JSC Bank of Georgia and Subsidiaries
Consolidated Financial Statements

Year ended 31 December 2007
Together with Independent Auditors' Report

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated financial statements of JSC Bank of Georgia and Subsidiaries which comprise the consolidated balance sheet as at 31 December 2007, and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of JSC Bank of Georgia and Subsidiaries as at 31 December 2007, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

15 April 2008



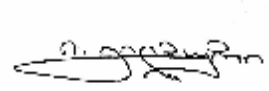
CONSOLIDATED BALANCE SHEET

As of 31 December 2007

(Thousands of Georgian Lari)

	Notes	*2007*	*2006*
Assets			
Cash and cash equivalents	7	405,770	108,045
Trading securities	8	6,342	–
Amounts due from credit institutions	9	154,560	65,475
Loans to customers, net	10	1,675,681	684,842
Finance lease receivables, net	11	46,674	9,091
Investment securities:	12		
- available–for-sale		42,387	9,887
- held–to-maturity		192,464	187,244
Investments in associates	13	5,208	496
Investment property	14	35,065	1,224
Property and equipment, net	15	204,656	66,828
Goodwill and other intangible assets, net	16	115,989	43,429
Current and deferred income tax assets	17	1,557	–
Prepayments		5,942	3,476
Other assets, net	18, 19	61,316	33,289
Total assets		**2,953,611**	**1,213,326**
Liabilities			
Amounts due to credit institutions	20	901,795	224,381
Amounts due to customers	21	1,355,476	559,646
Debt securities issued	22	4,993	1,073
Current and deferred income tax liabilities	17	37,209	8,138
Provisions	18, 24	1,003	672
Other liabilities	19	95,144	44,558
Total liabilities		**2,395,620**	**838,468**
Equity	23		
Share capital		27,155	25,202
Additional paid-in capital		315,415	277,440
Treasury shares		(1,737)	(1,004)
Other reserves		67,354	5,257
Retained earnings		136,342	63,746
Total equity attributable to shareholders of the Bank		**544,529**	**370,641**
Minority interests		13,462	4,217
Total equity		**557,991**	**374,858**
Total liabilities and equity		**2,953,611**	**1,213,326**

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

Irakli Gilauri  General Director

David Vakhtangishvili  Chief Financial Officer

15 April 2008

The accompanying notes on pages 5 to 60 are an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT

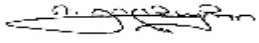
For the year ended 31 December 2007

(Thousands of Georgian Lari)

	Notes	*2007*	*2006*
Interest income			
Loans to customers		203,759	92,612
Investment securities – held-to-maturity		23,394	414
Investment securities – available-for-sale		1,073	792
Amounts due from credit institutions		9,942	5,310
Finance lease receivables		4,136	1,143
		242,304	**100,271**
Interest expense			
Amounts due to credit institutions		(58,072)	(14,128)
Amounts due to customers		(53,419)	(19,245)
Debt securities issued		(594)	(176)
		(112,085)	**(33,549)**
Net interest income		**130,219**	**66,722**
Loan impairment charge	10	(17,409)	(13,766)
Net interest income after loan impairment charge		**112,810**	**52,956**
Fee and commission income		48,358	28,139
Fee and commission expense		(6,610)	(3,453)
Net fee and commission income	25	**41,748**	**24,686**
Net gains from trading securities		2,930	–
Net gains from investment securities available-for-sale	23	2,481	–
Net gains from revaluation of investment property	14	16,362	–
Net gains/(losses) from foreign currencies:			
- dealing		22,395	12,049
- translation differences		4,315	(107)
Net insurance premiums earned		14,260	6,260
Other operating income		9,903	4,222
Other non-interest income		**72,646**	**22,424**
Salaries and other employee benefits	26	(75,639)	(33,316)
General and administrative expenses	26	(36,164)	(20,649)
Depreciation, amortization and impairment	15,16	(9,863)	(5,887)
Net insurance claims incurred		(8,799)	(1,827)
Other operating expenses		(7,392)	(3,654)
Reversal of impairment of other assets and provisions	18	365	170
Other non-interest expenses		**(137,492)**	**(65,163)**
Profit before income tax expense		**89,712**	**34,903**
Income tax expense	17	(14,070)	(8,131)
Profit for the year		**75,642**	**26,772**
Attributable to:			
- shareholders of the Bank		72,484	26,983
- minority interests		3,158	(211)
		75,642	**26,772**
Earnings per share:	23		
- basic earnings per share		2.958	1.622
- diluted earnings per share		2.947	1.445

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

Irakli Gilauri General Director



David Vakhtangishvili Chief Financial Officer



15 April 2008

The accompanying notes on pages 5 to 60 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2007

(Thousands of Georgian Lari)

	Attributable to shareholders of the Bank							
	Share capital	*Additional paid-in capital*	*Treasury shares*	*Other reserves*	*Retained earnings*	*Total*	*Minority interests*	*Total equity*
31 December 2005	**14,729**	**32,922**	**(81)**	**5,369**	**37,427**	**90,366**	**1,096**	**91,462**
Increase in share capital arising from share-based payments (Note 23)	175	2,343	68	–	–	2,586	–	2,586
Depreciation of revaluation reserve, net of tax	–	–	–	(112)	112	–	–	–
Total income and expenses recognised directly in equity	**175**	**2,343**	**68**	**(112)**	**112**	**2,586**	**–**	**2,586**
2006 profit	–	–	–	–	26,983	26,983	(211)	26,772
Total income and expenses for the year	**175**	**2,343**	**68**	**(112)**	**27,095**	**29,569**	**(211)**	**29,358**
Increase in share capital (Note 23)	10,298	249,571	–	–	–	259,869	–	259,869
Share offering costs recognised directly in equity	–	(5,040)	–	–	–	(5,040)	–	(5,040)
Dividends to shareholders of the Bank (Note 23)	–	–	–	–	(776)	(776)	–	(776)
Acquisition of additional interests in existing subsidiaries by minority shareholders	–	–	–	–	–	–	3,454	3,454
Acquisition of minority interests in existing subsidiaries	–	–	–	–	–	–	(122)	(122)
Purchase of treasury shares	–	(2,356)	(991)	–	–	(3,347)	–	(3,347)
31 December 2006	**25,202**	**277,440**	**(1,004)**	**5,257**	**63,746**	**370,641**	**4,217**	**374,858**
Net change in investment securities available-for-sale, net of tax	–	–	–	859	–	859	–	859
Revaluation of property and equipment and Investment Property, net of tax	–	–	–	59,295	–	59,295	964	60,259
Increase in share capital arising from share-based payments (Note 23)	146	948	–	–	–	1,094	–	1,094
Depreciation of revaluation reserve, net of tax	–	–	–	(112)	112	–	–	–
Share offering costs adjustment	–	1,321	–	–	–	1,321	–	1,321
Currency translation differences	–	–	–	2,055	–	2,055	–	2,055
Total income and expenses recognised directly in equity	**146**	**2,269**	**–**	**62,097**	**112**	**64,624**	**964**	**65,588**
2007 profit	–	–	–	–	72,484	72,484	3,158	75,642
Total income and expenses for the year	**146**	**2,269**	**–**	**62,097**	**72,596**	**137,108**	**4,122**	**141,230**
Increase in share capital (Note 23)	1,807	37,751	–	–	–	39,558	–	39,558
Acquisition of additional interests in existing subsidiaries by minority shareholders	–	–	–	–	–	–	3,494	3,494
Acquisition of minority interests in existing subsidiaries	–	–	–	–	–	–	(87)	(87)
Minority interests arising on acquisition of subsidiary	–	–	–	–	–	–	1,716	1,716
Sale of treasury shares	–	9,600	–	–	–	9,600	–	9,600
Purchase of treasury shares	–	(11,645)	(733)	–	–	(12,378)	–	(12,378)
31 December 2007	**27,155**	**315,415**	**(1,737)**	**67,354**	**136,342**	**544,529**	**13,462**	**557,991**

The accompanying notes on pages 5 to 60 are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2007

(Thousands of Georgian Lari)

	Notes	*2007*	*2006*
Cash flows from operating activities			
Interest received		234,083	96,231
Interest paid		(88,027)	(28,088)
Fees and commissions received		48,357	28,139
Fees and commissions paid		(6,608)	(3,453)
Net realized gains from trading securities		2,764	–
Net realized gains from investments securities		2,481	–
Net realized gains in foreign currencies		22,395	12,046
Recoveries of loans to customers previously written off	10	7,918	3,263
Insurance premiums received		19,336	3,070
Insurance claims paid		(6,554)	(1,492)
Other operating income received		9,504	3,877
Salaries and other employee benefits paid		(53,838)	(30,462)
General and administrative and operating expenses paid		(41,298)	(20,984)
Cash flows from operating activities before changes in operating assets and liabilities		**150,513**	**62,147**
Net (increase) decrease in operating assets			
Amounts due from credit institutions		(82,753)	(28,816)
Trading securities		(6,168)	-
Loans to customers		(774,471)	(396,543)
Finance lease receivables		(38,078)	(4,778)
Other assets		(11,504)	(10,914)
Net increase (decrease) in operating liabilities			
Amounts due to credit institutions		604,576	136,065
Amounts due to customers		537,984	248,982
Other liabilities		2,970	3,774
Net cash flows from operating activities before income tax		**383,069**	**9,917**
Income tax paid		(3,854)	(203)
Net cash from operating activities		**379,215**	**9,714**
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired	5	(12,256)	259
Purchase of investment securities		(11,838)	(186,288)
Purchase of investments in associates	13	(5,275)	(496)
Proceeds from sale of investments in associates	13	700	–
Purchase of investment property	14	(10,499)	(1,224)
Purchase of property and equipment and intangible assets	15, 16	(74,238)	(30,277)
Net cash used in investing activities		**(113,406)**	**(218,026)**
Cash flows from financing activities			
Proceeds from increase in share capital		38,908	259,770
Purchase of treasury shares		(11,728)	(3,347)
Sale of treasury shares		9,600	-
Purchase of additional interests by minority shareholders, net of cash acquired		3,494	3,454
Purchase of additional interests in existing subsidiaries, net of cash acquired		303	–
Proceeds from debt securities issued		(9,045)	–
Redemption of debt securities issued		49	(70)
Dividends paid to shareholders of the Bank		–	(579)
Net cash from financing activities		**31,581**	**259,228**
Effect of exchange rates changes on cash and cash equivalents		335	(107)
Net increase in cash and cash equivalents		**297,725**	**50,809**
Cash and cash equivalents, beginning		**108,045**	**57,236**
Cash and cash equivalents, ending	7	**405,770**	**108,045**

The accompanying notes on pages 5 to 60 are an integral part of these consolidated financial statements.

(Thousands of Georgian Lari)

1. Principal Activities

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

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and international and exchanges currencies. Its main office is in Tbilisi, Georgia. At 31 December 2007 the Bank has 117 operating outlets in all major cities of Georgia (2006: 100). The Bank's registered legal address is 3 Pushkin Street, Tbilisi 0105, Georgia.

As of 31 December 2007 and 2006 the following shareholders owned more than 5% of the outstanding shares of the Bank. Other shareholders individually owned less than 5% of the outstanding shares.

Shareholder	***31 December 2007, %***	***31 December 2006, %***
Bank of New York (Nominees), Limited	71.38%	43.01%
Firebird Avrora Fund	5.39%	5.81%
Firebird Republics Fund	5.27%	5.67%
East Capital Financial Institutions	5.03%	5.42%
Bank Austria Creditanstalt	–	16.53%
Others	12.93%	23.56%
Total	**100.00%**	**100.00%**

As of 31 December 2007, the members of the Supervisory Board and Board of Directors owned 214,146 shares (0.787%) (2006: 622,366 shares or 2.47%) of the Bank. Interests of the members of the Supervisory Board and Management Board were as follows:

Shareholder	***31 December 2007, shares held***	***31 December 2006, shares held***
Sulkhan Gvalia	188,050	224,000
Ramaz Kukuladze	23,094	22,122
Irakli Gilauri	1,587	–
Nicholas Enukidze	1,045	–
Irakli Burdiladze	370	–
Lado Gurgenidze	–	376,244
Total	**214,146**	**622,366**

In addition to shares held, the members of the Supervisory Board and Management Board were awarded 244,617 and 185,000 Global Depository Receipts ("GDR") in 2007 and 2006, respectively. The awards are subject to three-year vesting. As of 31 December 31, 2007 and 2006 31,665 GDRs owned by the members of the Supervisory Board and Management Board vested and comprised as follows:

Member of the Supervisory Board and/or Management Board	***31 December 2007 and 2006, GDRs vested***
Irakli Gilauri	16,666
Sulkhan Gvalia	13,333
Nicholas Enukidze	–
Ramaz Kukuladze	1,666
Irakli Burdiladze	–
Total	**31,665**

In November and December 2006, 8,880,207 shares of the Bank in the form of Global Depository Receipts ("GDRs") were sold on the London Stock Exchange (the "LSE") pursuant to an initial public offering to institutional investors. 7,440,207 shares in the form of GDRs were sold by the Bank while the balance was sold by the selling shareholders. Each GDR represents 1 ordinary share of the Bank. Bank of New York ("BNY") acts as a depository for these shares.

