	20,650	-	311,816
Net assets / (liabilities)	545	32,143	1,922	34,610	5,954	671	2,599	9,224

(Thousands of Georgian Lari)

24. Risk management (continued)

Liquidity risk and funding management

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

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. In addition, the Bank maintains a cash deposit (obligatory reserve) with the NBG, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratios established by the NBG.

Analysis of financial liabilities by remaining contractual maturities

The tables below summarise the maturity profile of the Bank's financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history. As of 31 December 2010 total time deposits of individuals stood at GEL 84,950, of which GEL 23,830 matured within the next three months and GEL 54,160 were due to mature within three to twelve months. Given that based on the historical data, the average time deposit renewal ratio stands at 43.49%, GEL 10,363 and GEL 23,554 can be considered to fall within one to five years maturity range rather than the Less than three months and three to twelve month ranges respectively. As at 31 December 2010, balances on accounts of individuals (excluding time deposits) amounted to GEL 74,926. Since January 2009, these balances have not fallen below GEL 42,374, and their largest decrease amounted to GEL 20,715 and occurred during an approximately five month period in 2009. Even if the Bank were to experience a similar decrease in balances on the accounts of individuals, GEL 54,211 (balances on the accounts of individuals at 31 December 2010 less the largest decrease in balances since January 2009) in Amounts due to customers may be considered to be in the one to five years maturity range. GEL 60,013 included in Amounts due to credit institutions represent the NBG source of funding collateralised by instruments issued by the government of Georgia and the NBG, drawn down for a seven-day period. It is the NBG's explicitly stated policy to guarantee the disbursement of such funds and the on-demand refinancing thereof to banks subject to the availability of such collateral. Therefore, Amounts due to credit institutions may be considered to fall within the one to five years maturity range. As of 31 December 2010, the Bank had sufficient liquid collateral to additionally draw down GEL 16,169 from the NBG at immediate notice. Additionally, as of 31 December 2010, the Bank had and continues to have an outstanding untapped credit line of GEL 45,000 with the NBG available until 28 July, 2013.

Financial liabilities As at 31 December 2010	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to credit institutions	76,916	107	391	-	77,414
Amounts due to customers	317,131	64,421	9,496	418	391,466
Other financial liabilities	704	3,488	20,022	-	24,214
Total undiscounted financial liabilities	394,751	68,016	29,909	418	493,094

Financial liabilities As at 31 December 2009	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to credit institutions	10,551	31,898	25,132	-	67,581
Amounts due to customers	167,086	58,847	30,953	150	257,036
Other financial liabilities	13	399	149	-	561
Total undiscounted financial liabilities	177,650	91,144	56,234	150	325,178

(Thousands of Georgian Lari)

24. Risk management (continued)

Liquidity risk and funding management (continued)

The table below shows the contractual expiry by maturity of the Group's financial commitments and contingencies. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
2010	11,911	5,876	13,387	3,585	34,759
2009	4,126	4,994	11,816	2,399	23,335

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

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

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. The Group classifies exposures to market risk into either trading or non-trading portfolios. Trading and Non-trading positions are managed and monitored using other sensitivity analysis. Except for the concentrations within foreign currency, the Group has no significant concentration of market risk.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Group's income statement.

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve.

Currency	*Increase in basis points 2010*	*Sensitivity of net interest income 2010*	*Sensitivity of equity 2010*
USD	100	-4	–

Currency	*Decrease in basis points 2010*	*Sensitivity of net interest income 2010*	*Sensitivity of equity 2010*
USD	-100	4	–

Currency	*Increase in basis points 2009*	*Sensitivity of net interest income 2009*	*Sensitivity of equity 2009*
USD	100	-6	–

Currency	*Decrease in basis points 2009*	*Sensitivity of net interest income 2009*	*Sensitivity of equity 2009*
USD	-100	6	–

(Thousands of Georgian Lari)

24. Risk management (continued)

Market risk (continued)

Currency risk

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

The tables below indicate the currencies to which the Group had significant exposure at 31 December on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Lari, with all other variables held constant on the income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on the income statement. A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase.