(Thousands of Georgian Lari)

2. Basis of Preparation

General

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

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

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

Subsidiaries

The consolidated financial statements as of 31 December 2007 and 2006 include the following direct and indirect subsidiaries:

Subsidiary	*31 December 2007 Ownership/ voting, %*	*31 December 2006 Ownership/ voting, %*	*Country*	*Date of incorporation*	*Industry*	*Date of acquisition*
JSC Insurance Company Aldagi-BCI	100.0%	100.0%	Georgia	22/06/2007	Insurance	–
JSC Insurance Company BCI	(a)	100.0%	Georgia	30/12/1995	Insurance	21/12/2006
JSC Insurance Company Aldagi	(a)	100.0%	Georgia	11/08/1998	Insurance	30/12/2004
JSC Galt & Taggart Securities	100.0%	100.0%	Georgia	19/12/1995	Brokerage and asset management	28/12/2004
Georgian Leasing Company LLC	100.0%	100.0%	Georgia	29/10/2001	Leasing	31/12/2004
JSC Insurance Company Europace	(b)	100.0%	Georgia	09/09/1998	Insurance (non–life)	18/10/2005
JSC Galt & Taggart Capital	71.6%	77.0%	Georgia	24/05/2006	Investment	–
JSC SB Outdoor and Indoor	100.0%	77.0%	Georgia	09/06/2006	Advertising	–
Brokerage Company Hedji LLC	100.0%	100.0%	Georgia	22/05/2002	Brokerage	17/04/2006
Tavazi LLC	100.0%	100.0%	Georgia	31/03/2001	Brokerage	20/04/2006
JSC DBL.ge	100.0%	–	Georgia	23/04/2007	Investment	–
JSC DBL Capital	100.0%	–	Georgia	27/04/2007	Brokerage	–
Georgian Securities LLC	100.0%	–	Georgia	19/06/2000	Brokerage	8/10/2007
JSC Universal Bank of Development and Partnership	98.8%	–	Ukraine	26/01/1994	Banking	1/10/2007
JSC Galt and Taggart Bank	100.0%	–	Georgia	30/12/1996	Banking	31/05/2007
Galt and Taggart Tax Advisory LLC	100.0%	–	Georgia	25/09/2007	Tax consulting	–
JSC Caucasus Energy and Infrastructure	100.0%	–	Georgia	7/06/2007	Investment	–
JSC SB Trade	100.0%	–	Georgia	26/02/2007	Import and distribution	–
SB Transport LLC	100.0%	–	Georgia	20/02/2007	Transportation	–
Metro Net LLC	100.0%	–	Georgia	23/04/2007	Communication services	–
"Club 24" LLC	100.0%	–	Georgia	27/11/2007	Entertainment	–
Galt and Taggart Asset Management LLC	100.0%	–	Georgia	31/05/2007	Asset management	–
Real Estate Brokerage-LUX LLC	100.0%	–	Georgia	16/11/2007	Real estate brokerage	–
GTAM limited	80.0%	–	Cyprus	23/10/2007	Asset management	–
Vere + LLC	100.0%	–	Georgia	22/05/1996	Real estate	6/02/2007
GC Holdings LLC	100.0%	100.0%	Georgia	29/10/2007	Investment	
JSC Georgian Card	55.7%	55.4%	Georgia	17/01/1997	Card processing	20/10/2004
Nova Technology, LLC	51.00%	–	Georgia	19/03/2007	Electronic payment services	11/11/2007
Intertour LLC	83.7%	64.4%	Georgia	29/03/1996	Travel agency	25/04/2006
Georgian-American Medical Rehabilitation Center Nautilus LLC	(b)	100.0%	Georgia	05/04/2004	Fitness centre	9/03/2006
JSC SB Reestri	100.0%	100.0%	Georgia	29/05/2006	Registrar	–
Metro Service + LLC	100.0%	81.6%	Georgia	10/05/2006	Business servicing	–
Direct Debit Georgia LLC	100.0%	77.0%	Georgia	22/02/2006	Electronic payment services	–
JSC My Family Clinic	100.0%	60.0%	Georgia	3/10/2005	Healthcare	–

(Thousands of Georgian Lari)

2. Basis of Preparation (continued)

Subsidiaries

Subsidiary	*31 December 2007 Ownership/ voting, %*	*31 December 2006 Ownership/ voting, %*	*Country*	*Date of incorporation*	*Industry*	*Date of acquisition*
JSC Prime Fitness	100.0%	77.0%	Georgia	03/07/2006	Fitness centre	–
JSC SB Real Estate	100.0%	77.0%	Georgia	27/09/2006	Real estate	–
Holiday Travel LLC	100.0%	64.4%	Georgia	11/02/2005	Travel agency	4/09/2006
United Securities Registrar of Georgia, LLC	100.0%	100.0%	Georgia	25/01/1999	Registrar	30/09/2006
ICT Delameni LLC	(c)	100.0%	Georgia	30/03/1999	Registrar	22/08/2006
Company Center LLC	(c)	100.0%	Georgia	21/10/1996	Registrar	9/08/2006
Register Center LLC	(c)	100.0%	Georgia	25/01/1999	Registrar	30/09/2006
Galt and Taggart Holding Limited	100.0%	100.0%	Cyprus	03/07/2006	Holding company	–
Galt and Taggart Securities (Ukraine) LLC	100.0%	100.0%	Ukraine	23/10/2006	Brokerage	–
Georgian Brokers Company LLC	100.0%	100.0%	Georgia	23/06/1999	Brokerage	21/12/2006
Aldagi-Assistance LLC	(b)	100.0%	Georgia	22/02/2000	Insurance	21/12/2006

(a) The subsidiary merged with JSC Insurance Company Aldagi-BCI in 2007.
(b) The subsidiary is either under liquidation, have been liquidated, or share ownership have been disposed of or sold, and therefore is not consolidated as of 31 December 2007.
(c) The subsidiary merged with JSC United Securities Registrar of Georgia in 2007.

3. Summary of Significant Accounting Policies

Subsidiaries

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

Acquisition of subsidiaries

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

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

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

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

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

Subsidiaries (continued)

Step-up acquisition

For business combination involving exchange transaction in stages by successive phase purchases, each exchange transaction is treated separately by the Bank, using the cost of the transaction and fair value information at the date of each exchange transaction, to determine the amount of any goodwill associated with that transaction. This results in a step-by-step comparison of the cost of the individual investments with the Bank's interest in the fair values of the acquiree's identifiable assets, liabilities and contingent liabilities at each step.

Increases in ownership interests in subsidiaries

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

Investments in associates

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

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

Financial assets

Initial recognition

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

Date of recognition

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss

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

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

Financial assets (continued)

Held-to-maturity investments

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

Loans and receivables

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

Determination of fair value

The fair value of financial instruments that are actively traded in organised financial markets is determined by reference to quoted market bid prices for long positions and ask price for short positions at the close of business on the balance sheet date, without any deduction for transaction costs. For all other financial instruments where there is no active market, fair value is determined using valuation techniques. Valuation techniques include using recent arm's length market transactions, which are determined not to be a result of a forced transaction, involuntary liquidation or distress sale, reference to the current market value of similar instrument, discounted cash flow analysis and other relevant valuation models.

Offsetting

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

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the National Bank of Georgia ("NBG") and the National Bank of Ukraine ("NBU"), 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.

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

Derivative financial instruments

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

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

Promissory notes

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

Borrowings

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

Leases

i. Finance - Group as lessor

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

ii. Operating - Group as lessee

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

iii. Operating - Group as lessor

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

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

Impairment of financial assets

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

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

Amounts due from credit institutions and loans to customers

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

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

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

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

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

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.

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

Impairment of financial assets (continued)

Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the consolidated statement on income, is transferred from equity to the consolidated income statement. Reversals in respect of equity instruments classified as available-for-sale are not recognised in the consolidated income statement. Reversals of impairment losses on debt instruments are reversed through the consolidated income statement if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss were recognised in profit or loss.

Renegotiated loans

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

De-recognition of financial assets and liabilities

Financial assets

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

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

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

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

Financial liabilities

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

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

Financial guarantees

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

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

Financial guarantees (continued)

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

Taxation

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

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

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet 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 and Ukraine also have various operating taxes that are assessed on the Group's activities. These taxes are included as a component of other operating expenses.

Investment property

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

Property and equipment

Property and equipment, except for buildings, are carried at cost less accumulated depreciation and any accumulated impairment in value. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met. Buildings are measured at fair value less depreciation and impairment charged subsequent to the date of the revaluation.

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

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

Any revaluation surplus is credited to the revaluation reserve for property and equipment included in equity, 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 statement of income. 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.

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

Property and equipment (continued)

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

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

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

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

Leasehold improvements are amortized over the life of the related leased asset. The assets residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

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

Goodwill

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

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- is not larger than a segment based on either the Group's primary or the Group's secondary reporting format determined in accordance with IAS 14 "Segment Reporting".

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

Other intangible assets

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

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

Intangible assets with indefinite useful lives are not amortised, but tested for impairment annually either individually or at the cash-generating unit level. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable.

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

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.

Insurance liabilities

General insurance liabilities

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

Provision for unearned premiums

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

Liability adequacy test

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

Retirement and other employee benefit obligations

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

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

Share-based payment transactions

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

Equity-settled transactions

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

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

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

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

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

Share capital

Share capital

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

Treasury shares

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

Dividends

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

Segment reporting

A segment is a distinguishable component of the Group that is engaged in providing products or services (business segments) or in providing products or services within particular economic environment (geographic segment), which is subject to risks and rewards that are different from those of other segments. The Group determines that the primary and secondary segments are business and geographical, respectively.

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

Contingencies

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

Income and expense recognition

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

Interest and similar income and expense

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

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

Fee and commission income

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

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

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

- *Fee income from providing transaction services*

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

Dividend income

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

Premium income

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

Claims

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

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

Income and expense recognition (continued)

Claims handling costs include internal and external costs incurred in connection with the negotiation and settlement of claims. Internal costs include direct expenses of the claims department and any part of the general administrative costs directly attributable to the claims function.

Functional and reporting currencies and foreign currency translation

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

Differences between the contractual exchange rate of a certain transaction and the NBG exchange rate on the date of the transaction are included in gains less losses from foreign currencies (dealing). The official NBG exchange rates at 31 December 2007 and 2006 were 1.5916 and 1.714 Lari to USD 1 and 2.3315 and 2.256 Lari to EUR 1, respectively.

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

Change in functional currency

Prior to 1 January 2007, the Bank determined that the Georgian Lari ("GEL") was its functional currency as it was the currency of the primary economic environment in which the Bank operated.

In 2007 however, the Bank performed a re-assessment of its functional currency in relation to International Accounting Standard 21 - "Effects of Changes in Foreign Exchange Rates" (IAS 21) due to the following:

- The USD share of the Bank's assets and liabilities was constantly increasing;
- Pricing of the loans is primary based on the cost of funds which are sourced primarily from USD denominated offshore banking borrowings and deposits; at the same time GDRs of the Bank, floated on the London Stock Exchange, are priced and traded in USD.
- After the Bank listed its shares in the form of Global Depositary Rights on the London Stock Exchange in November 2006, communication, planning and execution of business activities of the Bank with shareholders are generally

As a result, the Bank has changed its functional currency from GEL to USD starting 1 January 2007.

In accordance with IAS 21 - "The Effects of Changes in Foreign Exchange Rates", the change in the functional currency was accounted for prospectively from 1 January 2007. In these consolidated financial statements assets and liabilities in the comparative balance sheet as at 31 December 2006, were translated to the USD using the exchange rate as at 31 December 2006, equal to GEL 1.714/USD 1. The consolidated income statement for the year ended 31 December 2007 was translated to GEL using the average exchange rate for 2007, of GEL 1.692/USD 1, and the consolidated balance sheet as at 31 December 2007 were translated to the USD using the exchange rate as at 31 December 2007 of GEL 1.5916/USD 1. Any differences arising from translation is included in a separate component of equity. Upon the change in the functional currency all equity components were retranslated at the exchange rate as at 1 January 2007.

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

Changes in accounting policies

The Group followed the same accounting policies with those applied in the consolidated financial statements as at 31 December 2007 and for the year then ended, except as disclosed below:

Investment property

Effective 1 January 2007, the Group started to present investment property using fair value model. Adoption of this change in accounting policy did not have any significant effect on the 2006 consolidated financial statements of the Group.

Segment reporting

In 2007 the Group has revisited its segment policy relating to the allocation of assets and liabilities to the business segments and have accordingly revised the 2006 segment reporting to be consistent with the basis of allocation in 2007 segment reporting.

Adoption of new or revised standards and interpretations

The Group has adopted the following new and amended IFRSs and IFRIC Interpretations during the year. Adoption of these Standards and Interpretations did not have any effect on the financial performance or position of the Group. They did however give rise to additional disclosures.

IFRS 7 'Financial Instruments: Disclosures' and amendment to IAS 1 'Presentation of Financial Statements – Capital Disclosures'

IFRS 7 requires additional disclosure of qualitative and quantitative information regarding exposure to risks arising from financial instruments. In particular, it specifies minimum disclosures about credit risk, liquidity risk and market risk. IFRS 7 replaces IAS 30 'Disclosures in the Financial Statements of Banks and Similar Financial Institutions' and the disclosure requirements in IAS 32 'Financial Instruments: Disclosure and Presentation'.

The amendment to IAS 1 introduces disclosures relating to the level of an entity's capital and how it is managed.

The new disclosures are included throughout the consolidated financial statements.

IFRIC 8 'Scope of IFRS 2'

IFRIC 8 clarifies that IFRS 2 'Share-Based Payments' applies to any arrangement by which equity securities are granted or liabilities (based on the value of an entity's equity securities) are incurred and the identifiable consideration appears to be less than the fair value of the equity securities granted or the liabilities incurred. The adoption of IFRIC 8 did not have any impact on the consolidated financial statements of the Group.

IFRIC 9 'Reassessment of Embedded Derivatives'

IFRIC 9 requires an entity to assess upon entering into a contract, whether this contains an embedded derivative and prohibits reassessment unless there is a change to the contract terms as a result of which there are significant changes in the cash flows. The adoption of IFRIC 9 did not have any impact on the consolidated financial statements of the Group.

IFRIC 10 'Interim Financial Reporting and Impairment'

IFRIC 10 provides that, should any impairment losses be recognized in the interim financial statements in relation to goodwill, available-for-sale investments in equity securities or unquoted equity securities carried at cost, these impairment losses may not be reversed in subsequent interim periods or when preparing the annual financial statements. The adoption of IFRIC 10 did not have any impact on the consolidated financial statements of the Group.

Standards and interpretations that are issued but not yet effective

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

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

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

IFRS 8 'Operating Segments' (effective for annual periods beginning on or after 1 January 2009)

IFRS 8 replaces IAS 14 'Segment Reporting' and adopts a management-based approach to segment reporting. The information reported would be that which management uses internally for evaluating the performance of operating segments and allocating resources to those segments. This information may be different from that reported in the balance sheet and income statement and entities will need to provide explanations and reconciliations of the differences. The group will make the necessary changes to the presentation of its operating segments once it assesses the impact of this Standard on their consolidated financial statements.