Currency	*Appreciation / (depreciation) of the exchange rate of GEL against the respective currency in % 2010*	*Effect on profit before tax 2010*	*Appreciation / (depreciation) of the exchange rate of GEL against the respective currency in % 2009*	*Effect on profit before tax 2009*
USD	(5.02%)	81	(1.28%)	29
EUR	7.35%	(1)	(12.70%)	(15)
GBP	(9.53%)	(1)	(16.06%)	3
RUR	(14.66%)	0	34.36%	1
UAH	(7.19%)	0	3.42%	–

Operational risk

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

(Thousands of Georgian Lari)

25. Fair values of financial instruments

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

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

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

At 31 December 2010	*Level 1*	*Level 2*	*Level 3*	*Total*
Financial assets				
Investment securities – available-for-sale	271	446	-	717
	271	446	-	717
Financial liabilities				
Derivative financial instruments	-	102	-	102
	-	102	-	102

At 31 December 2009	*Level 1*	*Level 2*	*Level 3*	*Total*
Financial assets				
Investment securities – available-for-sale	319	1,941	-	2,260
	319	1,941	-	2,260

Financial instruments recorded at fair value

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

Investment securities available-for-sale

Investment securities available-for-sale valued using a valuation technique or pricing models primarily consist of unquoted equity and debt securities. These securities are valued using models which sometimes only incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

(Thousands of Georgian Lari)

25. Fair Value of financial instruments (continued)

Fair value of financial assets and liabilities not carried at fair value

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

	Carrying value 2010	*Fair value 2010*	*Unrecognised gain/(loss) 2010*	*Carrying value 2009*	*Fair value 2009*	*Unrecognised gain/(loss) 2009*
Financial assets						
Cash and cash equivalents	139,271	139,271	-	108,563	108,563	-
Amounts due from credit institutions	7,508	7,508	-	3,829	3,829	-
Loans to customers	159,166	159,166	-	82,752	82,693	59
Investment securities:			-			-
- held-to-maturity	83,860	84,496	636	1,995	1,995	-
Financial liabilities						
Amounts due to credit institutions	77,318	77,318	-	54,606	54,606	-
Amounts due to customers	385,445	385,445	-	246,638	246,638	-
Contingent capital participation notes	19,150	19,150	-	-	-	-
Total unrecognised change in unrealised fair value			636			(59)

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and savings accounts without a specific maturity.

Fixed and variable rate financial instruments

For quoted debt instruments the fair values are determined based on quoted market prices. The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

(Thousands of Georgian Lari)

26. Maturity analysis of assets and liabilities

The table below shows an analysis of monetary assets and liabilities according to when they are expected to be recovered or settled.

	2010			2009		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	139,271	-	139,271	108,563	-	108,563
Amounts due from credit institutions	7,508	-	7,508	2,762	1,067	3,829
Loans to customers	116,677	42,489	159,166	69,872	12,880	82,752
Investment securities:						
- available-for-sale	-	717	717	-	2,260	2,260
- held-to-maturity	32,340	51,520	83,860	1,995	-	1,995
Total	295,796	94,726	390,522	183,192	16,207	199,399
Amounts due to credit institutions	76,933	385	77,318	39,210	15,396	54,606
Derivative financial liabilities	102	-	102	-	-	-
Amounts due to customers	370,175	15,270	385,445	220,279	26,359	246,638
Contingent capital participation notes	-	19,150	19,150	-	-	-
Other liabilities	94	-	94	337	120	457
Total	447,304	34,805	482,109	259,826	41,875	301,701
Net	(151,508)	59,921	(91,587)	(76,634)	(25,668)	(102,302)

See Note 20 and Note 24 "Risk management" for the Group's contractual undiscounted repayment obligations and management's discussion on managing liquidity risk and resolving negative liquidity gaps.

(Thousands of Georgian Lari)

27. Related party disclosures

In accordance with IAS 24 "Related Party Disclosures", parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

	2010				*2009*				
	Parent	*Entities with significant influence over the Group*	*Entities under common control*	*Key management personnel*	*Parent*	*Entities with significant influence over the Group*	*Entities under common control*	*Associates*	*Key management personnel*
Loans outstanding at 1 January, gross	-	-	-	239	1,780	-	-	357	302
Loans issued during the year	-	-	-	162	215	-	-	5	206
Loan repayments during the year	-	-	-	(94)	(1,995)	-	-	(362)	(269)
Loans outstanding at 31 December, gross	-	-	-	307	-	-	-	-	239
Less: allowance for impairment at 31 December	-	-	-	5	-	-	-	-	5
Loans outstanding at 31 December, net	-	-	-	302	-	-	-	-	234
Interest income on loans	-	-	-	29	6	-	-	4	26
Impairment charge for loans	-	-	-	6	-	-	-	(7)	1
Deposits at 1 January	-	-	-	-	-	-	-	-	-
Deposits received during the year	-	17,784	-	177	-	-	-	-	-
Deposits repaid during the year	-	-	-	-	-	-	-	-	-
Deposits at 31 December	-	17,784	-	177	-	-	-	-	-
Contingent capital participation notes at 31 December	17,815	-	-	-	-	-	-	-	-
Current accounts at 31 December	173	917	-	3,694	790	19,912	-	119	272
Interest expense on deposits	59	923	-	21	212	169	-	-	5
Interest expense on the CCP	512	-	-	-	-	-	-	-	-
Commitments and guarantees issued	-	-	-	-	-	2,529	-	600	-
Fee and commission income	-	96	-	1	-	21	-	14	-
Other operating expenses	-	-	-	133	-	-	-	86	2

The number of key personnel at 31 December 2010 was 56 (2009: 58):

	2010	*2009*
Salaries and other benefits	3,493	2,155
Share based payment compensation	927	-
Total key personnel compensation	4,420	2,155

(Thousands of Georgian Lari)

28. Capital adequacy

The Group maintains an actively managed capital base to cover risks inherent in the business and aims at further enhancing its capital base. The adequacy of the Group's capital is monitored using, among other measures, the ratios established by the NBG and the ratios established by the Basel Capital Accord 1988 in supervising the Group.

Prior to 19 September 2009, the Bank had violated established regulatory capital requirements. However, on 19 September 2009, the Bank obtained a written waiver from the NBG, exempting the Bank from regulatory capital requirements for a three-year period ending 19 September 2012. According to the waiver letter, the Bank's regulatory capital shall be treated as though it were increased from its current level by GEL 108,000. The amount shall be considered as core capital (Tier 1 capital) and shall be included in the calculation of the prudential ratios, including, without limitation, the capital adequacy ratios. In order to enhance the Bank's capital base, Liberty Capital LLC, its new controlling shareholder, committed at the time of the purchase of a 91.218% equity interest in the Bank, to contribute USD 10 million equivalent in GEL in share capital within six months from the acquisition date. In October 2009 these funds were placed on deposit at the Bank and, in February 2010, were converted into share capital as described in Note 19. In 2010 the Bank issued the CCPN in the amount of GEL 18,615 of which 95.7% was purchased by Liberty Capital LLC, and, as described in Note 18 the CCPN shall be converted into ordinary shares of the Bank, if Tier I capital adequacy ratio is below the minimum NBG requirement as of 30 September 2012. In 2010 the Bank and Liberty Securities LLC sold 151,508,612 ordinary shares to third party investors for the aggregate consideration of GEL 4,553.

NBG capital adequacy ratio

The NBG requires banks to maintain the minimum capital adequacy ratio of 12% of the RWA, as well as the minimum core capital (Tier 1 capital) adequacy ratio of 8% of the RWA, computed based on the Bank's stand-alone financial statements, prepared in accordance with the NBG requirements. As of 31 December 2010 and 2009, the Bank's capital adequacy ratios calculated on this basis without the waiver were as follows:

	2010	*2009*
Core capital	5,787	(6,001)
Supplementary capital	5,787	-
Less: deductions from capital	(1,383)	(5,569)
Total capital	10,191	(11,570)
Risk-weighted assets	362,500	241,967
Capital adequacy ratio	2.81%	(4.78%)

As of 31 December 2010 and 2009, the Bank's capital adequacy ratios calculated on this basis and reflecting the above-mentioned NBG waiver were as follows:

	2010	*2009*
Core capital	5,787	(6,001)
Theoretical additions to capital (Tier 1) in accordance with the waiver obtained as described above	108,000	108,000
Supplementary capital	5,787	(5,814)
Less: deductions from capital	(1,383)	(5,569)
Total capital	118,191	90,616
Risk-weighted assets	362,500	241,967
Capital adequacy ratio	32.60%	37.45%

(Thousands of Georgian Lari)

28. Capital adequacy (continued)

Capital adequacy ratio under Basel Capital Accord 1988

The Group's capital adequacy ratios, computed in accordance with the Basel Capital Accord 1988, with subsequent amendments including the amendment to incorporate market risks, as of 31 December 2010 and 2009, were as follows:

	2010	*2009*
Tier 1 capital	15,276	(13,788)
Tier 2 capital	15,276	- *
Less: Deductions from capital	(3,371)	(347)
Total capital	27,181	(14,135)
Risk weighted assets	332,500	219,826
Tier 1 capital adequacy ratio	4.59%	(6.27%)
Total capital adequacy ratio	8.17%	(6.43%)

Proforma notional Tier 1 capital ratio (including the CCPN conversion of GEL 18,615 into ordinary shares resulting in an increase in Tier 1 capital)	10.20%	NMF
Proforma notional Total capital ratio (including the additionally available Tier 2 capital of GEL 11,307 eligible for the inclusion in Tier 2 capital upon the CCPN conversion)	17.17%	NMF

**Since Tier 1 capital was negative, none of the available Tier 2 capital has been taken into account for the purposes of Basel Capital Accord 1988 capital requirement computation.*

29. Events after the reporting period

On 28 March 2011 the Group disposed of one of its subsidiaries, NewSakkalakmshenproekti LLC, for cash consideration of GEL 18.

On 26 April 2011, the Bank sold 452,910,020 treasury and newly issued ordinary shares, for the aggregate consideration of GEL 11,322 to new institutional and retail investors