IFRIC 11, IFRS 2 'Group and Treasury Share Transactions' (effective for annual periods beginning on or after 1 March 2007)

IFRIC 11 requires arrangements whereby an employee is granted options to buy equity shares, to be accounted for as equity-settled schemes by an entity even if the entity chooses or is required to buy those equity shares from another party, or the shareholders of the entity provide the equity instruments granted. The interpretation also extends to the way in which subsidiaries, in their separate financial statements, account for such schemes when their employees receive rights to equity instruments of the parent.

Amendment to IAS 23 'Borrowing Costs' (effective for annual periods beginning on or after 1 January 2009)

The option in the current standard to expense borrowing costs to the income statement in case of a qualifying asset has been eliminated. All borrowing costs must be capitalised if they are directly attributable to the acquisition or construction of a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements of the standard, the Group will adopt this as a prospective change. Accordingly, borrowing costs will be capitalised on qualifying assets with a commencement date after 1 January 2009. No changes will be made for borrowing costs incurred to this date that have been expensed.

IFRIC 12 'Service Concession Arrangements' (effective for annual periods beginning on or after 1 January 2008)

IFRIC 12 outlines an approach to account for contractual arrangements arising from entities providing public services. It provides that the operator should not account for the infrastructure as property, plant and equipment, but recognise a financial asset and/or an intangible asset. IFRIC 12 is not relevant to the Group.

IFRIC 13 'Customer Loyalty Programmes' (effective for annual periods beginning on or after 1 July 2008)

IFRIC 13 requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. The Group expects that this Interpretation will not have a material impact on their consolidated financial statements at the date of adoption.

IFRIC 14 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' (effective for annual periods beginning on or after 1 January 2008)

IFRIC 14 provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognised as an asset under IAS 19 'Employee Benefits'. It also explains how this limit, also referred to as the 'asset ceiling test', may be influenced by a minimum funding requirement and aims to standardise current practice. The Group expects that this amendment will have no impact on their consolidated financial statements.

Further Amendment to IAS 1 'Presentation of Financial Statements' (effective for annual periods beginning on or after 1 January 2009)

IAS 1 has been revised to enhance the usefulness of information presented in the financial statements. The main revisions are the introduction of a new statement of comprehensive income that combines all items of income and expense recognised in profit or loss together with 'other comprehensive income' and the requirement to present restatements of financial statements or retrospective application of a new accounting policy as at the beginning of the earliest comparative period, i.e. a third column on the balance sheet. The Group will make the necessary changes to the presentation of its consolidated financial statements in 2009.

(Thousands of Georgian Lari)

3. Summary of Significant Accounting Policies (continued)

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

Amendment to IFRS 2 'Share Based Payment – Vesting Conditions and Cancellations' (effective for annual periods beginning on or after 1 January 2009)

The Amendment clarifies two issues. The definition of 'vesting condition', introducing the term 'non-vesting condition' for conditions other than vesting conditions. It also clarifies that the same accounting treatment applies to awards that are effectively cancelled by either the entity or a counterparty. The Group will assess the impact of this amendment on their consolidated financial statements at the date of adoption.

Revisions to IFRS 3 'Business Combinations' and Amendment to IAS 27 'Consolidated and Separate Financial Statements' (effective for annual periods beginning on or after 1 July 2009)

Main changes to the existing standards refer to: (a) addition of an option to measure minority interests (now called 'non-controlling interests') at fair value; (b) recognition of goodwill for step acquisitions; (c) recognition of acquisition-related costs; (d) recognition of contingent consideration; (e) transactions with non-controlling interests which do not result in loss of control; (f) allocation of subsidiary's losses between controlling and non-controlling interests; (g) re-measurement of retained interest on loss of control of a subsidiary. The Group will assess the impact of the revision on their consolidated financial statements at the date of adoption.

Amendments to IAS 32 and IAS 1 Puttable Financial Instruments (effective for annual periods beginning on or after 1 January 2009)

The amendment to IAS 32 requires certain puttable financial instruments and obligations arising on liquidation to be classified as equity if certain criteria are met. The amendment to IAS 1 requires disclosure of certain information relating to puttable instruments classified as equity.

4. Significant Accounting Estimates

Estimation uncertainty

The preparation of consolidated financial statements requires the Group to make estimates and assumptions that affect reported amounts. These estimates are based on information available as of the date of the consolidated financial statements. Actual results, therefore, could differ from these estimates. The most significant estimates are discussed below:

Allowance for impairment of loans and receivables

The Group regularly reviews its loans and receivables to assess impairment. The Group uses its judgment to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Group uses its judgment to adjust observable data for a group of loans or receivables to reflect current circumstances.

Contingent liabilities

The Group is subject to the possibility of various loss contingencies arising in the ordinary course of business. The Group considers the likelihood of the loss or the incurrence of a liability as well as its ability to reasonably estimate the amount of loss in determining loss contingencies. An estimated loss contingency is accrued when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. The Group regularly evaluates current information available to determine whether such accruals are required. As of 31 December 2007, the Group did not record any contingent liabilities.

(Thousands of Georgian Lari)

4. Significant Accounting Estimates (continued)

Estimation uncertainty (continued)

Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill as at 31 December 2007 was GEL 110,072 (2006: 40,279). More details are provided in Note 5.

Impairment of long-lived assets

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

Impairment of investments

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

5. Business Combinations

JSC Galt and Taggart Bank

On 30 May 2007 the Group acquired 100% of JSC Galt and Taggart Bank (former JSC Cascade Bank), a banking institution operating in Georgia. The fair values of identifiable assets, liabilities and contingent liabilities of JSC Cascade Bank as of the date of acquisition were provisionally estimated at:

	Fair value recognized on acquisition	***Carrying value***
Cash and cash equivalents	2,557	2,557
Due from credit institutions	256	256
Investment securities available-for-sale	6,565	6,565
Investments in associates	64	64
Loans to customers	1,786	1,786
Property and equipment	121	121
Intangible assets	41	41
Prepayments and accrued interest receivables	1,458	1,458
Deferred tax assets	524	524
	13,372	**13,372**
Amounts owed to credit institutions	9	9
Amounts owed to customers	2,085	2,085
Other liabilities	1,039	1,035
	3,133	**3,129**
Fair value of net assets	**10,239**	**10,243**
Goodwill arising on acquisition	599	
Consideration paid	**10,838**	

(Thousands of Georgian Lari)

5. Business Combinations (continued)

JSC Galt and Taggart Bank (continued)

The net cash outflow on acquisition was as follows:

	2007
Cash paid	10,838
Cash acquired with the subsidiary	(2,557)
Net cash outflow	**8,281**

If the combination had taken place at the beginning of the year, the net income of the Group would have been GEL 75,768 and the total revenue would have been GEL 363,823.

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

JSC Universal Bank of Development and Partnership

On 1 January 2007 the Group acquired 9.92% of JSC Universal Bank of Development and Partnership, a banking institution located in the Ukraine. On 1 October 2007 the Group acquired up to 98.76% of the JSC Universal Bank of Development and Partnership.

The fair values of identifiable assets, liabilities and contingent liabilities of JSC Universal Bank of Development and Partnership as of 1 January 2007 and 1 October 2007 were provisionally estimated at:

	1 January 2007		*1 October 2007*	
	Fair value recognized on acquisition	***Carrying value***	***Fair value recognized on acquisition***	***Carrying value***
Cash and cash equivalents	53,090	53,090	134,584	134,584
Due from credit institutions	61	61	5,649	5,649
Loans to customers	215,062	215,062	198,201	198,201
Investment securities available-for-sale	8,356	8,356	18,013	18,013
Property and equipment	4,872	4,872	7,399	7,399
Intangible assets	618	618	700	700
Other assets	258	258	503	503
	282,317	**282,317**	**365,049**	**365,049**
Amounts owed to credit institutions	22,073	22,073	21,288	21,288
Amounts owed to customers	188,774	188,774	252,341	252,341
Debt securities issued	7,463	7,463	12,965	12,965
Deferred income tax liabilities	4,299	4,299	6,664	6,664
Other liabilities	446	446	2,581	2,581
	223,055	**223,055**	**295,839**	**295,839**
Fair value of net assets	**59,262**	**59,262**	**69,210**	**69,210**
Share of net assets acquired	9.922%		88.844%	
Fair value of net assets acquired	**5,880**		**61,489**	
Total fair value of net assets acquired				67,369
Recognized Core Deposit Intangible				1,688
Goodwill arising on acquisition				68,016
Consideration paid				**137,073**

(Thousands of Georgian Lari)

5. Business Combinations (continued)

JSC Universal Bank of Development and Partnership (continued)

The net cash outflow on acquisition was as follows:

	2007
Cash paid	137,073
Cash acquired with the subsidiary	134,584
Net cash outflow	**2,489**

If the combination had taken place at the beginning of the year, the net income of the Group would have been GEL 80,344 and the total revenue would have been GEL 414,832.

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

JSC Nova Technology

On 23 November 2007 the Group acquired 51% Nova Technology LLC, an electronic payment service provider operating in Georgia. The fair value of identifiable assets of the company as of the date of acquisition were provisionally estimated at GEL 2,771, while liabilities at GEL 691. The provisional goodwill on acquisition amounted to GEL 411 and net cash outflow from acquisition amounted to GEL 1,486.

Acquisitions in 2006

The fair value of identifiable assets, liabilities and contingent liabilities of major business combinations that occurred during 2006 (i.e. JSC Intellect Bank, JSC Insurance Company Aldagi, Intertour LLC, Register Center LLC and Georgian-American Medical Rehabilitation Center Nautilus LLC) in aggregate as of the date of acquisition were provisionally estimated at:

	Recognized on acquisition	*Carrying value*
Cash and cash equivalents	12,182	12,182
Due from credit institutions	3,246	3,246
Deposits with banks	117	117
Investment securities– available-for-sale	92	92
Investments in associates	199	1,238
Loans to customers	8,644	8,644
Other debtors and receivables	2,614	2,614
Property and equipment	7,206	6,113
Intangible assets	256	1,103
Reinsurance assets	7,990	7,990
Other assets	3,352	2,297
	45,898	**45,636**
Amounts owed to credit institutions	8,175	8,175
Amounts owed to customers	37,419	37,419
Amounts owned to reinsurers	2,734	2,734
Unearned premiums reserve	4,558	4,588
Claims reserves	5,491	5,491
Borrowings	3,783	3,783
Accounts payable	768	768
Advances received	590	590
Other liabilities	3,232	3,332
	66,750	**66,880**
Fair value of net assets	**(20,852)**	**(21,244)**
Goodwill arising on acquisition	34,975	–
Consideration paid	**14,123**	**–**

(Thousands of Georgian Lari)

5. Business Combinations (continued)

The total net cash inflow on all acquisitions was as follows:

	2006
Cash paid	11,923
Cash acquired with the subsidiary	(12,182)
Net cash inflow	**(259)**

If the combination had taken place at the beginning of the period, the profit (loss) of the group would have been GEL 4,149 and the total revenue would have been GEL 120,247.

6. Segment Information

The primary segment is determined to be business segment as the Group's risks and rates of return are affected predominantly by differences in the products and services produced. Secondary segment information is reported geographically. The operating businesses are organised and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

For management purposes, the Group is organised into seven business segments:

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

For purposes of presentation in these consolidated financial statements, due to the insignificance of certain segments to be separately shown as of 31 December 2007 and to be consistent with the 2006 presentation of the business segments, Management has combined brokerage and asset and wealth management business segments into one. Therefore, segment information presented in these consolidated financial statements is classified as follows:

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

The Group's geographical segments are based on the location of the Group's assets. Income from external customers disclosed by geographical segments is based on the geographical location of its customers.In 2007 Group has revised its segment reporting policy in respect of the allocation of assets and liabilities to the business segments and have accordingly revised the 2006 segment reporting to be consistent with the basis of allocation in 2007 segment reporting.

(Thousands of Georgian Lari)

6. Segment Information (continued)

The following table presents operating income and profit and certain asset and liability information regarding the Group's business segments for the year ended 31 December 2007:

	Retail banking	*Corporate and investment banking*	*Brokerage and asset and wealth management*	*Corporate center*	*Insurance*	*Inter-company elimination*	*Total*
Revenue							
External operating income							
Net interest income	71,985	55,783	1,182	190	1,079	–	130,219
Net fees and commission income	21,628	12,057	7,225	(945)	1,783	–	41,748
Net dealing gains	1,231	3,799	6,009	15,671	-	–	26,710
Other external revenues	1,264	1,673	23,157	7,754	12,088	–	45,936
Operating income from other segments	–	–	15,184	94	4,228	(19,506)	–
Total operating income	**96,108**	**73,312**	**52,757**	**22,764**	**19,178**	**(19,506)**	**244,613**
Loan impairment charge/reversal	(12,338)	(8,988)	(332)	(274)	4,523	–	(17,409)
Results							
Segment results	35,343	36,819	21,339	(4,209)	6,437	–	95,729
Unallocated expenses							6,017
Profit before tax							**89,712**
Income tax expense							14,070
Profit for the year							**75,642**
Assets and liabilities							
Segment assets	1,530,339	1,240,984	123,172	31,159	26,400	–	2,952,054
Unallocated assets							1,557
Total assets							**2,953,611**
Segment liabilities	1,350,734	858,376	101,359	32,953	14,989	–	2,358,411
Unallocated liabilities							37,209
Total liabilities							**2,395,620**
Other segment information							
Capital expenditures:							
Property, plant and equipment	40,178	28,262	11,412	1,546	–	–	81,398
Intangible assets	43,571	28,443	1,041	712	–	–	73,767
Depreciation	4,464	3,283	747	147	–	–	8,641
Amortization	788	364	50	17	–	–	1,219

The following table presents operating income and profit and certain asset and liability information regarding the Group's business segments for the year ended 31 December 2006:

	Retail banking	*Corporate and investment banking*	*Brokerage and asset and wealth management*	*Corporate center*	*Insurance*	*Inter-company elimination*	*Total*
Revenue							
External operating income							
Net interest income	31,585	31,890	906	2,341	–	–	66,722
Net fees and commission income	12,917	7,241	3,015	1,513	–	–	24,686
Net dealing gains (losses)	449	1,726	610	9,277	(120)	–	11,942
Other external revenues	140	289	44	1,518	8,491	–	10,482
Operating income from other segments	1	923	(178)	(70)	228	(904)	–
Total operating income	**45,092**	**42,069**	**4,397**	**14,579**	**8,599**	**(904)**	**113,832**
Loan impairment charge/reversal	(4,396)	(8,433)	(398)	(539)	–	–	(13,766)
Results							
Segment results	18,056	28,907	961	(10,746)	279	–	37,457
Unallocated expenses							2,554
Profit before tax							**34,903**
Income tax expense							8,131
Profit for the year							**26,772**
Assets and liabilities							
Segment assets	483,065	613,445	60,302	17,324	38,407	–	1,212,543
Unallocated assets	–	–	–	–	–	–	783
Total assets	**–**	**–**	**–**	**–**	**–**	**–**	**1,213,326**
Segment liabilities	263,057	455,616	72,444	14,533	24,680	–	830,330
Unallocated liabilities							8,138
Total liabilities							**838,468**
Other segment information							
Capital expenditures:							
Property, plant and equipment	19,472	6,490	9,102	–	455		35,519
Intangible assets	9,924	8,175	970	–	18,124		37,193
Depreciation	2,925	744	702	–	70		4,441
Amortization	671	171	161	–	17		1,020

6. Segment Information (continued)

Secondary segment information – geographical segment

The Group operates in two main geographical markets: (a) Georgia, and (b) Ukraine and Cyprus. The following table show the distribution of the Group's external income, total assets and capital expenditure by geographical segment, allocated based on the location of the Group's assets, for the year ended 31 December 2007:

	Georgia 2007	*Ukraine and Cyprus 2007*	*Total 2007*
External income			
Net interest income	124,976	5,243	130,219
Net fee and commission income	40,088	1,660	41,748
Net dealing gains	24,601	2,109	26,710
Other non-interest income	45,532	404	45,936
Total external income	**235,197**	**9,416**	**244,613**
Total assets	**2,591,752**	**361,859**	**2,953,611**
Capital expenditures	73,931	81,234	155,165

The following table show the distribution of the Group's external income, total assets and capital expenditure by geographical segment, allocated based on the location of the Group's assets, for the years ended 31 December 2006:

	Georgia 2006	*Ukraine and Cyprus 2006*	*Total 2006*
External income			
Net interest income	66,722	–	66,722
Net fee and commission income	24,686	–	24,686
Net dealing gains	11,942	–	11,942
Other non-interest income	10,482	–	10,482
Total external income	**113,832**	–	**113,832**
Total assets	**1,213,326**	–	**1,213,326**
Capital expenditures	72,712	–	72,712

All components of external income under "Ukraine and Cyprus" location primarily and materially account for Ukrainian operations.

7. Cash and Cash Equivalents

Cash and cash equivalents comprise:

	2007	*2006*
Cash on hand	93,710	39,079
Current accounts with the NBG and NBU, excluding obligatory reserves	35,497	236
Current accounts with other credit institutions	20,208	12,994
Time deposits with credit institutions up to 90 days	256,355	55,736
Cash and cash equivalents	**405,770**	**108,045**

As of 31 December 2007 GEL 207,065 (2006: GEL 61,790) was placed on current and time deposit accounts with internationally recognized and OECD banks that are the counterparties of the Group in performing international settlements. The Group earned up to 2.70% interest per annum on these deposits (2006: 3.60%).

(Thousands of Georgian Lari)

8. Trading Securities

Trading securities owned are comprised of corporate shares amounting to GEL 6,342 as of 31 December 2007 (2006: nil).

9. Amounts Due from Credit Institutions

Amounts due from credit institutions comprise:

	2007	*2006*
Obligatory reserves with the NBG and NBU	144,631	61,461
Time deposits with effective maturity of more than 90 days	5,838	3,314
Inter-bank loan receivables	4,091	700
Amounts due from credit institutions	**154,560**	**65,475**

Obligatory reserves with NBG and NBU represent amounts deposited with NBG and NBU relating to daily settlements and other activities. Credit institutions are required to maintain an interest earning cash deposit (obligatory reserve) with NBG and NBU, the amount of which depends on the level of funds attracted by the credit institution. The Group's ability to withdraw these deposits is restricted by the statutory legislature. The Group earned up to 2% annual interest on obligatory reserve with NBG (2006: 1.5%).

As of 31 December 2007 GEL 610 (2006: GEL 1,181) was placed on current accounts and inter-bank deposits with one (2006: two) internationally recognised OECD banks. Those amounts were pledged to the counterparty bank as security for open commitments.

As of 31 December 2007 inter-bank time deposits and loan receivables include GEL 3,979 (2006: GEL 685) placed with an Azerbaijani bank (2006: Georgian bank).

10. Loans to Customers

Loans to customers comprise:

	2007	*2006*
Commercial loans	936,668	403,306
Consumer loans	331,082	91,901
Residential mortgage loans	236,397	82,307
Micro-loans	152,436	101,369
Gold-pawn loans	28,158	26,979
Others	19,869	–
	1,704,610	**705,862**
Less – Allowance for loan impairment	(28,929)	(21,020)
Loans to customers, net	**1,675,681**	**684,842**

(Thousands of Georgian Lari)

10. Loans to Customers (continued)

Allowance for impairment of loans to customers

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

	Commercial loans 2007	*Consumer loans2007*	*Residential mortgage loans 2007*	*Micro-loans 2007*	*Gold-Pawn Loans 2007*	*Others 2007*	*Total 2007*
At 1 January 2007	**15,522**	**3,606**	**1,223**	**668**	**1**	–	**21,020**
Charge/(reversal)	(4,093)	16,264	2,448	2,573	(1)	218	17,409
Recoveries	4,544	1,856	593	925	–	–	7,918
Write-offs	(4,173)	(7,577)	(1,445)	(2,380)	–	–	(15,575)
Interest accrued on impaired loans	(740)	(991)	(62)	(110)	–	–	(1,903)
Currency translation difference	60	–	–	–	–	–	60
At 31 December 2007	**11,120**	**13,158**	**2,757**	**1,676**	**–**	**218**	**28,929**
Individual impairment	5,330	3,311	479	539	–	–	9,659
Collective impairment	5,790	9,847	2,278	1,137	–	218	19,270
	11,120	**13,158**	**2,757**	**1,676**	**–**	**218**	**28,929**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**24,753**	**10,366**	**3,551**	**1,700**	**–**	**1,119**	**41,489**

	Corporate loans 2006	*Consumer loans 2006*	*Residential mortgage loans 2006*	*Micro loans 2006*	*Gold-Pawn Loans 2006*	*Others 2006*	*Total 2006*
At 1 January 2006	**11,319**	**1,984**	**1,834**	**1,455**	**394**	**–**	**16,986**
Charge/(reversal)	8,652	4,445	448	614	(393)	–	13,766
Recoveries	2,001	592	523	147	–	–	3,263
Write-offs	(3,339)	(2,674)	(1,403)	(1,241)	–	–	(8,657)
Interest accrued on impaired loans	(3,111)	(741)	(179)	(307)	–	–	(4,338)
At 31 December 2006	**15,522**	**3,606**	**1,223**	**668**	**1**	**–**	**21,020**
Individual impairment	12,171	16	446	–	–	–	12,633
Collective impairment	3,351	3,590	777	668	1	–	8,387
	15,522	**3,606**	**1,223**	**668**	**1**	**–**	**21,020**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**39,954**	**195**	**2,125**	**–**	–	**–**	**42,274**

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized as at 31 December 2007 comprised GEL 2,324 (2006: GEL 657).

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

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

(Thousands of Georgian Lari)

10. Loans to Customers (continued)

Collateral and other credit enhancements (continued)

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.

Concentration of loans to customers

As of 31 December 2007 concentration of loans granted by the Group to ten largest third party borrowers comprised GEL 226,989 accounting for 13% of gross loan portfolio of the Group (2006: GEL 103,563 and 15%, respectively). An allowance of GEL 1,705 (2006: GEL 1,877) was established against these loans.

As of 31 December 2007 and 2006 loans are principally issued within Georgia, and their distribution by industry sector is as follows:

	2007	*2006*
Individuals	699,456	244,462
Trade and services	648,086	297,819
Construction	157,797	78,273
Agriculture	64,567	13,990
Mining	55,053	17,674
Energy	11,512	10,261
Transport and communication	8,084	23,899
Others	60,055	19,484
	1,704,610	**705,862**
Less – allowance for loan impairment	(28,929)	(21,020)
Loans to customers, net	**1,675,681**	**684,842**

Loans have been extended to the following types of customers:

	2007	*2006*
Private companies	967,023	434,185
Individuals	699,456	244,462
State-owned entities	38,131	27,215
Loans to customers - Gross	**1,704,610**	**705,862**
Less – allowance for loan impairment	(28,929)	(21,020)
Loans to customers, net	**1,675,681**	**684,842**

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

	2007			*2006*		
	Individual impairment	*Collective impairment*	*Total*	*Individual impairment*	*Collective impairment*	*Total*
	2007	*2007*	*2007*	*2006*	*2006*	*2006*
At 1 January	**12,633**	**8,387**	**21,020**	**11,579**	**5,407**	**16,986**
Charge/(reversal) for the year	(4,207)	21,616	17,409	7,259	6,507	13,766
Recoveries	5,706	2,212	7,918	3,078	185	3,263
Write-offs	(3,945)	(11,630)	(15,575)	(5,680)	(2,977)	(8,657)
Interest accrued on impairment loans to customers	(588)	(1,315)	(1,903)	(3,603)	(735)	(4,338)
Currency translation differences	60	–	60	–	–	–
At 31 December	**9,659**	**19,270**	**28,929**	**12,633**	**8,387**	**21,020**

(Thousands of Georgian Lari)

11. Finance Lease Receivables

Finance lease receivables comprised the following:

	31 December 2007	*31 December 2006*
Minimum lease payments receivables	54,844	11,428
Less - Unearned finance lease income	(7,354)	(2,229)
	47,490	**9,199**
Less - Allowance for impairment	(816)	(108)
Finance lease receivables, net	**46,674**	**9,091**

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

As of 31 December 2007, concentration of investments in five largest lessees comprised GEL 38,723 or 83% of total finance lease receivables (2006: GEL 6,734 or 74%) and finance income received from them as of 31 December 2007 comprised GEL 2,627 or 64% of total finance income from lease. (2006: GEL 754 or 65%).

As of 31 December 2007 lease receivables amounting to GEL 38,783 represent receivables from a Government agency.

Future minimum lease payments to be received after 31 December 2007 and 31 December 2006 are as follows:

	31 December 2007	*31 December 2006*
Within 1 year	34,087	5,682
From 1 to 5 years	20,757	5,733
More than 5 years	–	13
Minimum lease payment receivables	**54,844**	**11,428**

Minimum lease payments to be received after 31 December 2007 and 2006 are denominated in the following currencies:

	31 December 2007	*31 December 2006*
US Dollars	48,208	5,494
Euros	6,636	5,934
Minimum lease payment receivables	**54,844**	**11,428**

The equipment the Group leases out at 31 December 2007 and 2006 can be segregated into the following categories:

	31 December 2007		*31 December 2006*	
	Amount	*Number of projects*	*Amount*	*Number of projects*
Air and land transport	44,035	87	1,648	30
Construction equipment	9,306	29	8,879	15
Machinery & equipment	1,503	16	901	10
Minimum lease payment receivables	**54,844**	**132**	**11,428**	**55**

12. Investment Securities

Available-for-sale securities comprise:

	2007	*2006*
Corporate bonds	24,879	4,353
Ministry of Finance treasury bills	10,745	–
Corporate shares	6,763	5,534
Available-for-sale securities	**42,387**	**9,887**

(Thousands of Georgian Lari)

12. Investment Securities (continued)

As of 31 December 2007 Corporate bonds included GEL 15,542 investment in six financial institutions in Ukraine. Corporate shares include investments in Georgian retail chain and wine producing company amounting to GEL 3,998 and GEL 1,555, respectively.

As of 31 December 2006, investments in available-for-sale corporate shares include GEL 4,353 investments in two financial institutions in Georgia and Ukraine. Corporate bonds comprise of GEL 5,534 investment in one financial institution in Georgia.

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

	31 December 2007		*31 December 2006*	
	%	*Maturity*	*%*	*Maturity*
Corporate bonds	14.47%	1-6 years	15%	2007
Ministry of Finance treasury bills	9.61%	1-4 years	–	–

Held-to-maturity securities comprise:

	2007		*2006*	
	Carrying value	*Nominal value*	*Carrying value*	*Nominal value*
NBG Certificates of Deposit	146,016	149,151	140,390	142,976
State debt securities	38,115	37,930	46,740	46,770
Corporate bonds	8,263	7,958	114	114
Ministry of finance treasury bills	70	70		
Held-to-maturity securities	**192,464**	**195,109**	**187,244**	**189,860**

As of 31 December 2007 corporate bonds comprised of GEL 8,263 investments in two Russian financial institutions securities.

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

	31 December 2007		*31 December 2006*	
	%	*Maturity*	*%*	*Maturity*
Corporate bonds	9.50%	2010	14.67%	2007
Ministry of Finance treasury bills	13.00%	2008	–	–
NBG Certificates of Deposit	9.79%	2008	11.77%	2007
State debt securities	13.00%	2009	13.00%	2008

13. Investments in Associates

Associates

The following associates are accounted for under the equity method:

2007

Associates	*Ownership / Voting, %*	*Country*	*Date of incorporation*	*Industry*	*Date of acquisition*
JSC SB Iberia	49.00%	Georgia	12/13/2007	Construction	N/A
JSC Teliani Valley	25.17%	Georgia	30/06/2000	Wine production	13/02/2007
JSC iCall	27.03%	Georgia	22/03/2005	Call center	22/11/2006
JSC One Team	25.00%	Georgia	23/04/2007	Entertainment	N/A
Matsne +	28.00%	Georgia	29/06/2005	Advertising	15/12/2006

(Thousands of Georgian Lari)

13. Investments in Associates (continued)

2006

Associates	*Ownership / Voting, %*	*Country*	*Date of incorporation*	*Industry*	*Date of acquisition*
JSC iCall	27.03%	Georgia	22/03/2005	Call center	22/11/2006
Matsne +	28.00%	Georgia	29/06/2005	Advertising	15/12/2006

Movements in investments in associates were as follows:

	2007	*2006*
Investments in associates, beginning of year	**496**	**–**
Purchase cost	5,275	496
Disposal	(700)	–
Share of profit	137	–
Investments in associates as end of year	**5,208**	**496**

Investments in associates at 31 December 2007 include goodwill of GEL 2,413 (2006: GEL 475).

The following table summarises certain financial information of the associates:

Aggregated assets and liabilities of associates	*2007*	*2006*
Assets	15,611	166
Liabilities	(5,722)	(147)
Net assets	**9,889**	**19**

Aggregated revenue and profit of associates	*2007*	*2006*
Revenue	10,973	–
Profit	1,089	–

14. Investment Property

	2007	*2006*
At 1 January	**1,224**	**–**
Purchases	10,499	1,224
Transfers from property and equipment (Note 15)	5,132	–
Net change in fair value through profit and loss	16,362	–
Fair value adjustment through equity	1,848	–
At 31 December	**35,065**	**1,224**

(Thousands of Georgian Lari)

15. Property and Equipment

The movements in property and equipment during 2007 were as follows:

	Buildings	*Furniture & fixtures*	*Computers & equipment*	*Motor vehicles*	*Leasehold improvements*	*Assets under construction*	*Total*
Cost or revaluation							
31 December 2006	**37,652**	**21,005**	**11,483**	**1,824**	**2,027**	**4,168**	**78,159**
Acquisition through business combinations	4,147	1,782	2,759	336	–	34	9,058
Additions	25,249	18,900	7,912	3,492	526	16,261	72,340
Disposals	–	(69)	(946)	(35)	(89)	(445)	(1,584)
Transfers	5,398	–	–	–	1,647	(7,045)	–
Transfers to investment property	(5,132)	–	–	–	–	–	(5,132)
Revaluation	66,975	–	–	–	–	–	66,975
Currency translation adjustment	795	667	308	148	–	–	1,918
31 December 2007	**135,084**	**42,285**	**21,516**	**5,765**	**4,111**	**12,973**	**221,734**
Accumulated impairment							
31 December 2006 and 31 December 2007	**467**	**–**	**–**	**–**	**–**	**–**	**467**
Accumulated depreciation							
31 December 2006	**1,227**	**4,314**	**4,097**	**749**	**477**	–	**10,864**
Depreciation charge	926	3,236	3,041	744	694	–	8,641
Currency translation difference	(7)	–	2	(5)	–	–	(10)
Disposals	(14)	(19)	(538)	(182)	(61)	–	(814)
Revaluation	(2,070)	–	–	–	–	–	(2,070)
31 December 2007	**62**	**7,531**	**6,602**	**1,306**	**1,110**	-	**16,611**
Net book value:							
31 December 2006	**35,958**	**16,691**	**7,386**	**1,075**	**1,550**	**4,168**	**66,828**
31 December 2007	**134,555**	**34,754**	**14,914**	**4,459**	**3,001**	**12,973**	**204,656**

The movements in property and equipment during 2006 were as follows:

	Buildings	*Furniture & fixtures*	*Computers & equipment*	*Motor vehicles*	*Leasehold improvements*	*Assets under construction*	*Total*
Cost or revaluation							
31 December 2005	**22,262**	**11,354**	**8,636**	**1,323**	**1,314**	**369**	**45,258**
Acquisition through business combinations	4,758	1,129	889	194	236	–	7,206
Additions	9,427	8,639	3,847	556	211	5,633	28,313
Disposals	(137)	(117)	(1,889)	(249)	(165)	(61)	(2,618)
Transfers	1,342	–	–	–	431	(1,773)	–
31 December 2006	**37,652**	**21,005**	**11,483**	**1,824**	**2,027**	**4,168**	**78,159**
Accumulated impairment							
31 December 2005 and 2006	**467**	**–**	**–**	**–**	**–**	**–**	**467**
Accumulated depreciation							
31 December 2005	**719**	**3,054**	**4,087**	**776**	**340**	**–**	**8,976**
Depreciation charge	616	1,401	1,905	217	302	–	4,441
Disposals	(108)	(141)	(1,895)	(244)	(165)	–	(2,553)
31 December 2006	**1,227**	**4,314**	**4,097**	**749**	**477**	**–**	**10,864**
Net book value							
31 December 2005	**21,076**	**8,300**	**4,549**	**547**	**974**	**369**	**35,815**
31 December 2006	**35,958**	**16,691**	**7,386**	**1,075**	**1,550**	**4,168**	**66,828**

(Thousands of Georgian Lari)

15. Property and Equipment (continued)

The Group engaged an independent appraiser to determine the fair value of its buildings. Fair value is determined by reference to market-based evidence. The latest date of the revaluation was 31 December 2007. If the buildings were measured using the cost model, the carrying amounts as of 31 December 2007 and 31 December 2006 would be as follows:

	2007	*2006*
Cost	62,605	32,148
Accumulated depreciation and impairment	(2,815)	(1,443)
Net carrying amount	**59,790**	**30,705**

16. Goodwill and Other Intangible Assets

Movements in goodwill and intangible assets during 2007 were as follows:

	Goodwill	*Core Deposit Intangible*	*Computer software*	*Total*
Cost				
31 December 2006	**40,705**	**–**	**6,355**	**47,060**
Acquisition through business combinations (Note 5)	69,026	1,688	1,155	71,869
Additions	767	–	1,131	1,898
Disposals	–	–	(1,030)	(1,030)
31 December 2007	**110,498**	**1,688**	**7,611**	**119,797**
Accumulated amortization and impairment				
31 December 2006	**426**	**–**	**3,205**	**3,631**
Amortization charge	–	–	1,219	1,219
Impairment charge	–	–	3	3
Disposals	–	–	(967)	(967)
Revaluation of amortization charge	–	–	(79)	(79)
Currency translation difference	–	–	1	1
31 December 2007	**426**	**–**	**3,382**	**3,808**
Net book value:				
31 December 2006	**40,279**	**–**	**3,150**	**43,429**
31 December 2007	**110,072**	**1,688**	**4,229**	**115,989**

Movements in goodwill and intangible assets during 2006 were as follows:

	Goodwill	*Computer software*	*Total*
Cost			
31 December 2005	**5,730**	**4,144**	**9,874**
Acquisition through business combinations	34,975	255	35,230
Additions	–	1,963	1,963
Disposals	–	(7)	(7)
31 December 2006	**40,705**	**6,355**	**47,060**
Accumulated amortization and impairment			
31 December 2005	**–**	**2,189**	**2,189**
Amortization charge	–	1,020	1,020
Impairment charge	426	–	426
Disposals	–	(4)	(4)
31 December 2006	**426**	**3,205**	**3,631**
Net book value:			
31 December 2005	**5,730**	**1,955**	**7,685**
31 December 2006	**40,279**	**3,150**	**43,429**

(Thousands of Georgian Lari)

16. Goodwill and Other Intangible Assets (continued)

As of 31 December 2007 goodwill acquired through business combinations has been allocated to the following cash-generating units for impairment testing purposes:

- JSC Bank of Georgia
- JSC Insurance Company Aldagi-BCI
- JSC Universal Bank of Development and Partnership
- JSC Galt & Taggart Bank
- JSC Intertour
- United Georgian Registrar Ltd
- JSC My Family Clinic
- JSC Nova Technology

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

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

		Carrying amount of goodwill	
	WACC applied for impairment	***31 December 2007***	***31 December 2006***
JSC Bank of Georgia	10%	21,308	21,308
JSC Universal Bank of Development and Partnership	9%	68,016	–
JSC Insurance Company Aldagi-BCI	13%	18,454	14,259
JSC Insurance Company BCI	13%	–	2,341
JSC Insurance Company Europace	13%	–	1,450
JSC My Family Clinic	13%	220	–
JSC Galt & Taggart Bank	10%	599	–
Intertour LLC	12%	698	514
United Securities Registrar of Georgia, LLC	14%	366	–
JSC Nova Technology	14%	411	–
Company Center LLC	14%	–	216
Register Center LLC	14%	–	90
ICT Delameni LLC	14%	–	60
Holiday Travel LLC	12%	–	41
Total		**110,072**	**40,279**

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

Impairment testing of goodwill and other intangible assets with indefinite lives

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

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

	2007	***2006***
Retail banking	55,036	13,628
Corporate banking	34,889	7,682
Insurance	18,673	18,049
Asset & wealth management and brokerage	1,474	920
	110,072	**40,279**

Key assumptions used in value in use calculations

The recoverable amount of the Asset Management unit has been determined based on a value-in-use calculation, using cash flow projections based on financial budgets approved by senior management covering a five-year period. The discount rate applied to cash flow projections beyond the five-year period are extrapolated using a projected growth rate. The following rates are used by the Bank for corporate banking and retail banking:

	Corporate Banking		*Retail Banking*	
	2007, %	***2006, %***	***2007, %***	***2006, %***
Discount rate	10%	11%	10%	11%
Projected growth rate	0%	0%	0%	0%

(Thousands of Georgian Lari)

16. Goodwill and Other Intangible Assets (continued)

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

	Insurance		*Asset & wealth management and brokerage*	
	2007, %	*2006, %*	*2007, %*	*2006, %*
Discount rate	13%	15%	12%-14%	14%
Projected growth rate	0%	0%	0%	0%

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

Interest margins

Interest margins are based on average values achieved in the three years preceding the start of the budget period. These are increased over the budget period for anticipated market conditions.

Discount rates

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

17. Taxation

The corporate income tax expense comprises:

	2007	*2006*
Current income tax expense	7,638	3,697
Deferred tax expense – origination and reversal of temporary differences	17,065	5,427
Less: Deferred tax recognised directly in equity	(10,633)	(993)
Income tax expense	**14,070**	**8,131**

The income tax rate applicable to the majority of the Group's income is 20%. The income tax rate applicable to subsidiaries income ranges from 15% to 25% (2006: 20%). The tax rate for interest income on state securities was 10%. Corporate income tax rate in Georgia reduced from 20% to 15% effective 1 January 2008. Reconciliation between the expected and the actual taxation charge is provided below.

The effective income tax rate differs from the statutory income tax rates. As of 31 December 2007 and 2006 a reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2007	*2006*
Profit before income tax expense	**89,712**	**34,903**
Statutory tax rate	20%	20%
Theoretical income tax expense at statutory tax rate	**17,942**	**6,981**
Tax at the domestic rates applicable to profits in the respective country	25	–
Non-deductible share-based compensation expenses	964	517
Interest income	–	46
Other income	62	–
State securities at lower tax rates	(1,900)	–
Permanent differences	63	–
Change in unrecognized deferred tax assets	144	–
Effect of reduction in tax rate	(3,226)	–
Non-deductible expenses:		
- impairment of intangible assets	–	40
- other impairment losses	(153)	75
- entertainment and business trips	–	225
- other	149	247
Income tax expense	**14,070**	**8,131**

(Thousands of Georgian Lari)

17. Taxation (continued)

Georgia currently has an updated tax code which has been adopted and put in force in 2005. Applicable taxes include corporate income tax (profits tax), individuals withholding taxes, property tax and value added tax, among others. However, regulations are often unclear or nonexistent and few precedents have been established. This creates tax risks in Georgia substantially more significant than typically found in countries with more developed tax systems. Management believes that the Group is in substantial compliance with the tax laws affecting its operations. However, the risk remains that relevant authorities could take differing positions with regard to interpretative issues.

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

		Origination and reversal of temporary differences			*Origination and reversal of temporary differences*		*Effect of business combi-*	
	2005	*In the income statement*	*Directly in equity*	*2006*	*In the income statement*	*Directly in equity*	*nation*	*2007*
Tax effect of deductible temporary differences:								
Amounts due to credit institutions	–	1,457	–	1,457	(1,422)	–	–	35
Loans to customers	–	–	–	–	80	–		80
Securities issued	–	–	–	–		–	55	55
Reinsurance reserves	–	–	–	–	21	–	–	21
Reinsurance premiums payables	–	–	–	–	103	–	–	103
Allowances for impairment and provisions for other losses	59	788	–	847	(622)	–	–	225
Tax losses carried forward	446	(446)	–	–	1,313	–	–	1,313
Finance lease receivables	12	(12)	–	–	7	–	–	7
Intangible assets	119	(119)	–	–	181	–	–	181
Property and equipment	30	(30)	–	–	2	–	–	2
Other assets	–	–	–	–	115	–		115
Other libilities	–	–	–	–	263	–	39	302
Gross deferred tax assets	**666**	**1,638**	**–**	**2,304**	**41**	**–**	**94**	**2,439**
Unrecognized deferred tax assets	(63)		–	63	(148)	–	(122)	(207)
Deferred tax assets	**603**	**1,638**	**–**	**2,367**	**(107)**	**–**	**(28)**	**2,232**
Tax effect of taxable temporary differences:								
Amounts due to credit institutions	–	–	–	–	–	–	1,710	1,710
Amounts due to customers	–	–	–	–	502	–	123	625
Securities available-for-sale	–	–	–	–	150	–	32	182
Loans to customers	665	915	993	2,573	(305)	–	2,223	4,491
Reinsurance reserves	–	–	–	–	27	–	–	27
Insurance receivables	–	–	–	–	6	–	–	6
Allowances for receivables	124	(124)	–	–	38	–	–	38
Property and equipment	1,638	4,136	–	5,774	3,149	10,173	1,060	20,156
Investment property	–	–	–	–	2,743	460	–	3,203
Intangible assets	–	731	–	731	277	–	–	1,008
Other assets	78	(78)	–	–	414	–	522	936
Other liabilities	185	491	–	676	(676)	–	–	–
Deferred tax liabilities	**2,690**	**6,071**	**993**	**9,754**	**6,325**	**10,633**	**5,670**	**32,382**
Net deferred tax assets (liabilities)	**(2,087)**	**(4,433)**	**(993)**	**(7,387)**	**(6,432)**	**(10,633)**	**(5,698)**	**(30,150)**

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

	2007	*2006*
Current tax assets	998	–
Deferred tax assets	559	–
Tax assets	**1,557**	**–**
Current tax liabilities	6,500	751
Deferred tax liabilities	30,709	7,387
Tax liabilities	**37,209**	**8,138**

(Thousands of Georgian Lari)

18. Other Impairment Allowance and Provisions

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

	Investments in associates	*Other assets*	*Guarantees and commitments*	*Total*
31 December 2005	**279**	**919**	**975**	**2,173**
Charge/(reversal)	(176)	309	(303)	(170)
Write-offs	(103)	(700)	–	(803)
Recoveries	–	–	–	–
31 December 2006	**–**	**528**	**672**	**1,200**
Charge/(reversal)	–	(696)	331	(365)
Write-offs	–	(100)	–	(100)
Recoveries	–	274	–	274
31 December 2007	**–**	**6**	**1,003**	**1,009**

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.

19. Other Assets and Liabilities

Other assets comprise:

	2007	*2006*
Reinsurers assets	15,768	11,279
Insurance premiums receivables	14,354	5,791
Prepayments for purchase of property and equipment	10,725	5,029
Account receivables	3,690	807
Operating taxes receivables	3,500	783
Foreclosed assets	3,415	4,543
Settlements on operations with securities	2,614	826
Operating lease receivables	1,286	226
Receivables from factoring operations	1,249	–
Receivables from money transfers	997	3,853
Due from reinsurers	219	–
Other	3,505	680
	61,322	**33,817**
Less – Allowance for impairment of other assets (Note 18)	(6)	(528)
Other assets	**61,316**	**33,289**

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

Other liabilities comprise:

	2007	*2006*
Accruals for employee compensation	20,943	4,476
Unearned premiums reserve	18,712	9,405
Insurance claims reserves	13,101	6,860
Creditors	10,907	12,920
Other taxes payable	7,384	623
Reinsurance accounts payable	6,151	4,288
Accounts payable	4,783	2,033
Amounts payable for acquisitions	1,316	2,475
Pension benefit obligations	1,262	–
Dividends payable	317	313
Other	10,268	1,165
Other liabilities	**95,144**	**44,558**

(Thousands of Georgian Lari)

19. Other Assets and Liabilities (continued)

Amounts payable for acquisitions includes GEL 1,084 hold-back amount for acquisition of JSC Galt and Taggart Bank. Dividends payable represent dividends accrued but not collected by the shareholders of the Bank. These dividends are those declared for years 1997 through 2006.

20. Amounts Due to Credit Institutions

Amounts due to credit institutions comprise:

	2007	*2006*
Correspondent accounts	18,119	2,920
Time deposits and inter-bank loans	62,009	79,180
Borrowings from international credit institutions	821,667	142,281
Amounts due to credit institutions	**901,795**	**224,381**

During 2007 the Group received short-term funds from Georgian banks in different currencies. As of 31 December 2007 the Group had an equivalent of GEL 4,744 (2006: GEL 871) in foreign currencies received as deposits from Georgian banks. In 2007 the Group paid up to 5% interest on these deposits (2006: 6%).

Time deposits and inter-bank loans, and borrowings from international credit institutions were comprised of:

As of 31 December 2007

Credit institution	*Grant date*	*Contractual maturity*	*Currency*	*Interest rate per annum*	*Facility amount in original currency*	*Outstanding Balance as of 31 December 2007 in GEL (*)*
BG Finance B.V.	8-Feb-07	8-Feb-12	USD	9%	200,000	323,110
Merrill Lynch International	21-Dec-07	21-Jan-09	USD	USDLIBOR+7.65%	65,000	101,577
Citibank International PLC	17-Aug-07	17-Aug-08	USD	LIBOR+1.9%	55,000	85,505
Citibank International PLC	17-Aug-07	17-Feb-09	USD	LIBOR+2.2%	43,500	69,386
Merrill Lynch International	17-Aug-07	17-Aug-17	USD	LIBOR+5.995%	35,000	58,135
National Bank of Georgia	31-Dec-07	4-Jan-08	GEL	14%	30,000	30,000
Citibank International PLC	20-Aug-07	20-Aug-10	USD	LIBOR+2.75%	25,000	45,665
Semper Augustos B.V.	31-Oct-07	25-Oct-17	USD	11.65%	15,000	24,360
National Bank of Georgia	21-Feb-06	20-Feb-08	GEL	6%	20,000	20,014
Netherlands Development Finance Company	22-Jan-07	15-Mar-14	USD	LIBOR+3.3%	12,500	20,157
European Bank for Reconstruction and Development	17-Dec-07	Revolving	USD	LIBOR+1.5%	5,800	9,253
World Business Capital	17-Feb-06	1-Oct-16	USD	LIBOR+2.75%	10,000	12,728
World Business Capital	29-Mar-07	25-Mar-17	USD	LIBOR+2.75%	4,607	7,363
Hillside Apex Fund Ltd (subordinated debt)	14-Aug-06	14-Aug-16	USD	LIBOR+6.20%	5,000	8,354
AKA Ausfuhrkredit-Gesellschaft m.b.H.	18-Nov-03	Revolving	EUR	LIBOR+2%	5,000	6,626
Commerzbank AG	16-Dec-05	30-Dec-10	USD	LIBOR+1.3%	5,000	5,816
Balances less than GEL 5,000	various	various	various	various	–	55,627
Total						**883,676**

As of 31 December 2006

Credit institution	*Grant date*	*Contractual maturity*	*Currency*	*Interest rate per annum*	*Facility amount in original currency*	*Outstanding Balance as of 31 December 2006 in GEL (*)*
HBK Investments LP (Semper Augustus B.V.) (convertible subordinated debt)	1-Oct-06	27-Sep-16	USD	4%	25,000	43,335
Citibank N. A. USA	24-Mar-06	24-Sep-07	USD	LIBOR+4.75%	25,000	42,886
Merrill Lynch International	15-Aug-06	15-Aug-07	USD	LIBOR+2.65%	25,000	44,320
National Bank of Georgia	21-Feb--06	20-Feb-08	GEL	6.20%	20,000	20,000
World Business Capital	17-Feb-06	01-Oct-13	USD	LIBOR+2.75%	10,000	17,168
Hillside Apex Fund Ltd (subordinated debt)	14-Aug-06	14-Aug-16	USD	LIBOR+6.20%	5,000	8,996
AKA Ausfuhrkredit-Gesellschaft m.b.H.	18-Nov-03	Revolving	EUR	LIBOR+2%	5,000	6,973
Commerzbank AG	16-Dec-05	30-Dec-10	USD	LIBOR+1.3%	5,000	6,586
International Finance Corporation	30-Jun-03	15-Sep-10	USD	LIBOR+4%	5,000	6,399
Balances less than GEL 5,000	various	various	various	various	–	24,798
Total						**221,461**

* - includes accrued interest

(Thousands of Georgian Lari)

20. Amounts Due to Credit Institutions (continued)

The borrowing received on 1 October 2006 from a fund, HBK Investments L.P. (Semper Augustus B.V.), had convertibility feature valid for 2 years from the loan granting date (convertibility period). HBK was able to convert the granted loan into ordinary shares of the Bank for price equal to USD 21.6 per share. According to the contract there was no lower end limit to the volume of conversion. As of 31 December 2007 HBK has exercised the convertibility option. For details please see Note 23.

In February 2007 BG Finance B.V., a special purpose entity with limited liability incorporated under the laws of the Netherlands, issued an aggregate principal amount of US$ 200 million 9.0% Loan Participation Notes ("LPN") due in 2012. The LPNs were issued for the sole purpose of financing a loan of the Bank pursuant to a loan agreement dated 6 February 2007 between BG Finance B.V. and the Bank. These LPNs are listed on the official list of the UK Listing Authority and traded on the London Stock Exchange.

Agreements for such borrowings contain certain covenants establishing for the Group different limits for capital adequacy, liquidity, currency position, credit exposures, leverage and others. As of 31 December 2006 and 2007, the Group complied with all the covenants of the loans received from credit institutions.

21. Amounts Due to Customers

The amounts due to customers include the following:

	2007	*2006*
Current accounts	737,045	361,164
Time deposits	618,431	198,482
Amounts due to customers	**1,355,476**	**559,646**
Held as security against letters of credit	**9,673**	**6,788**
Held as security against guarantees	**16,701**	**1,079**

At year-end, amounts due to customers of GEL 302,246 (22%) were due to the 10 largest customers (2006: GEL 139,866 (25%)).

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

	2007	*2006*
Individuals	582,991	273,650
Private enterprises	662,808	209,312
State and budget organizations	109,677	76,684
Amounts due to customers	**1,355,476**	**559,646**

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

	2007	*2006*
Individuals	582,991	273,650
Trade and services	354,874	107,082
Governmental	109,677	76,684
Energy	78,410	6,758
Mining	68,407	31,757
Construction	62,953	25,977
Transport and communication	61,636	18,515
Agriculture	260	625
Other	36,268	18,598
Amounts due to customers	**1,355,476**	**559,646**

(Thousands of Georgian Lari)

22. Debt Securities Issued

Debt securities issued consisted of the following:

	2007	*2006*
Series A bonds	1,603	–
Series B bonds	3,390	–
Promissory notes issued	–	1,073
Debt securities issued	**4,993**	**1,073**

In October 2005 the Bank issued two series (A and B) of domestic non-documentary interest bearing bonds denominated in Ukrainian Hryvnia ("UAH"). The total volume of issuance was 40,000 bonds for the total amount of UAH 40,000 (GEL 14,164) thousand (at par). Series A bonds bear interest at 8.50% p.a. and mature in October 2008. Series B bonds bear interest rate at 12.00% p.a. and mature in October 2010.

23. Equity

As of 31 December 2007, authorized share capital comprised 32,835,619 common shares, of which 27,154,918 were issued and fully paid (2006: 25,335,619 common shares, of which 25,202,009 were issued and fully paid). Each share has a nominal value of one (1) Georgian Lari. Shares issued and outstanding as of 31 December 2007 are described below. GEL 99 comprises non-cash contribution to share capital.

Movements of outstanding, issued and fully paid shares during 2007 and 2006 were as follows:

	Number of shares Ordinary	*Amount of shares Ordinary*
31 December 2005	**14,728,784**	**14,729**
Increase in share capital	9,448,225	9,448
Increase in share capital arising from share-based payments (Note 27)	175,000	175
Increase in share capital for placement of future share-based payments into trust	850,000	850
31 December 2006	**25,202,009**	**25,202**
Increase in share capital	1,157,407	1,157
Increase in share capital arising from share-based payments (Note 27)	145,502	146
Increase in share capital for placement of future share-based payments into trust	650,000	650
31 December 2007	**27,154,918**	**27,155**

Share capital of the Group was paid by the shareholders in Georgian Lari and they are entitled to dividends in Georgian Lari. For 2007 net income attributable to ordinary shareholders of the Bank was GEL 72,484 (2006: 26,983). As of 31 December 2007 weighted average number of ordinary shares outstanding during the year was 24,503,722 (2006: 16,635,635). At 31 December 2007 the diluted number of ordinary shares was 24,598,722 shares (2006: 18,673,356). Thus, the basic and diluted earnings per share amounted to GEL 2.958 (2006: 1.622) and GEL 2.947, respectively (2006: 1.445). The 2007 dilution includes the effect of dilution of 95,000 shares deliverable to former shareholders of JSC Europace. The 2006 dilution included the effect of share-based compensation of 650,000 shares (Note 27), guaranteed share-based compensation (Note 27), HBK conversion option (Note 20), and other dilutions of 95,000 shares. There has been no transaction involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these consolidated financial statements.

In March 2006 the Group issued 11,640 shares in exchange for 25% equity interest in an existing subsidiary Georgian Leasing Company LLC.

In November and December 2006 8,880,207 shares of the Bank in the form of GDRs were sold on the London Stock Exchange (the "LSE") pursuant to an initial public offering to institutional investors. 7,440,207 shares in the form of GDRs were sold by the Bank while the balance was sold by the selling shareholders. Each GDR represents 1 ordinary share of the Bank. Bank of New York acts as a depository for these shares.

On 2 August 2007 the Bank transferred 650,000 shares in the form of GDRs to Abacus Corporate Trustee Limited.

(Thousands of Georgian Lari)

23. Equity (continued)

On 18 August 2007 the Bank converted the convertible loan from HBK Semper Augustus for GEL 37,158 to equity and accordingly issued 1,157,407 shares in the exchange (Note 20).

As of 31 December 2007 treasury shares of GEL 1,737 at a value and additional paid-in capital of GEL 12,116 comprise the Group's shares owned by its subsidiary Galt & Taggart Securities, purchased in the open market (2006: treasury shares of GEL 222 and additional paid-in capital of GEL 2,657).

Treasury shares of Georgian Lari 1,500,000 par value comprise Group's shares in the form of GDRs held by Abacus Corporate Trustee Limited. (2006: 850). Of these, 206,000 GDRs were awarded and 68,660 GDRs vested in 2006 (Note 27). Another 322,167 GDRs were awarded in 2007.

During the year ended 31 December 2007, 145,502 ordinary shares of GEL 146 at par value and additional paid-in capital of GEL 948 have been granted as compensation to top management (2006: GEL 175 at par value and additional paid-in capital of GEL 402).

In April 2006 the Group declared dividends of GEL 776 in respect of 2005 financial results being Georgian Lari 0.05 per share.

Movements in other reserves

	Revaluation reserve for property and equipment and Investment Property	*Unrealised gains/(losses) on investment securities available-for-sale*	*Foreign currency translation reserve*	*Total*
At 1 January 2006	**5,369**	**–**	**–**	**5,369**
Depreciation of revaluation reserve, net of tax	(112)	–	–	(112)
At 31 December 2006	**5,257**	**–**	**–**	**5,257**
Revaluation of buildings and investment property	70,893	–	–	70,893
Tax effect of revaluation of buildings	(10,634)	–	–	(10,634)
Depreciation of revaluation reserve, net of tax	(112)	–	–	(112)
Net unrealised gains on available-for-sale investments	–	3,340	–	3,340
Transfer of net realized gains on investment securities available-for-sale to the consolidated income statement	–	(2,481)	–	(2,481)
Minority interest share in revaluation of property and equipment	(964)	–	–	(964)
Currency translation differences	–	–	2,055	2,055
At 31 December 2007	**64,440**	**859**	**2,055**	**67,354**

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 buildings and investment property 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.

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

(Thousands of Georgian Lari)

24. Commitments and Contingencies

Legal

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

Financial commitments and contingencies

As of 31 December 2007 and 31 December 2006 the Group's financial commitments and contingencies comprised the following:

	2007	*2006*
Credit-related commitments		
Undrawn loan facilities	39,962	44,337
Letters of credit	23,130	33,802
Guarantees	145,627	77,198
	208,719	**155,337**
Operating lease commitments		
Not later than 1 year	6,200	2,774
Later than 1 year but not later than 5 years	12,232	9,490
Later than 5 years	5,902	8,417
	24,334	**20,681**
Capital expenditure commitments	**2,623**	**1,129**
Less – Provisions (Note 18)	(1,003)	(672)
Less – Cash held as security against letters of credit and guarantees	(26,374)	(7,867)
Financial commitments and contingencies - net	**208,299**	**168,608**

As of 31 December 2007 the capital expenditures represented the commitment for purchase of property GEL 1,028, equipment of GEL 698 and software of GEL 897. As of 31 December 2006 the capital expenditure commitments represent the commitment for purchase of property of GEL 533, equipment of GEL 348, and software of GEL 248.

25. Net fee and Commission Income

Net fees and commission income comprises:

	2007	*2006*
Settlements operations	25,488	15,074
Guarantees and letters of credit	7,548	4,713
Cash collection	6,079	4,257
Brokerage service fees	3,448	2,632
Currency conversion operations	1,284	824
Advisory	215	178
Other	4,296	461
Fee and commission income	**48,358**	**28,139**
Settlements operations	(2,692)	(1,912)
Guarantees and letters of credit	(1,127)	(1,257)
Cash operations	(253)	(158)
Currency conversion operations	(162)	(81)
Other	(2,376)	(45)
Fee and commission expense	**(6,610)**	**(3,453)**
Net fee and commission income	**41,748**	**24,686**

(Thousands of Georgian Lari)

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

Salaries and other employee benefits, and general and administrative expenses comprise:

	2007	*2006*
Salaries and bonuses	64,388	28,454
Social security costs	11,251	4,862
Salaries and other employee benefits	**75,639**	**33,316**
Occupancy and rent	6,173	3,223
Marketing and advertising	4,767	2,564
Legal and other professional services	4,132	2,289
Communication	3,132	1,751
Repairs and maintenance	3,033	1,523
Office supplies	2,446	2,384
Security	2,432	1,592
Travel expenses	1,770	1,072
Operating taxes	1,720	998
Banking services	1,533	645
Penalties	900	50
Corporate hospitality and entertainment	681	539
Insurance	559	806
Personnel training and recruitment	342	399
Other	2,544	814
General and administrative expenses	**36,164**	**20,649**

27. Share-based Payments

In December 2006 Abacus Corporate Trustee Limited acting in its capacity as the trustee of the Bank's EECP resolved to award the Bank's 206,000 ordinary shares in the form of restricted GDRs to 18 executives of the Group in respect of the year ended 31 December 2005. The awards are subject to three year vesting. The Group considers 2 June 2006 as the grant date for these awards and estimates that the fair value of shares on 2 June 2006 was 12.85 Georgian Lari per share.

In February 2007 Bank of Georgia's Supervisory Board resolved to recommend to the trustee to award 267,550 Bank of Georgia ordinary shares in the form of restricted GDRs to the Group's 23 executives pursuant to the EECP in respect of the year ended 31 December 2006. The awards are subject to three year vesting. The Group considers 2 June 2006 as the grant date for 190,000 of the Bank of Georgia shares in the form of restricted GDRs and 16 February 2007 grant date for the remaining 77,550 of Bank of Georgia ordinary shares in the form of restricted GDRs. The Bank of Georgia estimates that the fair value of the shares on 16 February 2007 was 45.74 Georgian Lari per share.

The Group's expense arising from EECP awards was GEL 7,898 for 2007 and GEL 2,009 for 2006.

During 2007 the Group provided the Chairman of the Supervisory Board of the Bank with share-based compensation under the terms of the three-year service agreement signed in 2004. The total amount of compensation during 2007 under the terms of the service agreement totaled GEL 940 or 125,000 ordinary shares of the Bank. All shares are fully vested ordinary shares. The fair value of the shares at the grant date (August 18, 2004) was 3.299 Georgian Lari per share. The fair value of the shares was based on weighted average observable market prices for the shares traded at the Georgian Stock Exchange at the grant date. Total quantity of the shares granted at the grant date was 600,000 newly issued ordinary shares of which 500,000 shares were to vest over a 3-year period on a monthly basis starting 18 August 2004. The remaining 100,000 shares fully vested as of 31 December 2005.

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

In August 2007 Bank of Georgia's Supervisory Board resolved to propose to the trustee of the Bank's EECP the award of shares of the Bank in the form of restricted GDRs to the top three executives of the Bank. Each award will vest at the third anniversary of the date of grant. Award of each executive comprises of: top grant and annual grant. Top grant is a one-time action and has been awarded in 2007 only and its value is restricted by the 200% of the annual base salary of the respective executive in 2007. Annual grant will be awarded every year during the three consecutive years' period as such executive will be employed by the Bank and its value is restricted by the 100% of the annual base salary of the respective executive during the vesting period. For these reason, the Group estimated the annual expense of share-based compensation related to the above mentioned award scheme award equal as 300% of the annual base salary of each executive in 2007. Aggregate expense associated with this scheme comprised GEL 3,339 in 2007

(Thousands of Georgian Lari)

27. Share-based Payments (Continued)

The weighted average fair value of share-based awards at the measurement date comprised 28.95.Georgian Lari per share (2006: 12.85).

The Group's total share-based payment expenses for 2007 comprised GEL 8,992 (2006: 2,586).

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

Ordinary shares	***2007***	***2006***
Number of shares awarded	145,502	175,000
- Among them, to top management	*145,502*	*175,000*
Number of shares vested	145,502	175,000
Weighted average value at grant date, per share (GEL in full amount)	7.52	3.30
Value at grant date, total (GEL)	1,094	577
Expense recognized during the year (GEL)	**1,094**	**577**

GDRs	***2007***	***2006***
Number of GDRs awarded	322,167	206,000
- Among them, to top management	*244,617*	*185,000*
Number of GDRs vested	-	68,660
Weighted average value at grant date, per share (GEL in full amount)	28.95	12.85
Value at grant date, total (GEL)	9,328	2,647
Expense recognized during the year (GEL)	**7,898**	**2,009**

All instruments	***2007***	***2006***
Total number of equity instruments awarded	467,669	381,000
- Among them, to top management	*390,119*	*360,000*
Total number of equity instruments vested	145,502	243,660
Weighted average value at grant date, per share (GEL in full amount)	22.28	8.46
Value at grant date, total (GEL)	10,422	3,224
Total expense recognized during the year (GEL)	**8,992**	**2,586**

(Thousands of Georgian Lari)

28. Risk Management

Introduction

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

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

Risk management structure

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

Supervisory board

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

Management board

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

Audit committee

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

Bank treasury

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

Internal audit

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

Risk measurement and reporting systems

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

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

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

(Thousands of Georgian Lari)

28. Risk Management (continued)

Introduction (continued)

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

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

Risk mitigation

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

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

Excessive risk concentration

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

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

Credit risk

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

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

Derivative financial instruments

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

Credit-related commitments risks

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

(Thousands of Georgian Lari)

28. Risk Management (continued)

Credit risk (continued)

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

	Notes	*Gross maximum exposure 2007*	*Gross maximum exposure 2006*
Cash and cash equivalents (excluding cash on hand)	7	312,060	68,966
Trading securities	8	6,342	–
Amounts due from credit institutions	9	154,560	65,475
Loans to customers	10	1,675,681	684,842
Net investments in leases	11	46,674	9,091
Investment securities	12		
-Available-for-sale		42,387	9,887
-Held-to-maturity		192,464	187,244
		2,430,168	**1,025,505**
Financial commitments and contingencies	24	208,299	168,608
Total credit risk exposure		**2,638,467**	**1,194,113**

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

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

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group through internal credit ratings. The table below shows the credit quality by class of asset for loan-related balance sheet lines, based on the Group's credit rating system.

		Neither past due nor impaired				
	Notes	*High grade 2007*	*Standard grade 2007*	*Sub-standard grade 2007*	*Past due or individually impaired 2007*	*Total 2007*
Amounts due from credit institutions	9	154,560	–	–	–	154,560
Loans to customers	10					
Corporate lending		855,112	32,539	110	48,907	936,668
Consumer lending		242,844	64,561	2,793	20,884	331,082
Residential mortgages		224,065	7,486	71	4,775	236,397
Micro-loans		147,052	1,419	59	3,906	152,436
Gold Pawn Loans		28,158	–	–	–	28,158
Other		2,062	15,849	272	1,686	19,869
		1,653,853	**121,854**	**3,305**	**80,158**	**1,859,170**
Debt investment securities	12					
Available-for-sale		42,387	–	–	–	42,387
Held-to-maturity		192,464	–	–	–	192,464
		234,851	–	–	–	**234,851**
Total		**1,888,704**	**121,854**	**3,305**	**80,158**	**2,094,021**

(Thousands of Georgian Lari)

28. Risk Management (continued)

Credit risk (continued)

		Neither past due nor impaired				
	Notes	*High grade 2006*	*Standard grade 2006*	*Sub–standard grade 2006*	*Past due or individually impaired 2006*	*Total 2006*
Amounts due from credit institutions	9	65,475	–	–	–	65,475
Loans to customers	10					
Corporate lending		342,632	636	2	60,036	403,306
Micro–loans		98,984	467	22	1,896	101,369
Consumer lending		62,178	22,616	858	6,249	91,901
Residential mortgages		77,157	883	–	4,267	82,307
Gold Pawn Loans		26,979	–	–	–	26,979
		673,405	**24,602**	**882**	**72,448**	**771,337**
Debt investment securities	12					
Available–for–sale		9,887	–	–	–	9,887
Held–to–maturity		187,244	–	–	–	187,244
		197,131	**–**	**–**	**–**	**197,131**
Total		**870,536**	**24,602**	**882**	**72,448**	**968,468**

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

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

The credit risk assessment policy for non-past due and individually non-impaired financial assets has been determined by the Bank as follows:

A financial asset that has neither been in past due more than 30 days nor individually impaired is assessed as a financial asset with High Grade;

A financial asset that is neither past due nor impaired for reporting date, but historically used to be past due more than 30 is assessed as a financial asset with Standard Grade;

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

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

	Less than 30 days 2007	*31 to 60 days 2007*	*61 to 90 days 2007*	*More than 90 days 2007*	*Total 2007*
Amounts due from credit institutions	–	–	–	564	564
Loans to customers					
Corporate lending	22,549	1,774	80	4,371	28,774
Micro-loans	2,175	–	–	–	2,175
Consumer lending	10,008	58	40	1,180	11,286
Residential mortgages	2,640	47	31	–	2,718
Other	567	616	411	–	1,594
Total	**37,939**	**2,495**	**562**	**6,115**	**47,111**

(Thousands of Georgian Lari)

28. Risk Management (continued)

Credit risk (continued)

	Less than 30 days 2006	*31 to 60 days 2006*	*61 to 90 days 2006*	*More than 90 days 2006*	*Total 2006*
Loans to customers					
Corporate lending	19,805	–	42	2,285	22,132
Micro-loans	878	8	11	4	901
Consumer lending	3,371	40	20	41	3,472
Residential mortgages	1,881	–	11	2	1,894
Total	**25,935**	**48**	**84**	**2,332**	**28,399**

See Note 10 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.

	2007	*2006*
Loans to customers		
Corporate lending	10,651	4,964
Micro loans	638	221
Consumer lending	3,221	67
Residential mortgages	5,625	184
Other	762	–
Total	**20,897**	**5,436**

Impairment assessment

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

Individually assessed allowances

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

Collectively assessed allowances

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

(Thousands of Georgian Lari)

28. Risk Management (continued)

Credit risk (continued)

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the appropriate delay between the time a loss is likely to have been uncured and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. Local management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

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

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

	2007				*2006*			
	Georgia	*OECD*	*CIS and other foreign banks*	*Total*	*Georgia*	*OECD*	*CIS and other foreign banks*	*Total*
Assets:								
Cash and cash equivalents	105,393	207,049	93,328	405,770	40,370	61,790	5,885	108,045
Trading securities	–	–	6,342	6,342	–	–	–	–
Amounts due from credit institutions	140,852	609	13,099	154,560	62,602	1,166	1,707	65,475
Loans to customers	1,452,649	–	223,032	1,675,681	684,842	–	–	684,842
Finance lease receivables	46,674	–	–	46,674	9,091	–	–	9,091
Investment securities:								
- available-for-sale	6,234	231	35,922	42,387	9,819	67	1	9,887
- held-to-maturity	184,201	–	8,263	192,464	187,244	–	–	187,244
Others	396,938	17,281	15,514	429,733	136,866	8,062	3,814	148,742
	2,332,941	**225,170**	**395,500**	**2,953,611**	**1,130,834**	**71,085**	**11,407**	**1,213,326**
Liabilities:								
Amounts due to credit institutions	104,731	791,054	6,010	901,795	42,773	181,608	–	224,381
Amounts due to customers	1,085,505	–	269,971	1,355,476	559,646	–	–	559,646
Debt securities issued	–	–	4,993	4,993	1,073	–	–	1,073
Others	116,455	6,673	10,228	133,356	45,560	6,013	1,795	53,368
	1,306,691	**797,727**	**291,202**	**2,395,620**	**649,052**	**187,621**	**1,795**	**838,468**
Net balance sheet position	**1,026,250**	**(572,557)**	**104,298**	**557,991**	**481,782**	**(116,536)**	**9,612**	**374,858**

(Thousands of Georgian Lari)

28. Risk Management (continued)

Liquidity risk and funding management

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

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

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

	2007, %	*2006, %*
Average liquidity ratio for the year	47.5%	30.9%
Maximum Liquidity ratio	92.7%	65.7%
Minimum Liquidity ratio	19.5%	19.6%

Average liquidity ratio is calculated on stand-alone bases for JSC Bank of Georgia as annual average (arithmetic mean) of daily liquidity ratios computed as percentage of liquidity assets in liabilities determined by National Bank of Georgia as follows:

Liquid assets - comprise cash, cash equivalents and other assets that have character to be immediately converted into cash. Those assets include investment securities issued by Georgian Government plus Certificates of Deposit issued by NBG up to 10% of liabilities used in calculation of average liquidity ratio and not including amounts due from credit institutions, other than inter-bank deposits, and/or debt securities of Governments and Central Banks of non-OECD countries, amounts in nostro accounts which are under lien, impaired inter-bank deposits, amounts on obligatory reserve with NBG that are pledged due to borrowings from NBG.

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

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2007 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

Financial liabilities As at 31 December 2007	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to credit institutions	128,421	192,214	679,129	201,732	1,201,496
Amounts due to customers	1,006,758	302,902	77,374	3,785	1,390,819
Debt securities issued and other liabilities	5,130	4,153	4,220	149	13,652
Total undiscounted financial liabilities	**1,140,309**	**499,269**	**760,723**	**205,666**	**2,605,967**

Financial liabilities As at 31 December 2006	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to credit institutions	15,817	115,239	70,207	63,261	264,524
Amounts due to customers	441,049	99,614	24,888	1,260	566,811
Debt securities issued	–	1,494	–	–	1,494
Total undiscounted financial liabilities	**456,866**	**216,347**	**95,095**	**64,521**	**832,829**

(Thousands of Georgian Lari)

28. Risk Management (continued)

Liquidity risk and funding management (continued)

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

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
2007	114,361	76,578	55,364	18,429	264,732
2006	114,848	36,268	14,482	11,549	177,147

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

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

Included in due to customers are term deposits of individuals. In accordance with the Georgian legislation, the Bank Group is obliged to repay such deposits upon demand of a depositor. Refer to Note 21.

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.

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 2007. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2007 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve. During 2007 and 2006 sensitivity analysis did not reveal significant potential effect on Group Equity.

Currency	*Increase in basis points 2007*	*Sensitivity of net interest income 2007*	*Sensitivity of equity 2007*
UAH	0.75%	-	267
EUR	0.75%	(71)	–
USD	0.75%	(3,097)	–

Currency	*Decrease in basis points 2007*	*Sensitivity of net interest income 2007*	*Sensitivity of equity 2007*
UAH	-1.25%	-	(445)
EUR	-1.50%	142	–
USD	-1.25%	5,393	–

(Thousands of Georgian Lari)

28. Risk Management (continued)

Market risk (continued)

Currency	*Increase in basis points 2006*	*Sensitivity of net interest income 2006*	*Sensitivity of equity 2006*
UAH	0.50%	-	22
EUR	1.50%	(178)	(178)
USD	0.50%	(611)	(611)

Currency	*Decrease in basis points 2006*	*Sensitivity of net interest income 2006*	*Sensitivity of equity 2006*
UAH	-1.00%	-	(44)
EUR	-0.50%	59	59
USD	-1.00%	1,221	1,221

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 2007 on its trading and non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Georgian Lari, with all other variables held constant on the income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). 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. During 2007 and 2006 sensitivity analysis did not reveal significant potential effect on Group Equity.

Currency	*Change in currency rate in % 2007*	*Effect on profit before tax 2007*	*Effect on equity 2007*	*Change in currency rate in % 2006*	*Effect on profit before tax 2006*	*Effect on equity 2006*
EUR	4.6%	104	–	4.2%	(2)	–
GBP	5.0%	(137)	–	7.4%	(9)	–
RUR	0.1%	24	–			
UAH	0.7%	(38)	–	0.7%	8	–
USD	3.5%	(2,450)	–	3.6%	(327)	–

Prepayment risk

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

The Group uses regression models to project the impact of varying levels of prepayment on its net interest income. The model makes a distinction between the different reasons for repayment (e.g. relocation, refinancing and renegotiation) and takes into account the effect of any prepayment penalties. The model is back tested against actual outcomes.

The effect on profit before tax for one year and on equity, is as follows:

	Effect on net interest income	*Effect on equity*
2007	25,658	–
2006	52,521	–

(Thousands of Georgian Lari)

28. Risk Management (continued)

Operational risk

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

29. Fair Values of Financial Instruments

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

	Carrying value 2007	*Fair value 2007*	*Unrecognised gain/(loss) 2007*	*Carrying value 2006*	*Fair value 2006*	*Unrecognised gain/(loss) 2006*
Financial assets						
Cash and cash equivalents	405,770	405,770	–	108,045	108,045	–
Trading securities	6,342	6,342	–	–	–	–
Amounts due from credit institutions	154,560	154,560	–	65,475	65,475	–
Loans to customers	1,675,681	1,675,681	–	684,842	684,842	–
Finance lease receivables	46,674	46,674	–	9,091	9,091	–
Investment securities:						
- available-for-sale	42,387	42,387	–	9,887	9,887	–
- held-to-maturity	192,464	191,572	–	187,244	187,244	–
Financial liabilities						
Amounts due to credit institutions	901,795	901,795	–	224,381	224,381	–
Amounts due to customers	1,355,476	1,355,476	–	559,646	559,646	–
Debt securities issued	4,993	4,993	–	1,073	1,073	–
Total unrecognised change in unrealised fair value			**–**			**–**

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

Assets for which fair value approximates carrying value

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

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognised with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. For quoted debt issued the fair values are calculated based on quoted market prices. For those notes issued where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term to maturity.

(Thousands of Georgian Lari)

29. Fair Values of Financial Instruments (Continued)

Financial instruments recorded at fair value

The following table shows an analysis of financial instruments recorded at fair value, between those whose fair value is based on quoted market prices, those involving valuation techniques where all the model inputs are observable in the market, and those where the valuation techniques involves the use of non-market observable inputs.

	Quoted market price 2007	*Valuation techniques – market observable inputs 2007*	*Valuation techniques – non-market observable inputs 2007*	*Total 2007*
Financial assets				
Trading securities	6,342	–	–	6,342
Investment securities – available-for-sale	36,770	5,617	–	42,387
	43,112	**5,617**	**–**	**48,729**

	Quoted market price 2006	*Valuation techniques – market observable inputs 2006*	*Valuation techniques – non-market observable inputs 2006*	*Total 2006*
Financial assets				
Trading securities	–	–	–	–
Investment securities – available-for-sale	4,353	5,534	–	9,887
	4,353	**5,534**	**–**	**9,887**

30. Maturity Analysis of Financial Assets and Liabilities

The table below shows an analysis of financial assets and liabilities according to when they are expected to be recovered or settled. See Note 28 "Risk management" for the Group's contractual undiscounted repayment obligations.

	2007			*2006*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Financial assets						
Cash and cash equivalents	405,770	–	405,770	108,045	–	108,045
Trading securities	6,342	–	6,342	–	–	–
Amounts due from credit institutions	153,893	667	154,560	62,276	3,199	65,475
Loans to customers	929,246	746,435	1,675,681	410,545	274,297	684,842
Finance lease receivables	31,225	15,449	46,674	241	8,850	9,091
Investment securities:						
– available–for–sale	7,787	34,600	42,387	9,887	–	9,887
– held–to–maturity	176,466	15,998	192,464	159,641	27,603	187,244
Total	**1,710,729**	**813,149**	**2,523,878**	**750,635**	**313,949**	**1,064,584**
Financial liabilities						
Amounts due to credit institutions	146,815	754,980	901,795	100,248	124,133	224,381
Amounts due to customers	1,280,911	74,565	1,355,476	536,647	22,999	559,646
Debt securities issued	1,578	3,415	4,993	1,073	–	1,073
Total	**1,429,304**	**832,960**	**2,262,264**	**637,968**	**147,132**	**785,100**
Net	**281,425**	**(19,811)**	**261,614**	**112,667**	**166,817**	**279,484**

(Thousands of Georgian Lari)

30. Maturity Analysis of Financial Assets and Liabilities (continued)

The Group's capability to discharge its liabilities relies on its ability to realize an equivalent amount of assets within the same period of time. In the Georgian marketplace, many short-term credits are granted with the expectation of renewing the loans at maturity. As such, the ultimate maturity of assets may be different from the analysis presented above. In addition, the undiscounted financial liability analysis gap does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than one month in the tables above.

The Group's principal sources of liquidity are as follows:

- deposits;
- debt issues;
- proceeds from sale of securities;
- inter-bank deposit agreement;
- principal repayments on loans;
- interest income; and
- fees and commissions income.

As of 31 December 2007 deposits amounted to GEL 1,355,476 (2006: GEL 559,646) and represented 57% (2006: 67%) of Group's total liabilities. These borrowings continue to provide a majority of the Group's funding and represent a well-diversified and stable source of funds. As of 31 December 2007 amounts owed to other credit institutions amounted to GEL 901,795 (2006: GEL 224,381) and represented 38 % (2006: 27%) of total liabilities.

In management's opinion, liquidity is sufficient to meet the Group's present requirements.

31. Related Party Disclosures

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

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

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

	2007			*2006*		
	Parent	*Asso-ciates*	*Key management personnel*	*Parent*	*Asso-ciates*	*Key management personnel*
Loans outstanding at 1 January, gross	**–**	**6,010**	**312**	–	**3,272**	**1,143**
Loans issued during the year	–	14,237	507	–	11,494	591
Loan repayments during the year	–	(6,649)	(299)	–	(8,756)	(1,422)
Other movements	–	–	–	–	–	–
Loans outstanding at 31 December, gross	**–**	**13,598**	**520**	**–**	**6,010**	**312**
Less: allowance for impairment at 31 December	–	(324)	(10)	–	(185)	(6)
Loans outstanding at 31 December, net	–	**13,274**	**510**	–	**5,825**	**306**
Interest income on loans	–	1,102	58	–	634	10
Loan impairment charge	–	139	4	–	(55)	17
Deposits at 1 January	**11,281**	**2,944**	**7,252**	–	**1,751**	**113**
Deposits received during the year	1,452	95,488	12,038	11,281	36,246	13,672
Deposits repaid during the year	–	(93,947)	(18,664)	–	(35,053)	(6,533)
Other movements	–	–	–	–	–	–
Deposits at 31 December	**12,733**	**4,485**	**626**	**11,281**	**2,944**	**7,252**
Current accounts at 31 December						
Interest expense on deposits	746	178	97	483	147	157
Fee and commission income						
Other income	–	–	852	–	–	–

(Thousands of Georgian Lari)

31. Related Party Disclosures (continued)

Compensation of key management personnel was comprised of the following:

	2007	*2006*
Salaries and other benefits	16,104	3,723
- Among them, termination benefits	*4,876*	-
Share-based payments compensation	8,992	2,586
- Among them, termination benefits	*1,944*	-
Social security costs	4,124	282
Recruitment costs	20	24
Total key management compensation	**29,240**	**6,615**

There were 70 number of key management personnel as 31 December 2007 (2006: 57 number)

32. Capital

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

During the past year, the Bank and the Group had complied in full with all its externally imposed capital requirements.

The primary objectives of the Group's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

NBG capital adequacy ratio

The NBG requires banks to maintain a minimum capital adequacy ratio of 12% of risk-weighted assets, computed based on IFRS financial statements. As of 31 December 2007 and 2006, the Bank's capital adequacy ratio on this basis was as follows:

	2007	*2006*
Core capital	368,959	307,620
Supplementary capital	162,867	87,599
Less: Deductions from capital	(166,230)	(17,236)
Total regulatory capital	**365,596**	**377,983**
Risk-weighted assets	**2,796,443**	**1,325,114**
Banks capital adequacy ratio	**13.1%**	**28.5%**

Regulatory capital consists of Core capital, which comprises share, additional paid-up capital, retained earnings including current year profit, foreign currency translation and minority interests less accrued dividends, net long positions in own shares and goodwill. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the NBG. The other component of regulatory capital is Supplementary capital, which includes subordinated long-term debt preference shares and revaluation reserves.

(Thousands of Georgian Lari)

32. Capital (continued)

Capital adequacy ratio under Basel Capital Accord 1988

The Group's capital adequacy ratio, computed in accordance with the Basel Capital Accord 1988, with subsequent amendments including the amendment to incorporate market risks, as of 31 December 2007 and 2006, follows:

	2007	*2006*
Tier 1 capital	464,516	366,177
Tier 2 capital	159,914	57,534
Less: Deductions from capital	(214,615)	(37,124)
Total regulatory capital	**409,815**	**386,587**
Risk-weighted assets	**1,859,330**	**804,117**
Tier 1 capital ratio	25.0%	45.5%
Total capital ratio	22.0%	48.1%
Minimum capital adequacy ratio	8%	8%

33. Events Subsequent to Balance Sheet Date

On 23 January 2008 the shareholders' extraordinary general meeting (EGM) of the Bank acknowledged the resignation of Mr. Lado Gurgenidze, Chairman of the Supervisory Board and approved the nomination of Mr. Kakha Kiknavelidze as a member of the Supervisory Board.

On 10 January 2008 the Bank obtained a USD 65 million senior loan facility arranged, structured and provided by Merrill Lynch International. The term of the facility is 13 months and can be extended to 24 and 36 months by mutual consent.

On 18 January 2008 Caucasus Energy & Infrastructure (CEI), a wholly-owned subsidiary of the Bank as of 31 December 2007, went publicly listed at the Georgian Stock Exchange. On 15 February 2008 CEI completed a private placement of its shares and consequently raised US$50 million primarily for the purpose of investing in the construction of small and medium size hydropower plant in Georgia and other infrastructure projects. As a result of the public listing and private placement, the BOG shareholdings in CEI reduced from 100% to 8%. Further, in March 2008 CEI issued its first Euroclearable GDR with 1 GDR representing 10 local shares.

On 13 February 2008 the Bank sold four million new ordinary shares in the form of GDRs at a price of USD 25 per GDR (the "Offer Price"). The offering raised gross proceeds of USD 100 million. The offering represents approximately 14.7% of the issued share capital before the offering. The Offer Price is equal to 1.6% discount to the prevailing closing market price on the date of the offering. ING Bank acted as Sole Book runner, Unicredit Group was the Joint Lead Manager and Galt and Taggart Securities, the Bank's brokerage subsidiary, acted as Selling Agent, of the offering.